PRIVATE EQUITY, PUBLIC CAPITAL, AND LITIGATION RISK

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For nearly a century, securities regulation has drawn a sharp line: firms that seek to raise capital from the public must comply with strict governance and disclosure duties, while firms that remain "private" may organize their internal governance structures as they see fit. But the line between public and private capital is now eroding. Private equity firms, once funded solely by institutions, increasingly raise capital from ordinary investors, while remaining outside the reach of securities regulation through a combination of complex financial structures and well-worn legal exemptions. As a result, asset classes long confined to qualified investors are now being offered to the public, but without the protection traditionally attached to public offerings. This Article argues that this retailization of private equity creates a significant regulatory gap. Practices normalized in institutional settings—misleading performance metrics, manipulable valuations, opaque fees, limited liquidity, and fiduciary duty waivers—become significant litigation risks when ordinary investors enter the picture. Financial regulators are ill-equipped to address these risks, a problem exacerbated by the deregulatory agenda of the last two decades. But while public enforcement is likely to remain ineffective, private equity's retailization opens a new and potentially more powerful avenue for holding firms to account: private enforcement. By broadening their investor base, private equity firms have exposed themselves to litigation under a wide range of domains, from contract to tort, from fraud to consumer protection. These doctrines, long thought peripheral to private equity, are often broader and stricter than traditional securities regulation. This Article charts how private enforcement could reshape the industry and explores how the future of private equity will increasingly be shaped by judges, not regulators.

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INTRODUCTION

Among the many executive orders issued by President Donald Trump since taking office in January 2025, Executive Order 14330 does not immediately stand out as especially noteworthy.[1] It was the one hundred and eighty fourth such order of Trump's term, one of three issued on Thursday, August 7, 2025.[2] It received only passing mention in the press.[3] It was overshadowed by previous orders with seemingly greater political salience.[4] And yet, despite its apparent insignificance, Executive Order 14330 has a claim to be among the most consequential executive orders of President Trump's second term. For in its directives, the order, entitled "Democratizing Access to Alternative Assets for 401(k) Investors," contains the seeds of a fundamental rethinking of how our financial markets work. The order begins by declaring that "it is the policy of the United States that every American preparing for retirement should have access to funds that include investments in alternative assets."[5] "Alternative assets," the order then specifies, include private market investments, digital assets, commodities and other financial instruments.[6] The order concludes by directing agencies, including the Secretary of Labor and Securities and Exchange Commission, to reexamine their regulations to ensure that Americans have the right to participate in the "growth and diversification opportunities" provided by private market assets.[7] Together, these provisions mark a sea change in the nature of financial regulation.[8]

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[1] *Executive Order on Democratizing Access to Alternative Assets for 401(k) Investors*, WHITE HOUSE, Exec. Order No. 14,330, 90 Fed. Reg. 38921 (Aug. 7, 2025).

[2] *See Executive Order on Guaranteeing Fair Banking for All Americans*, WHITE HOUSE, Exec. Order No. 14,331, 90 Fed. Reg. 38925 (Aug. 7, 2025); *Executive Order on Improving Oversight of Federal Grantmaking*, WHITE HOUSE, Exec. Order No. 14,332, 90 Fed. Reg. 38929 (Aug. 7, 2025).

[3] The New York Times did not cover the executive order in its print edition, although a single online article discussed it. *See* Tara Siegel Bernard, *Trump Order Clears Way for Crypto and Private Equity in 401(k)s*, N.Y. TIMES, Aug. 7, 2025. The Washington Post wrote a single article, buried on page A9 of the print edition. *See* Margot Amouyal, *Trump Order Allows Retirement Funds to Include Alternative Assets*, WASH. POST, Aug. 8, 2025. The L.A. Times featured no articles on it. The Wall Street Journal, on the other hand, devoted several articles to the executive order. *See* Dylan Tokar & Miriam Gottfried, *Trump Shakes Up Wall Street With Orders on 401(ks)s, "Debanking"*, WALL ST. J., Aug. 7, 2025; Hal Scott & John Gulliver, *Trump Plans to Give Your 401(k) a Boost*, WALL ST. J., Aug. 10, 2025; Chris Cumming, *Trump's Order May Fall Short of Achieving Private Equity's 401(k) Dreams*, WALL ST. J., Aug. 13, 2025.

[4] *See Executive Order on Protecting the Meaning and Value of American Citizenship*, WHITE HOUSE, Exec. Order No. 14,160, 90 Fed. Reg. 8449 (Jan. 20, 2025); *Executive Order on Putting America First in International Environmental Agreements*, WHITE HOUSE, Exec. Order No. 14,162, 90 Fed. Reg. 8455 (Jan. 20, 2025); *Executive Order on Restoring Names That Honor American Greatness*, WHITE HOUSE, Exec. Order No. 14,172, 90 Fed. Reg. 8629 (Jan. 20, 2025).

[5] Exec. Order No. 14,330, § 2.

[6] Exec. Order No. 14,330, § 3.

[7] *Id.*

[8] *See* discussion *infra* Part I.B.

If there is one constant in the history of financial markets, it is that ordinary investors often bear the cost of other people's misbehavior.[9] This insight forms the basis of modern financial regulation.[10] After the Wall Street Crash of 1929 led to the discovery of widespread manipulation and fraud on stock markets, Congress enacted its landmark securities legislation aimed at protecting investors from deception in the marketplace.[11] Ever since, the framework of financial regulation has remained remarkably stable and defined by a basic dichotomy.[12] Companies that seek to raise capital from the public (ordinary humans) must abide by the strict substantive and disclosure rules of the Securities Act of 1933, the Securities Exchange Act of 1934 and related legislation.[13] Companies that choose not to raise capital from the public, on the other hand, are free to structure their governance through purely private ordering.[14] This dichotomy has led to a vast gulf between two sides of the financial market: on one side lie some public companies whose shares or bonds (or both) are traded on stock exchanges and who disclose extensive information to the public; on the other lie a range of private companies—from small mom-and-pop stores to large tech startups—who are lightly regulated and disclose little if any information to the public.[15]

But in recent years, the longstanding wall between public and private capital has begun to crumble. Struggling to raise new funds and seeking new engines of profit, private equity firms have increasingly sought access to the savings of

[9] *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534 (2006); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991); Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029 (2019).

[10] *See* Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851 (1992); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems,* 62 U. CHI. L. REV. 1047 (1995); Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711 (2006); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999); Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1 (1983); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VANDERBILT L. REV. 859 (2003).

[11] *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (1982).

[12] *See* Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L. J. 445, 453 (2017).

[13] *See* discussion *infra* Part I.A.

[14] *See* discussion *infra* Part I.A.

[15] Although scholars and policymakers have largely focused their attention on companies with *shares* listed on stock exchanges, companies that issue *debt* securities to the public also face important disclosure rules. This is a particularly relevant point in the world of private equity, as private-equity-owned companies often have extensive debt. For a discussion of corporate debt and the shifting structure of debt markets, see Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 YALE L. J. 779 (2025).

ordinary citizens.[16] Through a combination of complex ownership structures and new vehicles, private equity firms have allowed retail investors to acquire interests in their private funds.[17] This trend has slowly eroded the distinction between public and private finance.[18] It has also been accelerated by politicians and regulators, who, over the last decade, have pursued a comprehensive deregulatory agenda.[19]

Taken together, these developments have contributed to what some have called the "democratization of private equity," a phrase that itself is a remarkable act of marketing. There is nothing inherently democratic about extending risky, opaque, and ill-understood products to retail investors. Few of the things that we think of as typical of a democracy—the right to vote, the separation of powers, civil rights protecting the people from government overreaching—are present in the private equity governance model.[20] Would we speak of the "democratization of cannabis" whenever restrictions on its use are loosened? Would we call it the "democratization of driving" if we permitted twelve-year-olds to drive cars? The very ease with which private equity firms deploy such language—free to brand exclusion as inclusion, risk as opportunity—illustrates the larger problem: an industry able to market its products without the ordinary set of checks and balances.[21]

This Article argues that the dawn of private equity and public capital raises a series of regulatory risks that are underappreciated by policymakers and scholars alike.[22] Private equity firms simply do not operate like ordinary public companies.[23] Investors do not have the same governance rights.[24] They do not have the same exit rights.[25] They are not protected by the same fiduciary duties.[26] Just as importantly, several of the defining features of the private equity model—from performance metrics to fee structures to valuation practices—create

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[16] *See* Ian Frisch, *Wall Street Wants to Make Private Markets a Little More Public*, N.Y. TIMES, July 19, 2025; Antoine Gara, Jamie John, Eric Platt & James Politti, *Trump Opens US Retirement Plans to Crypto and Private Equity Investments*, FIN. TIMES, Aug. 7, 2025; Matt Wirz, *Wall Street Races to Bring Private Credit to the Masses*, WALL STREET JOURNAL, Oct. 3, 2024; The Economist, *The Risky World of Private Assets Opens Up To Retail Investors*, May 1, 2025. *See also* Benjamin C. Bates, *Retail Access to Private Markets*, SSRN Working Paper, Aug. 15, 2025, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5381902 (exploring the structures and risks raised by "retail private funds").

[17] *See* discussion *infra* Part I.B.

[18] *See* discussion *infra* Part I.B.

[19] *See* discussion *infra* Part I.B.

[20] *See* discussion *infra* Part II.

[21] *See* discussion *infra* Part II.

[22] *See* discussion *infra* Part I.C.

[23] *See* discussion *infra* Part II.

[24] *See* discussion *infra* Part II.D.

[25] *See* discussion *infra* Part II.B.

[26] *See* discussion *infra* Part II.D.

significant conflicts of interest between managers and investors.[27] While these problems have always existed in one form or another in the industry, private equity has historically shielded itself from regulatory enforcement by its focus on "sophisticated" investors, that is, large institutions with financial resources and legal counsel of their own. The "sophistication" of these institutional investors has always been debatable. No regulator administers a sophistication test to signatories of limited partnership agreement, there is no licensing regime certifying competence in investing in private market funds, and there is no law prohibiting a person with little financial training from being placed in charge of allocating billions of dollars to private equity funds on behalf of a pension fund. Yet sophistication has served as a powerful tool for minimizing regulatory concern. The industry's turn to retail investors, though, strips the terminology of its protective aura: once ordinary savers are invited in, the claim of sophistication can no longer shield the system from scrutiny.[28]

This Article's core contribution is to reframe the regulatory challenge of private equity's expansion into the retail market. Existing debates have focused on whether financial regulators like the Securities and Exchange Commission can or should adapt securities law to this new environment. But securities law was not designed to police many of the practices at issue—misleading performance metrics, manipulable valuations, opaque and discretionary fee structures, limited liquidity, and fiduciary duty waivers—and financial regulatory trends have pushed in the direction of deregulation, not adaptation.[29] By

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[27] *See* discussion *infra* Part II.A-C.

[28] Even large institutions have struggled to remove exploitative terms from limited partnership agreements, and most investors are presented with limited partnership agreements as basically "take-it-or-leave-it" offers. *See* William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REG. 67, 69 (2020) (arguing that it is a "myth" that "large investors in private equity funds use their bargaining power to negotiate for robust protections in fund agreements that benefit all investors in a fund"); Ludovic Phalippou, *Beware of Venturing Into Private Equity*, 23 J. ECON. PERSP. 147, 164 (2009) (arguing that "[t]he complexity of the private equity fund arrangements make fundamental measurements difficult, including the measurement of past performance, fees paid, and risk").

[29] *See* Investor as Owner And Market Structure Subcommittees of the SEC Investor Advisory Committee, *Recommendation Relating To Retail Investor Access To Private Market Assets (*Sept. 18, 2025), https://www.sec.gov/files/iac-private-markets-091125.pdf (arguing that retail investor access to private capital markets "necessitates a recalibration of the existing regulatory framework, which was designed for a world in which the public markets encompassed the vast majority of all investment opportunities"). It should be noted, though, that the history of mutual fund regulation suggests that fee structures are not entirely unregulatable. Mutual funds had largely opaque fee structures until the adoption of the SEC's Rule 12b-1 in 1980 and later revisions aimed at more accurate total expense ratio disclosures. *See* James D. Cox & John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 WASH. U. L.Q. 907 (2005); Martin E. Lybecker, *Enhanced Corporate Governance For Mutual Funds: A Flawed Concept Deserves Serious Reconsideration*, 82 WASH. U. L.Q. 1045 (2005); John C. Coates IV & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151 (2007); Quinn Curtis & John Morley, *The Flawed Mechanics of Mutual Fund Fee Litigation*, 32 YALE J. ON

contrast, doctrines not usually thought of as part of financial regulation—contract law, tort law, consumer protection, and fiduciary principles—are directly responsive to these practices. Recasting the regulatory debate in terms of private law versus public law tools not only highlights the limits of traditional securities regulation but also reveals the underappreciated capacity of private litigation to enforce market discipline.

To date, for a variety of reasons, from investor incentives to statutory limitations, private enforcement has played a minimal role in the regulation of private equity.[30] But as private equity firms increasingly tap into public capital, they expose themselves to a variety of new actions and actors, with different incentive structures and reputational concerns.[31] Historical doctrines drawn from areas such as contract and tort and consumer protection have surprising relevance to the private equity model and could be used to challenge a range of customary practices.[32]

This Article proceeds in three parts. Part I provides the legal and factual background, explaining the basic framework of financial regulation, the rise of retail-focused private equity funds, and how these new structures have created tensions for securities regulation. Part II offers a survey of potential risks raised by the spread of private equity and public capital. It describes the misleading performance metrics, discretionary valuation practices, liquidity restrictions, opaque fee structures and fiduciary duty waivers that are commonplace in the private equity industry. Finally, Part III addresses alternative mechanisms of investor protection. It argues that the decline of public enforcement by regulators could lead to a wave of private enforcement by individual (or aggregated) investors and outlines the forms that this enforcement might take. It concludes that private litigation doctrines drawn from contract, consumer and fiduciary law are in many ways more wide-reaching than traditional financial regulatory principles and, thus, could prove more effective at constraining misbehavior in private markets.

I. THE RISE OF PRIVATE EQUITY AND PUBLIC CAPITAL

For nearly a century, the structure of financial regulation has rested on a sharp divide. Firms that raise capital from the public must bear the burdens of securities law, while firms that remain private largely avoid them. This boundary has long shaped American markets, but in recent decades it has steadily eroded.

REG. 1 (2015); Stewart Brown & Steven Pomerantz, *Some Clarity on Mutual Fund Fees*, 20 U. PA. J. BUS. L. 767 (2018).

[30] *See* Kobi Kastiel & Yaron Nili, *Opting Out of Court? Reputation and Informal Norms in Private Equity*, VAND. L. REV. (forthcoming 2025) (arguing that limited partners have a variety of incentives *not* to pursue litigation against private equity firms).

[31] *See* discussion *infra* Part III.B.

[32] *See* discussion *infra* Part III.C.

Congress, courts, regulators, and law firms have dismantled many of the legal barriers separating public and private capital, enabling private equity firms to draw on the savings of ordinary citizens without assuming the obligations traditionally tied to public offerings.

A. The Public-Private Divide in Capital Market Regulation

Securities law draws a bright line between public and private capital.[33] Firms that sell securities to the public must register with the SEC, provide extensive disclosures, and comply with substantive governance rules.[34] Firms that raise capital privately, by contrast, are exempt from most of these duties, subject only to minimal anti-fraud provisions.[35] The underlying rationale for this regulatory divide is simple. Ordinary citizens are unable to protect themselves without mandatory rules, while large investors have the resources and bargaining power to fend for themselves.[36] This logic has always been more aspirational than real. Several studies, for example, have shown that private equity contracts are not the product of robust bargaining but are instead highly standardized contracts drafted by a handful of law firms acting on behalf of fund managers and accepted by investors with little ability to alter them.[37] Nevertheless, the public-private divide in capital has proved an enduring concept.

The primary way that the securities laws have policed this divide is through a general prohibition on companies selling their shares in a "public offering" without previously registering those shares with the Securities and Exchange

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[33] *See* SEC Commissioner Caroline A. Crenshaw, *The Autobahn and Private Markets Remarks at Better Markets Academic Advisory Board Annual Conference*, Sept. 19, 2025, available at https://www.sec.gov/newsroom/speeches-statements/crenshaw-remarks-better-markets-academic-advisory-board-annual-conference-091925 ("American capital markets appeal to investors the world over because of their depth, liquidity, and the stability created by well-crafted, conscientious, and reliable regulation. Underlying this complex ecosystem is the separation between public and private markets – and the regulations that draw those boundaries. That separation is deliberate, time-honored, and intended to reflect real, important differences between public and private investment opportunities and the nature of underlying issuers."); Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L. J. 445, 453 (2017) (federal securities regulation "most consequential intervention in this area is the sharp divide it creates between "public" and "private" securities transactions and—relatedly—between 'public' and 'private' companies"). *See generally* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (1982).

[34] *Id.*

[35] *Id.* at 467-70.

[36] *See* Elisabeth de Fontenay & Gabriel Rauterberg, *The New Public/Private Equilibrium and the Regulation of Public Companies*, 2021 COLUM. BUS. L. REV. 1199, 1209 (2021).

[37] *See, e.g.,* William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REG. 67, 74 (2020); Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 WASH. U. L. REV. 907 (2023); Peter Morris & Ludovic Phalippou, *A New Approach to Regulating Private Equity*, 12 J. CORP. L. STUD. 59 (2012).

Commission.[38] While the securities regulations do not define what a "public offering" is, they do contain a list of exemptions and safe harbors that are deemed *not* to be public offerings. Most importantly, Regulation D provides an array of exemptions from registration based on a firm limiting its sale of securities to large, sophisticated actors (known as "accredited investors").[39] The Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940 contain similar exemptions.[40] In short, so long as a company restricts its investor base to institutional investors such as pension funds, university endowments and sovereign wealth funds, it may operate largely outside the confines of burdensome securities regulation. If, instead, it opts to raise capital from the general public, it must follow the cumbersome and expensive path of an initial public offering ("IPO").[41]

The effects of this regime are stark. Public companies like Google and Apple disclose extraordinary details about their operations.[42] Meanwhile, private equity firms, despite a range of essential businesses, from hospitals to schools to housing providers, disclose almost nothing.[43] The differential is not incidental.

[38] *See* SECURITIES AND EXCHANGE COMMISSION, INVESTOR BULLETIN: INVESTING IN AN IPO (2013).

[39] *See* SEC. EXCH. COMM'N, Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, S.E.C. RELEASE NO. 33-6389 (Securities Act of 1933), 24 S.E.C. 1166, 47 Fed. Reg. 11,251 (Mar. 8, 1982) (codified at 17 C.F.R. §§ 230, 239).

[40] The Securities Exchange Act of 1934 exempts from its registration and disclosure requirements companies whose stock is "held of record" by fewer than 2,000 total persons and fewer than 500 non-accredited investors. 17 CFR § 240.12g-1. The Investment Company Act of 1940 exempts "[a]ny issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities." 15 U.S.C. § 80a-2(a)(51)(A), § 80a-3(c)(7). A "qualified purchaser" is defined as (i) a natural person that owns at least $5 million investments, (ii) a family-owned company that owns at least $5 million in investments, (iii) a person who, acting for themselves or for other qualified purchasers, invests at least $25 million in investments and (4) a trust whose trustee and contributors are persons who meet the qualifications of (i), (ii) or (iii). 15 U.S.C. § 80a-2(a)(51)(A). Under Rule 205-3 of the Investment Advisers Act of 1940, transactions with "qualified clients" are exempt from the statute's prohibitions on charging carried interest or other performance fee. 17 CFR § 275.205-3(a). A "qualified client" is defined as a natural person who has assets under management at the applicable investment adviser of at least $1.1 million, has a net worth of at least $2.2 million, or holds certain investments positions at the applicable investment adviser. 17 CFR § 275.205-3(d).

[41] *See* de Fontenay & Rauterberg, *supra* note XXX, at 1199.

[42] We know that Google paid its CEO, Sundar Pichai, $224,985,145 in 2022. We know that it earned $350 billion in revenue in 2024. We know how much it made from YouTube ads, how much it made from Google Search, and how much it made from Google Cloud. We know that it expects to spend more on AI-oriented servers and data centers in the coming year *etc*. *See* ALPHABET INC., 2025 PROXY STATEMENT 49 (2025); ALPHABET INC., 2024 ANNUAL REPORT ON FORM 10-K 31-37 (2025).

[43] *See* Reed Abelson & Margot Sanger-Katz, *Who Employs Your Doctor? Increasingly, A Private Equity Firm*, N.Y. TIMES, July 10, 2023; Ivan Levingston & Andrew Jack, *Private Equity Groups Battle It Out for $15 Billion Schools Group*, FIN. TIMES, July 19, 2024; Mike Baker, Maureen Farrell

It is the product of a regulatory structure that assumes that one set of investors deserves protection and the other does not.[44] Over time, that structure has tilted steadily toward opacity as capital has migrated from public companies to private ones, leaving a widening regulatory void at the center of corporate America.[45]

B. Private Equity and Public Capital

Historically, the private equity industry has stayed clearly on one side of the public-private divide. They have foregone public fundraising and instead raised capital mostly from institutional investors. Wealthy families and high-net-worth investors have long participated directly in some funds, and ordinary savers have been indirectly exposed through their defined benefit pension plans and mutual funds that themselves invest in private markets, but the direct and primary source of capital for private equity firms has always been institutions, not individuals.[46]

& Serge F. Kovaleski, *As Wall Street Chases Profits, Fire Departments Have Paid the Price*, N.Y. TIMES, Feb. 17, 2025; Rebecca Picciotto, *With Individual Home Buyers on the Sidelines, Investors Swoop Into the Market*, WALL ST. J., July 27, 2025. One major exception is the world of private equity firms that have themselves gone public, such as KKR and Blackstone. *See* Lloyd L. Drury, III, *Publicly-Held Private Equity Firms and the Rejection of Law as a Governance Device*, 16 U. PA. J. BUS. L. 57 (2013)

[44] Certain limited registration and reporting requirements apply to private equity firms, including Form D filings for exempt offerings of securities and investment adviser reporting rules under the Investment Advisers Act of 1940. *See* NORA M. JORDAN, LEOR LANDA, GREGORY S. ROWLAND, AND MICHAEL S. HONG, ADVISING PRIVATE FUNDS: A COMPREHENSIVE GUIDE TO REPRESENTING HEDGE FUNDS, PRIVATE EQUITY FUNDS, AND THEIR ADVISERS, Chs. 3, 13 (2025).

[45] The number of public companies has fallen by nearly 50% since 1996. *See* Jay R. Ritter, Initial Public Offerings: Updated Statistics, July 2, 2025, available at https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf; Mark J. Roe & Charles C.Y. Wang, *Half the Firms, Double the Profits: Public Firms' Transformation, 1996 – 2022*, 8 J. L. FIN. & ACCT. 211 (2025). On the other hand, Roe and Wang find that the net income of public companies has increased relative to U.S. gross domestic product, rising from 4.5% of GDP in 1996 to 6.4% in 2022. Roe & Wang, *supra*, at 213. In 2024, some 87% of firms with over $100 million were private. *See* Torsten Sløk, *Many More Private Firms in the US*, APOLLO DAILY SPARK, Apr. 20, 2024, available at https://www.apolloacademy.com/many-more-private-firms-in-the-us/; Rogé Karma, *The Secretive Industry Devouring the U.S. Economy*, THE ATLANTIC, Oct. 30, 2023. In 2022, 47 public companies were taken private. *See* Hal Weitzman, *Is The US Economy "Going Dark"*, CHICAGO BOOTH REV., May 20, 2023. *See also* Elisabeth de Fontenay, *Private Equity Firms as Gatekeepers*, 33 REV. BANKING & FIN. L. 115, 121–24 (2013); Elisabeth de Fontenay, *Private Equity's Governance Advantage: A Requiem*, 99 B.U. L. REV. 1095 (2019); Nicholas Bloom, Raffaella Sadun & John Van Reenen, *Do Private Equity Owned Firms Have Better Management Practices?*, 105 AM. ECON. REV. 442, 442 (2015); Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANTITATIVE ANAL. 1663, 1690 (2013).

[46] *See generally* Vikas Agarwal, Brad Barber, Si Cheng, Allaudeen Hameed & Ayako Yasuda, *Private Company Valuations by Mutual Funds*, 27 REV. FIN. 693 (2023); WILLIAM MAGNUSON, FOR PROFIT: A HISTORY OF CORPORATIONS 217-52 (2022); Mary McDougall, *Calpers Pushes Further Into Private Equity After Best Results in 4 Years*, FIN. TIMES, July 15, 2025.

In recent years, though, this model has begun to shift.[47] Rather than limit themselves to the capital they can raise from institutional investors, private equity firms have increasingly sought to raise capital from small retail investors, that is, ordinary humans. In the last decade, firms have created a new generation of vehicles designed for retail distribution: interval funds,[48] tender-offer funds,[49] business development companies,[50] feeder funds sponsored by banks and brokers, and many more.[51]

Notable examples include Vanguard partnering with Blackstone to sell an interval fund that invests in both public equities and private markets and Capital Group partnering with private equity firm KKR (Capital Group boasted that its fund had "no accreditation requirements").[52] In 2025, BlackRock announced

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[47] *See* Bates, *supra* note XXX; Ian Frisch, *Wall Street Wants to Make Private Markets a Little More Public*, N.Y. Times, July 19, 2025.

[48] An interval fund is a closed-end investment company that is registered under the Investment Company Act of 1940 and that provides periodic liquidity to shareholders by offering to repurchase between 5 and 25 percent of outstanding shares at pre-established intervals (typically every three, six or twelve months). Shares must be repurchased at the fund's net asset value, which must be calculated regularly (at least on a weekly basis). These funds are often not listed on exchanges but allow investors to purchase shares in them continuously. They are subject to leverage limitations. *See* Elliot J. Gluck et al., *Why More Alternative Asset Managers Should Embrace the 1940 Act*, 30 INV. L. 1, 1 (2023). Historically, the SEC also required interval funds that allocated more than 15% of their assets to private funds (such as private equity) to limit the sale of their shares to accredited investors who made minimum investments of at least $25,000. But as discussed below in Part I.C.2, the SEC has publicly stated that it will no longer enforce this restriction, meaning that there are no investor suitability or minimum investment requirements for these funds (although, if they wish to charge carried interest, they must limit their investors to qualified clients under Rule 205-3 of the Investment Advisers Act).

[49] A tender offer fund is a closed-end investment company that, like an interval fund, is registered under the Investment Company Act but that is not required to repurchase shares at pre-established intervals and, instead, chooses whether and when to provide periodic liquidity to shareholders through tender offers. Like interval funds, tender offers must occur at the fund's net asset value, but net asset values are typically calculated at the time of the tender offer, not on periodic bases as in interval funds. These funds are typically not listed on exchanges and are subject to leverage limitations. *See* Gluck, *supra* note XXX, at 2. As closed end funds, tender offer funds historically were required to meet investor suitability and minimum investment requirements, but the SEC has stated it will no longer enforce these requirements on them. *See* discussion *infra* Part I.C.2. Like interval funds, if they wish to charge carried interest, they must limit their investors to qualified clients. *See* Gluck, *supra* note XXX, at 2.

[50] A business development company is a closed-end investment company that is not registered under the Investment Company Act but that chooses to comply with certain of the Act's requirements, including its governance and recordkeeping provisions. They may be listed on exchanges or unlisted, and may provide period liquidity either on an interval basis or on a discretionary tender offer basis. One major advantage of a business development company structure is that the fund is generally permitted to charge performance fees such as carried interest. *See* Gluck, *supra* note XXX, at 2-6. Business development companies are, however, required to invest at least 70% of their assets in private companies or small public companies and are subject to leverage limitations. *See* 15 U.S. Code § 80a-54.

[51] *See* Bates, *supra* note XXX, at 25-41.

[52] *See* Loukia Gyftopoulou, *Blackstone, Vanguard, Wellington to Launch Private Markets Fund*,

that it was introducing a target-date fund that included "exposures" to private equity investments.[53] These financial products have shown explosive growth in recent years—net asset values of retail-oriented private market funds have experienced compound annual growth rates of around 60% for the last four years—and they are poised to increase even further given the regulatory and business trends discussed below.[54] It is estimated that retail investors' allocation to private capital will grow at a 76% annual rate between 2024 and 2030.[55] And the amount at stake is large. Global private wealth amounts to around $150 trillion, roughly the same as global institutional wealth. While institutions currently allocate about 10% of their capital to private markets, individuals allocate just 1%.[56]

Private equity firms have touted this retailization of their funds as a matter of fairness. Regular citizens, they argue, have been shut out of access to the world's best assets, and their pathway to wealth has been stymied as a result.[57] As the chief legal officer of Blackstone wrote in 2019, "retail investors remain under-allocated to alternative asset classes" and "given the decline in the number of public companies, achieving true diversification without an allocation to private markets is difficult."[58] In 2025, Larry Fink, the chairman of BlackRock, wrote a letter to investors that he titled "The Democratization of Investing":

> Assets that will define the future—data centers, ports, power grids, the world's fastest-growing private companies—aren't available to most investors. They're in private markets, locked behind high walls, with gates that open only for the wealthiest or largest market

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BLOOMBERG, May 8, 2025; Capital Group Companies, Press Release, *Capital Group Files for First Public-Private Equity Fund, Furthering Exclusive Strategic Partnership with KKR*, PR NEWSWIRE, July 30, 2025.

[53] *See* Anne Tergesen, *BlackRock Deepen Push Into Private Investments for the Masses*, WALL ST. J., June 26, 2025.

[54] *See* GOLDMAN SACHS GLOBAL INVESTMENT RESEARCH, AMERICAS ASSET MANAGERS: STATE OF RETAIL ALTERNATIVES, March 10, 2025.; Anne Moore et al., *Retail—What's Here, What's Coming, and What Do LPs Need to Do* 25 INST'L LTD. P'RS. ASS'N. CONF., June 3, 2025.

[55] *See* Eric Fox & Sean Collins, *Increasing Retail Client Exposure to Private Capital Investing*, DELOITTE, Apr. 24, 2025.

[56] *See* BAIN & COMPANY, GLOBAL PRIVATE EQUITY REPORT 2023 (2023).

[57] *See* COMMITTEE ON CAPITAL MARKETS REGULATION, EXPANDING OPPORTUNITIES FOR U.S. INVESTORS AND RETIREES: PRIVATE EQUITY 69 (2018) ("[R]etail investors are missing out on the returns and safety that private equity funds, and the private companies in which they invest, can offer a well-balanced portfolio."). *See also* Christina Parajon Skinner, *Private Equity for the People*, 171 U. PA. L. REV. 2059, 2059 (2023) ("[I]n a crypto world—which is also hallmarked with considerable macro-economic volatility—maintaining these legal barriers to private equity investment [by retail investors] restricts economic choice in a way that appears to be constitutionally unsupported.").

[58] John Finley, *Expanding Retail Access to Private Markets*, Small Business Capital Formation Advisory Committee, Nov. 2019, available at https://www.sec.gov/spotlight/sbcfac/expanding-retail-access-to-private-markets-finley.pdf.

> participants… But nothing in finance is immutable. Private markets don't have to be as risky. Or opaque. Or out of reach. Not if the investment industry is willing to innovate—and that's exactly what we've spent the past year doing at BlackRock.[59]

It is certainly striking that some of the wealthiest citizens in the world—poised to earn hundreds of millions of dollars of additional income as a result—present these new investments as a service to retirees of modest means. In any event, the shift opens a vast new market for private equity firms.

C. The Blurred Lines of Securities Regulation

The collapse of the public–private boundary in capital markets is no accident. It was driven by four actors—Congress, regulators, courts, and law firms—steadily expanding exemptions and weakening oversight. Together, they have enabled private equity firms to raise money from ordinary people while insulating them from public offering obligations.

1. Congress

In recent decades, Congress has ratcheted up the burdens on public companies while simultaneously multiplying exemptions for private ones.[60] The combination has meant that the cost of "going public" has increased and, conversely, the incentives to find ways to stay private have increased. On the substantive restrictions side, the landmark federal legislation under the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010 imposed extensive disclosure, certification, and governance rules.[61] Meanwhile, on the exemptions side, the JOBS Act and its progeny (including Regulation Crowdfunding and Regulation A+) have expanded the pathways for raising capital without full registration.[62] Even more significant has been the definition of "accredited

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[59] Larry Fink, *Larry Fink's 2025 Annual Chairman's Letter to Investors*, BLACKROCK (2025), https://www.blackrock.com/corporate/investor-relations/larry-fink-annual-chairmans-letter.

[60] *See* de Fontenay, *supra* note XXX, at 466-72.

[61] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002); Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Pub. L. No. 111-203, §§ 401–416, 124 Stat. 1376, 1571 (2010). *See also* Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1 (2002); William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private*," 55 EMORY L.J. 141, 159–60 (2006); Jeff Schwartz, *The Twilight of Equity Liquidity*, 34 CARDOZO L. REV. 531, 545 (2012); John C. Coates IV & Suraj Srinivasan, *SOX After Ten Years: A Multidisciplinary Review*, 28 ACCT. HORIZONS 627 (2014).

[62] *See* Joan MacLeod Heminway, *Crowdfunding and the Public/Private Divide in U.S. Securities Regulation*, 83 U. CIN. L. REV. 477 (2014); de Fontenay, *supra* note XXX, at 468-69; Neal Newman, *Regulation A+: New and Improved After the JOBS Act or a Failed Revival?*, 12 VA. L. & BUS. REV. 243 (2018); Andrew A. Schwartz, *Crowdfunding Issuers in the United States*, 61 WASH. U. J. L.

investor," which is based on fixed dollar values that are not indexed to inflation. As household wealth has grown, far more individuals have crossed the income and net worth thresholds. Just 1.8% of households qualified in 1983, 18.5% did in 2022, and projections suggest that over 30% will by 2032.[63] Those numbers are striking given the financial fragility of most American households. Surveys show that only a quarter of American households could pay for an unexpected expense that required them to come up with $2,000 within thirty days.[64] But Congressional action—and inaction—has exposed many of these financially fragile individuals to complex financial products with significant risks.

2. Regulators

Administrative agencies have reinforced the drift.[65] In 2019, SEC Chairman Jay Clayton noted that private capital raising was outpacing public markets and lamented that "Main Street investors have no effective access."[66] In 2025, Commissioner Hester Peirce urged loosening the accredited investor definition, contending that investors "resent being cut off from an increasingly large segment of the market."[67] Current SEC Chairman Paul Atkins has stressed that "financial innovation sometimes means getting out of the way of capital formation."[68] And in 2025, the SEC withdrew proposed rules on transparency and fees for private funds, citing the need to avoid barriers to retail access, and gave informal guidance that closed-end funds would no longer be required to cap their asset allocation to private equity at 15%.[69] The Department of Labor

& POL'Y 155 (2020).

[63] *See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE REVIEW OF THE "ACCREDITED INVESTOR" DEFINITION UNDER THE DODD-FRANK ACT 23-26 (2023).

[64] *See* Annamaria Lusardi, Daniel J. Schneider & Peter Tufano, *Financially Fragile Households: Evidence and Implications*, BROOKINGS PAPERS ON ECON. ACTIVITY 82 (Spring 2011).

[65] *See generally* MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 1237-40 (2021).

[66] *See* Chairman Jay Clayton, *Remarks at SEC's Small Business Capital Formation Advisory Committee Meeting* (Aug. 13, 2019), available at https://www.sec.gov/news/public-statement/statement-clayton-081319.

[67] Commissioner Hester M. Peirce, *Remarks by Commissioner Peirce at the Third Annual Conference on Emerging Trends in Asset Management*, HARV. L. SCH. FORUM CORP. GOV. (June 10, 2025), https://corpgov.law.harvard.edu/2025/06/10/remarks-by-commissioner-peirce-at-the-third-annual-conference-on-emerging-trends-in-asset-management/

[68] Chairman Paul S. Atkins, *Prepared Remarks Before SEC Speaks*, SECURITIES AND EXCHANGE COMMISSION (May 19, 2025), https://www.sec.gov/newsroom/speeches-statements/atkins-prepared-remarks-sec-speaks-051925. A group of securities law professors has written a letter to the SEC raising concerns about the SEC's move to expand exemptions, writing that "the Commission needs to consider the propensity of private offerings to divert capital away from public markets and the benefits of public markets that might be thus compromised." *See* Securities Law Professor letter on Harmonization of Exemptions, Sept. 24, 2019, available at https://www.sec.gov/comments/s7-08-19/s70819-6193340-192501.pdf.

[69] In his speech on May 19, 2025, Chairman Atkins stated: "Since 2002, the SEC staff has

has also issued guidance aimed at simplifying how retirement plans can invest in private equity funds.[70]

3. Courts

Courts, too, have played a role in narrowing regulators' reach. In 2023, the SEC promulgated a new rule designed to "increase visibility into certain practices involving compensation schemes, sales practices, and conflicts of interest through disclosure; establish requirements to address such practices that have the potential to lead to investor harm; and restrict practices that are contrary to the public interest and the protection of investors," as well as combat fraud and deception in the industry, which, the SEC concluded, were causing "significant investor harm."[71] Among other things, it restricted the ability of firms to offer special deals or side letters to certain favored investors and required firms to provide quarterly financial statements to investors.[72] After the rule was issued, trade groups challenged it in court, arguing that the rule was arbitrary and capricious and beyond the SEC's authority.[73] The Fifth Circuit Court of Appeals agreed.[74] In *National Association of Private Fund Managers v. Securities and Exchange Commission*, the court held that "by congressional design, private funds are exempt from federal regulation of their internal governance structure."[75] As a result, the relationship between investors and private funds was legally required to be "market-driven" and not subject to regulation by the SEC.[76] In 2024, the Supreme Court struck down the SEC's use of administrative

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taken the position that closed-end funds investing 15% or more of their assets in private funds should impose a minimum initial investment requirement of $25,000 and restrict sales to investors that satisfy the accredited investor standard. As a result, many retail investors have missed out on opportunities to invest in closed-end funds that invest in private investment funds, like hedge funds and private equity funds…With this in mind, I intend to have the Commission address this situation and reconsider this 23-year-old practice concerning investments by closed-end funds in private funds. This common-sense approach will give all investors the ability to seek exposure to a growing and important asset class, while still providing the investor protections afforded to registered funds. We must consider and resolve important disclosure issues for these products, particularly for those that trade on exchanges, including conflicts of interest, illiquidity, and fees. *See* Atkins, *supra* note XXX. *See also* Bill Alpert, *SEC Officially Withdraws 14 Biden-Era Proposals*, BARRON'S, June 14, 2025; Ropes & Gray, *SEC Drops 15% Limit in Private Funds for Retail Closed-End Funds*, May 23, 2025.

[70] *See* Emp. Benefits Sec. Admin., *Information Letter to Jon W. Breyfogle* (June 3, 2020), reprinted in ERISA FOR MONEY MANAGERS AND ADVISORS § 2:31 at 5 (2020).

[71] Securities and Exchange Commission, *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Final Rule, Release No. IA-6383 (2023).

[72] *Id.*

[73] *See Nat'l Ass'n of Priv. Fund Managers v. Sec. & Exch. Comm'n*, 103 F.4th 1097 (5th Cir. 2024).

[74] *Id.*

[75] *Id.* at 1111.

[76] *Id.* at 1112. The court explained that "[m]ainly, the [Investment Company Act]

law judges on Seventh Amendment grounds, voiding its primary enforcement mechanism for securities fraud.[77] These decisions sharply circumscribe the SEC's authority to regulate the private equity industry.

4. Law Firms

Finally, law firms have actively engineered structures to channel retail capital into private equity. In client memos and public presentations, several law firms have laid out strategies for expanding investor bases while minimizing regulatory burdens. In a 2018 presentation at the Private Investment Funds Annual Review Conference entitled "Expanding Your Investor Base," the law firm Proskauer explored the range of options available to asset managers to raise capital from individuals, explaining the benefits of various structures as providing access to "permanent capital," the ability to charge investors "private-fund"-like management fees, "preferential tax treatment" and reduced regulation.[78] Simpson Thacher has written that "the best way to increase investor access to private markets investment strategies" is through pooled investment vehicles like registered investment companies and business development companies and argued that "regulatory restrictions should be lifted to enable optimal regulated fund structures."[79] In 2023, Ropes & Gray published a client memo entitled, "Retail Investments in Private Funds: Regulatory Obstacles and Opportunities." After noting that "at a high level, the federal securities laws essentially foreclose significant direct retail investment in private funds," the memo then explores several alternatives including direct access, investment through registered vehicles and investments through feeder funds, that would nonetheless allow private funds to raise capital from retail investors.[80] After the SEC lifted its 15%

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purposefully exempted private funds from the prescriptive framework, permitting private funds to freely negotiate fund agreements concerning investor access to periodic financial reports, investor input on advisory fees chargeable to the fund, and terms—including redemption terms—available to particular investors. By congressional design, private funds are exempt from federal regulation of their internal "governance structure." The Commission cannot promulgate rules under the guise of section 206(4) that affects this internal governance structure." *Id.* at 1113-14.

[77] *Sec. & Exch. Comm'n v. Jarkesy*, 603 U.S. ___ (2024).

[78] *See* PROSKAUER, EXPANDING YOUR INVESTOR BASE: CAPITAL RAISING THROUGH REGISTERED ALTERNATIVE FUNDS, INTERVAL FUNDS AND BDCS (2018), available at https://prfirmpwwwcdn0001.azureedge.net/azstgacctpwwwct0001/uploads/4695e8714144b3a1f94a3f51daa1075c.pdf.

[79] *See* Simpson Thacher, Expanding Retail Access to Private Markets Through Regulated Funds: A Response to a Comment Letter From Securities Law Professors, Sept. 1, 2020, available at https://www.stblaw.com/about-us/publications/view/2020/09/01/expanding-retail-access-to-private-markets-through-regulated-funds-a-response-to-a-comment-letter-from-securities-law-professors.

[80] Ropes & Gray, Retail Investments in Private Funds: Regulatory Obstacles and Opportunities (2023), available at https://www.ropesgray.com/-/media/files/publications/2023/03/23_0434_bk_retail-investment-in-

rule on retirement plan allocations, the law firm issued a client alert stating that the change "will pave the way for more meaningful access to private capital by retail investors and result in greater product innovation."[81]

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In short, the rise of public capital in private equity seems poised to transform the nature of capital markets. The erosion of the public–private boundary has been deliberate and multi-sourced. Congress expanded exemptions, agencies promoted retail access, courts curtailed oversight, and law firms built the transactional machinery. The result is that private equity can now tap ordinary investors while avoiding the duties long attached to public offerings. But practices that were tolerated by institutional investors pose greater risks to individuals. The next Part turns to those practices.

II. THE RISKS OF PRIVATE EQUITY AND PUBLIC CAPITAL

Proponents of dismantling the long-standing barrier between public capital and private equity frame the shift as an opportunity for ordinary households. But the industry's underlying architecture has not changed: managers retain control of the levers, and investors have limited rights and even more limited visibility. Private equity's retailization transforms this structure from a quirk of high finance to a matter of serious public concern.

A. Performance Metrics

Among the many features of private equity, few are as systematically misunderstood and as widely tolerated as the industry's reliance on the internal rate of return ("IRR") as its primary performance metric.[82] IRR appears in pitchbooks, prospectuses, and regulatory filings, and is typically presented as an investor's annual rate of return.[83]

Formally, however, IRR is not an annual rate of return, but the discount rate (r) that sets the net present value of a sequence of cash flows equal to zero:

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pf_0316.pdf?rev=1de2fd6ccd7d4627b55fe3d234344e5c&hash=8E116119AD864D72C07BEF7CF696F060.

[81] *See* Ropes & Gray, Client Alert, *SEC Drops 15% Limit in Private Funds for Retail Closed-End Funds*, May 23, 2025, available at https://www.ropesgray.com/en/insights/alerts/2025/05/sec-drops-15-limit-in-private-funds-for-retail-closed-end-funds.

[82] *See* Ludovic Phalippou, *An Inconvenient Fact: Private Equity Returns and the Billionaire Factory,* 30 J. INVESTING 11 (2022). *See* Harris, Jenkinson & Kaplan, *supra* note XXX, at 10. Ludovic Phalippou, *The Hazards of Using IRR to Measure Performance: The Case of Private Equity*, 12 J. PERFORMANCE MEASUREMENT 55 (2008).

[83] *See* Ludovic Phalippou, *The Tyranny of IRR: A Reality Check on Private Market Returns*, CFA INST., Nov. 8, 2024, available at https://blogs.cfainstitute.org/investor/2024/11/08/the-tyranny-of-irr-a-reality-check-on-private-market-returns/.

$$0 = \Sigma [C_n / (1 + r)^n]$$

where n runs from 0 to N time periods.

To understand why IRR can significantly diverge from the rate at which an investor accumulates wealth, consider the following stylized situation. An investor contributes I at time 0, receives a distribution D after one year, and holds assets valued at NAV at year 20. The IRR is the solution to this equation:

$$-I(1 + r)^{20} + D(1 + r)^{19} + NAV = 0$$

Assume for now that the NAV is small relative to $D(1 + r)^{19}$. In that case, the solution for r will be close to the ratio D/I. If D/I is relatively large, then r must also be large. And if r is large, then $D(1 + r)^{19}$ is very large and much bigger than any realistic NAV, which confirms the assumption that NAV is relatively small. But what that means is that the first distribution D will determine the IRR, and whatever happens over the years to the value of the fund, IRR will remain high.

Let's take a numerical example. Suppose an investor contributes $100,000 and receives $130,000 back after one year, and let's leave NAV unspecified for now. Solving for IRR cannot be done analytically, but as just suggested r should be close to 30% (since 130/100 − 1 = 30%). The compounding is powerful:

$$120k^*(1.3)^{19} \approx \$17.5mn$$

Since the compounded dividend is worth $17.5 million, for NAV to matter, it would need to reach, say, at least $10 million — which is possible, but unlikely after twenty years, given an initial investment of just $100,000 and a large partial exit after one year. Therefore, whatever realistic number NAV becomes, it will have a muted effect on the IRR.

We can verify this claim directly. With NAV = 0, IRR is now 30%. With NAV = $500,000 IRR is 33%. With NAV = $1,000,000, IRR is 35%. At a $2mn NAV, IRR is 37%. For an investor, ending up with nothing or $2 million after 20 years on a $100,000 investment would make a huge difference, but IRR is 30% in the first case and 37% in the second. The initial distribution locks in a high IRR, and subsequent fund performance does little to move it.

Why do private equity firms use such a strange and misleading metric in the first place? The short answer is that a "rate of return" does not exist for an investment product that generates intermediate cash flows. A rate of return is only defined when there is a single investment followed by a single payoff. Once money moves in and out during the life of the investment, the question "what is the return?" has no correct answer. Nevertheless, people expect to see a single annualized number, so people invented one: IRR.

Let's continue with a simple example. You invest $100, receive $120 after one year, and at year 20 the remaining assets are worth $500. Without the early distribution, the annualized return is simple to compute:

$$(500 / 100)\hat{}(1/20) - 1 \approx 8.4\%$$

With the \$120 received at year 1, what happens next to that \$120 matters. If you reinvest it at some rate y, then after 19 years it becomes $120*(1 + y)^{19}$. Total wealth at year 20 is: $120*(1 + y)^{19} + 500$. The annualized return, then, is:

$$r = ((120*(1 + y)^{19} + 500) / 100)\hat{}(1/20) - 1$$

This one equation has two unknowns (y and r) and thus no unique solution. The man often credited with solving this conundrum is Irving Fisher, who, in his landmark 1930 finance book *The Theory of Interest*, proposed a solution he called (for some inscrutable reason) the "rate of return over cost."[84] Either way, his proposed solution was to assume that the reinvestment rate equals the rate of return (y = r) and now we have only one equation and one unknown. That definition yields the familiar IRR equation:

$$-I(1 + r)^{20} + D(1 + r)^{19} + NAV = 0$$

This equation cannot be solved by hand and must be solved numerically. For the example above, the IRR is 26.1%. Compare that to the 8.4% you would report if there was no early distribution. The early \$120 basically completely changes the picture. Of course, it matters that you get back such a relatively large amount early on. It is much preferred over the case in which you would not. The important point is that the rate at which your capital grows is 26.1% only if you reinvested that distribution at that rate of return, which is nearly impossible.

Two linked reasons explain why the industry uses IRR despite its defects:

1. It gives users what they want: a single, marketable number. Managers can present it as a compact summary of performance even if it does not capture what it is supposed to. And, in any case, there is no obvious replacement for it, since an actual return does not exist.
2. It is easy to engineer high IRRs. Because IRR implicitly assumes interim cash flows are reinvested at the same high rate, a manager who achieves a large early distribution—by selling early winners, using subscription lines in lieu of first capital calls, and other strategies—can produce very large IRR figures even if subsequent performance is poor.

Outside of the private equity context, IRR is widely used, but its quirks have generally been harmless. Any finance course and textbook will discuss the

[84] Irving Fisher, The Theory of Interest 155 (1930) ("When we compare two optional income streams, and either may be preferable to the other according as one rate of interest or another obtains, the two options would stand on a par if the right intermediate rate were used for calculating the present values of the two options. That is, this equalizing rate is such that the present values of the two options would be equal, or what amounts to the same thing, it is such that, if that rate is used for discounting, the present value of the cost of choosing one option instead of the other would be equal to the present value of the return. This hypothetical rate of interest which if used in calculating the present worth of the two options compared would equalize them or their differences (cost and return) may be called the rate of return over cost and hereafter this name will generally be employed. This new magnitude (or factor) in our study plays the central role on the investment opportunity side of interest theory.")

reinvestment assumption, the possibility of multiple solutions, or the odd behavior when cash flows change signs. But most corporate projects involve a single upfront investment followed by one or two payoffs at moderate rates of return. Under those conditions, IRR behaves well enough, and its drawbacks are just curiosities, leaving students with the impression that IRR can be "a bit off" but never seriously misleading. That classroom impression carries into practice. Professionals, academics, and regulators think they are familiar with IRR and tend to treat its weaknesses as manageable. Because "everyone knows" IRR's limits, there is little incentive to revisit how the metric behaves in settings outside those covered in textbooks. The result is a false confidence: people think they understand IRR, but in fact they do not.

In private equity, the quirks that are trivial in corporate finance exercises become central. Funds and especially old-firm track records involve long series of cash flows, often with large early distributions. As shown above, a relatively large early payout can only be reconciled mathematically by solving for a very high IRR. All subsequent flows are then treated as compounding at that rate. The effect is "stickiness": once an early payout occurs, the IRR hardly changes.

These strange mathematical features of IRR can be observed in private equity firm disclosures. For example, thanks to its being publicly traded, KKR has publicly disclosed its financial performance for over two decades now. In its 10-K filing for 2024, KKR reported a cumulative gross IRR of 25.5% over 48 years.[85] If interpreted as a compound annual return, this would imply that anyone who would have invested just $10 million in 1976 with KKR would be the world's richest person on earth with $540 billion by 2024. That alone should make clear that 25.5% is not the rate at which someone has grown their wealth. Moreover, KKR reports overall gross multiples-of-money of around 1.8x. Even adjusting for average holding periods (four years), the two figures remain irreconcilable.

Importantly, KKR has reported nearly identical IRRs year after year. In 2023, it reported a cumulative gross IRR of 25.5%.[86] In 2022, it was 25.6%.[87] In 2021, 25.6% once again.[88] In 2020, 25.6% again.[89] If one goes way back to its earlier public filings (2010), it was…25.8%.[90] Apollo, too, has reported basically the same high IRR each year. The firm has disclosed a gross IRR of 39 percent in its 10-K filings for more than a decade, year after year.[91] If that figure

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[85] KKR & CO., INC., 2024 ANNUAL REPORT ON FORM 10-K, 19, available at https://www.sec.gov/ix?doc=/Archives/edgar/data/0001404912/000140491225000015/kkr-20241231.htm.

[86] KKR & CO., INC., 2023 ANNUAL REPORT ON FORM 10-K, 19.

[87] KKR & CO., INC., 2022 ANNUAL REPORT ON FORM 10-K, 19.

[88] KKR & CO., INC., 2021 ANNUAL REPORT ON FORM 10-K, 11.

[89] KKR & CO., INC., 2020 ANNUAL REPORT ON FORM 10-K, 11.

[90] KKR & CO., INC., 2010 ANNUAL REPORT ON FORM 10-K, 4.

[91] *See, e.g.,* APOLLO GLOBAL MANAGEMENT, INC., 2024 ANNUAL REPORT ON FORM 10-K, 13 ("We have consistently produced attractive long-term investment returns in the traditional

reflected compound annual performance since inception, then $300 million invested in Apollo in 1990 alone would today exceed the entire GDP of the United States. Retail investors are unlikely to grasp these complexities. Very few would realize that a "39% internal rate of return" is not the same as a 39% annual return on their investment.

There are further issues with performance presentations. Let's consider an example from a typical retail-facing website. The figure below is a screenshot of how Altaroc, a French private equity firm, presents its performance to investors (the French acronym TRI is used for IRR, but the text itself is in English).[92] The chart displays a 20.5% IRR for top-quartile funds. As explained above, though, IRR is not a rate of return. If it was, with an average holding period of 4–5 years, this figure would imply a net multiple of 2.1–2.5x. It is very unlikely that any diversified investor—someone with commitments to more than ten private equity funds—has ever achieved such an outcome. For comparison, CalPERS, one of the largest institutional investors in the world, reports a multiple of 1.5x. Even the industry's own promotional materials suggest lower results. The American Investment Council recently highlighted a study claiming that private equity delivers the highest returns for U.S. pension funds, listing the top performers.[93] The highest was Vermont, with an IRR of 18.8%. In other words, even the very best U.S. pension investor, out of hundreds, has not achieved a 20% IRR. Nevertheless, the website graph above suggests that fully a quarter of its funds have delivered more than 20%, and retail investors will be told that the firm focuses on "top-quartile" funds. Thus, the message to prospective investors is that such outcomes are within reach. They are not. The top quartile figure is highly exaggerated by re-investment assumptions, and, when cash flows are aggregated at the investor level, IRR goes down mechanically (this is why IRRs on aggregated cash flows are also much lower than fund IRRs). Again, the odds of anyone understanding this type of mathematical features are very low.

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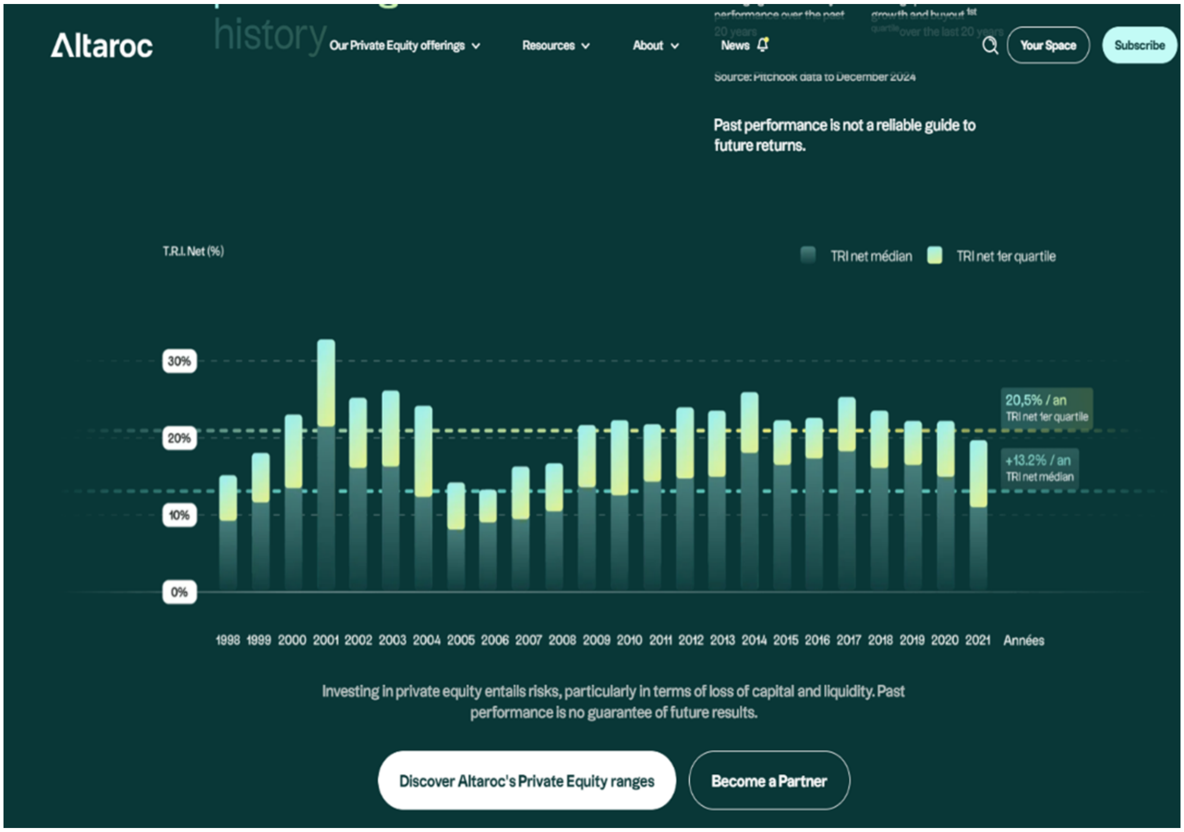
private equity funds we manage, generating a 39% gross IRR and a 24% net IRR on a compound annual basis from inception through December 31, 2024.); APOLLO GLOBAL MANAGEMENT, LLC, 2024 ANNUAL REPORT ON FORM 10-K 6 ("We have consistently produced attractive long-term investment returns in our private equity funds, generating a 39% gross IRR and a 25% net IRR on a compound annual basis from inception through December 31, 2014.").

[92] https://www.altaroc.pe/en#offre

[93] AMER. INV. COUNCIL, PRIVATE EQUITY DELIVERS THE STRONGEST RETURNS FOR RETIREES ACROSS AMERICA, July 17, 2025, available at

https://www.investmentcouncil.org/new-study-private-equity-delivers-the-strongest-returns-for-retirees-across-america/



The presentation is problematic in another way too. The chart shows that median funds produce between 10% and 15% IRR "per year." A casual reader might conclude that volatility is very low and returns never went below 10% in any year, which is extraordinary. However, the figures do not correspond to calendar years but rather to fund lifecycles starting in those years and running for 10–15 years. This overlapping construction explains why the line is so smooth. If one plotted 10-year forward returns for the U.S. stock market, the picture would look similar. Nevertheless, these types of misleading graphs are common in the private equity world. When presented to institutional investors, the argument was that sophisticated readers would understand their nuances. Now, while the graphs have remained the same, the audience has changed, and that has dramatic consequences.

B. Valuation Methodologies

A second major risk for investors in private equity funds is the way that funds value their assets. The key concept here is a financial metric known as "net asset value."[94] In finance, net asset value is ordinarily defined as the aggregate of an entity's assets and liabilities.[95] As such, it is an uncontroversial measure of a fund's total worth.[96] Net asset value is an essential feature of the private equity industry and is used to calculate everything from a fund's returns to its current size.[97]

As private equity investments are by their nature illiquid, their net asset value at any given time is difficult to determine.[98] Portfolio companies are usually not being traded on stock exchanges and, until the investment has been exited, valuations must instead be estimated by private equity fund managers; and their calculations necessarily involve substantial amounts of subjectivity.[99]

Several studies have concluded that private equity firms actively engage in manipulation of net asset values. In one large study of buyout and venture capital funds, the authors found that underperforming managers tended to inflate net asset values when they were seeking to raise new funds and that top-performing ones tended to understate them (presumably to safeguard their long-term reputation for accurate reporting).[100] Another study found that "low-reputation" private equity firms that had a low number of exits experienced performance peaks precisely timed around dates when they were fundraising for new funds, which the authors concluded was consistent with the hypothesis of "NAV management."[101] Another study found that when measured over the life of a fund, private equity valuations are conservative and tend to be smoothed, but that they jump during fund-raising periods—and then gradually fall after the new fund has been raised.[102]

Even outside of fundraising periods, private equity firms have an interest in biasing NAVs in certain directions. If the market rises in Q1 but falls in Q2, as the fund manager submits the NAV estimate for Q1 only after observing market behavior in Q2, they may have an interest in lowering their Q1 estimate so as to

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[94] GLEN ARNOLD, HANDBOOK OF CORPORATE FINANCE: A BUSINESS COMPANION TO FINANCIAL MARKETS AND DECISIONS 339 (2011).

[95] *Id.*

[96] *Id.*

[97] *See* Colleen M. Baker, *Net Asset Value Financing and Private Equity*, 171 U. PA. L. REV. ONLINE 45 (2024).

[98] *See* Gregory W. Brown, Oleg R. Gredil & Steven N. Kaplan, *Do Private Equity Funds Manipulate Reported Returns?*, 132 J. FIN. ECON. 267 (2019).

[99] *See* Steven M. Davidoff, *Fairness Opinions*, 55 AMER. U. L. REV. 1557, 1574 (2006).

[100] *See* Brown, Gredil & Kaplan, *supra* note XXX, at 13.

[101] *See* Brad M. Barber & Ayako Yasuda, *Interim Fund Performance and Fundraising in Private Equity*, 124 J. FIN. ECON. 172 (2017). Another similar study concluded that portfolio companies of low reputation private equity firms demonstrated significant levels of "earnings management" during fundraising periods. *See* Brian K. Baik, *Earnings Management in Private Equity Portfolio Firms During Fundraising*, Harvard Business Working Paper No. 23-013, Feb. 2025, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4199605.

[102] *See* Jenkinson, Sousa & Stucke, *supra* note XXX. *See* also Spencer J. Couts, Andrei S. Goncalves & Andrea Rossi, *Unsmoothing Returns of Illiquid Funds*, 37 REV. FIN. STUD. 2110 (2024).

minimize the drop in Q2. This kind of smoothing benefits both managers and investors as both can show lower volatility in their portfolios as a result. The bottom line is that we can expect NAVs to deviate from market value in predictable ways.

When we consider the fact that retail vehicles buy mostly on the secondary markets the problem compounds. Consider the following hypothetical for a semi-liquid retail vehicle called Lafayette. On October 30, 2025, Lafayette buys for $90 a fund interest that has a June 2025 NAV of $100. On October 31, Lafayette records the asset at $100, even though the only reason the NAV shows $100 is because it is an old one and possibly an inaccurate one; the true market value is expected to be closer to $90 since it has just traded at that price. This creates two issues. First, Lafayette books an immediate gain of $10, and as both management and performance fees may be calculated on NAV, the inflated mark generates excess fees.[103] Second, if an investor redeems their interest the next day, they will do so at the inflated NAV of $100, even though the underlying assets could only be sold in the secondary market at $90. That investor is effectively being subsidized by the investors who remain in the fund. It is a classic situation, and remaining investors would often sue as they lost money because of Lafayette's action.

It should come as no surprise, then, that fund documents frequently contain boilerplate provisions requiring investors to accept reported NAVs and refrain from challenging them. These documents might, for example, provide that "the investor agrees to accept NAV as reported by the fund as conclusive and binding, and waive any claim arising from NAV errors." The very fact that private equity firms have added these provisions to their contracts suggests that they have concerns about the accuracy of net asset values, and its consequences.[104]

C. *Fee Structures*

[103] This issue is not theoretical. The *Wall Street Journal* has reported that one private equity firm, Hamilton Lane, had its private assets fund purchased private equity stakes at significant discounts to their official NAVs, then mark them up almost immediately, producing large one-day gains. There is little doubt that most private equity firms have the same practice. *See* Jonathan Well, *Funds Are Booking Big One-Day Windfalls Buying Private-Equity Stakes*, WALL ST. J., June 7, 2024.

[104] Private equity funds market their smooth valuations as a sign of low risk, a practice that is itself potentially misleading *See* Jamil Baz, Josh Davis, Lloyd Han & Christian Stracke, *The Value of Smoothing*, PIMCO QUANT. RES. & ANAL. 1, 2 (2022) (arguing that the "substantial gap" in volatility between private assets and public ones "is an illusion driven by the lack of trading and different regulations around the valuation of private assets" but that it nonetheless provides benefits to managers "in terms of job security, wealth, disaster risk and the reduction of behavioral biases."); Evan Gunter, Ruth Yang & Leon Sinclair, *Private Markets: Still Waters Run Deep*, S&P GLOBAL (2023); Robin Powerll, *Private Equity Volatility: The True Risk May Be Far Higher Than You Think*, INDEX FUND ADVISORS, Jul 22, 2025.

Another major source of litigation risk is the fee structure.[105] Private equity compensation is often described as a "two and twenty" model. Firms earn (1) management fees that are assessed as a quasi-fixed annual charge, generally around 2% of committed capital, and (2) carried interest, calculated as a percentage of fund profits and customarily set at around 20% of fund profits, subject to applicable thresholds and waterfalls.[106] But this familiar framing obscures a much larger and less transparent world of charges. Beyond management fees and carried interest, private equity firms also collect a range of other fees and expenses that can extract large amounts of capital from investors.

Fund expenses generally are intended to cover the operating costs of the investment vehicle: legal expenses, audit fees, and compliance costs.[107] Over time, however, the "fund expense" category has expanded. Some general partners allocate to fund expenses a wide range of items, many of which resemble discretionary spending more than they do essential costs. Investors may find themselves paying for private jet travel, luxury hotels, internal staff salaries, cost of subscription credit lines and business development efforts.[108] The sections of limited partnership agreements devoted to "fund expenses" have grown from a few lines to several pages, filled with vague and ambiguous categories that leave wide latitude for interpretation.[109]

These allocations are rarely visible to investors and even more rarely challenged by them.[110] Even institutional limited partners often struggle to

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105 An extensive scholarly literature has shown that most investors pay little attention to fees—indeed, they are often entirely unaware of them—and instead focus on prior performance metrics. *See* Alan R. Palmiter & Ahmed E. Taha, *Mutual Fund Investors: Divergent Profiles*, 2008 COLUM. BUS. L. REV. 934 (2008). The problem of performance-chasing has been particularly acute in the mutual fund industry, where a practice known as "mutual fund incubation" allows mutual funds to launch a series of new funds privately and then market the high-performing ones to investors, while terminating the poor performers. The practice artificially inflates performance. *See* Alan R. Palmiter & Ahmed E. Taha, *Star Creation: The Incubation of Mutual Funds*, 62 VAND. L. REV. 1485 (2009).

106 *See* Magnuson, *supra* note XXX, at 1854-57.

107 *See* DUANE MORRIS, PRIVATE EQUITY FUND EXPENSES (2014), available at https://www.duanemorris.com/site/static/private_equity_fund_expenses.pdf.

108 *See* Alicia McElhaney, *Allocators Are Paying for Their Managers to Fly on Private Jets*, INSTITUTIONAL INVESTOR, June 18, 2024.

109 *Id.*

110 *See* U.S. SEC. & EXCH. COMM'N, RISK ALERT: OBSERVATIONS FROM EXAMINATIONS OF INVESTMENT ADVISERS MANAGING PRIVATE FUNDS, June 23, 2020, available at https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf. One exception here is Blackstone's Private Equity Strategies Fund, which is admirably clear about what expenses the firm plans to charge to the fund. In its annual report, it discloses to investors that "[t]ravel and related expenses described herein include, without limitation, first class and/or business class airfare (and/or private charter, where appropriate, such as when commercial equivalent travel is not available for the applicable itinerary), first class lodging, ground transportation, travel and premium meals (including, as applicable, closing dinners and mementos, cars and meals (outside normal business hours), and social and entertainment events with Portfolio Entity employees, customers, clients, borrowers, brokers and service providers) and related costs and expenses

obtain detailed breakdowns of expenses, and, even when they receive them, they are very costly to analyze. For retail investors, even this limited transparency is functionally non-existent. A retail investor accessing private equity through a feeder fund or semi-liquid vehicle will not receive expense data, nor will they be aware of what costs are being charged or why. Reports are typically aggregated at the intermediary level and presented without line-item visibility, if at all.

At the asset level, even more fees appear. General partners often sit on the boards of portfolio companies and authorize payments to themselves or to affiliated entities. These may include internal consultants, compliance staff, or operating teams, often spun out into wholly owned subsidiaries that charge supposedly "market rates" for services. Private equity firms have justified these practices as the result of arms-length bargaining between sophisticated investors, all of whom are well-advised and who understand the relevant risks.[111] In the context of public capital, though, this argument collapses. A pensioner investing through a semi-liquid fund marketed by a respected wealth platform has no idea that their capital may be paying for luxury travel, entertainment, or internal team costs several layers removed from the vehicle they invested into.

When the SEC was allowed to look into these types of problems in the industry, it repeatedly found abusive or misleading practices. Over the past decade, the SEC has brought several notable cases related to expense practices.

- In 2017, the SEC charged a former senior partner at the private equity firm Apollo, Mohammed Ali Rashid, with defrauding fund clients by billing approximately $290,000 in personal expenses including family vacations, luxury retail purchases (including a $3,500 suit for his father), and visits to a hair salon, as legitimate fund costs.[112]
- In 2015, the SEC sanctioned KKR for failing to disclose that it had unfairly allocated broken deal expenses between co-investors and its flagship funds.[113]
- In 2016, WL Ross & Co. was fined for improperly charging personal travel and entertainment costs to its funds and failing to properly offset management fees.[114]

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incidental thereto." BLACKSTONE PRIVATE EQUITY STRATEGIES FUND L.P., 2024 ANNUAL REPORT ON FORM 10-K 194 (2025).

[111] *But see* Clayton, *supra* note XXX, at 70 ("Unlike in a corporate setting, large investors in private equity funds commonly use their bargaining power to negotiate for individualized benefits outside of fund agreements, where the benefit of the bargain is not shared with other investors in the fund.").

[112] *See Securities and Exchange Commission v. Mohammed Ali Rashid*, Case No. 17-cv-8223, S. D. N. Y., Complaint (2017).

[113] *See* Alexandra Stevenson, *K.K.R. Settles Over "Broken Deal" Expenses*, N.Y. TIMES, June 29, 2015.

[114] *See* Koh Gui Qing, *SEC Fines Wilbur Ross Firm $2.3 Million Over Fees*, REUTERS, Aug. 24, 2016.

- In 2016, the SEC charged Apollo with failing to disclose accelerated monitoring fees.[115]
- Between 2015 and 2023, the SEC settled actions against Blackstone, TIAA, and others for inadequate disclosure around affiliated service providers, expense allocations, and conflicts of interest.[116]

But to date, the SEC response has remained largely reactive and case-specific, and its approach has varied significantly from administration to administration. In the cases they have brought, they have focused on disclosure failures, not on the underlying economics. The SEC has not challenged whether certain expenses should have been charged at all, only whether they were correctly disclosed. There is no requirement to show all fund-level and portfolio-level expenses, no mandate to present investors with a consolidated view of total charges, and no accounting standard for what constitutes an appropriate "market rate" in related-party transactions.

As retail capital flows into semi-liquid and evergreen fund structures, this regime looks increasingly untenable. The more fees are buried within opaque hierarchies of entities, the less plausible it becomes to argue that investors are fully informed. This opacity is what distinguishes private equity from other asset classes. In regulated retail products such as mutual funds or collective investment schemes, there are strict rules on total expense ratios, disclosure of inducements, and performance reporting net of all fees.[117] None of these protections apply to private equity structures, including when they access private equity through semi-liquid products or feeder funds. And the fees themselves are often based on unreliable net asset values. Blackstone's private equity strategies fund, for example, discloses that it charges a management fee of 1.25% per annum of "transactional NAV," but then warns investors that its net asset values, valuations and financial statements might not "reflect economic reality and actual value."[118] It also discloses that fund expenses "will be substantial,"

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[115] *See* U.S. SEC. & EXCH. COMM'N, APOLLO CHARGED WITH DISCLOSURE AND SUPERVISORY FAILURES, Aug. 23, 2016, available at https://www.sec.gov/newsroom/press-releases/2016-165.

[116] *See* U.S. SEC. & EXCH. COMM'N, BLACKSTONE CHARGED WITH DISCLOSURE FAILURES, Oct. 7, 2015, available at https://www.sec.gov/newsroom/press-releases/2015-235; U.S. SEC. & EXCH. COMM'N, SEC ANNOUNCES $97 MILLION ENFORCEMENT ACTION AGAINST TIAA SUBSIDIARY FOR VIOLATIONS IN RETIREMENT ROLLOVER RECOMMENDATIONS, July 13, 2021, available at https://www.sec.gov/newsroom/press-releases/2021-123.

[117] Mutual fund regulation also imposes strict rules on differential treatment between different share classes of the same fund, rules that are generally not applicable to private equity funds. *See* Jeffrey S. Puretz et al., *A Touch of Class: Mutual Fund Share Class Developments (Part 1)*, PRACTICAL L., June 2018. There are signs that the lack of private equity regulation may be leading to legislative pressure to deregulate mutual fund disclosures as well. *See* Jason Zweig, *Congress Thinks Hiding Fund Fees Is Good For You*, WALL ST. J., Oct. 10, 2025.

[118] *See* BLACKSTONE PRIVATE EQUITY STRATEGIES FUND L.P., 2024 ANNUAL REPORT ON FORM 10-K, 3-, 10, 29-30.

will reduce "actual returns" and "may exceed expectations."[119]

Even carried interest fees bring with them major pitfalls. One particularly pernicious source of confusion is the "waterfall" provision of a limited partnership agreement governing the distribution of profits. Carried interest generally refers to the percentage of profits from a fund that will be paid to a private equity firm and, as already mentioned, is often set at around 20%. But rarely is the waterfall calculation that simple. Investors long argued that private equity firms shouldn't be paid for returns that just matched the broader market and, instead, should only earn carried interest on returns that *beat* the market. And so a caveat was added to the carried interest provision: carried interest would be subject to a *hurdle rate*, under which investors would receive a preferred return of, say, 8% a year before the general partner began earning carried interest. But private equity firms, in turn, added a new provision caveating the caveat: after the hurdle rate is met, a general partner *catch-up* applies, redirecting future returns exclusively to the general partner until they are caught up to their full carried interest rate. The logic behind each of these provisions can be explained simply enough, but their interrelationship—and practical effect on returns—can confound even experienced investors, let alone ordinary citizens.

For example, imagine that a retail investor is told that a fund charges 20% of profits with an 8% hurdle rate. Suppose the investor makes a \$10 million investment that returns \$15 million after four years. Most investors would assume that the carry would equal $20\% \times (15 - 10 \times 1.08^4) = \$280{,}000$. It involves some calculation, but it seems straightforward. In fact, though, if the fund has a catch-up provision, in most cases, the manager would earn \$1 million of carry in this situation. This is more than triple what most investors would expect, and it effectively eliminates the hurdle rate. When investors were exclusively institutional, the argument was that they had advisors who would grasp these details. It is hard to imagine any retail investor grasping the full consequences of these complicated structures.

D. Fiduciary Duties

Another area of misalignment between private equity firms and their investors is the widespread elimination of fiduciary duties in the sector. Fiduciary duties have been the foundation of corporate law for nearly as long as corporations have existed.[120] Enormous amounts of caselaw, treatises and scholarly attention have been devoted to explaining the fundamental requirements of loyalty and care that all managers owe their shareholders.[121]

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[119] *Id.* at 190.

[120] *See* Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997); David J. Seipp, *Trust and Fiduciary Duty in the Early Common Law*, 91 B.U. L. REV. 1011 (2011).

[121] *See* Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899 (2011).

Fiduciary duties have served as one of the core protections that shareholders have against overreaching and self-interested behavior by directors and officers.[122] Fiduciary duty breaches have formed the basis for many of the most consequential judicial decisions governing corporate law over the last several decades.[123]

Despite the importance of fiduciary duty law to investor protection, or perhaps because of it, private equity formation documents frequently limit or entirely eliminate the fiduciary duties that managers owe to their investors.[124] Limited partnership and other operating agreements often modify the applicable standards of conduct for managers and restrict investors' right to sue for violations of those standards.[125] They also provide for the indemnification of officers and managers for any violations of whatever reduced obligations they still owe.[126]

Consider, for example, the operating agreement of Apollo Global Management, LLC. Section 6.2(e) of the agreement provides:

> To the fullest extent permitted by Applicable Law, neither the Manager nor any other Indemnified Person *shall have any duties or liabilities, including fiduciary duties*, to the Company, any Member or any other Person bound by this Agreement, and the provisions of this Agreement, to the extent that they restrict or otherwise modify or eliminate the duties and liabilities, including fiduciary duties, of the Manager or any other Indemnified Person otherwise existing at law or in equity, are agreed by the Members to replace such other duties and liabilities of the Manager or such other Indemnified Person.[127]

It goes on to provide:

> Except insofar as the Manager is specifically restricted by Section 6.18(a), each Indemnified Person shall have the right to engage in businesses of every type and description and other activities for

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[122] *See* Zachary J. Gubler, *The Neoclassical View of Corporate Fiduciary Duty Law*, 91 U. CHI. L. REV. 165 (2024).

[123] *See* Jack B. Jacobs, *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective*, 5 HARV. BUS. L. REV. 141, 148-50 (2015).

[124] *See* Kastiel & Nili, *supra* note XXX, at 15 (finding that, in a sample of reviewed limited partnership agreements, none contained waivers of fiduciary duties before 2008 and 92% contained them after 2008); Elisabeth de Fontenay, *Private Equity Firms as Gatekeepers*, 33 REV. BANKING & FIN. L. 115, 181 (2013); William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REG. 67, 74 (2020); James C. Spindler, *How Private Is Private Equity, and at What Cost?*, 76 U. CHI. L. REV. 311, 328-29 (2009); William Clayton, *Preferential Treatment and the Rise of Individualized Investing in Private Equity*, 11 VA. L. & BUS. REV. 249, 260 (2017).

[125] *See* Lloyd L. Drury, III, *Publicly Held Private Equity Firms and the Rejection of Law as a Governance Device*, 15 U. PA. J. BUS. L. 57 (2013).

[126] *Id.*

[127] Apollo Global Mgmt, LLC, Amended and Restated Ltd. Liab. Co. Agmt. 38 (July 13, 2007) (emphasis added).

> profit and to engage in and possess an interest in other business ventures of any and every type or description, whether in businesses engaged in or anticipated to be engaged in by any Company Group Member, independently or with others, including business interests and activities in direct competition with the business and activities of any Company Group Member, and none of the same shall constitute a breach of this Agreement or any duty otherwise existing at law."[128]

It concludes:

> To the fullest extent permitted by Applicable Law but subject to the limitations expressly provided in this Agreement, all Indemnified Persons shall be indemnified and held harmless by the Company from and against any and all losses, claims, damages, liabilities, joint or several, expenses (including legal fees and expenses), judgments, fines, penalties, interest, settlements or other amounts arising from any and all threatened, pending or completed claims, demands, actions, suits or proceedings, whether civil, criminal, administrative or investigative, and whether formal or informal and including appeals, in which any Indemnified Person may be involved, or is threatened to be involved, as a party or otherwise, by reason of its status as an Indemnified Person whether arising from acts or omissions to act occurring before or after the date of this Agreement [with the limitation that an indemnified person will not be indemnified if a court has found them guilty of fraud or willful misconduct in a "final and non-appealable judgment"].[129]

The basic thrust of the agreement is clear: the manager owes no fiduciary duties to the company, may engage in competing businesses that harm the company, and will be indemnified by the company for any lawsuits stemming from these actions. These one-sided provisions might strike an observer as extreme, but Apollo is no outlier. Fiduciary waivers are commonplace across the industry.[130]

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[128] *Id.*

[129] *Id.* at 34-35.

[130] Indeed, Carlyle's limited partnership agreement arguably goes further. Section 7.9 of the limited partnership agreement of The Carlyle Group L.P. provides, in admittedly garbled language, that "[n]otwithstanding anything to the contrary set forth in this Agreement or otherwise applicable provision of law or in equity, neither the General Partner nor any other Indemnitee shall have any fiduciary duties, or, to the fullest extent permitted by law, except to the extent expressly provided in this Agreement, other duties, obligations or liabilities, to the Partnership, any Limited Partner, any other Person who has acquired an interest in a Partnership Security, any other Person who is bound by this Agreement or any creditor of the Partnership, and, to the fullest extent permitted by law, the General Partner and the other Indemnitees shall only be subject to any contractual standards imposed and existing under this Agreement." The Carlyle Group L.P., Second Amended and Restated Agmt. Ltd. P'ship, Sept. 13, 2017:

The wholesale abandonment of fiduciary protections by the private equity industry raises particular concerns in the context of "continuation funds."[131] The basic idea of a continuation fund is that a private equity firm, rather than selling its portfolio companies to third parties or taking them public, will instead sell the companies to themselves through newly established funds.[132] Private equity firms defend these conflictual transactions by arguing that they provide benefits to investors: in times of depressed prices or difficult IPO markets, continuation funds offer current investors the ability to realize immediate returns on their investments and future investors the ability to realize greater gains when market conditions shift.[133] And continuation funds have indeed grown increasingly popular in recent years as private equity firms have struggled to offload portfolio companies. In 2024, 14% of all private equity exits were in the form of continuation deals.[134] But the transactions raise a host of red flags. Are they being used to artificially generate fees for private equity firms? Are they offering unreasonably high prices in order to artificially improve prior fund performance? Are they offering unreasonably *low* prices to incentivize new capital to flow into their funds? Investors have occasionally sought to challenge them for precisely these reasons.

In 2025, an investor sued a private equity firm, H.I.G. Capital, alleging that the firm had sold a portfolio company in one of its funds to another of its funds at an artificially low price in order to hand itself windfall profits (due to the funds' respective compensation structure) at the expense of investors.[135] Ordinarily, fiduciary duties would play an essential role in protecting investors in this type of scenario, but given the stripping of fiduciary protections from operating agreements, firms have insulated themselves from any obligation to operate their businesses with ordinary care or in the interest of shareholders.

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https://www.sec.gov/Archives/edgar/data/1527166/000119312517283778/d458115dex31.htm. On its face, the provision appears to assert that, notwithstanding "any provision of law or in equity," Carlyle's general partner has no fiduciary duties at all.

[131] *See* Kobi Kastiel & Yaron Nili, *The Rise of Private Equity Continuation Funds*, 171 U. PA. L. REV. 1601 (2024).

[132] *Id.* at 1604-06.

[133] *Id.* at 1617-19.

[134] *See* Houlihan Capital, *Continuation Funds and the Future of Private Equity Exits*, Mar. 4, 2025, available at https://www.houlihancapital.com/continuation-funds-and-the-future-of-private-equity-exits/.

[135] *See* Compl., *Dailane Investments Ltd. v. HIG Capital*, Case No. 1:25-cv-20568-RKA (S.D. Fla. 2025); *see also* Rod James, *H.I.G. Capital Is Sued Over Cross-Fund Deal*, WALL ST. J., July 3, 2025.

E. Liquidity

Private equity products marketed to retail investors are often described as "semi-liquid." But the exit rights attached to semi-liquid funds are in fact very limited.[136] Redemptions are typically subject to quarterly windows, capped at around 5% of fund net asset value, and conditioned on the discretion of the general partner. The result is that while these products appear to offer periodic liquidity, the underlying capital may be locked in for years. Evidence from recent practice underscores the risk, as several large asset managers have imposed redemption restrictions on retail-facing funds.[137]

For retail investors, the mismatch between marketing and reality poses special hazards. The branding of these investment products as "semi-liquid" might suggest to a reasonable investor that they will be able capital with a degree of flexibility comparable to mutual funds or exchange-traded products. But a saver who believes they can access their funds quarterly at fair value may well discover to their dismay that redemptions are delayed, capped, and poorly priced. Blackstone's private equity strategies fund even exacts an "early repurchase deduction" on investors who seek to sell their interest within two years of initial purchase, a penalty that amounts to 5% of net asset value.[138] Conversely, KKR's private equity conglomerate fund gives the fund authority to force investors to sell their shares back to the company at any time the board determines that it would be "in the interests of the company" to do so.[139]

The functional reality, then, is that retail private equity funds can, and often do, hold capital for extended periods, limiting investor exit rights precisely when they are most needed. Some investment managers have begun pitching this lack of liquidity as a benefit, arguing that it serves to protect investor interests by preventing them from triggering fire sales of assets.[140] But a redemption rate that

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[136] *See* Moody's, *Private Market Retail to Fuel Opportunity But Intensify Liquidity, Asset Quality Risks*, June 10, 2025, available at https://www.moodys.com/web/en/us/insights/credit-risk/private-credit/private-market-retail-to-fuel-opportunity.html; Matt Wirz, *Moody's Sounds Alarm on Private Funds for Individuals*, WALL ST. J., June 10, 2025.

[137] *See* Paula Sambo, *AGF-Backed Kensington Halts Redemptions on Flagship Private Equity Fund*, BLOOMBERG, Sept. 30, 2025; Chibuike Oguh, *KKR Blocks REIT Withdrawals in Latest Redemption Wave*, REUTERS, Jan. 19, 2023; Robin Wigglesworth, *BREIT Only Met a Quarter of January's Redemption Requests*, FIN. TIMES, Feb. 1, 2023.

[138] BLACKSTONE PRIVATE EQUITY STRATEGIES FUND L.P., 2024 ANNUAL REPORT ON FORM 10-K 144 (2025). KKR's private equity conglomerate fund charges a similar fee. *See* KKR PRIVATE EQUITY CONGLOMERATE LLC, 2024 ANNUAL REPORT ON FORM 10-K 12 (2025)

[139] *See* KKR PRIVATE EQUITY CONGLOMERATE LLC, 2024 ANNUAL REPORT ON FORM 10-K 12 (2025)

[140] *See* Alex Lynn, *Neuberger Berman: Redemption Limits "Feature Not Flaw" of Evergreens*, PRIVATE EQUITY INT'L, Aug. 4, 2025 (quoting one investment manager as stating that "[t]here may be times when an investor wouldn't be able to redeem the capital, where a redemption notice might be put in and not fully fulfilled…but importantly, that is not a flaw—that's actually a key protective feature of the vehicle because the assets are inherently illiquid").

is capped at 5% of NAV per quarter can hardly even be called semi-liquid: if other investors are seeking to sell as well, it could take half a decade or more for an investor to get their money back. And, obviously, if the fund manager has the right to buy back shares at a price of its own choosing (since it determines NAV), the targeted investors may be surprised.

III. REGULATING PRIVATE EQUITY AND PUBLIC CAPITAL

The new age of private equity represents a sea change in the nature of financial markets, and it presents significant risks to investors at a time when regulators have retreated from the field. But as this Part demonstrates, where the intensity of public enforcement relaxes, the pressures on private enforcement intensify. Ordinary citizens who find themselves exploited by sophisticated financial actors, and who discover that administrative agencies are either unable or unwilling to step in, may pursue private litigation to protect their interests. This shift in regulatory locus—from public regulators to private lawsuits—brings different types of rights and remedies into play, from class action lawsuits to consumer litigation to breach-of-contract actions. Perhaps ironically then, private equity's under-regulation in public law may well lead to the emergence of new, and stricter, regulation in private law.

A. Public Enforcement Gaps

Despite the unique risks raised by the private market fund model, financial regulators have largely taken a *laissez faire* approach to the sector. Rather than requiring substantive commitments and protections from private equity firms, regulatory agencies have instead been largely content to allow contractual freedom to reign. Private equity firms and their investors can, by and large, structure their mutual relationship as they see fit: if private equity firms can impose fiduciary duty waivers, or discretionary fees, then so be it. The prevailing assumption is that these are matters for contractual negotiation between sophisticated parties.

Regulators have not been completely blind to the issues surrounding the architecture of private equity. The SEC has taken several enforcement actions against private equity firms for disclosure failures and contract breaches.[141] In the U.K., the Financial Conduct Authority has identified opaque fee structures and weak cost transparency as systemic issues in the industry and, in 2022, even issued a letter warning private equity and other alternative investment firms about inadequate disclosure and governance practices.[142] But agency actions

[141] *See* discussion *supra* Part II.C.

[142] *See* U.K. FIN. CONDUCT AUTHORITY, ASSET MANAGEMENT MARKET STUDY: FINAL REPORT (2017) available at *https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf*; U.K. Fin. Conduct Authority, Out Alternatives Supervisory Strategy, Aug. 9, 2022, available at

have remained narrow in scope, focusing on technical breaches such as failing to disclose particular fees or expenses.[143] Rarely have regulatory agencies addressed the broader economic reality that private equity managers operate with near-complete discretion over how much they charge in fees and expenses.

In addition, public enforcement is limited by the fact that applicable regulatory structures have been designed under outdated assumptions about how financial markets work. The SEC's Regulation Best Interest, for example, imposes a general duty on brokers and advisors to act in the best interest of clients, but its focus is on product selection and conflicts at the distribution level, not downstream fee layers.[144] Similarly, the European Union's Markets in Financial Instruments Directive (MiFID II) mandates disclosure of costs and charges to investors, but it applies primarily to the point-of-sale intermediary.[145] Once money flows into a private equity structure, neither the intermediary nor the fund is required to present consolidated, investor-level accounting of cumulative charges, related-party payments or discretionary fees and expenses. In effect, there is no regulatory requirement to provide investors with a complete picture of what they are paying for, how much is being taken or by whom. Similarly, no regulatory agency has tackled the issue of misleading presentation of performance track records.

What is more, when administrative agencies have sought to heighten the standards of conduct for private equity firms, they have been stymied by a combination of industry lobbying, judicial decisions and shifting political priorities. In 2023, the SEC enacted a new private funds rule aimed at prohibiting fraud and manipulation by private equity fund managers, but trade groups challenged the rule in court, arguing that it was arbitrary and capricious.[146] The Fifth Circuit struck it down.[147] In 2024, the Supreme Court voided the SEC's administrative tribunals, the agency's primary way to try securities fraud cases, holding that their proceedings violated the constitutional right to a trial by jury.[148] And in 2025, the SEC withdrew a slew of proposed rules governing the private equity industry that had been proposed in the

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https://www.fca.org.uk/publication/correspondence/portfolio-letter-alternatives-2022.pdf.

143 *See* Kastiel & Nili, *supra* note XXX, at 26 ("[M]ost of the SEC enforcement actions [against private equity sponsors] in our sample focused on procedural violations, such as failure to adopt and implement written compliance policies and procedures to prevent the violation of the Investment Advisers Act of 1940 (47 cases) and inadequate disclosures (58 cases).").

144 *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 34-86031, 84 Fed. Reg. 33318 (July 12, 2019) (codified at 17 C.F.R. pt. 240). *See also* Jerry W. Markham, *Regulating Broker-Dealer Investment Recommendations—Laying the Groundwork for the Next Financial Crisis*, 13 DREXEL L. REV. 377 (2021).

145 Council Directive 2014/65, 2014 O.J. (L 173) 2, 349) (EU).

146 *See Nat'l Ass'n of Priv. Fund Managers v. Sec. & Exch. Comm'n*, 103 F.4th 1097 (5th Cir. 2024).

147 *Id.*

148 *Sec. & Exch. Comm'n v. Jarkesy*, 603 U.S. ___ (2024).

previous administration.[149] In short, financial regulators have been retreating from the field.

But the long-held assumption that private equity is the domain of large, sophisticated actors is no longer defensible. Retail capital is flowing into private equity structures where neither the product seller nor the end investor has access to, let alone understanding of, the complex thicket of legal agreements that govern their investment. No regulatory framework exists to force private equity firms to provide investors with disclosures that reflect fund-level economic reality in terms that any ordinary consumer could plausibly interpret. What exists instead is an enforcement regime that polices the margins while ignoring the architecture.

B. Private Enforcement Mechanisms

As financial regulators withdraw from active oversight, the task of enforcing discipline in private markets will increasingly fall to investors themselves. Paradoxically, though, private enforcement may prove more effective at constraining misconduct than public regulation ever was. Several factors suggest that private litigation could emerge as a central mechanism for addressing the structural sources of investor misalignment.

First, the expansion of private equity firms' investor base multiplies both the number and diversity of potential claimants. Losses that once registered only indirectly through institutional portfolios (through, for example, defined benefit pension plans) now fall directly on individual savers. As a result, abusive practices that cause financial harm will be more likely to be noticed by ultimate investors, and disgruntled investors will have greater incentives to pursue legal remedies.

Investor litigation has, of course, always been possible in the private equity industry, but it has rarely been pursued due to misalignments within institutional investors. Pension fund and endowment staff do not risk their own capital, and the personal costs of confrontation with private equity firms often outweigh the personal benefits.[150] Managers face clear career and commercial constraints: they wish to maintain access to top private equity firms, they want to preserve professional relationships, and, in many cases, they aspire to one day move to the GP side of the industry themselves. Suing a private equity firm could be career suicide. Similarly, personal ties, from having friends at a firm to having

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[149] *See* Bill Alpert, *SEC Officially Withdraws 14 Biden-Era Proposals*, BARRON'S, June 14, 2025.

[150] *See* Kastiel & Nili, *supra* note XXX, at 21 ("Investors' primary concern [with litigation] is the potential damage to their future allocation opportunities with GPs, particularly top-tier GPs. According to our interviewees, no LP wants the bad reputation of taking GPs to court. The need to preserve future investment opportunities with GPs may also explain why large public pension funds—despite frequently serving as lead plaintiffs in class actions against public companies —are rarely involved in litigation against GPs.").

relatives who want jobs there, provide more reasons for caution. These overlapping pressures make public dispute costly, even when economic harm is evident.[151] By contrast, ordinary investors face few reputational or career-related disincentives and their losses are personal and direct, giving them both the motivation and freedom to litigate.

Second, private litigation can often achieve what public regulation cannot.[152] Private plaintiffs, and their lawyers, are typically faster and more effective at detecting misconduct than regulators.[153] The financial incentives of private plaintiffs, and the litigation dynamics of lawsuits, mean that private litigation has a unique ability to make opaque practices visible, through court filings, expansive discovery procedures, expert testimony and the publication of judicial opinions. In past decades, private litigation has driven major reforms across industries, from tobacco in the 1990s to corporate fraud in the early 2000s.[154] Given the scale of private equity and the sums involved, a new generation of "private attorneys general" could use litigation to enforce norms that regulators have long neglected.

Recent industry litigation provides a glimpse into how private lawsuits might work in practice, and how enforcement pressure can arise from less constrained actors. Take the high-profile collapse of the Dubai-based Abraaj Group. The Abraaj Group was a private equity firm that was founded in 2002 by Arif Naqvi. By 2018, the firm had grown into the Middle East's largest private equity firm, managing some $14 billion in assets, and having its own Harvard Business School case study.[155] But in 2017, Hamilton Lane and other large limited partners began to receive messages—through anonymous emails—that the firm was inflating valuations.[156] Hamilton Lane not only failed to act but committed over $100 million to the firm.[157] Other major LPs apparently did the same. The decisive response came from an unexpected source: Andrew Farnum, a young investment officer at the Gates Foundation.[158] Farnum had studied molecular

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[151] *See* Kastiel & Nili, *supra* note XXX, at 11 (identifying just six lawsuits brought by private equity investors against private equity firms over the forty-year period from 1984 to 2024). *See also* Vladimir Atanasov, Vladimir Ivanov & Kate Litvak, *Does Reputation Limit Opportunistic Behavior in the VC Industry? Evidence From Litigation Against VCs*, 67 J. FIN. 2215, 2228 (2012) (identifying just twenty-one lawsuits by venture capital investors against venture capital firms in the period from 1975 to 2005).

[152] *See* ALEXANDRA LAHAV, IN PRAISE OF LITIGATION 1-2 (2017).

[153] *See* William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2147 (2004).

[154] *See* Myriam Gilles, *The Private Attorney General in a Time of Hyper-Polarized Politics*, 65 ARIZ. L. REV. 337 (2023).

[155] *See* Rory Jones, *Founder of Collapsed Private-Equity Firm Abraaj Fined $135 Million by Dubai Regulator*, WALL ST. J., Jan. 27, 2022.

[156] *See* THE ECON., *The Biggest Collapse in Private-Equity History Will Have a Lasting Impact*, May 18, 2019.

[157] *Id.*

[158] *See* SIMON CLARK & WILL LOUCH, THE KEY MAN: HOW THE GLOBAL ELITE WAS

biology as an undergrad at Princeton, but after joining the Gates Foundation, he grew concerned about the investment in the Abraaj Group.[159] Farnum eventually commissioned a forensic audit that uncovered widespread misbehavior at the firm, a discovery that led to the private equity firm's bankruptcy in 2018 and a slew of lawsuits around the world.[160] His efforts led to a chain reaction of follow-on investigations. A Kuwaiti pension fund that had invested in the Abraaj Group sued the firm in the Cayman Islands.[161] A St. Vincent-based fund run by American investors also sued the firm there.[162] In the U.S., the SEC sued Naqvi and other executives for securities fraud.[163] The Department of Justice brought criminal charges against Naqvi, and the founder was arrested in the U.K. in 2019.[164] In Dubai, the Dubai Financial Services Authority brought numerous charges against the firm's officers.[165]

What this anecdote illustrates is that meaningful enforcement only began when actors not embedded in the private equity ecosystem acted. The most "sophisticated" parties did not act.

C. The New Landscape of Market Regulation

Whereas previously, private equity was largely insulated from investor lawsuits, its expansion into public capital brings with it a new set of actors with a new set of incentives. As a result, both the substantive law that applies and the mechanisms used for enforcing it shift. This Subpart analyzes those questions with an eye towards understanding how private litigation could reshape the industry.

1. Substantive Law

The most important paradigm shift in private equity's regulation is likely to occur in the substantive law governing relationships between funds and investors. A range of common private equity practices could be challenged using contract, tort and consumer protection law. It should be noted that there is a

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DUPED BY A CAPITALIST FAIRY TALE 215-30 (2021).

[159] *Id.*

[160] *See* THE ECONOMIST, *Abraaj, A Private-Equity Firm, Files for Provisional Liquidation*, June 23, 2018.

[161] *See* Simon Clark, William Louch & Nicolas Parasie, *Abraaj Founder Scrambles as Empire Teeters*, WALL ST. J., June 10, 2018.

[162] *See* Davide Barbuscia & Stanley Carvalho, *UAE Businessman Transferred Debt to Fund Suing Abraaj*, Reuters, June 14, 2018.

[163] *See* U.S. Sec. & Exch. Comm'n, *SEC Charges Dubai-Based Advisory Firm and its Advisor*, Litigation Release No. 24449, Apr. 11, 2019, available at https://www.sec.gov/enforcement-litigation/litigation-releases/lr-24449.

[164] *See* Kaye Wiggins, *Former CEO Gets Record $20 Million Bail*, BLOOMBERG, May 3, 2019.

[165] *See* Hadeed Al Sayegh, *Dubai Regulator Upholds $135.6 Million Fine on Abraaj Founder and Former CEO*, REUTERS, Jan. 3, 2023.

threshold question here about whether private equity firms will be able to impose arbitration and waiver of class action provisions on retail investors.[166] Arbitration provisions are widely used in the industry, and class action waivers may become so.[167] Courts have reached diverging conclusions on the question of precisely when and how investors can waive their rights to sue, but over the last decade, the Supreme Court has leaned in favor of upholding arbitration provisions.[168] Such a result would not alter the substantive laws governing the underlying transactions, but it might well raise the economic costs of enforcing them.[169]

a. Contract Claims

The most straightforward claim that an investor in a private equity fund could bring against the fund and its managers for misbehavior is a breach of contract claim. As any introductory contract class teaches, the basic elements of a contract claim are simple: there must be a validly existing contract, a breach by one party of its obligations under the contract, and damages caused by the breach.[170] To put it simply, there must be a broken promise.[171] Where an investor is relying on a private equity firm to make reasonably informed decisions on when and where to invest a fund's capital, and that firm fails to live up to those expectations, a breach of contract claim could well be made out.[172] Private equity limited partnership agreements often specify that managers must act "reasonably" or "prudently," that they must comply with stated objectives and policies, that they must make only "reasonable and properly incurred" expenses, and that they must provide investors with financial statements that "fairly

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166 In 2012, when the private equity firm The Carlyle Group went public, it initially included a clause in its operating agreement prohibiting shareholders from filing class action lawsuits and requiring them to pursue any claims against the company in arbitration. Carlyle eventually removed the clause after what it described as "consultations with the S.E.C., Carlyle investors and other interested parties." *See* Kevin Roose, *Carlyle Drops Arbitration Clause From I.P.O. Plans*, N.Y. TIMES, Feb. 3, 2012. *See also* Kastiel & Nili, *supra* note XXX, at 14 (finding that 18% of limited partnership agreements contain mandatory arbitration provisions).

167 *See* JOHN CHOONG ET AL., ARBITRATION AS A TOOL FOR PRIVATE CAPITAL DISPUTES (2025).

168 *See, e.g., AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011); *Epic Systems Corp. v. Lewis*, 584 U.S. 497 (2018); *CompuCredit Corp. v. Greenwood*, 565 U.S. 95 (2012). The SEC has even opened the door to mandatory arbitration provisions and class action waives in public company articles of incorporation. *See* U.S. Sec. & Exch. Comm'n, *Acceleration of Effectiveness of Registration Statements of Issuers with Certain Mandatory Arbitration Provisions*, Rel. Nos. 33-11389, 34-103988 (Sept. 17, 2025).

169 *See* Marc I. Steinberg, *Securities Arbitration: Better for Investors Than the Courts?*, 62 BROOKLYN L. REV. 1503 (1996).

170 *See* E. ALLAN FARNSWORTH, III FARNSWORTH ON CONTRACTS 148-56 (2004).

171 *Id.* at 148.

172 *Id.* at 153.

present" the financial condition of the fund.[173] All of these broad provisions could provide investors with grounds for breach of contract if a private equity firm engages in the kinds of conflicted transactions, opaque fees, and misleading performance metrics detailed above.[174]

Private equity firms might also face lawsuits based on claims that they failed to satisfy their duties of good faith and fair dealing. The covenant of good faith and fair dealing is generally a mandatory one—it cannot be waived.[175] It requires the parties to a contract to perform their obligations honestly, reasonably and fairly.[176] While it does not prevent a party from pursuing their own interests in the contract, it does prevent them from evading the "spirit of the bargain," from abusing "a power to specify terms," and from engaging in "dishonest conduct."[177] So even where a private equity firm excludes basic fiduciary duty protections or purports to assume no duties whatsoever to the fund or its investors on the face of the contract, the implied covenant of good faith and fair dealing could provide substantial protection to investors deceptive and abusive conduct.

Private equity's current architecture also raises broader questions about the very validity and enforceability of its contracts. Do investors truly understand the fee structures of private equity investments? Can investors meaningfully consent to charges they cannot see, governed by documents they cannot access and implemented through mechanisms they cannot audit or possibly understand? What obligations do private equity firms have to align their investment practices with the interests of investors, and how far can they tilt practices in their own favor?

The advent of semi-liquid vehicles and the entry of retail investors changes the legal stakes of these questions. Private equity investment products are sold through regulated platforms, often with marketing language that mirrors mutual funds or pension products. The average investor might well assume, and reasonably, that the legal protections are similar as well. But in substance, they are entering into blind-pool arrangements governed by contracts they cannot read and fee regimes they cannot see. In this environment, the defense that "the investors knew what they signed up for" becomes untenable.

A variety of equity contract doctrines could operate to limit or rescind abusive contractual arrangements.[178] Even when subscription documents

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[173] *See* INST'L LTD. PARTNERS ASS'N, THE ILPA MODEL LIMITED PARTNERSHIP AGREEMENT (WHOLE-OF-FUND WATERFALL) (2020).

[174] *See* discussion *supra* Part II.

[175] *See* Daniel Markovits, *Good Faith as Contract's Core Value*, in EUROPEAN CONTRACT LAW AND THE CREATION OF NORMS 272, 272 (Stefan Grundmann & Mateusz Grochowski eds., 2021)

[176] *See* E. ALLAN FARNSWORTH, II FARNSWORTH ON CONTRACTS 393-401 (2004).

[177] *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. [d], [e] (1981).

[178] In addition, in *Oxford University Bank v. Lansuppe Feeder, LLC*, the Second Circuit held that contracts that violate the Investment Companies Act of 1940 are unenforceable and that

reference "fund expenses" and claim that investors preemptively assent to them, the language is typically boilerplate, with no dollar caps, no line-item disclosures and no functional limitation on what qualifies as a reimbursable cost. These provisions are backed by limited partnership agreements that routinely include express waivers of fiduciary duty, constrained only by vague standards of "good faith." In many jurisdictions, such waivers would be void or severely curtailed in consumer or fiduciary relationships. Where cumulative costs and fees exceed, say, 25% of invested capital or where key fee mechanisms are not clearly disclosed, courts would have ample grounds either for rescinding the contract or for finding unjust enrichment and breaches of the duty of good faith.

In civil law jurisdictions, a range of other doctrines could apply as well. In many European and Asian countries, the "abuse of economic dependence" doctrine acts to prohibit companies from taking wrongful advantage of another person's disadvantaged position.[179] In France, the *abuse de biens sociaux* law criminalizes certain kinds of self-dealing by company managers.[180] In Italy, corporate managers can be held criminally liable for *infedeltà patrimoniale*, a form of asset mismanagement based on unjust profits.[181] In short, abusive private equity practices could contravene a range of protective doctrines, rendering agreements voidable and exposing managers to substantial monetary liability (and even, potentially, criminal penalties).

b. Fiduciary Duty Claims

As mentioned before, private equity firms frequently seek to rid themselves of fiduciary duties. In their organizational documents, they often explicitly waive or limit fiduciary duties, even going so far as to provide that "to the fullest extent permissible by law" they owe no duties whatsoever to investors.[182] But such waivers may well be struck down by courts, particularly where investors are unsophisticated and unable to bargain for better rights.[183] If courts find such

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parties have a private right of action to sue for their rescission. *Oxford University Bank v. Lansuppe Feeder, LLC*, 933 F.3d 99 (2d Cir. 2019).

[179] *See* Sangyun Lee, *A Theoretical Understanding of Abuse of Economic Dependence in Competition Law*, 17th ASCOLA Conference, White Paper, (June 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4134583.

[180] Article L. 242-6, French C. Com. *See* Pierre Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. CO. & FIN. L. REV. 491, 518-19 (2007).

[181] *See* Conac, Enriques & Gelter, *supra* note XXX, at 522-23.

[182] *See generally* John D. Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L. J. 1228, 1232 (2014).

[183] *See, e.g., New Enterprise Associates 14 v. Rich*, 295 A.3d 520, 531 (Del. Ch. 2023) (stating that the validity of a stockholder waiver of rights depends on "a series of factors, including (i) the presence of a written contract, (ii) the clarity of the waiver, (iii) the stockholder's understanding of the waiver's implications, (iv) the stockholder's ability to reject the provision, (v) the existence of bargained-for consideration, and (vi) the stockholder's sophistication"). For

fiduciary duty waivers unenforceable, or if investors manage to negotiate contracts with greater fiduciary protections, private equity firms may suddenly face greater judicial scrutiny of their internal governance practices.

It is worthwhile, then, to sketch out the contours of what fiduciary law requires of managers and how it might apply in the private equity industry. There are two primary fiduciary duties: the duty of care and the duty of loyalty.[184] The duty of care requires managers to act in a reasonably informed manner.[185] This includes both an ongoing duty to monitor a company's operations as well as a duty to gather information before making business decisions.[186] In making decisions, they are ordinarily protected by the business judgment rule, which gives directors broad discretion to operate their businesses in the manner they believe appropriate.[187] But the business judgment rule does not negate the fundamental duty of directors and officers to act with care, and, where a fiduciary fails to act prudently and reasonably, they may face liability to their shareholders.[188]

The duty of loyalty, on the other hand, goes to motivation: managers must not just act in an informed manner, they must also act in the best interests of shareholders, not out of a desire for personal profit.[189] Historically, this has meant that managers have been prohibited from engaging in self-dealing—that is, entering into transactions with themselves or with companies that they have substantial interests in[190]—or competing with the corporation—that is, operating two businesses that are rivals in the marketplace.[191] As the classic formulation of the duty goes, managers are held to "something stricter than the morals of the market place."[192] "Not honesty alone, but the punctilio of an

scholarly debate on the extent to which fiduciary duties are mandatory or waivable, see Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); John Coffee, *No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOKLYN L. REV. 919 (1988); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779 (2006); Larry A. DiMatteo, *Policing Limited Liability Companies Under Contract Law*, 46 AM. BUS. L.J. 279 (2009).

[184] FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 837.60 (2025).

[185] *Id.* at § 1029.

[186] *Id.* at § 1032.

[187] *Id.* at § 1036.

[188] For scholarly discussion of the evolution of the business judgment rule, see Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VANDERBILT L. REV. 82 (2004); D. Gordon Smith, *The Modern Business Judgment Rule*, in RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 83 (Steven Davidoff Solomon & Claire Hills eds. 2016); Adam B. Badawi, *The Business Judgment Rule*, in ENCYCLOPEDIA OF LAW AND ECONOMICS, CORPORATE LAW (Adam B. Badawi, ed. 2023).

[189] *See* FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 837.60.

[190] *Id.*

[191] *Id.* at § 856.

[192] *Meinhard v. Salmon*, 249 NY 458, 464 (1928). Justice Cardozo, who wrote the opinion,

honor the most sensitive, is then the standard of behavior."[193]

Needless to say, these standards present something of a problem for private equity firms. It is no wonder that they have sought to exempt themselves from their reach. Private equity firms often take minimal operational roles in the portfolio companies they acquire, delegating most day-to-day decisions to local managers on the ground.[194] This could create significant risk for duty of care violations if shareholders can prove that the structure of private equity investment fails to protect the fund from misbehaviors at the portfolio company level, systematically prevents managers from becoming informed about red flags and amounts to corporate waste.[195] Similarly, the architecture of private equity presents inherent duty of loyalty problems as well. Compensation, fees, performance metrics and other behaviors all present stark conflicts of interest, and managers often have incentivizes to engage in behaviors that maximize their own profits while minimizing those of investors.[196]

Excessive fee litigation is a commonplace in the mutual fund industry and could become so in the private equity one.[197] Similarly, hedge fund investors have challenged redemption restrictions on fiduciary duty and contract grounds.[198] The rise of continuation funds presents the problem clearly: how can a private equity simultaneously protect the interests of two funds transacting with one another, one of which wishes to sell its portfolio companies for the highest price possible and one of which wishes to buy them at the lowest price possible? Firms have sought to protect themselves by introducing various procedural protections and third-party interventions, but the basic tension of

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was writing in the context of a partnership, but his classic statement has come to be cited frequently as the standard of conduct for the duty of loyalty.

[193] *Id.*

[194] *See* MAGNUSON, *supra* note XXX, at 236.

[195] *See Saxe v. Brady*, 184 A.2d 602, 616-17 (Del. Ch. 1962) (holding that an investment advisor's annual fee that amounted to between .5% and 1% of the fund's net asset value was not "legally excessive" but was "certainly approaching the point where they are outstripping any reasonable relationship to expenses and effort even in a legal sense"). *See also* Amy Y. Yeung & Kristen J. Freeman, *Gartenberg, Jones, and the Meaning of Fiduciary: A Legislative Investigation of Section 36(b)*, 35 DEL. J. CORP. L. 483 (2010).

[196] *See* Magnuson, *supra* note XXX, at 1847.

[197] In *Jones v. Harris Associates L.P.*, the Supreme Court held that an investment advisor breaches its fiduciary duty under § 36(b) of the Investment Company Act when it charges a fee that is "so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." *Jones v. Harris Associates L.P.*, 559 U.S. 335, 346 (2010). *See also* Quinn Curtis, *The Past and Present of Mutual Fund Fee Litigation Under 36(b)*, in ELGAR RESEARCH HANDBOOK ON MUTUAL FUNDS (John Morley & William Birdthistle eds., 2018); Quinn Curtis & John Morley, *An Empirical Study of Mutual Fund Excessive Fee Litigation: Do the Merits Matter?*, 30 J. L. ECON. & ORG. 275 (2014). Excessive fee litigation has also occurred in the ERISA-governed retirement plan industry. *See, e.g., Cunningham v. Cornell University*, 504 U.S. __ (2025) (involving a claim by Cornell employees who participated in defined-contribution retirement plans that Cornell paid excessive fees to plan administrators).

[198] *See Umbach v. Carrington Investment Partners*, 2014 WL 10537157 (D. Conn. 2014).

the continuation fund is unavoidable.

Self-dealing is not a new feature of private equity. A striking early example dates back to 1989, when Jerome Kohlberg—the first "K" in KKR—sued his former partners Henry Kravis and George Roberts after discovering that they had personally acquired shares in portfolio companies at discounted prices ahead of planned IPOs.[199] The dispute was eventually settled, but it revealed the extent to which general partners could use their position for personal gain.[200] The SEC has occasionally taken interest in fiduciary duty problems in private equity, but they have only rarely intervened directly.[201] In the future, private fiduciary duty litigation from individual investors could become a core and commonplace feature of the enforcement landscape.[202]

c. Fraud Claims

Another major doctrinal area that could be used to constrain private equity misbehavior is fraud, both in its common-law incarnation and its statutory one. Fraud has long been one of the most flexible, wide-reaching, and powerful judicial tools for remedying deception.[203] One finds its principles incorporated into a wide array of misbehaviors, ranging from negligence to crime: securities fraud, mail fraud, fraud-on-the-market, fraudulent misrepresentation, fraudulent conveyance, fraud-in-the-inducement and the list goes on.[204] As the Supreme Court has stated, fraud cannot be defined with a high level of precision, but generally revolves around some kind of "deception or trickery."[205] Common law

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[199] *See* Sarah Bartlett, *Kohlberg in Dispute Over Firm*, N.Y. Times, Aug. 30, 1989.

[200] *See* N.Y. TIMES, *Kohlberg Suit Settlement*, Feb. 23, 1990.

[201] *See In the Matter of WCAS Mgmt. Corp.*, SEC Admin. Proc. 3-18449 (2018).

[202] There might also be plausible ERISA-based fiduciary duty claims brought against pension fund managers who invest capital in private equity without proper due diligence. The Supreme Court heightened the bar for making such claims in *Thole v. U. S. Bank N. A.*, 590 U.S. 538 (2020), but did not entirely foreclose the route so long as plaintiffs can show that mismanagement of funds is "so egregious that it substantially increased the risk that the plan and the employer would fail and be unable to pay the participants' future pension benefits." *Id.* at 546.

[203] For classical discussions of the law of fraud and its many dimensions, see MELVILLE M. BIGELOW, A TREATISE ON THE LAW OF FRAUD ON ITS CIVIL SIDE (1890); WILLIAM WILLIAMSON KERR, A TREATISE ON THE LAW OF FRAUD AND MISTAKE (1902); SYDNEY HASTINGS, A SHORT TREATISE ON THE LAW RELATING TO FRAUD AND MISREPRESENTATION (1893).

[204] *See* John C.P. Goldberg, Anthony J. Sebok & Benjamin C. Zipursky, *The Place of Reliance in Fraud*, 48 ARIZ. L. REV. 1001, 1011 (2006).

[205] *Husky Int'l Elecs., Inc. v. Ritz*, 578 U.S. 355, 360 (2016). *See also* Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971, 1972-73 (2006) ("Instability in the law of fraud is structural. The constant and rapid pace of economic innovation, along with evolving sophistication of social norms about commercial behavior, guarantee that fraud law will always confront novel economic practices that have not previously been classified as fraudulent. It is not just that professionals continually produce novel means of doing business; context can shift

fraud (sometimes called deceit), while varying from jurisdiction to jurisdiction, centers around three core elements: (i) a misrepresentation or omission that is known to be false or misleading by the defendant; (ii) justifiable reliance of the other party; and (iii) resulting injury.[206] These are broad elements that can capture a wide range of communications aimed at improperly influencing counterparties, and they have often been used to protect investors from financial harm.[207]

Securities fraud law provides more targeted protections.[208] The primary federal antifraud rule—Rule 10b-5 of the Securities Exchange Act—has proven one of the most consequential laws in all of securities regulation.[209] One commentator has stated that it "can make a plausible claim to being the most consequential piece of American administrative law."[210] In its short text, the rule sets out a simple prohibition with broad consequences: in connection with the sale of a security, it is unlawful for any person to

> (a) employ any device, scheme, or artifice to defraud,
> (b) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[211]

While the rule is simple—companies cannot deceive or mislead their

too, transforming a benign existing practice into something quite threatening.").

[206] *See, e.g., Lama Holding Co. v. Smith Barney Inc.*, 668 N.E.2d 1370, 1373 (N.Y. 1966) ("In an action to recover damages for fraud, the plaintiff must prove a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury."); *Abry Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032, 1050 (2006) ("To state a claim [for common law fraud], the plaintiff must plead facts supporting an inference that: (1) the defendant falsely represented or omitted facts that the defendant had a duty to disclose; (2) the defendant knew or believed that the representation was false or made the representation with a reckless indifference to the truth; (3) the defendant intended to induce the plaintiff to act or refrain from acting; (4) the plaintiff acted in justifiable reliance on the representation; and (5) the plaintiff was injured by its reliance.").

[207] *See* Hillary A. Sale & Robert B. Thompson, *Market Intermediation, Publicness, and Securities Class Actions*, 93 WASH. U. L. REV. 487 (2015); Adam J. Gana & Michael Villacres, *Blue Skies for America in the Securities Industry…Except for New York: New York's Martin Act and the Private Right of Action*, 19 FORDHAM J. CORP. & FIN. L. 587 (2014).

[208] For a discussion of the relationship between common-law fraud and securities fraud, see John C.P. Goldberg & Benjamin Zipursky, *The Fraud-on-the-Market Tort*, 66 VAND. L. REV. 1755 (2013).

[209] *See* 2 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, FUNDAMENTAL OF SECURITIES REGULATION 1287–88 (6th ed. 2011).

[210] Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 540 (2011).

[211] 17 C.F.R. § 240.10b–5 (2025).

investors—the universe of potentially deceptive or misleading practices is large. An entire industry of securities litigation firms has sprung up to police public company disclosures, regularly suing companies and their directors for deceptive statements in their public filings and disclosures.[212] In 2023 alone, there were 215 securities class action lawsuits brought against companies, with maximum dollar losses estimated at $3.2 trillion.[213] In 2021, in one of the largest securities fraud settlements in history, Valeant Pharmaceuticals agreed to pay $1.2 billion to a class of plaintiffs to settle their claims that company executives had made false and misleading statements about their company's performance.[214]

While Rule 10b-5 has historically been enforced primarily against public companies, it could prove a powerful tool against private equity ones as well.[215] The rule does not apply solely to the sale of share in public companies. It applies to all securities. And importantly, it is non-waivable—private equity firms cannot deprive investors of its protections—and contains private rights of action—investors can bring the claims themselves and not wait for regulators to protect them. The standard for materiality is low as well. In *Basic v. Levinson*, the classic case on materiality, the Supreme Court held that "an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[216] "To fulfill the materiality requirement, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[217]

As retail exposure to private equity has grown, the line between stylized financial storytelling and actionable fraud has narrowed. Displays of internal rates of return that might once have passed as harmless exaggeration, for example, may soon fall on the wrong side of the fraud line. The same goes for fee and expense practices. Would more specific disclosures about the fee practices of private equity firms significantly alter the total mix of information available about their funds? Would it be considered important by reasonable shareholders? One could imagine many scenarios in which the answers to these questions would be yes.

Indeed, it is precisely these kinds of discrepancies—between public statements and economic reality—that fraud law is designed to address.

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[212] *See* Buell, *supra* note XXX, at 540; Jill E. Fisch, Jonah B. Gelbach & Jonathan Klick, *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 TEX. L. REV. 553 (2018).

[213] *See* CORNERSTONE, SECURITIES CLASS ACTION FILINGS: 2023 YEAR IN REVIEW 1 (2024).

[214] *See* Ross Todd, *How Robbins Geller Landed a $1.2B Settlemet in the Valeant Pharmaceuticals Securities Case*, AMER. LAWYER, Feb. 5, 2021.

[215] *See* Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353 (2020); Kenneth J. Black, Note, *Private Equity & Private Suits: Using 10b-5 Antifraud Suits to Discipline a Transforming Industry*, 2 MICH. J. PRIV. EQUITY & VENTURE CAP. L. 271, 271–72 (2013)

[216] *Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988).

[217] *Id.* at 231-32.

Deceptive devices and affirmative misrepresentations are impermissible, under Rule 10b-5, under the Investment Company Act of 1940 and under the SEC's marketing rule applicable to registered investment advisers. Private equity funds have largely avoided these regimes, or at least litigation under them, by virtue of limiting their marketing to qualified purchasers. That firewall has crumbled with the rise of semi-liquid funds, feeder structures, and retail-facing platforms.

These new structures have also reshaped what a "reasonable investor" looks like. Under Rule 10b-5, it is unlawful to make any statement of material fact that is misleading considering the circumstances in which it is made. The materiality standard is met when a reasonable investor would view the information as important to an investment decision. So far, the SEC has not brought a single enforcement action against the way private equity firms present track records, perhaps because the average investor was considered sophisticated. There have been no cases on internal rates of return, no challenges to cherry-picked results, and no sanctions for the appearance of implausible consistency across cycles. These practices remain widespread, normalized, and unchallenged. But courts have applied securities fraud tests flexibly, and there is no reason to think that performance marketing by private funds will remain unchallenged.

Inflated net asset values could also be challenged.[218] In some retail-oriented private equity products, asset valuation influences both fee calculations and performance reporting. If the valuation methodologies of a fund are unsound, then all of these related elements are questionable as well. Under U.S. accounting and valuation law, assets must be valued at fair value, defined as the price that would be received in an orderly transaction between market participants at the measurement date.[219] The standard explicitly incorporates secondary market information where available.[220]

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[218] Lawsuits involving net asset value disputes are common and cover a wide range of doctrines. *See, e.g., SEC v. Illaramendi*, 260 F.Supp.3d 166 (D. Conn. 2017) (involving Investment Advisers Act violations by a hedge fund manager who misrepresented the net asset value of his funds); *Security State Bank v. Ziegeldorf*, 554 N.W.2d 884 (Iowa 1996) (holding, in an appraisal action, that experts' estimates of net asset value were unreliable); *Manbro Energy Corp. v. Chatterjee Advisors LLC*, 2021 WL 2037552 (S.D.N.Y. 2021) (involving an investor's claim against a private equity fund that its profit distributions should have been paid based on the fair market value of its interest in the fund, not on net asset value, where "the fair market value of the shares …was orders of magnitude greater than [defendants'] calculated NAV"); *Cannonball Fund, Ltd. v. Dutchess Capital Management, LLC*, 84 Mass.App.Ct. 75, 93 N.E.2d 350 (2013) (involving duty of care claims brought against hedge fund administrator for inflating net asset values); *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008) (involving a dispute over whether a target company in a merger had suffered a material adverse effect where one expert concluded that the company's net asset value was $3.7 billion and another that it was *negative* $1.9 billion); *In re Bayou Group LLC*, 396 B.R. 810 (Bankr. S.D.N.Y. 2008) (involving Chapter 11 debtor claims based on a hedge fund's publishing falsely inflated net asset values).

[219] *See* FIN. ACCOUNTING STANDARDS BD., ACCOUNTING STANDARDS UPDATE: FAIR VALUE MEASUREMENT (TOPIC 820) (20), https://asc.fasb.org/imageRoot/00/7534500.pdf.

[220] *Id.* at 13.

The same principles apply in European jurisdictions through the International Financial Reporting Standards.[221] If a fund disregards observable market prices or credible third-party bids, it risks violating these accounting norms and misleading investors. Despite these rules, funds frequently buy secondary interests at a discount to reported NAV and, the very next day, record them at par. As *The Wall Street Journal* recently documented, Hamilton Lane's retail fund purchased private equity stakes at roughly 80% of stated NAV and immediately marked them up to 100%, creating large one-day paper gains.[222]

The lack of asset-value-based lawsuits in private equity to date is likely due to a combination of contractual waivers, lack of secondary liquidity and investor deference. But the rise of retail-facing vehicles with periodic liquidity changes the calculus. In these vehicles, reported NAV is no longer a passive accounting convention; it is the price at which investors buy, redeem, and calculate performance. Every quarter, NAV now determines who gains and who loses, how fees are charged, and how returns are presented. This gives valuation practices immediate economic consequences and transforms what was once an internal reporting choice into a legally material figure. The growing use of semi-liquid and interval funds also multiplies opportunities for valuation abuse. Retail investors who redeem at inflated NAVs no longer need to allege abstract misrepresentation—they can point directly to measurable price deviations and the resulting transfer of value.

d. Consumer Protection Statutes

Both federal and state law contains broad prohibitions against unfair and deceptive practices by companies. Section 5 of the Federal Trade Commission Act forbids unfair and deceptive acts and practices in or affecting commerce, including in financial services.[223] State consumer protection laws provide similar prohibitions on unfair and deceptive practices and sometimes go further, including long lists of specifically unlawful behaviors.[224] Texas's deceptive practices statute, for example, forbids companies from representing that their financial products or services have characteristics and benefits that they do not

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[221] *See IFRS 13 Fair Value Measurement*, INT'L FIN. REPORTING STANDARDS FOUND. (2021), available at https://www.ifrs.org/issued-standards/list-of-standards/ifrs-13-fair-value-measurement/.

[222] *See* Jonathan Well, *Funds Are Booking Big One-Day Windfalls Buying Private-Equity Stakes*, WALL ST. J., June 7, 2024.

[223] 15 U.S.C. § 45.

[224] *See* Rory Van Loo, *Helping Buyers Beware: The Need for Supervision of Big Retail*, 163 U. PA. L. REV. 1311, 1365-66 (2015); Dee Pridgen, *The Dynamic Duo of Consumer Protection: State and Private Enforcement of Unfair and Deceptive Trade Practices Laws*, 81 ANTITRUST L.J. 911, 912–13 (2017); Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 KAN. L. REV. 1, 15–16 (2005).

have,[225] representing that they are of a particular standard or quality that they do not meet,[226] and failing to disclose information in order to induce a consumer into a transaction.[227] All fifty states have adopted some version of an unfair and deceptive practices statute.[228] And while courts have held that there is no private right of action under Section 5 of the FTC Act, many states have "Little FTC Acts" that explicitly incorporate the language and interpretations of the federal statute and that provide private citizens a right to sue for violations.[229]

Consumer protection statutes are broadly written and flexibly interpreted. They prohibit "unfair" acts and practices, as well as "deceptive" and "abusive" ones.[230] These have been interpreted to prohibit acts that are "immoral, unethical, oppressive or unscrupulous."[231] This is the kind of broad, ethical language that calls for context-specific, totality-of-the-circumstances type analyses by judges. Consumer protection lawsuits also have relaxed pleading standards. Unlike with securities fraud claims, where plaintiffs must show actual reliance on the allegedly deceptive statement, plaintiffs in unfair trade practices cases often simply need to prove that a reasonable consumer under the circumstances would have been misled by the company's statements.[232] In sum, consumer protection statutes offer broad protection against financial misbehavior and grant private litigants improved access to courts.

Private litigants could use these consumer protection statutes to target private equity firms that engage in a range of abusive practices. They might, for example, challenge opaque and discretionary aspects of private equity fee practices. They might challenge misleading performance metrics like internal rates of return that lead investors to unreasonably high expectations of economic returns. They might challenge conflicts of interest and fiduciary duty waivers that reduce the quality and standard of care for financial products. All of these are well-grounded in prior case law.

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[225] TEX. BUS. & COM. CODE § 17.46(b)(5).

[226] *Id.* at § 17.46(b)(7).

[227] *Id.* at § 17.46(b)(24).

[228] *See* Matthew A. Edwards, *The Law, Marketing, and Behavioral Economics of Consumer Rebates*, 12 STAN. J.L. BUS. & FIN. 362, 397 (2007)

[229] *See* Samuel Evan Milner, *From Rancid to Reasonable: Unfair Methodes of Competition Under State Little FTC Acts*, 73 AM. U. L. REV. 857 (2024).

[230] *See* Allen Denson & Latif Zaman, *States' Divergent Aproaches to Unfair, Deceptive and Abusive Acts and Practices Reveal Consumer Protection Priorities*, BUS. LAW TODAY, Aug. 22, 2019.

[231] *See Raad v. Wal-Mart Stores, Inc.*, 13 F.Supp.2d 1003 (D. Neb. 1998) ("In order to prove an "unfair" practice [under Nebraska's Consumer Protection Act] when merchants have entered into a contract, the plaintiff must either prove that the practice: (1) fell within some common-law, statutory, or other established concept of unfairness or (2) was immoral, unethical, oppressive, or unscrupulous.").

[232] *See, e.g., Morris v. ADT Security Servs.*, 580 F. Supp. 2d 1305, 1309-10 (S.D. Fla. 2008) ("A Plaintiff can sustain an action under [Florida's Deceptive and Unfair Trade Practices Act] if a reasonable consumer acting in the same circumstances would likely be deceived by a company's business practice.").

In several high-profile cases of recent years, financial institutions have faced consumer protection lawsuits challenging their investment practices. In 2024, for example, a coalition of states sued Blackrock, State Street and Vanguard alleging that the investment firms had engaged in a wide-ranging plot against coal miners.[233] In addition to antitrust violations, the state attorneys general brought numerous unfair and deceptive practices claims against the firms, arguing that they deceived their customers about the true characteristics of their investment practices by hiding their real investment objectives.[234] In 2022, Missouri initiated an investigation of Morningstar, the financial research firm, for potential violations of consumer protection laws by misleading consumers about the nature of their ESG products.[235] In 2025, a group of retirement plan participants sued the investment company Empower, alleging that they charged them excessive and hidden fees.[236] These cases illustrate the expansive reading that plaintiffs and courts have given to state consumer protection laws.

Foreign jurisdictions often have even more plaintiff-friendly consumer protection statutes. In the UK, for example, the Financial Conduct Authority's new Consumer Duty Instrument, enacted in 2022, mandates that firms avoid "foreseeable harm" to retail clients.[237] The rule requires firms to refrain from "unfairly exploiting behavioural biases" in consumers, to avoid raising "unreasonable barriers" to consumers who wish to exit their investments, and to ensure that "all aspects" of the design and terms of its products avoid foreseeable harm.[238] Under the terms of the rule, courts may begin to take an expansive view of what constitutes exploitation in contractual investment schemes. In Singapore, the Consumer Protection (Fair Trading) Act prohibits unfair practices in trade, and lists among its many prohibitions taking advantage of a consumer where the consumer "is not reasonably able to understand the character, nature, language or effect of the transaction or any matter related to the transaction."[239] Australia's Competition and Consumer Act 2010 provides for strict liability.[240] In short, consumer protection laws could apply broadly in the private equity industry, leading both to significant liability risks for firms and

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[233] *See* Jonathan Stempel & Carolina Mandl*, BlackRock, Vanguard, State Street Sued by Republican States Over Climate Push*, Reuters, Nov. 29, 2024.

[234] *See Texas v. Blackrock*, Case No. 6:24-cv-00437-JDK, E.D. Tex. (2025) (Amended Complaint).

[235] *See* Ross Kerber, *Missouri Attorney General Investigates Morningstar Over ESG Ratings*, REUTERS, Aug. 3, 2022.

[236] *See* James Van Bramer, *Empower Sued Over "Deceptive" Sales Practices, High Fees*, PLANSPONSOR, Aug. 19, 2025.

[237] *See* Financial Conduct Authority, Policy Statement PS22/9, "A New Consumer Duty", July 27, 2022.

[238] *Id.* at 2A.2.10.

[239] Consumer Protection (Fair Trading) Act (Cap 50, 2020 rev. ed.), (Sing.), available at https://sso.agc.gov.sg/act/cpfta2003.

[240] Competition and Consumer Act 2010 (No. 51, 1974) (Austl.), https://www.legislation.gov.au/C2004A00109/latest/text.

broad litigation avenues for investors.

2. Procedural Design

Behind the substantive law question stands a procedural one: what form will lawsuits take and in which forums will they be decided. While these questions are largely administrative, they heavily affect the substance and treatment of claims and could go a long way in determining the deterrent and remedial effects of private enforcement. In particular, two procedural design questions stand out: first, will investors be forced into arbitration or will they be able to be able to bring their claims in court; and second, will investors need to sue individually, or will they be able to engage in mass litigation through class actions? As we will see below, these two questions are interrelated and have uncertain answers in the law.

The first procedural design question is whether investor claims will be heard by public courts or private arbitral bodies. The right to have one's claims heard in court has long been a fundamental aspect of American justice.[241] Well into the twentieth century, public litigation in court was the primary, and sometimes sole, avenue for individuals to vindicate their rights against offenders.[242] But over the last several decades, this understanding has shifted. The rise of forced arbitration has been one of the major trends in civil procedure of the last two decades.[243] Aided by the expansive terms of the Federal Arbitration Act and a friendly Supreme Court, arbitration has experienced a sharp increase in use and prevalence.[244] By one measure, some 81% of Fortune 100 companies have adopted forced arbitration agreements for their consumers.[245] Arbitration differs from ordinary litigation in many ways, but most fundamentally, it involves parties to a dispute, rather than having their claims settled by a judicial body, instead agree to submit them to a neutral third party, whose decision on the matter will be treated as final and binding.[246] The FAA strongly favors the enforcement of arbitration agreements and any resulting arbitration awards, and courts have extremely limited authority to review arbitral decisions.[247]

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[241] *See* Jaime L. Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 724, 725 (2011); J. Maria Glover, *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 WM. & MARY L. REV. 1137, 1140-41 (2012).

[242] *See* Dodge, *supra* note XXX, at 725.

[243] *See* Myriam Gilles, *The Day Doctrine Died: Private Arbitration and the End of Law*, 2016 U. ILL. L. REV. 371 (2016).

[244] *Id.* at 390-95.

[245] *See* Imre Stephen Szalai, *The Prevalence of Consumer Arbitration Agreements by Top Companies*, 52 U.C. DAVIS L. REV. ONLINE 233, 234 (2019).

[246] *See* Thomas J. Stipanowich, *Arbitration: The "New Litigation"*, 2010 U. ILL. L. REV. 1, 11-20 (2010).

[247] *Id.* at 11-12.

While many proponents of arbitration assert that it can help both plaintiffs and defendants by proving a more efficient way for parties to resolve their disputes, in practice, it tends to be heavily defendant-friendly.[248] One study found that the win rate of consumers in arbitrations against companies was a mere 0.7% in 2022.[249] Arbitration procedures also provide for limited discovery rights and high levels of confidentiality.[250] As a result, misbehaviors are more likely to remain undiscovered and, even when discovered, unlikely to lead to the kind of media coverage and public pressure that can spur executive shakeups and industry reform.[251] It should come as no surprise, then, that companies have rushed to adopt force arbitration clauses.

It remains to be seen whether the private equity industry will similarly attempt to adopt forced arbitration clauses. It does not appear to be a common practice currently—perhaps because, as the Institutional Limited Partners Association has pointed, "many investors have restrictions or preferences against agreeing to arbitration"—but the threat of public litigation might well force firms to rethink the practice.[252] Even still, courts could well view blanket litigation waivers for shareholders with skepticism, particularly as ordinary investors begin entering into financial relationships with private equity firms. Corporate law is fundamentally a matter of state law and, as such, state courts could find that arbitration provisions are inequitable and unenforceable.[253] Delaware law, for example, forbids charter and bylaw provisions that require shareholders to arbitrate state corporate law claims.[254] It also bars any provisions that "transgress a statutory enactment or a public policy settled by the common law or implicit in the [Delaware General Corporation Law] itself."[255] It would not be a leap for courts to conclude that blanket waivers of investors' ability to vindicate their rights in a public court of law violate state policy.[256]

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248 Cynthia L. Estlund, *Between Rights and Contract: Arbitration Agreements and Non-Compete Covenants as a Hybrid Form of Employment Law*, 155 U. PA. L. REV. 379, 427–30 (2006); Ronald J. Mann & Travis Siebeneicher, *Just One Click: The Reality of Internet Retail Contracting*, 108 COLUM. L. REV. 984, 990 (2008).

249 *See* AMERICAN ASSOCIATION FOR JUSTICE, FORCED ARBITRATION BY CORPORATIONS SURGES TO UNPRECEDENTED LEVELS 3 (2023).

250 Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights*, 67 LAW & CONTEMP. PROBS. 167, 200–04 (2004)

251 *Id.*

252 INST'L LTD. PARTNERS ASS'N, THE ILPA MODEL LIMITED PARTNERSHIP AGREEMENT (WHOLE-OF-FUND WATERFALL) 69 (2020).

253 *See* David S. Schwartz, *Claim-Suppressing Arbitration: The New Rules*, 87 INDIANA L.J. 239, 252 (2012); David Horton, *Arbitration About Arbitration*, 70 STAN. L. REV. 363, 363 (2018); Daniel Wilf-Townsend, *Deterring Unenforceable Terms*, 111 VA. L. REV. (forthcoming 2025).

254 Del. Code Ann. Tit. 7, § 115 (2023). *See also* Mohsen Manesh & Joseph A. Grundfest, *The Corporate Contract and Shareholder Arbitration*, 98 N.Y.U. L. REV. 1106, 1135 (2023).

255 *Salzberg v. Sciabacucchi*, 227 A.3d 102, 115-16 (2020).

256 *See* Manesh & Grundfest, *supra* note XXX, at 1106 ("It should be trivially easy for courts to conclude that an arbitration provision set forth in a corporate charter or bylaw is unenforceable against public company shareholders.").

The second major procedural design question is whether investors will be forced to litigate their claims individually or whether they can aggregate their them into class actions. Class actions are a powerful weapon against corporate wrongdoing. By enabling individuals to join together and bring a single lawsuit against a bad actor, rather than bringing multiple separate lawsuits, class actions serve a variety of compensation, deterrence and judicial efficiency goals.[257] From a compensation perspective, they help ensure that plaintiffs with low individual losses, but large aggregate ones, have the financial ability to bring lawsuits.[258] From a deterrence perspective, they provide incentives for firms to avoid wrongdoing that causes widespread harm.[259] And finally, from an efficiency perspective, they provide mechanism for judges to achieve universal resolutions of common issues.[260]

For retail investors in private equity funds, class actions could be essential to protecting them from conflicts of interest and abusive behavior. Most individual investors will have a relatively low ownership interest in a fund, particularly compared with the large allocations of capital that institutional investors typically make in private equity funds. As a result, individual investors will be disincentivized to bring claims based on misbehaviors like improper fees or misleading metrics, even if the violations are clear, when the individual harm to their own interests is too low to offset the time and expense of pursuing litigation (let alone arbitration). The only way for investors to vindicate their rights would be through mass litigation where claims are combined and costs shared.

Consider the following hypothetical. A private equity firm raises a retail-focused fund of $10 billion. Phoenix, a retired firefighter, invests $50,000 in the fund, amounting to 50% of his retirement savings.[261] Contrary to the terms of the limited partnership agreement, the firm invoices as fund expenses $100

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[257] *See* Robert H. Klonoff, *The Decline of Class Actions*, 90 WASH. U. L. REV. 729 (2013 Alexandra Lahav, *Fundamental Principles for Class Action Governance*, 37 IND. L. REV. 65, 100–01 (2003). *But see* Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J. L. & PUB. POL'Y 1187, 1205 (2013) (arguing that class action litigation has contributed to a reduction in the competitiveness of American capital markets).

[258] See David Rosenberg & Kathryn E. Spier, *Incentives to Invest in Litigation and the Superiority of the Class Action*, 6 J. LEGAL ANALYSIS 305, 347-48 (2014).

[259] *See* John C. Coffee, *Reforming the Securities Class Action: On Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534 (2006).

[260] *See* Linda S. Mullenix, *Ending Class Actions as We Know Them: Rethinking the American Class Action*, 64 EMORY L. J. 399, 421-23 (2014); Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399, 438–41 (1973); James M. Finberg, *Class Actions: Useful Devices that Promote Judicial Economy and Provide Access to Justice*, 41 N.Y.L. SCH. L. REV. 353, 353–54 (1997);

[261] In 2022, the median retirement savings account held a balance of $87,000. *See* CONG. RES. SERV., OWNERSHIP OF RETIREMENT ACCOUNTS IN 2022: AMOUNTS IN DEFINED CONTRIBUTION PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS 4 (2024).

million of business development (marketing campaigns, opening of offices abroad, etc.). Phoenix (somehow) finds out about this improper payment and wants to be compensated for the loss. Does it make sense for him to sue? The overall harm is clear, demonstrable and large—it represents a destruction of 1% of the fund's value, a massive windfall to the firm's partners and a large loss for investors. But the specific harm to Phoenix is small: only $500. A $500 recovery would not pay for even an hour of a lawyer's time at a large law firm, let alone the substantial expenses involved in filing fees, brief writing, and discovery. As a result, Phoenix might well conclude that he should simply let the transaction pass unchallenged. He might withdraw his investment from the fund (assuming the firm does not block him from withdrawing it), but he will have little incentive to pursue his (admittedly valid) claims in a court of law. What is more, there might be thousands or hundreds of thousands of similar investors making similar decisions. A class action, on the other hand, would resolve the low-threshold-amount problem. If all investors could aggregate their claims, they could spread out the cost of litigation and hire attorneys to bring their meritorious claim. It is precisely these kinds of large-*n* problems that class actions are intended to resolve. As Judge Richard Posner once wrote, "The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[262]

There are two major obstacles to class action in private equity. The first is the Securities Litigation Uniform Standards Act ("SLUSA"), a 1998 statute aimed at reining in securities litigation.[263] The law generally pre-empts private state-law class (and, in some cases, mass) action claims alleging manipulation, deception or misrepresentations in connection with the purchase or sale of "covered securities."[264] The statute defines "covered securities" to generally include stock traded on a national exchange, as well as securities issued by investment companies.[265] The broad coverage of the act could well pose an insurmountable barrier to fraud-based lawsuits against private equity firms.[266] But a number of uncertainties remain about the scope of the statute, with particularly uncertain wrinkles concerning whether the underlying investments

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262 *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004).

263 Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified in scattered sections of 15 U.S.C.). For scholarly discussion of the coverage and effects of the act, see Jennifer O'Hare, *Preemption Under the Securities Litigation Uniform Standards Act: If It Looks Like a Securities Fraud Claim and Acts Like a Securities Fraud Claim, Is It a Securities Fraud Claim?*, 56 ALA. L. REV. 325 (2004); John M. Wunderlich, *"Uniform" Standards for Securities Class Actions*, 80 TENN. L. REV. 167 (2013); Benjamin P. Edwards, *Disaggregated Classes*, 9 VA. L. & BUS. REV. 305 (2015); Jennifer J. Johnson, *Securities Class Actions in State Court*, 80 U. CIN. L. REV. 349 (2011); Larry E. Ribstein, *Dabit, Preemption, and Choice of Law*, 2006 CATO SUP. CT. REV. 141 (2006).

264 15 U.S.C. § 78bb(f).

265 *See* Wunderlich, *supra* note XXX, at 176.

266 See *Edwards, supra* note XXX, at 326-36.

by a private equity firm should be considered covered securities at all.[267] The answer may well depend on complex questions of fund structure and entity, and caselaw on the question is sparse.

The second obstacle to class actions is private contractually negotiated class action waivers, often included in arbitration clauses.[268] Arbitration does not technically preclude mass litigation: the last few years has seen the birth of so-called "mass arbitration" for consumers to aggregate their claims.[269] But arbitration provisions commonly include class action waivers and if they become commonplace in the market—and are upheld by courts—they could prove a significant obstacle to the vindication of investor rights.[270] Indeed, one of the reasons why the defense bar has argued in favor of shifting from public litigation to private arbitration was to limit or entirely opt out of class actions.[271]

3. Foreign Courts

A final mechanism for investor protection in the new era of public-oriented private equity is foreign litigation.[272] So far, our discussion has focused primarily on U.S. law, but there is no reason to think that foreign investors will limit themselves to U.S. courts and U.S. law. They might well prefer to have their claims against private equity firms heard in their home jurisdictions. They might wish to do so for any number of reasons, including the convenience of the forum, more favorable substantive law, and worries about judicial bias abroad (and, conversely, hopes for favoritism at home). Historically, U.S. courts, with their plaintiff-friendly reputations and broad jurisdictional rules, have been attractive to foreign litigants, but this trend has begun to shift in recent years.[273] After the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*

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[267] *See, e.g.*, *Anderson v. Edward D. Jones & Co., L.P.*, 990 F.3d 692, 697 (9th Cir. 2021) (holding that the Securities Litigation Uniform Standards Act does not bar state law class actions based on fiduciary duty breaches brought against financial advisory firms). *See also* Ribstein, *supra* note XXX, at 160-65 (discussing the uncertain reach of the act).

[268] *See* Keith N. Hylton, *The Economics of Class Actions and Class Action Waivers*, 23 SUP. CT. ECON. REV. 305 (2015); Albert H. Choi & Kathryn E. Spier, *The Economics of Class Action Waivers*, 38 YALE J. ON REG. 543 (2021).

[269] *See* J. Maria Glover, *Mass Arbitration*, 74 STAN. L. REV. 1283 (2022).

[270] Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 378 (2005) ("tak[ing] it ias beyond dispute that the threat of class action liability plays a vital role in deterring corporate wrongdoing").

[271] *See* Glover, *supra* note XXX, at 1295.

[272] *See generally* Martin Gelter, *Global Securities Litigation and Enforcement*, in GLOBAL SECURITIES LITIGATION AND ENFORCEMENt 3 (Pierre-Henri Conac & Martin Gelter eds. 2019); Martin Gelter, *Mapping Types of Shareholder Lawsuits Across Jurisdictions*, in RESEARCH HANDBOOK ON SHAREHOLDER LITIGATION (Jessica Erickson, Sean Griffith, David Webber & Verity Winship eds., 2018).

[273] *See* Marco Ventoruzzo, *Like Moths to a Flame? International Securities Litigation After Morrison: Correcting the Supreme Court's "Transactional Test"*, 52 Va. J. Int'l L. 405 (2012);

sharply curtailed the right of foreign investors to access American courts,[274] investors began exploring alternative forums abroad.[275] Over the last decade, international securities litigation has slowly shifted from its almost exclusively American focus to a much more balanced international one, with new rules and changing geopolitical dynamics providing incentives for plaintiffs to sue in foreign courts.[276] A steady expansion of class action procedures in Europe and elsewhere have also made foreign courts increasingly attractive venues for wronged consumers.[277] In the last five years alone, large American companies such as Apple, Microsoft and Google have all faced class action lawsuits in European jurisdictions, including Ireland, the U.K., and the Netherlands.[278]

Foreign litigation brings with it an array of new mechanisms for investor protection. Foreign laws often have different rules on the permissibility of fiduciary duty waivers, hidden fees and mandatory arbitration provisions.[279] They often have different standards of proof and substantive conduct requirements. Jurisdictions like the United Kingdom have robust doctrines like "unfair prejudice" and "oppression" that are circumscribed or non-existent in the United States.[280] All of these substantive and procedural rules could mean that foreign courts will reach different conclusions about the wrongfulness of private equity practices.

The efficacy of foreign litigation in private equity depends on a series of complicated conflict-of-law questions that are not amenable to simple or categorical resolution. Will courts have jurisdiction to hear disputes? What laws will they apply? Will private equity firms be able to exclude foreign investors entirely from their funds, or establish blocker fund structures that cabin their liability exposure? All of these questions will depend on traditional conflict of law principles, including the place of contracting, the identity of the parties, and the policy choices of home governments. Excluding foreign investors might be one solution for private equity firms, but is not as easy to accomplish as it might

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[274] *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 265 (2010) (holding that Section 10(b) of the Securities Exchange Act does not apply extraterritorially).

[275] *See* DECHERT LLP, GLOBAL SECURITIES LITIGATION TRENDS (2020), available at https://www.dechert.com/content/dam/dechert%20files/knowledge/onpoint/2017/11/Global%20Securities%20Litigation%202020.pdf.

[276] *See* Michael P. Murtagh, *The Rule 23(b)(3) Superiority Requirement and Transnational Class Actions: Excluding Foreign Class Members in Favor of European Remedies*, 34 HASTINGS INT'L & COMP. L. REV. 1, 36–39 (2011); U.S. CHAMBER INST. L. REFORM, THE GROWTH OF COLLECTIVE REDRESS IN THE EU: A SURVEY OF DEVELOPMENTS IN 10 MEMBER STATES (2017).

[277] *See* U.S. CHAMBER INST. L. REFORM, *supra note* XXX, at 1-2.

[278] *See* Jack Womack, *Microsoft and Apple Targeted With UK Class Actions*, Law.com, Dec. 3, 2024; REUTERS, *Dutch Groups Sue Google Over Alleged Privacy Violations*, Sept. 12, 2023; Zara West, *Landmark Microsoft Class Action Marks "Pivotal Moment" for Ireland*, PINSENT MASONS, July 17, 2025.

[279] *See, e.g., The Sumitomo Bank Limited v Banque Bruxelles Lambert SA* [1997] 1 Lloyd's Rep 487 (UK).

[280] *See* Gelter, *supra* note XXX, at 17-23.

sound.[281] It is one thing to verify citizenship when a firm's investors are large institutional investors where the total number of investors is somewhere in the range of a few dozen. It is another when the number of investors balloons to the thousands or tens of thousands. Firms could of course (and often do) require investors to fill out questionnaires identifying themselves, their citizenship, their wealth, etc.[282] They might also engage in separate due diligence on the citizenship of their investors, or outsource the process to third party auditors or brokers.[283] But questionnaires and audits are never foolproof. Some investors will slip through the cracks or make mistakes or answer incorrectly (either intentionally or unintentionally). If there are secondary markets available in which investors can sell their interests on to other investors, the difficulty of ring-fencing increases even further. In short, foreign courts may prove a powerful source of investor rights.

CONCLUSION

Private equity has long operated with limited transparency, minimal regulation, and contractual insulation. That equilibrium is now shifting. The expansion of retail-oriented funds has blurred the traditional boundary between public and private capital—the foundation on which modern securities law was built. Firms that once raised money exclusively from institutions are now drawing on household savings, while continuing to operate largely outside the disclosure and governance requirements applied to public issuers. This convergence strains the logic of the regulatory divide and exposes practices once tolerated in institutional settings to new forms of legal scrutiny.

As formal oversight recedes, private enforcement mechanisms are likely to assume greater importance. Litigation grounded in contract, fiduciary, tort, and consumer protection law—areas historically peripheral to financial regulation—may prove more effective at constraining opportunistic behavior than public enforcement has been. The discipline that regulators have been unwilling or unable to impose may instead emerge through courts.

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281 For an in-depth discussion of how companies handle compliance issues in global securities issuances, see LATHAM & WATKINS LLP, THE LATHAM FPI GUIDE: ACCESSING THE US CAPITAL MARKETS FROM OUTSIDE THE UNITED STATES (2025). *See also*

282 *See* Usha Rodrigues, *In Search of Safe Harbor: Suggestions for the New Rule 506(c)*, 66 VAND. L. REV. EN BANC 29 (2013).

283 *See* LATHAM & WATKINS LLP, *supra* note XXX, at 2.