Remaining, or Going, Private: Traditional and New Rationales

Patrick Muldoon[1]

The power of corporations has arguably never been greater in America. With a strong economy and corporate tax cuts, corporations are enjoying enormous success, while influencing the daily lives of Americans. One important question that corporations and their managers must consider is whether to operate publicly or privately. Current trends suggest that public corporations and their managers might prefer remaining, or going, private, rather than participating in public markets. Traditional rationales for going private focused on the avoidance of SEC filing requirements and refinancing or restructuring the company. In this paper, I will suggest that there are new rationales for going private or operating privately from the outset, including maintenance of control of the company by founders or managers, avoiding the input and votes of shareholders, and avoiding trends in the stock market, such as short selling.

These rationales and transactions going forward will be telling about modern companies in America. In the current corporate landscape, there are a greater number of founder-centric companies that are more or less controlled by their founders. These founder-centric companies are generally start-ups that are likely pressured by investors to go public. Investors want their money, and more, back; public securities offerings can provide superior liquidity as well as return on their investment. As a result of such pressure, before a founder knows it, their company can shift to the public market. What we are seeing, and will continue to see, is buyer's remorse, in a way, on the part of founders and managers that are eager to retake control of their companies. Two companies that are currently in the news, Tesla and Papa John's, seem to be struggling with this. But that control comes at a cost, to the company and founder, as well as to the investing public. The cost to the company and founders is the resulting debt or other financing that is required to take the company private again. Public markets, in theory, are efficient and quickly process information and that information is reflected in a company's stock price. If no information on a company is available publicly, then the investing public will not have the requisite information or knowledge to invest in that company.

These competing interests are coming to a head in the form of SEC enforcement, lawsuits, and involuntary resignations. With no end in sight, it is helpful to analyze some of the thinking that goes on behind the decisions managers make when considering whether to operate privately or publicly.

In Part I of this paper, I will review the going private transaction as a general matter. This section will be an overview of what the typical going private transaction looks like, including the consequences to the company, managers, shareholders, and other interested parties. Part II will discuss some of the rationales traditionally associated with remaining, or going, private, whether on part of the company or its managers. Finally, Part III will be my argument regarding new rationales, followed by a brief conclusion.

I. Going Private Transactions

There are several different ways to go from operating in the public market to being privately held. The end result is always the same, though: the company's securities

[1] J.D. 2019, University of Kentucky College of Law.

are no longer listed on an exchange.[2] One of the most common methods is a self-tender offer to buy the company's shares.[3] In a tender offer, the company will solicit offers to buy all or substantially all of the company's shares.[4] This offer will come in at a fixed price, usually at a premium, meaning a greater price than the stock is currently trading.[5] Additionally, the offer does not have to be all cash, but can be a mix of cash and the offeror's stock, or all stock. Determining the offer price and premium is an important step in the process and can vary depending on a variety of factors, but the basic premise is that the company will emerge as a "new" company with new corporate synergies and thus will be worth more.[6]

Recent studies suggest that offer premiums can be, and often are, as high as 45-50%.[7] This statistic changes slightly when the target company is private. When the target is private, the offer premium is 40%, as opposed to 46% when the company is public.[8] Interestingly, for our purposes, the statistic is further reduced when there is a "powerful entrenched target CEO[.]"[9] Assuming that founder-centric companies have powerful entrenched target CEOs, this data suggests that these founders actually hurt their company, in relation to companies without powerful entrenched target CEOS, when attempting to go private through a tender offer. This is an important statistic to think about going forward for companies like Tesla and Papa John's. When these companies contemplate going private, the reduced premium will likely play a big role in the type of transaction they consider. There is also an argument to be made that major public companies, say Fortune 500 companies, tend to have powerful entrenched CEOs. CEOs of large companies do not get to where they are without being powerful and entrenched. Regardless, the point of the statistic is to emphasize that these founder-centric companies are less attractive to potential bidders, and it is worth noting going forward.

The reasons for a reduction in the offer premium for companies with such powerful entrenched CEOs vary, but one study suggests that it is due to the fact that it is easier to "[e]xert influence on the target's management decisions, the more powerful the shareholders are relative to the target management."[10] With powerful entrenched target CEOs, especially those that control the company, it is much more difficult for an acquirer to exert this power over management's decisions because the CEOs are the managers and they choose to make those decisions. This reason seems accurate. Generally, acquirors are looking to acquire the target because of the value the acquirors believe they can get out of the company. The ability to get value out of the target usually comes with implementing new management, or in the alternative, to "exert influence on the target's

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[2] U.S. SEC, GOING PRIVATE (Sept. 2, 2011), https://www.sec.gov/fast-answers/answersgoprivhtm.html.
[3] *Id.*
[4] U.S. SEC, TENDER OFFER (Jan. 16, 2013), https://www.sec.gov/fast-answers/answerstenderhtm.html.
[5] *Id.*
[6] There must be an actual offer, which should probably go without saying, but not so in the case of Fitbit, where a holder of Fitbit options filed a phony tender offer with the SEC in an attempt to make a profit. Press Release, U.S. Attorney's Office, *Virginia Man Sentenced To Two Years In Prison For Scheme To Manipulate The Market For Fitbit Stock* (March 9, 2018), https://www.justice.gov/usao-sdny/pr/virginia-man-sentenced-two-years-prison-scheme-manipulate-market-fitbit-stock.
[7] B. Espen Eckbo, *Bidding Strategies and Takeover Premiums: A Review*, 15 J. CORP. FIN. 149, 154 (2009).
[8] *Id.*
[9] *Id.* at 155.
[10] Thomas Moeller, *Let's Make a Deal! How Shareholder Control Impacts Merger Payoffs*, 76 J. FIN. ECON. 167, 170 (2004).

management decisions."[11] When a founder will not leave the company or controls management's decision, an acquirer cannot replace them or exert much influence over them, hence the reduction in premium.

Another transaction capable of taking a company private is a leveraged buyout ("LBO"). An LBO is essentially what Elon Musk was proposing, or maybe not proposing, to do with Tesla. It appears, from his tweets[12] and the SEC's complaint,[13] that Musk was proposing to obtain a substantial amount of debt-financing in an effort to purchase Tesla's remaining outstanding shares. In an LBO, which can include a tender offer, the acquiring company or individual acquires all or substantially all of a company using debt to finance the transaction.[14] LBOs may be attractive to acquirors for multiple reasons, but the most prevalent is probably the prospective return on investment for the acquiring shareholders, if any. Because the LBO is debt-financed, it's necessary for the acquiror to pay off any creditors from whom the financing was obtained. However, "if the firm is successful, [the acquiror] can pay down the debt and keep whatever remains as the residual, which can be quite a lot."[15] Hence, the attractive nature of an LBO. If the company can survive being more levered than usual, the returns can be rewarding. The downside or disadvantage is that with so much leverage, a company becomes more susceptive to insolvency. If a company is not as fortunate or profitable, it will have trouble servicing its debt and becomes a default risk.[16] Regardless, after an LBO the acquiror may do with company as it pleases, including operating privately.

Relevant to our discussion is the management buyout ("MBO"). In an MBO, management of the company, instead of a third party, offers to buy the company.[17] This may be a more accurate description of what Elon Musk was attempting, as it appears he would be the party offering to buy Tesla, with the assistance of outside funding. MBO's further complicate the matter of valuation and offer premiums. The concept of "sandbagging,"[18] where management intentionally deflates the company's stock price by "being pessimistic about future performance,"[19] is a possibility. In that situation, the company would receive less than it would if management had not artificially deflated the company's stock price, while management will pay a lower price than it would have otherwise paid and preserve any value going forward if the company does well.[20] Sandbagging is difficult to prove,[21] but brings up questions of fiduciary duties and valuation that can pose problems for managers and directors.

Before these transactions can be completed, approval from shareholders is necessary. Further complicating the matter, dissenting shareholders have been granted statutory appraisal rights, importantly from the state of Delaware.[22] Shareholders that

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[11] *Id.*
[12] *See infra* note 79.
[13] *See infra* note 80.
[14] ROBERT J. RHEE, ESSENTIAL CONCEPTS OF BUSINESS FOR LAWYERS, 243 (2d ed. 2016).
[15] *Id.* at 244.
[16] *Id.*
[17] *See* Matt Levine, *Money Stuff: Going Public to Buy Back Stock*, BLOOMBERG OPINION (Nov. 6, 2018, 10:31 AM), https://www.bloomberg.com/opinion/articles/2018-11-06/going-public-to-buy-back-stock.
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] Del. Code Ann. tit. 8, § 262 (West).

wish to assert appraisal rights inform the company of their intent to do so and are entitled to a hearing and appraisal of the value of the company and its shares.[23] The shareholders' goal is to receive more money than what their shares were, or proposed, to purchase for. This can prolong the entire process, cost the company, and potentially kill the deal. Recent developments in Delaware's courts suggest that dissenting shareholders may want to tread lightly when asserting appraisal rights, as they could potentially receive less than what was paid.[24] In the past, dissenting shareholders were likely to receive more than the deal price, based on the "fair value"[25] of the company, which the appraisal court would find higher than the deal price, but with these rulings, dissenting shareholders cannot be so sure.

As mentioned above, in the end, the company's securities are no longer listed on an exchange. At this stage, the company still may not be done with the SEC and its rules. For companies that do go private, compliance with Rule 13e-3 of the Securities Exchange Act of 1934 ("34 Act") and Schedule 13E-3 may still be required.[26] To meet these requirements, a company may have to file documents with the SEC that explain the transaction that took the company private.[27] Further, requirements of Schedule 13E-3 include: "a discussion of the purposes of the transaction, any alternatives the company considered, and whether the transaction is fair to unaffiliated shareholders."[28] If all these requirements are met, at long last, the company or its managers will get its wish and operate privately.

II. Traditional Rationales

With the general going private transaction as a backdrop, it may be easier to see, or guess, some of the traditional rationales associated with the transaction. Above, I analyzed why a tender offer or LBO would be advantageous to an acquiror. One reason is the prospective residual profit to be gained after paying creditors. Another reason is the target and its shareholders want to take the premium payment resulting from a tender offer. But what are the rationales that traditionally explained why companies went private, or never went public?

At some point in the earlier stages of a company, its management must decide whether to go public or not. There is an increasing number of "exits,"[29] that is, startups that are either acquired or file for an initial public offering, so this phenomenon is likely here to stay. To go public a firm generally conducts an Initial Public Offering ("IPO"), where the company's shares are listed on exchange for the first time. Through this process, the company registers with the SEC and is expected to meet all of the SEC's filing and reporting requirements.[30] There are multiple other costs that a company must

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[23] *Id.*
[24] *See* DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017) (discussing fair value and rejecting lower court's weight of deal price); *see also* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017) (finding the market for Dell stock to be efficient and a "proxy for fair value").
[25] *See supra* note 22.
[26] U.S. SEC, *supra* note 2.
[27] *Id.*
[28] *Id.*
[29] *See infra* note 75.
[30] *See* RHEE, *supra* note 14 at 363.

factor into their decision, including the cost of underwriting by investment banks, as well as paying accountants and lawyers.[31] Other relevant costs may include increased compensation for the company's directors and officers, and the obligation to carry liability insurance.[32]

Instead of a public offering, a company may choose to go through an acquisition, where a larger, public company acquires the entire private company or its assets.[33] A recent rise in acquisitions suggests that some companies may favor this approach as a more cost-effective method in going public.[34] If a company is not a "unicorn,"[35] then it may not want to incur the substantial costs that are associated with an IPO. Furthermore, data suggests that the "IPO premium" disappears or is nonexistent for certain types of companies and may not be advantageous at all, thus resulting in a company choosing an acquisition instead.[36]

One rationale favoring operating privately, that may be the most cited by managers and companies, is the avoidance of various costs of operating in the public market. These costs include, in large part, "SEC disclosure requirements, securities filings, annual reports, . . . plaintiff's lawsuits, as well as the additional staff required to interface with a public company's shareholders."[37] As of 2001, the estimated savings from the avoidance of these costs was between $200,000 and $300,000 per year.[38] Seventeen years later, that number is likely higher, providing more incentive for a public company, especially one that is cash-strapped, to go private. This is likely the most cited reason by owners, when the owners really do not care much about cutting these costs but want to cover up their true rationales that I will examine below.

A recent case that held the attention of the public was the privatization of Dell, Inc. ("Dell"). The case and filings with the SEC occurred only five years ago, so one might have expected more modern rationales for going private, but Dell's founder, Michael Dell, provided many of the same rationales seen traditionally. In a Schedule 14A filed with the SEC, Michael Dell provided a shareholders' presentation that listed his reasons for wanting to take Dell private.[39] In that presentation, Mr. Dell posited that accomplishing the long-term goals of the company "is more challenging as a public company."[40] One of the reasons he asserted was the decline of the company's stock price, thereby "affect[ing] customer perception and mak[ing] it more difficult to retain

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[31] *Id*. at 364.
[32] David Brown et al., *Looking Behind the Declining Number of Public Companies*, ERNST & YOUNG, (May 2017), https://www.ey.com/Publication/vwLUAssets/an-analysis-of-trends-in-the-us-capital-markets/$FILE/ey-an-analysis-of-trends-in-the-us-capital-markets.pdf.
[33] Onur Bayar & Thomas J. Chemmanur, *What Drives the Valuation Premium in IPOs Versus Acquisitions? An Empirical Analysis*, 18 J. CORP. FIN. 451 (2012).
[34] *See id*.
[35] Brown et al., *supra* note 32. ("Startups with $1 + billion valuations.").
[36] Bayar & Chemmanur, *supra* note 33.
[37] Joseph L. Johnson III & Andrew J. Weidhaas, *The Going-Private Transaction*, N.Y. L.J. (2001), https://www.goodwinlaw.com/~/media/Files/Publications/Attorney%20Articles/2001/Going_Private_Transactions_Where_They_Have_Been_Where_They_Are_Now_Where_Theyre_Going.pdf.
[38] *Id*.
[39] U.S. SEC, DELL, INC. PROXY STATEMENT: SCHEDULE 14A (June 2013) https://www.sec.gov/Archives/edgar/data/826083/000119312513134486/d505470dprem14a.htm.
[40] *Id*.

employees."[41] Another reason he gave was that the new private equity owners had the financial "resources to provide additional capital if needed."[42] Implied, but not quite explicitly stated, in Mr. Dell's presentation is the notion that Dell's earnings were declining and investors were responding in the form of Dell's dropping stock price. These earnings would have to be reported and disclosed to the SEC and the investing public, which Dell did not want. Thus, a traditional rationale.

Michael Dell cited the ability to focus on long-term goals, and this is another rationale traditionally cited by companies and owners.[43] Because of quarterly and other filing requirements, companies that operate in the public market "are often forced to focus on quarterly results, as opposed to long-term goals and strategies."[44] Michael Dell said as much in his presentation: "Dell will be better able to aggressively pursue its long-term business strategy and thereby increase the speed and likelihood of success of the transformation," and a private Dell "will be able to absorb the risks of the transformation and the likely near-term adverse effects on earnings."[45] Failing to meet earnings or other quarterly goals often means the investing public and analysts view a company negatively. A simple "sell" rating by a respected analyst could mean that the company's stock price tanks. In light of this fact, and related to the rationale discussed previously, a company focuses on meeting quarterly targets, as opposed to long-term goals. What long-term goals do companies prefer to focus on? In Dell's case, growing a business segment that was more profitable than others and deemed "critical to [Dell's] future success"[46] was the main stated long-term goal. Growing a segment could take several years, and if Dell continued to operate publicly, the company would likely have to remain focused on quarterly goals instead of a long-term goal such as this.

At this juncture, it is appropriate to mention the possibility of a six-month or semi-annual reporting system. Recently, President Trump has requested that the SEC study a change from quarterly reporting to semi-annual reporting.[47] The quarterly reporting system has been in place since 1970,[48] and, predictably, opinions differ regarding this system.[49] One proponent of the semi-annual system, a former SEC chairman, suggests the semi-annual system should come with assurances "that investors . . . get information more quickly about new trends that emerged or old ones that have changed[,]" and "reducing reporting costs is 'something that investors should want as well.'"[50] Another suggests the semi-annual system will allow mangers to focus on "running [their] business," as opposed to "preparing quarterly earnings releases, holding investor conference calls and making SEC filings[.]"[51] This commentary supports Michael Dell's rationale. It seems that most managers see the quarterly filing

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[41] *Id.*
[42] *Id.*
[43]Johnson & Weidhaas, *supra* note 37.
[44] *Id.*
[45] Dell, Inc., *supra* note 39.
[46] *Id.*
[47] Dave Michaels et al., *Trump Asks SEC to Study Six-Month Reporting for Public Companies*, WALL ST. J. (Aug. 17, 2018), https://www.wsj.com/articles/trump-directs-sec-to-study-six-month-reporting-for-public-companies-1534507058.
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*

requirements as a hassle and detrimental to their management goals, especially in the long-term. Opponents of the semi-annual system believe there would be a reduction in the information publicly available to investors.[52] This shortfall could be solved by the assurances suggested by the former SEC chairman but is likely to be a prevalent concern going forward.

Publicly available information will be a concern going forward based, in part, on the Efficient Capital Market Hypothesis ("ECMH"). ECMH "is the hypothesis that the capital markets incorporate information into the price of securities."[53] ECMH comes in three forms: weak, strong, and semi-strong.[54] Professor Rhee suggests, and is supported by empirical evidence,[55] that weak form ECMH is correct in that "past public information is already factored into the stock price."[56] Strong form, on the other hand, "states that prices incorporate all public and non-public information.[57] Strong form will not matter to opponents of semi-annual filing because they are not concerned with non-public information, rather opponents are concerned with public information disseminated by companies. Semi-strong form ECMH is the hypothesis that "prices quickly incorporate current publicly disposed information."[58] There is much debate about this form of ECMH that is beyond the scope of this paper. For our purposes, it is important to know that the market will react to past public information and factor this information into the stock price of a company accordingly, as well as the arguments that proponents of different forms of ECMH will make. The strong form advocate will assert that formal public disclosures won't matter much because prices incorporate all relevant public and nonpublic information. Public disclosures will matter to semi-strong advocates because they expect prices to quickly incorporate this information.

Further complicating matters is the lack of trust on the part of investors.[59] As explained above, markets react to the dissemination of public information. But what happens when investors do not trust this information? A recent survey shows that, when investing in a company in "low trust areas" trade, there are "sluggish stock price responses."[60] While companies "with higher trust experience greater stock price reactions to earnings news."[61] The survey used regions of the United States as a barometer,[62] that is, companies located in particular regions that the authors controlled and deemed high or low trust. Lack of trust factors into our analysis because of the implications of operating publicly or privately. If a company is located in a region where there is low trust, then the market could react slowly to the dissemination of that company's information. This poses

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[52] *Id*.
[53] RHEE, *supra* note 14, at 342.
[54] *Id*.
[55] *Id*. (citing FRANK J. FABOZZI & FRANCO MODIGLIANI, CAPITAL MARKETS: INSTITUTIONS AND INSTRUMENTS 368 (4th ed. 2009)) ("The preponderance of empirical evidence supports the claims that the common stock market is efficient in the weak form.").
[56] *Id*.
[57] *Id*.
[58] *Id*.
[59] Chisen Wei & Lei Zhang, *Trust and Market Efficiency* (Oct. 30, 2014), https://ssrn.com/abstract=2517142.
[60] *Id*. at 31.
[61] *Id*.
[62] *Id*.

a problem to management in that they will feel the dissemination of information is a useless task, which fits the traditional rationale of distaste for disclosure requirements.

ECMH proponents and some of the investing public become concerned when an increasing number of companies stay private, which has become the case recently.[63] The concern stems from the fact that the investing public is "missing out on the chance to invest in dynamic public companies,"[64] as companies that are going public currently are "older and bigger than they used to be."[65] Because of these changes, there is not a significant amount of public information on companies that chose to stay private, as they mostly avoid disclosure requirements of the SEC. Also, institutional investors, and even the average person that feels strongly about a company, lose the opportunity to invest in "dynamic public companies," which I read to mean innovative startups.

Matt Levine[66] believes there are two explanations for the foregoing change, both being related to the rationales discussed herein. These explanations are: "1. Public markets are worse than they used to be, or 2. Private markets are better than they used to be."[67] As for explanation 1, Levine cites many of the traditional rationales we have talked about, including "[i]ncreased disclosure requirements, shareholder lawsuits, . . . [and] short sellers[.]"[68] Whereas explanation 2 leans more towards "let[ting] founders do whatever they want without disclosing anything."[69] Explanation 2 and that rationale is discussed further in Part III *infra*.

Continuing with rationales, a rationale that may not seem intuitive is to remove the company from the possibility of a takeover at an unfairly low price.[70] As explained above, a company is subject to a tender offer, and if its shareholders accept the tender offer, the company has to accept. This can be a tremendous disadvantage when thinking about return. If the company's stock is trading abnormally low and the shareholders accept the offer, all the owners, including mangers, are stuck with considerably less cash than they would have received if the stock was trading at a normal price.[71] To avoid this outcome, and if the managers predict a more favorable deal in the future, they may take the company private, "retaining more equity"[72] in expectation of the more favorable deal. Thus, the return to these managers would hypothetically be greater. This rationale is a little more difficult to unpack than the others, but when thinking about return, it makes sense. Managers, when it comes to money, are just like everyone else; they want more. As a former professor of mine says, "they just want to protect their fat jobs, houses, and Beamers."[73]

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[63] Erin Griffith & Matt Phillips, *More Small Companies Avoid I.P.O.s, Sapping U.S. Economy's Vitality*, N.Y. TIMES (Nov. 27, 2018), https://www.nytimes.com/2018/11/27/business/company-ipo-buyout-private.html.
[64] Matt Levine, *Money Stuff: Sears Default Bets Pay Off for Sears*, BLOOMBERGOPINION (Nov. 28, 2018, 11:44 AM), https://www.bloomberg.com/opinion/articles/2018-11-28/sears-default-bets-pay-off-for-sears.
[65] *Id*.
[66] *Id; see also* https://www.bloomberg.com/opinion/authors/ARbTQlRLRjE/matthew-s-levine.
[67] *Id*.
[68] *Id*.
[69] *Id*.
[70] *See* Johnson & Weidhaas, *supra* note 37, at 3.
[71] *Id* at 2.
[72] *Id* at 3.
[73] Thank you, Rutherford B. Campbell.

III. New Rationales

To be sure, most of the traditional rationales discussed above are justified and accurate. But I argue that current managers, especially founder/CEOs, state those traditional rationales as their justification for going private, when they really feel differently. The corporate climate has changed such that we are seeing the number of start-ups dramatically increase since 2007.[74] These startups are raising money and "exiting."[75] Exiting can be thought of as an "exit" from the private marketplace, and usually entails an IPO or acquisition by a larger company. Because an exit entails acquisition or an IPO, managers are likely yearning for the life of a private company, so let's talk about why.

First, it may be helpful to discuss some recent headlines that go to the core of this paper. Take Elon Musk and Tesla, for example. Musk is Tesla's founder, and until recently, was the CEO and Chairman of the Board.[76] On August 7th of 2018, Musk tweeted one message, "Am considering taking Tesla private at $420.[77] Funding secured," followed by another, "Shareholders could either to [sic] sell at 420 or hold shares & go private."[78] Unfortunately for Elon and Tesla shareholders, he did not have "funding secured."[79] In fact, the only possible funding he had came from a group from the Middle East, which Musk met with "for approximately 30 to 45 minutes."[80] Further complicating the matter, Musk made an appearance on a podcast[81] and did drugs with the host, while the host asked, "you probably can't because stockholders, right?" To which Musk replied, "I mean it's legal right." If that does not demonstrate a lack of regard for shareholders, I am not really sure what does.

From these circumstances, it is apparent that Musk wants to take Tesla private. Why? He often blames short sellers,[82] quarterly filings, and everything else imaginable, for the state of Tesla's stock. In reality, and this is a new rationale, Elon Musk just wants control of Tesla back. This situation can be distinguished from the situation in a case like Dell, where Michael Dell was attempting to implement long-term, large-scale policies

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[74] *See* Bloomberg L.P, *Bloomberg U.S. Startups Barometer* (Oct. 15, 2018), https://www.bloomberg.com/graphics/startup-barometer/.

[75] *Id*. (Bloomberg defines exiting as "startups that were sold to another company or filed for an initial public offering").

[76] In Musk's settlement with the SEC, a new, neutral chairman was appointed. U.S. SECS & EXCHANGE COMM'N, ELON MUSK SETTLES SEC FRAUD CHARGES; TESLA CHARGED WITH AND RESOLVES SECURITIES LAW CHARGE (2018), https://www.sec.gov/news/press-release/2018-226.

[77] 420 is, apparently, a marijuana reference that Elon Musk used to try and impress his girlfriend, according to the SEC.

[78] Elon Musk (@elonmusk), TWITTER, (Aug. 7, 2018, 11:48 AM), https://twitter.com/elonmusk/status/1026872652290379776?lang=en.

[79] Elon Musk (@elonmusk), TWITTER, (Aug. 7, 2018, 1:13 PM), https://twitter.com/elonmusk/status/1026894228541071360

[80] Complaint at 6, U.S. Secs & Exchange Comm'n v. Musk, No. 1:18-cv-8865, (S.D.N.Y. Sept. 7, 2018).

[81] Joe Rogan, *# 1169 - Elon Musk*, THE JOE ROGAN EXPERIENCE (Sept. 07, 2018), http://podcasts.joerogan.net/podcasts/elon-musk.

[82] One of Mr. Musk's favorite topics on Twitter is short sellers. *See, e.g.,* Elon Musk (@elonmusk), TWITTER, (June 17, 2018, 3:43 PM), https://twitter.com/elonmusk/status/1008450201885872129?lang=en. ("They have about three weeks before their short position explodes"); He even went as far as offering pairs of shorts for sale. Elon Musk (@elonmusk), TWITTER, (Aug. 10, 2018, 11:30 PM), https://twitter.com/elonmusk/status/1028121465785405441?lang=en. ("Short shorts coming soon to Tesla merch").

that he believed were hindered by shareholders. Instead of this type of policy implementation, Musk seems to desire control of all Tesla decisions, regardless of the way shareholders feel and vote. This distinction is where traditional and new rationales begin to diverge. Instead of motivation to implement particular long-term strategies that are hindered by shareholders and quarterly-focused thinking, founders like Musk and Schnatter are motivated by decision making and control, without having to answer to shareholders and the investing public. That is not to say that long-term policies will not play a role in decision making and rationales, but the shift will be more towards decision making and control.

Tesla followed the course described above and seen in the Bloomberg charts. It took off as a startup and went public with a large valuation. I think that Elon Musk has grown tired of having to deal with everyone else and just wants to make all the decisions for Tesla, without having to answer to shareholders or investors. Short sellers and filing requirements are just his scapegoats. A short seller, relying on the belief that a stock price will drop, sells stock at a higher price and borrows stock from a lender for a fee, returning the stock at a lower price.[83] There is a recent wave of "activist"[84] short sellers that seek enormous profit and supposedly ruin companies, but the leader of this movement admits "you can make millions of dollars, but you can lose millions of dollars, too."[85] Their ability to distort markets is actually very limited. A recent study[86] found that short sellers "reduc[e] over-pricing quickly and promot[e] price discovery in the equity market," but there was "no evidence that heavy shorting activity destabilizes the stock market by amplifying underpricing."[87] Given this information, short sellers are something to be wary of, but not a reason to take a company private.

What Elon Musk is really complaining about may be market manipulation.[88] The idea of market manipulation centers around "bad actors" that, in the course of massive financial transactions and hacking of various banks, "disseminat[e] fraudulent market information, and orchestrat[e] . . . multi-million dollar stock manipulation scheme[s]."[89] The swift advance of modern technology has brought "virtues and vices" to financial markets, with the virtues being reduction in labor costs and time, and the vices being the subject of market manipulation.[90] Because virtually all modern financial transactions are digital, markets open themselves up to risks, including "inadvertent errors, malicious acts, and technological disruptions."[91] Some forms of "new market manipulation,"[92] as a result of digitized financial markets, are beyond the scope of this paper and deal mainly with manipulating stock orders and other bad acts.

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[83] Jesse Barron, *The Bounty Hunter of Wall Street*, N.Y. TIMES, (June 8, 2017), https://www.nytimes.com/2017/06/08/magazine/the-bounty-hunter-of-wall-street.html.
[84] *Id*.
[85] *Id*.
[86] Eunju Lee, *Short Selling and Market Mispricing*, 47 REV. QUANTITATIVE FIN. & ACCT. 797 (2016).
[87] *Id*.
[88] *See* Tom C.W. Lin, *The New Market Manipulation*, 66 EMORY L.J. 1254 (2017).
[89] *Id*. at 1255.
[90] *Id*. at 1273-75.
[91] *Id*.
[92] *Id*. at 1287.

However, one form of relevant market manipulation is "mass misinformation."[93] This entails "disrupt[ing] and distort[ing] financial markets . . . by disseminating bad data, fake news, and faulty information into a marketplace that thrives on accurate information."[94] Bad actors engage in this type of behavior "through fake regulatory filings, fictious news reports, erroneous data, and hacking."[95] A large-scale example of this is what happened to the Associated Press in 2013.[96] The Associated Press's Twitter account was hacked, and a false attack on the White house was tweeted from the account.[97] "Automated programs traded on the bogus news," resulting in a temporary loss of "$136 billion in market value."[98] This is bad! Obviously, if you are the CEO and founder of a public company, it would be valid to be worried about market manipulation. The fear of losing billions of dollars in market value as a result of malicious actors is unsettling, and there is essentially nothing you could do about it. To combat these problems, various regulations have been enacted and proposed,[99] but it remains to be seen whether regulations will be effective or not. In sum, it is completely valid for Elon Musk, or basically any CEO of a public company, to worry about market manipulation. But to blame short sellers seems rather ludicrous.

Another example is Papa John's.[100] John Schnatter, another founder and former President who has fallen on hard times, may cause, or contribute to causing, Papa John's to go private. After allegedly using a racial slur on a conference call with an advertising agency, Schnatter resigned as Chairman of the Board.[101] As a result, clearly unhappy, Schnatter sued Papa John's.[102] This suit was the second since Schnatter's resignation and alleged breaches of the duty of loyalty and care on the part of "those individuals," meaning Papa John's management, that were causing "irreparable harm" to the company.[103]

Why would Schnatter sue? Considering he owned around thirty percent of the company,[104] it is not a stretch to think that he could regain control of the company. All he would need to do is acquire around twenty or thirty percent more of the company, or alternatively, find shareholders that were willing to vote his way. Accomplishing this would likely require a tender offer or LBO, likely resulting in the privatization of Papa John's. Like Musk, Schnatter wants to regain control of the company he founded. It is

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[93] *Id*. at 1292.
[94] *Id*.
[95] *Id*.
[96] *Id*. at 1293.
[97] *Id*.
[98] *Id*.
[99] *Id*. at 1294, 1303.
[100] Disclosure: My father was employed at Papa John's. Robert Klara, *Papa John's First Chief Ingredient Officer Gives the Chain an Edge on the Competition*, AD WEEK (Jan. 31, 2017), https://www.adweek.com/brand-marketing/papa-johns-first-chief-ingredient-officer-gives-the-chain-an-edge-on-the-competition/.
[101] Tiffany Hsu, *Racial Slur leads to Papa John's Founder Quitting Chairman Post*, N.Y. TIMES, (July 11,2018), https://www.nytimes.com/2018/07/11/business/papa-johns-racial-slur.html.
[102] The suit was filed under seal in the Delaware court system. Andrew Wolfson, *Schnatter Sues Papa John's to 'Stop Irreparable Harm' to the Company*, LOUISVILLE COURIER J., (Aug. 31, 2018), https://www.courier-journal.com/story/news/2018/08/31/john-schnatter-files-second-lawsuit-against-papa-johns/1156772002/.
[103] *Id*.
[104] *See id*.

apparent that he is tired of dealing with the public and decisions of others.[105] Amidst these comments regarding earnings reports, it would be easy for Schnatter to veil his reasoning in the traditional rationale of avoiding reporting requirements and costs. However, it seems to me that there is something more deeply rooted than this avoidance. Just look at his other comments regarding the lawsuit and his resignation: "I don't want to be in the CEO position, for sure, but you know I definitely want to be part of the company, and I am part of the company."[106] And also look at what the company said about him: "He continues to make reckless allegations in his attempts to *regain control* and serve his own interests."[107] It is simple; Schnatter just wants control of the company that he started back.

What do these two companies have in common? They are both founder-centric and have, or had at one-point, powerful entrenched CEOs that do not like taking directions from others. So, Musk and Schnatter could try to rationalize going private however they want, but it is really control they are seeking. There is a certain aspect of this rationale that appeals to the emotions. Imagine what these two individuals went through. To have built a company from the ground up, been through all the trials and tribulations, and then to essentially be kicked to the curb must be eye-opening and infuriating. I am not asking for sympathy for a multi-millionaire[108] and billionaire,[109] but I am asking for a little understanding. When looking at these companies through this lens, it is certainly understandable to want to control a company that you built from the ground up.

On the opposite end of this argument, and why these two have fallen on hard times, is our country's corporate governance system. If a company's shareholders or management is not satisfied with the performance of founders, CEOs, or chairmen of the board, there are appropriate channels to go through in their removal. Dissatisfied shareholders may bring a cause of action for breach of duty. The SEC may bring a cause of action for various reasons, including in Musk's case, securities fraud.[110] Alternatively, a resignation could be "forced,"[111] and there is no need for a suit – unless, it is by the aggrieved party after the fact – or SEC enforcement. The point is that if a company is struggling in the market or an ambitious CEO has no filter on Twitter, the rationale of

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[105] In the fall of 2017, Schnatter cited turmoil in the NFL as the reason for poor quarterly earnings. Cindy Boren & Des Bieler, *Papa John's Owner Blames Sagging Sales on NFL Anthem Protests and League Leadership*, WASHINGTON POST, (Nov. 1, 2017), https://www.washingtonpost.com/news/early-lead/wp/2017/11/01/papa-johns-owner-blames-sagging-sales-on-nfl-anthem-protests-and-league-leadership/?utm_term=.202a082d977e.
[106] Sarah Whitten et al., *Papa John's Founder John Schnatter Finally has his Day in Court, Testifies Against the Board*, CNBC, (Oct. 1, 2018), https://www.cnbc.com/2018/10/01/papa-johns-founder-john-schnatter-testifies-in-lawsuit-against-board.html.
[107] Wolfson, *supra* note 102. (emphasis added).
[108] Papa John's current market cap is $1.66 billion. YAHOO! FINANCE (Oct. 25, 2018, 9:07 PM), https://finance.yahoo.com/quote/PZZA/. Since Schnatter owns around thirty percent of the stock, I assumed he is a multi-millionaire.
[109] Musk's compensation package consists solely of Tesla stock, which at grant was valued around $2.6 billion. Joseph Bachelder & Andy Tsang, *Elon Musk's Compensation*, HARVARD L. SCHOOL FORUM CORP. GOV. & FIN. REG., (May 22, 2018), https://corpgov.law.harvard.edu/2018/05/22/elon-musks-compensation/.
[110] *See* Complaint, *supra* note 80.
[111] *See* Wolfson, *supra* note 102.

control may not be able to defeat corporate governance rules. Despite this fact, I argue that founder-centric companies now utilize the control rationale, whether it is veiled in something else or not.

Another way to look at these situations is to assess the similarities with the current political climate. This is not a political paper, and I will not venture into that trap. But some of the similarities are striking and may explain some of the thinking of founders. In the political world, we are currently seeing celebrities, and people that have gained significant status in the eyes of the public, run for, and achieve, office. The same could be said for certain founders, including Elon Musk and John Schnatter. Elon Musk currently has 23.5 million followers on Twitter.[112] Before the incident described *supra*, John Schnatter was seen in substantially all of Papa John's advertisements. They both achieved celebrity status, or at least significant popularity. Similar events are happening in the political world, as President Trump was certainly a celebrity before holding office, hosting popular television shows and running his business. Additionally, more celebrities are running for office, evidenced by Cynthia Nixon of "Sex and the City" running for governor of New York,[113] and Mark Cuban, billionaire investor and appearing on "Shark Tank," expressing interest in running for President.[114] The similarities make sense when thinking about why celebrities run for office or founders run their company. There are certainly other reasons, but I believe control is central to the decision. Celebrities run for office because they want to control and influence various arms of government, or in President Trump's case, the entire federal government, provided there are checks and balances. Famous founders run their companies because they want to control something they feel they built from the very beginning, without the worry of what others believe is the best decision for the company. As mentioned, there are certainly other reasons for actions in both scenarios, but control seems to be central to both and will be a rationale for staying, or going, private in the future.

On the topic of staying private, one other important piece to note from Levine is that private funding is the "increasing availability of private capital."[115] This private capital comes in the form of venture capital,[116] which has proven to be a profitable alternative to going public. Modern startups raise "mega-rounds"[117] of $100 million or more in funding in the venture capital market. These mega-rounds create tremendous pressure on startups to move swiftly in their financing and operating activities, with one startup even completing its round of financing in two months.[118] However, if the company can handle this pressure, there is not much incentive to ever go public. With

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[112] Elon Musk (@elonmusk), TWITTER (Nov. 29, 2018 5:00 PM), https://twitter.com/elonmusk.

[113] Daniel Trotta, *'Sex and the City' Actress Cynthia Nixon to Run for New York Govenor*, REUTERS (Mar. 19, 2018 2:38 PM), https://www.reuters.com/article/us-new-york-governor-cynthianixon/sex-and-the-city-actress-cynthia-nixon-to-run-for-new-york-governor-idUSKBN1GV2HU.

[114] Thomas Franck, *Mark Cuban Says He's Giving More Thought to Running for President as Speculation Swirls Around Howard Schultz*, CNBC (June 5, 2018 8:02 AM), https://www.cnbc.com/2018/06/05/mark-cuban-said-hes-giving-more-thought-to-running-for-president-as-speculation-swirls-around-howard-schultz.html.

[115] *Supra* note 64.

[116] *See* Griffith & Phillips, *supra* note 63.

[117] Erin Griffith, *$100 Million Was Once Big Money for a Start-Up. Now, It's Common*, N.Y. TIMES (Aug. 14, 2018), https://www.nytimes.com/2018/08/14/technology/venture-capital-mega-round.html?module=inline.

[118] *Id*.

this large amount of venture capital funding, companies can stay private and enjoy the benefits derived therefrom, including control by their founders.

This is an important development moving forward because situations like Tesla may never happen. If a startup has an eccentric founder that wants control of the company without having to answer to shareholders or the investing public, then the more desirable path for that company would be to remain private and pursue venture capital funding. This path gives everyone involved what they want, except for investors in the public market as discussed in Part II *supra*. The caveat here is that the company has to be attractive enough to venture capital financiers that they are willing to fund the company with hundreds of millions of dollars. That will not always be the case. Of course, venture capital funding rounds can raise less and still be successful. But in a case like Tesla's, $100 million might be low.[119] All of this is to say that, in the future, as is the case now,[120] there will likely be less companies that chose to go public in the first place. Instead, founders may retain control by operating privately with the assistance of venture capital.

IV. Conclusion

The going private transaction has been popular in the past and will likely continue in popularity, given the number of startup "exits." In the alternative, companies could continue to remain private, as venture capital funding and mega-rounds give companies a way to operate privately and their founders to retain control. Traditional rationales were centered around public speculation and filing or disclosure requirements. I suggest that new rationales include control by founder/CEOs, although it is hard to be sure. In the future, there could be new trends, less founder-centric companies, and more rationales for remaining, or going, private.

[119] Tesla's current market capitalization is $58.89 billion, and I am assuming it was a "unicorn" when going public, that is, it was valued at around $1 billion. YAHOO! FINANCE (Nov. 29, 2018, 3:46 PM), https://finance.yahoo.com/quote/TSLA?p=TSLA&.tsrc=fin-srch. (Nov. 29, 2018 3:46 pm).
[120] *See* Griffith & Phillips, *supra* note 63.