(MORE) LEGAL GUARDRAILS FOR A UNICORN CRACKDOWN

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The explosive growth of private markets and the proliferation of "unicorns," private startups valued at $1 billion or more, has pushed the U.S. Securities and Exchange Commission (SEC) away from the center of the action and towards the periphery. In 2021, the SEC announced plans to reassert its jurisdiction by forcing unicorns to go public. But those plans fizzled. By the end of last year, the legality of the maneuver had been called into question and key proponents had left the Commission, leaving the unicorn crackdown seemingly on ice.

Now the regulator is back with a new plan to reclaim its throne. In January 2023, one Commissioner proposed inventing a new mandatory periodic disclosure regime just for unicorns. Under this plan, the agency would amend Regulation D, the rule that allows unicorns and many other private companies to raise capital without going public, to require unicorns to disclose audited financial statements and to provide independent attestations regarding the issuer's internal controls over financial reporting, both at the time of offering and on an "ongoing" basis thereafter—just as public companies are required to do under the Securities Exchange Act of 1934.

This paper questions the legality of this proposal. I show that the SEC likely lacks legal authority to impose ongoing disclosure obligations on private companies not linked to any particular offering or transaction or to condition particular private offering-related disclosure obligations on issuer size. For the second time in two years, an SEC Commissioner has proposed a regulatory overhaul to fundamentally redraw the lines between public and private companies. And for the second time in two years, that proposal appears to fall outside of the agency's legal authority.

INTRODUCTION

Securities regulation is having an identity crisis. With our most successful, innovative, and impactful companies increasingly deferring the transition to "public" status, the Securities and Exchange Commission (SEC)

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and the mandatory corporate disclosure system it administers are slowly but unmistakably being relegated from the center of the action towards the periphery.[1] For those who have dedicated their careers to administering, studying, and working with this regime, the transformation is dizzying—and anxiety-inducing. If markets can thrive without mandatory disclosure, what is all of this even for?

Facing revolution, the liberal wing of the securities regulation universe has turned conservative, doubling down on history, tradition, and fealty to the *ancien régime*. First came a wave of law review articles lamenting the rise of "unicorns," private startups valued at over $1 billion, and calling on the SEC to reclaim its throne.[2] Then, after Gary Gensler's appointment as Chair, the Commission took up the call, signaling in late 2021 that it would begin *forcing* unicorns to go public.[3]

Those plans seem to have fizzled. Two years later, there is still no formal proposal. Although the idea remains on the official rulemaking docket, serious questions have been raised about the legality of the maneuver and key proponents have departed the Commission.[4]

But the SEC hasn't given up on a unicorn crackdown. In January 2023, Commissioner Caroline Crenshaw outlined a new strategy: Instead of forcing unicorns to go public, Crenshaw proposes inventing a new mandatory periodic disclosure regime just for this subset of private companies.[5] Specifically, she would like to revise Regulation D, the rule that allows unicorns and many other private companies to raise capital without going public, to require large private companies "to engage independent auditors and . . . to provide prospective and committed investors with financial statements audited in accordance with GAAS, along with auditor opinion letters, confirming the adequacy of the company's internal controls over financial reporting."[6] And these new unicorn disclosures would be required both at the point of offering and on an "ongoing" basis afterward.[7]

There's just one small problem: the law. This paper questions whether

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[1] *See* Caroline A. Crenshaw, Commissioner, SEC, *Big "Issues" in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute* (Jan. 30, 2023) [hereinafter Crenshaw, *Big Issues*] (surveying the negative "consequences to allowing issuers to grow so large without any of the requirements of registration").

[2] *See infra* Part I.A.

[3] *See* Allison Herren Lee, Commissioner, SEC, *Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy* (Oct. 12, 2021) [hereinafter Lee, *Going Dark*] (proposing that the SEC leverage its authority under § 12(g) of the Exchange Act to force large private companies to go public); *see also infra* Part I.B.

[4] *See infra* Part I.B.

[5] Crenshaw, *Big Issues*, *supra* note 1.

[6] *Id.*

[7] *Id.*

the SEC possesses legal authority to create a new mandatory periodic disclosure regime for unicorns under Regulation D. It presents a *Chevron* "step one" argument that Congress has "directly spoken to the precise question at issue" and has prohibited the SEC from implementing a mandatory periodic disclosure regime for unicorns.[8] If the SEC moves forward with Crenshaw's proposal, a court will likely strike it down.

The implications of this legal question extend beyond unicorns to the domain of climate disclosure. If the SEC has legal authority to require extensive periodic *financial* disclosure obligations on private companies, as Crenshaw proposes, the Commission might also require periodic *climate* disclosures from these same companies.[9]

The scope of this paper is limited. This paper does not address alternative possible grounds for a legal challenge, such as *Chevron* "step two" arguments that the proposal is not a "reasonable" exercise of agency discretion, or that the costs of the proposal outweigh the benefits.[10] It also does not address zeitgeisty arguments such as whether Crenshaw's proposal unlawfully promotes the interests of non-investor "stakeholders" over those

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8 *See* Chevron v. NRDC, 467 U.S. 837, 842–43 (1984). The hypothetical legal challenge would be filed in a U.S. Court of Appeals by a person "aggrieved" by the new rule (perhaps an industry group representing large private issuers or a venture capital fund) pursuant to Securities Act § 9(a) and APA § 702. The reviewing court would have to "hold unlawful and set aside" the rule if it determined it to be "in excess of [the SEC's] statutory jurisdiction [or] authority." APA § 706(2)(c). Under *Chevron*, the reviewing court would answer this question in the first instance by asking whether Congress had already "directly spoken to the precise question at issue"—namely, whether the SEC can condition the private offering exemption of the Securities Act for large private issuers on their undertaking to make ongoing periodic disclosure obligations long after the subject offering has closed. *Chevron*, 467 U.S. at 842–43. This paper contends that Congress *has* spoken to that precise question—and that the SEC can*not* do this.

9 *Cf.* Statement from Allison Herren Lee, Commissioner, SEC, *Public Input Welcomed on Climate Change Disclosures* (Mar. 15, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures [https://perma.cc/5NA5-KQS5] ("[H]ow should the Commission's rules address private companies' climate disclosures, such as through exempt offerings . . .?").

10 *See, e.g.*, Bus. Roundtable v. SEC, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (holding that "the Commission inconsistently and opportunistically framed the costs and benefits of the rule"). I believe they do. *See* Alexander I. Platt, *Unicorniphobia*, 13 HARV. BUS. L. REV. 115 (2023) [hereinafter Platt, *Unicorniphobia*] (raising significant substantive policy problems with the unicorn crackdown agenda).

of investors[11] or runs afoul of the "major questions" doctrine.[12] Nor does this paper address potential alternative statutory or regulatory avenues for a unicorn crackdown beyond the one Crenshaw articulated.[13]

This paper proceeds in four parts. Part I very briefly reviews the transformation of public and private markets, the SEC's first—seemingly fizzled—effort to redraw these boundaries, and the new proposed unicorn disclosure regime. Part II argues that the SEC may lack legal authority to impose *ongoing* disclosure obligations not linked to any particular offering or transaction on private companies. Part III argues that the SEC may lack legal authority to condition particular private offering-related disclosure obligations on issuer size. Part IV disputes Crenshaw's claim that the exclusive original purpose of Regulation D was to promote small business.

I
BACKGROUND

A. The Rise of Unicorns and Calls for a Crackdown

Traditionally,[14] a company that reached a certain size would "go

11 *Cf.* Caroline A. Crenshaw, Commissioner, SEC, Remarks at Symposium on Private Firms: Reporting, Financing, and the Aggregate Economy at the University of Chicago Booth School of Business, *Grading the Regulators and Homework for the Teachers*, U.S. SEC (Apr. 14, 2022) [hereinafter Crenshaw, *Grading the Regulators*], https://www.sec.gov/news/speech/crenshaw-remarks-symposium-private-firms-041422 [https://perma.cc/ASP6-48PN] (worrying about the lack of "meaningful disclosure to investors, stakeholders and regulators" in private markets); Lee, *Going Dark*, *supra* note 3 (calling for regulatory crackdown on unicorns because "investors, policymakers, and the public know relatively little about them compared to their public counterparts"). *But see* Platt, *Unicorniphobia*, *supra* note 10 at 162–82 (using the examples of Moderna and "climate tech" unicorns to argue that stakeholders reap significant benefits from the regulatory status quo).

12 *See* West Virginia v. EPA, 142 S. Ct. 2587, 2608–09 (2022) (holding that agencies seeking to exercise "extraordinary" regulatory authority or make a "radical or fundamental change to a statutory scheme" must do more than point to a "merely plausible textual basis" for such action and instead identify a "clear congressional authorization"); *cf.* Lee, *Going Dark*, *supra* note 3 (analogizing the present moment to the 1930s and 1960s when *Congress*, rather than the SEC, stepped in to fundamentally redraw the lines between public and private markets).

13 For instance, I do not consider whether the SEC could lawfully impose periodic disclosure through its regulation of resales, *see* 17 C.F.R. § 230.502(d) (2022) (prohibiting resale of Rule 506 securities "without registration under the Act or an exemption therefrom"); Securities Act § 4(a)(1), 15 U.S.C. § 77(d)(a)(1) (exempting from registration "transactions by any person other than an issuer, underwriter, or dealer"); Rule 144, 17 C.F.R. § 230.144 (2022) (creating safe harbor from statutory definition of "underwriter"), or its regulation of offerings to employees, 17 C.F.R. § 230.701 (2022), or its regulation of the private funds who invest in Rule 506 securities. For a skeptical legal response to the SEC's prior unicorn crackdown proposal, see Alexander I. Platt, *Legal Guardrails for a Unicorn Crackdown*, 120 MICH. L. REV. ONLINE 89 (2022) [hereinafter Platt, *Legal Guardrails*] (evaluating the legality of the 2021 SEC proposal to leverage Exchange Act § 12(g) to force unicorns to go public).

14 Calling this the "traditional" approach is an oversimplification. For several decades prior to

public"—conduct an IPO, begin making mandatory annual and quarterly disclosures, perhaps list its securities on a national stock exchange, and take on all the trappings of a "public company" under the federal securities laws.[15]

Times have changed. Due to a constellation of legislative,[16] regulatory,[17] institutional,[18] and market developments,[19] private startups are now able to raise massive amounts of capital without tapping public capital markets and thereby delay taking on the full weight of federal securities regulation. Not so long ago, it was rare enough for a private company to

1964, it was possible to be a very large and widely held company without going public because there was not yet any "holder of record" threshold at which companies had to go public. *See* An Act of Aug. 20, 1964, Pub. L. No. 88-467, sec. 3(c), § 12(g), 78 Stat. 565, 566–67 (1964). And there have always been very large closely held companies not subject to public company regulation. *See* George S. Georgiev, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J.L. & BUS. 221, 281 n.209 (2021) (describing exceptions to the public-private divide, such as large, family-owned firms).

15 *See* Crenshaw, *Big Issues*, *supra* note 1.

16 For instance, in 2012, Congress encouraged private market expansion by raising the section 12(g) shareholder count threshold from 500 to 2,000 and by declining to explicitly authorize the SEC to substitute "beneficial" for "record" holders. Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, § 501, 126 Stat. 306, 325 (2012); *see also* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 355–70 (2013) (analyzing this change); 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, 169–78 (2013) (same).

17 For instance, the SEC has loosened restrictions on who may invest in private companies and relaxed the rules governing how private companies raise capital. *See, e.g.*, Accredited Investor Definition, 85 Fed. Reg. 64234, 64273 (Oct. 9, 2020) (to be codified at 17 C.F.R. pts. 230, 240); Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3496, 3556 (Jan. 14, 2021) (codified at 17 C.F.R. pts. 227, 229, 230, 239, 240, 249, 270, 274); *see also* Crenshaw, *Big Issues*, *supra* note 1, at n.1 (analyzing these changes); Andrew F. Tuch & Joel Seligman, *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers, and Direct Listings*, 108 IOWA L. REV. 303, 319–20 (2022) (same). And the SEC has also made it easier for private companies to issue stock options to employees. *See* Exempt Offerings Pursuant to Compensatory Arrangements, 83 Fed. Reg. 34940 (July 24, 2018) (to be codified at 17 C.F.R. pt. 230); Abraham J.B. Cable, *Fool's Gold? Equity Compensation & The Mature Startup*, 11 VA. L. & BUS. REV. 615, 624–26 (2017) (reviewing the regulatory landscape on this topic); Anat Alon-Beck, *Unicorn Stock Options: Golden Goose or Trojan Horse*, 2019 COLUM. BUS. L. REV. 107, 180–83 (same).

18 For instance, accredited investors may now buy and sell private company securities on several markets. *See* Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 175 (2017); Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 182 (2012).

19 For instance, corporate venture capital arms, hedge funds mutual funds, and others have grown increasingly interested in investing alongside traditional venture capital funds in some private firms. *See* Jones, *supra* note 18, at 173; Jennifer S. Fan, *Nontraditional Investors*, 48 BYU L. REV. 463 (2022); Matthew T. Wansley, *Moonshots*, 2023 COLUM. BUS. L. REV. 859; Darian M. Ibrahim, *Corporate Venture Capital*, 24 U. PA. J. BUS. L. 209 (2021); Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 87 TENN. L. REV. 983 (2020); Jennifer S. Fan, *Catching Disruption: Regulating Corporate Venture Capital*, 2018 COLUM. BUS. L. REV. 341–425.

achieve a billion-dollar valuation to warrant the nickname "unicorn."[20] Today, there are more than 1,000 such companies globally,[21] nearly half of which are U.S.-based.[22]

This explosive growth of private markets provoked a torrent of criticism from the legal academy.[23] And, following President Joe Biden's election, the SEC signaled that it shared these concerns and planned to rein in private markets.

B. The SEC's First Idea: Force Unicorns to Go Public

The SEC's first solution was to leverage its authority under § 12(g) of the Securities Exchange Act of 1934 to force these large private companies to "go public."[24] That provision requires any company with at least $10 million in assets whose shares are "held of record" by more than 2,000 persons (or 500 non-accredited persons) to take on the obligations imposed by federal securities regulations on public companies, including disclosure.[25] Today, this 2,000 shareholder "of record" trigger has no real constraining effect: Because a single holder "of record" can—and often does—stand in for tens, hundreds, or even thousands of actual beneficial owners, private companies can raise endless amounts of capital without tripping the

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20 Aileen Lee, *Welcome to the Unicorn Club: Learning from Billion-Dollar Startups*, TECHCRUNCH (Nov. 2, 2013, 10:00 AM), https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/ [https://perma.cc/9HR4-D6GQ].

21 *The Complete List of Unicorn Companies*, CB INSIGHTS, https://www.cbinsights.com/research-unicorn-companies [https://perma.cc/Y83B-RUNT] (last visited April 14, 2023); *see also* Crenshaw, *Grading the Regulators*, *supra* note 11.

22 Georgiev, *supra* note 14, at 227 fig. 1.

23 *See, e.g.*, Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583 (2016) [hereinafter Fan, *Regulating Unicorns*]; Jones, *supra* note 18; Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445 (2017); Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. REG. 499, 519–26 (2020); Verity Winship, *Private Company Fraud*, 54 U.C. DAVIS L. REV. 663 (2020); Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353 (2020); Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 TEX. L. REV. 1347 (2021); Amy Deen Westbrook, *We('re) Working on Corporate Governance: Stakeholder Vulnerability in Unicorn Companies*, 23 U. PA. J. BUS. L. 505 (2021); Georgiev, *supra* note 14, at 225; Matthew Wansley, *Taming Unicorns*, 97 IND. L.J. 1203 (2022); Anat Alon-Beck & John Livingstone, *Mythical Unicorns and How to Find Them: The Disclosure Revolution*, 2023 COLUM. BUS L. REV. 69; Brian J. Broughman & Matthew T. Wansley, *Risk-Seeking Governance*, 76 VAND. L. REV. (forthcoming 2023) https://ssrn.com/abstract=4344939 [https://perma.cc/W6VS-9AJA]. *But see* Platt, *Unicorniphobia*, *supra* note 10 (providing a skeptical evaluation of this wave of unicorn-skepticism in the legal academy); Abraham J.B. Cable, *Time Enough for Counting: A Unicorn Retrospective*, 39 YALE J. REG. BULL. 23 (2021) (providing an empirical assessment of unicorn performance).

24 *See* Exchange Act § 12(g)(1), 15 U.S.C. § 78l(g)(1) (footnote omitted).

25 *Id.*

threshold.[26]

In October 2021, then-Commissioner Allison Herren Lee called for the SEC to redefine the way issuers count shareholders "of record" for purposes of section 12(g) so that more companies will quickly exceed the 2,000 threshold and, therefore, be forced to go public.[27] Lee proposed that issuers *look through* the first-line holders of record, which are often pooled investment vehicles, to the beneficial owners who are invested in that pooled investment vehicle.[28]

The *Wall Street Journal* soon reported that the SEC was gearing up to implement Lee's idea.[29] Staffers were apparently at work drafting a proposed change to the Commission's interpretation of shareholders "of record" in order to "push large, private companies into the same disclosure regime that their publicly traded counterparts face."[30]

At the time, it was assumed that the SEC had the legal authority to proceed with this plan.[31] That assumption was soon contested.[32] And two

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26 *See* Lee, *Going Dark*, *supra* note 3.

27 *Id*.

28 *Id*.

29 Paul Kiernan, *SEC Pushes for More Transparency From Private Companies*, WALL ST. J. (Jan. 10, 2022 6:00 PM), https://www.wsj.com/articles/sec-pushes-for-more-transparency-from-private-companies-11641752489 [https://perma.cc/VC2Q-J3BJ].

30 *Id*.

31 *See* Lee, *Going Dark*, *supra* note 3 (claiming that it is "clear" that the SEC has legal authority to "require issuers to look through to beneficial owners" for purposes of section 12(g)); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 359 n.97 (2013) (stating that the SEC "presumably" could modify the rule "to refer to beneficial ownership known or reasonably available to the issuer"); Georgiev, *supra* note 14 at 294, 302 (writing that the SEC could implement this change "fairly easily by acting on its existing authority, without the need for additional congressional action" and that its authority to do this was "beyond question"); TYLER GELLASCH & LEE REINERS, GLOB. FIN. MKTS CTR. AT DUKE L. FROM LAGGARD TO LEADER: UPDATING THE SECURITIES REGULATORY FRAMEWORK TO BETTER MEET THE NEEDS OF INVESTORS AND SOCIETY 11 (2021), https://web.law.duke.edu/sites/default/files/centers/gfmc/From-Laggard-to-Leader.pdf [perma.cc/3WN4-FGCX] (asserting that the "change can be made without legislation").

32 Shortly after Lee's speech and the Wall Street Journal report, I posted a legal analysis arguing that the text and legislative history of section 12(g) indicated that the SEC may not redefine "held of record" as "beneficially held" and has only limited authority to mandate a "look-through" for purposes of the shareholder count. Platt, *Legal Guardrails*, *supra* note 13, at 90.

In a recent paper, Anat Alon-Beck and John Livingstone challenged my conclusion, writing that "there is strong evidence suggesting that the SEC does, in fact, have this authority. . . ." Alon-Beck & Livingstone, *supra* note 23, at 86. Respectfully, neither of the arguments presented in their paper alters my conclusion.

First, Alon-Beck and Livingstone claim that the SEC could rely on Exchange Act § 36. They correctly note that this provision gives the commission "expansive general exemptive authority to permit rulemaking to the extent that it is 'necessary or appropriate in the public interest, and is consistent with the protection of investors.'" *Id.* The problem for their argument is the word "exemptive." Section 36 gives the SEC authority to "exempt . . . any class . . . of persons" (presumably including unicorns) "from any provision . . . of this title" (presumably including §

years after Commissioner Lee's speech, the Commission still has not issued a formal proposal. Although it still appears on the SEC's regulatory agenda,[33] it may not be a continuing priority for the Commission. The main advocate for this proposal, Commissioner Lee, left her position,[34] and one of the remaining Democratic Commissioners, Caroline Crenshaw, has signaled reticence. In April 2022, Crenshaw delivered a speech in which she mentioned and conspicuously failed to endorse the proposal and instead asked "to hear from the academic community on that proposal."[35] And in Crenshaw's more recent speech on the unicorn problem, discussed in the next part, she failed to even mention the 12(g) proposal until the very bottom of her very final footnote—again conspicuously failing to endorse the idea.[36]

But, it turns out, the SEC hasn't given up on a unicorn crackdown just yet.

12(g)). Securities Exchange Act of 1934, 15 U.S.C. § 77mm(a)(1). But while the SEC surely could use § 36 to *exempt* unicorns from § 12(g), it is unclear how this *exemptive* authority could possibly be used to *expand* the reach of § 12(g) and bring a class of previously exempt issuers *within* the scope of that provision. Alon-Beck and Livingstone do not explain how that expansion of § 12(g) could be construed as "exempt[ing]" unicorns from any Exchange Act provision—and it certainly appears to be exactly the opposite. *Cf.* Georgiev, *supra* note 14, at 259–60 (discussing how the SEC used its "broad exemptive authority" under this provision to "delay" and "water down" various provisions of the Sarbanes-Oxley Act); Daniel T. Deacon, *Administrative Forbearance*, 125 YALE L.J. 1548, 1573 (2016) (describing this provision as "a forbearance power to relieve parties of statutory requirements").

Second, Alon-Beck and Livingstone note that several respected scholars had expressed the opinion that the SEC possessed legal authority to proceed with this reform. Alon-Beck & Livingston, *supra* note 23, at 86–87 (citing Georgiev, Langevoort & Thompson, and the Global Financial Markets Center at Duke Law). Alon-Beck and Livingstone do not mention any evidence or legal arguments these authors identify about how the text, structure, or purpose of the Exchange Act authorizes the proposal. Rather, they seem to be relying on the prestige of these authors as a source of legal authority in and of itself. But, with due respect, I do not believe this would convince a court, particularly in the face of strong textual and legislative history evidence to the contrary. *See* Platt, *Legal Guardrails*, *supra* note 13, at 90 (explaining that although Georgiev, Langevoort & Thompson, and the Global Financial Markets Center at Duke Law had all claimed that the reform was legally authorized, they had done so in passing without supporting this conclusion with extensive legal analysis of the text or legislative history of the operative provisions).

33 OFF. OF MGMT. & BUDGET, EXEC. OFF. OF THE PRESIDENT, 3235-AN05, SEC AGENCY RULE LIST – SPRING 2022: REVISIONS TO THE DEFINITION OF SECURITIES HELD OF RECORD (2022) ("The Division is considering recommending that the Commission propose amendments to the 'held of record' definition for purposes of section 12(g) of the Exchange Act.").

34 SEC Statement, Gary Gensler, SEC Chair, Hester M. Peirce, Caroline A. Crenshaw & Mark T. Uyeda, SEC Comm'rs, Statement on Departure of Allison Herren Lee (Jul. 15, 2022), https://www.sec.gov/news/statement/sec-statement-departure-commissioner-allison-herren-lee-071522#:~:text=We%20will%20miss%20her%20warmth,with%20and%20learn%20from%20her [https://perma.cc/Z73X-2XU2].

35 Crenshaw, *Grading the Regulators*, *supra* note 11.

36 Crenshaw, *Big Issues*, *supra* note 1, at n.50.

C. The SEC's New Idea: A New Mandatory Periodic Disclosure Regime for Unicorns

In a January 2023 speech, Commissioner Caroline Crenshaw proposed a different course.[37] Instead of forcing unicorns to go public, Crenshaw proposed that the SEC invent a new periodic mandatory disclosure regime just for those companies.[38]

Crenshaw's idea is to build this new system into Regulation D, the SEC's regulation governing so-called "private placement" investments.[39] A quick primer: Under the Securities Act of 1933, any company offering securities must either file a registration statement with the Commission making extensive disclosures[40] or qualify under a statutory exemption. Section 4(a)(2) exempts transactions "not involving any public offering" from the obligation to register.[41] With Rule 506 of Regulation D,[42] the SEC created a regulatory safe harbor that companies could rely on to meet the § 4(a)(2) exemption—providing legal certainty about which transactions will qualify.[43]

Regulation D allows private companies to raise enormous sums without making meaningful disclosures.[44] Specifically, Rule 506 allows issuers to raise *unlimited* funds from "accredited" investors,[45] which the SEC has defined to include financial institutions as well as individuals who meet certain income and wealth thresholds or other criteria of financial sophistication.[46] As Crenshaw points out, companies have to file a Form D

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37 *Id.*

38 *Id.* Crenshaw had hinted at this in her prior unicorn crackdown speech. *See* Crenshaw, *Grading the Regulators*, *supra* note 11 (worrying about the lack of "meaningful disclosure to investors, stakeholders and regulators" in private markets).

39 *See* Crenshaw, *Big Issues*, *supra* note 1.

40 Securities Act of 1933 § 5, 15 U.S.C. § 77e.

41 *Id.* § 4(a)(2), 15 U.S.C. § 77d(a)(2).

42 17 C.F.R. § 230.506 (2021). As discussed below, Regulation D also contains other exemptions tied to different parts of the Securities Act. *See infra* Part II.

43 *See, e.g.*, 17 C.F.R. § 230.506(a) (2022) ("Offers and sales of securities by an issuer that satisfy the conditions in paragraph (b) or (c) of this section shall be deemed to be transactions not involving any public offering within the meaning of section 4(a)(2) of the Act."); *see also* III LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION 394 (6th ed. 2020) ("Rule 506 is based on § 4(a)(2), not §3(b) . . . .").

44 *See* Crenshaw, *Big Issues*, *supra* note 1.

45 *Private Placements – Rule 506(b)*, U.S. SEC (Apr. 6, 2023), https://www.sec.gov/education/smallbusiness/exemptofferings/rule506b [https://perma.cc/T3BG-XNEM] ("Companies conducting an offering under Rule 506(b) can raise an unlimited amount of money and can sell securities to an unlimited number of accredited investors.").

46 17 C.F.R. § 230.501(a) (2020) (defining accredited investor as, *inter alia*, banks, savings and loan institutions, brokers, dealers, investment advisers, insurance companies, investment companies, pension plans, directors, officers and general partners of the issuer of the securities, individuals with net worth of $1 million or more, individuals with individual income of $200,000

with the Commission when they raise funds under Rule 506, but that Form provides only bare bones information—nothing remotely close to the detailed disclosure required in the Registration Statement that companies must file when they go public.[47]

Crenshaw wants to solve the unicorn problem by amending Regulation D to require unicorns to make "ongoing" disclosures, including disclosures long after the specific offering has been completed.[48] She says unicorns "could be required to engage independent auditors and . . . to provide prospective and committed investors with financial statements audited in accordance with GAAS, along with auditor opinion letters, confirming the adequacy of the company's internal controls over financial reporting."[49] And she emphasized that these "additional obligations would be triggered by the *size of the company*, in terms of market cap, value or the size of the investor base" so that only "*large* private issuers – and not the small businesses at the heart of Regulation D – would have additional obligations."[50]

The SEC's most recently published regulatory agenda includes an item entitled "Regulation D and Form D Improvements" which states that the SEC is considering "amendments to Regulation D . . . and Form D to improve protections for investors."[51] And, in March 2023, the SEC Investor Advisory Committee met to discuss "the growth of private markets" and to consider "modifications to the existing disclosure . . . framework."[52]

Crenshaw is not the first to propose a new mandatory disclosure regime

or household income of $300,000, and individuals holding certain professional certifications relevant to investing).

47 *See* Crenshaw, *Big Issues*, *supra* note 1. Private company Rule 506 offerings made to non-accredited investors must provide that investor with a private placement memorandum including specific financial and non-financial information, which varies depending on the size of the offering as required under the rule. 17 C.F.R. § 230.502(b) (2021). One treatise describes this disclosure document as "a prospectus" (i.e., the document used in registered offerings) "without the benefit of review by the Commission staff." I HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 9:16 (2022 ed.). An official Note to the operative rule suggests that "[w]hen an issuer provides information to investors pursuant to paragraph (b)(1), it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws." Note to Rule 502(b)(1), 17 C.F.R. § 230.502(b)(1) (2022).

48 *See* Crenshaw, *Big Issues*, *supra* note 1.

49 *Id.*

50 *Id.*

51 OFF. OF MGMT. & BUDGET, EXEC. OFF. OF THE PRESIDENT, 3235-AN04, SEC AGENCY AGENDA – FALL 2022: REGULATION D AND FORM D IMPROVEMENTS, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202210&RIN=3235-AN04 [https://perma.cc/Q27Q-WAL9].

52 *Investor Advisory Committee Meeting Agenda*, U.S. SEC (Mar. 2, 2023), https://www.sec.gov/spotlight/investor-advisory-committee/iac030223-agenda.htm [https://perma.cc/675W-99WD].

for unicorns.[53] However, earlier proposals do not seem to squarely address the question of whether such a reform would be authorized under current law. The remainder of this paper argues that it is not.

II
The SEC May Lack Legal Authority to Require Private Companies to Make Ongoing Disclosures Not Linked to Any Particular Offering

Crenshaw's proposal to impose periodic disclosure obligations on private companies ignores the foundational distinction between the Securities Act of 1933 and the Securities Exchange Act of 1934. The key legal authorities supporting the SEC's public company periodic disclosure system—Exchange Act §§ 13(a) and 15(d)—present a major challenge for Crenshaw's proposal because they expressly authorize the SEC to implement a periodic disclosure regime for *public* companies, not private ones. Section 13 authorizes the SEC to administer a mandatory disclosure system for "[e]very issuer of a security *registered* pursuant to [section 12]."[54] Section 12, in turn, requires registration by companies who have listed securities on a national securities exchange[55] or who have exceeded specified thresholds with regard to both valuation and shareholder base.[56] And § 15(d) extends this regime to all other companies who have registered securities under § 5 of the Securities Act.[57]

In other words, the Exchange Act creates a foundational fault-line: Public companies have to make periodic disclosures; private ones do not.[58]

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53 *See* Fan, *Regulating Unicorns*, *supra* note 23, at 608–09, 640–42; Jones, *supra* note 18, at 183–84.

54 15 U.S.C. § 78m(a).

55 Exchange Act § 12(a), 15 U.S.C. § 78*l*(a).

56 Exchange Act § 12(g), 15 U.S.C. § 78*l*(g)(1).

57 Exchange Act § 15(d), 15 U.S.C. § 78o(d)(1). Registration under Section 5, in turn, is required for all non-exempt offerings. Section 4(a)(2) provides an exemption for transactions not "involving any public offering." And Regulation D Section 506 provides a regulatory safe harbor for the § 4(a)(2) exemption.

58 *See The Laws That Govern the Securities Industry*, U.S. SEC (Oct. 1, 2013) (explaining that the Exchange Act "empowers the SEC to require periodic reporting of information by *companies with publicly traded securities*") (emphasis added) https://www.sec.gov/answers/about-laws#secexact1934 [https://perma.cc/H2B8-LMVY]; *see also* Gary Gensler, SEC Chair, *Statement on Proposed Mandatory Climate Risk Disclosures* (Mar. 21, 2022), https://www.sec.gov/news/statement/gensler-climate-disclosure-20220321 [https://perma.cc/2M4N-ESMM] ("Our core bargain from the 1930s is that investors get to decide which risks to take, as long as *public companies* provide full and fair disclosure and are truthful in those disclosures."); Winship, *supra* note 23, at 671 ("What is a private company? The most straightforward way to define private companies is in opposition to the public counterpart. Private companies do not have publicly traded stock and are not subject to periodic reporting obligations."); de Fontenay, *supra* note 23, at 448 n.6 (defining private companies as "businesses that are not subject to periodic reporting requirements under the securities laws and whose stock is not publicly

As Crenshaw herself observed in another recent speech:

> [Y]ou can have two firms that are virtually identical in every respect . . . . Yet, those two companies can have completely different . . . disclosure obligations . . . . Public Company A would need to provide public disclosure about financial results, operations, trends, executive compensation, corporate governance, among other disclosures. . . . Private Company B would have none of those . . . obligations . . . .[59]

Similarly, unicorn skeptic and then-SEC Commissioner Allison Herren Lee explained that after enacting the 1933 Act, "Congress saw that a one-time obligation to file information was insufficient, and a year later it passed the Securities Exchange Act of 1934 to, among other things, create ongoing periodic reporting obligations."[60]

Crenshaw's proposal obliterates this fundamental statutory fault-line, requiring extensive periodic disclosure from companies who have decidedly *not* met any of the public-company triggering criteria articulated by the Exchange Act provisions reviewed above. By definition, unicorns have not registered any securities under § 15(d), listed securities on national exchanges under § 12(a), or surpassed the valuation and investor thresholds of § 12(g). Imposing a mandatory periodic disclosure regime on these companies would render those provisions superfluous and destroy the foundational securities regulation fault-line they create, contravening well-established principles of statutory interpretation.[61]

The Securities Act does not provide any superseding authority that would support the SEC undercutting this core structural feature of the securities laws. As mentioned above, the operative provision of Regulation D (Rule 506) that Crenshaw wants to revise is a regulatory safe harbor authorized by § 4(a)(2) of the Securities Act. This provision creates an exemption from the registration requirements of § 5 for "transactions by an issuer not involving any public offering."[62] As explained *supra*, once a company registers an offering under § 5, they become subject to periodic reporting under the Exchange Act § 15(d).

Section 4(a)(2) cannot be reasonably construed as authorizing the SEC to condition a particular offering's eligibility for an exemption from § 5 as being contingent on whether the issuer will make disclosures about its

traded"); Lipton, *supra* note 23, at 508 ("Whatever path the company takes to becoming 'public,' once it does so, it remains subject to the securities disclosure regime . . . .").

59 Crenshaw, *Grading the Regulators*, *supra* note 11 (citing Georgiev, *supra* note 14).

60 Lee, *Going Dark*, *supra* note 3.

61 *See, e.g.*, Cir. City Stores, Inc. v. Adams, 532 U.S. 105, 113 (2001) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment.") (citation omitted).

62 Securities Act § 4(a)(2), 15 U.S.C. § 77d(a)(2).

business and finances years after the offering has been completed. The plain text makes the § 4(a)(2) exemption contingent on whether or not the "transaction" involves a public "offering."[63] The focus is unmistakably on characteristics of the particular transaction, not the particular issuer or even the particular security.[64] This focus on transactions, rather than issuers, is entirely in keeping with the Securities Act as a whole.[65] The central provision of that statute, Section 5, regulates public *offerings*—not public *companies*.[66] The core distinction between the regulation of transactions and the regulation of entities is what allows public companies to make private offerings, "PIPEs" or private investments in public equity[67] and private companies to make public ones, "IPOs" or initial public offerings.[68]

The Securities Act's focus on transactions, not issuers, makes it an uncomfortable place to ground *ongoing* disclosure requirements. The core of the Securities Act is the combination of a *one-time* disclosure obligation and strict "gun-jumping" rules for public offerings contained in § 5.[69] The unmistakable goal of this regime is to elicit information *before* the transaction is completed in order to help prospective investors evaluate the offering.[70] As the Supreme Court has explained: The design of the statute is

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63 *Id.*

64 *Compare, e.g.*, Securities Act § 3(a) ("exempted securities"), *with* § 4 ("exempted transactions").

65 LOSS ET AL., *supra* note 43, at 379 ("The [Securities] Act is concerned by and large with the initial distribution of securities rather than with their subsequent trading.").

66 15 U.S.C. § 77e.

67 *See, e.g.*, SEC, REPORT TO CONGRESS ON REGULATION A / REGULATION D PERFORMANCE 73 (Aug. 2020) (reporting data on Regulation D offerings by public companies); *see also* THOMAS LEE HAZEN, § 4:88. Section 4(a)(2)—"The Private Placement Exemption"—Exemption for Issuer Transactions Not Involving a Public Offering, Treatise on the Law of Securities Regulation (2023) ("Over the years, the section 4(a)(2) exemption . . . has proven useful for both closely held and public issue corporations.").

68 *See, e.g.*, *Going Public*, SEC (Apr. 6, 2023) https://www.sec.gov/education/capitalraising/goingpublic [https://perma.cc/5UE6-2TCC].

69 *See, e.g.*, JOHN C. COFFEE, JR., HILLARY A. SALE & CHARLES K. WHITEHEAD, SECURITIES REGULATION: CASES AND MATERIALS 103 (13th ed. 2015) ("A key provision is § 5, which is the hinge on which most of the rest of the Act turns. Its overall purpose is to require that new issues of securities . . . shall be registered with the Commission, and that a prospectus (filed as part of the registration statement) shall be furnished to the purchaser prior to the sale or, in some cases, at the time of the delivery of the security after sale."); STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 38 (5th ed. 2019) ("The Securities Act of 1933 . . . requires issuers making a public offering to file disclosure documents containing information deemed important to investors [and] . . . provides for an intricate public offering procedure, often referred to as the 'gun-jumping' rules, designed . . . to ensure that the prospectus is distributed widely to investors . . . .").

70 *The Laws That Govern the Securities Industry, Securities Act of 1933*, SEC (Oct. 1, 2023), https://www.sec.gov/about/about-securities-laws [https://perma.cc/H4L2-9KGS] (describing the "basic objective[]" of the Securities Act as ensuring that "investors receive financial and other significant information concerning securities being offered for public sale" so that they can "make

to protect investors by promoting full disclosure of information thought necessary for informed investment decisions. The natural way to interpret the private offering exemption is in light of the statutory purpose.[71]

Information provided one, two, or three years after an offering cannot help anyone make "informed investment decisions" in that offering. Therefore, it is difficult to see how such disclosures fit inside the § 4(a)(2) exemption.

Further, Crenshaw's proposal would turn the relationship between § 5 and § 4(a)(2) on its head—making the safe harbor (§ 4(a)(2)) in some sense *more arduous* than the provision it is supposed to insulate issuers from (§ 5): Issuers would be able to avoid a *one-time* disclosure only by undertaking to make *ongoing* disclosures.[72]

When courts consider what "transactions" involve a "public offering" for purposes of § 4(a)(2), they do not consider post-offering disclosure and instead focus on disclosures at the time of the offering. In the landmark *Ralston Purina* case, the Supreme Court held that the statutory exemption was contingent, in part, on whether investors had "access to the same kind of information that the [Securities] act would make available in the form of a registration statement"[73]—the one-time transactional disclosure required for public offerings under § 5. Similarly, lower courts subsequently "conditioned the private offering exemption on either actual disclosure of the information registration would provide or the offerees' effective access to such information."[74] That is, the only disclosure relevant to § 4(a)(2) is disclosure made at the time of the offering, not two, three, or four years later.

The SEC has never previously construed the private offering exemption as turning on post-offering disclosures. Instead, to the extent the SEC has conditioned § 4(a)(2) safe harbor on disclosures, the relevant disclosures are required to be made at the time of the offering. The original § 4(a)(2) safe harbor adopted by the SEC in 1974 required that offerees must either have access to or be furnished with certain information "during the course of the transaction and prior to the sale."[75] Similarly, the original version of Regulation D adopted in 1982 conditioned the § 4(a)(2) safe harbor for transactions involving non-accredited investors on whether offerees were

informed judgments about whether to purchase a company's securities").

71 SEC v. Ralston Purina Co., 346 U.S. 119, 124–25 (1953).

72 The point holds only when treating the Securities Act in isolation and breaks down once the Exchange Act is brought back into the picture because a registered offering under the Securities Act would trigger the periodic disclosure obligations of the Exchange Act. *See* 15 U.S.C. § 78o(d).

73 *Ralston Purina Co.*, 346 U.S. at 125–26.

74 Doran v. Petroleum Mgmt. Corp., 545 F.2d 893, 909 (5th Cir. 1977); *see also* LOSS ET AL., *supra* note 43, at 348–53 (noting that this disjunctive test became "widely followed" after *Doran*).

75 Transactions by an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. 15261, 15267 (May 2, 1974) (to be codified at 17 C.F.R. pts. 230.146).

furnished certain information "during the course of the offering and prior to sale."[76] And Regulation D continues to condition the exemption for certain transactions involving non-accredited investors on information being furnished "at a reasonable time prior to the sale of securities."[77]

Crenshaw relies on Regulation A as a model, but this reliance is misplaced. Although the SEC does impose a periodic disclosure requirement on some smaller companies who raise the smaller amounts of funds allowed under Regulation A, that's only because Congress provided direct statutory authorization for such disclosure in 2012. In the JOBS Act, Congress amended Securities Act § 3(b) to permit the Commission to exempt certain offerings up to $50 million from the registration provisions of § 5[78] and expressly authorized the Commission to require issuers qualifying for this exemption to "make available to investors and file with the Commission periodic disclosures regarding the issuer, its business operations, its financial condition, its corporate governance principles, its use of investor funds, and other appropriate matters . . . ."[79] This provision is not going to help regulate unicorns, whose offerings invariably exceed $100 million.[80] Regulation A is the exception that proves the rule: Absent specific Congressional authorization, the SEC may lack the authority to mandate periodic disclosure from private companies.

The same is true for Regulation Crowdfunding. That regulation requires crowdfunding issuers to "file with the Commission and post on the issuer's website an annual report along with the financial statements of the issuer certified by the principal executive officer of the issuer to be true and complete in all material respects and a description of the financial condition of the issuer . . . ."[81] But that is only because the JOBS Act of 2012 specifically authorized the SEC to impose this ongoing disclosure requirement on crowdfunding issuers.[82]

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[76] Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11251, 11264 (Mar. 16, 1982) (to be codified at 17 C.F.R. pts. 230, 239).

[77] Rule 502(b)(1), 17 C.F.R. § 230.502(b)(1) (2022).

[78] Securities Act § 3(b)(2)(A), 15 U.S.C. § 77c(b)(2)(A) ("The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on the exemption added in accordance with this paragraph shall not exceed $50,000,000.").

[79] JOBS Act of 2012, Pub. L. No. 112-106, § 401(a)(2), 126 Stat. 306, 324–25 (codified at 15 U.S.C. § 77c(b)(4)); *see also* Regulation A, Rule 251(a), 17 C.F.R. § 230.251(a) (2022) (providing that Regulation A offerings "shall be exempt under section 3(b) from the registration requirements of the Securities Act of 1933").

[80] *See* Crenshaw, *Big Issues*, *supra* note 1 (discussing a unicorn Form D seeking to raise over $300 million).

[81] 17 C.F.R. § 227.202(a) (2022).

[82] *See* JOBS Act § 302(b) (requiring crowdfunding issuers to "not less than annually, file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer, as the Commission shall, by rule, determine appropriate").

If anything, these two preceding examples of Securities Act exemptions with periodic disclosure requirements actually serve to further confirm that ongoing periodic disclosure cannot possibly be a part of the § 4(a)(2) or Rule 506 exemptions. In the JOBS Act, Congress added periodic disclosure requirements to these two other Securities Act exemptions, but *not* to the § 4(a)(2) / Rule 506 exemption. Indeed, the JOBS Act actually *liberalized* this exemption, directing the SEC to "revise [Rule 506] to provide that the prohibition against general solicitation or general advertising contained in [Rule 502] shall not apply to offers and sales of securities made pursuant to [Rule 506], provided that all purchasers of the securities are accredited investors."[83] Congress seems to have deliberately decided *not* to make periodic disclosure part of the § 4(a)(2) / Rule 506 framework. A court is unlikely to allow the SEC to overrule that decision.[84]

III
THE SEC ALSO MAY LACK LEGAL AUTHORITY TO CONDITION OFFERING-LINKED DISCLOSURE OBLIGATIONS ON ISSUER SIZE

A separate aspect of Crenshaw's proposal that may fail a legal challenge is her plan to condition the new private company disclosure obligations on the "size of the company, in terms of market cap, value or the size of the investor base."[85]

Inventing a *new* issuer-size trigger for mandatory disclosures would impermissibly circumvent the statutory issuer-size trigger for mandatory disclosure that Congress articulated in § 12(g) of the Exchange Act. That provision requires any issuer with $10 million in assets and 2,000 accredited holders of record (or 500 non-accredited) to register with the Commission and begin making the full range of public company periodic disclosures.[86]

83 JOBS Act § 201.

84 It might be argued that the SEC has broader interpretive license in this context because Rule 506 is merely an optional regulatory safe harbor not a prescriptive rule. But Rule 506 is not a pure optional safe harbor. Offerings under Rule 506 are exempt from state blue sky laws whereas offerings under § 4(a)(2) are not. Securities Act § 18(b)(4)(F), 15 U.S.C. § 77r(b)(4)(F); HAZEN, *supra* note 67, § 4:91(2023) ("Congress could have provided for preemption . . . to all section 4(a)(2) offerings but [] the statute . . . appl[ies] only to an exemption under. . . section 4(a)(2). . . . [U]nless the transaction qualifies for Rule 506's safe harbor in a section 4(a)(2) offering, the issuer must either find an exemption or register . . . where the securities are being offered."). Rule 506 is therefore not merely a purely administrative safe harbor but rather is, in part, a Congressionally designated regime for allocating a Constitutional benefit (federal preemption of state law). Therefore, if anything, the SEC should have *less* interpretive license to set the contours of Rule 506, not more. In any case, the proposition that agencies have greater interpretive license (not to say *carte blanche*) in promulgating exemptive as compared to prescriptive rules is itself suspect. *Cf.* Cary Coglianese, Gabriel Scheffler & Daniel E. Walters, *Unrules*, 73 STAN. L. REV. 885 (2021).

85 Crenshaw, *Big Issues*, *supra* note 1.

86 Exchange Act § 12(g), 15 U.S.C. § 78l.

Setting a different issuer-size threshold for mandatory disclosure would seem to directly conflict with that provision.

More broadly, when Congress wants to make disclosure contingent on issuer size, it knows how to do it expressly. Beyond § 12(g), several provisions of the Exchange Act provide exemptions from generally operative disclosure requirements for "emerging growth companies"[87]—i.e., issuers with less than $1 billion in revenues.[88] In 2012, Congress amended the Sarbanes-Oxley Act § 404 to exempt "emerging growth companies" from the requirement that public companies include, along with their disclosures, a report by the firm's auditor attesting to and reporting on management's assessment of its internal controls for financial reporting.[89] Similarly, the Securities Act provides dialed-down registration disclosures for "emerging growth companies."[90]

The proposed unicorn disclosures cannot be grounded in any of those provisions. As private companies, unicorns by definition have not triggered § 12(g)'s 2,000 "holder of record" trigger, and so they cannot be subject to that provision. And, by definition, unicorns are neither public nor going public, and so they do not fit into the provisions moderating disclosure obligations for "emerging growth companies."

Instead, the proposed new unicorn disclosures would be grounded in Securities Act § 4(a)(2), which exempts "transactions by an issuer not involving any public offering" from registration.[91] This provision is an unlikely legal foundation for the proposed issuer-size-based disclosures. As discussed above, this provision is unmistakably focused on *transactions* not *issuers*: To determine whether a given offering qualifies for the exemption from registration, the provision's plain language indicates that we are to ask about the characteristics of the *transaction* not the *issuer*. The proposal would do the opposite.[92]

Unsurprisingly, courts have not conditioned the availability of the § 4(a)(2) exemption on the size of the issuer or its number of extant investors,

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87 *See, e.g.*, Exchange Act § 13(a) (exempting emerging growth companies from certain financial disclosures); § 14(i) (exempting emerging growth companies from pay versus performance disclosures); § 14A(e)(2) (exempting emerging growth companies from say on pay disclosures).

88 Exchange Act § 3(a)(80).

89 JOBS Act of 2012, Pub. L. No. 112-106, § 103, 126 Stat. 306, 310 (codified at 15 U.S.C. § 7262(b)).

90 Securities Act § 7(a)(2), 15 U.S.C. 77g.

91 15 U.S.C. § 77d(a)(2).

92 *Cf.* Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1584 (2013) (contrasting the disclosure triggers in the '33 and '34 Acts and noting that "[t]he '34 Act traditionally has used different metrics for determining what companies have disclosure obligations, focusing on *the company's size*").

and instead have routinely looked to the size and number of investors in the *offering*.[93]

Similarly, the SEC has consistently construed § 4(a)(2) in Regulation D and elsewhere as making the exemption contingent, among other factors, on the size of the *offering* and the number of *purchasers* or *offerees*—and has not construed the exemption as contingent, even in part, on the size of the issuer or the number of pre-existing investors in that issuer. For instance, the SEC's first interpretation of § 4(a)(2) in 1935 stated that the exemption was conditional on (*inter alia*) "the number of offerees," "the number of units offered," and "the size of the offering."[94] In 1974 the Commission adopted Rule 146 which provided a safe harbor under § 4(a)(2) for certain offerings of any value made to no more than 35 purchasers, excluding purchasers who satisfied certain criteria.[95] The same rule remains in force today under Rule 506 of Regulation D, although the details of the enumerated criteria for uncounted purchasers have changed.[96] Although Rule 506 does not impose a ceiling on the size of the offering, for Rule 506 offerings made to at least one non-accredited investor, there is a sliding scale for the scope of required disclosures based on the size of the offering, with the level of disclosure increasing along with the size of the offering.[97]

In sum, the SEC has consistently interpreted § 4(a)(2) as making a registration exemption contingent on (in some cases, and in part) the number of purchasers and the size of the offering. It has *never* read the section to condition the exemption on the number of extant investors in the issuer or the value or market cap of the issuer.

Crenshaw's specific proposal to require unicorns to provide "auditor opinion letters, confirming the adequacy of the company's internal controls over financial reporting,"[98] also contradicts Congress's express instruction in

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93 *See* LOSS ET AL., *supra* note 43, at 328–29 ("Apart from the number of offerees, important factors have been and remain their relationship to each other and to the issuer; the number of units offered, and the manner of offering."); HAZEN, *supra* note 67 ("The number of offerees and size of the offering, as measured by the number of units offered, are significant . . . ."); *see, e.g.*, Doran v. Petroleum Mgmt. Corp., 545 F.2d 893, 900 (5th Cir. 1977) ("The relevant factors include the number of offerees . . . , the number of units offered, the size of the offering . . . .").

94 Securities Act Release No. 285, 11 Fed. Reg. 10952, 10952 (Jan. 24, 1935); *see also* STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: THE ESSENTIALS 300 (2008) (reviewing this history).

95 Transactions By an Issuer Deemed Not To Involve Any Public Offering, 39 Fed. Reg. 15261, 15268 (May 2, 1974) (to be codified at 17 C.F.R. 230.146).

96 Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, Rule 506(b)(2), 17 C.F.R. § 230.506(b)(2) (2022); *see also infra* Part IV (discussing differences in criteria for uncounted purchasers between the 1974 Rule 146 and the 1982 Rule 506).

97 *See* 17 C.F.R. § 230.502(b) (2022) (providing for increasingly rigorous disclosure requirements as the offering amount increases).

98 Crenshaw, *Big Issues*, *supra* note 1.

the JOBS Act of 2012 to exempt "emerging growth compan[ies]" (i.e., companies with up to $1 billion in revenue)[99] from precisely that requirement.[100] Many unicorns who would be swept into Crenshaw's proposal have revenues under $1 billion. For instance, as of 2018, Moderna Inc. was a unicorn with no actual products on the market and therefore was exempt from the internal controls attestation requirement.[101] Crenshaw's proposal would reverse that legislative exemption.

IV
REGULATORY PURPOSE: REGULATION D WAS NOT SOLELY INTENDED TO ASSIST "SMALL BUSINESS"

Crenshaw claims that her proposal is necessary to restore Regulation D to its "intended purpose" and "original intent" of helping small businesses raise funds outside the public offering process.[102] Crenshaw claims that "from its inception, Reg D was intended to facilitate access to capital by small businesses," refers to Regulation D as the "Small Business Safe Harbor," and says small businesses are "at the heart of Reg D."[103] On this view, the current dominance of large issuers in the Regulation D private placement market is utterly contrary to the original regulatory purpose.[104] Thus, Crenshaw claims, her proposal to crack down on the larger issuers taking advantage of this regulatory safe harbor would bring the regulation back to its original purpose.[105]

But Regulation D was never exclusively intended to help "small business."[106] To begin, Regulation D has always been comprised of several distinct safe harbors with distinct legal bases and distinct purposes.[107] Rule 504 is based on Securities Act § 3(b) which provides the Commission with

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[99] *See* JOBS Act of 2012 § 101.

[100] JOBS Act of 2012 § 103; 15 U.S.C. § 7262(b).

[101] *See* MODERNA, INC., REGISTRATION STATEMENT (FORM S-1) 72 (2018) ("[W]hile we remain an emerging growth company, we will not be required to include an attestation report on internal control over financial reporting issued by our independent registered public accounting firm.").

[102] Crenshaw, *Big Issues*, *supra* note 1.

[103] *Id.*

[104] *Id.* ("To me, this says that Reg D is not serving its intended purpose.").

[105] *Id.* (stating that the proposed reforms would serve "Reg D's purpose in allowing reprieve to smaller businesses, and also help eliminate the benefit and effective subsidy being given to large private issuers on the backs of these same small businesses").

[106] *Id.* ("And, from its inception, Reg D was intended to facilitate access to capital by small businesses.").

[107] *See* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11251, 11252 (Mar. 16, 1982) (to be codified at 17 C.F.R. pts. 230, 239) ("Regulation D . . . establishes three exemptions from the registration requirements of the Securities Act . . . .").

the authority to exempt "small issues"[108] and is intended to promote small business offerings. Rule 506, however, is based on Securities Act § 4(a)(2), which exempts "transactions by an issuer not involving any public offering,"[109] and has always been intended to serve purposes beyond small business.

When the SEC adopted Regulation D in 1982, it explained that, whereas Rule 504 represented an effort to set a "clear and workable exemption for . . . *small* issuers," Rule 506 provided an exemption "available to *all* issuers."[110] From the beginning, Rule 506 was available to public companies without any restriction on size, although Rule 504 was not.[111] This distinction remains true today.[112] In other words, from the beginning the SEC set up Rule 506 to be useful to the largest companies in the world. And one year after Regulation D's original adoption, the North American Securities Administrator Association protested that "[w]ith inclusion of Rule 506, the major objective of the exemption is not limited to facilitating the capital-raising ability of small business."[113] A "small business safe harbor" it was not.

And while Crenshaw may be correct Regulation D's adoption in 1982 "was prompted by the Small Business Incentives Act" of 1980,[114] the most critical part of that rule—a regulatory safe harbor under § 4(a)(2)—had been adopted in 1974, six years before Congress intervened.[115] As the table below shows, the earlier safe harbor already contained many of the same features

108 *See* Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. § 230.504(a)(3) (2022) (providing exemption "from the provision of section 5 of the Act under section 3(b) of the Act"); Securities Act of 1933, 15 U.S.C. § 77c(b)(1).

109 17 C.F.R. § 230.506(a) (providing exemption under "section 4(a)(2) of the Act"); *see also* LOSS ET AL., *supra* note 43 at 394 ("Rule 506 is based on §4(a)(2), not §3(b) . . . .").

110 Revision of Certain Exemptions from Registration For Transactions Involving Limited Offers and Sales, 47 Fed. Reg. at 11252 (emphasis added).

111 *See id.* (stating that Rule 506 is "available to all issuers" while Rule 504 is for "small offerings by small issuers").

112 *See* 17 C.F.R. § 230.504(a) (2022) (excluding issuers who are subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act).

113 NASAA, UNIFORM LIMITED OFFERING EXEMPTION 4 n.1 (1989), https://www.nasaa.org/wp-content/uploads/2011/07/UNIFORM-LIMITED-OFFERING-EXEMPTION.pdf. [https://perma.cc/5KH6-RX78].

114 Crenshaw, *Big Issues*, *supra* note 1. The full title of the legislation is the Small Business Investment Incentive Act of 1980, 15 U.S.C. §§ 80a-51.

115 Transactions By an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. 15261, 15265 (May 2, 1974) (to be codified at 17 C.F.R. pt. 230) (describing that Rule 146 "provides a safe harbor for certain offers and sales"); *see, e.g.*, Revision of Certain Exemptions from Registration for Transactions Involving Limited and Sales, 47 Fed. Reg. at 11252 (adopting Regulation D and noting that "Rule 506 takes the place of rule 146"). Crenshaw acknowledges this earlier safe harbor in a footnote. Crenshaw, *Big Issues*, *supra* note 1, at n.9 ("In 1982, the SEC adopted Regulation D. Rules 504, 505, and 506 replaced 240, 242, and 146, respectively.").

as what the SEC would ultimately adopt in Rule 506 of Regulation D:

TABLE 1. SIDE-BY-SIDE COMPARISON OF EARLY § 4(A)(2) EXEMPTIONS

	Rule 146 (1974)	**Rule 506 (1982)**
Maximum Offering?	No[116]	No[117]
Maximum number of purchasers who satisfied certain wealth/sophistication criteria?	No[118]	No[119]
Specific wealth/sophistication criteria for unlimited purchasers	"Any person who purchases . . . securities of the issuer in the aggregate amount of $150,000 or more."[120]	"Accredited Investors," defined as (*inter alia*) financial institutions; directors and officers of the issuer; "Any person who purchases at least $150,000 of the securities being offered . . .;" individuals with >$1,000,000 net worth or >$200,000 individual income.[121]
Maximum other purchasers?	35[122]	35[123]
Requirement that all offerees and/or purchasers have some baseline financial understanding.	Yes[124]	Yes[125]
General solicitation permitted?	No[126]	No[127]

116 LOSS ET AL., *supra* note 43, at 382 ("There was no dollar limit on the amount of a Rule 146 offering.").

117 Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. at 11259.

118 Transactions By an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. at 15268 (providing the relevant rules on wealth/sophistication criteria under Rule 146(g)(2) and not establishing a maximum number of purchasers who meet such criteria).

119 Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. at 11263 (Rule 501(e)(1) states that "[f]or purposes of calculating the number of purchasers under . . . § 230.506(b) only, . . . [t]he following purchasers shall be excluded: . . . [a]ny accredited investor").

120 Transactions By an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. at 15268 (providing the requirements under Rule 146(g)(2)(i)(d)).

121 Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sale, 47 Fed. Reg. at 11262–63.

122 Transactions By an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. at 15268 (providing the requirements under Rule 146(g)(1)).

123 Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sale, 47 Fed. Reg. at 11266 (providing the requirements under Rule 506(b)(2)).

124 Transactions By an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. at 15267 (Rule 146(d) states that the issuer "shall have reasonable grounds to believe . . . That the

In sum, many of the core features of Rule 506 were already in place six years before Congress enacted the Small Business Investment Incentives Act of 1980.

CONCLUSION

For the second time in two years, an SEC Commissioner has proposed a regulatory overhaul to fundamentally redraw the lines between public and private companies. And for the second time in two years, that proposal appears to fall outside of the SEC's legal authority.

offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or . . . is a person who is able to bear the economic risk").

[125] Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sale, 47 Fed. Reg. at 11266 (Rule 506(b)(2)(ii) states that "[t]he issuer shall reasonably believe immediately prior to making any sale that each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the . . . investment").

[126] Transactions By an Issuer Deemed Not to Involve Any Public Offering, 39 Fed. Reg. at 15267 (Under Rule 146(c) "[n]either the issuer nor any person acting on its behalf shall offer, offer to sell, offer for sale, or sell the securities by means of any form of general solicitation or general advertising").

[127] Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sale, 47 Fed. Reg. at 11265 (Rule 502(c) states that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising").