U.S. Chamber of Commerce

Preserving and Promoting the Private Company Ecosystem

Executive Summary

Two principal ways exist for businesses to raise capital on a large scale in the U.S.—offer and sell securities to the general public or raise capital through private channels. Businesses that sell securities to the public and file mandatory disclosure reports with the Securities and Exchange Commission (SEC) are typically referred to as "public companies," while businesses that are not subject to mandatory SEC filings are typically referred to as "private companies."

For decades, Congress has wisely decided that a company should be afforded the opportunity to choose the path that best fits its capital-raising needs. Generations of prominent companies, both public and private, have driven—and continue to drive—American job creation, economic growth, and innovation. These companies have benefitted from the optionality provided by the securities laws and the ability to enter or exit public markets based on investor interest, marketplace dynamics, and careful consideration of what would make the company competitive in domestic or global economies. There are different risks to investors based on whether a company is public or private, and those risks have guided disclosure policy.

Businesses that initially raise capital through private channels often must decide whether they should register their securities with the SEC and go public. For some companies, going public is the best course of action. For others, remaining private may be the appropriate choice. Making this decision is a rigorous process that helps a company determine whether going public or remaining private is in the long-term best interests of the company, its shareholders, and its customer base.

Allowing companies to choose whether to remain private or pursue investment from the public is vital to the enhanced competitiveness of the U.S. economy. Unfortunately, some policymakers have proposed to restrict the flexibility companies have enjoyed to raise capital private in the private market, subject private companies to certain disclosure requirements designed for public companies, or even force private companies to go public against their wishes—in each instance, threatening growth, opportunity, and innovation in the American economy.

This paper explores why companies, investors, and the American economy benefit from both robust public and private markets, and explains why the regulatory distinctions between the two markets must be preserved.

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Introduction

Why are some companies legally mandated to regularly report information to the SEC while other companies are not? What does it mean to be a public company in the U.S.? What are the impacts of allowing companies to remain private?

For over 90 years, federal legislators in Congress and regulators at the SEC have sought to define the line between public company and private company status. As time has passed, capital markets have matured, new innovations have emerged, and the world has become more economically competitive. It is no surprise, then, that succeeding policymakers have taken an interest in the public/private boundary. More recently, with the success of private securities markets in funding the startup and growth of private companies—some of which have developed into unicorn companies valued in excess of $1 billion—there has been renewed focus on the issue.

It is essential to preserve and promote the long-standing approach, rooted in the federal securities laws since their inception in 1933, of ensuring that companies are afforded a vibrant pathway to raise capital privately and are relieved of undue mandatory disclosure that has enabled and encouraged entrepreneurism, opportunity, growth, and innovation. Federal securities regulation has always created space for private companies to grow and thrive, recognizing the economic costs of overburdening the capital formation process and the economic benefits when companies can fund their operations and pursue expansion efficiently.

First, a word on terminology. When we refer to public companies, we mean businesses that are subject to the mandatory reporting requirements that the SEC imposes under the U.S. federal securities laws as a condition to raising capital or having the companies' securities held broadly by investors. These disclosure mandates typically are triggered when a company has made a public offering of securities, listed its securities on a national stock exchange so that they trade widely among investors, or surpassed a threshold number of investors and assets under the federal securities laws, thereby compelling public disclosures even if the company has never raised funds publicly. While it is true that most public companies are still private enterprises (relatively few SEC-reporting entities are agencies or instrumentalities of the U.S. or foreign governments), when this paper refers to private companies, we mean those enterprises that have not yet tripped one of the three tests (public offering, stock exchange listing, or number of shareholders plus assets) obligating them to begin filing periodic reports with the SEC.[1] We discuss these distinctions further as they have proven important in advancing the goal of businesses launching, growing, and prospering.

In addition, we discuss the society-wide benefits that private companies generate and provide an overview of the federal securities laws to describe the intentional differences between the disclosure regimes applicable to public and private companies. Of particular importance are the policy and historical underpinnings that have led policymakers—Congress, presidential administrations from both political parties, and numerous SECs—to differentiate in the regulatory treatment of public and private companies. Indeed, there are notable examples, such as the SEC's adoption of Regulation D under the Securities Act of 1933 and the enactment of the Jumpstart Our Business Startups Act of 2012 (JOBS Act), designed to facilitate private companies' access to capital. The current regulatory structure is not the result of happenstance or coincidence, but rather it reflects deliberate policy choices made over the last 10 decades.

We recognize that other views may exist of what it means for a company to be public, separate and apart from when the federal securities laws mandate companies to make public disclosures. In considering these perspectives, we emphasize the many beneficial contributions private companies make across the economy, including creating jobs, spurring innovation, and fostering competition, precisely because private companies are subject to less costly and burdensome federal securities regulation than public companies. This sets the stage for policies in favor of encouraging private companies by differentiating between the regulatory treatment of public and private companies under the federal securities laws.

Importantly, facilitating private companies' ability to raise funds, as the federal securities laws purposefully do, does not compromise core investor protection concerns, and we catalog just a few of the key ways that private companies keep investors informed. Furthermore, the antifraud provisions of the federal securities laws serve as an critical bulwark in private markets that prohibit private companies from engaging in fraud, and even in the absence of detailed mandatory disclosure rules, investor due diligence and market discipline elicit material investor disclosures. Not to be overlooked, maintaining room for private companies simultaneously creates investment opportunities for investors to invest in companies with distinctive growth prospects.

As some advocate for greater homogenization of the regulatory regimes that public and private companies are subject to under the federal securities laws, we caution that neither Congress nor the SEC should make it more difficult for private companies to raise capital by regulating them like public companies. If anything, the costs and burdens that public companies must bear under SEC disclosure obligations should be streamlined to avoid making the U.S. public capital markets less attractive. Moreover, although the SEC has a distinctive mission and critical expertise as the country's capital markets regulator, the SEC was never meant to be, and should not become, the omnibus regulator of American business through an expansive claim of authority.

Ultimately, we conclude that private companies and the securities markets that support them are a strength of the U.S. economy that the federal securities laws should continue to nurture.

1 In addition, by public companies we refer to those businesses that are not required to register as investment companies under the Investment Company Act of 1940. Public and private pools of capital are beyond the scope of this discussion.

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Societal Benefits of Private Companies

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The private company ecosystem in the U.S. benefits private companies and their investors. But crucial societal benefits attributable to private companies exist too.

Private markets allow focus on long-term performance and value enhancement

Every business must perform well financially to compete and survive, but public companies are unique relative to private ones in that the former are under more pressure to meet or exceed near-term revenue and earnings guidance and expectations. Yet sometimes it can take time even for a successful strategy to generate solid results, and investments in a strategy can come at the expense of today's reported income where costs are incurred now and revenues will not be realized until the future. A benefit of being private is that it allows a company space to invest in and grow its business over a longer period without the same pressure to meet short-term financial targets. When allocating capital and running the business, management can focus on longer-term goals and value enhancement that benefit the company's stakeholders in a way that does not unduly prioritize the short term at the expense of longer-term strategic initiatives and capital expenditures that, while they can be a drag on current-period financial performance, help the company succeed. Facing external pressure to continuously generate quarterly results that meet or beat expectations to satisfy public shareholders, analysts, and others can also place heavy stress and take its toll on employees who are responsible for hitting these goals.

For earlier stage and growth companies, particularly if developing an innovative product or deploying new technology for which it can take time for the market to develop, room to make decisions that will unfold and payoff over a longer time horizon can be invaluable. Patient capital with a comparable time horizon can make a tremendous difference for private companies such as these. Moreover, greater flexibility to structure the management and operations of the business with a smaller external shareholder constituency can facilitate quicker responses to rapidly changing market conditions. Fewer resources spent on compliance with SEC reporting and related requirements crafted for public companies frees up additional human and financial capital for the development of new goods and services, reinvestment in the business, and increased employee wages and benefits.

Additionally, not only investors read companies' SEC reports; competitors do too. A consequence of being public, therefore, is that competitors have access to information about a business' finances, product development, quarterly operations, and other potentially sensitive information, all of which can serve to inhibit future growth.

Private businesses drive innovation and job creation

The strategy of many businesses does not include substantial (perhaps, bet the company) investments in research and development of new products or technologies that may not succeed precisely because they are cutting-edge and consumer demand is uncertain. And not every company commits itself to disruptive innovation, especially if its own business is what stands to be disrupted.

Early-stage and growth businesses (which usually are private companies funded by private markets) see backing technological advances and bringing innovative products or services to market as imperative because that is the essence of their business in many instances. Their prospects and survival depend on it. Without public visibility into the creativity and progress of their research, development, and go-to-market strategy, private companies can more freely experiment with new technology and innovation, including greater tolerance for what others might see as "failure", adjust product designs, refine what is brought to market, redirect resources as priorities evolve, and hire employees whose skills fit the business' direction. Public disclosure of all of this and more would, undoubtedly, disadvantage private companies and impede their success. It is not surprising that many groundbreaking companies release their game-changing goods and services while still private.

New, emerging, and growing private companies create jobs. Most obvious, these companies need to hire, and often quickly, so that they can get to market and compete as timing can be make or break. Delay can stifle a company from getting off the ground or from reaching the needed scale to survive after starting up. But there is more to job creation than the demand for employees. Many workers are attracted to private companies as employers because of what often is the exciting pace when leveraging technological advances, the sense of community that can characterize a smaller enterprise, or a desire to be part of a big change that private companies are often striving to make. Thus, many private businesses develop an innovation culture that is highly sought after and can help individuals meet their own personal ambitions beyond employment. Companies that become public seek to preserve this culture, but it can be challenging as the very nature of being public brings new demands, scrutiny, and pressures.

Innovation can and does occur at public companies, and public companies are significant employers. That said, private company entrepreneurism and risk-taking stand out as hallmarks of the U.S., both economically and socially, that should be encouraged, not stymied. Therefore, it should not become more difficult for private companies to engage in private offerings to raise the capital required to fund their innovation and growth, nor should private companies be compelled to become public sooner than they choose to.

Private companies promote U.S. competitiveness and help solve difficult challenges

The U.S. faces a number of growing challenges, along with opportunities, on a range of fronts: artificial intelligence, climate, public health, consumer finance, privacy, and cybersecurity. The list goes on. American industry will need to be an integral part of developing new solutions to address these and other risks to our standard of living and seize on the opportunities they afford to create new goods and services that meet consumer needs and improve people's lives. And a vibrant and dynamic U.S. economy, with new competitors, new technologies, and new growth opportunities, helps American business on the whole by expanding markets, sharpening competitive edges, raising people's incomes, improving investment returns, and boosting consumer confidence. In turn, American national security and economic prosperity are dependent on our ability as a country to innovate and find solutions.

Remaining private is a vital lynchpin to all of this in that it can enhance competition to spur development of new products and services in important areas as varied as climate tech, fintech, and biotech. The benefits from future innovation inure to a range of stakeholders beyond a company's investors to also include customers, the U.S. workforce, and broader American society. In the aggregate, the contributions of private companies and the private securities markets that fuel them with financial backing generate society-wide macro benefits that the U.S. needs to remain in its leadership position.[2]

2 See: U.S. Chamber of Commerce, "Large Private Companies Strengthen Communities," Oct. 22, 2024. Available at: https://www.uschamber.com/economy/large-private-c. See also: Babina, et. al, "IPOs, Human Capital, and Labor Reallocation," Jun. 2020. Available at: https://business.columbia.edu/sites/default/files-efs/pubfiles/19253/Babina_IPOs.pdf.

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The Regulation of Raising Capital

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Over the past 90 years, Congress has provided a highly calibrated framework for the federal regulation of securities offerings, drawing purposeful distinctions between public offerings and private offerings. Providing optionality for companies to access capital through either the public markets or the private markets has fostered the growth of countless businesses across the American economy over the intervening decades, thus setting the stage for the societal benefits that private companies generate as mentioned.

Differences between public and private companies

In the aftermath of the stock market crash of October 1929, Congress set out to investigate the root causes of the collapse and propose regulatory reforms. That effort led to the creation of what became known as the Pecora Commission—named for its chief counsel and future SEC commissioner Ferdinand Pecora—which from 1932 to 1934 conducted a lengthy investigation, held public hearings, and ultimately produced a series of reports detailing recommendations for legislative action. Congress, heavily influenced by the Pecora Commission's work, passed several new laws to regulate the financial system, including two landmark statutes that for the first time provided federal regulation over securities and the capital markets: the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Securities Act of 1933, often called the Securities Act or simply the '33 Act, provides a regulatory framework for the offer and sale of securities in interstate commerce and is centered on requiring companies engaged in a public offering to make certain public disclosures in filings with the SEC.

The Securities Act creates two primary categories of securities offerings: (1) public offerings of securities that must be registered with the SEC and are subject to a host of mandatory disclosure requirements in the form of a registration statement and prospectus filed with the SEC; and (2) private offerings of securities (sometimes called private placements) that do not require registration with the SEC and are relieved from the mandatory disclosures that public offerings must abide by. Notably, when raising capital in private offerings, companies still make key disclosures to investors And these disclosures, although not mandated by law, remain subject to federal securities law antifraud provisions.[3]

Under the Securities Act, public offerings may only be made by means of a prospectus that includes audited financial statements and several nonfinancial mandatory disclosures. The prospectus is part of a more thorough and lengthy registration statement that a company must file with the SEC before launching any public offering, and public sales of securities can only begin after the SEC has declared the registration statement effective. While private offerings can be made without a registration statement or prospectus, as a matter of practice, private companies routinely prepare disclosure documents (called offering memoranda or private placement memoranda) to provide essential information of significance to investors, and they often create a dedicated data room that investors can use to perform additional diligence in evaluating the investment opportunity.

Whereas the Securities Act regulates the offer and sale of securities, comprehensive regulation of the capital markets did not come until the passage of the Securities Exchange Act of 1934, often shorthanded as the Exchange Act or ’34 Act. The Exchange Act created the SEC as a bipartisan, five-member independent agency, whose commissioners serve staggered five-year terms after they are appointed by the president and confirmed by the Senate, with statutory authority to administer and enforce both the ’33 and ’34 Acts.[4] Among other provisions, and most relevant for this paper, the Exchange Act provides for a series of reporting obligations for companies that have completed a public offering, listed securities for trading on a national exchange, or crossed the reporting thresholds under Section 12(g),[5] each of which is discussed further in this paper. In other words, the Securities Act is about registering and providing one-time disclosure about a particular public securities offering, and the Exchange Act is about registering and providing ongoing disclosure about a company that has issued securities. The structure of the Securities Act and the Exchange Act evinces a long-standing determination to differentiate in the regulatory treatment of publicly- and privately-held businesses.

3 Section 3 of the Securities Act provides that certain securities are not subject to the statute, but offerings of these securities typically account for a small minority of the total capital raised in private offerings each year. See generally 15 U.S.C. § 77c.

4 In addition to creating the SEC as the dedicated federal agency to administer and enforce the federal securities laws, the Exchange Act established a regime for SEC registration and oversight of key securities intermediaries and market infrastructure, including brokers and dealers in securities, transfer agents, and securities exchanges. The Exchange Act also includes a powerful antifraud provision, Section 10(b), as discussed, which prohibits making a misstatement or omission of material information in connection with the purchase or sale of a security.

5 15 U.S.C. § 78l(g).

Capital formation optionality is essential

The structure of the Securities Act captures an intentional policy decision favoring capital-raising options for companies: offer and sell securities to the public as a whole in accordance with the registration requirements of Section 5 of the Securities Act and related compliance obligations or raise capital in private offerings as long as the offering meets specific constraints and prerequisites. Different pathways for companies to access capital have permitted the U.S. capital markets to be the deepest in the world and have facilitated the growth of countless businesses, large and small, throughout our economy. The U.S. stands out in the success of its startup, early-stage, and growth companies, all of which depend on the viability of a robust private market.

A company issuing securities in the U.S. has optionality to select how best to raise capital, considering the investors it wishes to reach, the amount of capital it wishes to raise, and the way it wishes to communicate to investors. Generations of startups and small business owners and businesses with significant growth opportunities have relied on private offerings to raise capital from friends, neighbors, wealthy individuals, institutional investors, and others who choose to back private companies for any number of reasons, ranging from supporting one's local community to diversifying an investor's portfolio to seeking the kinds of financial returns private companies can offer. As those businesses grow, they continue to have the option to raise capital from larger groups of investors, culminating for some in a public offering. Without a viable path to raise capital in a private offering, many, if not most, emerging and earlier-stage entrepreneurs and businesses would struggle to raise seed, venture, and growth capital, impeding their ability to create jobs and innovate new products and services for American consumers across economic sectors and industries.

Different regulation for public and private offerings

Under Section 5 of the Securities Act,[6] when a company offers and sells securities to the public, the company must register the offer and sale with the SEC by filing, as mentioned, a detailed registration statement that includes lengthy disclosures. However, from the beginning, the federal securities laws have established room for nonpublic offerings—in other words, private offerings. The cornerstone for private offerings of securities by private companies (as well as by public companies that also can engage in private offerings) is Section 4(a)(2) of the Securities Act[7] (long known as Section 4(2) until renumbered). For "transactions by an issuer not involving any public offering" (i.e., private offerings), Section 4(a)(2) of the Securities Act provides that private offerings of securities are not subject to the registration provisions of Section 5, although, importantly, any disclosures a company makes when raising capital privately are subject to liability for fraud under the federal securities laws if materially misleading.[8] The antifraud provisions apply even to securities offerings that are outside Section 5's registration requirements for public offerings.

This regulatory framework reflects a policy determination that has persisted for decades—namely, that the costs and burdens of registering a public offering are in many instances too costly, ultimately discouraging beneficial economic activity. There should be—and since the 1930s there has been—a viable opportunity for companies to raise the capital they need privately in a manner that is more efficient and more practicable than engaging in a public offering. The securities laws construct allowing for private companies to issue securities privately enables this to occur by easing the regulatory requirements when a company accesses the private markets rather than the public at large. In short, it has been a policy choice not to regulate all aspects of capital formation to the same degree and in the same way precisely because it is important to ensure that private companies can get the resources they need to grow and compete.

6 Id. § 77e.

7 Id. § 77d(a)(2).

8 Section 4 also provides that certain other discrete classes of offerings are likewise not subject to the Section 5 registration regime, including transactions by any person other than an issuer, underwriter, or dealer; certain dealer transactions; certain brokers' transactions; certain private offerings raising no more than $5 million; certain crowdfunding offerings; and certain resales to accredited investors. See 15 U.S.C. § 77d.

The courts define private offerings

In 1953, the U.S. Supreme Court considered how to distinguish a private offering from a public offering in the landmark case of SEC v. *Ralston Purina Co*.[9] The effect of the distinction, as noted previously, is to demarcate the regulatory approach to capital raising that applies under the Securities Act. The Court ruled that in order to qualify as a private offering within the scope of Section 4(2) (since renumbered Section 4(a)(2)) of the Securities Act—such that the offering could be used to raise capital without bearing the costs and requirements of a public offering under Section 5 of the Securities Act—an offering must be made to investors who are able to "fend for themselves," as the Court phrased it.[10] That remains the touchstone as a jurisprudential matter, charting a course for private companies under today's Section 4(a)(2).

Since *Ralston Purina* was decided, the difficulty with the principle of "fend for themselves" has been that it lacks clarity and predictability in practice. Even if a company genuinely concludes it is engaging in a private offering under this standard, it is not difficult to imagine being second-guessed. Without legal and regulatory certainty, the usage of private offerings of securities is hindered, frustrating the very structure of the Securities Act. The case law that developed interpreting and applying *Ralston Purina* did not result in the needed certainty.[11]

Under *Ralston Purina*, some lower courts focused attention on the information investors had access to in the context of a particular offering, often drawing comparison to the disclosures that must be made in a public offering of securities. Sometimes courts factored in the number of investors and the manner of the securities offering to inform whether it was public or private in nature, where a general offering to a wide swath of investors that had no relationship to the company would weigh in favor of finding the offering was public. Still, other courts emphasized whether investors were "sophisticated," as courts described it, in financial, investing or business matters on the basis that this type of knowledge or experience would allow investors to evaluate the investment opportunity effectively. Courts also considered the financial well-being of investors regarding the view that wealthy investors or those with higher incomes could better bear the risk of a financial loss if an investment did not pan out.

9 *SEC v. Ralston Purina Co*., 346 U.S. 119 (1953).

10 Id. at 125.

11 For a discussion of several of the cases citing *Ralston Purina*, see Loss, Seligman, and Paredes, III Securities Regulation 3.C.7 (6th ed. 2020).

The SEC adopts rules for private offerings

Against the backdrop of the *Ralston Purina* line of cases, in 1982 the SEC ushered in a mechanism intended to promote private offerings of securities by creating well-defined requirements that companies could confidently use to raise capital privately. This mechanism—which continues in effect to this day—is Regulation D, adopted under the Securities Act.[12] As indicated in the following summary of Regulation D, the regulation's conditions for when a private offering is allowed under Regulation D are rooted in the case law that burgeoned in the decades after *Ralston Purina* was handed down.

Regulation D establishes clear criteria that companies can apply to ensure that they abide by the requirements for engaging in a private offering. The principal defining feature of Regulation D is that private offerings are limited to "accredited investors," with some exceptions. At present, Regulation D contains two alternate pathways for conducting a private offering: Rule 504[13] and Rule 506.[14] Regulation D is only available for offers and sales by an issuer of securities to initial purchasers, meaning, among other things, that an investor wishing to resell securities acquired in a private offering cannot rely on Regulation D to do so. Companies issuing securities can rely on Rule 504 for certain offerings with an aggregate offering price of up to $10 million, but there is not a cap on the amount an issuer can raise under Rule 506.[15] Accordingly, Rule 506 is used in the vast majority of private offerings.

Issuers relying on Rule 506 must satisfy a number of conditions intended to protect investors in private offerings. The key inquiry under Rule 506 is whether the offering is made to accredited investors. Examples of accredited investors include individuals or couples with a high annual income or significant personal assets, excluding the value of a person's primary residence; institutions with substantial assets; holders of certain professional certifications or designations or credentials; and certain knowledgeable employees of the issuer.[16] Rule 506 does not restrict the number of accredited investors a private company can raise capital from. But Rule 506 limits the maximum number of nonaccredited investors a company can offer securities to in a private offering to 35. In addition, Rule 506(b) specifically prohibits the use of general solicitation, (which is a form of public advertising) to offer securities on television, radio, in print and online media, or through other widespread means of communication.

To expand opportunities for businesses to use Rule 506 to access capital, the JOBS Act directed the SEC to ease its prohibition on general solicitation. Accordingly, in 2013 the SEC adopted Rule 506(c) to permit general solicitation, subject to the antifraud provisions if any communication is materially misleading. If an issuer undertakes permissible advertising, Rule 506(c) requires the issuer to limit the actual sale of securities to accredited investors even if the advertising reached more broadly.

Although an issuer relying on Regulation D need not register the offering with the SEC, the issuer is generally required to file a

12 See generally SEC Release No. 33-6389, Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11,262 (Mar. 16, 1982).

13 17 C.F.R. § 230.504.

14 Id. § 230.506.

15 Whereas Rule 506 was adopted pursuant to Section 4(2) (now Section 4(a)(2)) of the Securities Act, Rule 504 was adopted under Section 3.

16 The SEC's more recent amendments to the accredited investor definition provide additional history and discussion of the topic. See generally SEC Release No. 33-10824, Accredited Investor Definition, 85 Fed. Reg. 64,234 (Oct. 9, 2020).

Form D with the SEC and the states in which the offering is conducted within 15 days after the first sale of securities. This filing requirement applies to both reporting and nonreporting companies under the Exchange Act, assisting the SEC and state securities regulators in enforcing federal and state securities laws, monitoring private placement activity, and informing rulemaking efforts with the information provided in the Form D filings. Form D, as a notice filing, does not create ongoing reporting requirements for the issuer, but it does disclose basic identifying information regarding the issuer like names of directors, executive officers, and promoters, as well as the issuer's jurisdiction of organization and principal place of business. Additionally, Form D includes the securities regulation provision or provisions the issuer is relying on in making the private offering; the identity of brokers, dealers, and finders used to solicit investors in the offering, along with any fees paid to those persons; and the total offering amount, the amount sold, and the gross proceeds paid to promoters, executive officers, and directors of the issuer. Importantly, Regulation D generally is not available to companies if they or key members of management are bad actors who have previously violated various banking, securities, or commodities laws.

Securities acquired in a private offering, such as those under Section 4(a)(2) or Regulation D, are considered restricted securities under the federal securities laws in that their resale is limited. To allow for a measure of liquidity for securities acquired in a private offering, SEC Rule 144,[17] adopted in 1972, sets forth requirements that investors can follow to resell privately placed securities they bought without having to register the resale transaction under Section 5 of the '33 Act. Before an investor may resell restricted securities under Rule 144, the investor must have held them for a prescribed period of time, depending on whether the issuing company is a public company that files reports with the SEC. Rule 144 imposes other conditions on resales too, depending on the status of the issuer and whether the seller is affiliated with the company.[18]

17 17 C.F.R. § 230.144.

18 Additionally, reporting companies must generally be current with their periodic reporting requirements under the '34 Act. For nonreporting companies, company information, including the nature of its business, the identity of its officers and directors, and its financial statements, must be publicly available. Affiliates of the company (such as certain officers, directors, and controlling shareholders) must file a notice with the SEC on Form 144 if the sale involves more than 5,000 shares or the aggregate dollar amount is greater than $50,000 in any three-month period. Affiliates are also limited in the number of equity securities they may sell during any three-month period, affiliate sales must be handled as routine trading transactions under a series of SEC rules, and brokers may not receive more than a normal commission. For affiliates, neither the seller nor the broker can solicit orders to buy the securities.

How Private Companies Inform Investors

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Private companies are not legally required to make public disclosures on an ongoing basis like those required of public companies. But this is not to say that private companies do not provide their investors with meaningful disclosure. To the contrary, as a matter of practice, even though not mandated by the federal securities laws, private companies provide their investors with consequential information so that they can make informed decisions and with that information hold the private company's management team accountable for how the business is operated. In fact, many investors demand detailed disclosure about a private company before they will invest, and investors likewise bargain for ongoing information rights so that they can track the performance of the company over the life of the investment.

When it comes, in particular, to using private offerings to raise capital in private markets, through what is commonly referred to as market discipline and private ordering, a market disclosure practice has developed for private companies to communicate with investors. Private companies typically prepare an offering document for prospective and current investors providing information both about the company's historical operations and financial results, as well as the company's future projections and prospects. Over the years, these offering documents have come to resemble, in many respects, the kinds of disclosures public companies make when engaged in a public offering. But private companies have more room, by design of the federal securities laws, to tailor their disclosures to the information that their investors find most useful.

Antifraud provisions of the federal securities laws protect investors

Communications made to investors, including those that private companies make in a private offering or thereafter to investors, are subject to the antifraud provisions of the federal securities laws, which are enforced through civil, criminal, and SEC administrative proceedings, as appropriate based on the underlying facts. Under Section 10(b) of the Exchange Act[19] and Rule 10b-5 thereunder,[20] it is illegal to defraud investors. Section 17(a) under the Securities Act[21] also empowers the SEC to police materially misleading statements or omissions in the offer and sale of securities, but unlike Section 10(b) that requires a showing of scienter—that is, the intent to engage in misconduct, which recklessness can be adequate to demonstrate—some elements of Section 17(a) only require a showing of negligence. By enforcing these statutes, the SEC is able to "hold violators of the federal securities laws accountable for their misconduct and recover money for the benefit of harmed investors."[22]

The SEC regularly uses its broad authority to pursue civil charges for violations of the federal securities laws, including the antifraud provisions, pursuing cases against both public and private companies.[23] The SEC can seek diverse remedies, such as civil monetary penalties, disgorgement of ill-gotten gains, injunctions against future violations, and industry bars that exclude bad actors from the securities industry and from being a part of certain securities transactions. When criminal intent is present, the U.S. Department of Justice may pursue criminal charges for securities law violations. State securities regulators also investigate thousands of cases each year and initiate enforcement actions that lead to fines, restitution, criminal sentences, and other remedies under state-level securities statutes and regulations known as blue sky laws.[24]

Further, a private right of action exists under the core antifraud provision of '34 Act Section 10(b). Investors that believe they have been harmed in a securities transaction can therefore pursue an action on their own behalf if they choose to beyond any investigation the government may advance. In addition to state authorities, private plaintiffs may also be able to enforce antifraud provisions that exist under state law through private claims.

19 15 U.S.C. § 78j(b).

20 12 C.F.R. § 240.10b-5.

21 15 U.S.C. § 77q(a).

22 See SEC "Enforcement and Litigation," available at https://www.sec.gov/enforcement-litigation#:~:text=The%20SEC's%20civil%20law%20enforcement,the%20benefit%20of%20harmed%20investors.

23 FINRA, a self-regulatory organization that oversees U.S. broker-dealers, investigates potential securities violations and can bring formal actions against broker-dealers and their employees.

24 See NASAA Enforcement Statistics, available at https://www.nasaa.org/policy/enforcement-statistics.

Disclosure practices in private offerings

Since *Ralston Purina* was decided in 1953 and Regulation D was adopted in 1982, market practices have developed in private offerings leading to private company disclosures that enable investors to conduct due diligence. While not always legally required, investors usually expect to receive some form of a disclosure document from private companies to inform their investment decisions. The documents provided to investors (commonly called private placement memorandums or PPMs) in private offerings are tailored according to a number of factors to fit the relevant offering. These factors include the timing and legal structure of the transaction, the '33 Act provision or SEC rule being relied on to conduct the offering, the quality of available information already provided by the company or information already in the public domain about the company, and other market practices and customs for similar offerings. The particular nature and level of disclosure is generally determined by the issuer and its advisors after considering the investor base in the offering, such as whether the investors are accredited or nonaccredited, the type of securities being offered, the relative complexity of the offering structure, and information customarily included in offering documents. It is often the case that private company disclosure materials, in terms of the key content they disclose to investors, bear a resemblance to the most useful information required in public offering registration statements and prospectuses.

Occasionally, no dedicated offering document is used, particularly if there is a preexisting relationship between the issuer and investor base or if the investor base includes only a small number of professional investors like angel investors or venture capital funds. In these situations, instead of the company incurring the cost and spending the time preparing a lengthy disclosure document, investors obtain the necessary information by performing their own due diligence, which the company routinely facilitates by setting up a data room for investors to visit and making key members of the company's leadership team available for discussions.[25] Indeed, data rooms may be set up and management may participate in discussions with investors even if a disclosure document as such is prepared. If a company is unwilling to accommodate an investor's interest in certain information, that investor is free to refrain from purchasing the offered securities.

Whether or not a formal offering document is prepared or a data room is set up, the purchase agreement between the issuer and investors will typically include factual representations and warranties about the issuer, its historical operations, the current status of the business, compliance with laws and contracts, and a host of other topics that convey useful information to investors in evaluating the company.

25 Data rooms typically include a wide range of information useful for investor due diligence, such as financial information, copies of key commercial and financing agreements, copies of charter documents, litigation files, evidence of regulatory compliance, business plans and sales data, information about employees and employee benefit plans, tax information, and other relevant business and legal information about a company in light of its stage of development, industry, competitive position, and other criteria relevant to investors.

Regulation D informational requirements are significant

Private companies frequently limit Regulation D private offerings to accredited investors. However, if a company issues securities under Regulation D to nonaccredited investors, Rule 502(b) of Regulation D requires the issuer to disclose certain information similar to that which would be required in an SEC registration statement for a public offering, including a description of the company's business, key risks, and other information about the company's operations. Issuers must also provide financial statements to nonaccredited investors, which for certain offerings must be fully audited. The antifraud provisions require that any disclosure neither misstate nor omit any material qualitative or quantitative information.

Although the Securities Act reflects the choice not to require private companies to make specific disclosures in offerings made only to accredited investors, issuers often provide comparable information to accredited investors too, as mentioned. For an early-stage business, providing information about a company's future plans to bring goods or services to market and generate revenue is often especially useful to investors. For more mature businesses, investors also are interested in the company's financial and operational track record. And beyond disclosures made in connection with a capital raise, investors typically seek ongoing insight into the finances, operations, and plans of the business as it progresses.

Venture capital and private equity investors provide oversight

Venture capital firms, private equity sponsors, and others focused on startups, growth, or other privately held businesses regularly bargain for specific rights, preferences, and restrictions relating to an investment's economics and governance when investing in a private company. These terms and conditions vary from investment to investment, but common provisions include, by way of illustration, negotiating for protections against economic dilution and for preferential treatment if the company were in liquidation, special voting rights and rights to appoint members of the company's board of directors, contractual rights that oblige the company to take certain business actions or refrain from taking certain business actions without investor consent, rights to participate in future capital raises by the company, and special rights to participate in a sale of the business.

Venture and private equity investors will also often bargain for informational rights as a condition to invest in a private offering by a private company. Informational rights likewise take a variety of forms and will frequently include rights to periodic financial information, rights to briefings and reports from management, access to annual and periodic budget data, and rights to inspect corporate records. These rights provide investors with important information regarding the ongoing performance of the investment and the company it is in, facilitating investor monitoring and oversight as means of safeguarding investor interests. Private companies, in turn, develop policies, procedures, and processes to collect and report the required information to investors all without any specific regulatory mandate to do so.

How Companies Become Public

Contents

Building on the foregoing discussion of the ’33 Act and ’34 Act framework, there are three ways that a company ceases to be private and becomes public (as those concepts are understood under the federal securities laws), at which point the company must begin making mandatory disclosures in disclosure reports filed with the SEC under the Exchange Act. Preparing SEC reports is a costly, complicated process that requires specialized expertise and detailed policies, procedures, and controls to collect and ensure the accuracy of reported information.

Becoming public: registration requirements under the Exchange Act

First, under Section 15(d) of the Exchange Act,[26] SEC reporting becomes required when an issuer completes a public offering of securities under the Securities Act. This corresponds to what is usually associated with an initial public offering (IPO), although a company may become a public company without undertaking an IPO. Second, under Section 12(b) of the Exchange Act,[27] a company must register with the SEC when the company lists its securities for trading on a national securities exchange, like Nasdaq or the New York Stock Exchange. Third, under Section 12(g)

26 15 U.S.C. § 78o(d).

27 Id. § 78l(b).

28 Id. § 78l(g).

of the Exchange Act,[28] a company must register with the SEC when it exceeds a threshold amount of total assets and shareholders of record, even if the company has never raised capital from the public at large and does not have securities listed on an exchange that the public can buy and sell.[29] The current Section 12(g) thresholds require an otherwise private company essentially to become public if the company has (1) total assets exceeding $10,000,000, and (2) over 2,000 total shareholders of record for a class of equity securities or over 500 nonaccredited investors as shareholders. Section 13(a) of the Exchange Act subjects a company registered under any provision of Section 12 to the SEC's periodic reporting requirements.

Whether the federal securities laws should have a mechanism that forces certain private companies to become public and regulated as such under the federal securities laws has long been a topic of discussion and debate. Since the inception of the federal securities laws, commentators have argued both for and against the expansion of SEC reporting obligations to private companies that have neither raised capital from the public at large nor opted to list on an exchange where their securities could freely trade among the public.[30] Key legislative decision points came in 1934, 1964, and 2012, eventually landing on the Section 12(g) mechanism we have in an effort to strike the right balance.

When the Exchange Act was signed into law in 1934, Congress only required ongoing reporting for those companies that completed a public offering under the '33 Act or with securities listed on a national exchange.[31] This intentionally did not capture all U.S. businesses and carved out a class of private companies that were not subject to SEC-mandated reporting. At the time, there was a burgeoning over-the-counter market for securities in companies that had not undertaken a public offering;[32] brokers bought and sold these private company securities on behalf of customers in bilateral transactions without a formal exchange listing. Congress did not include periodic reporting obligations for these companies in the Exchange Act.

In 1963, Congress commissioned a special study of the SEC, which found, among other things, that trading in the over-the-counter market had increased substantially since 1934.[33] For this reason and recognizing certain incongruities that resulted from the sequential adoption of the '33 and '34 Acts, Congress ultimately decided in 1964 to amend the Exchange Act to implement a mechanism compelling otherwise private companies to begin filing SEC reports once they reached a certain size.[34]

As enacted in 1964, Section 12(g) required companies to file reports with the SEC when they (1) had total assets exceeding $1 million

28 Id. § 78l(g).

29 Id. § 78m(a).

30 See Richard M. Phillips & Morgan Shipman, An Analysis of the Securities Acts Amendments of 1964, 1964 Duke L.J. 706, 707-10 (1964) (an overview of the extensive discussions preceding the passing of what today is Section 12(g)).

31 See 48 Stat. 892, § 13 (June 6, 1934).

32 See Report of the Special Study of the Securities Markets of the SEC, H. Doc. No. 95, 88th Cong., 1st Sess., Part 1, 22 (Apr. 3, 1963) (Special Study) (estimating that around the time of the passing of the Exchange Act there were over 3,000 U.S. company stocks traded over-the-counter.

33 Special Study, at Part 1, 22.

34 See Securities Acts Amendments of 1964, Pub. L. 467, 88th Cong., 2d. Sess. (Aug 20, 1964).

and (2) had 500 shareholders of record.[35] The effect was to convert an otherwise private company that did not offer or sell securities to the public or select to have its securities trade on a stock exchange into a public company by mandating the same public reporting under the ’34 Act.[36] By rule, the SEC later increased the 1964 limits under Section 12(g) to include companies with total assets exceeding $10 million and 500 shareholders of record.[37]

Underlying Congress’ decision to amend the ’34 Act with Section 12(g) was the view that certain companies already had developed a public market for their securities. The goal was not, however, to eradicate the public/private distinction either philosophically or structurally under the federal securities laws by treating all companies the same insofar as SEC mandatory reporting is concerned; nor did the ’34 Act amendments impose additional regulation on private offerings undertaken in accordance with the ’33 Act.[38]

By the early 2000s, it had become commonplace for private early-stage and growth companies, particularly those in high-tech industries, to offer employees stock options and later, other forms of company equity as additional compensation and a way of better aligning employee and company longer-term incentives to drive the company’s success. This phenomenon increased the number of private companies that might approach Section 12(g)’s 500 shareholder limit.

At the dawn of the 21st century, advocates for small business and venture capital also began to promote a new formulation of the Section 12(g) thresholds. With a shareholders-of-record limit of 500, early-stage companies could be faced with the prospect of having to publicly file SEC reports before they desire or intend to. Registration under Section 15(d) of the Exchange Act upon completing a public offering and registration under Section 12(g) upon crossing the asset/shareholder limits have the same effect of requiring a company to prepare and file extensive periodic ’34 Act disclosures. If required to bear ongoing ’34 Act costs and burdens, companies that otherwise would have found it appropriate to continue to raise capital privately may reconsider if they should just go ahead and raise capital publicly. In that sense, many worried that Section 12(g) could distort how companies funded themselves. Thus, the ’33 Act choice between conducting a private or public offering could be influenced by ’34 Act reporting being imposed under Section 12(g). Congress took note, and in 2012 responded by alleviating some of Section 12(g)’s pressure to ensure that private companies were not unduly forced into being public as a result of mandatory ’34 Act reporting. In the JOBS Act signed into law by President Obama, among several provisions designed to stimulate capital formation and job growth, bipartisan majorities in Congress raised the Section 12(g) shareholder threshold to either (1) 2,000 total shareholders or (2) 500 nonaccredited investor shareholders.[39]

35 Id. Banks, securities brokers, trustees, and other nominees often hold securities for the benefit of customers or other third parties who are entitled to the ultimate economic interests in the shares. These customers and third parties are referred to as the “beneficial” owners of securities, rather than the bank, broker, trustee or nominee who is the “record” owner.

36 The initial Section 12(g) was a relatively aggressive measure, as only seven years prior, a more tempered bill that would have forced private companies to report publicly only after exceeding $10,000,000 in assets and 1,000 shareholders failed to garner any momentum in the Senate. See Phillips & Shipman, supra note 29, 1964 Duke L.J at 714-15.

37 See Report of the Special Study of the Securities Markets of the SEC, H. Doc. No. 95, 88th Cong., 1st Sess., Part 1, 22 (Apr. 3, 1963) (Special Study) (estimating that around the time of the passing of the Exchange Act there were over 3,000 U.S. company stocks traded over-the-counter.

38 After 1964, the U.S. capital markets continued to evolve, and more companies began to trade over-the-counter without meeting the then-current Section 12(g) limits. In 1999, the SEC approved rules effectively requiring companies trading on an electronic marketplace known as the OTC Bulletin Board to begin providing ’34 Act reporting. See SEC Release No. 34-40878, Order Granting Approval of Proposed Rule Change and Amendment No. 1 To Be Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Microcap Initiatives-Amendments to NASD Rules 6530 and 6540, 64 Fed. Reg. 1,255 (Jan. 8, 1999). As a result, the primary effect was potentially to force private companies that had not raised money publicly nor had securities trading publicly on a national exchange to nonetheless file SEC reports, contrary to Congress’ expectation in 1964 and in tension with the securities laws’ intention of creating room for private companies.

39 126 Stat. 306, Title V § 501.

Additionally, the JOBS Act excluded holders of securities issued pursuant to certain employee compensation plans from the "holders of record" calculation.[40]

Perhaps one of the most important aspects of the JOBS Act as it concerns Section 12(g) is what it did not do. Leading up to the JOBS Act, there were legislative proposals to significantly expand Section 12(g) by counting all beneficial shareholders rather than only shareholders of record. After a vigorous debate, Congress decided against requiring companies to measure beneficial ownership to determine if an otherwise private company would have to report under Section 12(g).[41]

In sum, the extent of the statutory obligations for going public under the '34 Act have been a well-considered choice at each stage, and today's private companies are the result of intentional and well-grounded policy decisions that acknowledge the important contributions private companies make to our economy and the need for appropriately calibrated regulatory requirements that enable private companies' access to capital and growth.

Summary of public disclosure requirements in SEC filings

The Securities Act lays out stringent requirements for companies conducting a public offering, including mandating detailed disclosures that are filed publicly that investors and noninvestors can access and review. Under Schedule A of the Securities Act, which governs public offering disclosures,[42] a company must disclose a substantial amount of financial and business-related information in the prospectus included within an SEC registration statement.[43] Preparing these disclosures is a costly, time-consuming process that requires specialized expertise in law, finance, accounting, and disclosure controls.

The requirements of the Exchange Act, as amended over the years since 1934, coupled with substantial SEC rulemaking activity, have created an extensive reporting regime that public companies must also comply with, whether or not they engage in a public offering.[44] For each of the first three fiscal quarters of the year, a domestic U.S. public company[45] must prepare

40 Id. § 502. Under SEC Rule 12g-6, companies that have raised capital under Regulation Crowdfunding that remain current in filing SEC reports required under that Regulation and satisfy other conditions need not count those investors toward the Section 12(g) limit. Further, under current SEC Rule 12g-1, banks, saving and loan holding companies, and bank holding companies are only subject to the $10 million total asset/2,000 shareholder of record tests and are not subject to the test for 500 nonaccredited investors.

41 Notably, the SEC's Small Business Forum recently issued its annual report, which urged policymakers to revise Section 12(g) to remove the threshold for non-accredited investor holders and increase the asset threshold to $20 million. SEC Report on the 43rd Annual Small Business Forum, at 29 (Apr. 2024), available at https://www.sec.gov/files/2024-oasb-annual-forum-report.pdf.

42 15 U.S.C. § 77aa.

43 Schedule A lists over 30 separate categories of information that must be disclosed about a company, including information about the business and its management, information about securities underwriters, information about shareholders beneficially owning more than 10% of the company's shares, a description of the business, a description of outstanding equity and debt, terms of the offering and use of proceeds, audited financial statements, charter documents, material contracts, and opinions of counsel. By rule, the SEC has mandated still more disclosure requirements in SEC registration statements.

44 The SEC has adopted entire sets of rules devoted solely to narrative disclosure (Regulation S-K) and financial disclosure (Regulation S-X).

45 The disclosure requirements for foreign public companies with securities issued and trading in the U.S. are similar to those for domestic public companies, but they rely more heavily on filing with the SEC (on SEC-prescribed forms) home-country reports for most topics, other than the annual report to shareholders.

and file with the SEC a publicly available quarterly report on Form 10-Q discussing the company's financial performance over the prior fiscal quarter.[46] Preparing the disclosure requires the involvement of senior management, the board of directors, and many others within and outside the company, and, among other things, necessitates carefully tracking multiple streams of company information, assessing and drafting narrative disclosures about the completed quarter, and engaging with independent accountants to review financial information.[47]

After the completion of the fiscal year, a domestic public company must publicly file with the SEC an annual report on Form 10-K that includes even more extensive information on these and related topics as well as audited financial statements. The Form 10-K is intended to serve as a comprehensive description of the company's business, management and governance, financial condition, risk profile, executive compensation, legal proceedings, and results of operations for the full year. Assembling the report is an even more ambitious project than the quarterly disclosure on Form 10-Q and requires an independent accounting firm to complete an audit of the financial statements and for management to sign off on the company's internal controls over financial reporting.[48]

In addition to a public company's quarterly and annual disclosures filed with the SEC, when a public company solicits proxies for a meeting of shareholders it must disseminate a detailed proxy statement describing the matters to be voted upon so that investors have key information needed when deciding how to vote.[49] Companies often spend months drafting the proxy statement, producing necessary graphics and tables, polling banks and brokers, and preparing the final document.[50]

Public companies are subject to additional reporting obligations as well. Outside the quarterly cadence of Form 10-Q and the yearly annual report on Form 10-K, certain significant events, such as a public company's entry into a material agreement, the departure or retention of an executive officer or director, the engagement of a new financial statement auditor, or the occurrence of a material cybersecurity incident, mandate public reporting within four business days on the SEC's Form 8-K. Purchases and sales of company securities by directors, executive officers, or key shareholders must also be reported to the SEC.

46 Form 10-Q contains unaudited financial information and narrative information about the business, regulatory environment, material risks, management's discussion and analysis of the company's financial performance and operating results, and other information. The Form 10-Q is intended to provide an ongoing periodic view of the company's financial position and business landscape from quarter to quarter during the year.

47 Given the breadth of this undertaking, the SEC permits public companies 40 to 45 days after a quarter's end, depending on the company's size, to file the Form 10-Q report.

48 Because of the time and expense associated with preparing Form 10-K, the SEC permits public companies 60 to 90 days after the fiscal year-end to file the disclosure, again dependent on the size of the company.

49 In particulthe process of shareholders to communicate with the board; and details about the board's leadership structure and role in risk oversight. Executive compensation is even more detailed, requiring tabular disclosure about compensation paid to the chief executive officer, chief financial officer, and next three-highest paid executive officers, particularly: salary, bonuses, and perquisites; grants of equity awards; outstanding equity awards; option exercises; pension benefits; and deferred compensation. Similar information about directors is also required and includes director fees paid in cash; stock awards; option awards; nonequity incentive compensation; and changes in the value of deferred compensation. SEC rules permit smaller reporting companies (generally those with less than $250 million in public float or less than $100 million in revenue) to prepare abbreviated disclosures on executive compensation matters.

50 Under certain circumstances, a company has the option to send shareholders a postcard with instructions on how to view the full proxy statement online.

Among the numerous amendments to the federal securities laws since the 1930s, the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) is well-known concerning the sweeping obligations it imposed on public companies on matters involving ethics, corporate governance, board oversight of management, and, perhaps most notably, for mandating that public companies comply with standards regarding the development and maintenance of internal controls over financial reporting. Relatedly, Sarbanes-Oxley created a separate regulator, the Public Company Accounting Oversight Board, charging it with regulating accounting firms that audit public company financial statements.

In all, the regulatory obligations that public companies are subject to under the Securities Act and the Exchange Act—which the above only outlines and which are significantly more far-reaching in actuality—have continued to expand considerably as the SEC steadily mandates more disclosure through rulemakings and other regulatory actions it takes, not to mention new legislation compelling new disclosures that Congress enacts periodically. This disclosure regime is not costless. To comply with the myriad public company reporting and governance-related requirements, companies must hire personnel with specialties in accounting, internal controls, and SEC reporting. Public companies must develop detailed policies and procedures regarding information collection and SEC compliance and engage counsel, external auditors, and other advisers with experience serving public companies.

Annual compliance costs easily run into the millions of dollars, and each time the SEC adopts a new rule or Congress adopts a new statutory requirement, the costs increase. These annual out-of-pocket expenditures to properly prepare SEC-required disclosures do not factor in the time, effort, and attention that is taken away from what may, in some instances, be more pressing priorities. The SEC's own analyses as part of its rulemaking process when proposing or adopting new public company obligations have a tendency to overlook these opportunity costs.

06

Other Views on Being Public

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Traditionally, whether a company is considered public or private has hinged on its treatment under the federal securities laws, turning on whether the company has raised money from the public, has shares that trade among the public, or has crossed certain asset/shareholder thresholds. In each case, the practical consequence is that the company becomes obligated to file extensive disclosures publicly with the SEC. However, we recognize that sometimes what it means to be public, compared to private, is viewed from a different angle, one that is not rooted in either the ’33 Act or the ’34 Act.

Weighing societal impacts

In this conception, a company’s public nature is not principally a function of its treatment under the federal securities law but of its overall impact on broader society based on the company’s sheer size, the importance of the goods and services it produces and sells, the degree to which certain communities depend on it, the effect of its operations and activities beyond consumer welfare, its influence across different dimensions, and comparable considerations. This perspective, buttressed with reasoning that disclosure is a public good that constituencies other than shareholders find useful, has led some to press for the federal securities laws to compel more companies to be under SEC-imposed mandatory disclosure obligations, essentially shrinking the space for private companies by expanding the reach of public company status.

Without question, the impacts of business reach far and wide. Management teams and boards are well-known to take diverse interests into account in determining how best to run their businesses successfully to create value over time, including managing risks that can erode value. And whether or not a company is subject to public disclosure obligations under the federal securities laws, myriad statutes, rules, and regulations exist other than the Securities Act and the Exchange Act that govern the operations, activities, and conduct of business that are specifically designed to address the full gamut of their impacts.

Therefore, even from a broader perspective of what it means to be public, we do not think limiting the room that the federal securities laws have carved out for private companies is warranted. In fact, if private offerings were conditioned on more disclosures being made, or if Section 12(g) limits were adjusted so that more companies had to file public disclosure documents with the SEC, we risk losing many of the beneficial impacts private companies generate across society. Private companies are, in large measure, able to achieve what they achieve exactly because the federal securities laws, since their adoption, have tailored regulation to accommodate space for them and the private markets that fuel them. And in this day and age, there is a great deal of information publicly available about many private companies, particularly unicorn companies or others that are more mature and have garnered considerable media attention, irrespective of their status as nonreporting companies under the Exchange Act.

Securities law disclosure for other regulatory reasons

If the goal is for more companies to report publicly so that the marketplace has more insight into more companies, we have long urged a rationalization and modernization of the federal regulation of public offerings and the SEC's ongoing disclosure requirements for public companies to make the U.S. public securities markets more attractive. Doing so expands investment opportunities for investors who can and do participate in public markets.[51] On the contrary, if the goal is to advance interests and objectives that are not related to the SEC's mission of protecting investors, facilitating capital formation, and promoting fair and efficient markets, then the SEC's authority is restricted, as the courts have indicated as a matter of both federal securities law and administrative law.

The SEC is the nation's capital markets regulator, with jurisdiction grounded in a regulatory philosophy of disclosure; the SEC is not an omnibus regulator of the U.S. economy and U.S. business. One may argue that compelling more companies to make public disclosures will provide regulators with enhanced tools to supervise certain industries and economic activity or pursue other regulatory priorities. But historically that has not fallen within the SEC's core remit under the Securities Act or the Exchange Act.[52]

Likewise, other regulators do not routinely rely on SEC public company disclosures but instead prescribe their own forms to satisfy their own specific regulatory objectives. Federal antitrust regulators, for example, require detailed filings from parties to a merger or other transaction subject to preclearance under the Hart-Scott-Rodino Antitrust Improvements Act. The federal banking regulators, the Environmental Protection Agency, and the Equal Employment Opportunity Commission, to name a few, also have promulgated their own unique requirements to collect data from businesses in their respective jurisdictions.

In short, it is not necessary for the government to mandate '33 or '34 Act disclosures to serve interests that these statutes were not set up to achieve.

51 The Chamber has discussed these issues at length in other recent thought pieces. See, for example, *Investors and the Markets First: Reforms to Restore Confidence in the SEC*, available at https://www.uschamber.com/finance/investors-and-the-markets-first-reforms-to-restore-confidence-in-the-sec; and *Capital Formation—Strengthening the JOBS Act*, available at https://www.uschamber.com/finance/growth-engine/capital-formation-strengthening-the-jobs-act.

52 On rare occasions, the SEC has been directed by Congress to mandate a specific disclosure to serve a specialized public policy goal, such as reporting on supply chains for gold and certain metals mined in central Africa or compliance of reporting companies with U.S. economic sanctions against Iran. In those instances, the SEC's tendency has been to require public company reporting on a specialized form that distinguishes the disclosure from other public company disclosures of a more general nature.

07

Creating Space for Private Companies Is Appropriate and Should Persist

Contents

Congress has drawn a clear distinction between public and private companies at various points in the evolution of federal securities regulation, beginning with the original design of the Securities Act and the Exchange Act and most recently in 2012 when the JOBS Act was passed into law. That Congress has taken up the different treatment of public and private companies at key junctures in the history of our capital markets substantiates that creating considerable and lasting space for private companies to raise capital and pursue their business strategies without being subject to a host of mandatory disclosure requirements is a conscious policy choice, not reflective of any sort of regulatory gap or oversight that warrants being addressed with more regulation. Indeed, the SEC, over 40 years ago when it adopted Regulation D, was instrumental in ensuring that private companies could remain private by providing critical clarity to facilitate private offerings of securities.

For decades, the decision has consistently been to tailor regulatory requirements under the federal securities laws to spur the entrepreneurism, innovation, job creation, and economic growth that private companies and the private markets that fund them foster. That decision should persist.

Private companies should have the option to decide whether to become public

Companies contemplating a public offering of securities or a new stock exchange listing do not undertake these decisions lightly. A great deal of preparation, resulting in significant expenditures of human and financial resources, must be undertaken. Numerous policies, procedures, processes, and controls must be enhanced to align with SEC disclosure requirements and stock exchange listing standards. Specialists in topics as varied as corporate governance, SEC financial reporting, and legal compliance often must be recruited. Further, companies looking to become and remain public typically seek to expand the diversity and skill set of their boards of directors, with a particular eye toward recruiting directors with prior public company experience as a senior executive or board member. The necessary work to accomplish this and much more frequently begins at least a year before the expected launch date of becoming a public company. The costs, including out-of-pocket financial costs plus the opportunity costs of people's efforts and energy at the company, to do so are substantial.

Implicit in such an ambitious project as going from private to public is a single-minded determination of the management team, supported by the board, to devote the time, attention, and funding to complete the transaction under the Securities Act and maintain ongoing reporting obligations under the Exchange Act. In contrast, a company that is not ready to begin the SEC reporting process may encounter unforeseen costs and difficulties if forced to do so without sufficient ramp-up time. Being forced to begin SEC reporting prematurely is a problem that policymakers should endeavor to avoid.

The federal government—whether through legislation or regulation—should not further constrict the regulatory zone carved out for private companies under the federal securities laws. Simply put, private companies should not face more conditions and requirements under the Securities Act that make it more difficult for them to access capital. Nor should Section 12(g) or any other statutory provision of the Exchange Act be amended to set thresholds and standards that would result in forcing more private companies to transform into public companies with mandatory disclosure obligations. Requiring companies that have not chosen to raise money publicly or have their shares traded publicly to nonetheless begin filing information with the SEC will result in serious market issues. Such a requirement could impede the ability of private companies to raise capital, could divert a private company's valuable resources from investment in developing and actuating its business strategy, could compromise a long-term focus by growth companies on how to drive value creation over time even at the expense of short-term earnings, and could disadvantage the interests of investors who bear the consequences when it becomes more challenging for early-stage and growth companies they are invested in to innovate, compete, and grow.

The time for a private company to become public needs to be right

All things considered, a private company generally is better positioned than the federal government to determine when the right time for it to assume the mandatory disclosure obligations of a public company with SEC-imposed reporting requirements. Even if a company is private as a matter of federal securities regulation, the company still must abide by and comply with a host of statutory and regulatory requirements that make up other bodies of law that the company may be subject to depending on its sector, activities, and practices. That is true for private companies of all shapes and sizes, from startups to unicorns. Furthermore, as mentioned, the disclosures that private companies do make to investors, although not mandated by the ’33 or ’34 Acts, cannot be materially misleading under the antifraud provisions of the securities laws, adding a key element of investor protection in private markets. And while fraud is not and should not be countenanced, SEC enforcement actions and judicial opinions demonstrate that a company’s being public does not in and of itself immunize investors from the risk of being defrauded.

When it comes to the quality of a company’s disclosures specifically, the timing needs to be right for a company to be public in light of the disclosure infrastructure that must be put into place so that a company can meet the demands of being a public company under the federal securities laws. Not all companies are ready to take on the burden of SEC reporting and all that comes with it. Accordingly, it should not be —nor for all intents and purposes has it historically been—the policy of the federal government to compel wide segments of private companies to begin making public filings simply because they cross an arbitrary size threshold. While Section 12(g), of course, exists, it has been used judiciously to preserve substantial room for private companies to remain private as they mature and prosper, growing in assets, revenues, employees, and investors.

Private company governance mechanisms can be effective at managing risk and protecting investors

Market discipline and the corresponding accountability it enables are important mechanisms by which investors can participate in the governance and oversee the behavior at private companies they invest in. When presented with an investment opportunity, investors need not invest if they are uncomfortable or unsatisfied with the business' governance, finances, strategy, or future prospects or with the structure or economics of the securities offering. If insufficient information is available, investors can perform additional due diligence and bargain for going-forward information rights or walk away if they conclude they do not have an adequate basis upon which to invest. If investors do not favor certain members of a management team, they can press for a change to the C-suite or board and may obtain the right to appoint directors to the board now or later. Investors can contractually bargain for voting or consent rights beyond what state corporate law generally affords shareholders. If investors do not like the potential economic returns of an investment, they can negotiate for a different economic arrangement, such as a higher payout rate or greater share of the proceeds in a sale or liquidation of the business. The list of possibilities is seemingly endless. Preferring that its offering is fully subscribed creates an incentive to accede to many investor demands.

Investing in private companies comes with a liquidity trade-off that investors in private companies understand. A company that is not listed on an exchange or that does not meet the SEC's public reporting requirements is limited in its ability to develop a secondary trading market in its securities. As mentioned, securities sold in a private offering are restricted securities and are limited in their ability to trade unless a minimum holding period up to one year and other conditions are satisfied. Even then, without an exchange listing, broker-dealers are limited in their ability to make an active over-the-counter market in securities that do not meet certain SEC informational requirements.[53] Accordingly, investors seeking to buy or sell securities issued in private placements can face hurdles in locating a willing counterparty and agreeing on a price.[54] Investors in private companies understand the lack of liquidity that holding securities of private companies entails. They realize that they may not be able to sell at an opportune moment. But they accept illiquidity in exchange for the upside potential of owning a stake in a company with outsize growth prospects and may seek to compensate for illiquidity by negotiating better investment terms.

By tailoring their contractual protections to the circumstances of a particular company, investors are able to mitigate the risks inherent in any investment. A one-size-fits-all approach rarely produces the optimal outcome, so maintaining investors' flexibility to negotiate for the protections that are most important to them is critical. In this way, investors can bargain for the investment terms—economic, governance, and information—they see as most beneficial in the context of a given company. While informational rights are important for investors, disclosure is only one lever investors in private companies can pull.

53 Rule 15c2-11 under the '34 Act governs the publication of quotations in over-the-counter markets for securities of unlisted companies, which includes quotes that are published away from a securities exchange. Under Rule 15c2-11, broker-dealers must collect and review issuer information before initiating quotations over-the-counter. See generally 17 C.F.R. § 240.15c2-11.

54 Efforts over the past 20 years to create deeper, more broadly accessible trading markets to trade privately placed securities have faced difficulties gaining widespread acceptance. Furthermore, private companies often impose contractual limitations on transfers even when the federal securities laws would otherwise permit a resale.

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Conclusion

Private companies are engines of entrepreneurism, innovation, new goods and services for consumers, and job creation across the economy. The dynamism of private companies is possible because legislators and regulators—as far back as the 1930s—have designed a federal securities regulatory regime that allows companies to raise capital in private offerings that are not weighed down by extensive mandatory disclosure obligations. The laws have purposefully fashioned room for private companies, so as to be unburdened by the costs of regulatory impositions that public companies are subject to under the Exchange Act. None of this is by accident; rather, this regulatory framework is the product of well-considered judgments over the decades that have purposefully distinguished between private and public offerings under the Securities Act and between reporting and nonreporting companies under the Exchange Act.

Now is not the time to change direction. There is no justification for compelling additional disclosures on private offerings that would hinder private companies' ability to raise the resources they need to foster their startup, investment, hiring, and growth. Nor is there justification to force otherwise private companies that have not raised money from the public and have no securities trading publicly to begin filing public disclosures with the SEC because they meet liberalized thresholds under Section 12(g), thereby mandating that more companies become public against their best judgment, regardless of whether they are ready (or desire) to be public. To the contrary, private companies ought to be encouraged and empowered as engines of growth and opportunity that, in addition, play a central role in enabling the U.S. to meet the tough challenges of today and tomorrow.

If we are to benefit from all that private companies have to offer, the federal securities laws must continue to carve out a sizable space for them. The private/public distinction is a hallmark of the Securities Act and the Exchange Act—a distinction that should not be blurred by trending in the direction of treating private companies more like public ones.

U.S. Chamber of Commerce