# Corporate Adolescence: Why Did "We" Not Work?

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In academic and public commentary, entrepreneurial finance is usually portrayed as a quintessential American success story, an institutional structure whereby expert venture capitalists with strong reputational incentives channel much-needed equity to deserving entrepreneurs, then subject them to intense monitoring to assure they stay on the path to hoped-for success in the form of an initial public offering or public company acquisition.[1] Thus, it is jarring that in recent years there have been so many troubles, from gross embarrassments to allegations of outright criminality, at companies like Uber, Theranos, and our subject here, WeWork. These dramas are often portrayed in terms of the predictable sins of youthfulness: reckless, disruptive, risk-taking behaviors that come from the volatile interaction of a charismatic young leader and a cult(ure) of STEM-smart followers who buy into the dream.[2]

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1. *E.g.*, Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets*, 47 J. FIN. ECON. 243 (1998).

2. *See generally* JOHN CARREYROU, BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP (2018) (discussing the Theranos scandal and the fraud committed by Elizabeth Holmes against investors, government officials, and company employees that led Theranos to receive a multibillion dollar valuation and receive investments from some of the biggest names in Silicon Valley); ANTONIO GARCÍA MARTÍNEZ, CHAOS MONKEYS: OBSCENE FORTUNE AND RANDOM FAILURE IN SILICON VALLEY (2016) (providing a personal account by a member of Facebook's advertising team about its quest to turn user data into profits and describing his eventual departure to Twitter, while detailing the lewd antics common among Silicon Valley employees); MIKE ISAAC, SUPER PUMPED: THE BATTLE FOR UBER (2019) (discussing Uber's rise into a multibillion dollar startup, and subsequent turmoil stemming from the "blind worship" of CEO Travis Kalanick, including a toxic internal culture and Kalanick's eventual ouster); REEVES WIEDEMAN, BILLION DOLLAR LOSER: THE EPIC RISE AND SPECTACULAR FALL OF ADAM NEUMANN AND WEWORK (2020) (discussing Adam Neumann's breakneck style of management and WeWork's rise into a multibillion dollar company with high-profile investors, and providing a day-by-day account of the five weeks leading up to WeWork's failed IPO); Steve Blank, *When Founders Go Too Far*, HARV. BUS. REV. (Nov.–Dec. 2017), https://hbr.org/2017/11/when-founders-go-too-far [https://perma.cc/RS5G-6JMZ] (discussing Uber's "bro culture" including years of "jousting with local taxi authorities"); Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353 (2020) [hereinafter Pollman, *Private Company Lies*] (explaining how the explosive growth of private markets in the United States has left some of the largest U.S. companies in an environment with no securities fraud regulation, which creates extreme information asymmetry and a pressure, opportunity, and rationalizing culture that can foster misconduct and deception); Erin Griffith, *The Ugly Ethical Underside of Silicon Valley*, FORTUNE, Jan. 1, 2017, at 73, 76, https://fortune.com/longform/silicon-valley-startups-fraud-venture-capital/ [https://perma.cc/38VF-TDXT] (giving examples of "lone-

We have no quarrel here with the historical record of success. But the market for start-up capital constantly changes.[3] We are not the first legal academics to express concern about whether the conventional model is descriptively or normatively suited to today's world, particularly as the period of time from the first capital raise to exit becomes much longer and sources of private capital grow much larger.[4] This allows some privileged

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cowboy tales" that "make is easy for [startup] founders to rationalize questionable decisions"). On the myths and realities of youthfulness, see generally Pierre Azoulay, Benjamin F. Jones, J. Daniel Kim & Javier Miranda, *Age and High-Growth Entrepreneurship*, 2 AM. ECON. REV. INSIGHTS 65, 65–66 (2020) (providing research to support the advantages and disadvantages young entrepreneurs face); Spencer E. Ante & Joann S. Lublin, *Young CEOs: Are They Up to the Job?*, WALL ST. J. (Feb. 7, 2012), https://www.wsj.com/articles/SB10001424052970203315804577207131063501196 [https://perma.cc/P8AX-MAPM] (noting the debate regarding the value of youth in corporate decision, which typically pits the creativity of younger CEOs against the experience and steady hand of older CEOs, and referencing studies that successful start-up founders among Silicon Valley companies tend to be older, contrary to public belief); Noam Scheiber, *The Shkreli Syndrome: Youthful Trouble, Tech Success, Then a Fall*, N.Y. TIMES (Sept. 14, 2017), https://www.nytimes.com/2017/09/14/business/entrepreneur-young-trouble.html [https://perma.cc/7V64-CAKA] (discussing the driving "psychological forces" on young entrepreneurs). We wrote this Article in the midst of the COVID-19 pandemic, which has disrupted all aspects of the economy and society. We express no opinion on what the world of start-ups (or anything else) will be like when the virus finally fades and recognize that it could force a greater level of maturity in the short run. *See* Rolfe Winkler, *Coronavirus Forces Tech Startup Founders to Grow Up Fast*, WALL ST. J. (Apr. 18, 2020, 12:26 AM), https://www.wsj.com/articles/coronavirus-tech-startup-founders-silicon-valley-economy-11587163061 [https://perma.cc/G8AD-S5GA] ("[Tech] founders were still following a go-big-or-go-home approach . . . when the pandemic arrived. After years of blowing through cash, they have to grow up fast and must make tough decisions to conserve it.").

3. *See* Josh Lerner & Ramana Nanda, *Venture Capital's Role in Financing Innovation: What We Know and How Much We Still Need to Learn*, 34 J. ECON. PERSP. 237, 253 (2020) (pointing to high-profile scandals where large sums of money were entrusted to entrepreneurial founders with little oversight and governance protection and noting that "[u]nderstanding why traditional venture capital contractual provisions have faded in importance and their social welfare implications appears to be a promising area of future research for both theorists and empiricists alike").

4. *See, e.g.*, Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583 (2016) (arguing that "unicorns"—large, successful private companies—are distinct from smaller private companies and should be subject to enhanced disclosure requirements); Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules That Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151 (2013) (surveying the history of periodic disclosure regulation in the United States and suggesting new, harder-to-avoid periodic disclosure rules distinct from those in the JOBS Act); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337 (2013) (discussing how societal demands on economically powerful business institutions in terms of transparency, accountability, and openness create a broader definition of "publicness" and drive the creation of contemporary securities regulation); Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019) (surveying governance problems unique to venture-backed start-up companies); Usha R. Rodrigues, *The Once and Future Irrelevancy of Section 12(G)*, 2015 U. ILL. L. REV. 1529 (2015) (arguing, against conventional wisdom, that the Securities Exchange Act § 12(g)—requiring public disclosure for private firms with over 500 shareholders—forced very few private firms to go public since 2000).

firms (especially the so-called "unicorns"[5]) to deepen their footprint on society and the economy substantially before taking on the disclosure-oriented obligations of public corporation status. Or maybe never take them on at all. Indeed, while the public and private worlds stay distinct as a matter of law,[6] the forces of publicness are intruding on the private domain[7] and raising the risks to recklessness and avoidance.

Our title's metaphorical reference to corporate adolescence is meant to underscore the ever-lengthening period of time and the resulting temptations without sufficient grown-up supervision that high-tech start-up companies have before undergoing the so-called rites of passage to public adulthood.[8] We argue that this runs the risk of a build-up of bad choices and testy behaviors commonly observed in human adolescents, e.g., risk-taking and rule-breaking, thereby embedding in the firm's habits and culture problems that may later be hard to fix. This is especially true when the founders themselves are young and prone to immature behavior, though we do not so limit our attention. There is rhetorical expression of the problem in familiar memes like "fake it 'til you make it" and "move fast and break things."

To explore all this, we borrow an approach from business school case studies.[9] We tell the WeWork story in some detail, not simply because it is interesting (which it is) but because it starkly poses a question that many—investors, board members, lawyers, and regulators, among others—will find difficult to answer. How could this happen as against all the high-powered

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5. *See* Keith C. Brown & Kenneth W. Wiles, *The Growing Blessing of Unicorns: The Changing Nature of the Market for Privately Funded Companies*, 32 J. APPLIED CORP. FIN. 52, 52 (2020) (defining "unicorns" as "companies that have reached market valuations of $1 billion without access to public capital" and noting their increasing frequency over the past decade).

6. *See generally* Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1575 (2013) (discussing distinctions between the legal treatment of private and public security offerings).

7. *See* Donald C. Langevoort, *The Effects of Shareholder Primacy, Publicness, and "Privateness" on Corporate Cultures*, 43 SEATTLE U. L. REV. 377, 406 (2020) (discussing the "cultural effects of external pressures from public shareholders and stakeholders"). For a discussion on publicness and corporations, see generally Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629 (2014).

8. *See* Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 169 (2017) ("A stock market debut signifies that a promising new company has finally arrived, ready to join the 'grown ups' in the economy by listing shares on a national stock exchange."). There is a strand of literature on the "mature" start-up; however, this appears simply to refer to firms well along the pre-public growth curve, not the behavioral context. *See, e.g.*, Abraham J.B. Cable, *Fool's Gold?: Equity Compensation & the Mature Startup*, 11 VA. L. & BUS. REV. 613, 618 (2017) (stating that "this Essay primarily uses the term 'mature startup' in lieu of 'unicorn'" to refer to private companies like Uber—that have multi-billion dollar valuations, a geographically diverse and fully-developed product offering, and thousands of employees).

9. For a case study involving legal ethics in the context of the Theranos scandal, see generally G.S. Hans, *How and Why Did It Go So Wrong?: Theranos as a Legal Ethics Case Study*, 37 GA. ST. U. L. REV. 427 (2021).

incentives and smart-money discipline that supposedly exists in venture finance?[10] And what if anything could or should have been done differently, particularly by way of corporate governance? By itself, WeWork is just an anecdote and to an extent an aberration. But toggling back and forth between narrative and analysis, our article makes the case that start-up adolescence is both an apt metaphor and real cause for concern.

We do not try to resolve all this normatively, content mainly with showing the interplay of conflicts in start-up financing that lead to the prediction that the situation is a persistently risky one, where the risks and costs fall on less sophisticated investors, retail and institutional, and with unfortunate spillovers to the capital markets generally. Insistence on private ordering has a dark side. So, we point with some frustration to the recent pushes by Congress and the SEC to increase the number of retail investors eligible to invest in this space, in the name of "opportunity" that is more likely to turn into opportunism.

## I. The WeWork Story, Part 1

A dreamer who envisions co-working office space on Mars, and a man raised by a women's collective in Oregon.[11] They were the builders of WeWork—literally. Adam Neumann was a schemer, who persuaded long-time real estate moguls and Silicon Valley funders, who didn't do real estate, to support the company.[12] Miguel McKelvey was part architect, part schemer, and a hands-on builder. In 2019, McKelvey was the Chief Culture Officer and Neumann was the Chief Executive Officer of a Series H Unicorn with a valuation of $47 billion.[13] In 2020, Neumann was out as CEO, and the private

10. *See* Pollman, *supra* note 4, at 200 ("If VCs are strong monitors, why are examples of oversight failures in startups so plentiful and varied?").

11. Alex Konrad, *Inside The Phenomenal Rise Of WeWork*, FORBES (Nov. 5, 2014, 9:42 AM), https://www.forbes.com/sites/alexkonrad/2014/11/05/the-rise-of-wework/#6a557b606f8b [https://perma.cc/FZ7A-BRJW].

12. *See, e.g.*, *id.* (before investing in WeWork, "Benchmark had never backed a real estate play").

13. Sophia Kunthara, *From Hot to Not: A Timeline of WeWork's IPO Implosion*, CRUNCHBASE (Oct. 1, 2019), https://news.crunchbase.com/news/from-hot-to-not-a-timeline-of-weworks-ipo-implosion/ [https://perma.cc/AA6S-7T62]. Indeed, just two years earlier, the company had the third largest start-up valuation, after Uber and Airbnb. Rani Molla, *Uber Is the Most Valuable U.S. Startup, with Airbnb and WeWork Following Far Behind It*, VOX (Aug. 8, 2017, 4:55 PM), https://www.vox.com/2017/8/8/16113140/top-10-most-valuable-startups-uber-spacex-wework-airbnb [https://perma.cc/FV23-9HJ2].

valuation was down to $7.3 billion.[14] By March of 2020, the valuation was at $2.9 billion, and by June, McKelvey had stepped down as well.[15]

WeWork began when Adam Neumann rented out part of the office space he was using in a Brooklyn office where he was selling high-end baby clothes.[16] In an effort to cut costs, he rented out a corner of his office to someone he found on Craigslist.[17] Shortly thereafter, Neumann looked at another building with his landlord, Joshua Guttman, and proposed a co-working idea with a shared profit.[18] Guttman bit, and Neumann then approached McKelvey about the idea.[19] Green Desk was the outcome—and the predecessor to WeWork, though it was decidedly different from what WeWork would become.[20]

Despite fears about the economy, the company opened in 2008, and the idea took off.[21] Later, Neumann and McKelvey sold their share of the business to Guttman for $3 million dollars to be paid over several years.[22] In 2009, they used cash from the sale, credit cards, and loans from friends to relocate the concept to SoHo, and opened the first office of what was to become the WeWork model.[23] Neumann then sent "free" plane tickets to friends in Israel who thought they were coming to the States for fun, and who ended up working seven days a week, doing the construction build out.[24]

By 2012, WeWork had multiple locations and big aspirations. Neumann spoke publicly about expanding technology, but when asked how or why, he did not have an answer.[25] This is notable, because such statements, in a

14. Lauren Feiner, *SoftBank Values WeWork at $2.9 Billion, Down from $47 Billion a Year Ago*, CNBC (May 18, 2020, 9:48 AM), https://www.cnbc.com/2020/05/18/softbank-ceo-calls-wework-investment-foolish-valuation-falls-to-2point9-billion.html [https://perma.cc/3FKU-WXSE].

15. Deirdre Bosa, *WeWork Co-founder Miguel McKelvey Is Leaving at the End of the Month*, CNBC (June 5, 2020, 8:55 AM), https://www.cnbc.com/2020/06/05/wework-co-founder-miguel-mckelvey-is-leaving-at-the-end-of-the-month.html [https://perma.cc/FJ55-SYEW].

16. Konrad, *supra* note 11.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *See* Ben Weitzenkorn, *WeWork Raises $6.85 Million and Moves West, Young Man*, OBSERVER (Jan. 30, 2012, 5:38 PM), https://observer.com/2012/01/weworks-raises-6-85-million-and-moves-west-01302012 [https://perma.cc/H82Y-ES47] (after raising $6.85 million in 2012, Neumann told reporters he planned to use the money to develop new technology and "invest in some startups that are in our technology incubator," adding, "[a]ll the money is for growth. It's for building community, building technology," but declining to provide any specifics because he "didn't want to reveal too much").

publicly traded company, can be the root of class action claims for liability.[26] Nevertheless, the company continued to grow and to raise private money. In January, 2012, WeWork raised $6.85 million from friends and family; $17 million in a Series A in July, 2012; $40 million in a Series B in May, 2013; and $150 million in a Series C in February, 2014.[27] The Series A and B numbers were about double the size of the average Series rounds in the same timeframe, while the Series C was over five-times the average.[28]

The Series C round was particularly notable because the company attracted the attention of Benchmark, one of Silicon Valley's most well-known venture capital funds.[29] Because Benchmark had not done real estate before, its leader flew to New York to vet the concept and see firsthand why WeWork was different from other shared office space concepts.[30] Sold on Neumann's vision, Benchmark valued the company at $100 million and then, when the investment bank Jefferies joined, the valuation increased to $450 million.[31] Shortly thereafter, McKelvey pitched Jared Kushner and won a prize spot as an anchor tenant in a Dumbo project.[32]

In the same time frame, the adolescent side of WeWork was increasingly becoming public—and receiving press coverage. For example, in 2012, the company started taking entrepreneurs and employees to camp, and in 2014, the New York Times went along.[33] The family of Adam Neumann's wife,

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26. *See* Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5(b) (1951) (prohibiting anyone from "mak[ing] any untrue statement of a material fact or . . . omit[ting] to state a material fact necessary in order to make the statements made," among other things).

27. Dylan Tweney, *WeWork Raises $355M at Nearly $5B Valuation, Plans IPO*, VENTUREBEAT (Dec. 15, 2014, 6:55 PM), https://venturebeat.com/2014/12/15/wework-raises-355m-at-nearly-5b-valuation-plans-ipo/ [https://perma.cc/J8UR-R4NS].

28. Average seed capital in 2012 was $1.7 million; average series A in 2012 was 9.2 million; average series B in 2013 was 17.2 million. Connie Loizos, *A Quick Look at How Series A and Seed Rounds Have Ballooned in Recent Years, Fueled by Top Investors*, TECHCRUNCH (Apr. 25, 2019, 3:34 PM), https://techcrunch.com/2019/04/25/a-quick-look-at-how-fast-series-a-and-seed-rounds-have-ballooned-in-recent-years-fueled-by-top-investors/ [https://perma.cc/JJF9-ETMJ]. The average series C in 2014 was $26 million. Kira M. Newman, *How Much Funding to Raise in Each Round*, TECH.CO (May 15, 2015, 8:00 AM), https://tech.co/news/much-funding-raise-round-2015-05 [https://perma.cc/Z82C-GZ84].

29. Konrad, *supra* note 11.

30. *Id.*

31. *Id.*

32. *Id.* Neumann, a former Israeli soldier, reportedly assisted longtime friend Kushner in the development of a video promoting peace in the Middle East. Gabriel Sherman, *"You Don't Bring Bad News to the Cult Leader": Inside the Fall of WeWork*, VANITY FAIR (Nov. 21, 2019), https://www.vanityfair.com/news/2019/11/inside-the-fall-of-wework [https://perma.cc/J5HY-FCGT]. According to Vanity Fair, Neumann asked WeWork development director Roni Bahar to find an advertising firm to create "a slick video for Kushner that would showcase what an economically transformed West Bank and Gaza would look like." *Id.*

33. Marisa Meltzer, *Camping out with the Office*, N.Y. TIMES (Sept. 5, 2014), https://www.nytimes.com/2014/09/07/fashion/wework-goes-to-summer-camp.html [https://perma.cc/NCE8-45H6].

Rebekah Paltrow Neumann, owns a summer camp in the Adirondacks, and the company used it for several years. The culture at camp—which echoed that of the company—was, well, adolescent. The goal was networking and "a change of pace."[34] At camp, "[t]here was neither reliable cellphone service nor Wi-Fi. Instead, hookahs, vintage typewriters, and canoes loaded with beer were aplenty," and while marijuana was not provided, it was in "abundance."[35]

In 2014, at the time when Benchmark was considering investing additional funds, one thirty-one-year-old entrepreneur at camp was wearing tattoos on his face and body and holding Super Soaker Water Guns filled with vodka.[36] He stated that he was "'getting into as much trouble as humanly possible.'"[37] Another man, also carrying a Super Soaker, "declared to the crowd, '[i]f you don't want to see me naked, don't go to camp.' Another had turned his free camp T-shirt into a crop top and said, '[w]e're gonna bro out so hard.'"[38] One entrepreneur noted that the camp had a "different vibe than . . . 'the city or even the Hamptons, [where] you still have a certain level of internal restraint[.]'"[39]

Restraint and WeWork, however, did not go hand-in-hand. Neumann roamed the office in bare feet. The company offered unlimited free beers to employees and tenants at all hours of the day. Neumann loved Don Julio tequila and would persuade employees to take shots of it, while also scheduling 2:00 a.m. meetings.[40] Marijuana at work was common, as was dancing around fires in the woods on the weekends.[41] Neumann even "installed an infrared sauna and a cold plunge pool in his Manhattan office."[42]

Despite the adolescent antics, the funding continued. Indeed, a few months after the 2014 New York Times camp article appeared, in December 2014, WeWork raised $355 million in a Series D offering.[43] It was still not profitable but was valued at $5 billion.[44] The investors included big names:

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. Amy Chozick, *Adam Neumann and the Art of Failing up*, N.Y. TIMES (Nov. 2, 2019), https://www.nytimes.com/2019/11/02/business/adam-neumann-wework-exit-package.html [https://perma.cc/ZR5D-5H2J].

41. *Id.*

42. *Id.*

43. Lindsay Gellman & Eliot Brown, *WeWork: Now a $5 Billion Co-Working Startup*, WALL ST. J., https://www.wsj.com/articles/wework-now-a-5-billion-real-estate-sartup-1418690163 [https://perma.cc/M47M-HR7Z] (last updated Dec. 15, 2014, 9:53 AM).

44. *Id.*

Goldman Sachs and J.P. Morgan, and the press reported that an initial public offering (IPO) was likely in the next few years.[45]

Although Neumann compared the company to Uber and Airbnb, both of which were in the "sharing" economy, WeWork's model was riskier, because WeWork actually owned or leased the office space that people shared.[46] The liability, so to speak, belonged to WeWork. Even before the COVID-19 pandemic, the success of the business model depended on WeWork's continued ability to service long-term leases on real estate by renting out office space at a higher price on a short-term lease. The model also relied upon continued demand for cramped office space where people work elbow-to-elbow. At the time of the Series D, of course, money for entrepreneurs was flowing and making it possible for them to afford the rent, but the key question was what would happen to the business model when the bubble burst and WeWork still had all that property.[47]

As we will see, the bubble did burst—when publicness intervened, but not before WeWork did a Series E ($434 million), F ($690 million), G ($4.4 billion), and H ($1 billion).[48] All of these fundraising rounds were delineated as "late stage," and all were significant in size. None raised eyebrows. Instead, initially skeptical investors, like J.P. Morgan, lined up for opportunities, and Masayoshi Son of Softbank jumped on board with the Series G and had a wild and expensive ride.[49]

The story of Mr. Son's investment is apparently "famous."[50] Neumann spent only twelve minutes with Son touring the WeWork headquarters before reaching agreement on a $4.4 billion investment[51]—an investment for which Mr. Son has expressed regret.[52] Then, Neumann hopped into his white Mercedes-Maybach and, while his chauffeur drove, listened to rap and

45. Tweney, *supra* note 27.

46. Issie Lapowsky, *Believe It: Co-Working Space Startup WeWork Is Now Worth $5B*, WIRED (Dec. 16, 2014, 2:17 PM), https://www.wired.com/2014/12/wework-valuation/ [https://perma.cc/D9WM-YUXJ].

47. *Id.*

48. Sophia Kunthara, *WeWork May Reduce Its Valuation Ahead of IPO by Tens of Billions*, CRUNCHBASE (Sept. 5, 2019), https://news.crunchbase.com/news/wework-may-reduce-its-valuation-ahead-of-ipo-by-tens-of-billions/ [https://perma.cc/E5UR-7YHL].

49. *See* Katrina Brooker, *WeFail: How the Doomed Masa Son-Adam Neumann Relationship Set WeWork on the Road to Disaster*, FAST CO. (Nov. 15, 2019), https://www.fastcompany.com/90426446/wefail-how-the-doomed-masa-son-adam-neumann-relationship-set-wework-on-the-road-to-disaster [https://perma.cc/JC49-3PJL] (discussing the history of Son's investment in WeWork and relationship with Neumann).

50. Chozick, *supra* note 40.

51. *Id.*

52. *See* Feiner, *supra* note 14 (recounting that, in 2020, Son said his firm's multibillion investment in WeWork was "foolish").

enjoyed the win.[53] Many say that this investment and the opinion of Son, that Neumann should take on even more wild ideas, is part of what led to the WeWork downfall.[54] But, as Part III reveals, the board, the bankers, and others all played a role.

After the Softbank investment, Neumann's grandiosity accelerated. He wanted to be the world's first trillionaire.[55] He wanted to be president of the world.[56] He started WeLive, a concept for short-term apartment rentals—but framed them as places that would "drive down suicide rates because 'no one ever feels alone.'"[57] He described the WeGrow school and a plan to "shelter the world's orphans" and "give them a new family: the WeWork family."[58] "There was talk of a WeBank, WeSail, WeSleep, [and] an airline."[59] And still the money came in and talk of an IPO grew.

The IPO, however, was the financial undoing of WeWork. The antics and choices, the burn rate, the conflicts of interest, and the lack of hope for profitability all became public—though not until after the bankers had floated a huge valuation with an "incoheren[t]" prospectus and were forced to pull it back.[60] The business model, long-term leases on real estate that was renovated and rented with short-term leases—i.e., no long-run predictability of revenues—was always flawed. Initial valuations for the IPO were in the $40–50 billion range, and even when dropped to $10 billion, the company discovered it had no buyers.[61] This was the point at which publicness met WeWork and its governance choices head on.

Although the wheels came off the WeWork bus at the time of the IPO, the seeds of its crash were planted much earlier. The culture inevitably produced allegations like those at Uber: of discrimination and a "frat-boy culture."[62] Neumann's chief of staff claimed she was demoted and fired for being pregnant and raising concerns about Neumann turning the company jet into a "hotbox" filled with marijuana smoke.[63] Another lawsuit included

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53. Chozick, *supra* note 40.

54. Brooker, *supra* note 49.

55. Chozick, *supra* note 40.

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. Joshua Franklin & Anirban Sen, *WeWork Delays IPO After Frosty Investor Response*, REUTERS (Sept. 16, 2019, 5:26 PM), https://www.reuters.com/article/us-wework-ipo/wework-delays-ipo-after-frosty-investor-response-idUSKBN1W12T6 [https://perma.cc/G7WJ-DJMM].

62. Gaby Del Valle, *A WeWork Employee Says She Was Fired After Reporting Sexual Assault. The Company Says Her Claims Are Meritless*, VOX, https://www.vox.com/the-goods/2018/10/12/17969190/wework-lawsuit-sexual-assault-harassment-retaliation [https://perma.cc/92TU-429D].

63. Chozick, *supra* note 40.

claims of sexual assault at a work event and groping at the summer camp.[64] According to the complaint, both incidents were reported to H.R. and neither resulted in discipline to the men involved.[65] The company later stated, without admitting anything, that such behavior would not be tolerated,[66] but the problem was that the "culture" of WeWork was the product of the corporate adolescence and cult of personality our "regulatory" regime has promoted.

WeWork grew because it was the beneficiary of the "private" offering regime and a tech "unicorn" bubble in which the market encouraged companies with huge burn rates and behavior that, in the public space, would not have been acceptable. When the venture capital investors, who had put more than $12 billion into WeWork, wanted to cash out and Masayoshi Son's cash infusions stopped, "Neumann was blindsided[.]"[67] It appears that although he may not have understood the potential for the party to stop, he did understand the value of the privilege with which he was operating. But, without cash to support the burn, Neumann who "never wanted to go public . . . [and] wanted to remain private so he could do whatever the fuck he wanted[,]" yielded to the pressure to go public—or at least tried to do so.[68]

Unfortunately for Neumann, the market's interest in and tolerance for companies based on ideas that might generate cash but not profits had waned. Uber's offering was a huge disappointment to investors.[69] Another company with a culture of corporate adolescence, Uber had faced a series of scandals that, because its founder, Travis Kalanick, retained control, had been consistently ignored—that is, until the company's board finally bowed to publicness and pressure. A venture capital director who had made sexist comments resigned,[70] Kalanick was pushed out (and paid off), and a new

64. Del Valle, *supra* note 62.

65. Charge of Discrimination at ¶¶ 66, 71, 73, 75, 79, Bardhi v. WeWork (E.E.O.C. N.Y. 2019), http://www.wigdorlaw.com/wp-content/uploads/2019/10/Bardhi-v.-WeWork-Filed.pdf [https://perma.cc/S4G4-MSMD].

66. David Yaffe-Bellany, *WeWork's Ousted C.E.O. Adam Neumann Is Accused of Pregnancy Discrimination*, N.Y. TIMES (Oct. 31, 2019), https://www.nytimes.com/2019/10/31/business/wework-neumann-discrimination-complaint.html [https://perma.cc/255S-6SGS].

67. Sherman, *supra* note 32.

68. *Id.*

69. Maureen Farrell, *2019: The Year of IPO Disappointment*, WALL ST. J. (Dec. 29, 2019, 5:30 AM), https://www.wsj.com/articles/2019-the-year-of-ipo-disappointment-11577615400 [https://perma.cc/VRZ7-YQQV].

70. Mike Isaac & Susan Chira, *David Bonderman Resigns from Uber Board After Sexist Remark*, N.Y. TIMES (June 13, 2017), https://www.nytimes.com/2017/06/13/technology/uber-sexual-harassment-huffington-bonderman.html [https://perma.cc/DV4C-243H].

CEO, with a strong positive and public company reputation, Dara Khosrowshahi, was installed.[71]

Khosrowshahi's job was to clean up Uber and manage the company through an IPO.[72] He did so, but with mixed results. He began with apologies and statements about the commitment to a changed culture, one that would not tolerate sexual harassment and law breaking in the core of the business.[73] He used words like "trust" and stressed the choices the company was now making to, arguably, grow up and understand its publicness and social license.[74] Although the scandals played a significant role in pressuring a cultural shift, both Uber and WeWork craved cash. Cash is king in a company with a high burn rate, and as the private money dries up, IPO pressure increases. Eventually, Khosrowshahi did take Uber public, but the private "value" of the company never materialized. The offering price, $45.00 per share, was well below the company's private valuations, and before the pandemic hit, Uber's stock was trading only at $41.00 per share.[75]

Whether the same will be true for WeWork remains to be seen.[76] Its attempted IPO failed in a very public fashion, resulting in considerable media coverage about the adolescent antics of its founders, its conflicted structure, and the lack of corporate governance controls, to which we return in Part III.

## II. The Potential Pathologies of Start-Up Capital Raising

The WeWork story shows what can happen within the domain of corporate adolescence, but not whether it is commonplace enough to worry deeply about. Surely most start-ups are not so immature. And even if the risk of such behavior is worrisome, the conventional venture finance narrative

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71. Davey Alba, *A Short History of the Many, Many Ways Uber Screwed Up*, WIRED (June 21, 2017, 2:42 PM), https://www.wired.com/story/timeline-uber-crises/ [https://perma.cc/9VNX-9NN7]; Mike Isaac, *With Uber's I.P.O., Dara Khosrowshahi Is Taking Travis Kalanick's Company Public*, N.Y. TIMES (May 3, 2019), https://www.nytimes.com/2019/05/03/technology/uber-ipo-ceo-dara-khosrowshahi-travis-kalanick.html [https://perma.cc/3QLQ-UAXG].

72. Isaac, *supra* note 71.

73. *See id.* (discussing Khosrowshahi's role in cleaning up Uber's culture under Kalanick that enabled a "pileup of scandals among Uber employees—from sexual harassment charges to systematically evading law enforcement").

74. *See* Geoffrey A. Fowler, *I Was Team #DeleteUber. Can Uber's New Boss Change My Mind?*, WASH. POST (May 11, 2018, 11:13 AM), https://www.washingtonpost.com/news/the-switch/wp/2018/05/11/i-was-team-deleteuber-can-ubers-new-boss-change-my-mind/ [https://perma.cc/3DJU-7FPU] (discussing an interview with Khosrowshahi where he states that Uber has a "trust" problem, which he remediated in Uber's new motto, "We do the right thing, period").

75. Mike Isaac, Michael J. de la Merced & Andrew Ross Sorkin, *How the Promise of a $120 Billion Uber I.P.O. Evaporated*, N.Y. TIMES (May 15, 2019), https://www.nytimes.com/2019/05/15/technology/uber-ipo-price.html [https://perma.cc/E9TJ-ZXH4].

76. WeWork remains an operating company with considerable presence in the shared office space marketplace, but without the mythology that drove its ambitions. What we describe here is a financial implosion, not (yet) its failure, as a going concern.

predicts that it should be self-correcting: bad experiences like these will teach funders a lesson that they would be foolish not to learn from, and their reputational interests will incentivize them to take interest. We pause here to address these two arguments.

When VCs finance a high-potential start-up, they only fund enough to get the company moving toward success,[77] at which point the start-up must obtain a second round of financing, mostly from new sources of money, and then a third, and so on. (Seven or eight rounds would not be unusual today.) There is a high-powered incentive to make it up each step of the ladder, with regular scrutiny of the value of the firm at this still early stage. The founders feel this sharply; so do the funders who have sunk so much money in an earlier round. With growing evidence of success, the founders and early funders can hold onto more of the enterprise; with troubles, that may be hard. Those investors who have tied their fortunes to the founder do not want to mess with what appears (in myth or reality) to be the firm's best shot.

### A. *Behavioral Agency Costs*

*1. Edgy Behavior.*—Our quick overview of high-tech start-up financing gives ample reasons to explain why founders will often find themselves shading the truth to stand out. The initial pitch requires aggressive claims of an ability to achieve promised results; after that, their feet are to the fire through the search for new rounds of investment. The risk of failure is palpable—most start-ups do not survive the gauntlet.

The temptation to dissemble in such high-stakes, high-expectations environments would be natural for most people and most organizations.[78] "Motivated inference" is the general phenomenon by which people exploit the moral wiggle-room of ambiguity about both reality and expectations—reality in terms of the enterprise being pitched; expectations about what to say or do (or not say or do). Early-stage ventures reek of uncertainty, which can support inflated optimism that may be in good faith but not necessarily

77. *See* Darian A. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1410–11 (2008) (describing the "staging" of sequential rounds of investment by venture capitalists and other providers of start-up capital). On the considerations that go into VC decision making, see generally Paul A. Gompers, Will Gornall, Steven N. Kaplan & Ilya A. Strebulaev, *How Do Venture Capitalists Make Decisions?*, 135 J. FIN. ECON. 169 (2020).

78. *See generally* Yuri Mishina, Bernadine J. Dykes, Emily S. Block & Timothy G. Pollock, *Why "Good" Firms Do Bad Things: The Effects of High Aspirations, High Expectations, and Prominence on the Incidence of Corporate Illegality*, 53 ACAD. MGT. J. 701 (2010) (finding empirically that a firm's "prominence" and "high-performance" above internal and external expectations in the past might increase its propensity to engage in illegal behavior in the future).

warranted.[79] Gradually, and down a very slippery slope of self-deception along with the deception of others, representations about the venture's progress take on a life of their own.[80] If there are conscious doubts about the project in its early stages, ambiguity about disclosure norms can provide comfort. Many people feel justified in leaving out troubling details from a statement otherwise technically true,[81] even though half-truths are fraudulent as a matter of law.[82] This is where the perception (if not reality) of prevailing norms can be summoned to duty for good cause: success of the project. Some version of "everyone does it" enables those with brilliant hopes and dreams to fake it with the expectation that all will be forgiven or forgotten when they make it.

Certain situational pressures abundant in start-ups increase the likelihood of dishonesty.[83] Loss aversion is the tendency of people to take greater risks to avoid losing what they possess relative to what they would take when seeking to gain precisely the same thing; once started and financed, threats are filtered through a loss frame.[84] Cognitive stress and physical

79. For how this can take the form of conscious rationalization by entrepreneurs, see Elizabeth Pollman, *supra* note 2, at 383–86, or for a more pernicious form of self-deception whereby the entrepreneur is firmly convinced of the rightness, and righteousness, of what he or she says or thinks, see DONALD C. LANGEVOORT, SELLING HOPE, SELLING RISK: CORPORATIONS, WALL STREET, AND THE DILEMMAS OF INVESTOR PROTECTION 26–28, 38–41 (2016) (describing various forms of self-deception common in business practice).

80. For an in-depth explanation of legitimacy lies, see generally Vasilis Theoharakis, Seraphim Voliotis & Jeffrey M. Pollack, *Going Down the Slippery Slope of Legitimacy Lies in Early-Stage Ventures: The Role of Moral Disengagement*, J. BUS. ETHICS (Apr. 20, 2020), https://doi.org/10.1007/s10551-020-04508-2 [https://perma.cc/4LUS-3369].

81. *See* Todd Rogers, Richard Zeckhauser, Francesca Gino, Michael I. Norton & Maurice Schweitzer, *Artful Paltering: The Risks and Rewards of Using Truthful Statements to Mislead Others*, 112 J. PERSONALITY & SOC. PSYCH. 456, 456–57 (2017) (identifying and explaining "paltering"—making truthful statements to create a mistaken impression—as a distinct form of deception). *See also* Christina Bicchieri & Eugen Dimant, *It's Not a Lie If You Believe It: Lying and Belief Distortion Under Norm-Uncertainty* 4 (Philosophy, Politics & Econ., Univ. Pa., PPE Working Paper No. 0012, 2018) (exploring how normative uncertainty shapes whether individuals lie or not).

82. *See* Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1951) ("It shall be unlawful for any person . . . to make any untrue statement of a material fact or to omit to state a material fact . . . in connection with the purchase or sale of any security.").

83. *See* Theoharakis et al., *supra* note 80 (documenting how factors like financial distress, moral intensity, and obsessive passion can lead to moral disengagement and the telling of lies). For further discussion of ethics in the start-up arena, see generally Robert Cressy, Douglas Cumming & Christine Mallin, *Entrepreneurship, Governance and Ethics*, 95 J. BUS. ETHICS 117 (2010) (highlighting several works exploring this area); Jared D. Harris, Harry J. Sapienza & Norman E. Bowie, *Ethics and Entrepreneurship*, 24 J. BUS. VENTURING 407 (2009) (reviewing and classifying research connecting ethics and entrepreneurship).

84. Scott Rick & George Loewenstein, *Hypermotivation*, 45 J. MARKETING RES. 645, 645 (2008).

tiredness make misrepresentation more likely.[85] What starts out as innocent becomes a trap as the adverse consequences of telling the truth grow.

That much applies to just about anybody in those circumstances.[86] But those who choose to become entrepreneurs have dispositions that can make them more susceptible than most. A body of specialized research exists about entrepreneurial psychology, suggesting that start-up founders have greater-than-normal tendencies toward self-efficacy, self-assurance, autonomy, power, and independence.[87] They are often highly intense and creative "think outside the box" people. And even though each of these traits is an attractive one in terms of who we think of as likely to succeed, each is also associated with a higher risk of the kind of ethical risk-taking referred to earlier. Danny Miller, a noted organizational psychologist who focuses on entrepreneurs, refers to this as the "Janus face" problem.[88] The adulation of the good face obscures the heightened risk of the bad. In other words, the hyper-creative looks outside the lines for opportunities and so discovers value; he (or less likely, but not impossibly, she) also ignores lines that are not supposed to be crossed.[89] Somewhat provocatively, one econometric study of entrepreneurs suggests a combination of high cognitive ability and a history of illicit adolescent behavior correlates with later success in this rough and tumble world.[90]

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85. *See* Theoharakis et al., *supra* note 80 (discussing individual "entrepreneurial stress" caused by the struggle for resources and support as a cause of "moral disengagement" and entrepreneurial deception).

86. *See* Rick & Loewenstein, *supra* note 84, at 645 (describing general studies of how loss aversion often produces "hypermotivation," a visceral state that leads people to take actions that they would normally deem unacceptable).

87. *See, e.g.*, Danny Miller, *A Downside to the Entrepreneurial Personality?*, 39 ENTREPRENEURSHIP THEORY & PRAC. 1, 2 (2015) (discussing the "special type of individual" needed to meet the demands of entrepreneurship). Many of these can be bundled into what is the most widely recognized bias of successful businesspeople: overconfidence. *See generally* David Hirshleifer, Angie Low & Siew Hong Teoh, *Are Overconfident CEOs Better Innovators?*, 67 J. FIN. 1457 (2012) (finding that overconfident CEOs achieve more innovative success); *see also* LANGEVOORT, *supra* note 79, at 27 (noting how managerial overconfidence and overoptimism bring additional innovation).

88. Miller, *supra* note 87, at 2.

89. *See generally* Francesca Gino & Dan Ariely, *The Dark Side of Creativity*, 102 J. PERSONALITY & SOC. PSYCH. 445 (2011) (finding through empirical studies that creative thinkers and those who think "outside the box" are more likely to behave dishonestly and find ways to justify their behavior).

90. *See* Ross Levine & Yona Rubinstein, *Smart and Illicit: Who Becomes an Entrepreneur and Do They Earn More?*, 132 Q.J. ECON. 963, 965 (2017) (noting that those who become incorporated business owners "tend to be more educated and—as teenagers—score higher on learning aptitude tests, exhibit greater self-esteem, reveal stronger sentiments of controlling their futures, and engage in more illicit activities than others").

*2. Youth.*—If entrepreneurs are generally more disposed toward risky behaviors, then the young entrepreneurs who have such a claim on the public's fascination presumably inhabit an even higher behavioral risk category. To be clear, we are not claiming that young founders dominate the start-up world. One study shows that the average age of a successful founder is in the early-to-mid 40s, often after one or more unsuccessful tries.[91] But the authors of that study acknowledge that young founders are a significant presence in the start-up world and may be even preferred by many venture capitalists.[92] They generate a powerful mythology.

Entrepreneurs in their 20s and early 30s are, presumably, more likely than their elders to exhibit the kinds of adolescent and post-adolescent behaviors—impulsiveness, aggressiveness, and the propensity to challenge norms. Those given millions of dollars in early-round funding have their self-esteem validated before ever having struggled to succeed and are prone to compensate for the reality that they may be in over their head with grandiose expressions of self-efficacy. Putting aside for a moment their VC handlers on the board of directors, they are likely to be surrounded by similarly young cohorts with a resulting echo chamber in terms of exuberance and confidence. If given a long (or no) leash, they may be especially creative, intense, and motivated, but undisciplined. Not having much in the way of experience to draw from in knowing which lines are meant to be challenged or not, they may convince each other that all lines are suspect or to be ignored.

Because of the closed-in, secretive nature of early-stage ventures, this is a hard proposition to test empirically. With respect to public companies, CEO age is associated with a higher risk appetite among males[93] and greater competitiveness.[94] CEO behavior (on the job and private), in turn, has a viral effect on the rest of the team of employees, signaling that ethical aggression is indeed the way to get ahead.[95] In other words, the youthful organization as

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91. Azoulay et al., *supra* note 2, at 72–73.

92. *Id.* at 66.

93. Matthew A. Serfling, *CEO Age and the Riskiness of Corporate Policies*, 25 J. CORP. FIN. 251, 256–58 (2014); Jarrko Peltomäki, Jukka Sihvonen, Steve Swidler & Sami Vähämaa, Age, Gender, and Risk-taking: Evidence from the S&P 1500 Executives and Market-Based Measures of Firm Risk (forthcoming) (manuscript at 15–16), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2547516 [https://perma.cc/G9HP-PKHH].

94. *See* Maurice Levi, Kali Li & Feng Zhang, *Deal or No Deal: Hormones and the Mergers and Acquisitions Game*, 56 MGMT. SCI. 1462, 1465–66, 1476 (2010) (using CEO age as proxy for male hormone-driven behavior and finding that younger CEOs tend to be more combative); Soojin Yim, *The Acquisitiveness of Youth: CEO Age and Acquisition Behavior*, 108 J. FIN. ECON. 250, 260 (2013) (finding that younger CEOs have a higher propensity to engage in acquisitions).

95. *See* Lee Biggerstaff, David C. Cicero & Andy Puckett, *Suspect CEOs, Unethical Culture, and Corporate Misbehavior*, 117 J. FIN. ECON. 98, 99 (2015) (finding that executives with questionable behavior often lead their firms to engage in broader corporate malfeasance). On off-the-job behavior, see *Why Boards Should Worry About Executives' Off-the-Job Behavior*, HARV.

a whole is arguably more susceptible to inflated entitlement precisely because of its collective naiveté.

*3. Gender.*—By all accounts, the world of high-tech start-up capital-raising has a diversity problem, including massive gender inequality. Stories of hostile work environments abound. Despite evidence that female start-ups are more successful than those of their male counterparts,[96] in 2017, for example, venture capitalists put thirty-five times more money into male-founded start-ups than female-founded ones; while the total number of male-founded start-ups financed was sixteen times the number of female-founded ones.[97] The venture capital industry itself is heavily male-dominated. The reasons are many, no doubt, for this situation. While there is some evidence showing willingness to hear diverse pitches,[98] VCs may well be using stereotypical heuristics for deciding what constitutes promise—mental images of the aggressiveness and single-minded intensity it takes to succeed that generate a natural gender bias in funding choices.[99] The gross gender imbalance in an industry where connections and networks matter is bound to be self-perpetuating and slow to change. And the supply of talented women is truncated by stereotypes and bias all along the career progression, so that the pool of women entrepreneurs is smaller than it should be.

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BUS. REV., Jan.–Feb. 2020, at 17, 18, 20 (finding that firms that submitted fraudulent financial statements to the SEC were more likely to have CEOs with a legal record than a control group, and that factors like materialism and socially-irresponsible behavior in corporate leaders' personal lives were correlated to fraudulent business activities); Tom C.W. Lin, *Executive Private Misconduct*, 88 GEO. WASH. L. REV. 327, 329 (2020) (exploring the "convergence of the private lives and public consequences of executive personal misbehavior").

96. *See* Katie Abouzahr, Matt Krentz, John Harthorne & Frances Brooks Taplett, *Why Women-Owned Startups Are a Better Bet*, BOS. CONSULTING GRP. (June 6, 2018), https://www.bcg.com/publications/2018/why-women-owned-startups-are-better-bet [https://perma.cc/2YJP-3TGG] (finding that start-ups founded and co-founded by women generated 78 cents for every dollar of funding, while those founded by men produced only 31 cents per dollar).

97. Will Gornall & Ilya A. Strebulaev, Gender, Race and Entrepreneurship: A Randomized Field Experiment on Venture Capitalists and Angels 2 (Dec. 16, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3301982 [https://perma.cc/WQ2V-HYRL]. One argument in favor of a liberalized crowdfunding exemption was that the "crowd" would be more open to diversity in founders of start-ups. There is some evidence to support that hope as to women founders. *See* Andrew A. Schwartz, *Crowdfunding Issuers in the United States*, 61 WASH. U. J.L. & POL'Y 155, 170–71 (2020) (finding at least twenty-eight percent of crowdfunded start-ups had at least one woman on their executive team—nearly double the rate in the venture capital market).

98. *See* Gornall & Strebulaev, supra note 97, at 1 (presenting research findings that female-crafted VC pitches do not encounter discrimination).

99. *See* Kamal Hassan, Monisha Varadan & Claudia Zeisberger, *How the VC Pitch Process Is Failing Female Entrepreneurs*, HARV. BUS. REV. (Jan. 13, 2020), https://hbr.org/2020/01/how-the-vc-pitch-process-is-failing-female-entrepreneurs [https://perma.cc/8T8M-WJCN] (noting empirical evidence that men are seen as performing better in pitches, and that male "overconfidence and bluster" may be a "misunderstood strength").

Whatever the precise cluster of reasons for the bias, male domination is likely to amplify the risky and aggressive traits and behaviors predicted above. By some combination of hormones and role socialization, men are more likely to cheat than women in group settings.[100] From this, one might presume that early-stage start-ups too often offer, among many other things, an intense male bonding experience that trumps truth-telling.

### *B. Downstream Agency Costs*

In the conventional account of start-up finance, VC and other funders bargain for sufficient control rights to enable close monitoring of risky behaviors by founders and their teams. There is ample evidence of founders being deposed as CEOs by funder-dominated boards.[101] So in theory, the tendencies described above should be kept in check.

But that depends on funder bargaining power at each stage of financing, and by many accounts, the last decade (at least) has been marked by a shift in power to the founder. There are more non-traditional sources of capital to compete with the well-known VC firms, placing considerable limitations on what they can demand from founders with good ideas.[102] Neither VCs nor private equity funders want a reputation for being overbearing, which might hurt when competing for the next hot deal.[103] New money sloshes around over the course of all the financing rounds, a reason start-ups can stay private

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100. *See* Gerd Muehlheusser, Andreas Roider & Niklas Wallmeier, *Gender Differences in Honesty: Groups Versus Individuals*, 128 ECON. LETTERS 25, 28 (2015) (documenting group level effects in experimental settings).

101. *See, e.g.*, Gompers et al., *supra* note 77, at 171 (noting a study finding that only one-third of VC-backed companies still have a founder as CEO at the time of an IPO). That said, one reason given for VC preference for youthful founders is that they might not drive as hard a bargain out of inexperience. *See* Azoulay et al., *supra* note 2, at 66, 78–79 (discussing how younger entrepreneurs have more difficulty accessing capital and noting that VCs prefer to invest in start-ups with young founders because these founders tend to sell their equity at lower prices).

102. Lerner & Nanda, *supra* note 3, at 244, 252. Many investors that once participated in venture capital via investments in venture capital funds now invest directly, which they treat as a major disruption of conventional venture finance. *Id.* One major change has been the growth in size and influence of corporate venture capital (e.g., captive funds deployed via investments in start-ups that could benefit the corporate owner of the fund in various ways). *See* Jennifer S. Fan, *Catching Disruption: Regulating Corporate Venture Capital*, 2018 COLUM. BUS. L. REV. 341, 375–76 (2018) (noting how the "dramatic increase in corporate venture capital activity contributed to the mind-boggling valuations of private companies" and their ability to stay private for longer).

103. Lerner & Nanda, *supra* note 3, at 252 (describing a "pattern" of founder friendly behavior that "has been especially true in the last few years, given the proliferation of . . . non-traditional investors such as SoftBank, sovereign wealth funds, and corporations," and noting that "[i]n an intensely competitive market, some venture capital firms may be tempted to pitch entrepreneur-friendly contracts to founders in an attempt to get access to the most attractive deals . . . [and] outdo each other in the extent of their hospitality toward company founders").

longer to capture as much of the upside potential as possible for founders and early funders before exit.[104]

This leads to mixed incentives, especially (as with SoftBank and WeWork) for later investors who are willing not only to buy new rounds of equity from the issuer, but also let earlier funders cash out, at least partially, in the same transaction. Monitoring via internal controls can be costly, which is of concern because start-ups tend to be cash poor and motivated to spend precious capital on that which demonstrates tangible progress. Better governance devices might seem a luxury early on, especially to entrepreneurs new to the business world, and quickly become a form of deferred maintenance.

There are also mixed incentives that come from the frequent re-valuations that accompany each new round of financing. Start-ups are naturally hard to value because they are so speculative, which is problematic in and of itself since relative power and control rights shift at each funding round. That creates an incentive for the creation of good news and the suppression of bad, which need not necessarily suggest fraud but, as discussed earlier, produces biased perceptions.[105] Whether VCs or other early-stage funders have an incentive to expose risks and shortfalls via heavy monitoring is questionable, suggesting some slack. Knowing too much can be dangerous. Sophisticated funders will understand this, but may nonetheless be limited by competitive pressures from the increasingly diverse funding sources, especially at the later stages.[106] With larger and larger sums of money in the hands of competing later-round funders like private equity firms, hedge funds, and even mutual funds, bidding wars can ensue to reveal who has the most optimistic (not realistic) valuation—the so-called winner's curse.[107] There is no good way of betting against the company on the short-side, as there is in more well-developed financial markets.[108] Bubbles can result that no one has a strong incentive to pop by looking too closely for misbehavior in the face of apparent progress.

104. *See* Fan, *supra* note 4, at 637 & n.322 (discussing unicorns' ability to raise massive funding rounds and thus avoid public pressure to IPO).

105. *See supra* notes 78–90 and accompanying text.

106. *See supra* notes 102–04 and accompanying text.

107. *See* Fan, *supra* note 102, at 375–76 (discussing the proliferation of "tourist investors" like hedge funds and mutual funds in the venture capital space).

108. *See* Jesse M. Fried & Jeffrey N. Gordon, *The Valuation and Governance Bubbles of Silicon Valley*, COLUM. L. SCH.: BLUE SKY BLOG (Oct. 10, 2019), https://clsbluesky.law.columbia.edu/2019/10/10/the-valuation-and-governance-bubbles-of-silicon-valley/ [https://perma.cc/6R8B-A2QU] (discussing how the rise of index funds has lowered the cost of short-selling in public equity markets, while the current VC ecosystem does not allow any way to "short" overvalued start-ups).

We leave to others further exploration of the directly conflicting interests among founders and multi-round funders that this valuation uncertainty produces and the wide array of contractual responses.[109] The less well-appreciated conflicts story, among legal academics at least, faces in a different direction: the conflicts (and incentive to inflate values) arising from the relationship between funders and their own upstream suppliers of capital. Nearly all the funders, from VC to later-round funders, are themselves managing other peoples' money.[110] The VC, for example, will have a set of limited partners—institutions like pension funds, university endowments, etc.—who contribute most of the capital to be invested in a range of start-ups, hoping for a few big scores. The fund manager is compensated with sizable fees, often combining ongoing management fees and high-powered incentive fees. The asset base on which the periodic fees are calculated is based on current valuations—commonly, the price set at the latest round. In this sense, the VC gets a tangible payoff from an inflated valuation even if, later on, the bubble deflates. In a widely-noted article published recently, two financial economists criticized the industry for basing reported valuations on the most recent round's price without adjustment for the special rights and privileges of pre-existing classes—a practice that they say inflates later-round private share values by nearly 50% compared to a more rigorous econometric method.[111] In a recent SEC advisory, the staff observed that failures to value private funds' holdings in accordance with the disclosed

109. *See, e.g.*, Pollman, *supra* note 4 (analyzing the unique governance and monitoring issues that persist through the life cycle of a start-up). In the WeWork story, it was notable that SoftBank's large later-stage investment came with a ratchet clause that promised to increase its equity in the event of an exit at a lower valuation than anticipated at the time of its investment, protecting it at the expense of other funders. *See* John C. Coffee, Jr., *Toxic Unicorns: What Has Been Missed About WeWork's Fiasco*, COLUM. L. SCH.: BLUE SKY BLOG (Nov. 6, 2019), https://clsbluesky.law.columbia.edu/2019/11/06/toxic-unicorns-what-has-been-missed-about-weworks-fiasco/ [https://perma.cc/9FV9-A54L] (observing that WeWork's dilution of others was not clearly disclosed even in the public offering documents filed with the SEC).

110. On the conflicts and incentives associated with managed investment portfolios, see generally Anita K. Krug, *Downstream Securities Regulation*, 94 B.U. L. REV. 1589 (2014) (arguing that lack of oversight in the downstream securities market has created a multitude of harms to investors); John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228 (2014) (arguing that the unique organizational structure of investment funds presents unique contractual and regulatory problems); James C. Spindler, *How Private Is Private Equity, and at What Cost?*, 76 U. CHI. L. REV. 311 (2009) (exploring the agency costs between limited partner investors and general partner managers); Luigi Zingales, *The Future of Securities Regulation*, 47 J. ACCT. RES. 391 (2009) (discussing investor perceptions that they have been defrauded by unaccountable managers).

111. Will Gornall & Ilya Strebulaev, *Squaring Venture Capital Valuations with Reality*, 135 J. FIN. ECON. 120, 120 (2020); *see also* Yves Smith, *Fake 'Unicorns' Are Running Roughshod over the Venture Capital Industry*, N.Y. MAG. (Nov. 14, 2018), https://nymag.com/intelligencer/2018/11/fake-unicorns-are-running-over-the-venture-capital-industry.html [https://perma.cc/EHH9-RTMR] (discussing the Squaring Venture Capital Valuations with Reality study).

valuation process have led to overcharging management fees and carried interest based on inappropriately overvalued holdings.[112]

Just as concerning are the effects of bubbles on the attraction of investors to new funds being sponsored by the VCs and later-round asset managers. These portfolio managers should be somewhat disciplined by the fact that they raise new rounds of capital as earlier portfolios age out—the failure to achieve real returns, not just inflated valuations, should be noticed by savvy investors looking for talented money managers. That discipline does exist for highly reputable funds that cater to savvy investors.[113] But not all sources of private capital seem to figure that out, and so there are opportunities for new fund-raising to high points in valuation, and of obscuring actual performance at the end of a fund's run so that comparative success or failure is hard to parse out for any but the most astute.[114] The emergence of mutual funds, with their large numbers of retail investors, as major funders has underscored this particular problem because they are constantly in search of new money.[115]

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112. The SEC's Office of Compliance Inspections and Examinations recently issued a list of the kinds of conflicts of interest it has observed, including valuation biases. OFFICE OF COMPLIANCE INSPECTIONS & EXAMINATIONS, RISK ALERT: OBSERVATIONS FROM EXAMINATIONS OF INVESTMENT ADVISERS MANAGING PRIVATE FUNDS 2–4 (June 23, 2020), https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf [https://perma.cc/85DA-3GNS].

113. *See* Gregory W. Brown, Oleg R. Gredil & Steven N. Kaplan, *Do Private Equity Funds Manipulate Reported Returns?*, 132 J. FIN. ECON. 267, 267–68 (2019) (demonstrating the incentive for lower reputation funds to distort earnings but suggesting that on average they do not succeed due to investor sophistication).

114. *See* Ranko Jelic, Dan Zhou & Wasim Ahmad, *Do Stressed PE Firms Misbehave?*, 66 J. CORP. FIN (forthcoming 2021) (discussing the tendency of private equity firms to inflate net asset values during fundraising campaigns and time fundraising to coincide with periods when the current portfolio performance is at its peak). On the incentives to obscure directed at those who invest in venture capital, see generally Indraneel Chakraborty & Michael Ewens, *Managing Performance Signals Through Delay: Evidence from Venture Capital*, 64 MGMT. SCI. 2875 (2018) (finding that venture capitalists hide actions from their investors until after new funds are raised); in private equity funds, see generally Brad M. Barber & Ayako Yasuda, *Interim Fund Performance and Fundraising in Private Equity*, 124 J. FIN. ECON. 172 (2017) (finding that general partners in private equity firms strategically time fundraising to match periods of peak performance, especially lower reputation firms); Ludovic Phalippou, *Beware of Venturing into Private Equity*, 23 J. ECON. PERSP. 147 (2009) (arguing that agency problems and opaque structuring fool many investors into believing private equity firms enjoy above-average performance).

115. *See* Jeff Schwartz, *Should Mutual Funds Invest in Start Ups?: A Case Study of Fidelity Magellan Fund's Investments in Unicorns (and Other Start-ups) and the Regulatory Implications*, 95 N.C. L. REV. 1341, 1371 (2017) (noting incentives for mutual fund managers to inflate asset values as a means of attracting new investors); Serge Chernenko, Josh Lerner & Yao Zeng, *Mutual Funds as Venture Capitalists? Evidence from Unicorns* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 18-037, 2017) (describing mutual funds' concerns that liquidity issues will result in the loss of investors). The SEC recently proposed a good faith rule on the valuation of private investments by mutual funds. Good Faith Determinations of Fair Value, Investment Company Act Release No. 33,845, 85 Fed. Reg. 28,734 (proposed Apr. 21, 2020) (to be codified at 17 C.F.R. pts. 210, 270).

We have only scratched the surface here, hopefully enough to add to the list of reasons why heavy monitoring might be in decline and the conventional monitoring model of venture finance under stress. Presumably, sophisticated upstream suppliers of capital will understand the conflicts, seek out the intermediaries with good reputations, and insist on transparency and protection. But less diligent investors will increasingly be subject to attraction to segments of the private markets via sales savvy as much or more than evidence of skill and loyalty,[116] so that the conflicts of interest become all the more pernicious.[117] How this works out in contemporary venture financing is still only dimly understood because of lack of transparency but surely raises doubts about the assumption that upstream investor diligence offers a dependable check on founder overreaching as funders become more diverse in interests and incentives, and compete with each other for the allotments they lust over for more reasons than appear at first glance.

## III. The WeWork Story, Part 2: Culture of Conflicts

We now resume our case study of WeWork, where the hypermotivation and agency costs associated with corporate adolescence appeared to contribute to the culture of conflicts and the lack of internal controls. From the self-interested transactions, to the taking of corporate opportunities, to the personal loans and nepotism, the array of conflicts was considerable and implicated not just Neumann and his family but members of the board and the investment bankers as well.

Neumann embodied all of the adolescent characteristics described in Part II. He was bold, young, and male, and he had conflicts of every sort. He owned stakes in buildings leased to WeWork.[118] He sold the trademark "We,"

116. For a discussion on the wide variety of financial products that straddle the line between public and private, see Sun Eun (Summer) Kim, *Typology of Public-Private Equity*, 44 FLA. ST. U. L. REV. 1435, 1438–39 (2017) (sorting public–private equity into three different broad types—(1) funds that allow the public to purchase shares of private fund managers and advisers; (2) funds that allow the public to purchase shares directly of a private equity fund; and (3) funds that are a combination of types one and two).

117. Of particular concern here are public pension funds, whose asset managers may be insulated from competitive pressures. *See* William W. Clayton, *Public Investment, Private Funds, and State Law*, 72 BAYLOR L. REV. 294, 353 (noting that market pressures from private funds are not present in "most public pension plans because investors are typically locked in"). Clayton points to SEC doubts about investor diligence in private equity, pointing to a speech by the SEC's director of the Office of Compliance Inspections and Examinations. *Id.* (citing Andrew J. Borden, Dir., Office of Compliance Inspections & Examinations, U.S. Sec. & Exch. Comm'n, Address at the Private Equity International Private Fund Compliance Forum: Spreading Sunshine in Private Equity (May 6, 2014), https://www.sec.gov/news/speech/2014—spch05062014ab.html [https://perma.cc/PAZ7-3AZT]).

118. We Co., Registration Statement Under the Securities Act of 1933 (Form S-1), 200 (Aug. 14, 2019), https://sec.report/Document/0001193125-19-220499/ [https://perma.cc/KVP5-EZMN] [hereinafter We Co. Registration Statement (Aug. 2019)].

to the company for $6 million dollars.[119] He had voting control over the company, and his wife had control over his replacement.[120] He was allowed to "sell and borrow more than $1 billion dollars against his WeWork stake."[121]

The corporate adolescent culture also allowed for the masking of conflicts as creativity. Consider WeGrow, the school the Neumanns built, with WeWork money, to educate their own children.[122] Whether through action or inaction, the board acquiesced in WeGrow, a school that had nothing to do with the business of the company—unless nurturing the entrepreneurial spirit of elementary school children connects to the core of an office leasing company. Rebekah Neumann was the CEO and opened WeGrow at WeWork headquarters in the fall of 2018.[123] The for-profit school cost $42,000 per year and offered yoga, mindfulness, Spanish, Mandarin, and Hebrew.[124] Like all WeWork projects, this one had its quirks, including that although parents were allowed into the family waiting room, nannies were required to wait outside.[125] Why? Apparently because Rebekah Neumann did not want her nannies inside.[126] In short, "'[t]he whole thing was about her and what was right for her children,' a person close to the school said."[127] Indeed, when the Neumanns relocated to San Francisco in the winter of 2019, they took a teacher from WeGrow with them[128]—a conflict within a conflict.

Adam Neumann also borrowed from the company—repeatedly. At one point, the total seemed to be over $740 million tied to his shares in the company.[129] He also had a low-interest loan from the company for $360 million that allowed him to exercise stock options *early*.[130] If the company

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119. Eliot Brown, *WeWork's Long List of Potential Conflicts Adds to Questions Ahead of IPO*, WALL ST. J. (Sept. 6, 2019, 6:26 PM), https://www.wsj.com/articles/weworks-long-list-of-potential-conflicts-adds-to-questions-ahead-of-ipo-11567808023?mod=article_inline [https://perma.cc/9CTL-GP8D]; We Co. Registration Statement (Aug. 2019), *supra* note 118, at 199.

120. We Co. Registration Statement (Aug. 2019), *supra* note 118, at 197–98.

121. Maureen Farrell & Eliot Brown, *The Money Men Who Enabled Adam Neumann and the WeWork Debacle*, WALL ST. J. (Dec. 14, 2019, 12:00 AM), https://www.wsj.com/articles/the-money-men-who-enabled-adam-neumann-and-the-wework-debacle-11576299616 [https://perma.cc/SU3P-9TBU].

122. Sherman, *supra* note 32.

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. Brown, *supra* note 119.

130. We Co. Registration Statement (Aug. 2019), *supra* note 118, at 199.

had been public, this loan would have been illegal—as a result of the IPO issues and other excesses that led to the Sarbanes Oxley Act in 2002.[131]

In addition, the company employed lots of "Neumanns." Rebekah was CEO of WeGrow and the Chief Brand and Impact Officer at WeWork.[132] Her brother-in-law was the Chief Product Officer.[133] Adam's brother-in-law ran the fitness part of the company.[134] The company also regularly used contractors and vendors owned by family of executives.[135] And the parents of the vice-chair of the real estate division were the real-estate brokers on a building lease in Miami.[136] Indeed, "[a]t an executive retreat in Montauk on Long Island, Mr. Neumann once raised a glass in a toast 'to nepotism,'" further exhibiting the total lack of controls or even appreciation for them.[137] No doubt, the nepotism contributed to the echo chamber of entitlement and confidence.

The board and investors also allowed Neumann to do something generally frowned upon in start-ups—when new money came in, Neumann sold his own stock and reaped profits.[138] He also restructured the company's voting stock in order to continue to maintain control.[139] Bruce Dunlevie, from Benchmark, pushed back, arguing that "absolute power corrupts absolutely."[140] Despite those concerns, the board voted unanimously to allow both the voting stock change and the stock sales.[141]

Neumann's voting control, like that of Mark Zuckerberg,[142] Travis Kalanick,[143] and others, meant that he had the power to oust dissenting voices

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131. *See* Sarbanes-Oxley Act § 402, 15 U.S.C. § 78m(k) (2018) (prohibiting public companies from making personal loans to executives).

132. We Co. Registration Statement (Aug. 2019), *supra* note 118, at 172, 197.

133. Brown, *supra* note 119.

134. *Id.*

135. *Id.* We had a lease with a building in Miami owned by the brother of Arash Gohari—We's co-head of real estate. *Id.*

136. *Id.*

137. Farrell & Brown, *supra* note 121.

138. *Id.*

139. When T. Rowe Price invested, Neumann restructured WeWork's stock so his shares had ten times the votes of a normal share. *Id.*

140. *Id.*

141. *Id.*

142. *See* Emily Stewart, *Mark Zuckerberg Is Essentially Untouchable at Facebook*, VOX (Dec. 19, 2018, 11:19 AM), https://www.vox.com/technology/2018/11/19/18099011/mark-zuckerberg-facebook-stock-nyt-wsj [https://perma.cc/YFJ6-233J] (noting that Facebook CEO, Mark Zuckerberg, owns shares that receive ten votes per share, controlling alone sixty percent of shareholder votes).

143. *See* Katie Benner, *How Uber's Chief Is Gaining Even More Clout in the Company*, N.Y. TIMES (June 12, 2017), https://www.nytimes.com/2017/06/12/technology/uber-chief-travis-kalanick-stock-buyback.html [https://perma.cc/C8JD-6W49] (noting that Uber's CEO, Travis Kalanick, owns "super-voting shares" that give him ten votes per share).

on the board. The early board had four people,[144] but even as it grew with new investors, rising to seven by the time of the S-1,[145] the culture of conflicts and Neumann's voting power remained. The directors gave Neumann that power but risked losing their seats and a view of the company in which they were invested—even though their legal role was as fiduciaries for the company and the other shareholders.

The conflicts were not limited to Neumann. Indeed, the terms "related parties" or "related party" appeared more than 100 times in the prospectus the company filed.[146] Consider the board member conflicts. WeWork employed the son of John Zhao, from the investor Hony Capital.[147] Dunlevie's daughter was also an employee.[148] Lew Frankfort, the former CEO of Coach, Inc., "borrowed from WeWork to buy stock and exercise some stock options early—a move typically made to save on taxes."[149] Steve Langman's private equity group, Rhône Group, became a co-manager of the WeWork real estate fund business and earned management fees and profits on any properties purchased.[150] Then, when WeWork expanded its own involvement in the real estate fund business, and Rhône's stake decreased, WeWork gave Langman restricted shares to make up for the changed business model.[151] In short, the culture bred conflicts at all levels, and because investors and board members alike were involved, no one had an incentive to say no.

144. The early board members were: Adam Neumann, Bruce Dunlevie (July 2012—Benchmark), M. Steven Langman (July 2012—Rhône), and Lewis (Lew) Frankfort (July 2014). We Co. Registration Statement (Aug. 2019), *supra* note 118, at 172–74.

145. In September 2019 the board consisted of: Adam Neumann, Bruce Dunlevie, M. Steven Langman, Lew Frankfort, John Zhao (added July 2016—Hony Capital), Mark Schwartz (added Mar. 2017—former VC at Goldman), Ronald (Ron) Fisher (added Nov. 2017—Softbank), *id.*, and Frances Frei (added 2019—Harvard Business School Professor). We Co., Registration Statement Under the Securities Act of 1933 (Form S-1), 176 (Sept. 3, 2019), https://www.sec.gov/Archives/edgar/data/1533523/000119312519236798/d781982ds1a.htm [https://perma.cc/MQ4Z-3JDM]; Patrick Clark & Jeff Green, *WeWork Adds Harvard's Frei to All-Male Board After Criticism*, BLOOMBERG (Sept. 4, 2019, 7:14 AM), https://www.bloomberg.com/news/articles/2019-09-04/wework-adds-a-woman-to-all-male-board-ceo-returns-grant [https://perma.cc/4X5N-GP5D].

146. *See* We Co. Registration Statement (Aug. 2019), *supra* note 118 (within which the term "related parties" appearing forty times and the term "related party" appearing sixty-eight times).

147. Farrell & Brown, *supra* note 121; *see supra* note 144 and accompanying text.

148. Farrell & Brown, *supra* note 121.

149. *Id.*

150. Konrad Putzier, *Investor's Ties to WeWork Raise Conflict-of-Interest Concerns*, WALL ST. J. (Aug. 27, 2019, 7:00 AM), https://www.wsj.com/articles/investors-ties-to-wework-raise-conflict-of-interest-concerns-11566903601 [https://perma.cc/8H4N-D23Q].

151. *See* We Co. Registration Statement (Aug. 2019), *supra* note 118, at 206 (discussing the creation of ARK to "serve as [We's] global real estate acquisition and management platform," and Langman's appointment onto the "management committee" of ARK, for which he was granted restricted stock "for his ongoing services to the We Company").

The money continued to flow and so did the acquisitions and business decisions—arguably unrelated to the business of WeWork and certainly unchecked by the board. The core business of WeWork was real estate, but it bought an event planning business, a search engine optimization company, and a coding school.[152] Neumann made an offer for the salad company, Sweetgreen, Inc., and, as noted before, opened WeGrow.[153] The directors apparently raised concerns about the disparate choices, but the company kept spending on unrelated companies—with tacit, if not explicit, board approval.[154]

Also, without board intervention, Neumann lavished money on an executive suite, building an exercise room and adding a sauna and ice bath to his offices in New York and San Francisco.[155] He used the company jet for personal trips,[156] and when he decided to buy a top-of-the-line Gulfstream jet, the directors acquiesced—even though investors like T. Rowe Price complained and told "management and the board [that] it had grown sour on the company."[157] T. Rowe Price then sold off as much stock as it could in the SoftBank transactions.[158]

Throughout all of these transactions, the directors, who had a voice and could have, for example, made noisy exits, continued to enable the scheme and hope for an IPO. Why? Because they had money in the company, and they believed the public markets would provide both an exit and a necessary check on Neumann. As a result, Mark Schwartz, Dunlevie, and Langman urged Neumann to commit to an IPO, but SoftBank and Neumann resisted—at least until SoftBank's own investment value plunged.[159]

The banks also played a role. Just like at Enron, the bankers had been developing relationships with Neumann, hoping for the IPO. They had earned fees on the private offerings and were invested in the company, but now, millions of dollars in IPO fees were around the corner, and Neumann's self-prescribed "personal banker" Jamie Dimon and Goldman Sachs were on

152. Farrell & Brown, *supra* note 121; We Co. Registration Statement (Aug. 2019), *supra* note 118, at 35.

153. Farrell & Brown, *supra* note 121.

154. *Id.*

155. *Id.*

156. *See* Eliot Brown, *How Adam Neumann's Over-the-Top Style Built WeWork. 'This Is Not the Way Everybody Behaves.'*, WALL ST. J. (Sept. 18, 2019, 12:23 PM), https://www.wsj.com/articles/this-is-not-the-way-everybody-behaves-how-adam-neumanns-over-the-top-style-built-wework-11568823827 [https://perma.cc/ZZ2T-HR8Q] (discussing a trip to Israel Neumann took "with friends" on WeWork's G650 private jet where they smoked marijuana throughout the flight).

157. Farrell & Brown, *supra* note 121.

158. *Id.*

159. *Id.*

board.[160] They provided no check or balance, drafting a prospectus that was subject to derision for its wacky language and valuations that the market immediately rejected as unsupported by a company that had turned a profit only once—many years prior.[161] Investors also revolted against the "string of conflicts."[162]

Indeed, according to the Financial Times, the investment banks vying for the IPO pitched Neumann with valuation numbers based on nothing more than teenage exuberance.[163] Proposals ranged from $46 to $63 billion (JP Morgan), $61 to $96 billion (Goldman Sachs), and $43 to $104 billion (Morgan Stanley).[164] Yet, when the public spoke, WeWork had to ratchet down its expectations, pulling the offering when the valuation was trending toward $15 billion,[165] or more than $30 billion below the valuation at the time of the last SoftBank infusion.

The underwriting arm of the banks, of course, had already earned millions in fees and stood to gain much more on the public offering as well as loans they planned to structure. JP Morgan had loaned Neumann, in his personal capacity, hundreds of millions of dollars, including for the buildings that he bought and then leased back to WeWork.[166] Indeed, the role of the banks in WeWork, its "growth," and its IPO has been described as "enabl[ing]," to be distinguished from evaluating, checking, balancing, or even providing healthy skepticism.[167]

As IPO hopes deflated and in an attempt to stem controversy and complaints, Neumann searched for more money and added a woman to the board—without consulting the other directors.[168] When they found out, they "vented" about it at a board meeting, where, as was typical, Neumann was

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160. *Id.* JPMorgan lent a $500 million credit line to Mr. Neumann and lent another $97.5 million in other forms of debt, largely mortgages with low rates on his many homes. We Co. Registration Statement (Aug. 2019), *supra* note 118, at 216.

161. *See* Farrell & Brown, *supra* note 121 ("The language used to describe the company was widely derided. The prospectus was dedicated to the 'energy of we,' and the company's mission statement was to 'elevate the world's consciousness.'").

162. *Id.* (noting that multiple banks had warned Neumann the conflicts would be a problem).

163. *See* Eric Platt, Andrew Edgecliffe-Johnson, James Fontanella-Khan & Laura Noonan, *WeWork Turmoil Puts Spotlight on JPMorgan Chase and Goldman Sachs*, FIN. TIMES (Sept. 24, 2019), https://www.ft.com/content/272d408e-de40-11e9-b112-9624ec9edc59 [https://perma.cc/SP9B-W8V2] (discussing the high valuations pitched by investment banks to WeWork despite the "clear signals from public investors that they were not willing to bankroll lossmaking unicorns at any price" and noting questions within the VC industry why "underwriters had not identified investor concerns sooner in the process").

164. *Id.*

165. *Id.*

166. *See supra* note 160 and accompanying text.

167. Farrell & Brown, *supra* note 121.

168. *Id.*

not present.[169] Later, Neumann apologized and said he would change his ways.[170] Nevertheless, he pushed back on the governance changes his bankers said were necessary for the IPO—acceding when desperation prevailed. Neumann then agreed to the following: the appointment of a lead independent director by the end of the year, a 50% decrease in his voting rights, and the elimination of the provision allowing his wife to select his successor.[171] It was, however, too little, too late.

The interest in the offering was insufficient and calls for Neumann to step down grew. Even Mr. Son's representative board members understood that Neumann had to go. Indeed, "[i]nvestors and executives at companies backed by SoftBank urged Mr. Son to move against Mr. Neumann."[172] Finally, Jamie Dimon told Neumann he had to choose—IPO or CEO.[173]

For Neumann, the choice was clear. If he didn't step down, the IPO would not happen. There would be no cash, and his stake would be worthless. At first, he agreed to relinquish his CEO title but not voting control, but to do so, he demanded payment, and SoftBank bought him out with a consulting fee and stock purchases.[174] Then, the board forgave $1.75 million in funds he owed to WeWork for personal travel and other expenses.[175] When the offering failed outright, the board switched its focus to saving the company.

Ironically, reflecting on the process many months later, Goldman's CEO, David Solomon, indicated that the public process was key to the demise of WeWork and that the private process was to blame. Speaking on a Unicorn panel at Davos in January of 2020, Solomon stated, "[o]ne of the things that I've said publicly . . . is the process actually worked around WeWork[.]"[176] In an IPO, the banks are faced with a private company with numbers that are not public and must work with the company to see whether the model works—before setting an actual public market value. According to Solomon, the vetting occurs when, "ultimately[,] there's a diligence process, there's a proving out process, there, at times, are meetings with investors before hand [sic], and that process grounds to reality."[177] The WeWork process, he said, worked, even if it "might not have been as pretty as everybody would like it

169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.*
176. Oscar Williams-Grut, *Goldman Sachs CEO Defends Work on Failed WeWork IPO,* YAHOO! FIN. (Jan. 21, 2020), https://finance.yahoo.com/news/davos-2020-unicorns-wework-ipo-david-solomon-stacey-cunningham-goldman-145306829.html [https://perma.cc/HN53-PUVN].
177. *Id.*

to be."[178] As he noted, part of the issue is that private companies are also "not held to the same standard around producing information" as their public counterparts,[179] arguably causing distortions like those in Uber, Theranos, and WeWork.

Importantly, missing from these statements is a recognition, let alone ownership, of Goldman's contribution to this "private" adolescence. Goldman and the other banks provided funding to WeWork, series after series, enabling Neumann's every choice along the way. At each series, the banks had the power to set the valuation and the opportunity to demand better information from the company. Yet only when faced with the public regime, their own potential for strict liability, and the market rejection of an arguably ridiculous, if not false, prospectus, were they forced to recalibrate and withdraw the offering.

## IV. Private Privileges, Enabling Boards, and Fiduciary Deficits

Start-up financing occurs under a set of exemptions—some long-standing, others more recent—that remove the disclosure obligations required in public markets on the assumption that private ordering suffices.[180] This exemptive privilege, in turn, assumes that the parties to the sequential rounds of financing will be faithful agents, i.e., fiduciaries, to their own sources of capital. Where there are conflicts of interest, fiduciary deficits will arise unless either the threat of litigation for breaches of duty sufficiently deters the resulting opportunism or the sources of capital are themselves sufficiently watchful and savvy to combat the opportunism. As sources of private capital become more numerous and diverse, as suggested in Part II, the latter may not happen so reliably.

By all accounts, WeWork's extraordinary growth over eight rounds of financing strengthened Neumann's hand and concealed ample danger signs. In the absence of required disclosure, fiduciary duties take on extra significance. We understand that the board was limited in its power once Neumann took his super-voting rights and lost more maneuvering room when

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178. *Id.*

179. *Id.*

180. Jill E. Fisch, *Private Ordering and the Role of Shareholder Agreements* 20–48 (European Corp. Governance Inst., Law Working Paper No. 538/2020, 2020), https://ecgi.global/sites/default/files/working_papers/documents/fischfinal.pdf [https://perma.cc/4SL3-UWJY] (discussing the use of shareholder agreements to evade statutory limits on private ordering, noting "corporate law has embraced private ordering . . . . Firms, particularly venture-capital backed start-ups, are increasingly adopting firm-specific governance provisions . . . that limit the permissible fora for shareholder litigation"). *See* Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 410–11 (2018) (defining "private ordering" as "private governance, self-regulation, and voluntary regulation regimes that complement, substitute for, or intersect" with government regulatory regimes).

SoftBank opened its checkbook with what seemed to be blind faith in Neumann's leadership. There is still a cautionary story about governance failure. This Part thus turns to the role of the WeWork board of directors in this story.

### A. *The Culture of Conflicts and an Enabling Board*

Consider the simple controls built into the fiduciary duties of directors and officers, and how they were designed to address these issues. Duties of candor, obligations surrounding conflicts of interest and corporate opportunities, and requirements for conscious choices (whether "good" or "bad") should mediate agency costs. Those duties are about loyalty, good faith, and oversight, and all were at issue in the WeWork story, where the board enabled conflicts, was controlled by Neumann, and neglected the investors and stakeholder employees who funded it.

The boards are missing in the WeWork saga and those of its "peers." With each additional funding round, while WeWork's paper valuation grew, the mechanisms for control did not. When Masayoshi Son told Adam Neumann to spend faster, Neumann did so, and the directors failed to ask questions and question answers.[181] The company grew, the nature of the investors changed, but the leaders did not grow up. Instead, they went to summer camp and drank tequila shots, seemingly stuck in adolescence, while the board watched but did not engage.[182] In doing so, the board abdicated its most important responsibility: to make, not avoid, decisions; thus, violating its duties of care and loyalty, including good faith. There are many complicated reasons for these failures, which Elizabeth Pollman has detailed—contracts around or embedding conflicts, investor outs, and ratchets to name a few.[183] Her premise, with which we do not quibble, is that start-up governance problematizes corporate governance norms.[184] It does not, however, eliminate the duties—just the internal controls those duties impose and create.

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181. Brooker, *supra* note 49.

182. Brown, *supra* note 156.

183. *See* Pollman, *supra* note 4, at 172–73, 175 (describing how these factors typical in start-up capital structure impact start-up governance); *see also* Coffee, *supra* note 109 (describing how WeWork's ratchet clause was primarily held by principal backer, Masyoshi Son, whose investment was protected in the form of millions of dollars if the WeWork IPO failed to reach its lofty goals—creating a conflict between him and other shareholders).

184. *See* Pollman, *supra* note 4, at 159 (noting that "startups are different from both public corporations and traditional closely held corporations" and discussing "the governance problems in venture-backed startup companies" including giving rise to a "framework . . . involv[ing] heterogenous shareholders in overlapping governance roles that give rise to vertical and horizontal tensions between founders, investors, executives, and employees").

In short, good faith, and the disclosure discourse inherent in it, is designed to play a role in establishing internal controls—even in start-ups and even more problematically with longer term corporate adolescents. Recall Mark Schwartz's statements at WeWork's board meeting in October 2019 noting that he had "stayed silent too long," and that he would tolerate "[n]o more fantasies."[185] According to the Wall Street Journal, Schwartz and his fellow directors had "stayed silent so long that the story was almost over."[186] In doing so, the directors enjoyed the privilege of private status, doomed the company's IPO, and failed to adhere to their fiduciary duties.

Neumann, who was no longer CEO, was present at that board meeting;[187] yet, when CEO, he rarely attended board meetings—presumably, because he controlled the decisions anyway.[188] Yet, allowing him to skip meetings was a failure on the board's part. So, why was he there this time? Because WeWork was "perilously low on cash after years of freewheeling spending" and was the "butt of jokes on Wall Street."[189] Despite receiving over $6.5 billion in cash over the years (arguably a powerful misallocation of capital),[190] at the date of the board meeting, the hoped-for IPO had crashed and burned, and the company had only a few weeks of funds left.[191]

To be sure, the directors' repeated silence was a governance failure. Indeed, the failure of the people and entities on which the privilege of private ordering was bestowed, and the resulting failure of culture, were both enabled by board members and investment bankers, all of whom failed to engage.[192] This board, like those of other corporate adolescents, was comprised of investor representatives with negotiated roles. From Softbank, which, through Masayoshi Son, urged Neumann to spend with abandon, to the venture capitalists who did not raise or push issues, the board members failed to fulfill their fiduciary duties. The gatekeeper bankers, of course, were not on the board, but they funded the choices, supporting Neumann, championing the company, and hoping for the chance to do the IPO[193]—at least until

185. Farrell & Brown, *supra* note 121.

186. *Id.*

187. *Id.*

188. *See supra* note 169 and accompanying text.

189. Farrell & Brown, *supra* note 121.

190. *See supra* notes 27, 43, 48 and accompanying text.

191. Farrell & Brown, *supra* note 121.

192. The funding and growth processes were fraught with conflicts of interest on all sides, and as the investors "ceded control," the company spun out of control, missing projections—year after year. *Id.*

193. *Id.*

publicness intervened.[194] And everyone joined in the adolescent culture, enabling the culture of conflicts to grow unchecked.[195]

Consider the conflicts and related party transactions listed in the prospectus and detailed in Part III. The WeWork offering documents stated that all were approved by the board, but after reading about how the board operated and its culture of silence, one wonders what really happened with each conflict. Indeed, the fact that many of the directors had conflicts of their own presumably embedded a you-scratch-my-back-I'll-scratch-yours culture that lowered the threshold for discourse and candor and enabled Neumann's ongoing conflicts. Who wants to engage in deep scrutiny of another's conflict when it might result in greater scrutiny of your own? Moreover, as Part II revealed, the motivations of the board members were at best mixed even before the culture of conflicts becomes embedded. Here, the result was the failure to examine and recognize privilege, the failure to understand the choices, and the failure of the IPO.[196]

Notably, without affirmative approval by disinterested directors or shareholders, corporate law once would have declared many of the WeWork conflicts void and now views them as voidable.[197] Yet, there are no "disinterested" or independent directors in today's start-ups.[198] Even if they are not implicated in the Neumann-specific transactions, and thus conflicted in the traditional sense, the behavior of the WeWork directors reveals that they viewed their role as enablers of the choices and were unwilling or incapable of playing the role corporate law prescribes.[199] Indeed, conflicted themselves, they did not question the choices or give voice to concerns; instead, they enjoyed the privileges of the private offering regime and engaged in the very fiduciary deficits corporate law is designed to prevent.

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194. *See supra* notes 60–61 and accompanying text.

195. *See supra* Part III. Consider John Zhao, from Hony Capital, who invested after doing tequila shots with and being sprayed with a fire extinguisher by Neumann. Farrell & Brown, *supra* note 121.

196. For an analysis of how transparency and disclosure decrease when companies experience downturns, see generally Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L. REV. 967 (2019).

197. DEL. CODE ANN. tit. 8, § 144 (West 2010) (providing that no conflicting interest transaction shall be void or voidable solely by reason of the conflict if the transaction takes various cleansing steps); *see also* Stuart R. Cohn, Conflict of Interest Transactions: Principal Concerns and Interpretive Issues, COLUM. L. SCH.: BLUE SKY BLOG (Dec. 18, 2019), https://clsbluesky.law.columbia.edu/2019/12/18/conflict-of-interest-transactions-principal-concerns-and-interpretive-issues/ [https://perma.cc/E97S-YKYY] (describing the relaxation of judicial attitude toward conflict of interest transactions, moving from "void *ab initio* to voidable").

198. *Cf.* Michael Ewens & Nadya Malenko, *Board Dynamics Over the Startup Life Cycle*, (Nat'l Bureau of Econ. Research, Working Paper No. 27769, 2020), http://www.nber.org/papers/w27769 [https://perma.cc/3AMS-C9FN] (providing evidence of the timing and role of independent directors in start-ups and opining on their potential as mediators and advisors).

199. *See supra* notes 146–59 and accompanying text.

### *B. The Nature of Candor, Discourse, and Good Faith*

Traditionally, the role of venture capitalists on start-up boards was perceived as providing a strong guiding hand to get the company to maturity.[200] Yet, the dialogue and engagement necessary to affect that was missing at WeWork. Also seemingly missing were conversations about conflicts and whether they should be avoided, or the question-asking, dialogue-building role that would allow the directors to vet risks and challenge management's understanding of its own role, choices, and privileged status.

Indeed, the power of good faith discourse is that it has the power to alter choices—and that is its purpose.[201] It can reaffirm initial choices, and that is also its purpose. Both outcomes are examples of the power of the information-forcing-substance theory in action. Both are also examples of active and engaged decision making[202]—the opposite of staying silent and feeding fantasies. And they are examples of good faith in application and the creative friction that boards are supposed to provide and is their value. The goal is the conversation, the dialogue, the discourse, and the substance it produces.

Corporate directors, even those adhering to the proverbial nose-in-fingers-out line, are required to engage in monitoring and oversight.[203] This fiduciary duty is at the core of the good-faith obligation rooted in the duty of loyalty. Staying silent was not Mark Schwartz's role—nor was it the role of any of the other directors. In doing so, they presumably failed to make

200. The conventional view of venture capitalists on start-up boards, with which we do not take issue, received considerable scholarly attention—but mostly before the more recent growth in private funding rounds. *See* Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. REV. 967, 989–90 (2006) (lauding VCs on the board as able to control entrepreneur opportunism, monitor operations, and if necessary, implement new management); *see also* Brian Broughman & Jesse M. Fried, *Carrots and Sticks: How VCs Induce Entrepreneurial Teams to Sell Startups*, 98 CORNELL L. REV. 1319, 1329 n.39 (2013) (noting the "important purposes" that VC board control serves).

201. *See generally* Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L.J. 1045 (2019) (developing an understanding of the importance of disclosure to stakeholders and the public); *see also* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 861, 874–78 (2003) (describing mandatory disclosure as a "legal constraint on managerial behavior" and discussing the duty of care and loyalty that comes along with mandatory disclosure law, and how it influences the behavior of corporate managers).

202. *See* Hillary A. Sale & Donald C. Langevoort, *"We Believe":* Omnicare*, Legal Risk Disclosure and Corporate Governance*, 66 DUKE L.J. 763, 786–88 (2016) (discussing the information-forcing-substance theory and how dialogue can result in either a different outcome or the same outcome and both reflect active decision-making).

203. *See, e.g.*, Hillary A. Sale, *Monitoring* Caremark's *Good Faith*, 32 DEL. J. CORP. L. 719, 729–30 (2007) (discussing obligations for corporate directors to act in good faith as held by the Delaware Supreme Court in *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006)).

conscious choices—a precondition for the application of the business judgment rule.[204] They also presumably violated their duty of care and arguably failed to act in the face of problematic information, a hallmark of bad faith, which when sustained violates good faith.[205]

Of course, corporate law has the ability to sanction bad faith via derivative litigation, and deception via the duty of candor. But these are notoriously difficult to prove. Delaware courts have carved out room for a disloyalty claim for exit transactions that favor preferred stockholders (i.e., funders) over founders and employees who hold options, signaling that directors cannot simply claim loyalty to those shareholders responsible for their appointment to the board.[206] But this "*Trados*" line of cases has been heavily criticized by academics as inefficient and unrealistic,[207] and, in any event, has not been extended to oversight or monitoring. The natural human inclination to represent one's principal is hard to overcome. Independent directors have persuasively been characterized as there mainly to play a mediator role, limiting their involvement unless needed to referee a dispute between founders and funders.[208] This enables avoidance when the primary constituents are at peace, which is likely when the start-up has momentum.

There are also practical reasons to doubt that litigation will produce an optimal level of attentiveness, whether state or (as to fraud) federal.[209] There

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204. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (noting that the business judgment rule does not protect directors who failed to inform themselves of all material facts prior to making a business decision); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (noting that to invoke the business judgment rule's protection, "directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them").

205. Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." (footnote omitted)).

206. *In re* Trados Inc. Shareholder Litigation, 73 A.3d 17, 40–41 (Del. Ch. 2013).

207. Pollman, *supra* note 4, at 217–18; *see generally* Sarath Sanga & Eric Talley, Don't Go Chasing Waterfalls: Fiduciary Duties in Venture Capital Backed Startups (Oct. 31, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3721814 [https://perma.cc/MF2U-Q9J4] (arguing that the *Trados* doctrine "cannot categorically reconcile private interest with value maximization" and that regulations emphasizing a preference for shareholders' interests is more efficient).

208. *See supra* note 198 and accompanying text.

209. For doubts about litigation, see Verity Winship, *Private Company Fraud*, 54 U.C. DAVIS L. REV. 663, 710 ("The information benefits from private securities litigation are deeply contested, as are the benefits of shareholder litigation overall."); Pollman, *supra* note 2, at 391 (observing the "relative paucity" of securities litigation in private companies). To their concerns, we would add some additional points. If it is indeed true that VCs and other early funders want to avoid too much potentially troubling information even when represented on the board, this might result from—or be motivated by—a desire to avoid the scienter required under Rule 10b-5 in suits brought by later arrivals to the funding party. In many jurisdictions, sophisticated purchasers of securities can lose their fraud remedy—even when lied to about material facts—if they failed to do due diligence, a considerable (and perhaps reputation-tainting) possibility when financing rounds are done quickly

are many reasons for this result, including, for example, the ratchet provision protecting Masayoshi Son, and, as Elizabeth Pollman points out, the contracts and other provisions investors build in to protect themselves.[210] Further, in the case of WeWork, we know that T. Rowe Price, a key institutional investor, recouped its earlier stage investment in a later round while making clear that it was disgusted by the company's antics.[211] That ability to recoup, however, also decreases the likelihood of litigation. Conflicts of interest may arise as well—portfolio managers may hesitate to sue well-established VCs and other early investors because the result might be exclusion from future opportunities.[212]

The challenge in WeWork and other unicorn adolescents is that the privilege of private status was not designed for companies that stay "private" for as long as or of the size of WeWork. It was designed with the idea that sophisticated investors, including venture capitalists and banks, would invest in the companies, perform gatekeeping functions, nurture the companies, and allow the public regime, including its powerful litigation remedies, to take over.[213]

This, then, is where the system failed. The private offering regime has layered on privileges for adolescents incapable of managing the business, particularly long-term, let alone navigating lines related to legality. The mythology has fueled spectacular growth and equally spectacular failures, making money for venture capitalists, banks, and money managers but without asking the corporate adolescents or their funders to adult up. The result is the misallocation of capital, risky choices, and spillovers to downstream investors and stakeholders.[214]

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and many investors want in on the action. *See* Mario J. Suarez, *A Comparative Fault Approach to the Due Diligence Requirement of Rule 10b-5*, 49 FORDHAM L. REV. 561, 561–63 (1981) (listing examples of cases in various jurisdictions denying fraud claims based on failure to perform due diligence). Conflicts of interest may arise as well—portfolio managers may hesitate to sue well-established VCs and other early investors if it might result in being excluded from future opportunities. *See supra* note 4 and accompanying text.

210. *See* Pollman, *supra* note 4, at 175 (describing protective terms built into investments).

211. *See supra* notes 157–58 and accompanying text.

212. *See supra* note 209 and accompanying text.

213. *Compare* Fried & Ganor, *supra* note 200, at 987 (stating "[s]tartup boards—unlike public company boards—are frequently and intimately involved in strategic decisionmaking and personnel issues"), *with* Lerner & Nanda, *supra* note 3, at 252 (emphasizing the rise of founder-friendly behavior and the pressure for VCs not to be overbearing). *See also* Ewens & Malenko, *supra* note 198, at 3 (discussing the fall of VC majority board control from 60% in 2002 to 25% for start-ups originated in 2013).

214. *See* Yusuf Khan, *WeWork Is Reportedly Cutting 2,000 Jobs as Soon as This Week, with the Staff Turning Against Adam Neumann*, MKTS. INSIDER (Oct. 15, 2019, 4:21 AM), https://markets.businessinsider.com/news/stocks/wework-reportedly-cutting-2000-jobs-staff-turning-on-ceo-adam-neumann-2019-10-1028598379# [https://perma.cc/TXV8-Y3B5] (relating how

In the end, WeWork failed to sustain its massive valuation in ways that seem to have confounded regulators, policy makers, and academics. Its companies evolved, but private governance aspirations failed to do so. The system simply is not designed for long-term "start-up" governance, and WeWork reveals the systemic slack and flaws. The "fix" requires some of the myth-busting we have attempted in this article and understanding that the system is not nearly perfect. The reliance on reputational capital, if appropriate a decade ago, is no longer so.[215] Indeed, assuming that conflicts and fiduciary deficits are either unsolvable or always beneficial produces WeWorks. When the adults in the room are not accountable for the adolescents, candor, discourse, and good faith don't stand a chance: there is no internal control system to prevent fiduciary deficits. When fiduciary obligations fail to grow with the funding rounds, the need for an increased focus on risk and its consequences is ignored.[216] Yet, as a company's reach grows, the range of harm also expands, allowing failures that impact many more people and stakeholders than simply the venture capitalists and investment banks.[217]

## Conclusion

Drawing from the WeWork saga and academic research about changing motivations, incentives, and opportunities in start-up financing, we see an accumulating set of deficits that makes the current state of affairs more problematic than the conventional account would suggest:

- Founder control is increasingly frequent, enabling more sustained self-centered and biased behaviors that, even if adaptive to an extent, produce risky behaviors among those not able to handle the glorification or freedom.
- The market for funding is more crowded, with private equity and venture finance being offered by a wider range of funders who have diverse incentives driven by the opportunities for fees and new funding opportunities before earlier investments pan out or not. As such, agency cost issues are present not simply at the level

WeWork's financial peril and fall from grace led to mass job losses as well as managerial malfeasance).

215. *See* Fried & Gordon, *supra* note 108 (discussing VCs' fascination with brand name, late-stage, hot start-ups to list on their portfolio pages, which in turn fuels overpayment for start-ups).

216. Langevoort & Thompson, *supra* note 4, at 342 (describing the need for two distinct tiers of companies within securities regulation: first, those with a large societal footprint for which "[f]ull publicness treatment should be reserved" and second, smaller companies needing only core disclosure obligations and governance requirements).

217. *Id.* at 374 (highlighting how the fall of companies such as Enron and WorldCom damages not only shareholders and debt holders, but also employees, retirees, and competitors, and causes distortions in the market in which they operate).

of the start-up, but upstream to the relationship between funders and their own (increasingly diverse and not always sophisticated) sources of capital.

- Start-up valuations are set in a market lacking many of the mechanisms of efficiency and subject to a winner's curse, which plays into these upstream and downstream incentives and biases. As a result of all the foregoing, fiduciary and information-forcing norms weaken.
- Directors focus on constituent protection or conflict mediation in exercising whatever power they possess, rather than attending in good faith to their duties of candor, care, and loyalty.
- These deficits combine with the fast-growing flow of money into start-up financing to enable a longer period of undisciplined corporate adolescence during which the misbehavior risk rises, threatening investors and others.

That is as far as we will go here. What to do about all of this is a hard question; we recognize, for example, that expansive disclosure requirements are not necessarily well-suited for start-ups pursuing innovative strategies. However, we are convinced that the more dark space we afford start-ups and funders in the name of innovation, the more important it is for there to be good governance to oversee how that freedom is being used and to lessen the fiduciary deficits exhibited in the WeWork story and elsewhere. Maybe the better policy is to nudge start-ups toward a quicker IPO, with at least some of the rites of passage.[218] At least then disclosure and publicness have the potential to shed light on the private choices of funders and founders.[219]

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218. Other regulatory reforms associated with the JOBS Act simplified the IPO process for emerging growth companies, which produced a step-up in biotech capital formation and accompanying innovation. *See* Craig M. Lewis & Joshua T. White, Deregulating Innovation Capital: The Effect of the JOBS Act on Biotech Startups 14 (Aug. 21, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3640852 [https://perma.cc/6YTQ-FXDQ]. That said, registration is no cure-all for conflicts of interest. *See* Coffee, *supra* note 109 (discussing the complexities associated with disclosure of the various conflicting rights and privileges, like "IPO racheting," in the registration statement and other disclosures).

219. From a policy perspective, there is good reason to consider tweaking the law if only to lessen the negative externalities of start-up misbehavior on others. Private issuers attract capital from investors in a competitive market including a wide range of opportunities; misinformation or other deficits result in a misallocation of capital, distortion of investment choices, and harm to non-cheating firms competing for capital based on the bona fide qualities of their ideas. *See, e.g.*, Elizabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 447–51 (2017) (arguing that increased access to private capital and the ability of private companies to "freeride" off of the information disclosed by public counterparts has eliminated incentives to go public, but that the policy is naturally in conflict with itself and should lead to a dearth of publicly-available information in the future); Langevoort & Thompson, *supra* note 4, at 364–65, 372 (stating that the ideal regulatory regime for when to subject companies to mandatory disclosure laws would enable "private issuer status [to] be limited to those situations where the bargaining over the allocation of capital to the issuer gives us enough confidence that the

We are more confident as to what *not* to do, but what nonetheless has been happening rapidly. For much of its history, as noted earlier, securities regulation sought to limit access to the private markets to qualified investors presumed able to fend for themselves, [220] a category that has expanded slowly but surely in recent decades.[221] In the JOBS Act of 2012, Congress gave a boost to the effort by making it easier to prospect for such accredited investors. While this was often portrayed in terms of allowing start-ups to find a greater number of investors, the main effect was to give investment intermediaries (e.g., hedge funds) greater ability to attract capital to invest under its portfolio management, exacerbating the upstream agency cost problem and diminishing the ability of conventional VCs to dampen adolescent impulses.

This effort accelerated considerably in 2019, when the SEC began an effort to make private investments more readily available to retail

price at which buyers are attracted will be a fully informed one" and pointing out the benefits that public companies provide—and thus, conversely, private companies do not provide—through information disclosure). The misallocation in turn adversely affects labor markets (especially when, as in the tech field, equity-based compensation is so common), among others. *See* Yifat Aran, *Making Disclosure Work for Start-Up Employees*, 2019 COLUM. BUS. L. REV. 867, 917 (noting the difficulty of employees who receive offers of equity compensation in start-ups to properly value the best offer of employment given the difficulty in estimating the value of the underlying securities); Jennifer S. Fan, *Employees as Regulators: The New Private Ordering in High Technology Companies*, 2019 UTAH L. REV. 973, 994–95 (describing the ubiquity of equity-based compensation in public companies and barriers to employee-driven shareholder proposals). This is the main reason we, like others, would favor moving public company status and the attendant governance obligations to a somewhat earlier phase in the successful start-up's adolescence once the basic science or technology is in place and before its footprint on society grows deeper and deeper.

220. *See* Langevoort & Thompson, *supra* note 4, at 343–46 (discussing the development of United States securities law and the carved-out exemption allowing companies with investors who could "fend for themselves" to remain private).

221. Once based on subjective factors like genuine sophistication and ready access to information, the scope of the exemptive philosophy has become more objective over time: today, financial status (more than $1 million in assets, or more than $200,000 in annual income, with a variety of adjustments) sets the basic threshold. A higher level of wealth ($5 million in investible assets) is needed to invest in high performance fee-paying entities in the private capital markets, like hedge funds, under the § 3(c)(7) exemption from investment company status in the Investment Company Act of 1940. 15 U.S.C. § 80a–2(a)(51)(A)(i) (2018). That statutory exemption utilizes the higher $5 million standard for "qualified purchasers." *Id.* § 2(a)(51). Less well-off investors, as we have seen, can enter the private investment realm, but for the most part, only through a willingness to invest through more heavily regulated mutual funds and similar vehicles. *See supra* note 115 and accompanying text.

investors.[222] Exempt offerings were expanded,[223] and the Commission doubled down on the strategy by proposing exemptive relief from broker-dealer status to those who hustle to find accredited investors for private offerings.[224] The Trump Administration's Department of Labor joined the deregulation party with its own ERISA-based directive to allow retirement savings of accredited investors to move more heavily in alternative private investments.[225]

The "equity" claim that ordinary investors deserve comparable investment opportunities to those now limited to the relatively privileged few comes through loud and clear. There is no reason, however, to believe that retail investors newly introduced into this space will find comparable opportunities to those afforded truly sophisticated, experienced players who can lean in against agency costs in how their money is invested. Rather, these new investors will find their way to market segments where salesmanship and marketing savvy abound and then overpay in search of already picked-over chances. How well upstream investors fend for themselves remains to be seen; we know much too little. Yet the regulatory movement is to open the private markets to more retail investors, ignoring the costs of the fiduciary deficits and, instead, relying on the myth of corporate adolescence, the infatuation with innovation, and the winning lottery tickets for those who get in the game early enough.

Why the politics of entrepreneurial capital-raising tilted this way is a complicated question. No doubt much of what is pushing this is pure special interest muscle, which is a good reason by itself for legal academics to take

222. *See* Concept Release on Harmonization of Securities Offering Exemptions, 84 Fed. Reg. 30,460 (proposed June 26, 2019) (to be codified at 17 C.F.R pts. 210, 227, 230, 239, 240, 249, 270, 274, 275) (seeking to "simplify, harmonize, and improve the exempt offering framework to promote capital formation and expand investment opportunities"). Some rules have already been amended. *See* Amending the Accredited Investor Definition, 85 Fed. Reg. 64,234 (Oct. 9, 2020) (to be codified at 17 C.F.R. pts. 230, 240) (expanding the accredited investor definition to include additional categories of qualifying persons and entities); Facilitating Capital Formation and Expanding Opportunity by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3496 (Mar. 15, 2021) (to be codified at 17 C.F.R. pts. 227, 229, 230, 239, 240, 249, 270, 274) [herein after Facilitating Capital Formation] (altering aspects of the exempt offering framework to "facilitate capital formation and increase opportunities for investors").

223. Facilitating Capital Formation, *supra* note 222. We do not yet know how regulators under the Biden Administration will feel about this reform effort.

224. Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders, Securities Act Release No. 34–90112, 85 Fed. Reg. 64,542, 64,546–47 (proposed Oct. 7, 2020).

225. *See* Louis J. Compagna, *Information Letter 06-03-2020*, DEP'T. OF LAB., EMP. BENEFITS SEC. ADMIN (June 3, 2020), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020 [https://perma.cc/XS6G-NYKL] ("The Department believes that a plan fiduciary of an individual account plan may offer an asset allocation fund with a private equity component . . . .").

more of an interest in the subject. The inspiring narratives about start-ups as drivers of innovation and job creation, geniuses who promise to invent us a better future, and the potential "equal playing field" created by allowing more retail investors into a space heretofore reserved for the already over-privileged all enable corporate adolescence.

Our cautionary note here, then, is not that innovation is an unworthy goal compared to investor protection but simply that the assessment should be a sober one. High-tech innovation, after all, has decidedly mixed effects on employment, destroying jobs at incumbent firms without necessarily creating a comparable number of new ones. Some researchers believe that we are facing a time of harder-to-find good technological ideas,[226] meaning that the money chasing the best ideas will face greater risk of disappointment on average and a winner's curse as to financing the occasional breakthroughs. Meanwhile, the fees keep coming to the money managers. There is reason to question the assumption that the system of entrepreneurial finance we've chosen is necessarily the best—or fairest—at allocating capital to the most socially productive ideas.[227] Thus, the payoff from telling stories like WeWork and of coming to better understand ever-changing incentives for rent-seeking inside that system is that we expose the adolescent culture of conflicts and fiduciary deficits and put away the rose-colored glasses when deciding what is best going forward.

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226. *See* Nicholas Bloom, Charles I. Jones, John Van Reenen & Michael Webb, *Are Ideas Getting Harder to Find?*, 110 AM. ECON. REV. 1104, 1104 (2020) ("[E]verywhere we look we find that ideas, and the exponential growth they imply, are getting harder to find."). Even a decade ago, there was some recognition that venture capital is less "scalable" than private equity generally. Andrew Metrick & Ayako Yasuda, *The Economics of Private Equity Funds*, 23 REV. FIN. STUD. 2303, 2306 (2010) (finding that the buyout business is much more scalable than the VC business).

227. Lerner & Nanda, *supra* note 3, at 252. *See also* Nathan Heller, *Is Venture Capital Worth the Risk?*, NEW YORKER (Jan. 20, 2020), https://www.newyorker.com/magazine/2020/01/27/is-venture-capital-worth-the-risk [https://perma.cc/HAS2-GHP9] (discussing the WeWork disaster as a challenge to the assumptions of the venture capital enterprise).