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THE NEW PUBLIC/PRIVATE EQUILIBRIUM AND THE REGULATION OF PUBLIC COMPANIES

Elisabeth de Fontenay and Gabriel Rauterberg*

This Symposium Article examines how the public/private divide works today and maps out some of the potential implications for major issues in securities law. Classic debates in securities law were often predicated on the idea that public companies are a coherent class of firms that differ markedly from private companies. For more than fifty years after the adoption of the federal securities laws, this view was justified. During that period, the vast majority of successful and growing private firms eventually accepted the regulatory obligations of being public in order to access a wider and deeper pool of capital, among other benefits. This was a descriptive reality, but it had important normative implications as well. An identifiable class of large, growing firms went public, and they generally went public for a reason they shared: raising capital. As a result, regulatory interventions imposed on the category of “public companies” had a coherent target.

We argue that firms’ going public decisions are now shaped by a much larger and more varied set of factors. These factors are complex, cross-cutting, and impact firms considering going public in very heterogeneous ways. This complexity results from several developments and we emphasize two. First, it is a result of the fact that while the public/private divide was created by securities law, public and private markets now

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provide two widely different ecologies for firms, which profoundly shape firms' governance as well as the issuance and trading of their shares. Second, long-term advances in the ease of capital raising in private markets have made it possible for firms to remain private indefinitely and have diminished or eliminated the capital-raising advantages of public markets. The result of this latter change has been rightly called a "new equilibrium." In that equilibrium, fewer and older firms go public, while other successful firms remain private indefinitely. In this equilibrium, capital raising is no longer the primary reason firms go public. Rather, we argue, firms go public due to one or more of the many other features of the public market's ecology.

The normative implication of this new equilibrium is to reduce the coherency of the regulation of public companies. The benefits and costs of being public (or private) apply unevenly to firms eligible to go public. Instead, to a greater degree firms now face idiosyncratic, company-specific tradeoffs between being public or private, and they often go public for reasons unrelated to the original design of the public/private divide. Regulations imposed on public firms are likely to not only be increasingly under- and over-inclusive, but also to apply to a class of companies whose coherency as an economic phenomenon may be increasingly suspect.

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I. INTRODUCTION

There may be no more profound issue facing securities regulation than reimagining the public/private divide. The divide is a centerpiece of securities law. It partitions securities, offerings, and issuers into two halves, the private and public, with each side subject to distinct privileges and burdens.¹ The issuance and trading of private companies’

¹ Despite its defining role, for a long time, scholars failed to directly analyze how the public/private divide worked and should work. In extraordinarily prescient articles, Hillary Sale, Donald Langevoort, and Robert Thompson observed the stresses that divide was encountering and asked how it might be reimagined. See Hillary A. Sale, *The New “Public” Corporation*, 74 LAW & CONTEMP. PROBS. 137, 138–41 (2011); Donald C. Langevoort & Robert B. Thompson, *“Publicness” in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337 (2013). See also Onnig H. Dombalagian, *Principles for Publicness*, 67 FLA. L. REV. 649 (2016); Hillary A. Sale & Robert B. Thompson, *Market Intermediation, Publicness, and Securities Class Actions*, 93 WASH. U. L. REV. 487, 538 (2015); Robert B.

shares is restricted, but private firms' regulation is otherwise light, while public companies' shares enjoy free issuance and trading, but are subject to extensive mandatory disclosure. Both public and private companies are of great consequence. In the United States, the 6 million private firms and 3,600 public companies each account for roughly half of total sales, pretax profits, and non-residential fixed investment.² The divide has existed since the beginning of federal securities regulation, even as its details have shifted along the way.

So why rethink the divide? There are old and new motivations. A familiar one centers on the perceived decline of public firms. The number of U.S. public companies has fallen from a peak of 8,025 in 1996 to 3,600 in 2020.³ Given that the U.S. economy and global listings grew substantially during that period, there is a case for a substantial "gap" in the number of America's public companies.⁴ This decline is often

Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1574, 1578–79 (2013). For an excellent overview of the securities law details of the divide, see Edward F. Greene et al., *The Need for a Comprehensive Approach to Capital Markets Regulation*, 2021 COLUM. BUS. L. REV. 714.

² The number of private firms is taken from the Statistics of U.S. Businesses. See 2018 SUSB Annual Data Tables by Establishment Industry, U.S. CENSUS BUREAU, [census.gov/data/tables/2018/econ/susb/2018-susb-annual.html](https://www.census.gov/data/tables/2018/econ/susb/2018-susb-annual.html) (last updated Oct. 8, 2021) (on file with the Columbia Business Law Review); see also John Asker, Joan Farre-Mensa & Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle?*, 28 REV. FIN. STUD. 342, 345 (2015). The number of public companies is taken from a recent Morgan Stanley report. See MICHAEL J. MAUBOUSSIN & DAN CALLAHAN, MORGAN STANLEY, PUBLIC TO PRIVATE EQUITY IN THE UNITED STATES: A LONG-TERM LOOK 3 (2020), https://www.morganstanley.com/im/publication/insights/articles/articles_publictoprivateequityintheusalongtermlook_us.pdf [<https://perma.cc/57BV-42HL>].

³ Craig Doidge, G. Andrew Karolyi & René M. Stulz, *The U.S. Listing Gap*, 123 J. FIN. ECON. 464, 464 (2017); Mauboussin & Callahan, *supra* note 2.

⁴ Doidge et al., *supra* note 3. It is highly controversial as to whether this gap in nominal listings actually constitutes an economic problem. See, e.g., B. Espen Eckbo & Markus Lithell, *Merger-Driven Listing Dynamics* 24, 26 (Eur. Corp. Governance Inst., Fin. Working Paper No. 752/2021, 2021),

attributed to increasing regulation imposed on public companies, under the theory that firms need to access public markets but cannot do so because of the high costs of being public.⁵ A newer reason is that while the costs of being public may have increased, as importantly, the costs of staying private have *decreased*.⁶ In particular, private capital markets have grown enormously. The traditional balance of capital raising has reversed itself, with companies raising more funds in private markets every year since 2009 and twice as much in private markets than public markets in 2017.⁷ This growth is not merely or fundamentally the story of a small number of highly valued venture-backed firms. Rather, it is decades in the making and affects the structure of the entire economy.⁸

Alongside these changes, developments in capital markets during the last two decades have also made for an increasingly hazy border between the private and public markets. Private markets have grown increasingly complex and sophisticated.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3547581# (on file with the Columbia Business Law Review) (arguing that the listing gap disappears after accounting for M&A transactions involving public acquirers, and suggesting that there is little evidence of a recent decline in public firms' contribution to the U.S. economy).

⁵ Doidge et al., *supra* note 3, at 465–66, is sometimes cited as refuting the view that recent public company regulation materially deters IPOs because it shows that the decline of IPOs precedes the adoption of new regulation. See Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs*, 33 REV. FIN. STUD. 5463, 5464 (2020) This interpretation is probably overstated, as recent evidence suggests. See Michael Ewens, Kairong Xiao & Ting Xu, *Regulatory Costs of Being Public: Evidence from Bunching Estimation* 3–5 (Nat'l Bureau of Econ. Rsch., Working Paper No. 29143, 2021), <https://www.nber.org/papers/w29143> (on file with the Columbia Business Law Review).

⁶ Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 448 (2017); Ewens & Farre-Mensa, *supra* note 5, at 5463–64.

⁷ SCOTT BAUGUESS, RACHITA GULLAPALLI & VLADIMIR IVANOV, U.S. SEC. & EXCH. COMM'N, CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF THE MARKET FOR UNREGISTERED SECURITIES OFFERINGS, 2009-2017, at 7–9, 8 fig.1, 9 tbl.1 (2018).

⁸ *Id.* at 3–4.

Mutual funds invest in mature private companies,⁹ secondary markets for private company stock grow larger and more liquid,¹⁰ and the size and social impact of some private firms rivals that of major public companies.¹¹ Public markets reflect increasing pressure to permit governance paradigmatic of late-stage private companies,¹² as well as changing technologies for going public, such as primary and secondary direct listings or SPACs.¹³ Many of these trends are longstanding, even as their magnitude has grown. And so these reasons, old and new, motivate regulators, academics, and market participants to question the public/private divide.

In this Symposium Article, we sketch one way in which we believe the public/private divide should be rethought. In particular, we argue that the calculus facing firms between being public or private has grown more idiosyncratic, making the concept of “public companies” a less coherent one. Classic debates in securities law were often predicated on the idea that public companies are a coherent class of firms that differ markedly from private companies. Indeed, for more than fifty years after the adoption of the federal securities laws, this view was justified. During that period, the vast majority of successful and growing private firms eventually accepted the

⁹ See, e.g., Sergey Chernenko, Josh Lerner & Yao Zeng, *Mutual Funds as Venture Capitalists? Evidence from Unicorns*, 34 REV. FIN. STUD. 2388 (2021).

¹⁰ See, e.g., Darian M. Ibrahim, *The New Exit in Venture Capital*, 65 VAND. L. REV. 1, 3, 16 (2012).

¹¹ See, e.g., Matt Levine, *SoftBank Has a Bigger, Weirder Vision*, BLOOMBERG: OP. (May 3, 2019, 12:00 PM), <https://www.bloomberg.com/opinion/articles/2019-05-03/softbank-has-a-bigger-weirder-vision> [<https://perma.cc/S447-WTY6>].

¹² See, e.g., Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REG. 1124, 1129–31 (2021) (exploring the role of shareholder agreements in post-IPO firms); Jordan Schoenfeld, *Contracts Between Firms and Shareholders*, 58 J. ACCT. RSCH. 383, 385–86 (2020) (exploring firm-shareholder contracting in public companies).

¹³ See, e.g., *A Current Guide to Direct Listings*, GIBSON DUNN (Jan. 8, 2021), <https://www.gibsondunn.com/wp-content/uploads/2021/01/a-current-guide-to-direct-listings-january-2021.pdf> [<https://perma.cc/DLE8-FBVD>].

regulatory obligations of being public in order to access a wider and deeper pool of capital, among other benefits.¹⁴ This was a descriptive reality, but it had important normative implications as well. An identifiable class of large, growing firms went public, and they generally went public for a reason they shared: raising capital.¹⁵ As a result, regulatory interventions imposed on the category of “public companies” had a coherent target.

We argue that firms’ going public decisions are now shaped by a much larger and more varied set of factors. These factors are complex, cross-cutting, and impact firms considering going public in very heterogeneous ways. This complexity results from several developments, and we emphasize two. First, it is a result of the fact that while the public/private divide was created by securities law, public and private markets now provide two widely different ecologies for firms, which profoundly shape firms’ governance as well as the issuance and trading of their shares. Second, as noted, long-term advances in the ease of capital raising in private markets have diminished or eliminated the capital-raising advantages of public markets. As Donald Langevoort predicted,¹⁶ this vast growth in capital raising in private markets has made for an “issuer choice”¹⁷ regime, in which large, successful private

¹⁴ de Fontenay, *supra* note 6.

¹⁵ *Id.*

¹⁶ Donald Langevoort, *The Regulation of Primary Markets*, in *SECURITIES MARKET ISSUES FOR THE 21ST CENTURY* 101, 122, 127 (Merritt Fox et al. eds. 2018) (“[P]robably the most conceptually interesting subject in securities law . . . is it possible—indeed desirable—that a large segment of economically important firms in the American economy stay private, perhaps indefinitely, yet with easy access to large amounts of capital?”).

¹⁷ “Issuer choice” refers the ability of issuers to decide under which regulatory regime they fall. See Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1337–39 (1999) (arguing against issuer choice); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047, 1093 (1995) (noting ways in which federal securities regulation always offered some optionality as to regulatory environment). This Article uses the term to describe the choice issuers have between staying private or going public.

firms can remain private indefinitely while still enjoying growth. The result of this latter change has been rightly called a “new equilibrium.”¹⁸ In that equilibrium, fewer and older firms go public, and firms’ decisions between the public or private ecologies is no longer principally driven by capital raising.¹⁹ We argue that firms primarily go public due to one or more of the many other features of the public market’s ecology.

In developing this argument, we aim to synthesize a large and sprawling literature that addresses the public/private divide in order to show that it now consists of two complex and multidimensional ecologies that differ along a host of different economically important axes. Of course, capital raising was never the sole determinant of firms’ going-public decisions—a large literature spanning multiple markets and nations has documented the many determinants of firms’ decisions to cross the public/private divide.²⁰ But with the astonishing growth in capital raising in private markets, the remaining determinants of firms’ decisions have become more varied and idiosyncratic.

How the public/private divide works matters to the success of the regulation of public and private companies. The normative implication of this new equilibrium is to reduce the coherency of the regulation of public companies. The benefits and costs of being public (or private) no longer apply consistently to firms eligible to go public (or remain private); instead, to a greater degree firms now face idiosyncratic, company-specific tradeoffs, and they often go public for

¹⁸ Ewens & Farre-Mensa, *supra* note 5, at 5498.

¹⁹ *Id.* at 5506.

²⁰ Global evidence suggests that the principal determinants of firms’ decisions to go public vary enormously. *See, e.g.*, Marco Pagano, Fabio Panetta & Luigi Zingales, *Why Do Companies Go Public? An Empirical Analysis*, 53 J. FIN. 27, 27–30 (1998) (finding that Italian firms go public to alter their capital structure and benefit from misvaluation of their sector); Michelle Lowry, Micah S. Officer & G. William Schwert, *The Variability of IPO Initial Returns*, 65 J. FIN. 425, 463 (2010) (finding capital demands and investor sentiment predict firms’ IPO decisions); Sreedhar T. Bharath & Amy K. Dittmar, *Why Do Firms Use Private Equity To Opt Out of Public Markets?*, 23 REV. FIN. STUD. 1771, 1776–80 (2010) (collecting sources).

reasons unrelated to the original design of the public/private divide. Regulations imposed on public firms are likely to not only be increasingly under- and over-inclusive, but also to apply to a class of companies whose coherency as an economic phenomenon seems increasingly fraught.

This Article proceeds as follows. Part II briefly surveys some of the relevant literature. Part III describes the legal architecture of the public/private divide established by securities law as well as the separate divide established by investment fund regulation and emphasizes how the two interact. It also notes how the growth of capital raising in private markets has led to an issuer choice regime for large private firms. Part IV explores the complexity and many determinants of the widely distinct, if also overlapping, ecologies of public and private markets. Alongside the distinctions created and contemplated by legal design, a number of other differences have grown more significant. Part V considers some of the normative implications of these changes. We then conclude.

II. RELATED LITERATURE

Given the public/private divide's foundational role in securities law, a large literature has developed around it—one far too large to discuss comprehensively. But three facets of that literature are especially relevant here. One facet theorizes the public/private divide itself. Pioneered by Donald Langevoort, Robert Thompson, and Hilary Sale, this literature seeks to both rationalize and question the structure of how the public and private are divided and the nature of

the dividing line itself.²¹ Where should that line be drawn?²² And should it be one line between two fundamentally different alternatives,²³ several distinct regulatory classifications,²⁴ or a continuum of regulatory treatment?²⁵

Another facet of the literature addresses the soundness of the policy interventions imposed on those firms classified as public or private. One of securities law's core debates explored the desirability of the mandatory disclosure regime that is the centerpiece of the regulation of public issuers and offerings.²⁶

²¹ See, e.g., Sale, *supra* note 1, 138–41; Langevoort & Thompson, *supra* note 1; Sale & Thompson, *supra* note 1; see also Joan MacLeod Heminway, *Crowdfunding and the Public/Private Divide in U.S. Securities Regulation*, 83 U. CIN. L. REV. 477, 481–84 (2014) (applying the framework developed by Langevoort, Sale, and Thompson to crowdfunding); Jill E. Fisch, *The Mess at Morgan: Risk, Incentives and Shareholder Empowerment*, 83 U. CIN. L. REV. 651, 654 (2015) (arguing that efforts to deploy corporate governance to shape corporation's social role are misguided).

²² See, e.g., 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, 195–211 (2013) (proposing modifications to federal periodic disclosure regime structure); A. C. Pritchard, *Revisiting "Truth in Securities" Revisited: Abolishing IPOs and Harnessing Private Markets in the Public Good*, 36 SEATTLE U. L. REV. 999, 1002 (2013) (proposing to re-design the public/private divide with trading volume or market capitalization triggering the transition between public and private markets).

²³ See, e.g., Usha R. Rodrigues, *The Once and Future Irrelevancy of Section 12(G)*, 2015 U. ILL. L. REV. 1529, 1561 (discussing trading volume as a trigger for public status).

²⁴ See, e.g., Langevoort & Thompson, *supra* note 1, at 342.

²⁵ Jeff Schwartz, *The Twilight of Equity Liquidity*, 34 CARDOZO L. REV. 531, 579 (2012).

²⁶ Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2373–80 (1998) (arguing that mandatory disclosure rules do not contribute to investor welfare and that corporate firms have other incentives to disclose information); Fox, *supra* note 17, at 1340–42 (advocating for the present mandatory disclosure regime); Merritt B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQUIRIES L. 563, 568–571 (2001) (arguing against an issuer choice regime and for mandatory disclosure laws) [hereinafter Fox, *Issuer Choice*]; John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 721–23 (1984) (arguing for mandatory

A generation later, progress has been made, but basic questions remain as to the optimal design of a disclosure regime, both in terms of whom it should apply to and its content.²⁷

A last and sprawling facet of the literature explores the effects of differences in public and private markets on the operation of firms.²⁸ This literature addresses issues as varied as the determinants of whether firms go public or not,²⁹ and the effects of being private or public on innovation,³⁰ issuer malfeasance,³¹ and corporate time-horizons.³²

III. SECURITIES LAW ORIGINS OF THE PUBLIC/PRIVATE DIVIDE

In this Part, we describe the original securities law distinctions at the heart of the public/private divide. Current debates center on the legal distinction between public and private operating companies, which we describe in Section III.A. What is often missed in these debates, however, is that, in practice, the public/private divide for *operating companies* is also profoundly affected by the public/private divide for *investment funds*, which we describe in Section III.B. Finally, in Section III.C, we engage in a thought experiment, imagining how an idealized version of the public/private

disclosure to promote market efficiency and suggesting an investor-oriented mandatory disclosure system).

²⁷ See Guttentag, *supra* note 22.

²⁸ Asker et al., *supra* note 2, at 344–45 (finding that short-termism distorts the investment decisions of public firms); Eric L. Talley, *Public Ownership, Firm Governance, and Litigation Risk*, 76 U. CHI. L. REV. 335, 336 (2009) (analyzing and empirically exploring how litigation risk might affect firms' going private decisions in comparison with governance changes); Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353, 359–360 (2020) (exploring information asymmetry and securities fraud in the context of private markets and proposing an enforcement regime).

²⁹ Ewens et al., *supra* note 5, at 5–6.

³⁰ See, e.g., Shai Bernstein, *Does Going Public Affect Innovation?*, 70 J. FIN. 1365, 1365, 1367–68 (2015).

³¹ Pollman, *supra* note 28.

³² Asker et al., *supra* note 2, at 344.

divide could work. That idealized picture will prove a useful contrast to how we think the public/private divide actually works today, which we explore in Parts IV and V.

A. The Public/Private Divide for Operating Companies

Although the public/private divide now pervasively characterizes capital markets in the U.S., it originally began as a *legal* distinction.³³ That divide was first constructed and mandated by the federal securities laws almost ninety years ago, in the wake of the Great Depression.³⁴ Since the public/private divide was established, both the lines of demarcation and their consequences have periodically shifted. Yet the regulatory divide itself persists, and it profoundly shapes market activity.

Arguably, the best known of the public/private divides is the distinction between public and private issuers.³⁵ The

³³ Indeed, the public/private divide established by the Securities Act of 1933 and the Exchange Act of 1934 (together, the “Securities Acts”) actually encompasses a set of four distinctions between “public” and “private”: (1) *companies*, (2) *securities*, (3) *offerings* of securities; and (4) *trading markets*. These distinctions arise by operation of the Securities Act of 1933 (“Securities Act”), Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa), and the Securities Exchange Act of 1934 (“Exchange Act”), Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a–78qq), as well as the respective regulations thereunder. The Exchange Act imposes disclosure and other requirements on a specific set of companies (“public companies”), and the Securities Act requires disclosure in connection with specific securities offerings (“public offerings”). See *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM’N, <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry> [https://perma.cc/JK6V-74PJ] (last visited Oct. 15, 2021). Finally, the two statutes combine to create two different securities trading environments (the “public” and “private” markets). See de Fontenay, *supra* note 6, at 452–53.

³⁴ de Fontenay, *supra* note 6, at 452–53; see also Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUD. 1 (2001) (describing the origins of the federal securities laws).

³⁵ As discussed *infra* in Section II.B., there is a separate regulatory framework and public/private divide for companies that are *investment funds*.

Securities Act of 1933,³⁶ together with the Securities Exchange Act of 1934,³⁷ sought to ensure that companies whose securities were issued to or traded by the general public disclosed sufficient information for investors to make good decisions about whether, how much, and when to invest.³⁸ There are three basic criteria or “triggers” for when an operating company becomes “public” under the securities laws and subject to the obligations of public status: (1) they offer to sell their securities to the general public;³⁹ (2) they grow large enough that their assets or shareholders of record exceed specified thresholds;⁴⁰ or (3) at least one class of their securities is traded on a national securities exchange.⁴¹ We loosely refer to companies subject to these disclosure burdens as “public” companies. In this sense, these three triggers define the public/private divide.

The centerpiece of the obligations imposed on public companies by the Securities Acts is a mandatory disclosure system.⁴² The disclosure obligations of public companies are substantial. Public firms must provide not only financial statements, but also detailed information about governance,

³⁶ Securities Act of 1933 (Securities Act), Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa).

³⁷ Securities Exchange Act of 1934 (Exchange Act), Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a–78qq).

³⁸ See Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. CIN. L. REV. 1023, 1023 (“Congress intended the securities laws to ‘substitute a philosophy of full disclosure for the philosophy of caveat emptor[.]’”).

³⁹ See Securities Act § 77e(c) (prohibiting the sale of any security unless a registration statement is effective); *id.* § 77d(2) (declaring that the prohibition does not apply to “transactions by an issuer not involving any public offering”).

⁴⁰ Section 12(g) of the Exchange Act, as amended by the JOBS Act, requires a company to register its securities under the Exchange Act if it has ten million dollars or more in total assets and a class of equity securities “held of record” by 2000 or more persons (or 500 or more persons who are not “accredited investors”). See Exchange Act § 78l(g)(1)(A).

⁴¹ See *id.* § 78l(d).

⁴² See Bainbridge, *supra* note 38, at 1023–24 (“Mandatory disclosure is a—if not the—defining characteristic of U.S. securities regulation.”).

operations, and risks to investors.⁴³ Public company disclosure is required both upon the occurrence of notable events in the company's life (including securities issuances, entry into transactions and other materials contracts, and major governance changes) and on a periodic basis (including every quarter and prior to every annual shareholders' meeting).⁴⁴ The disclosure and associated regulatory burdens on public companies are significant, and the aggregate out-of-pocket costs of being a public company have been estimated at an additional \$2.5 million per year.⁴⁵ For the most part, "private" companies avoid all public disclosure requirements under the federal securities laws.⁴⁶ Given that the disclosure and other securities law burdens on public companies have increased significantly over time, while private company burdens have long remained a null set,⁴⁷ the public/private divide has become only sharper since its inception—at least, when it is conceived of solely as a legal distinction.

At the same time, the composition of public and private companies has shifted, with the number of public companies in the U.S. economy shrinking significantly over the past twenty-five years.⁴⁸ The average public company today is

⁴³ These disclosure requirements are found in Sections 12 and 13 of the Exchange Act and the SEC rules that implement it. *See* 15 U.S.C. §§ 78l, 78m (2018); 17 C.F.R. § 229.301 (2021).

⁴⁴ *See* 15 U.S.C. § 78m.

⁴⁵ *See* Alix Stuart, *The True Costs of Being Public: More Than You Think*, CFO (Nov. 18, 2011) <https://www.cfo.com/credit-capital/2011/11/the-true-costs-of-being-public-more-than-you-think/> [https://perma.cc/A4RK-QUVG] (reporting on the results of a survey by Ernst & Young). Note that the \$2.5 million in additional costs also includes items that are not directly related to compliance with the securities laws, such as \$1.5 million in added costs of attracting and retaining management and board members. *See id.*

⁴⁶ Zoeanna Mayhook, *Privately-Held Companies: Legislation, Regulation, and Limited Dissemination of Financial Information*, 47 DTTP 28, 28 (2019).

⁴⁷ *Id.* at 28–32 (detailing changes in federal disclosure requirements over time).

⁴⁸ *See supra* notes 3–4; Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANTITATIVE ANALYSIS 1663 (2013) (documenting and explaining the long-term decline in initial public offerings by U.S. firms).

considerably older and larger in terms of market capitalization than it was three decades ago, and, overall, the number of public companies has shrunk relative to the number of private companies.⁴⁹ The plausible explanations for this development are many and varied, as both sides of the public/private company divide have experienced major changes in recent decades. Most notably, (1) public-company disclosure and other regulatory burdens have increased; (2) capital raising by private firms has grown significantly;⁵⁰ and (3) the requirements for when private companies *must* become public companies have been materially loosened.⁵¹

B. The Public/Private Divide for Funds

1. Description

As they exist today, public and private markets are a product not only of the public/private divide for *companies*, but also of the distinct public/private divide for *funds*. This Section describes the public/private divide that investment fund regulation creates for funds and how it interacts with the public/private divide created by securities law. The interaction of these two bodies of securities law plays a key role in explaining (1) which companies tend to fall on each side of the divide, (2) how companies behave on each side, including how they are governed and financed, (3) what

⁴⁹ MICHAEL J. MAUBOUSSIN, DAN CALLAHAN & DARIUS MAJD, CREDIT SUISSE, THE INCREDIBLE SHRINKING UNIVERSE OF STOCKS: THE CAUSES AND CONSEQUENCES OF FEWER U.S. EQUITIES, 2 exhibit 1 (2017), https://www.cmgwealth.com/wp-content/uploads/2017/03/document_1072753661.pdf?mod=article_inline [<https://perma.cc/8LQK-DJ8M>] (showing the increase in age and market capitalization and the decrease in number of U.S. listed companies).

⁵⁰ de Fontenay, *supra* note 6.

⁵¹ See Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended at 15 U.S.C. 78l(g)(1)) (modifying Section 12(g)(1) of the Exchange Act to increase the number of shareholders of record beyond which a firm must register under the Exchange Act from 500 to 2,000).

information is available about these companies, and (4) how their securities are traded.

Investment funds (or simply “funds”) are pools of capital, typically raised from many institutional or individual investors, which are then used to make investments at the direction of the fund’s investment manager(s).⁵² Mutual funds, exchange-traded funds (“ETFs”), real estate investment trusts (“REITs”), hedge funds, private equity funds, and venture capital funds are all different types of investment funds.⁵³ These funds are typically distinguished based on what types of assets they invest in and whom they admit as investors.⁵⁴ In recent decades, as banks and other financial institutions have declined in importance, investment funds have assumed a dominant role in providing capital to both public and private companies. It is estimated, for example, that approximately 80% of the stock of U.S. public companies is held by institutional investors, most of which are investment funds.⁵⁵ Investment funds have become so dominant in U.S. corporate finance and financial markets generally that our age has been described as “the empire of the fund.”⁵⁶

⁵² See John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1232.

⁵³ *Id.* at 1231, 1234–36.

⁵⁴ WILLIAM A. BIRDTHISTLE, *EMPIRE OF THE FUND: THE WAY WE SAVE NOW* 6 (2016).

⁵⁵ See *80% of Equity Market Cap Held by Institutions*, PENSIONS & INVS. (Apr. 25, 201, 1:00 AM), <https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions> [<https://perma.cc/CRQ2-KR7B>]; see also John C. Coates, IV, *The Future of Corporate Governance Part I: The Problem of Twelve* 13 (Harv. Pub. Law Working Paper No. 19-07, 2018), <https://ssrn.com/abstract=3247337> (on file with the Columbia Business Law Review) (estimating that 20-30% of the stock of U.S. public companies is owned solely by indexed funds—that is, funds that passively track a specified market index—and noting that three indexed fund providers (Vanguard, State Street, and BlackRock) on their own controlled approximately 15% of the stock of companies in the S&P 500 in 2017).

⁵⁶ See BIRDTHISTLE, *supra* note 54.

Operating companies and investment funds are subject to distinct securities laws, and each body of law constructs a different public/private divide.⁵⁷ Funds are governed by the Investment Company Act of 1940 (“ICA”), which defines their divide.⁵⁸ Similar to the framework for operating companies, funds on the public side—commonly known as “registered” funds—are permitted to raise capital from virtually anyone, including retail investors, and are subject to extensive disclosure requirements under the ICA.⁵⁹ Private investment funds, by contrast, may generally raise capital only from large institutional investors or from a very limited number of investors,⁶⁰ and they face extremely limited disclosure obligations.⁶¹

2. Interactions and Overlap Between the

⁵⁷ See John Morley, *Why Do Investment Funds Have Special Securities Regulation?*, in RESEARCH HANDBOOK OF MUTUAL FUNDS 9, 9 (William A. Birdthistle & John Morley eds. 2018). That funds are governed by their own securities law, and have their own public/private divide, are foundational issues, but until recently they were largely overlooked by the scholarly literature. For leading work on these issues, see *id.* 9–21; see also Allen Ferrell & John D. Morley, *The Regulation of Intermediaries*, in SECURITIES MARKET ISSUES FOR THE 21ST CENTURY, *supra* note 16, at 313, which also provides an elegant overview of current fund regulation and open questions regarding it.

⁵⁸ Investment Company Act of 1940, 15 U.S.C. §80a-6(c) (2018).

⁵⁹ Morley, *supra* note 57, at 13–14.

⁶⁰ Specifically, the ICA exempts from public registration those funds whose investors are all “qualified purchasers” or funds with fewer than 101 investors. Investment Company Act § 80a-3(c)(1)–(c)(7) (exempting issuers from “investment company” status if the issuer’s securities are owned by 100 persons (or fewer) or if all securities are held by qualified purchasers); 17 C.F.R. § 270.2a51-1(h) (2021) (defining “qualified purchaser”).

⁶¹ *Private Equity Funds*, U.S. SEC. & EXCH. COMM’N, <https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity> [https://perma.cc/GBY2-JQLU] (last visited Oct. 16, 2021).

Company and Fund Divides

It is worth considering the regulatory framework for funds in greater detail, as it ultimately shapes in what they invest.⁶² Consider first the investment restrictions imposed on public funds such as mutual funds and ETFs. Public funds' investment portfolios are subject to strict diversification and liquidity requirements.⁶³ Public funds wishing to invest in corporate securities must therefore invest almost exclusively in those that can be bought and sold in a large, continuous trading market. In practice, as we shall see, those will tend to be the equity and debt securities of *public companies*.

Private funds, by contrast, face no such constraints on their investment portfolios, and therefore do not require the near-perfect liquidity and easy diversification of a securities market with an enormous volume of trading. To the contrary, they are at liberty to make a very small number of highly illiquid investments.⁶⁴ The purpose of leveraged buyout funds, for example, is to acquire controlling stakes in companies as

⁶² Beyond the disclosure obligations described above, public funds face significant constraints on their investment portfolios, their governance, and their compensation models, none of which are imposed on private funds. Among other things, the ICA requires public funds (1) to constrain leverage, (2) avoid incentive compensation, and (3) provide frequent redemptions. On the first point, the ICA only permits open-end mutual funds to become indebted to banks, 15 U.S.C. § 80a-18(f)(1); prohibits issuing debt securities, *id.* 80a-18(a); and requires that total assets must always equal or exceed bank loan principal by a ratio of 3 to 1, *id.* 80a-18(f)(1). On the second point, Provisions of the Investment Advisers Act ("IAA") only permit adviser performance fees if the fee is symmetric with poor performance punished to the same extent good performance is rewarded, and performance is based on a benchmark. Investment Advisers Act of 1940, 15 U.S.C. § 80b-5(b)(2) (2018). The ICA prohibits mutual funds from issuing shares for services. Investment Company Act, 15 U.S.C. §80a-22(g). Finally, on the third point, *see* Sections 2(a)(32) (defining redeemable security as a security whose holder, upon presenting it to the issuer, is entitled its proportionate share of net assets) and 22(e) of the Investment Company Act (constraining the suspension of registration rights). Investment Company Act §§ 80a-2(a)(32), 22(e).

⁶³ *See* I.R.C. §§ 851, 852 (2018).

⁶⁴ U.S. SEC. & EXCH. COMM'N, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS 7 (2003)

their sole investments over such funds' typical ten-year life span.⁶⁵

All this explains in part why public funds such as mutual funds and ETFs invest overwhelmingly in *public* companies with exchange-traded stock,⁶⁶ while private funds such as private equity, leveraged buyout funds, and venture capital funds make highly illiquid investments in *private* companies.⁶⁷ This, then, is the fundamental way in which the public/private divide for funds interacts with and shapes the public/private divide for *operating companies*—by structurally biasing the universe of prospective shareholders for companies on each side of the public/private divide. *Public companies will be financed primarily by public funds, while private operating companies will be financed primarily by private funds.*

To be clear, there is no securities law restriction whatsoever on private funds investing in public companies, and there is no direct prohibition on public funds investing in private companies—the legal constraints on public funds operate indirectly through the diversification and liquidity requirements, as we have seen. Although hedge funds are set up as private funds, their equity investments are overwhelmingly in public company stocks,⁶⁸ while some open-end mutual funds have recently made major investments in large private companies.⁶⁹ Yet by dollar volume, the overwhelming preponderance of investment by private funds is in private companies and by public funds in public

⁶⁵ See Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSP. 121, 123 (2009).

⁶⁶ See Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 10,649, Exchange Act Release No. 86,129, Investment Company Release No. 33,512, 84 Fed. Reg. 30,460, 30,515 (proposed June 26, 2019) (noting that “registered investment companies” such as mutual funds and ETFs are limited in their ability to invest in private companies).

⁶⁷ See Ann-Kristin Achleitner & Christoph Kaserer, *Private Equity Funds and Hedge Funds: A Primer* 9, 11 (Ctr. For Entrepreneurial & Fin. Studs., Working Paper 2005-03, 2005).

⁶⁸ See *id.*

⁶⁹ Chernenko et al., *supra* note 9, at 2370.

companies.⁷⁰ The two divides both interact and overlap. It would not matter if registered funds invested overwhelmingly in public companies and private funds in private companies, if those funds did not fundamentally differ in how they affected the companies they own. But, as we will argue in Part III, they do.

3. An Idealized Public/Private Divide

To grasp how the public/private divide actually works, it is illuminating to contrast it with an idealized, simple version of how a public/private divide could in principle work. In this simple version, few regulatory requirements are imposed on private companies beyond the anti-fraud rule, while an extensive disclosure regime is imposed on public companies. However, private firms are severely restricted in their ability to raise capital from third parties. Public firms, by contrast, may sell their securities to anyone, and thus can access a substantially cheaper and deeper pool of capital than private firms.⁷¹ In this simple framework, firms are founded and

⁷⁰ Why do private funds typically invest in private companies and public funds in public companies? Registered funds must offer daily redemption. A registered fund that invested in illiquid securities would be exposed to a run. See Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings* 27 (Eur. Corp. Governance Inst., Law Working Paper No. 594/2021, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3707249 (on file with the Columbia Business Law Review); see also 17 C.F.R. § 270.22e-4(b)(1)(iv) (2021) (restricting open-end mutual funds from holding more than 15% of their portfolio in assets without an available quotation). Conversely, a fund structured to specialize in investing in illiquid securities would choose *not* to be a registered fund. SIMPSON THACHER, REGISTERED FUNDS ALERT 6–7 (2020), stblaw.com/docs/default-source/Publications/registeredfundsalert_september2020.pdf (on file with the Columbia Business Law Review) (discussing lack of registered funds' investment in illiquid private corporate equities).

⁷¹ Historically,

[c]ompanies that went public took on the obligation of publicly disclosing substantial amounts of information and, in return, were permitted to solicit the largest (and therefore cheapest) source of capital: the general public. Conversely, private companies were restricted to raising

begin operating as private companies. Some of those firms fail, others succeed moderately, and all of those firms can and do remain private. Highly successful, large private firms, however, almost inevitably require access to the broader world of capital available in public markets. Thus, they almost invariably go public.

In this idealized version, a firm's decision to cross the public/private divide is a near-mechanical result of that firm growing to a certain size and needing to meet its accompanying capital-raising needs. Successful firms facing the decision between going public and staying private do encounter a tradeoff, which is that being public offers cheaper capital but higher regulatory costs. That tradeoff is relatively simple to evaluate, however, and it applies fairly uniformly across the broad set of private firms successful enough to contemplate going public.⁷²

This vision is worth considering because it shows how the answers to foundational questions about the public/private divide might change with time. Consider three basic questions about the public/private divide: (1) How does the divide work? (2) How does the tradeoff facing firms work? (3) How should we judge the divide's success?

We have already described how the divide works in this simple model as well as the effects of the tradeoff facing firms determining whether to be public or private. The divide creates a set of capital-raising benefits and costly regulatory mandates that arise as a kind of rite of passage for successful firms. The tradeoff is a calculation that pits these costs and benefits against each other in a fairly uniform way for firms.

capital primarily from insiders and financial institutions, without publicity and subject to severe limitations on subsequent transfers of their securities—effectively precluding any sort of market for private company equity.

de Fontenay, *supra* note 6.

⁷² Our contention is not that the regulatory costs and capital-raising benefits of being public would apply in the same way to firms. Regulatory costs are more likely to be largely fixed, Ewens, *supra* note 5, while the benefits of capital raising are more likely to scale with the size of a firm. Rather, it is that the factors important to this tradeoff are the same for IPO-eligible companies.

What constitutes success for this divide? Presumably, this public/private divide is a success if the mandatory regulations imposed on public firms appropriately mitigate market failures made more probable (or significant) when a firm is public.⁷³ Therefore, such regulations should target market failures likely to accompany firms with a broad and diffuse shareholder base, such as managerial agency costs stemming from collective action problems among shareholders.⁷⁴

This view of how the public/private equilibrium works is a positive theory, dedicated to describing and explaining firm behavior. But it has clear normative implications as well. Because an identifiable class of firms will go public for the same basic reason, regulatory interventions targeting public firms have a coherent target.

In the next Part, we argue that a much broader set of legal, economic, and social factors have developed downstream from the public/private divide that securities law established in the 1930s. The result is two broadly distinct public and private ecologies. These two ecologies differ along a large number of economically consequential dimensions that are materially important to the decisions firms make about being public or private as well as any social welfare analysis of the consequences of those decisions. Even as these ecologies have developed, moreover, the original driving force for going public—capital raising—has materially diminished.⁷⁵ As noted, considerably more capital is now raised in exempt than registered offerings.⁷⁶ As a result, firms no longer share one leading reason for going public. Instead, we argue that the factors that are now material to firms' decisions are many, complex, and often cross-cutting. The cumulative effect is that

⁷³ It is not our contention that the world was ever so simple or that securities scholars or regulators took it to be. Instead, we think this simple picture offers a useful contrast. We will argue that the public/private divide works today as a vastly complex and varied set of institutions, many of which are more important to firms' decisions than the legal rules that define the public/private divide and its obligations.

⁷⁴ Asker et al., *supra* note 2, at 355.

⁷⁵ de Fontenay, *supra* note 6, at 448.

⁷⁶ BAUGUESS ET AL., *supra* note 7.

IPO-eligible firms do not encounter one going public versus staying private tradeoff, but many, firm-specific tradeoffs.

We begin by describing the complex and multi-dimensional character of today's public and private ecologies, drawing extensively on prior work discussing one or more of these dimensions. This sets the stage for discussing how features of these ecologies shape different firms' private/public decisions.

IV. COMPLEXITY: THE PUBLIC/PRIVATE DIVIDE OFFERS TWO DIFFERENT ECOLOGIES FOR FIRMS

In this Part, we describe the complexity of the public/private ecosystems today. The complexity results from the interaction of many different features of markets, including corporate governance, securities markets, and investment management regulation. This interaction, and the accretion of decades of practices and institutional features, suggest that despite its prominence, it is not at all clear how the public/private divide today actually works.

A. The Public/Private Divide Today: Functional Complexity

As the securities laws designed it, the public/private divide is a set of criteria that defines the divide and a set of different burdens and privileges that accompany falling on one side or the other. In this Section, we discuss the many economically and socially consequential features of capital markets that seem to also turn on the divide. In the face of these many features, it becomes plausible that the public/private divide is no longer principally a matter of the features initially designed by securities law. While the Securities Acts created the public/private divide almost nine decades ago,⁷⁷ it has become much more than originally envisioned. The public/private divide of today is best conceptualized as a hazy

⁷⁷ *Supra* note 34 and accompanying text.

division between two different *ecologies*—complex systems characterized by complicated interactions.⁷⁸

Below we describe—and attempt to explain—some of the most salient features of the private and the public ecologies, and how they interact. First, we discuss key rules and regulations that turn directly on the divide established by securities law. Second, we describe features that turn on the public/private divide in practice but that are not directly entailed by any legal requirements; they are downstream of law. **Table 1** summarizes these differences.

Table 1: Key Differences Between Average Public and Private Companies

		PUBLIC COMPANIES	PRIVATE COMPANIES
Distinctions imposed by law	Mandatory Disclosure Rules	Substantial periodic and episodic disclosure ⁷⁹	No mandatory disclosure ⁸⁰
	Governance Rules	Extensive regulation of (1) shareholder voting, (2) tender offers, (3) internal financial controls, (4) board composition, and (5) disclosure and process surrounding executive compensation ⁸¹	No comparable requirements under state law ⁸²

⁷⁸ For a compelling example of ecological analysis of public markets, see Spamann, *supra* note 70.

⁷⁹ *See infra* note 105 and accompanying text.

⁸⁰ *See infra* note 106 and accompanying text.

⁸¹ *See infra* Section IV.A.1.a.

⁸² *See infra* Section IV.A.1.a.

	Reg. FD	Prohibition on selective disclosure by companies ⁸³	Selective disclosure permitted ⁸⁴
Distinctions that arise in practice	Ownership (shareholder base)	Dispersed, mostly passive shareholder base ⁸⁵	Small shareholder base, selected by insiders and composed primarily of active investors ⁸⁶
	Trading environment	Continuous stock prices ⁸⁷ Market approaches informational efficiency ⁸⁸	Little or no trading; valuation occurs only upon major corporate events (capital raising, acquisition, etc.) ⁸⁹ Market is not informationally efficient ⁹⁰
	Information environment	Very rich set of regularly updated, publicly available information, as a result of (i) mandatory disclosure, (ii) analyst reports, media, and other market research, and (iii) stock	Very limited information, not only for the general public but also for investors ⁹²

⁸³ See *infra* notes 115–118 and accompanying text.

⁸⁴ See *infra* note 119 and accompanying text.

⁸⁵ See *infra* note 123 and accompanying text.

⁸⁶ See *id.*

⁸⁷ See *infra* note 126 and accompanying text.

⁸⁸ See *infra* Section IV.A.1.b.

⁸⁹ See *infra* note 128 and accompanying text.

⁹⁰ See *infra* Section IV.A.1.b.

⁹² See *infra* Section IV.A.2.c.

		prices ⁹¹	
	Governance	Centralized, professional management by a board of directors appointed each year by shareholders and including several independent directors ⁹³	Management mostly by largest shareholders; governance and control rights established in connection with major corporate transactions, rather than on a yearly basis ⁹⁴
	Regulation and Enforcement	Aggregate shareholder litigation (e.g., class actions) common ⁹⁵	Relatively little shareholder litigation ⁹⁶

1. Securities Law Rules that Turn Directly on the Divide

Securities law's public/private divide was designed to impose disclosure obligations on public issuers. We begin by discussing the range of other rules that now also turn directly on securities law's public/private divide.

i. Governance Rules

Traditionally, corporate governance has been a matter of state law.⁹⁷ Under the "internal affairs doctrine," the law of a

⁹¹ See *infra* Section IV.A.2.c.

⁹³ See Del. Code. Ann. tit. 8, § 141 (2021)

⁹⁴ See Rauterberg, *supra* note 12, at 1133–36 (describing how shareholder agreements often determine control of private firms).

⁹⁵ See *infra* Section IV.A.2.d.

⁹⁶ See *infra* Section IV.A.2.d.

⁹⁷ Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REGUL., Spring 2003, at 26, 26 ("For over 200 years, corporate governance has been a matter for state law.").

firm's state of incorporation governs the relationships among the firm, its directors and officers, and its shareholders.⁹⁸ As a result, matters such as shareholder voting, board action, and fiduciary duties are governed by state corporate statutes and common law.⁹⁹ For public companies, however, federal law has progressively layered over a partly superseding corporate governance regime by way of amendments to the securities laws.¹⁰⁰ This includes: (1) an extensive regulatory regime governing almost every aspect of shareholder voting (referred to as the "federal proxy rules"), (2) rules governing a prominent form of acquisition (the tender offer),¹⁰¹ (3) requirements of internal financial controls and certification, (4) board composition requirements, and (5) executive compensation reforms.¹⁰² This "federalization" of corporate governance has accelerated over the last two decades, primarily in response to major scandals or crises involving public companies.¹⁰³

⁹⁸ See RESTATEMENT (SECOND) OF CONFLICTS OF LAWS §§ 302 cmt. a (1971); see also *Cort v. Ash*, 422 U.S. 66, 84 (1975).

⁹⁹ RESTATEMENT (SECOND) OF CONFLICTS OF LAWS §§ 302 cmt. a, 303–309 (1971).

¹⁰⁰ For an analysis of federal incursions into corporate governance, see Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649, 1694–97 (2015).

¹⁰¹ Aspects of federal tender offer regulation do apply to tender offers in private markets. See Dawn Belt, *Pre-IPO Liquidity for Late Stage Start-Ups*, LEXIS PRACTICE ADVISOR (2020), <https://assets.fenwick.com/legacy/FenwickDocuments/Pre-IPO-Liquidity-for-Late-Stage-Start-Up.pdf> [<https://perma.cc/6XN5-MW4P>].

¹⁰² For a detailed description of these provisions, see Talley, *supra* note 100.

¹⁰³ See *id.* at 1693 (arguing that the separation between corporate and securities law "began disintegrating substantially after the bursting of the dot-com bubble"). The extent of this displacement is controversial. For instance, fiduciaries duties—perhaps the heart of corporate law—remain largely if not wholly a creature of state law. See Roberta Romano, *The Market for Corporate Law Redux* 47, 60, (Eur. Corp. Governance Inst., Law Working Paper No. 270/2014, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2514650 (on file with the Columbia Business Law Review).

As a result, two similar corporations, one public and the other private, will be subject to very different corporate governance mandates. Because Delaware is the dominant state for incorporations,¹⁰⁴ it is useful to compare its requirements to the federal regime for public companies. Federal law now requires that public companies provide substantial mandatory disclosure to shareholders around voting, shareholder proxy access, independent board and board committee members, and ex ante controls and compliance to prevent misconduct, alongside ex post enforcement.¹⁰⁵

In contrast, Delaware law has remained largely silent on each of these matters, allowing private companies to gravitate toward the opposite pole, if they wish. Private companies can largely forgo disclosure to their shareholders, whether in connection with shareholder votes or otherwise: Their only mandatory obligation is to respond to certain specific shareholder requests for information.¹⁰⁶ Second, regulation of the substance and process of takeovers is left to the common law, which tends to steer clear of bright-line rules in this context.¹⁰⁷ Third, private companies, including those financed by private equity or venture capital funds, can have boards composed solely of insiders and sometimes do.¹⁰⁸ Finally,

¹⁰⁴ William J. Carney, George B. Shepherd & Joanna Shepherd Bailey, *Lawyers, Ignorance, and the Dominance of Delaware Corporate Law*, 2 HARV. BUS. L. REV. 124, 126 (2012).

¹⁰⁵ See JAMES D. COX, SECURITIES REGULATION: CASES AND MATERIALS 597–98, 601–02, 956, 959 (7th ed. 2013) (discussing each of these features of public-company regulation under the federal securities laws).

¹⁰⁶ See Del. Code. Ann. tit. 8, § 220 (2021) (delineating shareholders' rights to inspect the corporation's "books and records"). Even then, shareholders must first demonstrate that they have a proper purpose for requesting the information (other than for the stockholder list). See *id.* § 220(b).

¹⁰⁷ See James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 324–26 (2018) (describing the role of the Delaware courts in mergers and acquisitions law).

¹⁰⁸ Michael Ewens & Nadya Malenko, *Board Dynamics over the Startup Life Cycle* 32, 46 tbl.2 (Nat'l Bureau of Econ. Rsch., Working Paper No.

Delaware's corporate statute simply does not address internal controls. This leaves fraud or misconduct in private companies to be dealt with *ex post* and indirectly through shareholder lawsuits alleging breach of directors' and officers' fiduciary duties to the corporation.¹⁰⁹

ii. Regulation Fair Disclosure ("Reg. FD")

For public companies whose stock is traded in a liquid market, new information about the firm rapidly affects its stock price as market actors incorporate the information into their trading.¹¹⁰ If material information moves stock prices, it signals that the market is working well: In an informationally efficient market, a company's stock price *should* reflect all available information about the firm.¹¹¹ Yet, such efficiency also creates a profit opportunity for those who acquire material information about the company *before* the rest of the market.¹¹² Concerns about the potential inefficiency or unfairness of such profit opportunities have led to prohibitions on insider trading.¹¹³

But what happens when companies *voluntarily* disclose material nonpublic information selectively to specific market actors, because they believe that doing so will benefit the

27769, 2020), <http://www.nber.org/papers/w27769> (on file with the Columbia Business Law Review).

¹⁰⁹ See Donald C. Langevoort, *Caremark and Compliance: A Twenty-Year Lookback*, 90 TEMP. L. REV. 727, 734 (2018) (describing how the Delaware common law has shaped corporate compliance).

¹¹⁰ See Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 565–67 (1984).

¹¹¹ *Id.* at 554–57.

¹¹² *Id.* at 554, 556.

¹¹³ Insider trading consists of trading on the basis of material nonpublic information in violation of a relationship of trust and confidence, whether by (1) corporate insiders (such as directors, officers, and large stockholders), (2) tippees of corporate insiders who were given the information in a quid pro quo, and (3) anyone who misappropriated the information in breach of a duty to whomever was in possession of that information and their tippees. See Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 863–68 (2018) (Overviewing the regulation of insider trading).

company? Corporate management routinely meets privately with corporate analysts and large shareholders. It is almost inevitable that these meetings will involve management sharing information or insights that are not yet public, and which may sometimes be material. This was a long-accepted practice in corporate America.¹¹⁴

In exchange for this access to management, corporate analysts might produce more favorable reports on the company, and large shareholders might be more supportive of management's plans or provide useful guidance to management.¹¹⁵ Despite these perceived benefits to the corporation, the SEC ultimately determined that much selective disclosure should be prohibited. In 2000, the SEC adopted Regulation Fair Disclosure ("Reg. FD"), which prevents selective disclosure of corporate information.¹¹⁶ Under Reg. FD, if a public company has material information that it discloses to a particular broker-dealer, investment fund, or investment adviser, it must instead disclose that information to *everyone* (with some exceptions).¹¹⁷ Selective disclosure of material nonpublic information to *any shareholder* is also generally prohibited if it occurs "under circumstances in which it is reasonably foreseeable that the

¹¹⁴ See Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,715, 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, 249) (stating in the final rulemaking for Reg. FD that "many issuers [were] disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public").

¹¹⁵ *Id.* at 51,716–17.

¹¹⁶ See Regulation FD, 17 C.F.R. § 243.100–103 (2021).

¹¹⁷ Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,735. For an insightful argument of the consequences of Reg. FD for private and public companies' management of their cash holdings, see Joan Farre-Mensa, *The Benefits of Selective Disclosure: Evidence from Private Firms* (Harv. Bus. Sch. Working Paper No. 15-095, 2017), <https://ssrn.com/abstract=1719204> (on file with the Columbia Business Law Review).

person will purchase or sell the issuer's securities on the basis of the information."¹¹⁸

Once again, the contrast with private companies is striking. There is no prohibition whatsoever under state or federal law on selective disclosure by private companies. In fact, selective disclosure of material information is the norm.¹¹⁹ Take a venture capital-financed private company, for example. Venture capital funds typically negotiate for the contractual right to obtain certain disclosures from the company and will often receive more information than is contractually required.¹²⁰ Further, fund investors in startups are often entitled to designate one or more directors to the corporate board,¹²¹ in which case the fund will enjoy a steady stream of access to nonpublic information from the firm. Yet other shareholders of the company, such as employees compensated with restricted stock or options, may receive no disclosure whatsoever.¹²²

2. Devices that Turn on the Divide in Practice

Some of the most important features of the public and private company ecologies are not directly imposed by law. Rather, they reflect practices that are indirectly a consequence of the legal architecture of the public/private divide. Nonetheless, these features now represent some of the most fundamental differences between public and private companies observed in practice, including differences in (i) ownership, (ii) governance, (iii) the informational

¹¹⁸ 17 C.F.R. § 243.100(a)(2)(iv).

¹¹⁹ Farre-Mensa, *supra* note 117, at 1, 3.

¹²⁰ *Model Legal Documents* NAT'L VENTURE CAP. ASS'N ("Information and Observer Rights"), <http://nvca.org/resources/model-legal-documents/> (on file with the Columbia Business Law Review) (select "Investors' Rights Agreement (Updated August 2021)").

¹²¹ Brian J. Broughman & Jesse M. Fried, *Carrots and Sticks: How VCs Induce Entrepreneurial Teams to Sell Startups*, 98 CORNELL L. REV. 1319, 1329–30 (2012).

¹²² See Pollman, *supra* note 28, at 374 (2020) (discussing the paucity of information disclosure required under the securities laws for employees receiving equity compensation in private companies).

environment, (iv) trading, and (v) regulation and enforcement. We discuss these differences below.

As with any ecology, however, the relationships among the various organisms (or “stakeholders,” in our context) are generally reciprocal and circular. Because all five features listed above interact with each other, it is difficult to discuss them in isolation. As a result, we also describe some—though by no means all—of the ways in which they are connected to one another.

i. Control Over Shareholder Base

For companies that choose to take on the disclosure requirements and other obligations tied to going public, one countervailing benefit is public companies’ ability to raise capital from anyone and to have their securities traded on a national securities exchange. In practice, then, a public company will tend to have a more dispersed and diverse shareholder base.¹²³ Further, the company itself will typically not seek to limit or maintain control over the identity or actions of its shareholders. Private companies, by contrast, tend to maintain tight control over their shareholder base, often through restrictions contained in a shareholders’ agreement.¹²⁴

ii. Continuous Stock Prices

Public companies typically seek to maintain a highly liquid trading market for their stock.¹²⁵ This allows them to access the widest possible shareholder base, and therefore to achieve the lowest cost of capital. It also enables them to reconcile the interests of shareholders with different time horizons. In turn, liquidity requires that the stock be continually tradable, and that the pricing be publicly available. Continuous stock prices

¹²³ de Fontenay, *supra* note 6.

¹²⁴ See Rauterberg, *supra* note 12, at 1126–27.

¹²⁵ See *supra* note 60 and accompanying text.

are therefore a defining feature of public companies, even though they are not required by rule or regulation.¹²⁶

Yet private companies face significant restrictions on the trading of their securities. Other than the very largest private companies (referred to as “unicorns”), private companies typically do not enjoy meaningful secondary trading of their stock.¹²⁷ Valuations of the firm (and therefore of its stock) only tend to occur when the firm accepts new financing or when the company is acquired.¹²⁸ For this reason, it is usually inapt even to refer to the “stock price” of a private company.

iii. Informationally Rich Environment

The active secondary market for public companies’ stock reflects extensive and continually updated information. In addition to the disclosure required of public companies under the securities laws, information is also generated and rapidly disseminated through the continuous stock prices discussed above,¹²⁹ as well as the combination of stock analyst reports, media coverage, and publicly available data sets that have developed around public companies and publicly-traded stock.

Most importantly, the combination of continuous stock prices and copious, widely available information ensures that the market for publicly-traded stock is a relatively efficient

¹²⁶ RICHARD A. BREALEY ET AL., *PRINCIPLES OF CORPORATE FINANCE* 448 (12th ed. 2017) (demonstrating that shareholders with diverse time horizons will want corporate managers to maximize the firm’s current stock price, assuming that the stock trades in a liquid and informationally efficient market).

¹²⁷ See COX ET AL., *supra* note 105, at 276–77 (noting the many restrictions typically placed on the trading of privately issued securities).

¹²⁸ See David F. Larcker et al., *Cashing It In: Private-Company Exchanges and Employee Stock Sale Prior to IPO*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REGUL. (Oct. 9, 2018) (“[E]mployees who sell equity awards in private-company securities that are not registered with the SEC might not get a ‘fair’ price for their investment, based on previous funding valuations or what they would get through an IPO or acquisition.”); see also Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 203, 209 (2012) (noting that the market for private company stock remains largely illiquid).

¹²⁹ See *supra* Section IV.A.2.b.

one—by which we mean that stock prices rapidly incorporate material information, due to the trading of informed market participants, and change accordingly.¹³⁰ Market efficiency in turn affects the governance and ownership characteristics of public companies in a number of ways, such as by allowing for purely passive investors like index funds.

The information environment for private companies is strikingly different. As discussed, private companies may forgo virtually all disclosure regarding their operations, governance, and financial condition to the public and regulators, and may even refrain from disclosing much to some or many of their own shareholders, unless the latter specifically contract for disclosure rights.¹³¹ Among other things, this poses significant valuation and monitoring challenges for private companies, whose ownership is largely limited to insiders and active shareholders with large stakes in the firm.¹³²

iv. Aggregate Litigation

A final explanation for why public and private companies differ in their governance and behavior has to do with the amount and types of litigation that each face, respectively. Public companies are frequent targets of aggregate litigation, including shareholder claims in the form of class action lawsuits under the federal securities laws or state corporate law.¹³³ This is so for several reasons. First, the

¹³⁰ See de Fontenay, *supra* note 6, at 485 (“At a minimum, there is overwhelming evidence that stock prices on the major exchanges change virtually instantaneously in response to salient new investment information.”).

¹³¹ *Supra* note 119 and accompanying text.

¹³² See Thomas J. Chemmanur & Paolo Fulghieri, *A Theory of the Going-Public Decision*, 12 REV. FIN. STUDS. 249, 250 (1999) (“In the case of public firms, the required capital is generated (in general) by selling shares to a large number of investors, whereas with private firms, much of the external financing is provided by one large investor (often a venture capitalist) or a small group of large investors (‘angels’).”).

¹³³ See Emily Strauss, *Is Everything Securities Fraud?* 3 (Duke L. Sch. Pub. L. & Legal Theory Series, Working Paper No. 2021-04, 2021),

informationally rich environment of public companies does much of the legwork for plaintiffs' lawyers: they can generally expect to learn of misconduct within the company (and the surrounding details) in due course, or they can pour over a company's securities filings to find discrepancies between the company's voluminous disclosures and subsequent events, regardless of whether there is any harm to the company's shareholders.¹³⁴ Second, the relatively efficient market for publicly-traded securities eases the task of proving damages. If a company experiences an abnormally large stock price decline following the announcement of corporate misconduct or the correction of a prior misstatement, for example, the plaintiffs can simultaneously use it as evidence of both causation and amount of damages.¹³⁵ Third, plaintiffs are not required to prove reliance on a company's misconduct or misstatement if the stock is deemed to trade in an efficient market, under the "fraud-on-the-market" doctrine.¹³⁶ Finally, the large and dispersed shareholder base of most public companies¹³⁷ makes for a ready class of plaintiffs: Individual shareholders with small holdings have no reputation to protect from sanction by firms.

In private companies, by contrast, shareholders may not learn of corporate misconduct or potential fiduciary duty breaches until there is nothing left for plaintiffs to recover.¹³⁸ Obtaining the information necessary to bring a claim and prove damages can be an exceptionally difficult task. More importantly, perhaps, private-company shareholders tend to be insiders or large stockholders, as we have seen, such that they actively participate in the firm's governance and are

<http://dx.doi.org/10.2139/ssrn.3664132> (on file with the Columbia Business Law Review).

¹³⁴ *Id.* at 3–4.

¹³⁵ Jill E. Fisch, Jonah B. Gelbach & Jonathan Klick, *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 TEX. L. REV. 553, 562 (2018).

¹³⁶ John C.P. Goldberg & Benjamin C. Zipursky, *The Fraud-on-the-Market Tort*, 66 VAND. L. REV. 1755, 1759 (2013).

¹³⁷ de Fontenay, *supra* note 6.

¹³⁸ Pollman, *supra* note 28, at 390.

therefore less likely to sue. Even where they are otherwise inclined to sue, large stockholders may be dissuaded from doing so out of concern for their reputation or their relationship with the company.¹³⁹

3. Unbundling the Public/Private Divide

It is worth noting that while the public and private markets ecologies differ along a host of dimensions, the border between them has also become increasingly blurry in recent years. In a sense, capital markets have seen the “unbundling” of the package of traits associated with public and private markets. The paradigmatic public company, for instance, bundles together centralized management, an independent board, extensive disclosure, dispersed share ownership by passive investors, and so forth.¹⁴⁰ In contrast, the paradigmatic large private company bundles together shareholder control, ownership by a small number of insiders and active shareholders, a thin information environment, and an illiquid secondary market.¹⁴¹

Yet these two paradigms have become increasingly disaggregated in recent years. As a result of (i) continued deregulation of private capital raising and of trading in private securities, (ii) increased competition among private funds, and (iii) the relative scarcity of high-return opportunities in today’s low-interest-rate environment, we increasingly see characteristics of private markets entering the public markets, and vice versa.¹⁴²

Consider first governance devices associated with private markets that have migrated to public markets. First, corporate founders and insiders increasingly succeed in retaining control of public companies, through strategies such as adopting dual class stock structures in connection with an

¹³⁹ David Rosenberg, *The Two “Cycles” of Venture Capital*, 28 J. CORP. L. 419, 421 (2003) (discussing how reputation explains the absence of litigation in the venture capital industry).

¹⁴⁰ de Fontenay, *supra* note 6.

¹⁴¹ *Id.*

¹⁴² *See id.*

IPO.¹⁴³ Dual class public companies behave very differently from the classic public company paradigm in which a widely dispersed set of passive shareholders leaves management effectively in control of the firm.¹⁴⁴ Second, private investment funds that have historically been confined to private markets are operating in public markets to a greater degree. Private equity leveraged buyout funds, for example, now make minority investments in public companies through PIPE transactions.¹⁴⁵ Further, where they retain stakes in public companies, either through PIPEs or following the IPO of one of their portfolio companies, they increasingly seek to impose private company governance devices, such as shareholders' agreements.¹⁴⁶ Third, the surge in popularity of SPACs suggests strong appetite among large funds and institutional investors for a form of publicly-traded private equity.¹⁴⁷ More generally, both SPACs and direct listings reveal private companies' desire to go public other than through the traditional channel of an underwritten initial public offering.

In the other direction, public market features are appearing in private markets. First, some of the largest private companies now allow their stock to be traded in secondary markets, even in the absence of ongoing

¹⁴³ Jill E. Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1069–70 (2019).

¹⁴⁴ *Id.* at 1065.

¹⁴⁵ See *Frequently Asked Questions About PIPEs*, MORRISON & FOERSTER, <https://media2.mofo.com/documents/faqspipes.pdf> [<https://perma.cc/JQC3-ZFX4>] (last visited Oct. 17, 2021) (defining PIPE transactions and detailing the increase in such transactions); Ari B. Blaut et al, *Market Trends 2020/21: PIPEs*, LEXIS PRACTICAL GUIDANCE (May 18, 2021), https://www.sullerom.com/files/upload/Market-Trends-2020_21_%20PIPEs.pdf [<https://perma.cc/ENB9-E44C>] (detailing 59% increase in number of PIPE deals from 2019 to 2020 and an 110% increase in total volume of deals).

¹⁴⁶ See Rauterberg, *supra* note 12, at 1129–1130.

¹⁴⁷ See Michael Klausner, Michael Ohlrogge & Emily Ruan, *A Sober Look at SPACs* 13, 18 (Eur. Corp. Governance Inst., Fin. Working Paper No. 746/2021, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3720919 (on file with the Columbia Business Law Review) (discussing popularity of SPACs).

disclosure.¹⁴⁸ Second, some mutual funds have begun investing a small portion of their assets in mature venture-backed *private* companies with high valuations.¹⁴⁹ This is notable because mutual funds are open to retail investors and have therefore traditionally invested exclusively in public markets. In addition, attempts have been made to create diversified portfolios of private company stocks, though the possibility of indexing appears to be a long way off.¹⁵⁰

Each of these developments puts pressure on the regulatory divide between public and private companies and warrants a careful restatement of the goals motivating the public/private divide and a clear-eyed assessment of whether such goals are being achieved. As we will see, however, the functional complexity of the public/private divide translates into considerable normative complexity too, when the task turns to assessing the divide and considering regulatory changes.¹⁵¹

B. Capital Raising and Issuer Choice

Several years ago, Donald Langevoort, perhaps the leading theorist of the public/private divide, suggested that “the most conceptually interesting subject in securities law” was the question whether it was “possible—indeed desirable—that a large segment of economically important firms in the American economy stay private, perhaps indefinitely, yet with

¹⁴⁸ See Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. Pa. L. Rev. 179, 193–199 (2012).

¹⁴⁹ Jeff Schwartz, *Should Mutual Funds Invest in Startups? A Case Study of Fidelity Magellan Fund’s Investments in Unicorns (and Other Startups) and the Regulatory Implications*, 95 N.C. L. REV. 1341, 1348–50, 1359–60 (2017).

¹⁵⁰ See, e.g., THE PRIVATE SHARES FUND, PROSPECTUS (2021), <https://privatesharesfund.com/downloads/prospectus/> [<https://perma.cc/9YD2-DE74>]

¹⁵¹ For an important example of re-thinking the basic framework of the public/private divide from the vantagepoint of the securities laws, see Guttentag, *supra* note 22.

easy access to large amounts of capital?”¹⁵² In essence, Langevoort was suggesting that capital markets in the United States had or would soon come to sustain a state of affairs in which successful, growing private firms could access sufficient capital while operating as public *or* private companies.

Empirical research since then suggests that we have indeed arrived at this state of affairs, and that private companies now enjoy an *issuer choice* regime—an environment in which a successful large firm can successfully operate in public or private markets, making the choice between them truly optional.¹⁵³ As a result, private companies decide to go public only if—and only when—it is privately desirable for them to do so, based on their own balancing of the costs and benefits of being a public company.

A major cause of this state of affairs was the growth in the availability of capital in private markets, where capital raising now far outstrips public markets.

Second, and relatedly, the increasing availability of private capital seems to have lessened companies’ desire to go or remain public.¹⁵⁴ Several factors, including the removal of various state-level restrictions on private issuers’ securities offerings, led to increases in the supply of private capital.¹⁵⁵ This increased supply, in turn, enables late-stage private firms to grow to a size, levels of employment, and levels of revenue, which few private firms could previously obtain.¹⁵⁶ The product of this issuer choice regime is that fewer highly-

¹⁵² Donald Langevoort, *The Regulation of Primary Markets*, in SECURITIES MARKET ISSUES FOR THE 21ST CENTURY, *supra* note 16, at 122.

¹⁵³ Ewens & Farre-Mensa, *supra* note 5, at 5467–68. *See, e.g.*, Romano, *supra* note 26 (advocating for more issuer and investor choice in securities regulation); John C. Coates IV, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, 41 VA. J. INT’L L. 531, 543–49 (2001) (noting that certain key features of the securities regulatory regime are subject to issuer choice).

¹⁵⁴ *See* de Fontenay, *supra* note 6 (arguing that the deregulation of private capital raising over the last few decades has contributed significantly to the decline in U.S. public companies); Ewens & Farre-Mensa, *supra* note 5, at 5467.

¹⁵⁵ *Id.* at 5467.

¹⁵⁶ *Id.* at 5468.

valued private firms choose to go or remain public—thus the observed decline in the share of public companies.¹⁵⁷ The remaining universe of public companies is smaller and older. In sum, the growth of private capital led to an issuer choice environment for firms because private market financing was a viable substitute for public markets financing; in this “new equilibrium,” fewer and older firms go public.¹⁵⁸

C. Firms Now Face Complex, Idiosyncratic Tradeoffs in Determining Whether to Be Public or Private

In this Section, we argue that the tradeoffs that private firms face in determining whether to go public (or that public firms face in contemplating going private) have become increasingly firm-specific and idiosyncratic. This is partly due to the diminishing importance of capital raising as the leading attraction of going public. Private firms can now raise enormous sums, funding growth that previously would have been possible only for public companies.¹⁵⁹ As importantly, however, successful private firms differ considerably along the other dimensions that empirical research suggests are important to firms’ going public decisions.

The going-public versus staying-private tradeoff facing firms becomes profoundly firm-specific because the principal attractions of being public are now many, distinct, and apply to firms heterogeneously. What may be a core attraction of going public for one large and successful private firm may be insignificant to another successful, growing private company.

For instance, a prominent survey of CFOs suggests that the most common reasons for firms to go public are to (1) create public stock for use in acquisitions, (2) establish a

¹⁵⁷ See de Fontenay, *supra* note 6 (arguing that the deregulation of private capital raising over the last few decades has contributed significantly to the decline in U.S. public companies); Ewens & Farre-Mensa, *supra* note 5, at 5467.

¹⁵⁸ *Id.* at 5467, 5498, 5506.

¹⁵⁹ *Id.* at 5466; BAUGUESS ET AL., *supra* note 7.

market stock price, and (3) enhance a firm's reputation.¹⁶⁰ Other commonly cited reasons for going public include allowing major pre-IPO investors to liquidate part or all of their ownership position.¹⁶¹ To motivate the idea that firms face idiosyncratic tradeoffs because the determinants of decisions to go public (or private) apply heterogeneously to them, consider a few illustrations.

While it may be surprising that a leading attraction of going public is creating an acquisition currency, evidence suggests that newly public firms are, on average, aggressive acquirers.¹⁶² IPOs are more common in industries with a high degree of M&A, but newly public firms also conduct far more acquisitions than private companies of similar size and maturity.¹⁶³ For instance, research in financial economics documents both that newly public firms are prolific acquirers and that the torrid pace of post-IPO firm acquisitions is due in part to the industries in which those firms are concentrated.¹⁶⁴

Conversely, Ewens and Farre-Mensa explore why firms choose to remain private.¹⁶⁵ They investigate a preference among founders for control, studying whether the size of founders' initial equity stake influences firms' later decisions

¹⁶⁰ James C. Brau & Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 J. FIN. 399, 407 tbl.II (2006). As an example of how reputation's importance may differ among firms, firms that make consumer-facing products would arguably benefit more from the additional publicity of being a public company than a firm that makes intermediate products in a supply chain.

¹⁶¹ *Id.*; MAUBOUSSIN & CALLAHAN, *supra* note 2, at 4.

¹⁶² See Ugur Celikyurt, Merih Sevilir & Anil Shivdasani, *Going Public to Acquire? The Acquisition Motive in IPOs*, 96 J. FIN. ECON. 345, 346 (2010).

¹⁶³ *Id.*

¹⁶⁴ *Id.* at 351 (“[A] substantial portion of the M&A activity of IPO firms is due to industry-level M&A activity, perhaps because firms go public to exploit industry-level M&A opportunities.”).

¹⁶⁵ Ewens & Farre-Mensa, *supra* note 5, at 5498–500; see also Brau & Fawcett, *supra* note 160, at 401 (separately researching why firms choose to remain private).

to go public.¹⁶⁶ Ewens and Farre-Mensa suggest that as founder control increases, founders use that control to delay or prevent startups' exit to public markets.¹⁶⁷ As part of this, they buttress the central point for our argument, which is that the size of founders' initial control stakes differs considerably across late-stage startups.¹⁶⁸

In a vein that cleaves closer to the original design of the federal securities laws, recent empirical evidence suggests that increasing the disclosure obligations imposed on *private* companies increases their propensity to *go public*.¹⁶⁹ In 2007, Congress passed the Food and Drug Administration Amendments Act (FDAAA).¹⁷⁰ The FDAAA requires all biopharmaceutical companies, whether private or public, to publicly disclose material information, including results, of all clinical trials in Phase II or further.¹⁷¹ Yet, the FDAAA does not simply automatically induce firms that are subject to it to go public, nor does it mechanically and uniformly increase the likelihood of subject firms going public. Instead, well-designed research exploring its effects finds that the FDAAA increases the propensity of subject firms to go public in *distinctively asymmetric* ways. Firms with an extensive drug development portfolio were significantly affected by the law and were much more likely to go public, and firms obviously differ significantly in this respect.¹⁷²

¹⁶⁶ Ewens & Farre-Mensa, *supra* note 5, at 5498–500; *see also* Brau & Fawcett, *supra* note 160, at 403 tbl.I, 422, 423 tbl.VIII, 424. Founders' initial equity stakes are obviously endogenous, but Ewens and Farre-Mensa employ a plausible instrumental variables approach based on exogenous variation in the supply of financing to address this issue. Ewens & Farre-Mensa, *supra* note 5, at 5498–500.

¹⁶⁷ *Id.* at 5502.

¹⁶⁸ *Id.* at 5494 fig.7, 5498–5502.

¹⁶⁹ Cyrus Aghamolla & Richard T. Thakor, *Do Mandatory Disclosure Requirements for Private Firms Increase the Propensity of Going Public?*, J. ACCT. RSCH., July 2021, at 4–5.

¹⁷⁰ Pub. L. 100-85, 121 Stat. 823 (2007)

¹⁷¹ *Id.* (codified in 42 U.S.C. § 282(j)(2)(A)) Aghamolla & Thakor, *supra* note 169, at 3 (discussing details of law).

¹⁷² Aghamolla & Thakor, *supra* note 169, at 4.

V. IMPLICATIONS OF THE NEW PUBLIC/PRIVATE EQUILIBRIUM

We have argued that two sets of developments in capital markets have undermined the coherency of the concept of public companies. One development has been the increasing complexity of the public and private market ecologies. The securities laws established important differences for public and private issuers, but alongside those necessitated by law, public and private markets now differ along a host of other important dimensions as well. A second development has been the growth of private capital markets, which has led to an issuer choice regime in which successful private firms can remain private indefinitely. A significant result of these changes is that firms now face a more complex calculus between going public and staying private that differs considerably from the tradeoff originally contemplated by the securities laws.¹⁷³

This is a descriptive picture, but it has implications for policy too. One implication of these changes for securities law is that the category of public companies makes *relatively* less sense. The reason for this lies in the issuer choice regime in which firms' decisions regarding whether to be public or private are driven by varied and different considerations. This change matters to securities regulation because its core rules impose mandatory regulations on public companies.

Consider the following way to rationalize the mandatory regulation of public companies. Defenders of the mandatory disclosure system imposed on public companies have sometimes argued that it mitigates the under-production of socially useful information by firms.¹⁷⁴ The logic runs thus:

¹⁷³ See *infra* Section IV.C.

¹⁷⁴ See Fox, *Issuer Choice*, *supra* note 26, at 568–71, 585–90. Other defenders of mandatory disclosure have focused on how it mitigates a specific set of market failures involving firms with dispersed ownership. This is a seemingly plausible way to rationalize the operating company divide whose triggers turn on the number of shareholders of record or on offering securities to the general public. For a powerful defense of mandatory disclosure along functional lines, see Guttentag, *supra* note 22;

Many parties benefit from the information revealed by firms through public disclosure, including that firm's investors, customers, suppliers, and competitors. Yet the firm itself only internalizes some of these benefits from the information it discloses. Thus, firms will under-produce information from a social perspective, if left to their own devices. The magnitude of these spillovers also might be thought to roughly track the size of a firm. Thus, a distinct regime of regulation should apply to large firms. This argument rationalizes the distinct treatment of "private" and "public" firms.¹⁷⁵

But the changes in capital markets that we sketch weaken the appeal of this view of the public/private divide. Why? Because as the reasons for going and staying public fragment, it becomes less likely that the underlying market failure targeted by the mandatory treatment is correlated with a firm being public. Returning to the previous paragraph, it becomes less likely that firms that produce important informational spillovers will happen to be public, rather than private. Of course, an issuer choice regime does not completely undermine the logic of the mandatory interventions imposed on a specific set of public companies. Public companies, on average, remain much older, larger, and more profitable than private companies. Our point is simply that an issuer choice regime, in which issuer choices are motivated by many and different factors, means that the firms that ultimately choose to become public are likely to have less in common.

As a result, if we want to continue to impose mandatory rules on public companies, it is worth reconsidering the triggers for when companies cross the public/private divide. Under the status quo—where the fundamental triggers for being public have given rise to an issuer choice regime, and where issuers' choices are driven by complex and heterogeneous features of public and private markets—the case for mandatory regulation of public companies has weakened. *If* the public/private tradeoff has become

Michael D. Guttentag, *Accuracy Enhancement, Agency Costs, and Disclosure Regulation*, 3 REV. L. & ECON. 611, 625–27 (2007).

¹⁷⁵ John C. Coffee, Jr. provided a powerful early defense of the United States' mandatory disclosure regime. Coffee, *supra* note 26.

profoundly idiosyncratic, then it makes mandatory regulation that turns on the *current* public/private divide less likely to be apt and less likely to be appropriately tailored to a market failure associated with that divide. It is worth emphasizing that we do not think this problem is fatal to the basic vision of public markets as subject to mandatory regulation, nor do we necessarily favor eliminating the mandatory regulation imposed on public markets.

But for these reasons we do conclude that the public/private divide in securities regulation is overdue for a fundamental reexamination. This rethinking must address not simply where to draw the line between public and private companies, but also whether to draw a line at all—and if so, on what basis—and how to regulate firms on each side of the divide. Crucially, these questions must be answered *simultaneously*—rather than serially as they often have been over the last several decades—considering the unavoidable connections between securities regulation and firms’ governance, capital structure, trading environment, and information environment. Viewed in that light, the task faced by Congress and the SEC in reassessing the public/private divide is even more difficult than we imagined.

VI. CONCLUSION

How the public/private divide works shapes the success of how we regulate public and private companies. While the original architecture of the divide was designed by securities law, two rich ecologies have developed around that legal design that cause public and private markets to differ along a host of dimensions. The broad availability of capital in private markets has created an issuer choice regime in which firms’ decisions regarding whether to be public or private are influenced in idiosyncratic ways by different aspects of these ecologies. The normative implication of these changes is to reduce the coherency of the regulation of public and private markets.