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Interview of Renee Jones by June Carbone

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This conversation occurred at the start of the conference on "Women at Work" on Friday, October 25, 2024, 9:00 to 9:30 a.m. What follows is the conversation with Renee Jones,† *edited for clarity. June Carbone's questions are in italics, and Renee Jones' responses are in regular type.*

June: As I read Renee's work in getting ready for this conference. I was impressed at the richness of her experiences in examining modern business enterprises and gratified that she saw many of the same things we discovered, without necessarily focusing on women at all. So, Renee, why don't you start by saying something about your background at the SEC?

Renee: I was privileged to serve as the Director of the SEC's Division of Corporation Finance from mid-2021 to early 2023. In that role, I oversaw a division of more than 400 lawyers, accountants, and analysts charged with interpreting and ensuring compliance with the principal securities statutes: the Securities Act of 1933 and the Securities Exchange Act of 1934. The bulk of the Division's staff (about 300 lawyers and accountants) works in its disclosure review program, reviewing corporate filings to ensure compliance with the securities laws' disclosure requirements. Division staff reviews filings for securities offerings such as IPOs, offerings in connection with mergers, and offerings by Special Purpose Acquisition Companies (SPACs). Staff also reviews ongoing disclosure by public companies including annual reports, quarterly reports, and proxy statements. The staff reviews these filings and provides comments to companies to improve the quality of disclosure. The disclosure review process and staff comments also inform the Commission and the entire SEC staff on important market trends and possible areas for reform.

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†. Renee Jones is a professor and Dr. Thomas F. Carney Distinguished Scholar at Boston College Law School. She teaches Corporations, Securities Regulation, Startup Company Governance, and Financial Regulation. After serving as an associate dean, she escaped herding faculty in 2021 to become the Director of the Division of Corporation Finance at the U.S. Securities and Exchange Commission. As Division Director, Professor Jones led a team of more than 400 lawyers, accountants and analysts charged with interpreting, implementing and ensuring compliance with the Securities Act of 1933, the Securities Exchange Act of 1934 and related statutory provisions.

The other major component of the Division's work is legal and regulatory policy, with a focus on rulemaking. During my tenure, we worked to advance Chair Gensler's ambitious rulemaking agenda. Our Division had more than twenty items within our purview on the rulemaking agenda. I oversaw our staff's work in making recommendations to the Commission and drafting proposals and final rules for the Commission's approval. We made remarkable progress on these projects, moving twenty-three proposed and final rules through the Commission during my tenure. Among the most significant newly proposed and final rules were rules governing climate-related disclosures, rules governing disclosure in SPAC transactions, and reforms that closed loopholes in insider trading rules by amending Rule 10b5-1.

June: Based on your experiences, can you describe any changes in corporate America you have observed regarding how business is conducted or overseen?

Renee: One of the biggest changes I've seen that impacts corporate financing practices is a series of deregulatory reforms that have reduced the insights investors, regulators, and the public have into a large swath of the economy occupied by large private companies.

This deregulatory trend began in the 1980s with the adoption of Regulation D and Rule 506, which eliminated disclosure obligations in connection with securities offerings to financial institutions and wealthy individuals. This trend accelerated in the mid-1990s when Congress adopted the National Securities Market Improvement Act (NSMIA) which eliminated investor caps for private investment funds and preempted state regulation of most private securities transactions. Then, in 2012, Congress adopted the Jumpstart Our Business Startups Act (JOBS), which eliminated the longstanding requirement that companies with 500 shareholders or more register with the SEC and become public reporting companies.

Once the 500-shareholder rule was eliminated, all bets were off in terms of constraining the growth of private securities markets. The amount of capital flowing into private markets grew dramatically after the 1996 NSMIA reforms. The JOBS Act allowed startups to stay private indefinitely. With this combination of legal reforms and changes in market structures, startup founders began to amass more power, and existing mechanisms for investor oversight of startups began to fail.

June: When you're talking about investor oversight, are you talking about venture capital firms or boards?

Renee: In the traditional venture capital financing model, venture capitalists (VCs) raised money from limited partners—mostly public and private pension funds, university endowments, and some wealthy individuals. The VCs put all that money in a big pot, the VC fund, and went out and looked for promising new companies to finance. Traditionally, VCs doled out money to startups in small increments, with continued funding conditioned on the startup meeting certain milestones. VCs got seats on the startup board when they invested, and as they increased their investment the VCs eventually acquired control over the board. So, in the traditional VC financing model, the investors were in control and could replace the founders if they weren't doing a good job and dictate pivots in business strategy when necessary.

We now have a lot more money in private markets seeking to invest in startups. So, VCs are now competing with other categories of private funds (hedge funds, private equity, sovereign wealth funds) for the opportunity to invest in promising startups. With all that money chasing startup deals, founders began to gain the upper hand when negotiating with potential investors. This competition among funders led to a new financing model, which I call the "unicorn governance model."

It's now common for founders of successful startups to be handed control over the board by being granted a special class of stock with super-voting powers. When founders control the board, it is difficult for VCs and other investors to exercise proper oversight, or to discipline founders who engage in misconduct. Without an imminent IPO on the horizon, there are fewer incentives for startups to adopt the bureaucratic structures and internal controls that are essential for effective management of large complex enterprises.

June: What can go wrong?

Renee: A lot has gone wrong. In the traditional VC Model, a successful VC-funded startup would either go public or be sold within five to seven years from founding. In 1996, the median age at IPO for tech-based startups was seven years. By 2022, the median age at IPO had increased to fifteen years. Once founders gained the upper hand in the startup financing system, we began to see major scandals at well-known startups. Uber, Theranos, and WeWork are the most famous examples, but there are dozens of other lesser-known startup founders who have been implicated in significant frauds. We have also seen a number of startup founders convicted for fraud, including Elizabeth Holmes, founder of the blood-testing startup Theranos, and Sam Bankman-Fried, founder of the crypto trading platform FTX.

Corporate scholars and policy makers have long focused on addressing governance problems at public companies related to the separation of ownership from control. We are now seeing the same types of problems that triggered the Sarbanes-Oxley reforms of public company governance occurring at private companies.

June: When interest rates spiked, the amount of VC money declined from a high last seen in the nineties. What happened with the VC downturn?

Renee: Since the downturn in VC funding that began in 2022, we're seeing more startups fold when they run out of cash, so not as many startups are staying alive for ten or twelve years without an exit. Some newer, younger startups are having trouble finding money. But the large, mature private companies (the unicorns and the decacorns—companies valued at $1 billion and $10 billion, respectively) will continue along waiting for an opportunity for a lucrative exit. In the crypto asset and artificial intelligence (AI) spaces, where a lot of VC money is being invested, we're seeing a troubling lack of concern about the potential negative social impacts of the products that are being developed. There is a singular emphasis on achieving rapid growth at any cost and emerging as the market leader. As a result, investors are pouring as much money as possible into companies in these sectors in the hopes of backing the next winner in the category.

June: So, do you have any insight into what this does to the relationships between the start-ups and their employees, customers, and others who lose in this environment?

Renee: I have concerns about how the unicorn governance model impacts startup employees. From the perspective of employees as investor—most startup employees are compensated with equity (stock options or restricted shares), where they accept a reduction in pay in exchange for equity in the company they work for. These employees need to stay at the firm for an extended period (four to five years) before they realize the full value of any equity grant. Unfortunately, most startup employees lack good insight into the market valuation of their firms. There are often lofty valuations tossed around in the press with each new financing round, but these valuations do not reflect the value of the employees' common shares.

Employees often face difficult investment decisions, including whether to stay at a firm until their options vest, and whether to exercise their options or let them expire. In these situations, startup employees often take on significant debt to exercise options and pay the taxes due on exercise. Other employees sell their shares in private markets, sometimes at a significant discount. In any case, when employees are making these consequential decisions, they often lack reliable information about the firm's future prospects, the value of their equity stake, and the likely timing of an exit transaction.

June: Are things improving or worsening? Is the situation spiraling, or is it stable? Is it like charter schools, where 20% are outright frauds, 20% are run by dedicated teachers, and the rest produce about the same as public schools? What's happening?

Renee: Fraud in private markets seems to be increasing, but we don't really have good insight into that question. When problems develop at startups, there are strong incentives for employees, directors, and investors to try to keep a lid on it, so they can achieve a lucrative exit or go public.

June: So, what are the solutions?

Renee: I have been thinking about this a lot as I work on my forthcoming book, *Untamed Unicorns,* which makes recommendations for reforming regulation of private markets.

Part of the solution is increased transparency and enhanced disclosure from the largest private companies. Under traditional securities law rules, when companies sold securities in private transactions, they were required to provide investors with substantive disclosure, similar to what would be provided in a registration statement filed with the SEC. In 1982, when Regulation D was adopted, these rules changed. Now companies can sell securities to wealthy institutions and individuals without providing disclosure. We now see some transactions, including some of the largest private offerings, where some investors are not getting disclosure at all.

Not only are some investors not receiving information when they initially invest, they are not always receiving updates after their investment is made. Traditionally, VCs bargained for extensive information rights and could withhold additional funding if the information was not provided. Now we see some startup investors forgoing information rights, or not enforcing their rights when founders fail to provide required updates. If we had ongoing disclosure requirements for large private companies, directors, investors, and employees would have better insight into their companies' operations.

June: I'm going to ask the final two questions together. Do you see room for a different kind of leadership? Does the diversity of people selected as leaders serve as part of the problem or the solution?

Renee: Yes, we need a different model of leadership for startups. There is a huge problem in the VC industry (some call it the "Elephant in the Valley") which is that 82% of the VCs who make funding decisions are men, almost all of whom are white.[1] These white, male VCs who make most of the funding decisions mainly invest in startups whose founders have a similar social background. A leading VC partner once said that the most successful entrepreneurs "all seem to be white, male, nerds who've dropped out of Harvard or Stanford and they have absolutely no social life." He added, "when I see that pattern coming in, it was very easy to decide to invest."[2]

We have a lot of survey data on the experiences of women founders and women working in tech. In one survey, 65% of women founders reported being told they would raise more money if they were men, or if they had a male co-founder. 40% of women founders reported being harassed, with half of those reporting sexual harassment stating they were propositioned for sex in exchange for funding. Women working in tech also reported high levels of harassment. Other surveys show that most women who report their harassment receive an unsatisfactory response. These data suggest there are significant leadership problems in Silicon Valley, both in VCs' investment practices and in VCs' failure to police sexual harassment by their partners and at the startups that they fund.

One thing that troubles me is that a good chunk of the money managed by VC funds is the public's money, invested by states, cities, and towns to fund pension obligations. The public officials who control the flow of resources to VCs do not focus enough on VC demographics, the history of discriminatory practices at VC firms, or governance flaws now prevalent in the startup sector. Pension fund managers are more focused on a VC's record for producing returns than governance, fairness, and equity. From the perspective of a citizen whose tax dollars are being deployed in a way that perpetuates historic inequities in entrepreneurial finance, pension funds' failure to hold VCs accountable for partner misconduct and for their lax oversight of the startups is highly problematic.

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1. *Diversity, Equity, and Inclusion in the VC Industry*, DELOITTE (2023), https://www.deloitte.com/us/en/pages/audit/articles/diversity-venture-capital-human-capital-survey-dashboard.html [https://perma.cc/LT3Q-A56N].

2. MARGARET O'MARA, THE CODE: SILICON VALLEY AND THE MAKING OF AMERICA 75 (2020).

June: I would note that one of the things we found in the book is that the number of women receiving VC funding has increased. However, the percentage of funding going to all female founders has stayed under 2% of VC funding. The number of women co-founders has increased, partly because it helps the men get money. But when the downturn occurred, firms with women founders did better. Why? The limited evidence we have suggests that because women pay themselves less, they burn through cash less quickly, and they are quicker to get to an exit, meaning an IPO or acquisition by a larger company, which ultimately involves greater transparency and accountability. So, what Renee is describing remains not only a male dominant system, but maybe even more male dominant than it was before the recent downturn.

I see the SEC as having been defanged over the last several decades—defanged by the courts, defanged by lack of funding, and defanged by the reforms in the law you describe. Do you see the SEC, especially right now, as being any more effective?

Renee: When I was at the SEC, we focused on improving market transparency, improving the efficiency of securities markets, and improving investor protections. We made a lot of progress over the past three years. The industry has been fighting back hard, and getting a huge assist from the 5th Circuit, so there is a lot left to do. Part of the reason for the lack of continued progress is industry resistance, Congressional pressure, and fear of litigation, all of which have impeded the ability of regulators make greater progress during periods when Democrats control the federal agencies.