



The Silicon Valley Initiative – unicorns in SEC’s line of sight: action items

Quarterly Governance Review

26 MAY 2016

By:

SEC Chair Mary Jo White and a delegation of officials from the SEC traveled to Silicon Valley early this spring to deliver a shot across the bow to technology and healthcare businesses, entrepreneurs, investors and their advisers.

In a speech delivered at the Stanford Law School’s Rock Center on Corporate Governance on March 31, SEC Chair White announced the SEC’s “Silicon Valley Initiative” to an audience of regulators, academics, lawyers and entrepreneurs assembled to discuss the issues impacting the startup, venture capital and private equity worlds rooted in Silicon Valley. Noting the prevalence of high-growth innovative companies in Silicon Valley that are not yet public, the SEC chair aimed squarely at private companies: “[b]eing a private company obviously does not mean that you can disregard the interests of investors.”

Chair White warned that “unicorns” with sky-high valuations merit special scrutiny and expressed concern that these companies maintain internal controls and investor protections appropriate for the promised projected growth. To be clear, when referring to unicorns, Chair White was not referring to those creatures of fantasy, but to private companies valued at more than \$1 billion.

Referring to unicorns, Chair White said “[t]hey do not appear to be an endangered species,” and expressed worry that “the tail might wag the horn.” “The concern is whether the prestige associated with reaching a sky-high valuation fast drives companies to try to appear more valuable than they actually are.”

In reference to the online lending industry, Chair White noted that “[a]s investors are attracted by potentially higher yielding but riskier marketplace loans as an investment strategy, information about the borrower’s ability to repay the loan underlying the investment is critical.... Innovation in finance...must be built upon the disclosure of material information.”

SEC Enforcement Division Chair Andrew Ceresney was also in attendance, noting that, while based in Washington, he had visited the Silicon Valley region three times in the past year, with more trips planned. Speaking as part of a panel of Silicon Valley executives and investors following Chair White, Mr. Ceresney noted that “[y]ou can’t say we don’t focus on the West Coast. Not that you want us to, but we are.”

Action items

As private companies continue to elect to remain private longer, expect the SEC’s regulatory and enforcement efforts to adjust accordingly to ensure appropriate oversight and protection of investors. Founders and advisers of fast-growing private companies should consider governance mechanisms and investor protections, including:

- Whether boards of directors have expanded beyond entrepreneurs and original investors
- Whether boards have sufficient regulatory expertise
- Whether leadership includes outsiders with relevant industry experience or experience in public companies
- Whether board directors understand their fiduciary duties, and that they extend to all stockholders
- Instituting internal controls over financial reporting to avoid errors or misconceptions in valuation.

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