

## LEGAL GUARDRAILS FOR A UNICORN CRACKDOWN

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The Securities and Exchange Commission (SEC) is undertaking a historic effort to redraw the boundary between public and private companies.<sup>1</sup> After years of watching—and sometimes encouraging—the explosive growth in less tightly regulated private markets and the proliferation of so-called “unicorns,”<sup>2</sup> the agency is now reasserting its authority.

A key arrow in the agency’s regulatory quiver is its authority under section 12(g) of the Securities Exchange Act of 1934 (Exchange Act) to force private companies to “go public” when they reach a certain size. The provision requires any company whose shares are “held of record” by more than 2,000 persons to take on the obligations imposed by federal securities regulations on public companies, including extensive disclosure.<sup>3</sup> But today, this 2,000 shareholder trigger has no real constraining effect; because a single holder “of record” can easily (and often does) stand in for tens, hundreds, or even thousands of real beneficial owners, private companies can easily raise endless amounts of capital without tripping the threshold.<sup>4</sup>

Now, the SEC wants to close this loophole by mandating a “look-through” to the beneficial owners of the securities for purposes of the shareholder count.<sup>5</sup> The details remain to be seen, but the agency is apparently eager to significantly curtail the ability of private companies to grow outside of the regulatory scrutiny that accompanies public company status.

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1. See Allison Herren Lee, Comm’r, U.S. Sec. & Exch. Comm’n, *Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy* (Oct. 12, 2021).

2. Private startups with a market capitalization exceeding \$1 billion.

3. See Securities Exchange Act of 1934 § 12(g)(1), 15 U.S.C. § 78l(g)(1) (requiring registration by companies with “total assets exceeding \$10,000,000 and a class of equity security (other than an exempted security) held of record by either— (i) 2,000 persons, or (ii) 500 persons who are not accredited investors” (footnote omitted)).

4. See Lee, *supra* note 1.

5. *Id.*; Paul Kiernan, *SEC Pushes for More Transparency from Private Companies*, WALL ST. J. (Jan. 10, 2022, 6:00 PM), <https://www.wsj.com/articles/sec-pushes-for-more-transparency-from-private-companies-11641752489> [perma.cc/K5LH-AZQ2].

So far, it has been widely assumed that the SEC has the legal authority to do this and that new legislation isn't required. SEC Commissioner Allison Herren Lee claimed that it is "clear" that the SEC has legal authority to "require issuers to look through to beneficial owners" for purposes of section 12(g).<sup>6</sup> Donald Langevoort and Robert Thompson observed that the SEC "presumably" could modify the rule "to refer to beneficial ownership known or reasonably available to the issuer."<sup>7</sup> George Georgiev wrote that the SEC could implement this change "fairly easily by acting on its existing authority, without the need for additional congressional action" and that its authority to do this was "beyond question."<sup>8</sup> And a report from the Duke Global Financial Markets Center asserted that the "change can be made without legislation."<sup>9</sup>

The reality is more complicated. The text and legislative history of section 12(g) appear to indicate that the SEC may *not* redefine "held of record" as "beneficially held" and has only *limited* authority to mandate a look-through for purposes of the shareholder count.<sup>10</sup> If that's correct, the agency's authority under section 12(g) to fundamentally alter the public/private line without additional legislative authorization may be substantially constrained.<sup>11</sup>

This paper proceeds in five Parts. Part I provides a brief background on the rise of private markets and the SEC's budding efforts to reassert its authority in this domain. Part II examines the text and legislative history of section 12(g) and shows how Congress limited the agency's authority to mandate a look-through for purposes of the shareholder count. Part III considers various possible interpretations of the SEC's authority to mandate a look-through and shows that the more limited interpretations of this authority are the most reasonable. Part IV shows that the limited interpretations presented in Part III are also consistent with the small number of look-throughs previously authorized by the agency. Part V shows how these limited interpretations might significantly restrict the

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6. Lee, *supra* note 1.

7. Donald C. Langevoort & Robert B. Thompson, "Publicness" in *Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 359 n.97 (2013).

8. George S. Georgiev, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J.L. & BUS. 221, 294, 302 (2021).

9. TYLER GELLASCH & LEE REINERS, FROM LAGGARD TO LEADER: UPDATING THE SECURITIES REGULATORY FRAMEWORK TO BETTER MEET THE NEEDS OF INVESTORS AND SOCIETY 11 (2021), <https://web.law.duke.edu/sites/default/files/centers/gfmc/From-Laggard-to-Leader.pdf> [perma.cc/3WN4-FGCX].

10. See *infra* Part II.

11. I am solely focused here on the *legality* of the SEC's plans to invoke section 12(g) to force large private companies to go public. I have analyzed the costs and benefits elsewhere. See Alexander I. Platt, *Unicorniphobia*, HARV. BUS. L. REV. (forthcoming 2022), <https://ssrn.com/abstract=3915793> [perma.cc/XC6P-CZR9]. I focus only on section 12(g) and do not address other components of the SEC's private market agenda. And I do not focus on the closely related effects of this proposed change in limiting the ability of *public* companies to "go dark." See Lee, *supra* note 1.

agency's ability to fundamentally redraw the lines between public and private companies.<sup>12</sup>

### I. BACKGROUND<sup>13</sup>

Traditionally, a company that reached a certain size would “go public”—conduct an IPO, begin making periodic disclosures, perhaps list its securities on a national stock exchange, and take on all the trappings of a “public company” under the federal securities laws.

Times have changed. Due to a constellation of legislative,<sup>14</sup> regulatory,<sup>15</sup> institutional,<sup>16</sup> and market developments,<sup>17</sup> private startups are now able to raise massive amounts of capital without resorting to public capital markets, and so they may defer taking on the full weight of federal securities regulation. Not so long ago, it was rare enough for a private company to achieve a billion-dollar valuation to warrant the nickname

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12. To my knowledge, this is the first sustained analysis of the SEC's look-through authority under section 12(g). But some others have registered doubts about the SEC's proposal. Hester M. Peirce & Elad L. Roisman, Comm'rs, U.S. Sec. & Exch. Comm'n, *Falling Further Back—Statement on Chair Gensler's Regulatory Agenda* (Dec. 13, 2021) (suggesting that the proposal “may . . . contradict the express will of Congress”); John C. Coffee, Jr., *Climate-Risk Disclosures and “Dirty Energy” Transfers: “Progress” Through Evasion*, COLUM. L. SCH.: CLS BLUE SKY BLOG (Jan. 25, 2022), <https://clsbluesky.law.columbia.edu/2022/01/25/climate-risk-disclosures-and-dirty-energy-transfers-progress-through-evasion> [perma.cc/3LQL-XRFQ] (suggesting, in passing, that the proposal amounts to “effectively reversing the JOBS Act without new legislation, and this seems legally vulnerable”).

13. For a deeper overview, see Georgiev, *supra* note 8.

14. For instance, the JOBS Act of 2012 encouraged private market expansion by raising the section 12(g) shareholder count threshold from 500 to 2,000 and by declining to explicitly authorize the SEC to substitute “beneficial” for “record” holders. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 501, 126 Stat. 306, 325 (2012); *see infra* Part II.

15. For instance, the SEC has loosened restrictions on who may invest in private companies and relaxed the rules governing how private companies raise capital. *E.g.*, Accredited Investor Definition, 85 Fed. Reg. 64,234, 64,273 (Oct. 9, 2020) (to be codified at 17 C.F.R. pts. 230, 240); Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3,496, 3,556 (Jan. 14, 2021) (to be codified at 17 C.F.R. pts. 227, 229, 230, 239, 240, 249, 270, 274); *see also* Lee, *supra* note 1 at n.6 (listing SEC actions contributing to private market expansion); Abraham J.B. Cable, *Fool's Gold? Equity Compensation & the Mature Startup*, 11 VA. L. & BUS. REV. 613 (2017) (discussing the role of changing rules governing equity compensation in facilitating private market expansion).

16. For instance, accredited investors may now buy and sell private company securities on several markets. *See* Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 175 (2017).

17. For instance, hedge funds, sovereign wealth funds, mutual funds, banks, and others have grown increasingly interested in investing alongside traditional venture capital funds in late-stage private ventures. *Id.* at 173.

“unicorn.”<sup>18</sup> Today, there are at least 1,000 such companies globally,<sup>19</sup> nearly half of which are U.S.-based.<sup>20</sup>

This explosive growth of private markets, and high-profile scandals at unicorns like Uber and Theranos, provoked a torrent of criticism from the legal academy.<sup>21</sup> And, immediately following Joe Biden’s election and his appointment of Gary Gensler as SEC chair, the SEC began sending clear signals that it was sympathetic to these criticisms and planned to take action.

A key early signal was the appointment of one of the leading academic unicorn critics to a senior leadership position at the agency. Back in 2017, Renee Jones published a scathing critique entitled “The Unicorn Governance Trap,” calling for the imposition of mandatory disclosure on any company with a market capitalization above thirty-five million dollars and more than one hundred beneficial owners unless they maintained strict restrictions on the transfer of their shares.<sup>22</sup> In 2019, she raised these concerns in her testimony before the House Financial Services Committee and called on Congress to reduce the section 12(g) shareholder trigger from 2,000 back down to 500 (as it was before 2012).<sup>23</sup> When she was appointed to lead the SEC’s Division of Corporation Finance in June 2021, the *Wall Street Journal*’s headline read: “SEC

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18. Aileen Lee, *Welcome to the Unicorn Club: Learning from Billion-Dollar Startups*, TECHCRUNCH (Nov. 2, 2013, 10:00 AM), <https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club> [perma.cc/84QR-53Q3].

19. *The Complete List of Unicorn Companies*, CB INSIGHTS, <https://www.cbinsights.com/research-unicorn-companies> [perma.cc/EWS3-B85].

20. Georgiev, *supra* note 8, at 227 fig.1.

21. See Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583 (2016); Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165 (2017); Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. REG. 499 (2020); Verity Winship, *Private Company Fraud*, 54 U.C. DAVIS L. REV. 663 (2020); Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353 (2020); Matthew Wansley, *Taming Unicorns*, 97 IND. L.J. 1203 (2022); Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did “We” Not Work?*, 99 TEX. L. REV. 1347 (2021); Amy Deen Westbrook, *We(re) Working on Corporate Governance: Stakeholder Vulnerability in Unicorn Companies*, 23 U. PA. J. BUS. L. 505 (2021); George S. Georgiev, *The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J.L. & BUS. 221, (2021); see also Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445 (2017); 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 (2013); Usha R. Rodrigues, *The Once and Future Irrelevancy of Section 12(g)*, 2015 U. ILL. L. REV. 1529 (2015).

22. Jones, *supra* note 16, at 184.

23. *Hearing Before the Subcomm. on Inv. Prot., Entrepreneurship, & Cap. Mkts of the H. Fin. Servs. Comm.*, 116th Cong. (2019) (written statement of Renee M. Jones, Professor of Law and Associate Dean for Academic Affairs, Boston College Law School).

Picks Professor Who Criticized Startup ‘Unicorns’ as Top Corporate Regulator.”<sup>24</sup>

The next signal came in October 2021, when Democratic Commissioner Lee delivered public remarks embracing the academic criticisms that private markets had grown too large and calling for the reassertion of SEC’s role in this domain.<sup>25</sup> Lee explained that the “explosive growth of private markets” was “[p]erhaps the single most significant development in securities markets in the new millennium.”<sup>26</sup> Lee focused particular skepticism on unicorns, which are large enough to “have a dramatic and lasting impact on our economy” all the while leaving investors, policymakers, and the public knowing “relatively little about them compared to their public counterparts.”<sup>27</sup>

Lee emphasized the high stakes of the current moment, analogizing to two of the most significant episodes in securities regulation history. First, she compared the present moment to the early 1930s, when Congress responded to the crash of 1929 and the Great Depression by creating the SEC and the mandatory disclosure regime. She also analogized to the early 1960s, when Congress introduced section 12(g) and brought larger over-the-counter companies under this regime.<sup>28</sup>

Most importantly, Lee also identified the main regulatory remedy: redefining the way issuers count shareholders “of record” for purposes of section 12(g).<sup>29</sup> Lee explained that it was “clear” the Commission has legal authority to “require issuers to look through to beneficial owners.”<sup>30</sup> And she concluded her remarks by calling on issuers to “look through to the actual investors whose economic well-being is at stake, including looking beyond street name accounts held at brokers and banks, as well as potentially looking through special purpose vehicles and partnerships.”<sup>31</sup>

In January 2022, the *Wall Street Journal* reported that the SEC was gearing up to propose a change to its interpretation of “held of record” in order to “push large, private companies into the same disclosure regime that their publicly traded counterparts face.”<sup>32</sup> The article noted that the

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24. Dave Michaels, *SEC Picks Professor Who Criticized Startup ‘Unicorns’ as Top Corporate Regulator*, WALL ST. J. (June 14, 2021, 4:51 PM), <https://www.wsj.com/articles/sec-hires-boston-college-professor-as-top-corporate-regulator-11623686494> [perma.cc/P9MH-Y4MM].

25. Lee, *supra* note 1 at nn.11, 12, 21, 22, 30 & 77 (citing papers by law professors Renee M. Jones, Elisabeth de Fontenay, Jennifer S. Fan, Ann M. Lipton, Verity Winship, and Elizabeth Pollman, among others).

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. Kiernan, *supra* note 5.

proposal was still at an “early stage” but noted that the SEC might, for instance, decide to “count the number of people investing through a venture-capital fund or private-equity fund” towards the 2,000 shareholder limit.<sup>33</sup>

## II. CONGRESS LIMITED THE SEC’S LOOK-THROUGH AUTHORITY

Section 12(g)(5) authorizes the SEC to redefine the term “held of record” “as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions of this subsection.”<sup>34</sup> Conventional wisdom is that this provision gives the agency extremely broad powers to mandate a look-through for purposes of the shareholder count, up to and including the *ultimate* look-through: redefining the term “held of record” as “beneficially owned.”<sup>35</sup>

This Part challenges this conventional wisdom through a close analysis of the statute’s text and legislative history. Section A shows that the text of the Exchange Act reveals a scheme that distinguishes between different types of legal interest in securities—focusing on “beneficial” owners in some provisions and holders “of record” in others. Under well-recognized principles of statutory interpretation, courts will interpret

33. *Id.* Since this article was first posted on SSRN in February 2022, three signals indicate the SEC may be backing down.

*First*, Commissioner Lee announced that she would be stepping down at the end of her term in June 2022 upon the confirmation of her replacement. Allison Herren Lee, *Statement on Planned Departure from the Commission*, U.S. SEC. & EXCH. COMM’N (Mar. 15, 2022), <https://www.sec.gov/news/statement/lee-20220315> [perma.cc/999H-HL2S]. Lee’s replacement was confirmed by the Senate in June. See Lydia Beyoud, *Senate Confirms Uyeda and Lizarraga to Open SEC Commission Slots*, BLOOMBERGLAW (June 16, 2022), <https://news.bloomberglaw.com/securities-law/senate-confirms-uyeda-and-lizarraga-to-open-sec-commission-slots> [perma.cc/Q4YH-ATHU].

*Second*, the agency’s climate disclosure proposal threw cold water on key premises underlying the call for redrawing the public-private line. The proposal considered the possibility that high compliance costs associated with the new climate disclosure rules “could influence the marginal firm’s decision to . . . refrain from going public . . . in order to circumvent the disclosure requirements”; however, the proposal concluded that “it is unlikely that a significant number of firms would pursue this avoidance strategy given that it would come with significant disadvantages, such as higher costs of capital, limited access to capital markets, and limits to their growth potential.” The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334, 21,448 (Apr. 11, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, 249).

*Third*, Democratic Commissioner Caroline A. Crenshaw delivered a speech in which she mentioned, but conspicuously failed to endorse, the section 12(g) proposal and instead asked “to hear from the academic community on that proposal.” Caroline A. Crenshaw, Comm’r, Grading the Regulators and Homework for the Teachers: Remarks at Symposium on Private Firms: Reporting, Financing, and the Aggregate Economy at the University of Chicago Booth School of Business (Apr. 14, 2022).

34. Securities Exchange Act of 1934 § 12(g)(5), 15 U.S.C. § 78l(g)(5).

35. See *supra* Introduction & Part I.

Congress's choice to use "held of record" in section 12(g) as a deliberate and intentional choice *not* to use "beneficial owner." Section B examines the legislative history of the Jumpstart Our Business Startups Act of 2012 (JOBS Act)—which raised the shareholder count trigger from 500 to 2,000—and shows that Congress repeatedly declined to authorize the SEC to redefine "held of record" as "beneficially held." Finally, Section C looks back at the legislative history of the 1964 Act that added section 12(g) and shows, again, that Congress's choice of "held of record" was a deliberate rejection of "beneficially owned."

#### A. *The Text of the Exchange Act*

Like other kinds of property, securities "ownership" is comprised of various distinct legal interests that may be allocated to different parties.<sup>36</sup> The Exchange Act reflects the heterogeneous nature of securities ownership, imposing distinct rules and obligations depending on the specific nature of a person's property interest in securities. Specifically, the Act distinguishes between "record" and "beneficial" ownership of securities.<sup>37</sup>

*Shareholders "of record"*: Several provisions of the Exchange Act focus on holders "of record." Section 12(g), for example, requires registration by issuers with more than ten million dollars in assets if their securities are "held of record by either— (i) 2,000 persons, or (ii) 500 persons who are not accredited investors."<sup>38</sup> Similarly, section 12(b) provides that an issuer may register a security on a national securities exchange by filing an application that contains certain information regarding "each security holder of record holding more than 10 per centum of any class of any equity security of the issuer (other than an exempted security)."<sup>39</sup> And section 14(c) requires issuers to transmit certain proxy information to "all holders of record" prior to any annual meeting.<sup>40</sup>

*Beneficial Owners*: Other provisions of the Exchange Act focus on the "beneficial" owners of securities. For instance, section 16 requires certain disclosures by "[e]very person who is directly or indirectly the beneficial owner of more than 10 percent" of any class of registered securities.<sup>41</sup> Two subsections of section 12—including one within section 12(g) itself—are keyed to section 16's reference to "beneficial owners."<sup>42</sup>

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36. Armen A. Alchian, *Some Economics of Property Rights*, in 30 IL POLITICO 816 (1965).

37. Cf. SEC Staff Legal Bulletin No. 14F (CF) (Oct. 18, 2011) ("There are two types of security holders in the U.S.: registered owners and beneficial owners.").

38. § 12(g)(1).

39. *Id.* § 12(b)(1)(D).

40. *Id.* § 14(c).

41. *Id.* § 16(a)(1).

42. *Id.* §§ 12(g)(2)(G)(iii), 12(h).

Similarly, sections 13(d) and (g) require certain disclosures by persons who become “directly or indirectly the beneficial owner of more than 5 per centum” of any class of registered securities.<sup>43</sup> Section 14(d) requires that persons making tender offers provide certain filings and disclosures if, “after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class.”<sup>44</sup> And section 9(a) makes it unlawful to create a false or misleading appearance of active trading in a security by effecting “any transaction in such security which involves no change in the beneficial ownership thereof.”<sup>45</sup>

The Supreme Court has repeatedly instructed that, “[w]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.”<sup>46</sup> The Court has applied this principle in interpreting the Exchange Act,<sup>47</sup> and the SEC itself has also invoked this principle when construing its own authority.<sup>48</sup> Accordingly, section 12(g)’s use of shareholders “of record” as the metric for triggering mandatory registration may be best interpreted as a purposeful decision not to use “beneficial owners.”

#### B. *The Legislative History of the JOBS Act*

Democrats in Congress tried and failed no fewer than *four* times to add a provision to the JOBS Act that would have explicitly authorized the SEC to redefine “held of record” as “beneficially owned.” Where Congress has “considered and rejected [a] ‘precise issue,’” at least some courts will defer to this legislative decision.<sup>49</sup>

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43. *Id.* §§ 13(d)(1), 13(g)(1).

44. *Id.* § 14(d)(1).

45. *Id.* § 9(a)(1)(A). For an additional example of explicit reference to “beneficial owner[ship]” in the statute, see *id.* § 6(b)(10)(A).

46. *E.g.*, *Salinas v. U.S. R.R. Ret. Bd.*, 141 S. Ct. 691, 698 (2021) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)).

47. *E.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 207–10 (1976) (declining to construe section 10(b) of the Exchange Act as impliedly imposing liability for mere negligence where other provisions of the securities laws provided expressly for such liability).

48. *In re Mphase Techs., Inc.*, Admin. Proc. File No. 3-1513, Release No. 74187 (Feb. 2, 2015).

49. *Rapanos v. United States*, 547 U.S. 715, 750 (2006) (emphasis omitted) (quoting *Bob Jones Univ. v. United States*, 461 U.S. 574, 600 (1983)); *accord Michigan v. Bay Mills Indian Cmty.*, 572 U.S. 782, 801–02 (2014); *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 144 (2000). *But see, e.g.*, *Pension Benefit Guaranty Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990).



### 1. The First Failed Effort

At an October 2011 House Financial Services Committee markup of a bill raising the section 12(g) investor threshold, Democratic Representative Mike Capuano proposed an amendment that would have substituted “beneficial holder” for “holder of record” and specifically required the SEC to revise the definition of “beneficial holder” to include shareholders invested in a “special purpose vehicle.”<sup>50</sup> Capuano explained that “effectively we have a loophole in the law that . . . provides an opportunity to have an unlimited number of investors without any public documentation, and that’s the broker-dealer exception, and now an exception . . . has been recently created, called a ‘special purpose vehicle.’”<sup>51</sup> Capuano complained that under current law, “[t]here are no limits on what the special purpose vehicles can do. They operate completely in the dark.”<sup>52</sup> When asked by the Committee Chair, “for the purposes of the law, a single special purpose vehicle is one investor, right?” Capuano responded, “[t]hat’s what I’m trying to change.”<sup>53</sup> When Republican Representative Steve Stivers protested that Capuano’s amendment would “legislate[] the change” rather than leaving it in the SEC’s hands, Ranking Member Barney Frank proposed an alternative version that would simply “make it explicit that the SEC has the power” to make the changes, removing any possible “ambiguity.”<sup>54</sup> Capuano withdrew the amendment before the end of the markup hearing.

### 2. The Second Failed Effort

A few months later, in March 2012, a bill raising the section 12(g) threshold was on the floor of the House, and the House considered two rival amendments back-to-back, ordering the SEC to study the issue of defining record ownership for purposes of section 12(g). The first one, sponsored by Republican Representative David Schweikert, called on the agency to conduct a study to “determine if new enforcement tools are needed to enforce the anti-evasion provision” and “transmit its recommendations to Congress.”<sup>55</sup> The second, sponsored by Capuano, called on the agency to conduct a study to determine whether the term “held of record” should be changed “to mean the beneficial owner of the security” and further require the Commission to make such a change, if the study

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50. H.R. REP. NO. 112-327, at 4 (2011).

51. *Private Company Flexibility and Growth Act: Markup Hearing on H.R. 2167 Before the H. Comm. on Fin. Servs.*, 112th Cong. 8 (2011) [hereinafter *Markup Hearing*].

52. *Id.* at 9.

53. *Id.* at 10.

54. *Id.* at 17.

55. 158 CONG. REC. 3163 (2012).

concluded that such a change was “necessary and appropriate in the public interest and for the protection of investors.”<sup>56</sup>

During the debate over the rival proposals, Schweikert initially stated that his amendment “has the SEC stand up and say yes, they have the authority, or no, they don’t, and then transmit that back to us in the committee.”<sup>57</sup> When asked by Capuano whether he agreed that “the SEC is currently empowered to take these actions on their own without congressional approval,” Schweikert initially confessed, “I actually do,”<sup>58</sup> but pivoted to emphasize that “I also believe you and I and all of us in this body are responsible for the ultimate policy, that this policy should be coming back before us, particularly those in the Financial Services Committee, because we’re going to also see it as it ties into this whole package of legislation, but also other moving parts out there.”<sup>59</sup> Schweikert explained that, for this reason, he preferred his own amendment over Capuano’s because it ensured that “we’re also going to be the ones also touching it.”<sup>60</sup> And, to close the debate, Schweikert reiterated that “we also want this brought back to us if the SEC does see an issue. That’s the proper venue.”<sup>61</sup> The House adopted Schweikert’s amendment,<sup>62</sup> rejected Capuano’s,<sup>63</sup> and went on to pass the bill as amended.<sup>64</sup>

### 3. The Third Failed Effort

In March 2012, after the House had passed the bill and before the Senate took it up, Senate Democrats offered a substitute bill that would have required the SEC to “revise the definition of the term ‘held of record’ pursuant to section 12(g)(5) . . . to include beneficial owners.”<sup>65</sup> Democratic Senator Jack Reed urged adoption of the substitute, arguing that the House bill failed to “deal[] with the so-called beneficial owners problem.”<sup>66</sup>

The next day, Democratic SEC Commissioner Luis Aguilar delivered a public statement criticizing the House bill, noting that it would enable

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56. *Id.* at 3164.

57. *Id.*

58. *Id.*

59. *Id.* at 3165.

60. *Id.*

61. *Id.*

62. *Id.* at 3164.

63. *Id.* at 3165.

64. *Id.* at 3172–73. The SEC completed the study but did not address whether it possessed authority to redefine “held of record” as “beneficial investor.” U.S. SEC. & EXCH. COMM’N, REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12G5-1 AND SUBSECTION (B)(3) (2012), <https://www.sec.gov/files/authority-to-enforce-rule-12g5-1.pdf> [perma.cc/5L4K-3VHH].

65. 158 CONG. REC. 3543 (2012).

66. *Id.* at 3502–03.

many companies to avoid public disclosure because “the reporting threshold only counts records holders, excluding the potentially unlimited number of beneficial owners who hold their shares in ‘street name’ with banks and brokerage companies, and thus are not considered record holders.”<sup>67</sup>

As debate continued in the Senate, Reed continued to promote the substitute, arguing, “we believe the holder of record actually needs to be the beneficial owner of the security.”<sup>68</sup> Democratic Senator Carl Levin similarly explained that the substitute “eliminate[s] a loophole that allows one shareholder to hold shares for many beneficial owners by clarifying . . . that when determining whether a stock is widely enough held to trigger the disclosure requirements, what counts is beneficial owners, not just owners of record.”<sup>69</sup> The substitute was rejected by the Senate.<sup>70</sup>

#### 4. The Fourth Failed Effort

Finally, the Senate took up the House Bill. The Democrats tried one last time, offering an amendment that would have again required the SEC to “revise the definition of the term ‘held of record’ pursuant to section 12(g)(5) . . . to include beneficial owners.”<sup>71</sup> Majority Leader Harry Reid stated that the amendment would “stop businesses from gaming the system and avoiding oversight by hiding thousands—or maybe tens of thousands—of investors.”<sup>72</sup> Reed explained that the amendment was needed because “[t]he House legislation would allow many companies with a substantial number of beneficial shareholders . . . to remain dark.”<sup>73</sup> Levin explained that this amendment “close[d] [an] important loophole[] in the current law—one the House bill fails to address” by making it “harder to evade registration and disclosure requirements by using shareholders of record who exist only on paper but who hold shares for large numbers of actual beneficial owners.”<sup>74</sup>

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67. Luis A. Aguilar, *Investor Protection Is Needed for True Capital Formation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 25, 2012), <https://corpgov.law.harvard.edu/2012/03/25/investor-protection-is-needed-for-true-capital-formation> [perma.cc/BAU5-QVMK].

68. 158 CONG. REC. 3561 (2012).

69. *Id.* at 3575.

70. *Id.* at 3671.

71. *Id.* at 3764.

72. *Id.* at 3765.

73. *Id.* at 3769.

74. *Id.* at 3986.

The amendment failed.<sup>75</sup> The Senate passed the bill with an unrelated amendment,<sup>76</sup> which the House promptly agreed to,<sup>77</sup> and President Obama signed the bill into law.

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This history is best interpreted as evidence that Congress decided not to authorize the SEC to make this change.

*First*, at the earliest hearing on the issue, Capuano and Frank both made statements on the record indicating they doubted whether the SEC currently had this authority.<sup>78</sup> Although Capuano would later reverse himself—stating on the House Floor that his amendment was merely clarifying and that the SEC already had the authority—his initial statements tend to undercut those later ones. When he later reversed his legal views on the House Floor, Capuano admitted that he was “just trying to build the record.”<sup>79</sup>

*Second*, Aguilar’s warning that the House bill failed to address the “record holder” issue is essential context for the Senate Democrats’ efforts to add explicit authorization to the statute—and for the Senate’s ultimate rejection of these efforts.

*Third*, Schweikert’s exchange with Capuano on the House Floor indicates that Section 504 of the JOBS Act was designed to retain for Congress the exclusive right to authorize the redefinition of “held of record” as “beneficially owned.” That section required the SEC to “examine its authority to enforce Rule 12g5-1 to determine if new enforcement tools are needed to enforce the anti-evasion provision contained in subsection (b)(3) of the rule.”<sup>80</sup> In arguing for this provision and against Capuano’s, Schweikert specifically stated that his version would require the SEC to come back to Congress rather than acting alone. Congress chose Schweikert’s version and rejected Capuano’s. And although the SEC did issue a report under this provision, the report was silent on this topic.

To be sure, the legislative record is not one-sided. The SEC’s Director of Corporation Finance gave testimony that could be construed as asserting that the SEC possessed the requisite authority.<sup>81</sup> And, as noted above, some legislators took care in making a record that, even if their language explicitly authorizing the SEC to do this was excluded (as it was), the SEC

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75. *Id.* at 3999.

76. *Id.* at 3999–4000.

77. *Id.* at 4142–43.

78. *See supra* Part II.B.1.

79. 158 CONG. REC. 3165 (2012).

80. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 504, 126 Stat. 306, 326 (2012).

81. *Spurring Job Growth Through Capital Formation While Protecting Investors- Part I: Hearing Before the S. Comm. on Banking, Hous., & Urb. Affs.*, 112th Cong. 39 (2011) [hereinafter *Spurring Job Growth I*] (statement of Meredith Cross, Director, Division of Corporation Finance, Securities and Exchange Commission).

still would have this power. Still, there is serious evidence that Congress intended to restrict the SEC's authority in this domain.

#### 5. Congress' Awareness of Changes in Record Ownership

Lee attempts to justify the need for dramatic regulatory action on the fact that "ownership in the securities markets has undergone a fundamental shift since the 1960s" because "[t]oday, almost no one holds shares in record name."<sup>82</sup> She argues for recalibrating "the way issuers must count shareholders of record under Section 12(g) (and Rule 12g5-1) in order to hew more closely to the intent of Congress and the Commission in requiring issuers to count shareholders to begin with."<sup>83</sup>

But in 2011 and 2012, Congress was very much aware of these changes and nonetheless decided to *raise* the shareholder threshold from 500 to 2,000 and declined to authorize the SEC to swap in "beneficial" for "record" ownership for purposes of this count. Not only was there substantial testimony regarding these changes from the SEC,<sup>84</sup> academics,<sup>85</sup> industry,<sup>86</sup> and interest groups,<sup>87</sup> many Representatives themselves acknowledged these changes in their own remarks.<sup>88</sup>

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82. Lee, *supra* note 1.

83. *Id.*

84. *E.g.*, *Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation: Hearing Before the Subcomm. on Cap. Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 112th Cong. 70–71 (2011) [hereinafter *Legislative Proposals*] (statement of Meredith B. Cross, Director, Division of Corporation Finance, Securities and Exchange Commission); *Spurring Job Growth I*, *supra* note 81, at 50 (statement of Meredith Cross, Director, Division of Corporation Finance, Securities and Exchange Commission).

85. *E.g.*, *Spurring Job Growth I*, *supra* note 81, at 14 (statement of John C. Coffee, Jr., Professor of Law, Columbia University Law School); *Examining Investor Risks in Capital Raising: Hearing Before the Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Hous., and Urb. Affs.*, 112th Cong. 36 (2011) [hereinafter *Examining Investor Risks*] (statement of John Coates, Professor, Harvard Law School); *Spurring Job Growth Through Capital Formation While Protecting Investors- Part II: Hearing Before the S. Comm. on Banking, Hous., and Urb. Affs.*, 112th Cong. 43 (2012) [hereinafter *Spurring Job Growth II*] (statement of Jay Ritter, Professor of Finance, University of Florida).

86. *E.g.*, *Examining Investor Risks*, *supra* note 85, at 9 (2011) (statement of Barry E. Silbert, Founder and Chief Executive Officer, SecondMarket, Inc.).

87. *E.g.*, *Spurring Job Growth II*, *supra* note 85, at 111 (statement of Americans for Financial Reform).

88. *Spurring Job Growth I*, *supra* note 81, at 21 (statement of Tim Johnson, Chairman, Comm. on Banking, Hous., and Urb. Affs.); *Markup Hearing*, *supra* note 51 (statements of Rep. Jim Himes); *Spurring Job Growth I*, *supra* note 81, at 83 (statement of Sen. Carl Levin); *Spurring Job Growth I*, *supra* note 81, at 34–35 (statement of Sen. Robert Menendez); *Examining Investor Risks*, *supra* note 85, at 25 (statement of Sen. Jack Reed, Chairman, S. Subcomm. on Sec., Ins. & Inv.).

C. *The Text and Legislative History of the 1964 Securities Act Amendments*

Just like the Exchange Act as a whole, the 1964 Securities Act Amendments (1964 Act), which introduced section 12(g), distinguished between “holders of record” and “beneficial owners.”

*Holders of Record:* Several provisions added in 1964 focused on holders “of record.” Section 3(c) of the Act added new subsection (g) to section 12, which mandated registration for issuers with assets exceeding \$1,000,000 “and a class of equity security . . . held of record by five hundred or more persons.”<sup>89</sup> And section 5(c) added a new subsection (c) to section 14 requiring certain proxy filings and disclosures ahead of annual meetings to “all holders of record.”<sup>90</sup>

*Beneficial Owner:* Other parts of the 1964 Act focused on beneficial owners. Section 8(a) amended section 16(a) to require certain disclosures by “[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of equity security.”<sup>91</sup> Several parts of the Act were keyed to this provision’s focus on “beneficial” shareholders. For instance, section 3(c)—the same provision that added the new section 12(g) requirement—also exempted certain insurance companies from that requirement if “the purchase and sales of securities issued by such insurance company by beneficial owners . . . are subject to regulation (including reporting) by its domiciliary State.”<sup>92</sup> And section 3(d) added new subsection (h) to section 12, providing that the SEC could, under certain circumstances, “exempt from section 16 any . . . beneficial owner of securities of any issuer.”<sup>93</sup>

Once again, well-established principles of statutory interpretation suggest that the right inference to draw here is that the choice to use “record holder” in section 12(g) was a deliberate and intentional choice *not* to use “beneficial owner.”<sup>94</sup>

Legislative history of the 1964 Act provides further support. Although Lee emphasizes the SEC’s 1963 “Special Study” as the source of the section 12(g) proposal,<sup>95</sup> the SEC had been proposing similar language to be added to the statute as section 12(g) for decades.<sup>96</sup> Critically, several

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89. Act of Aug. 20, 1964, Pub. L. No. 88-467, sec. 3(c), § 12(g), 78 Stat. 565, 566–67 (1964).

90. *Id.* sec. 5(c), § 14(c).

91. *Id.* sec. 8(a), § 16(a).

92. *Id.* sec. 3(c), § 12(g).

93. *Id.* sec. 3(d), § 12(h).

94. *See supra* notes 47–49.

95. Lee, *supra* note 1.

96. Langevoort & Thompson, *supra* note 7, at 344–45, 345 n.27; Guttentag, *supra* note 21, at 166.

earlier proposed iterations of section 12(g) had used a version of “beneficial” rather than “record” ownership for the shareholder count; they would have mandated registration for all companies except those whose securities were “held *directly or indirectly* by fewer than three hundred persons.”<sup>97</sup> In 1963, the SEC explained that it settled on “record” ownership instead of “beneficial” ownership for this proposed legislation because “[i]ssuers generally cannot readily ascertain the number of beneficial owners of securities, held by broker-dealers in street name and by banks or other nominees, for the purpose of determining the number of record holders of a class of equity security.”<sup>98</sup>

Again, this is evidence that Congress’ decision to use “record” ownership was, at the same time, a deliberate choice *not* to use “beneficial” ownership.<sup>99</sup>

### III. REINTERPRETING THE SEC’S LOOK-THROUGH AUTHORITY

Section 12(g)(5) provides that “[t]he Commission may for the purpose of this subsection define by rules and regulations the terms “total assets” and “held of record” as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions of this subsection.” Read in isolation, this language appears to grant the SEC broad authority to bring more companies into registration by redefining “held of record.” But the full statutory context of the provision and its legislative history (reviewed above) seem to indicate that Congress repeatedly and deliberately attempted to *limit* the SEC’s authority to mandate a look-through for purposes of the shareholder count.

This Part presents six possible interpretations of the SEC’s look-through authority: three broad and three limited, arranged roughly from broadest to narrowest. After reviewing each of these options, it concludes that the more limited interpretations of the SEC’s look-through authority are the most plausible constructions.

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97. *Securities Exchange Act Amendments: Hearing on S. 2408 Before a Subcomm. of the Comm. on Banking & Currency*, 81st Cong. 1 (1950) (emphasis added); see also *Stock Market Study: Regulation of Unlisted Securities: Hearing Before a Subcomm. of the S. Comm. on Banking & Currency*, 84th Cong. 1024 (1955) (similar).

98. *SEC Legislation, 1963: Hearing on S. 1642 Before a Subcomm. of the S. Comm. on Banking and Currency*, 88th Cong. 395 (1963) [hereinafter *SEC Legislation, 1963*].

99. Lee points to rulemaking petitions on this issue as support for the legality of her proposal. Lee, *supra* note 1. But one of these petitioners may have been unsure as to whether the SEC had authority to proceed. Compare Letter from Lawrence J. Goldstein to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Feb. 25, 2009), <https://www.sec.gov/rules/petitions/2009/petn4-483supp.pdf> [perma.cc/K33R-V4A4] (suggesting the SEC make the change to section 12(g)), with Letter from Lawrence J. Goldstein to Richard Breedon, Chairman, Sec. & Exch. Comm’n (Mar. 28, 1990) <https://www.sec.gov/rules/petitions/2009/petn4-483supp.pdf> [perma.cc/K33R-V4A4] (suggesting that the SEC recommend Congress change section 12(g)).

### A. Broad Interpretations

#### 1. Look-Throughs Deemed "Necessary"

The sentence's two "ors" can be read as splitting the sentence into three alternative criteria for agency action. The provision would authorize the SEC to adopt any definition (1) "necessary," (2) "appropriate in the public interest," or (3) "for the protection of investors in order to prevent circumvention of the provisions of this subsection." This would authorize *any* change in the definition of "held of record" that the SEC deems "necessary," essentially stripping away all limits on the SEC's authority to mandate look-throughs.<sup>100</sup>

#### 2. Look-Throughs in the "Public Interest"

The next broadest definition would read only the second "or" as splitting the sentence into two criteria and the first "or" as merely sub-dividing the first criteria.<sup>101</sup> Now, the SEC could adopt any definition of "held of record" that it deems (1) "necessary or appropriate in the public interest" or (2) "for the protection of investors in order to prevent circumvention of the provisions of this subsection."

Under this interpretation, the SEC's authority to mandate look-throughs would still be virtually limitless. For instance, if there is a general public interest in making more companies go public,<sup>102</sup> this interpretation would authorize the SEC to adopt *any* look-throughs to cause more companies to go (or stay) public.

#### 3. Look-Throughs To "Prevent Circumvention" of Section 12(g)

A narrower interpretation would read the anti-circumvention language at the end of section 12(g)(5) as applying to *each* of the three criteria expressed in the first half of the sentence, rather than only the final one (as the prior two interpretations did). On this view, the SEC may be empowered to redefine "held of record" *only* to prevent circumvention of the statute.

This reading finds support in the fact that the full phrase "necessary or appropriate in the public interest or for the protection of investors," which immediately precedes the anti-circumvention language, appears *more than 80 times* in the Exchange Act, and in most of these cases is an unmodified, self-contained phrase. For instance, section 12(f)(4) enables the Commission to terminate or suspend unlisted trading privileges if it

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100. This interpretation might raise a nondelegation issue.

101. That is, on this view, criteria (1) and (2) above express a single, joint criteria that is still separate from criteria (3).

102. Lee, *supra* note 1.



finds that doing so is “necessary or appropriate in the public interest or for the protection of investors.”<sup>103</sup>

Therefore, it is more reasonable to treat the first half of the phrase (“as necessary or appropriate in the public interest or for the protection of investors”) as a single package and read the modifying phrase tacked on at the end (“in order to prevent circumvention of the provisions of this subsection”) as modifying the whole thing. On this reading, the SEC could only mandate a look-through based on some sort of anti-circumvention justification.

But this interpretation fits in the “broad” category because the SEC may be tempted to construe this anti-circumvention requirement as imposing no additional burden on the agency. For instance, the SEC may say that “circumvention” of the *purposes* of section 12(g) includes anything that undermines the *purpose* of forcing more companies to go public.<sup>104</sup> However, as explained below, such a weak interpretation of the anti-circumvention language would conflict with the statutory text as well as the SEC’s long-standing interpretation.

#### B. Limited Interpretations

##### 4. Look-Throughs for Holders “Primarily” Used to Circumvent Section 12(g)

The full statutory context of section 12(g)(5) rules out any reading that essentially nullifies the anti-circumvention language tacked on to the end of that provision. As mentioned above, the phrase “necessary or appropriate in the public interest or for the protection of investors” appears more than 80 times in the Exchange Act. Section 12(g)(5) is unique among these uses because it tacks on an additional requirement at the end of the phrase: “in order to prevent circumvention of this provisions of this subsection.” Statutory interpretation 101 dictates that this variation be treated as meaningful, and not ignored, because it shows Congress intended to require something *beyond* what was required in the other provisions.<sup>105</sup> It follows that any reasonable interpretation of section 12(g)(5) must require the SEC to show something different and meaningfully *beyond* the fact that its action is merely “necessary or appropriate in the public interest or for the protection of investors.”

The SEC’s own long-standing interpretation of this language gives effect to this reading. For over half a century, the SEC’s own regulations

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103. Securities Exchange Act of 1934 § 12(f)(4), 15 U.S.C. § 78l(f)(4); *see e.g., id.* §§ 12(f)(6), 13(d)(1)–(2), 13(e)(1), 13(f)(4), 13(g)(2), 13(g)(5)–(6), 13(q)(2)(D)(VII), 14(a)(1), 14(b)(1), 14(d)(1), 14(d)(4)–(5), 15(b)(1), 15(b)(2)(A).

104. *Cf. Lee, supra* note 1 (urging action to “ensure that the boundaries between public and private markets are sensibly drawn and maintained, and that the incentives for going public remain balanced”).

105. *See supra* notes 47–49.

have construed the anti-circumvention language as imposing a significantly more stringent and specific burden than a mere showing that the action is “necessary or appropriate in the public interest or for the protection of investors.” In 1965, the SEC promulgated a regulation under section 12(g)(5) that authorized a look-through on a case-by-case basis where “the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the provisions of section 12(g).”<sup>106</sup>

As explicated by the Seventh Circuit, the “primarily” standard constitutes a significant burden; the court held that an investment trust that allowed company employees to hold stock in a pooled vehicle was not “primarily” used to circumvent section 12(g) where it also “serve[d] other important purposes” such as incentivizing employees to “work diligently to increase company production,” “to stay in the employ of the company,” and to give “promising new employees . . . an opportunity to share in company growth.”<sup>107</sup>

The “primarily” standard on the books has been used exclusively for case-by-case applications, which is a different context than the class-wide rulemaking the agency is planning now. Translating this standard to the rulemaking context does not require the SEC to demonstrate that every single use of a given form of record holding is used primarily to circumvent. Rather, it should have to show that, as a general matter, the form is primarily used for this purpose. The challenge for the agency in meeting this burden likely becomes more severe as the SEC chooses to define the targeted forms more broadly.

##### 5. Look-Throughs Only to Other “Record” Holders

The textual and historical evidence surveyed above appear to show that Congress intentionally did not authorize the SEC to tie the section 12(g) count to “beneficial” owners. Another key interpretive limitation on the SEC’s look-through authority may follow from this. Section 12(g)(5) authorizes the SEC to mandate a look-through only from one class of record holder to another class of *record* holder, not to “beneficial” holders.

This interpretation poses a thorny question. Which forms of holding should count as “record” holders? From the legislative history, just a single criterion emerges: the ease of identifying a holder. This was the sole reason given by the SEC back in 1963 for its decision to change the bill’s language to held “of record” from “directly or indirectly” held.<sup>108</sup> Similarly, in 2011, when the SEC’s Director of Corporation Finance was asked

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106. 17 C.F.R. § 240.12g5-1(b)(3) (2020).

107. *Tankersley v. Albright*, 514 F.2d 956, 969–70 (7th Cir. 1975).

108. *SEC Legislation, 1963*, *supra* note 98, at 395.

for the policy argument for using a holder of record designation as opposed to a beneficial holder, she emphasized “workability”—meaning the ability of issuers to actually identify the holders.<sup>109</sup>

Other factors may also be relevant to the determination. Drawing on SEC rules and opinions in this and other related legal contexts, some factors that are possibly relevant to such a determination include whether the holder:

- (1) is a non-human legal entity,<sup>110</sup>
- (2) is holding the securities for the benefit of another person or persons,<sup>111</sup>
- (3) lacks *economic* rights in the securities,<sup>112</sup>
- (4) lacks *voting* discretion in the securities,<sup>113</sup> and
- (5) lacks *investment* discretion over the securities.<sup>114</sup>

This interpretation may provide a separate, collateral limit apart from the restriction on anti-circumvention authority articulated in Interpretations 3 and 4.<sup>115</sup>

#### 6. Look-Throughs for Record Holders Primarily Used to Circumvent Section 12(g) Only to Other Record Holders

Finally, the narrowest possible interpretation would combine both the “primarily to prevent circumvention” restriction of Interpretation 4 with the “record holders only” restriction of Interpretation 5. On this reading, the SEC could mandate a look-through past a class of record holders only where (1) they are primarily used to circumvent section 12(g), and issuers know it; and (2) the holders being looked through to are also “record” holders.

### C. Analysis

Read in isolation, there are numerous reasonable interpretations of the language of section 12(g)(5). But, once the full context and history of the provision are considered, many of these interpretations fail.

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109. *Legislative Proposals*, *supra* note 84, at 21 (statement of Meredith B. Cross, Director, Division of Corporation Finance, Securities and Exchange Commission).

110. *Cf.* 17 C.F.R. § 240.16a-1 (2020).

111. *Cf. id.*

112. *Cf. id.*

113. *Cf. id.* § 240.13d-3(a) (2020).

114. *Cf. id.*

115. For simplicity, assume that this Interpretation 5 is combined with the textual reading provided in Interpretation 2.

The broader interpretations (Interpretations 1, 2, and 3) provide an essentially limitless authority to the agency to mandate look-throughs that is difficult to reconcile with the substantial evidence regarding the limited nature of the look-through authority. If “necessity” or “the public interest” or “the need to make companies go public” is treated as the only constraint on the SEC’s authority, Congress’s intent will have been ignored.

Further, Interpretations 1 and 2 also fail because they depend on an implausible reading of Section 12(g)(5) itself—one that artificially divides the phrase “necessary or appropriate in the public interest *or* for the protection of investors” and applies the anti-circumvention requirement only to the final five words, notwithstanding the fact that the entire phrase appears as a self-contained standard more than 80 times in the statute.

And while Interpretation 3 avoids this problem by accepting the applicability of the “anti-circumvention” restriction on the SEC’s look-through authority, it then takes all force out of that restriction by reading “circumvention” as adding nothing of meaning to the requirement that the SEC act in the “public interest.” This contradicts the statutory context and the SEC’s own longstanding construction of this language.

By contrast, the limited interpretations (Interpretations 4, 5, and 6) seem to present reasonable resolutions of the main interpretive dilemma posed above: balancing the explicit grant of authority in section 12(g)(5) with the textual and legislative history evidence of Congress’ intent to constrain that authority. Interpretation 5 directly respects Congress’ repeated and deliberate denials of the SEC authority to permit look-throughs to beneficial investors. Interpretation 4 also provides a meaningful restriction on the agency’s authority to mandate look-throughs, which likewise carries out Congress’ restrictive purposes and has the added advantage of being consistent with SEC’s longstanding interpretation of the anti-circumvention language. At the same time, each of these limited interpretations preserves the SEC’s discretion to act to mandate a look-through. In sum, the limited interpretations (Interpretations 4, 5, and 6) described above would appear to be the more reasonable interpretations of the SEC’s look-through authority under section 12(g).

#### IV. LIMITED INTERPRETATIONS OF THE SEC’S LOOK-THROUGH AUTHORITY ARE CONSISTENT WITH ITS PRIOR REGULATIONS AND GUIDANCE.

One way to “test” the competing interpretations sketched above is to see how well they fit with the past cases in which the SEC has previously mandated a look-through for the section 12(g) shareholder count. Lee invoked some of these past look-throughs as demonstrating that the Commission possesses unlimited authority to mandate a look-through to all

beneficial owners.<sup>116</sup> In fact, the SEC's past look-throughs are also consistent with a more limited interpretation of SEC authority.

#### A. *Cede & Co.*

The SEC has specified that “[i]nstitutional custodians, such as Cede & Co. and other commercial depositories, are not single holders of record for purposes of the Exchange Act’s registration and periodic reporting provisions” and that “[i]nstead, each of the depository’s accounts for which the securities are held is a single record holder.”<sup>117</sup> Commissioner Lee points to this as proof of the agency’s legal authority to mandate a look-through to beneficial owners across the board.<sup>118</sup> In other words, she suggests that this guidance proves that Interpretation 1, 2, or possibly 3 must be correct.

But this guidance is consistent with at least one of the limited interpretations offered above—namely, Interpretation 5. The guidance is reasonably construed as merely mandating a look-through from one layer of “record” ownership (Cede & Co.) to another (the banks and brokers with accounts at that depository).<sup>119</sup>

Applying the factors above, they hold securities for the benefit of others; are readily identifiable to the issuer; are institutions, not humans; and have customers who possess economic rights over the securities in these accounts (other than the accounts in which they are trading their own securities). Accordingly, this guidance is consistent with at least one of the limited interpretations above.

On the other hand, it is inconsistent with the other limited interpretations (Interpretations 4 and 6). These interpretations would require a showing that the Depository Trust Company is “primarily” used to circumvent section 12(g). This is a nonstarter. As the SEC has explained, the current system creates “a more efficient and safer market for trading securities” by avoiding the “risks, additional costs and time delays associated with the physical movement and possession of stock certificates.”<sup>120</sup>

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116. See Lee, *supra* note 1; see also Langevoort & Thompson, *supra* note 7, at 356 n.86 (similar).

117. Section 152 Rules 12g5-1, Question and Answer to Exchange Act Rules, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm> [perma.cc/M7WS-3BGY] (Mar. 31, 2020); accord U.S. SEC. & EXCH. COMM’N, *supra* note 64, at 11.

118. See Lee, *supra* note 1.

119. Cf. *Legislative Proposals*, *supra* note 84, at 15 (statement of Meredith B. Cross, Director, Division of Corporation Finance, Securities and Exchange Commission) (distinguishing between broker-dealers and “beneficial owners” for purposes of the section 12(g) shareholder count). For a review, see U.S. SEC. & EXCH. COMM’N, *supra* note 64, at 9–10.

120. U.S. SEC. & EXCH. COMM’N, *supra* note 64, at 10 n.35.

### B. *Foreign Issuers*

Rule 12g3-2 exempts from section 12(g)'s registration requirements any foreign private issuer whose shares are held by fewer than 300 "holders resident in the United States."<sup>121</sup> However, the rule provides that, in counting holders for purpose of this rule, any "securities held of record by a broker, dealer, bank or nominee for any of them for the accounts of customers resident in the United States shall be counted as held in the United States by the number of separate accounts for which the securities are held."<sup>122</sup>

At first glance, this rule does not seem to qualify for any of the limited interpretations (Interpretations 4, 5, or 6) above. But there is a separate source of legal authority for this rule that takes it outside of this domain. Section 12(g)(3) broadly empowers the SEC to "exempt from [section 12(g)] any security of a foreign issuer."<sup>123</sup> The special look-through mandated for foreign issuers can be reasonably explained as an exercise of this exemptive authority. As such, it is fully consistent with the limited interpretation of the SEC's look-through authority.

### C. *Limited Interpretations of the SEC's Look-Through Authority May Constrain Its Proposed Actions.*

The limited interpretations of the SEC's authority to mandate a look-through may turn out to restrain the agency's ability to dramatically redraw the line between public and private markets. This Part applies these restrictive interpretations to some of the possible look-throughs that have been aired for an SEC rule in this domain.

#### 1. Universal Look-Through

The boldest option on the table is for the SEC to simply redefine "held of record" as "beneficially held" across the board. For instance, Lee specifically raised the possibility of requiring issuers to "look through to the actual investors whose economic well-being is at stake."<sup>124</sup> At the extreme, this would mean not only looking through, for instance, a venture capital fund to its beneficial investors, but also through those investors (such as pension funds) to *their* beneficial investors. And on and on until all real human investors are actually counted.

This proposal would likely fail under *any* of the limited interpretations above. It straightforwardly fails under Interpretation 5 (and Interpretation 6), which permit look-throughs only to other "record" holders,

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121. 17 C.F.R. § 240.12g3-2(a) (2020).

122. *Id.* § 240.12g3-2(a)(1).

123. Securities Exchange Act of 1934 § 12(g)(3), 15 U.S.C. § 78l(g)(3).

124. Lee, *supra* note 1.

not “beneficial” ones. It also would certainly fail Interpretation 4 (and Interpretation 6), which mandate a showing that the entities being looked through are used “primarily” to circumvent section 12(g). A broad look-through for *all* intermediate holders would be applicable to a huge array of entities, the overwhelming majority of which are used primarily for many legitimate economic functions and have nothing at all to do with circumventing section 12(g). Thus, the only way for the SEC to pursue this universal look-through would be to persuade a court that one of the broad interpretations (Interpretation 1, 2, or 3) is correct.

## 2. Special Purpose Vehicles

Another key target for any potential look-through mandate may be the Special Purpose Vehicle (SPV).<sup>125</sup> These are legal entities created for purposes of pooling investments in a single private company.

The most famous SPV is one that helped precipitate the JOBS Act. In late 2010, Facebook was a large private company looking to stay that way.<sup>126</sup> But even with the forgiving treatment of the “held of record” test, the company was hovering near the (then) 500 shareholder threshold.<sup>127</sup> Facebook turned to Goldman Sachs, who proposed an SPV to pool the investments of various parties together and would count as just a record holder.<sup>128</sup> The press caught wind,<sup>129</sup> which led to SEC scrutiny<sup>130</sup> and the collapse of the deal.<sup>131</sup> Facebook was forced to go public in 2012, sooner than it wanted to. All of this fed *directly* into the push to raise the shareholder threshold in the JOBS Act.<sup>132</sup>

An SPV look-through may face serious legal challenges under the limited interpretations offered above. A major challenge for such a rule under Interpretation 4 (and Interpretation 6) would be showing that SPVs

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125. *Id.*

126. Susanne Craig & Andrew Ross Sorkin, *Goldman Offering Clients a Chance to Invest in Facebook*, N.Y. TIMES: DEALBOOK (Jan. 2, 2011, 12:42 PM), <https://dealbook.nytimes.com/2011/01/02/goldman-invests-in-facebook-at-50-billion-valuation> [perma.cc/85T2-X5PV].

127. de Fontenay, *supra* note 21, at 460; Rodrigues, *supra* note 21, at 1537.

128. Langevoort & Thompson, *supra* note 7, at 338.

129. *Id.*

130. Jean Eaglesham & Aaron Lucchetti, *Facebook Deal Spurs Inquiry*, WALL ST. J. (Jan. 5, 2011, 12:01 AM), <https://www.wsj.com/articles/SB10001424052748704723104576062280540485652> [perma.cc/3E54-MTKV].

131. Dominic Rushe, *Goldman Sachs Suffers Facebook Fiasco*, GUARDIAN (Jan. 17, 2011, 4:41 PM), <https://www.theguardian.com/business/2011/jan/17/goldman-sachs-facebook-private-placement> [perma.cc/WX9L-XUN3].

132. de Fontenay, *supra* note 21, at 460; Langevoort & Thompson, *supra* note 7, at 339.

are “primarily” used to circumvent section 12(g). The SEC itself has acknowledged the legitimate functions that SPVs may serve.<sup>133</sup>

An SPV look-through may also falter under Interpretation 5 (and Interpretation 6). The SEC would have to show that holders on the other side of the SPVs could be reasonably defined as “record” holders. But the agency may not be able to meet this burden since SPV holders may not be readily identifiable to issuers. On the other hand, other factors may weigh in the other direction. A firm conclusion on this depends on additional fact-gathering on SPV practices.

### 3. Private Funds

The *Wall Street Journal*'s January 2022 story noted that the SEC could decide to “count the number of people investing through a venture-capital fund or private-equity fund” towards the 2,000 shareholder limit.<sup>134</sup> Because private funds are not used “primarily” to circumvent section 12(g), such a plan would not survive under Interpretations 4 or 6.

Such a look-through may also falter under Interpretation 5. Again, the SEC would have the burden to establish that the investors on the other side of these funds can be reasonably construed as “record” holders. It seems doubtful that most of these investors are readily identifiable to the issuer.

### CONCLUSION

Lee's October 2021 speech cites two historical precedents for the SEC's coming action: the early 1930s and the early 1960s. Each time, Congress responded with transformational new legislation. The SEC now wants to accomplish a similarly fundamental redrawing of the boundaries between public and private markets on its own.

There is reason to doubt that the statute authorizes this. The text and legislative history of section 12(g) suggest that Congress deliberately limited the SEC's look-through powers. The best interpretations of the statute will give effect to this intent, not ignore it.

Even under the more restrictive interpretations, the SEC would still retain meaningful authority to mandate a look-through in particular limited domains. However, any fundamental redrawing of the lines between public and private markets must come from Congress—just as it did in 1933 and 1964.

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133. U.S. SEC. & EXCH. COMM'N, *supra* note 64, at 21–22; Letter from Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n, to Darrell E. Issa, Chairman, House Comm. on Oversight and Gov't Reform, at 20 (Apr. 6, 2011), <https://www.sec.gov/news/press/schapiro-issa-letter-040611.pdf> [perma.cc/VR37-DEUJ].

134. Kiernan, *supra* note 5.