

Private Equity for the People

Christina Parajon Skinner[†]

INTRODUCTION

During a 1912 presidential campaign speech, Woodrow Wilson commented on one of the most divisive subjects in American society: the debate that surrounds capital and equality. According to then-Governor Wilson, “The great monopoly in this country is the monopoly of big credits. So long as that exists, our old variety and freedom and individual energy of development are out of question.”¹ The same speech described financiers, as the commandants of capital, as inherently disposed to “chill and check and destroy genuine economic freedom.”²

The notion that capitalist institutions--and financial markets and financiers in particular--entrench wealth inequality through their grasp on capital has endured in American political rhetoric and popular imagination.³ The Article posits that this oft-repeated

© 2023 Christina Parajon Skinner. Draft 2023-06-07 13:30.

[†] Assistant Professor, The Wharton School of the University of Pennsylvania. Gilles Delporte and Andrew Orita provided excellent research assistance.

¹ Woodrow Wilson, *The New Freedom: A Call for the Emancipation of the Generous Energies of a People* 185 (1913).

² Id.

³ See, e.g. Louis D. Brandeis, *Other People’s Money and How the Bankers Use It* 3 (arguing investment bankers are “masters” of United States’s business world) (1913); Thomas Picketty, *Capital in the Twenty-First Century* 305 (“The distribution of capital ownership (and of income from capital) is always more concentrated than the distribution of income from labor”) (2014); Thomas Picketty, *Capital and Ideology* 1 (arguing the narratives regarding the causes of modern inequality are incomplete) (2020); Thomas Picketty & Emmanuel Saez, *Income Inequality in the United States: 1913-1998*, 118 Q.J. of Econ. 1, 35 (2003) (suggesting “steep progressive taxation, by reducing the rate of wealth accumulation, has yet prevented the large fortunes to recover fully from [the] shocks” of the Great Depression and World War II); Thomas Picketty & Emmanuel Saez, *The Evolution of Top Incomes: A Historical and International Perspective 201-02* (Nat’l Bureau of Econ. Rsch., Working Paper No. 11955, 2006)

narrative--that the capitalists are causing inequality--unhelpfully conceals the State's own role in "chilling and checking" economic freedom, contributing to wealth disparity in the process. In today's macro-financial environment, the constraints imposed on private equity investment provide an ideal case study to illustrate this problem.

Private equity is often maligned in the capital-versus-equality debate. The term "private equity" is a more of a short-hand for the set of alternative investment classes that includes private equity, private debt, venture capital, and early growth.⁴ It has, since 2008, become a poster child for the 1% and, in turn, emboldened the viewpoint that capitalism, when insufficiently constrained, increases inequality by

(analyzing the pattern of top income share results from 1917 to 2002); Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* 2 (2019) (considering whether the United States's levels of inequality have reached the level of the French Revolution); Raghuram G. Rajan & Luigi Zingales, *Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity* 26--29 (2003); Olufunmilayo B. Arewa, *Investment Funds, Inequality, and Scarcity of Opportunity*, 99 B.U. L. Rev. 1023, 1028 (2019) (quoting the concerns of Larry Fink--founder of BlackRock--regarding income inequality). See also President Joseph R. Biden, Remarks by President Biden on the Economy (Sept. 16, 2020) ("CEOs used to make about 20 times the average worker in the company that they ran. Today, they make more than 350 times what the average worker in their corporation makes."); President Barack H. Obama, Remarks by the President on the Economy in Osawatimie, Kansas (Dec. 6, 2011) ("Those at the very top grew wealthier from their incomes and their investments--wealthier than ever before. But everybody else struggled with costs that were growing and paychecks that weren't . . .").

⁴ See Private Equity Investments, CFA Inst., <https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/private-equity-investments> [<https://perma.cc/QC9U-PQAL>] ("Private equity stretches from venture capital (VC)--working with early-stage companies that may be without revenues but that possess good ideas or technology--to growth equity, providing capital to expand established private businesses often by taking a minority interest, all the way to large buyouts (leveraged buyouts, or LBOs), in which the private equity firm buys the entire company.") (last visited Jan. 12, 2023), <https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/private-equity-investments>. [<https://perma.cc/QC9U-PQAL>]

husbanding resources for the already wealthy.⁵ In just the past three years, such antipathy toward private equity has found tailwinds in the now thrice-debated question whether companies should be profit-maximizing institutions or instead try to increase social and economic equity by shifting their purpose to broader stakeholder-oriented goals.⁶

Notwithstanding these critiques, private equity has been ascendant as an asset class since 2008. To be precise, institutional investors have been piling in: “Since 2000, the assets managed by private markets have risen elevenfold—over four times faster than

⁵ On that view, prominent articles in main financial presses have quipped, in the past few years, that “PE has largely been the preserve of institutional investors and the very rich,” and that “[p]rivate equity has become politically symbolic for the rich getting richer.” Joshua Oliver, Time for Retail Investors to go into Private Equity?, *Fin. Times* (Sept. 23, 2022), ft.com/content/8875aed5-ebb7-466c-ad6e-287a22eecd0e [<https://perma.cc/F4WF-676V>]; see also Jessica Mathews, Super Rich Individuals are Private Equity’s Growing LP Base, *Fortune* (May 4, 2022), <https://fortune.com/2022/05/04/super-rich-private-equity-limited-partners/> (“Rather than settle on endowments or pension funds, the biggest private equity firms are also looking to a new cohort—the world’s richest people—as a source of capital.”).

⁶ See, e.g., Adolf Berle & Gardiner Means, *The Modern Corporation and Private Property* viii (1933) (considering the relationship between corporation and property); Henry Manne, Shareholder Social Proposals Viewed by an Opponent, 24 *Stan. L. Rev.* 481, 482 (1972) (examining shareholder social proposals which have led to “publicized struggles between the activists and corporate management, and they have increased tremendously the popular attention focused on the annual meeting of shareholders”); Edward B. Rock, *For Whom is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 *Bus. Law.* 363, 364–65 (2021) (quoting a variety of proposals regarding corporate management); Martin Wolf, We Must Rethink the Purpose of the Corporation, *Fin. Times* (Dec. 11, 2018), <https://www.ft.com/content/786144bc-fc93-11e8-ac00-57a2a826423e> [perma.cc/65X5-Q679] (arguing the Anglo-American model of corporate governance may not be the best way to structure corporations); Alex Edmans, *Grow the Pie* (2022); Christina Parajon Skinner, *Cancelling Capitalism?*, 97 *Notre Dame L. Rev.* 417, 418 (2021) (“Academic, policy, and boardroom conversations about the merits (and demerits) of capitalism have taken shape in the ‘corporate purpose’ debate.”); Christina Parajon Skinner & Genevieve Helleringer, *The Hardening of Corporate ESG* (forthcoming 2023).

stock markets.”⁷ In 2021, private equity raised \$1.2 trillion globally. The alternative assets industry research group Preqin now predicts that assets under management (“AUM”) by private equity funds will likely double, measured from \$9.3 trillion AUM at end of 2021 to \$18.3 trillion by the end of 2027.⁸

This steady investor appetite for private equity is not at all surprising given these funds’ returns. As one McKinsey Report noted in 2022, “For the fifth consecutive year, PE was the highest performing private markets asset class.”⁹ More specifically, in 2021, private equity produced 54% returns, “12% better than the public stock markets.”¹⁰ Even during more volatile years which included the global financial crisis, funds vintaged 2002-2016 returned a 15% IRRs to investors”, according to Pitchbook data.¹¹

⁷ Ruchir Sharma, How Private Markets Became An Escape from Reality, *Fin. Times* (Dec. 19, 2022), <https://www.ft.com/content/7416159d-fa24-4c97-b4a7-302696cdoede>; [perma.cc/QL7-38QG] see Alejandro Beltran de Miguel et al., McKinsey & Co., *Private Markets Rally to New Heights* 6 fig. 1 (2022), <https://www.mckinsey.com/~media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2022/mckinseys-private-markets-annual-review-private-markets-rally-to-new-heights-vf.pdf> [perma.cc/U94E-3BC8] (noting that “private markets fundraising reached a new high” in 2021).

⁸ *Global Private Capital AUM to Double to \$18.3tn by 2027--Preqin Forecasts*, PREQIN (Oct. 5, 2022), <https://www.preqin.com/Portals/0/Documents/FOA%20press%20release%20FINAL.pdf?ver=2022-10-05-093626-147>. According to consultant-analysis at Ernst & Young, given “a solid track record of generating alpha in the market and the potential to navigate uncertainties have kept LP confidence intact. As the immediate volatility caused by the macro shift begins to recede, it’s possible, and perhaps even likely, that LPs pivot to even higher allocation to PEs in pursuit of increased returns despite recent mark-to-market price erosions.” Pete Witte, Private Equity Pulse: Five Takeaways from 3Q 2022, EY (Nov. 14, 2022), https://www.ey.com/en_us/private-equity/pulse. [perma.cc/7QFN-PZE3]

⁹ Beltran de Miguel et al., supra note 7, at 10. The report noted IRR of median 20% net to date September 30, 2021 with funds of vintage 2008-18. *Id.* at 12 fig. 6.

¹⁰ Stephen L. Nesbitt, Long-Term Private Equity Performance: 2000 to 2021, CAIA Ass’n (July 20, 2022), <https://caia.org/blog/2022/07/20/long-term-private-equity-performance-2000-2021>. [perma.cc/PZZ3-RGMK]

¹¹ Witte, supra note 8.

Importantly, these returns outstrip what could financially be accomplished from investing in the public markets alone.¹² In a 2021 study of private equity risk and returns between 2000 and 2021, researchers found that over this twenty-one-year period, the “private equity allocations by state pensions produced a 11% net-of-fee annualized return, exceeding by 4.1% the 6.9% annualized return that otherwise would have been earned by investing in public stocks.”¹³ With compounding, this means that returns from private equity create about “twice the investment gains” over a ten-year period when compared to public equity.¹⁴ Meanwhile, there is no concrete evidence that these high-yielding returns from private equity come with higher financial risk relative to public markets.¹⁵

One might think that private equity’s success would be celebrated as good news for inequality. For most of human history, wealth-generation required collateral—that which could be pledged to borrow more capital to invest in hard assets (like real estate) or in the public equity or debt markets. As such, wealth begot more wealth. But private equity funds make pre-existing access to capital irrelevant. Whereas debt contracts, like loans, revolve around collateral,¹⁶ no collateral beyond the actual investment is necessary to buy in to a private equity fund.¹⁷ As such, the marketplace, on its own, poses no property-based barriers to individuals wishing to contract for a private equity investment and reaping those high returns.

Yet legal barriers to accessing private equity investment remain firmly entrenched in our financial regulatory framework. In the interest of protecting investors, in 1980 the SEC created a category of

¹² Even the often-skeptical financial press cannot deny that “Private equity delivered annualized total returns of about 13 percent over the past 15 years, on a risk-adjusted basis, against about 8 percent for the S&P 500, according to Morgan Stanley research.” Oliver, supra note 5.

¹³ Nesbitt, supra note 10.

¹⁴ Id.

¹⁵ “The annualized standard deviation of returns for private equity equaled 16.1% for the 21-year period, compared to 17.1% for public stocks.” Id.

¹⁶ See infra Part III.A.

¹⁷ The PE business model turns on pooling together discrete investments rather than maturity and liquidity transformation.

“accredited investors” to distinguish these investors from others that could better “fend for themselves” in the riskier corners of financial markets.¹⁸ Accredited investors are defined by law as individuals that earn over \$200,000 per year or have a net worth of over \$1 million dollars (excluding the value of their home).¹⁹ Later, in the 1990s, the SEC created, and Congress formalized in law, a definition for a “qualified purchaser;” another standard defined by wealth--this time, only people that own at least \$5,000,000 in other investments are “qualified.”²⁰

Practically speaking, as will be discussed, only accredited investors and qualified purchases have access to private fund investments. Yet recent estimates suggest that only 13% of American households meet the accredited investor definition standard and only 2% meet the qualified purchaser one.²¹ The remaining households are America’s “retail investors.” For these “retail investors, private equity has long looked like the mythical crock of gold that is tantalizingly out of reach.”²²

For some time now, various academics and policymakers have pointed to myriad reasons why maintaining the accredited investor definition is harmful to individuals’ economic wellbeing or logically misguided.²³ This literature argues that the definitions aggravate

¹⁸ See *infra* Part I.B.

¹⁹ 17 C.F.R. § 230.501 (2021).

²⁰ 15 U.S.C. § 80a-2(a)(51).

²¹ See Comm. on Cap. Mkts. Regul., *Expanding Opportunities for Investors and Retirees: Private Equity 2*, <https://www.capmksreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf>. [perma.cc/57S9-9VUT] (noting this phenomenon)

²² Oliver, *supra* note 5.

²³ It bears noting, however, that this view is far from unanimous. Some academics continue to assert that private equity investments are too risky for retail investors. See Erik F. Gerding, *The Cost to Retail Investors and Public Markets of “Harmonizing” Securities Offering Exemptions*, Colum. L. Sch.: Blue Sky Blog (Oct. 1, 2019), <https://clsbluesky.law.columbia.edu/2019/10/01/the-cost-to-retail-investors-and-public-markets-of-harmonizing-securities-offering-exemptions/> (providing a contrary view focusing on the risks of allowing retail access); Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did “We” Not Work?*, 99 Tex. L. Rev. 1347, 1347-48 (2021) (discussing the risks of start-up financing and is critical of allowing retail investors in this space).

wealth and perhaps racial inequality;²⁴ that the presumption that wealth correlates with investment know-how lacks credible evidence, especially given the democratization of information over the internet;²⁵ and that the definition impedes investors' ability to engage in financially prudent strategies of diversification.²⁶ Other scholars point to that fact that private equity funds complement other aspects of the financial system (i.e., the banking sector) in ways that benefit financial stability and the liberal flow of credit across the economy.²⁷ Stitching these various critiques together, Professor Roberta Karmel

Others suggest that private equity firms possess too much bargaining power, where the general partners domineer the limited partners (the investors), and that these bargaining powers would be even more detrimental to retail investors than they are to the current institutional investors. William W. Clayton, The Private Equity Negotiation Myth, 37 Yale J. on Reg. 67, 68, 72 (arguing this theory).

²⁴ See, e.g., Grier E. Barnes, Racial Exclusion in Private Markets: How the New Accredited Investor Standard is Arbitrary and Capricious, 96 N.Y.U. L. Rev. 1966, 1968 (2021); Kevin G. Bender, Note, Giving the Average Investor the Keys to the Kingdom: How the Federal Securities Laws Facilitate Wealth Inequality, 15 J. Bus. & Sec. L. 1, 7-8 (2016); Usha Rodrigues, Securities Law's Dirty Little Secret, 81 Fordham L. Rev. 3389, 3389 (2013) (exploring the implications of this designation).

²⁵ See, e.g., Thomas M. Selman, Protecting Retail Investors: A New Exemption for Private Securities Offerings, 14 Va. L. & Bus. Rev. 41, 41 n.1 (2020) (noting this advent); So-Yeon Lee, Why the Accredited Investor Standard Fails the Average Investor, 31 Rev. Banking & Fin. L. 987, 991 (2012) (same); see also Thaya Brook Knight, Your Money's No Good Here: How Restrictions on Private Securities Offerings Harm Investors, Cato Inst. (Feb. 9, 2018), <https://www.cato.org/policy-analysis/moneys-no-good-here-how-restrictions-private-securities-offerings-harm-investors> [perma.cc/49PX-4KVR] (pointing out that these investments aren't riskier than others that the law permits all investors to access).

²⁶ Kelli A. Alces, Legal Diversification, 113 Colum. L. Rev. 1977, 2015--16 (2013). Although Alces discusses the novel idea of legal diversification, she also recognizes the importance of classic diversification across financial asset classes according to modern portfolio theory.

²⁷ Christina Parajon Skinner, Regulating Nonbanks: A Plan for SIFI Lite, 105 Geo. L.J. 1379 (2017); Steven M. Davidoff, Black Market Capital, 2008 Colum. Bus. L. Rev. 172, 250.

has referred to these definitions as a collection of “bureaucratic rulemaking” which displays “intellectual incoherence.”²⁸

Almost all market and industry groups to consider the issue have urged some sort of reform, most focusing on the “accredited investor” definition in particular. The Small Business Forum, the Advisory Committee on Small and Emerging Companies, and the Small Business Capital Formation Advisory Committee have all advised the SEC to create “additional methods of accreditation other than financial criteria.”²⁹ The U.S. Treasury also, in 2017, recommended an expansion of the definition.³⁰ And in Congress, lawmakers have proposed at least three separate bills in 2021 and 2022 aiming to expand access to private investment in various forms.³¹ Notwithstanding this widespread recognition, when the accredited investor definition was amended in 2020, the opportunity to level private fund access was largely missed.³²

²⁸ See Roberta S. Karmel, Regulation by Exemption: The Changing Definition of an Accredited Investor, 39 Rutgers L.J. 681, 685 (2008)(arguing this point).

²⁹ Concept Release on Harmonization of Securities Offering Exemptions, Securities Act Release No. 33-10,649, 84 Fed. Reg. 30,460, 30,474--75 (proposed June 26, 2019).

³⁰ See U.S. Dep’t Treasury, A Financial System that Creates Economic Opportunities: Capital Markets 44 (2017).

³¹ The Increasing Investor Opportunities Act, introduced in the Senate in March 2022, would facilitate indirect retail investment through (listed) closed-ended funds. See Increasing Investor Opportunities Act, H.R. 4262, 117th Cong. (2021). The Equal Opportunity for all Investors Act would further expand the definition of accredited investor and allow for self-certification or through an SEC administered exam. See Equal Opportunity for all Investors Act, S.3921, 117th Cong. (2022). Several other bills have been included by U.S. Senate Banking Committee Republicans in the draft JOBS Act 4.0, which aims to enhance retail investor access. See S. Banking Comm. Republican Staff, 117th Cong., JOBS Act 4.0 (2022).

³² The amendment merely added to the definition of accredited investor those that possess certain “professional certifications and designations and other credentials designated by the Commission as qualifying for accredited investor status.” See Amendments to Accredited Investor Definition, U.S. Sec. & Exch. Comm’n (Mar. 29, 2021), <https://www.sec.gov/corpfin/amendments-accredited-investor-definition-secg#:~:text=The%20amendments%20codified%20a%20long,of%20acquiring%20the%20securities%20offered.> [perma.cc/LJ5P-32G6]

Given the weight of academic, policy, and legislative support for abandoning the arguably arbitrary divide among investors, why does it persist? At surface level, there may well be a public choice story here, about an agency keen to retain power in the domain that it has—the public capital markets.³³ Stopping the attrition from public markets (i.e., the decline in public market capital formation) would certainly seem a plausible motive to explain the SEC’s resistance to revision. In Congress, meanwhile, freeing markets is often viewed as a conservative ideal and thus has a fate tied to the political cycle, resulting majorities, and the vagaries of horse-trading.³⁴

Setting political-economy to one side, this Article cuts to the heart of the private market investment regime by examining it through the lens of individual economic rights. Although fidelity to economic rights was maintained from the Founding of America through the 1930s, that constitutional ideology was necessarily set to the side in the mid-1930s to make way for the rise of the administrative state, including the SEC. A rejection of economic rights in favor of economic paternalism explains why, by 1980, the SEC met with little resistance when it blocked private markets from ordinary Americans in order to protect them from the consequences of their poor decisions that they apparently could not fathom.³⁵ But as this Article will argue, adopting these definitions appears to have been more a political choice that rest on expedience rather than a constitutionally required or historically justifiable one. It thus warrants reconsidering.

³³ See Karmel, *supra* note 28, at 685 (“If such a large proportion of managed pooled investments were occurring outside of the SEC’s jurisdiction, the SEC Could become marginalized, and investors and fund managers could begin to question why investment companies were so heavily regulated.”).

³⁴ See, e.g., Hans Noel, *Ideological Factions in the Republican and Democratic Parties*, 667 *Annals Am. Acad. Pol. Soc. Sci.* 166(2016), 168 (noting that conservatives favor free markets); 7 *Core Principles of Conservatism*, U.S. Congressman Mike Johnson, <https://mikejohnson.house.gov/7-core-principles-of-conservatism/> (including free markets in the summary of central beliefs of American conservatives).

³⁵ See Exemption of Limited Offers and Sales by Qualified Issuers, Securities Act Release No. 33-6180, 45 Fed. Reg. 6362 (Jan. 28, 1980), 6362 (noting that the SEC received almost 300 comment letters on proposed Rule 242, none of which opposed its adoption).

Moreover, as just discussed, in recent years the inputs to inequality have shifted along with the financial system's structure. Whereas access to capital may have supplied a partial explanation for inequality during the banking system's heyday, today, the lack of access to myriad financial investment opportunities presents a more compelling economic problem. And so it is the question of access to private markets that proponents of greater wealth equality and free-markets should assiduously turn.

To that end, this Article proceeds in three parts. Part I provides some basic context by explaining the structural shift from public markets to private markets. It also discusses the history and rationale for the accredited investor and qualified purchaser definitions. To animate this context toward the Article's main point, Part II then explains how the current macro environment--shaped by monetary policy--has made the accredited investor and qualified purchaser constraints more economically harmful than ever. In particular, it argues that monetary policy has incentivized speculative substitution and thus led to a ballooning of unorthodox alternatives, like SPACs, initial coin offerings, and other crypto-assets, which carry high-risk and low-reward over the medium- to longer-terms.

Part II then argues in favor of a return to the principles of economic liberty, which include equal access to economic opportunity. A renaissance of economic rights commitments would, ultimately, require greater freedom of contract between retail investors and general partners in private funds--in short, the freedom to invest absent initial intervention from the State. Overall, Part II urges that, in light of the macro considerations fleshed out in Part II.A, the current exemption framework is constitutionally unsupported even under a rational basis review. Part III briefly considers how private equity for the people might be operationalized. While much academic literature has canvassed the subject, few have considered a comparative approach. In the European Union, the 'retailization' of private equity has gained much more political support and hence the evolution of legal frameworks has developed more to that end. The Article thus suggests ideas that might be borrowed from the EU.

Ultimately, wealth inequality reduces the popular legitimacy of capitalism and, as such, impedes capitalism's potential to serve

society and advance human flourishing.³⁶ As this Article will urge, the continued diminution of Founding-era principles of economic liberty, which prescribe equality of economic rights, cannot be squared with legal and policy aspirations to narrow the wealth gap.

I. THE GREAT DIVIDE

Although the SEC first bifurcated investors into two groups according to wealth in the 1980s,³⁷ the structural shifts in the financial markets that made this divide more of a chasm have transpired only in the past fifteen years. These shifts put renewed pressure on the logic and legitimacy of those legal divisions.

A. The Post-2008 Shifts in Capital Raising

Without a doubt, private markets are overtaking public ones. Public markets refer generally to the market for public equity (i.e., publicly traded stocks) and public debt (i.e., publicly traded corporate bonds). Traditionally, issuing public equity or public debt, or borrowing from a bank, were the principal financing options available to firms, aside from the use of retained earnings.³⁸ Where public securities were concerned (stocks and bonds) public investment funds would invest in these assets as a way of intermediating credit to the borrowers and supplying an investment product (i.e., shares in a mutual fund) to the public.

However, like the securities themselves, public funds are required to register the shares they offer to the public under section 5 of the Securities Act of 1933,³⁹ and they must also register under the Investment Company Act of 1940.⁴⁰ In many cases, fund managers register as Investment Advisers under the Investment Advisers Act of

³⁶ See generally Robert Shiller, *Finance and the Good Society* 187 (2012) (arguing that public aversion to inequality and the problems it poses must be addressed).

³⁷ See *infra* note 75.

³⁸ Richard Brealy et al., An Overview of Corporate Financing, in *Principles of Corporate Finance* xx (14th ed. 2023)

³⁹ Securities Act of 1933, Pub. L. No. 73-22, § 5, 48 Stat. 74, 77 (1933).

⁴⁰ Investment Company Act of 1940, Pub. L. No. 76-768, § 7, 54 Stat. 789, 802 (1940).

1940.⁴¹ The Securities Act requires significant disclosure. In addition to requiring disclosure, the Investment Company Act imposes rules on the fund concerning its governance structure (mandating an independent board),⁴² limits the use of leverage,⁴³ and requires a certain amount of liquidity to its investors.⁴⁴ The Investment Advisers Act of 1940, meanwhile, imposes limits on performance-based management fees.⁴⁵

Private markets refer to the markets for the private placement of equity or debt securities, which securities are often held by private equity funds. As buyers of privately placed securities, these funds are an alternative source of capital to all sizes and stages of companies, and under the conditions discussed below, they are exempt from registration under the Securities Act and the Investment Company Act.⁴⁶ It bears emphasis that securing these exemptions is critical to the private equity business model.⁴⁷

Three separate trends since 2008 have driven a decline in public market activity and bank-based lending. First, for some time, companies have considered the regulatory burden of issuing securities in the public markets too high. Mainly, the aversion to these costs relates to mandatory disclosure requirements, but also, the ever-present prospect of new rulemaking and regulation by the SEC.⁴⁸ The

⁴¹ Investment Advisers Act of 1940, Pub. L. No. 76-768, 54 Stat. 847, 850 (1940).

⁴² See 15 U.S.C. § 80a-10(a) (regarding governance).

⁴³ See 15 U.S.C. § 80a-18(f) (regarding leverage).

⁴⁴ See 15 U.S.C. § 80a-18(a)-(b) (regarding liquidity).

⁴⁵ See 15 U.S.C. §80b-5 (regarding fees).

⁴⁶ See infra Part I.B.

⁴⁷ See Karmel, supra note 28, at 696 (detailing the practices of private equity businesses not compatible with statutory requirements).

⁴⁸ See Jay Clayton, Chairman, Sec. & Exch. Comm'n, Remarks at the Economic Club of New York (July 12, 2017), <https://www.sec.gov/news/speech/remarks-economic-club-new-york> [perma.cc/GKL5-Q53N] (“As the SEC evolves alongside the markets, however, we must remember that implementing regulatory changes has costs. Shareholders and customers bear these costs, which is something that should not be taken lightly . . .”).

SEC's 2022 proposed climate disclosure rule⁴⁹ is a case-in-point.⁵⁰ For issuers, private placements thus provide a relatively more attractive alternative because their regulatory requirements are considerably leaner.⁵¹

Industry data bears this out. In 2019, around 70% of capital in the U.S. capital markets were raised in private offerings, leaving just 30% to public markets.⁵² In 2022, Morningstar reported that the number of

⁴⁹ The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (proposed Apr. 11, 2022).

⁵⁰ See Lawrence A. Cunningham et al., The SEC's Misguided Climate Disclosure Rule Proposal, 41 Banking & Fin. Servs. Pol'y Rep. 1, 1, 7 (2022) (opposing the adoption of the rule in its current state).

⁵¹ See 17 C.F.R. 230.501 (2023) (detailing the requirements under Regulation D of the Securities Act); Private Placements under Regulation D--Updated Investor Bulletin, U.S. Sec. & Exch. Comm'n: Investor.gov (Sept. 24, 2014), <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-31>[perma.cc/P6RA-YT95] (noting private placements are not subject to same laws as publicly registered offerings). In 2022, the SEC proposed a rule to require more public-company like disclosures from private funds. See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16886, 16886 (proposing rule to require registered investment advisers to provide more transparency and to act in public interest).

⁵² Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 85 Fed. Reg. 17,956, 17,957 (proposed Mar. 31, 2020). Companies have raised more money in private markets than in public markets in each year since 2009. Michael J. Mauboussin & Dan Callahan, Public to Private Equity in the United States: A Long Term Look at 4 (2020), https://www.morganstanley.com/im/publication/insights/articles/articles_publicprivateequityintheusalongtermlook_us.pdf [perma.cc/QL9B-LQ6N]; Allison Herren Lee, Commissioner, Sec. & Exch. Comm'n, Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy (Oct. 12, 2021), <https://www.sec.gov/news/speech/lee-sec-speaks-2021-10-12> [<https://perma.cc/6RT3-UU2M>]; Scott Bauguess et al., Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017 7--8 (2018), https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_o82018.pdf [perma.cc/QDT2-3YRL]. See also Tom Zanki, Changes to Accredited Investor Rules Take Priority at SEC, LAW360 (Aug. 13, 2019, 7:03 PM), <https://www.law360.com/articles/1188099/changes-to-accredited-investor-rules-take-priority-at-sec> [perma.cc/KR4A-ZXLS] ("Companies raised \$2.9

public companies in America had peaked in 1996, at a little over 8,000, and has since halved.⁵³ Amplifying this dynamic, it appears that growing companies now choose to stay private longer, likely for these cost related reasons.⁵⁴ Overall, as writers at Bloomberg observed in 2022, “the capital behind corporate growth around the world is a product of private, not public, markets.”⁵⁵

The second trend regards banks, rather than the public securities markets. Prior to 2008, while banks and capital markets were in relative equipoise, banks commanded the market in terms of lending directly to firms.⁵⁶ But the United States’ centerpiece post-crisis legislation, the Dodd-Frank Act 2010, imposed significantly steeper capital and liquidity requirements, making it more expensive for banks to lend to certain middle market or risky corporate sectors.⁵⁷ One consequence of this regulatory change was that over time, many large banks realized that it was more profitable to lend to the private

trillion in private markets last year, compared with \$1.4 trillion in public markets . . .”).

- ⁵³ Dan Lefkovich, Public/Private Markets: Structural Shifts in Markets Make Private Assets Hard to Ignore, Morningstar (May 22, 2022), <https://www.morningstar.com/articles/1092511/publicprivate-markets> [perma.cc/Z5WM-PZ4E].
- ⁵⁴ Bain & Company, Global Private Equity Report 2022 37 (2022), https://www.bain.com/globalassets/noindex/2022/bain_report_global-private-equity-report-2022.pdf [perma.cc/3S6D-M95X].
- ⁵⁵ Dawn Lim & David Brooke, The Boom in Private Markets Has Transformed Finance. Here’s How, Bloomberg (June 14, 2022), <https://www.bloomberg.com/news/articles/2022-06-14/how-the-boom-in-private-markets-has-changed-finance-quicktake?leadSource=uverify%20wall> [perma.cc/A3NK-PXW2].
- ⁵⁶ See Jonathan Guilford & Neil Unmack, Breakdown: Private Credit’s Main Threat is Itself, Reuters (July 7, 2022, 11:20 AM), <https://www.reuters.com/breakingviews/breakdown-private-credits-main-threat-is-itself-2022-07-07/> [perma.cc/8UK8-2HTW] (“Before 2008, banks generally dominated the world of corporate credit . . .”).
- ⁵⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 101--176, 124 Stat. 1376, 1391--442 (2010); 12 C.F.R. pt. 217 (articulating Fed-enacted capital and liquidity requirements); see Lim & Brooke, supra note 52 (“[P]rivate credit took off when investment firms . . . stepped into a void left when banks retreated from middle-market or other kinds of risky lending.”).

debt funds that had begun direct lending to fill the credit gaps the banks' post-2008 retrenchment had left behind.⁵⁸

The third important trend is that, concurrent to these changes in the banking regulatory regime, the monetary policy atmosphere shifted considerably. After the financial crisis of 2008, the Federal Reserve reduced interest rates to (essentially) zero, an expansionary policy that made investors engage in speculation in pursuit of yield in lieu of more traditional investments.⁵⁹ This so-called search for yield prompted many institutional investors to turn to private equity.⁶⁰

Investor appetite for private funds is likely to increase alongside the Fed's current contractionary policy as well.⁶¹ In 2022, the Fed's

⁵⁸ See Bank and Nonbank Lending over the Past 70 Years, 13 FDIC Q. 31, at 34 (2019), <https://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2019-vol13-4/fdic-v13n4-3q2019-article1.pdf> [perma.cc/W9BG-573U] ("Large bank sales of financial crisis-era legacy servicing portfolios contributed to the shift in servicing from banks to nonbanks."); see also Christina Parajon Skinner, Regulating Nonbanks: A Plan for SIFI Lite, 105 Geo. L.J. 1379, 1388-89 (2017) (examining the post-crisis regulatory response to "systemic risk[s]" involving "nonbank institutions and activities"); Christina Parajon Skinner, Nonbank Credit, 9 Harv. Bus. L. Rev. 149, 172 (2019) ([B]anks' losses on mortgage-related credit assets during and after the crisis, . . . combined with heightened regulatory capital requirements, curtailed banks' ability to lend. Investment funds stepped in to fill the gap between the available bank supply and corporate demand for credit."); Bis Statistics, Bank for Int'l Settlements, https://stats.bis.org/statx/srs/tseries/LBS_D_PUB/Q.S.L.A.TO1.A.5J.A.US.N.5J.N?t=a5&c=US&m=S&p=2022&i=5.2 [perma.cc/X7JH-6CGP] (last visited Jan. 29, 2023); Pablo García Luna & Bryan Hardy, Non-bank Counterparties in International Banking, BIS Q. Rev., Sept. 2019, at 16, https://www.bis.org/publ/qtrpdf/r_qt1909b.pdf [perma.cc/48QB-NYPX] ("[B]anks' exposures to non-bank financial institutions (NBFIs) have trended upwards in recent years At the same time, NBFIs have become important sources of cross-border funding for banks").

⁵⁹ See, e.g., Howard Marks, Sea Change, Oaktree, at 4 (Dec. 13, 2022), <https://www.oaktreecapital.com/insights/memo/sea-change> [perma.cc/KV7N-X3ND] (summarizing the effects of "[a]n all-time low in interest rates . . . when the Fed cut the fed funds rate to approximately zero").

⁶⁰ Beltran de Miguel et al., supra note 7, at 6 (noting that institutional investors' allocations to private markets averaged 18.5 percent in 2020, up nearly five percent since 2012).

⁶¹ See Nina Trentmann, Fed Rate Increases Upend Funding Markets in 2022. Here's What CFOs Can Expect in 2023, Wall St. J. (Dec. 14, 2022, 2:33 PM),

increasing interest rates--required to curtail inflation--induced significant volatility in the public markets, and the equities market in particular.⁶² But private equity funds have long-time horizons and locked-in capital.⁶³ Accordingly, the private equity funds' investments themselves are less susceptible to interest rate movements that surprise the public market. Even where a private equity fund's investments are temporarily marked down in value alongside a depressed market, because capital gains are only realized once assets are sold, a private fund will wait as long as necessary to sell assets and return profits to the fund.⁶⁴ In contrast to the managers of a Registered Investment Company (i.e. a Investment Company Act Fund), a private fund manager can be patient with its invested capital to avoid financial-cyclical related loss.⁶⁵

Together, these three trends have pushed companies to prefer to issue their securities to private funds, which has in turn increased the

<https://www.wsj.com/articles/fed-rate-increases-upended-funding-markets-in-2022-heres-what-cfos-can-expect-in-2023-11670984197> [perma.cc/UV9E-QDME] (forecasting the impact of "the Fed's monetary tightening campaign").

⁶² See, e.g., Tobias Adrian, Interest Rate Increases, Volatile Markets Signal Rising Financial Stability Risks, IMF Blog (Oct. 11, 2022), <https://www.imf.org/en/Blogs/Articles/2022/10/11/interest-rate-increases-volatile-markets-signal-rising-financial-stability-risks> (analyzing the effects of "monetary policy tightening" as a response to "inflationary pressures"); Misyrlena Egkolfopoulou, Bloomberg Wealth: Fed Outlook Promises More Market Volatility Ahead, Bloomberg (Sept. 22, 2022, 6:30 AM), <https://www.bloomberg.com/news/newsletters/2022-09-22/fed-rate-hike-outlook-indicates-stock-market-volatility-is-here-to-stay> [perma.cc/EPV9-LPAQ] ("As expected, Federal Reserve officials raised interest rates by another 75 basis points on Wednesday as they fight to tame surging inflation. . . . Stocks seesawed after the decision before closing with a significant drop. And it's unlikely the volatility will end here.").

⁶³ See Jill Shaw, A Framework for Benchmarking Private Investments, Cambridge Assocs. (Mar. 2014), <https://www.cambridgeassociates.com/insight/a-framework-for-benchmarking/> [perma.cc/7X5C-AL4G] (outlining a framework for measuring and benchmarking private investment performance).

⁶⁴ See generally Felix Barber & Michael Goold, The Strategic Secret of Private Equity, Harv. Bus. Rev. (Sept. 2007), <https://hbr.org/2007/09/the-strategic-secret-of-private-equity> [perma.cc/A7DJ-SUDJ] (discussing the reasons why the private equity business model is so successful).

⁶⁵ Id.

universe of investable private securities alongside hard assets like real estate and infrastructure. Data now show that capital raised through private placements far exceeds the amount raised by public equity and debt offerings.⁶⁶ Concurrently, investors have pursued investment in private funds to avoid both the regulatory tax on public-fund profits as well as their volatility. Accordingly, these post-2008 trends made what was an already profitable sector even more so relative to the public market alternatives.⁶⁷ These trends, and the structural shift they have occasioned in financial markets, do not seem likely to reverse.⁶⁸

B. Dividing Investors

Most people in America are not “accredited investors” according to the SEC’s definition. Pursuant to the rule, accredited investors include institutions and any person with a net worth of at least \$1 million (excluding their primary residence) or an income of at least \$200,000 (\$300,000 together with a spouse) each year for the last two years.⁶⁹ The accredited investor definition matters because it is the pathway to private funds’ exemption from the registration requirements of the Securities Act.⁷⁰

⁶⁶ Bauguess, supra note 49, at 15.

⁶⁷ See The Blackstone Group L.P., Registration Statement (Form S-1) 5 (Mar. 22, 2007) (disclosing at the time of filing it had earned an annual return of 30.8% on investments gross of fees since the firm began in 1987, and an annual return of 22.8% net of fees); KKR & Co. L.P., Registration Statement (Form S-1) 132-33 (July 3, 2007) (disclosing an annual average return of 20.2% net of fees on its first ten private equity funds during a period spanning over thirty years).

⁶⁸ See also Steven N. Kaplan & Antoinette Schoar, Private Equity Performance: Returns, Persistence and Capital Flows, 60 J. Fin. 1791, 1797--99 (2005) (finding excess returns for a dataset of private equity funds maintained by Venture Economics over the S&P 500 gross-of-fees for the period 1980-1997; as it has for the last decade, PE continued to outperform other private market asset classes (its median IRR is markedly higher), as well as public markets equivalents. Median funds in every PE vintage since 2009 have returned, to date, at least 1.06 times the returns of PME’s).

⁶⁹ 17 C.F.R. § 230.501(a).

⁷⁰ Concept Release on Harmonization of Securities Offering Exemptions, 84 Fed. Reg. 30460, 30463 (proposed June 26, 2019) (“The emphasis on the characteristics

The rationale of the definition is grounded in the SEC's main statutory mission: investor protection.⁷¹ The rule evolved from Congress's realization in 1933 that not everyone would need the statute's protections; namely, "where there is no practical need for its application or where the public benefits are too remote."⁷² Congress thus included section 4(1) in the Act, which exempts from the statute's requirements transactions that do not involve a "public offering"--though Congress unhelpfully did not define the term.⁷³

Although in 1953 the Supreme Court would attempt to give content to the term "public offering," by tying the transaction to whether the affected investors could "fend for themselves,"⁷⁴ confusion still abounded. Accordingly, in 1982, the SEC promulgated Regulation D to clarify which offerings were not public (in other words, what counted as a private placement).⁷⁵ In concept, an important characteristic of the accredited investor was his or her possession of sufficient "economic bargaining power to obtain access to the information he requires to make an informed investment decision."⁷⁶

of the investors extends throughout the current exempt offering framework, in which the fewest conditions apply to an offering under an exemption where sales are restricted to accredited investors").

⁷¹ Comm. on Cap. Mkts. Regul., supra note 21, at 28 ("Congress's primary goal was to provide full and fair disclosure to investors in connection with offers and sales of securities.").

⁷² H.R. Rep. No. 85, at 5 (1933).

⁷³ Securities Act of 1933, Pub. L. No. 73-22, § 4(1), 48 Stat. 74, 77 (1933).

⁷⁴ Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 125 (1953).

⁷⁵ 17 C.F.R. § 230.500--508. Prior to Regulation D, the idea of the accredited investor emerged formally in 1980, in Rule 242, a predecessor to Regulation D. Exemption of Limited Offers and Sales by Qualified Issuers, 45 Fed. Reg. 6,362 (Jan. 28, 1980). In 1980, Congress passed the Small Business Investment Incentive Act of 1980, which added the "accredited investor" definition to the Securities Act and gave the SEC the authority to define the term based on an investor's financial sophistication, net worth, knowledge, and experience in financial matters. Small Business Incentive Act of 1980, Pub. L. No. 96-477, § 602, 94 Stat. 2275 (1980). See also 15 U.S.C. § 77b(a)(15) (defining accredited investor).

⁷⁶ Exemption of Limited Offers and Sales by Qualified Issuers, 45 Fed. Reg. 6,362, 6,364 (Jan. 28, 1980).

Today, Rule 506 under Regulation D is the most frequently used exemption because there is no dollar limit on the amount that can be raised provided the offering is made available only to accredited investors and the issuer does not engage in general solicitation.⁷⁷ According to the SEC, “Rule 506 offerings to accredited investors occur with greater frequency than any other type of offering surveyed by the staff.”⁷⁸

Separately, the Investment Company Act of 1940 would, as discussed, impose a separate set of obligations on a fund were it not exempt.⁷⁹ There are two exemptions under the Investment Company Act relevant for private funds. The first, pursuant to section 3(c)(1), is not routinely used by large private equity firms as it requires fewer than 100 beneficial owners.⁸⁰ The second exemption, created by Congress in 1996, is however frequently relied upon. Section 3(c)(7) of the Investment Company Act supplies an exemption for funds that are sold only to “qualified purchasers.”⁸¹

Like the accredited investor definition, the qualified purchaser standard is also meant to proxy for sophistication. At the time of its passage, the Senate Banking Committee noted that “the qualified purchaser [standard] reflects the Committee’s recognition that

⁷⁷ 17 C.F.R. § 230.506. The SEC did relax some of the general solicitation rules in 2013. Henceforth, an offering under Rule 506(c) can use general solicitation in connection with the sale of securities if all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify they meet that definition. However, engaging in general solicitation may impose additional disclosure and legal risk on funds, so it is not clear whether uptake on this waiver has been large. See Mark S. Bergman et al., How Will the SEC’s New Reg D Rules Affect Offerings by Private Funds?, Paul, Weiss, Rifkin, Wharton & Garrison LLP 1 (July 17, 2013), https://www.paulweiss.com/media/1717486/17july13_sec.pdf. [perma.cc/4BLS-NCT3]

⁷⁸ Concept Release on Harmonization of Securities Offering Exemptions, 84 Fed. Reg. 30460, 30470 (proposed June 26, 2019).

⁷⁹ The statute defines an investment company as any entity that holds itself out as primarily engaged in the business of investing, reinvesting, or trading in securities.” 15 U.S.C. § 80a-3(a)(1).

⁸⁰ 15 U.S.C § 80a-3(c)(1).

⁸¹ 15 U.S.C. § 80a-3(c)(1), (7).

financially sophisticated investors are in a position to appreciate the risks associated with investment pools that do not have the Investment Company Act's protections."⁸² The SEC, for its part, seems to view the qualified purchaser standard as a floor underneath the accredited investor definition. In a 2007 release, the SEC described the qualified purchaser definition as meant "to safeguard investors seeking to make an investment in [private funds] in light of their unique risks, including risks with respect to undisclosed conflicts of interest, complex fee structures, and the higher risk that may accompany such vehicles' anticipated returns."⁸³ The premises asserted in these statements--of questionable accuracy--will be addressed below.⁸⁴

When viewed in light of the three post-2008 trends discussed above--banks' retreat from lending, the increasing costs to issuers associated with raising funds in public markets, and dramatic monetary policy swings--these accredited and qualified investor rules seem increasingly arbitrary and unfair.

II. REEXAMINING ECONOMIC RIGHTS

As Part I explained, shifts in the macro-financial environment over the past fifteen years have amplified the longstanding problems associated with dividing investors according to their wealth. This Part first considers how speculative substitution harms investors and then unpacks the constitutional illegitimacy of the accredited investor and qualified purchaser constraints.

A. Speculative Substitution

Increasingly since 2008, investing behaviors have skewed financial activity toward the more speculative end of the spectrum. By blocking access to the higher-yields and inflation hedges that private markets can offer, many retail investors have turned to much more speculative

⁸² S. Rep. No. 104-293, 10 (1996).

⁸³ Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 33-8828, 72 Fed. Reg. 45,116, 45,127 (Aug. 10, 2007)

⁸⁴ See *infra* Part III.

and lighter (if at all) regulated investments--these include SPACS, crypto assets, and ICOs. Each of these, in its own way, can be seen as a speculative substitute for a private fund investment.

SPACs--"special purpose acquisition corporations"--appear to be an obvious end-run around the accredited investor and qualified purchaser definitions because they so closely attempt to mimic the methodology and returns of private funds.⁸⁵ SPACS are publicly traded companies, whose strategy is to merge or "combine" with a private company (effectively, by buying all of its target's shares), which combination then allows that previously private company to become public--as it becomes one-in-being with the SPAC.⁸⁶ The SPAC disappears after two years, and the public company remains.⁸⁷

Even though SPACs raise money from the public--i.e., retail investors--and initiate their initial private offerings ("IPOs") through the public markets, SPACs use elements of the private equity playbook. SPACs operate like so-called "blank check corporations," which is to say that the SPAC is a shell company with no assets when it goes public. Investors that have bought shares of the SPAC then rely on the SPAC sponsors' future judgment about which asset to invest in--asset is singular here, as for the most part, a SPAC invests only in one company (using the money that it acquired during the IPO of its shares).⁸⁸

⁸⁵ See Davidoff, *supra* note 27, at 178--79 (noting that "[a]verage investors substitute a permitted investment with characteristics as close as possible to hedge funds or private equity" and that one example "comes from special purpose acquisition companies ('SPACs')").

⁸⁶ Max H. Bazerman & Paresh Patel, *SPACS: What You Need to Know*, Harv. Bus. Rev., July-Aug. 2021), at 104.

⁸⁷ *Id.* at 108-09.

⁸⁸ *What You Need to Know About SPACs – Updated Investor Bulletin*, U.S. Securities & Exchange Commission (May 25, 2021), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin> [https://perma.cc/KP35-DMWA]. As Davidoff explains,

At the time of the offering, the actual target acquisitions are unknown; it is only afterwards that the SPAC's organizers will begin to identify and attempt to acquire these businesses. The SPAC's organizational documents will typically provide it eighteen to twenty-four months to

Now, this is effectively what a private equity firm will do—first, raise a fund (pooling investors’ capital or capital commitments), generally providing disclosure about the sector or type of assets to be targeted, but not firmly identifying which assets will become targets of opportunity. After all, the private equity manager would be imprudent to constrain his or her business judgment in that way; the freedom to invest when opportunity arises is a key component in the PE model's success.

But there are certain key differences between a SPAC and a private fund that make SPACs much riskier for investors. For one, the SPAC lacks diversification relative to a private fund. This is because a SPAC acquires a single asset whereas the vast majority of private funds hold a range of assets which, in complement, guarantee high returns as well as risk diversification. Second, many SPAC sponsors do not have the management skill or business acumen of private fund managers.⁸⁹ And third, SPACs are hotbeds of investor fraud.⁹⁰ Large and well-established private funds are not routinely scamming their investors.

Plenty of companies seem to like the SPAC as a short-cut IPO. For those companies seeking to go public, the SPAC-route is much faster than an IPO, and thus offers more certainty in a macroenvironment of high volatility.⁹¹ For retail investors, SPACs offer a higher-returning

agree or complete an acquisition before the SPAC is required to liquidate and return the remaining offering proceeds to investors.

Davidoff, *supra* note 27, at 224.

⁸⁹ Davidoff, *supra* note 27, at 239 (remarking that SPAC advisers “often lack the buy-out expertise that fund advisers have, typically do not have the equivalent level of resources, experience or investment affiliations, and often are not as well versed in the industry of their acquisitions as fund adviser principals are”).

⁹⁰ See, e.g., Press Release, Sec. & Exch. Comm’n, SEC Charges Former SPAC CFO for Orchestrating 5% Million Fraud Scheme (Jan. 3, 2023), <https://www.sec.gov/news/press-release/2023-1> [<https://perma.cc/8L9W-TXQB>] (describing fraud charges against a former SPAC CFO for orchestrating a scheme in which he stole over \$5 million from the company and from investors).

⁹¹ See Camila Domonoske, *The Spectacular Rise of SPACs: The Backwards IPO That’s Taking Over Wall Street*, NPR (Dec. 29, 2020, 5:00 AM), <https://www.npr.org/2020/12/29/949257672/the-spectacular-rise-of-spacs-the-backwards-ipo-thats-taking-over-wall-street>. [<https://perma.cc/G2H3-ALRE>] (explaining that the built-in advantages of “speed, control and less uncertainty for founders” made SPACs particularly appealing in a volatile year like 2020)

investment than the ordinary public markets and, for those who were bored by the low-rate environment, SPACs offered some thrill of investing in an exotic product. SPACs' popularity among issuer and investor alike is evident in the data: "In 2019, 59 [SPACs] were created, with \$13 billion invested; in 2020, 247 were created, with \$80 billion invested; and in the first quarter alone of 2021, 295 were created, with \$96 billion invested."⁹² To put these figures in context, in 2020, "SPACs accounted for more than 50% of new publicly listed U.S. companies."⁹³ It is no coincidence that the exponential growth of the SPAC coincided with the three macro-financial trends discussed above against a legal backdrop that restricts retail investors from accessing alternative asset investments.

Crypto investing has also taken off since 2020. This Article can hardly do justice to the full range of crypto-assets that investors have been drawn to. They run the gamut from currency-like instruments, like well-known stablecoins such as Tether and USDC,⁹⁴ to decentralized cryptocurrencies that economically resemble a commodity, like Bitcoin and Ether.⁹⁵ Relatedly, to raise funding for a new kind of crypto-asset (and/or the blockchain infrastructure that it runs on), occasionally, a crypto-coin's creator--the crypto-equivalent of a sponsor--will engage in an ICO.

Each of these crypto products maps onto some or all of the aforementioned macro-financial trends. Many investors in Bitcoin believe it is the truest inflation hedge; unaffected by a government's monetary policy fluctuation. According to these proponents, the value of an unbacked crypto asset is inherent, unlike a fiat currency.⁹⁶ As

⁹² Bazerman & Patel, supra note 81, at 104.

⁹³ Id.

⁹⁴ Tether, <https://tether.to/en/> (last visited Jan. 29, 2023) [<https://perma.cc/NP9R-94GY>]; USD Coin, Circle, <https://www.circle.com/en/usdc> (last visited Jan. 29, 2023). [<https://perma.cc/U6GF-GQAJ>]

⁹⁵ See generally Matt Levine, The Only Crypto Story You Need, Bloomberg (Oct. 25, 2022, 5:00 AM), <https://www.bloomberg.com/features/2022-the-crypto-story/>. [<https://perma.cc/E3M4-YEWH>] (describing how Bitcoin and Ether work, including how they resemble economic commodities)

⁹⁶ See Francisco Rodrigues, Gold, Bitcoin or DeFi: How Can Investors Hedge Against Inflation?, Cointelegraph (Dec. 4, 2021), <https://cointelegraph.com/news/gold-bitcoin-or-defi-how-can-investors-hedge->

for stablecoins, today, most investors in stablecoin use it to gain access and exposure to unbacked crypto-currencies and the broader universe of ‘decentralized finance’.⁹⁷ In general, this search for a decentralized and stateless financial system evidences disillusionment with the State-centralized financial system (along with its regulations and restrictions on accessing investments).

Then, there are the ICOs that function similar to an IPO. During an ICO, a token (much like a security) is exchanged for the promise of some future equity or other stream of financial rewards associated with a venture (this is often, but not always the launch of a new crypto currency).⁹⁸ Sometimes ICOs involve “utility” tokens, which can be used to buy whatever product or service the venture aims to create or offer when it eventually launches.⁹⁹ The story of the ICO more closely tracks the SPAC. ICOs have attracted issuers who are weary of the costs and delay associated with going public via IPO as well as investors who are eager to reap the financial benefits that derive from investing in companies that can bring their shares to market faster and more cheaply.¹⁰⁰

against-inflation (referencing industry professionals endorsing Bitcoin as an inflation hedge). It bears noting that, while crypto industry participants continue to believe this narrative, it has largely been debunked in the current inflationary period (at least, it has not proven true just yet). See, e.g., Bryce Elder, Opinion, [Can Bitcoin Hedge Inflation, and Other Questions to Which the Answer Is No](https://www.ft.com/content/f1ec9dfo-091f-4e13-b7b7-cb53df3c9478), Financial Times (Mar. 7, 2023), <https://www.ft.com/content/f1ec9dfo-091f-4e13-b7b7-cb53df3c9478> (noting that current studies suggest that Bitcoin does not function as an inflation hedge).

⁹⁷ Christina Parajon Skinner, [Recentralized Finance](#), 60 Harv. J. on Legis. (forthcoming 2023)(manuscript at 33).

⁹⁸ Christian Fisch, [Initial Coin Offerings \(ICOs\) to Finance New Ventures](#), 34 J. Bus. Venturing 1, 3. See also Dirk A. Zetzsche et al., [The ICO Gold Rush: It’s a Scam, It’s a Bubble, It’s a Super Challenge for Regulators](#), 60 Harv. Int’l L.J. 267, 275 (2019) (describing the various functions of a securities token).

⁹⁹ Rüdiger Fahlenbrach & Marc Frattaroli, [ICO Investors](#), 35 Fin. Mkts. & Portfolio Mgmt. 1 (2021), <https://link.springer.com/article/10.1007/s11408-020-00366-0>. [<https://perma.cc/T29T-EWZ2>]

¹⁰⁰ There is significant empirical literature showing the ICOs generate more return than IPOs. See, e.g., Christian Catalini & Joshua S. Gans, [Initial Coin Offerings and the Value of Crypto Tokens](#) (Nat’l Bureau of Econ. Rsch., Working Paper No. 24418, 2018), at 2 (describing how blockchain startups have raised significantly more through ICOs than through traditional venture capital); Ryan

Though the cryptoasset world is new, fraud and incompetence have already become widespread. Most notably, in May 2022, one of the most prominent algorithmic stablecoins--Terra USD--effectively melted down by failing to maintain its \$1 peg, causing significant volatility in the rest of the crypto market.¹⁰¹ Even more high-profile a scandal was the November 2022 collapse of the crypto exchange FTX, which involved allegations of fraud against its founder and CEO Sam Bankman-Fried (known as "SBF").¹⁰² Essentially, Bankman-Fried misappropriated customer funds from FTX to prop up his failing crypto trading and research firm, Alameda (which was something like a crypto hedge fund).¹⁰³ Given the pseudonymous nature of the crypto exchange and its transactions, and the commingling of funds, FTX's investors seem unlikely to recover their "deposits."¹⁰⁴

Likewise in the ICO market, fraud is prevalent--at least one research group estimated in 2020 that of 1,500 ICOs it investigated, 576 were fraudulent and had resulted in \$10.12 losses to investors.¹⁰⁵

Amsden & Denis Schwizer, *Are Blockchain Crowdsales the New 'Gold Rush'? Success Determinants of Initial Coin Offerings* (2018), at 2-3, <https://ssrn.com/abstract=3163849> [https://perma.cc/C8ES-Q4Z3] (describing how ICOs have dwarfed crowdfunding and venture capital in recent years with respect to funds raised); Hugo Benedetti & Leonard Kostovetsky, *Digital Tulips? Return to Investors in Initial Coin Offerings*, 66 J. of Corp. Fin., Feb. 2021., at 2-3 (describing the differences between ICOs and the IPOs which could give ICOs an advantage).

¹⁰¹ See Andrew Ross Sorkin et al., *A Stablecoin 'Death Spiral'*, N.Y. Times (May 12, 2022), <https://www.nytimes.com/2022/05/12/business/dealbook/terra-crypto-stablecoin.html> [perma.cc/AU2C-7W4G] (explaining that a sell-off of Luna, Terra's sister currency, caused Terra's price to plunge to 23 cents).

¹⁰² See Andrew Ross Sorkin et al., *Sam Bankman-Fried's 'House of Cards' Teeters*, N.Y. Times (Dec. 13, 2022), <https://www.nytimes.com/2022/12/13/business/sam-bankman-fried-sbf-arrest-ftx-crypto.html>. [***] (reporting that federal prosecutors would charge Sam Bankman-Fried with "wire fraud conspiracy, securities fraud, securities fraud conspiracy and money laundering.")

¹⁰³ *Id.*

¹⁰⁴ Nik Popli, *Why FTX Account Holders Are Unlikely To Get Their Money Back*, Time (Nov. 25, 2022), <https://time.com/6236610/ftx-account-holders-money-back/>.

¹⁰⁵ Klaus Grobys, *Did You Fall For It? 13 ICO Scams That Fooled Thousands*, Cointelegraph (Dec. 6, 2020), <https://cointelegraph.com/news/did-you-fall-for-13-ico-scams-that-fooled-thousands> [perma.cc/29EX-E7V8].

Fraud has not abated in the past two years, and ICO investment has marched on.¹⁰⁶ Short of fraud, researchers have found that ICO investors receive very little downside protection or governance rights along with their investment, of the kind that are typically afforded to private fund investors.¹⁰⁷ Moreover, unlike a private fund, ICOs rarely specify milestones for release of funds, making the investment relatively blind similar to a SPAC.¹⁰⁸ In short, there is a startling “lack of transparency and investor protection” associated with the ICO.¹⁰⁹

Overall, in each case--SPACs, direct crypto-asset investing, and ICO investing--regardless of how few protections these sponsors offer for investors, retail money has been flocking to these grey zones of the financial markets since 2020.¹¹⁰ Before 2022 at least, these investors were presumably motivated to seek yield in a low-rate environment, just as they now (in 2022 and 2023) seek hedges against inflation and diversification away from the volatility of the public markets. Issuers, for their part, long exasperated by the expense and rhythm of the public market, are happy to fuel these investors’ demand by continuing to choose alternatives to the classic IPO or debt underwriting structure--the SPAC, the ICO, or a direct listing on a crypto-currency exchange.

¹⁰⁶ Spotlight on Initial Coin Offerings (ICOs), Sec. & Exch. Comm’n (July 14, 2021), <https://www.sec.gov/ICO>. [<https://perma.cc/KKY3-7Q68>] (warning investors of risks of fraud and manipulation surrounding ICOs).

¹⁰⁷ Fahlenbrach & Frattaroli, supra note 97, at 3.

¹⁰⁸ Id.

¹⁰⁹ Id.

¹¹⁰ Goldman Sachs, 2020: The Year of the SPAC, in Top of Mind: The IPO SPAC-Tacle 12, 13 (Jan. 28, 2021, 6:05 PM), <https://www.goldmansachs.com/insights/pages/top-of-mind/the-ipo-spac-tacle/report.pdf> (“Lockdowns associated with the pandemic

have prompted a surge in retail trading and demand for the highly-volatile shares of firms with perceived hyper-growth prospects”); Raphael Auer et AL., Crypto Trading And Bitcoin Prices: Evidence from a New Database of Retail Adoption, at 10, BIS Working Papers No 1049 (Nov. 2022), <https://www.bis.org/publ/work1049.pdf> (showing a significant increase in daily active users of crypto-exchange apps as of 2020). See also Paul Vigna, NFT Sales Are Flatlining, Wall St. J. (May 3, 2022, 7:15 AM), <https://www.wsj.com/articles/nft-sales-are-flatlining-11651552616> (describing the mid-2021 to early 2022 NFT (non-fungible token) boom).

There are very good reasons why each of these activities should be regulated more stringently than they presently are.¹¹¹ The point here, however, is solely focused on access to investment contract. We can infer from these high-risk, low-protection investments that investors do not always primarily care about being protected from financial risk; they have strong preferences for yield and are willing to accept in return a host of contractually agreed trade-offs concerning governance, information, and potential conflicts of interest. As such, while much scholarship attributes retail investors' penchant for speculation to bad or ignorant habits (e.g., the propensity to hold undiversified portfolios with idiosyncratic volatility) or their psychology (the desire to "gamble with lottery-like stocks"),¹¹² this Article urges that these habits and preferences may well reveal a group of investors who are engaging in financial optimization in a world of State-imposed (i.e., regulatory) constraints.

B. A Tradition and Jurisprudence of Economic Rights

By now it should be clear that there are both micro and macro-financial costs to constraining retail investors' freedom to enter into investment contracts with private funds. The law, while grasping tightly to investor protection ideology, has consequently reduced economic opportunity relative to economic risk for individual households while simultaneously increasing the proportion of financial activity taking place outside the regulatory perimeter (which also happens to have a track-record for provoking financial instability). Those distortions alone might be reason enough to

¹¹¹ See, e.g., Michelle W. Bowman, Governor, Bd. of Governors of the Fed. Rsrv. Sys., Brief Remarks on the Economy and Bank Supervision (Jan. 10, 2023), <https://www.federalreserve.gov/newsevents/speech/bowman20230110a.htm> [perma.cc/4LPA-2KFJ] ("The dysfunction in cryptocurrency markets has been well-documented, with some crypto firms misrepresenting that they have deposit insurance, the collapse of certain stablecoins, and, most recently, the bankruptcy of the FTX cryptocurrency exchange. These events have made it clear that cryptocurrency activities can pose significant risks to consumers, businesses, and potentially the larger financial system.").

¹¹² Fahlenbrach & Frattaroli, supra note 94, at 3.

discard the accredited investor and qualified purchaser standards. But these legal frictions seem somewhat stuck.

Accordingly, where consequentialist arguments fail to carry the day, a rights-based critique might just prevail. Specifically, it is arguable that constructing de facto categorical bars to contracting for private fund investment using de jure legal definitions is constitutionally unsupported from an economic rights perspective.

1. The Framers' Free Markets

For more than half of American history, economic rights were a robust part of the country's constitutional tradition. Broadly speaking, these economic rights protected what we refer to today as economic liberty: equal access to economic opportunity, the freedom to use one's skills (physical and intellectual) to earn a living, and the freedom to enter into economic contract.¹¹³ According to prevailing views of the time, an individual's right to private property was a pre-political right and thus unalienable by the State.¹¹⁴

The Founding generation appears to have considered economic liberty to be a fundamental tenet of a republican form of self-government that elevated individual choice. On the economics of transacting, the enlightenment thinkers of that era viewed equal access of opportunity as critical to a modern, market-oriented society. Indeed, in developing the concept of specialization, comparative advantage, and exchange, Adam Smith's Wealth of Nations was predicated on equality of economic opportunity as necessary to pursue one's skills and interests. His words to that effect are worth reading in some depth:

The difference of natural talents in different men, in reality, must be less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown up to maturity, is not upon many occasions so

¹¹³ Professor Randy Barnett defines economic liberty similarly, as "the right to acquire, use, and possess private property, as well as the right to enter into private contracts of one's choosing." Randy E. Barnett, Does the Constitution Protect Economic Liberty?, 35 Harv. J.L. & Pub. Pol'y 5, 5 (2012).

¹¹⁴ Id. at 6--8.

much the cause, as the effect of the division of labour. The different between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom, and education. When they first came into the world, and for the first six or eight years of their existence, they were, perhaps, very much alike, and neither their parents nor play-fellows could perceive any remarkable difference. About that age, or soon after, they come to be employed in very different occupations. The difference of talents comes then to be taken notice of, and widens by degrees, till at last the vanity of the philosopher is willing to acknowledge scarce any resemblance. But without the disposition to truck, barter, and exchange, every man must have procured to himself every necessary and convenience of life which he wanted

Among men . . . the most dissimilar geniuses are of use to one another; the different produces of their respective talents, by the general disposition to truck, barter, and exchange, being brought, as it were, into a common stock, where every man may purchase whatever part of the produce of other's men's talents he has occasion for.¹¹⁵

As such, the original text of the Constitution and the Bill of Rights expressly protected private property alongside liberty in general.¹¹⁶ Later, the Fourteenth Amendment, when added to the Constitution in 1868, breathed real life into the term "liberty" by cementing the full complement of economic rights referenced above.¹¹⁷

¹¹⁵ Adam Smith, Of the Principle Which Gives Occasion to the Division of Labor, in Wealth of Nations 15, 17 (1776).

¹¹⁶ U.S. Const. amend. V ("No person shall . . . be deprived of life, liberty, or property, without due process of law; not shall private property be taken for public use, without just compensation.").

¹¹⁷ See George Thomas, Economic Liberty in the Courts, Nat'l Affs., Summer 2010, <https://www.nationalaffairs.com/publications/detail/economic-liberty-in-the-courts> [https://perma.cc/4BXX-RVJQ] (arguing that economic liberty was at the "heart of the 14th Amendment" in its original application)

To be certain, the Fourteenth Amendment, together with the Thirteenth and the Fifteenth, was meant to eradicate the practice and possibility of slavery in America. The physical freedom granted by the Thirteenth Amendment would have been meaningless without the economic freedoms secured by the Fourteenth.¹¹⁸ Because the drafters of the Amendment wanted to preclude all possible future permutations of slavery, the guarantees against deprivation of “liberty” and the abridgement of the “privileges and immunities of citizens of the United States” were applied to, in the case of the former, “any person” and in the latter, any “citizen of the United States.”¹¹⁹ In other words, the liberties, privileges and immunities are meant to be universal within each category. As Professor David Bernstein has written, many “postbellum legal scholars and judges . . . argued that the Clause gave courts the right and obligation to enforce against the states not just the largely procedural rights protected by the Magna Carta and long-standing Anglo-American traditions, but all fundamental individual rights deemed essential to the development of American liberty, including economic rights.”¹²⁰

2. Equal Economic Opportunity

Chief among these economic liberties was the right of equal access to economic opportunity, which rejected class-based economic regulation. Citing one of the Amendment’s main advocates in Congress, Professor George Thomas explains that the Fourteenth

¹¹⁸ See id. (“In the immediate aftermath of the Civil War, Southern states had attempted to maintain the functional inequality of newly freed slaves by subjecting them to unequal laws. While whites could operate unfettered within the economic sphere, blacks were limited in their choices of occupation, in their freedom to own and acquire property, and in their right to engage in lawful contracts. The aim of the 14th amendment, then, was to force the states to protect all citizens’ civil liberties equally--liberties that, in many cases, pertained to economic activity.”)

¹¹⁹ U.S. Const. amend XIV, § 1.

¹²⁰ David Bernstein, Lochner Era Revisionism, Revised: Lochner and the Origins of Fundamental Rights Constitutionalism, 92 Geo. L. J. 1 (2003), 33--34. See also Thomas, supra note 109 (“In the late 1860s--in the environment out of which the 14th Amendment emerged--civil rights were seen as rights to equal opportunity and equal treatment by the law, especially in the economic sphere”).

Amendment's main "aim[] was the abolishment of 'all class legislation in the States,'" in order to secure "the principles lying at the very foundation of all republican government: the principles of equality, protection of property, and the impartial rule of law."¹²¹

For some time after the passage of the Fourteenth Amendment, the Supreme Court scrutinized regulation for class-legislation subterfuge; and most of these illegitimate laws took the shape of economic regulation that crimped equal economic opportunity. Consider, as a prime example, the 1886 case Yick Wo v. Hopkins.¹²² The case involved a San Francisco ordinance regarding the kind of building structure in which one could operate a laundry (only structures of stone or brick were permitted for fire safety reasons).¹²³ The Court found that the ordinance, though neutral on its face, was in fact not a legitimate exercise of the police power of the state of California because it was applied "with a mind so unequal and oppressive as to amount to a practical denial by the state of that equal protection of the laws which is secured to the petitioners . . . by the broad and benign provisions of the fourteenth amendment to the constitution of the United States."¹²⁴

The Court was clearly applying the Equal Protection Clause of the Fourteenth Amendment, but with an equally clear-eyed view to the petitioners' economic rights in the pursuit of their livelihood. The Court seemed most animated about the wedge driven between access to the business of laundering by Chinese Americans and that access afforded to everyone else:

"No reason whatever, except the will of the supervisors, is assigned why they should not be permitted to carry on, in the accustomed manner, their harmless and useful occupation, on which they depend for a livelihood; and while this consent of the supervisors is withheld from them, and from 200 others who have also petitioned, all of whom happen to be Chinese subjects, 80 others, not Chinese

¹²¹ Thomas, supra note 109.

¹²² 118 U.S. 356 (1886).

¹²³ Id. at 368.

¹²⁴ Id. at 373.

subjects, are permitted to carry on the same business under similar conditions.”¹²⁵

3. Freedom of Contract

The ability to access economic opportunity depends, in many cases, on the freedom to contract. The Framers and the drafters of the Civil War Amendments considered this manner of individualism essential to incentivizing robust self-governance; it was therefore considered paramount that the Constitution enabled and inspired people to freely pursue their own economic fortune “through the market-oriented economy that had taken hold in the colonies in lieu of the mercantile system that England sought to impose on the New World.”¹²⁶ The canonical case espousing this view is Lochner v. New York.¹²⁷ The question in Lochner was whether the state of New York could exercise its police power to enforce a law that prohibited bakers from working more than sixty hours per week.¹²⁸

The Court held that “[t]he general right to make a contract in relation to his business is part of the liberty of the individual protected by the Fourteenth Amendment of the Federal Constitution,” and thus the labor law was not a valid exercise of the state’s police powers.¹²⁹ Although the Court acknowledged that states may legitimately intervene in contractual relations on public morality or public safety grounds, the case of the sixty-hour baker workweek did not pass the bar.

To distinguish valid from invalid uses of the police power, the Court referred to a rationale of reasonableness. The question would be whether the state’s intervention in an individual’s otherwise freedom to contract meets the following test:

¹²⁵ Id. at 374.

¹²⁶ Paul Larki et al., *Economic Liberty and the Constitution: An Introduction* (2014), <https://www.heritage.org/the-constitution/report/economic-liberty-and-the-constitution-introduction> [perma.cc/Q73F-ZYTH].

¹²⁷ 198 U.S. 45 (1905).

¹²⁸ Id. at 46.

¹²⁹ Id. at 53.

“Is this a fair, reasonable, and appropriate exercise of the police power of the State, or is it an unreasonable, unnecessary, and arbitrary interference with the right of the individual to his personal liberty, or to enter into those contracts in relation to labor which may seem to him appropriate or necessary for the support of himself and his family.”¹³⁰

Put another way, “[t]he act must have a more direct relation, as a means to an end, and the end itself must be appropriate and legitimate, before an act can be held to be valid which interferes with the general right of an individual to [freely] contract . . . his own labor.”¹³¹

And it was important to the Lochner Court that individuals enjoy a presumption in the law that, unless proven otherwise, they are intelligent and rational actors:

“There is no contention that bakers as a class are not equal in intelligence ad capacity to men in other trades of manual occupations, or that they are not able to assert their rights and care for themselves without the protecting arm of the State, interfering with their independence of judgment and of action.”¹³²

Though Lochner is often cited for establishing “economic due process” and substantive due process more generally,¹³³ the rationale in Lochner may well have drawn inspiration from Justice Field’s dissent in the Slaughterhouse Cases, interpreting the privileges and immunities clause of the Fourteenth Amendment.¹³⁴ At issue in that

¹³⁰ Id. at 56.

¹³¹ Id. 57--58.

¹³² Id. at 57.

¹³³ See, e.g., Note, Resurrecting Economic Rights: The Doctrine of Economic Due Process Reconsidered, 103 Harv. L. Rev. 1363, 1365-66 (1990) (stating that the majority opinion in Lochner “solidified the doctrine” of substantive due process and that “[i]n the thirty years after Lochner, the Court invalidated many federal and state statutes on economic due process grounds”).

¹³⁴ 83 U.S. 36 (1872).

case was whether the state of Louisiana could confer monopoly rights on one slaughter-house corporation in the city of New Orleans for the ostensible purpose of improving public health and safety.¹³⁵ This was the first opportunity for the Court to interpret the Civil War Amendments, and the majority opinion construed them narrowly. It rejected the petitioners' argument that the Privileges or Immunities Clause protected their right to be free from state-imposed monopoly, which effectively would inhibit their entrepreneurial freedom.¹³⁶ Overtime, however, many jurists and academics took a negative view of Justice Miller's opinion and considered the case to have been wrongly decided, erringly narrowing the Fourteenth Amendment's protections.¹³⁷ Justice Field's dissent became the more prominent and oft-quoted viewed.¹³⁸

Justice Field's dissent focused mostly on the privileges and immunities clause. Interpreting earlier case law, Justice Field understood these privileges and immunities to be those that are "in their nature, fundamental; which belong of right to citizens of all free governments,"¹³⁹ and which "[c]learly among these must be placed the right to pursue a lawful employment in a lawful manner, without other restraint than such as equally affects all persons."¹⁴⁰ At least for Justice Fields, fundamental rights were not just civil liberties--as that term would later be equated--but also included those economic freedoms that could secure meaningful and gainful employment.

Of course, Lochner was later gutted by 1930s-New Deal-era precedent that was necessary to legitimate the substitution of

¹³⁵ Id. at 38--39.

¹³⁶ Id. at 80--81.

¹³⁷ See, e.g., Richard L. Aynes, Constricting the Law of Freedom: Justice Miller, The Fourteenth Amendment, and the Slaughter-house Cases, 70 Chi.-Kent L. Rev. 627, 627 (1994) (arguing that the Slaughter-House Cases were wrongly decided because they limited freedom).

¹³⁸ David E. Bernstein, Rehabilitating Lochner: Defending Individual Rights Against Progressive Reform 17 (2011) (noting that Field's dissent was crucial to the development of the liberty of contract idea).

¹³⁹ 83 U.S. 36, 97 (1872) (Field, J., dissenting) (quoting Corfield v. Coryell).

¹⁴⁰ 83 U.S. at 97--98.

economic liberty for the efficiency of the administrative state.¹⁴¹ (And Justice Field's dissent, as it were, was never binding precedent.) It is no accident that the rise of America's administrative apparatus coincided with the relegation of economic rights. Indeed, the diminution of economic rights as something less important than other individual rights was part of the intellectual putsch to develop an American administrative state--even well before FDR took office and operationalized the idea. Writing in 1885, Woodrow Wilson would state in The Art of Governing that "The period of constitution-making is passed now. We have reached a new territory in which we need new guides, the vast territory of administration."¹⁴² By that, Wilson was alluding to a viewpoint that the era of original understanding of economic rights as fundamental rights should come to an end.

But there is no constitutionally prescribed reason to continue the path started in the 1930s, that veered away from the Court's earlier economic rights jurisprudence. After all, neither Lochner nor Yick Wo were formally overruled, and the majority's decision to gut the privileges and immunities clause in the Slaughter-House cases subsequently produced perverse results that were quickly thereafter recognized as legally unsupported¹⁴³ and morally repugnant.¹⁴⁴

¹⁴¹ See, e.g., West Coast Hotel Co. v. Parrish, 300 U.S. 379, 391 (1937) ("The Constitution does not speak of freedom of contract. It speaks of liberty and prohibits the deprivation of liberty without due process of law."); United States v. Carolene Products Co., 304 U.S. 144, 152, 152-153 n.4 (1938) (finding a presumption of constitutionality for "regulatory legislation affecting ordinary commercial transactions" may not exist in certain cases); Williamson v. Lee Optical of Oklahoma, Inc., 348 U.S. 483, 491 (1955) (reversing the district court's opinion under rational basis review, noting the regulation's "attempt to free the profession...from all taints of commercialism").

¹⁴² Woodrow Wilson, The Art of Governing, in The Papers of Woodrow Wilson 52 (Arthur S. Link ed., 1993).

¹⁴³ Aynes, *supra* note 134, at 644.

¹⁴⁴ For example, the Slaughter-House cases' rejection of any rights under the privileges and immunities clause led to Bradwell v. Illinois, 83 U.S. 130, 138 (1872), in which the Court held that Myra Bradwell did not have a constitutionally protected right to practice law on the same terms as a man. It also led to United States v. Cruikshank, 92 U.S. 542, 554 (1875), in which the Court sanctioned the rejection of a prosecution of a state official who had led a mob to murder over 100 black citizens in Louisiana.

Assuming one were to revive Lochner's views on free contract, Yick Wo's stance on equal economic access, and Justice Field's conclusion that the pursuit of economic opportunity is a fundamental privilege of American citizenship--what would happen in the capital markets space seems, at this point, rather obvious. The accredited investor and qualified purchaser definitions would fall away and retail investors would be free to contract for--that is, to access--private fund investments. One cannot know *ex ante* whether the removal of this constraint would then stem the tide of speculation in crypto and crypto-adjacent areas, but it would at least level the playing field and quite likely confer financial benefit to most households.

III. THE PATH TO PRIVATE MARKET ACCESS

Assuming courts and jurists were to reconsider economic rights, as urged above, one might still anticipate considerable anxiety about the nature of the private equity contract that would be offered to retail investors. The charge that private equity sponsors are "barbarians" in their bargaining-- exerting undue influence on counterparties, targets, and now lenders--has been leveled against them for some time.¹⁴⁵ This Part suggests that those bargaining-power arguments do not, when properly put in context, negate the implication of the overarching economic rights analysis advanced above: that retail investors can and should have access to private fund investments. In particular, this Part drills down to what matters most to the conscionability of the private equity contract--the autonomy to accept the risk of financial losses in view of the prospect for economic reward.

A. Bargaining and the Private Equity Contract

Implicit in this Article's discussion is the fact that a private equity investment is a contract. A private equity fund is organized as a limited partnership, under state partnership law (usually

¹⁴⁵ This is a reference to the infamous novel, Barbarians at the Gate, by Bryan Burrough & John Heyar (1989). It discusses the leveraged buy-out of RJR Nabisco.

Delaware).¹⁴⁶ The limited partners (LPs) are the investors--without governance rights, typically¹⁴⁷--and the fund's managers are the general partners (GPs) who manage the operations and investments of the fund. The relationship between the LPs and the GPs is governed entirely by contract, in what is known as the LP Agreement or LPA.

The LPA is a contract, like any other, negotiated between the two parties--the LPs and the GP. The LPA sets out the terms of the fund, including when LPs are obligated to contribute capital (respond to "capital calls"), the stipulated end date of the fund at which point assets must be disposed and proceeds distributed to LPs, and whatever assurances against self-dealing and other conflicts that might be included.¹⁴⁸ With little doubt, the law gives GPs maximal freedom to draft the terms of an LPA. As former Delaware judges Leo Strine and J. Travis Laster point out, as "alternative entities" limited partnerships:

[e]schew the supposedly rigid mandatory default rules that characterize American corporate law statutes, the statutes that authorize alternative entities declare as public policy the goal of granting the broadest contractual freedom possible., and permit the parties to the governing instrument to waive any of the statutory of common law default principles of law and to shape their own relationships.¹⁴⁹

¹⁴⁶ PE funds are typically formed as limited partnerships in the State of Delaware, pursuant to the Delaware Revised Uniform Limited Partnership Act. *See* Del. Code Ann. tit. 6, § 17-101 et seq. (2022) (describing governance of limited partnerships).

¹⁴⁷ *See, e.g.,* Unif. Ltd. P'ship Act § 302 (Unif. L. Comm'n 2013) ("A limited partner is not an agent of a limited partnership solely by reason of being a limited partner.") ([year]); *see also* Revised Unif. Ltd. P'ship Act § 302 ((Unif. L. Comm'n 1985) ("[T]he partnership agreement may grant to all or a specified group of the limited partners the right to vote . . . upon any matter.").

¹⁴⁸ *See* William W. Clayton, *The Private Equity Negotiation Myth*, 37 Yale J. on Reg. 67, 74--76 (2020) (explaining how a private equity fund works).

¹⁴⁹ Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom, in* Partnerships, LLCs and Alternative Forms of Business Organizations 11 (Robert W. Hillman & Mark J. Loewenstein eds., 2015).

At first blush, this might seem somewhat shocking but it is perfectly consistent with the structure of the securities law itself. To the extent federal securities law inhibits the freedom of investment context, for the most part, (absent the rules discussed herein), its intervention is to require “default terms for those agreements” in the form of disclosure.¹⁵⁰ So it makes sense that where the securities law has decided that investors do not require that much disclosure, that the relevant business organization law would also take a light-touch approach regarding mandatory rules of contract. And ordinarily, where parties are generally free to contract, a court would not intervene unless the terms of the contract were unconscionable or the disparity in bargaining power egregious.¹⁵¹

So, is the private equity contract full of unconscionable terms that are extracted on unfair terms? There is no shortage of such critiques pointing out that, among other things, sponsors set the terms of the agreement and propose them to investors “on a take-it-or-leave-it basis”¹⁵²; that LPAs typically waive most of the GPs’ fiduciary duties (as is permitted under Delaware law)¹⁵³; and that the agreements are far too dense and incomplete for anyone to grasp let alone negotiate.¹⁵⁴

¹⁵⁰ Kelli Alces Williams, Legal Diversification, 113 Colum. L. Rev. 1977, 1993 (2013).

¹⁵¹ Restatement (Second) Of Contracts § 208 (1981) (paraphrasing principally U.C.C. § 2-

302); M. Neil Browne and Lauren Biksacky, Unconscionability and the Contingent Assumptions of Contract Theory, 2013 Mich. St. L. Rev. 211, 218–23.

¹⁵² See Strine & Laster, supra note 149, at 11-12.

¹⁵³ See Del. Code tit. 6, 17-1101(e) (2022) (eliminating fiduciary duties in partnerships); id. at §18-1101© (2013) (describing the expansion and elimination of duties). It bears noting, however, that most agreements include liability for acting in bad faith and that absent any contractual modification, default fiduciary duties of loyalty and care would still apply under Delaware law. See Strine & Laster, supra note 149, at 12 (“Among the hallmarks of these agreements are broad waivers of all fiduciary duties, including the duty of loyalty.”).

¹⁵⁴ See (“Ironically, when investors try to evaluate contract terms, the expansive contractual freedom authorized by the alternative entity statutes hampers rather than helps. Precisely because the statutes lack mandatory terms and permit great flexibility, a profusion of provisions abounds.”) Strine & Laster, supra note 149, at 12; Marco Da Rin & Ludovic Phalippou, The Importance of Size in Private Equity: Evidence from a Survey of Limited Partners, 31 J. Fin

But many bargains are this way. Most contracts in everyday life are a little bit complicated and struck between counterparties that have at least some difference in negotiating power. Yet, the law generally takes no position at all on this vast majority of economic bargains that retail investors make. To put the point in context, just consider that many contracts for lawful employment include take-it-or-leave-it terms; yet they rarely if ever invite categorical bars on an individual's ability to pursue the job.¹⁵⁵ Offers of employment to join the faculty of prestigious universities, as associates at big law firms, or analysts at "bulge bracket" investment banks are all good examples. Nor does the law ordinarily modulate people's propensity to take on economic (as opposed to financial) risk. Reflecting on the nature of entrepreneurship is also quite instructive. Investment in one's own business of course carries significant economic risk. And yet there is no government agency that prohibits the mom and pop who wish to stake it all on a restaurant, an inn, or a crafty jewelry line.

Perhaps more to the point, whether LPA terms are gained in the GPs' favor due to their outsized bargaining power is debatable at best. The negotiating climate surrounding sponsors' borrowing terms is telling in this regard. For some time, market-watchers and academics had noted, and similarly critiqued, the rise of so-called covenant-lite agreements. The agreements referred to loan documents that provided little protection for the lenders in terms of covenants (protection against loss or downside risk).¹⁵⁶ For private funds, covenant-lite agreements translated into relatively more beneficial

Intermediation 64, 69 (2016) ("LPAs are technical and lengthy documents, typically over 100 pages.").

¹⁵⁵ Cf. Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 Yale L.J. 2032, 2047, 2054 (2012) (describing language in contracts that provide alternatives to default terms.).

¹⁵⁶ See Matthew W. Abbot et al., *A Covenant-Lite Refresher*, Paul, Weiss Priv. Equity Dig., Sept. 2019, at 1, <https://www.paulweiss.com/media/3978898/23sep19-pe-digest.pdf>. [<https://perma.cc/4ZZM-WV4U>] <https://perma.cc/4ZZM-WV4U>](discussing how many cov-lite loans allow the borrower to incur additional debt and additional secured debt.)

arrangements for the GPs' ability to secure leverage to finance their acquisitions.

Yet time has proven that covenant-lite loans were not the product of grossly unequal power between the GP-borrowers and bank-lenders--rather, they were also a product of the macroeconomic environment. Low interest rates had empowered borrowers between 2008-2021, not the strong-arm or obfuscatory tactics of PE fund managers. In reversal of that trend, now that interest rates are rising, covenant-lite agreements are retreating as lenders gain the upper hand.¹⁵⁷ This all suggests that, while the LPAs might fluctuate according to the supply and demand for private investment in the marketplace, considering these agreements categorically unfair would seem a bridge too far.

In short, when the private equity contract is properly understood--and put in the right context--Lochner and Ralston Purina might just become mutually reinforcing. Provided society concedes that retail investors "as a class" are "equal in intelligence and capacity" to the accredited investors and qualified purchasers so defined by law and are not in any "sense wards of the state", we can arguably assume that retail investors can "care for themselves" in the private equity bargain.¹⁵⁸

B. Regulatory Adaptation

If we give retail investors more autonomy to decide their level of risk-appetite--let them enter the market for private investing as they

¹⁵⁷ Mark Vandavelde, The 'Covenant Lite' Loans are Not the Menace They Seem, *Fin. Times* (Feb. 15, 2019), <https://www.ft.com/content/7f80d354-311b-11e9-8744-e7016697f225> [perma.cc/BJ4C-67MT]; Mike Preston & Jim Ho, Comment, Investors Shift Away From Super Covenant-Lite Packages as Borrowing Costs Rise, *Priv. Equity News* (Nov. 15, 2022, 9:46 AM), <https://www.penews.com/articles/investors-shift-away-from-super-covenant-lite-packages-as-borrowing-costs-rise-20221115> [perma.cc/ZJL9-5K4F]; Jessica M. Ball et al., Documentary Development in Tighter Times, *White & Case LLP* (Aug. 11, 2022), <https://www.whitecase.com/insight-our-thinking/us-levfin-2022-documentary-developments> [perma.cc/95SL-CRYC].

¹⁵⁸ *Lochner v. New York*, 198 U.S. 45, 57 (1905).

wish--this implies a lower responsibility for the SEC to protect.¹⁵⁹ But it still might imply the need for some kind of regulation.

Typically, the ability to negotiate for oneself depends on access to complete information.¹⁶⁰ Translated to this debate, that means that the State has some legitimate role to play in ensuring that any private funds that accept or solicit retail investors' money are providing adequate disclosure. And it would be reasonable to conclude that adequate, in this setting, means understandable and perhaps even well-explained.

In this respect, the European Union's approach to opening access to private funds to retail investors is instructive. The baseline regulatory framework is the same as the United States'. In Europe, private equity funds generally qualify as alternative investment funds ("AIFs") and fall within the scope of the Alternative Investment Fund Managers Directive (the "AIFMD").¹⁶¹ Through their (regulated) alternative investment fund managers ("AIFMs"), interests in these AIFs can be freely marketed to "professional investors" across the EEA (using a so-called AIFMD marketing passport)¹⁶² --these "professional investors" include institutions, larger corporations, and

¹⁵⁹ It should be noted that, in addition to preventing losses that would be intolerable for a retail investor, the other principal obstacle to retail investment in private equity regards these funds' traditional lack of liquidity because it implies retail investors must agree to lock up capital for a typical term of ten years. As liquidity innovation is outside the scope of this Article's analysis on contract access and equality, I do not address this issue here.

¹⁶⁰ George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q.J. of Econ. 488, 489 (1970).

¹⁶¹ Directive 2011/61/EU of the European Parliament and Council of 8 June 2011 on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, 2011 O.J. (L 174) art 1 (describing "the rules for the authorization, ongoing operation and transparency of the managers of alternative investment funds (AIFMs) which manage and/or market alternative investment funds (AIFs) in the Union").

¹⁶² Id. arts. 31--32 (explaining how European AIFMs can market AIFs in the European Union).

trusts.¹⁶³ But in response to retail demand¹⁶⁴, in 2015 the EU created the European Long-Term Investment Fund (“ELTIF”).¹⁶⁵ Once a fund has obtained the ELTIF label, which is granted by the relevant national supervisory authority, these funds and their managers benefit from a marketing passport to retail investors in the EEA.¹⁶⁶

Yet regulation still requires that the investment contract is digestible. According to Article 28(1) of the ELTIF Regulation, the offering or placement of units or shares in an ELTIF to a retail investor must be preceded by a “suitability test”--an assessment of whether the note is a suitable investment for the retail investor in light of the latter’s knowledge and experience, their financial situation and their investment objectives.¹⁶⁷ Pursuant to article 30(1), retail investors must also be provided with appropriate investment advice from the manager of the ELTIF or the distributor.¹⁶⁸

If the private equity product is made available non-professional investors (i.e., to retail investors), then the EU’s PRIIPs legislation will also apply, requiring a “Key Information Document” (“KID”) to be produced for the fund, note or insurance policy (as applicable).¹⁶⁹ A KID is a short, three-page template document that has to be completed, covering certain information on performance scenarios, risk indicators and costs relating to the product. Certain jurisdictions

¹⁶³ Id. art. 4(1)(ag) (defining “professional investor”).

¹⁶⁴ Commission Staff Working Document: Impact Assessment Accompanying the document Proposal for a Regulation of the European Parliament and of the Council on European Long-term Investment Funds, Eur. Parl. Doc. (COM(2013) 462 final) 35.

¹⁶⁵ Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European Long-Term Investment Funds, 2015 O.J. (L 123) 98, 98.

¹⁶⁶ Id. art 31.

¹⁶⁷ Id. art. 28(1).

¹⁶⁸ Id. art. 30(1).

¹⁶⁹ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), 2014 O.J. (L 352) 1, 10 art. 5(1).

may require the KID to be translated into the local language.¹⁷⁰ Overall, this could be a sensible model for the United States to follow.

It bears noting that Europe is moving even further toward liberalization of private fund investing. In particular, the European Parliament recently approved changes to the ELTIF regime that will, *inter alia*, remove the existing cap on retail investors' private fund investing, and these amendments have enjoyed widespread support.¹⁷¹ Presently, retail investors whose financial instrument portfolio does not exceed 500,000 euros may not invest more than 10% of their financial instrument portfolio in ELTIFs in aggregate. The ELTIF's manager and/or relevant distributor must verify this requirement on the basis of information obtained from the investor.¹⁷² But the Commission now recognizes that the cap conflicts with the original goal of the ELTIF regime to establish a retail alternative

¹⁷⁰ For a short explainer, see KID Documents for Retail Products, CFA Inst., [https://www.cfainstitute.org/en/advocacy/issues/kid-documents-retail-products\[perma.cc/6VSA-7G8Q\]](https://www.cfainstitute.org/en/advocacy/issues/kid-documents-retail-products[perma.cc/6VSA-7G8Q]) (last accessed Jan. 12, 2023).

¹⁷¹ Regulation (EU) 2023/606 of the European Parliament and of the Council of 15 March 2023 amending Regulation (EU) 2015/760 as regards the requirements pertaining to the investment policies and operating conditions of European long-term investment funds and the scope of eligible investment assets, the portfolio composition and diversification requirements and the borrowing of cash and other fund rules, OJ (L 80) 1. The new rules will apply across the EEA from 10 January 2024.

¹⁷² Regulation (EU) 2015/760, *supra* note 162, art. 30. Other requirements aim to ensure that the contract is digestible. According to art. 28, the offering or placement of units or shares in an ELTIF to a retail investor must be preceded by a "suitability test"--an assessment of whether the note is a suitable investment for the retail investor in light of the latter's knowledge and experience, their financial situation and their investment objectives. *Id.* art. 28. Under the new rules, the ELTIF suitability test has been aligned with that of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, 2014 O.J. (L 173), which applies to the provision of any type of investment advice and portfolio management. Pursuant to art. 30, retail investors must also be provided with appropriate investment advice from the manager of the ELTIF or the distributor. *Id.* art. 30.

investment fund product.¹⁷³ Accordingly, the new rules stipulate in lieu of a cap that, when an ELTIF is marketed to retail investors, the distributor or manager shall issue clear written alerts informing the investor (i) for ELTIFs with a lifetime exceeding ten years, that the ELTIF product might not be fit for retail investors that are unable to sustain such a long-term and illiquid commitment; and (ii) for ELTIFs that allow for (full or partial) matching of transfer requests between existing investors and transfer requests from potential investors, such a mechanism does not guarantee or entitle the investor to exit or redeem its units or shares in the fund.¹⁷⁴ In addition, if the suitability assessment is not provided in the context of investment advice and the ELTIF is not suitable on the basis of that assessment, a retail investor who still wishes to proceed with the investment must provide express consent indicating the investor's understanding of the risks.¹⁷⁵ The investor ultimately decides.

In closing, one should note that there are some permutations of retail-private fund investing that could warrant a more qualified approach. In particular, if retail investors were to gain access to private equity indirectly through their 401K plans--a policy proposal presently underway--it might seem reasonable, and still support an expansive vision of economic rights, to cap or cabin their private fund exposure.¹⁷⁶

These 401K retirement plans receive preferential tax treatment, to effectuate the public policy goal of incentivizing individuals to save

¹⁷³ EU Commission, ELTIF Impact Assessment, Accompanying the Proposal for a Regulation of the Eur. Parliament & of the Council Amending Regulation (EU) 2015/760, at 12 (Nov. 25, 2021).

¹⁷⁴ Regulation (EU) 2023/606, *supra* note 168, art. 1(20).

¹⁷⁵ *Id.*

¹⁷⁶ Compare U.S. Dep't of Lab., U.S. Department of Labor Supplement Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives (2021), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020-supplemental-statement> [perma.cc/D99A-572L]; with Letter from Louis J. Campagna, Chief, Div. of Fiduciary Interpretations, Off. Of Reguls. & Interpretations, Emp. Benefits Sec. Admin., U.S. Dep't of Lab., to Jon W. Breyfogle (June 3, 2020), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020> [perma.cc/YFD4-72YZ].

for retirement. Because the 401k confers these benefits in exchange for this personal financial commitment, the 401k is different in kind from purely individualized investing. Accordingly, in that setting, it would be consistent with even a strong commitment to economic rights for the law to set some parameters around portfolio construction so that the public benefits conferred on individuals continue to incentivize that public goal. In particular, caps on the amount of private equity one could invest within a 401K might be set as defaults to avoid distorting investors' incentives toward over reliance on private funds (or disincentivizing individuals' due diligence). When viewed in that light, using law to set a limit on a 401k plan's private fund exposure would not be a naked constraint on private contract but more a mechanism to ensure that individual incentives are aligned with the State's asserted public policy goals for secure retirement.

CONCLUSION

Over time capitalism has proven to be an evolving system, which expands and innovates in order to survive as legitimate in the eyes of the People. The challenge for capitalist institutions today is to reconcile the benefits that profit and incentives confer to society while also leaving fewer people behind. There are concrete steps to take toward those aspirations. This Article has considered just one corner of capitalism--the private capital markets--and urged that removing constitutionally superficial legal frictions around access and contract could go far in freeing markets to serve a broader swath of U.S. society.