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The Dodge Brothers' Monster: A Legal Analysis of The Effect of Fiduciary Duty on Dual Voting Structures

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Contents

Introduction[1]

"If you really look closely, most overnight successes took a long time."[2] From the most iconic businesses like Dodge to the more recent little Facebook, they all started from a continuing effort of people. In business, success is a direct result of a hoard of people actively committing acts for the benefit of a venture that is incapable of acting on its own. Companies and particularly corporations, require people to act on their behalf.[3]

However, a business is nothing more than a legal fiction.[4] While we treat a business as a legal person separate from that of shareholders, in truth, a corporation without people is incapable of acting.[5] So the question arises on how to structure the governance system of a corporation? Is implementing a system of one share equals one vote the best option? Or is an alternative a better approach, such as having some people's vote count more than others, or should some people not have the right to vote at all? Or is the best option some mathematic equations that determine a person's voting power? Most importantly, are there consequences to the action of choosing one method?

Businesses have tried several different options in order to govern their affairs, but the default has become one share equals one vote. In practice, about nine out of ten public companies employ this method.[6] However, a resurgence is occurring of another type of structure, particularly seen in the technology industry.[7] That structure is the dual voting structure.[8] The

1 A special thanks to Professor Michele Benedetto Neitz and Dean Michael Daw for their assistance with the creation of this paper.

[2]Jacquelyn Smith, Emmie Martin, and Jenna Goudreau, 88 Quotes n Success From The World's Most Accomplished People, Business Insider (Sept 22, 2014), https://www.businessinsider.com/success-quotes-from-accomplished-people-2014-9. (Quoting Steve Jobs).

[3] The use of word corporation or business is meant to refer to a corporation, companies, subchapter C corporation, business, and similar structures.

[4] The Editors of Encyclopaedia Britannica, Legal Fiction, Encyclopaedia Britannica (April 12, 2018), https://www.britannica.com/topic/law-report.

[5] Id.

[6] Council of Institutional Investors, Dual Voting Stock, https://www.cii.org/dualclass_stock.

[7] James Chen, Dual-class Stock, (Updated Apr 26, 2019), https://www.investopedia.com/terms/d/dualclassstock.asp.

reason behind the resurgence of dual voting structures is unknown; it could be a result of stories of founders like Steve Job being pushed out, a method to keep more control over their creation, or some other business or personal reason.

In essence, a dual voting structure separates the economic interest of a share from its voting power. This system is supposed to grant the founder with autonomy and the ability to not be beholden to a Wall Street Investor's desire for instant gratification. This system allows the founders to take more risks and execute long term plans without the threat of being removed from their position because that plan threatens or diminishes the immediate profitability of the company despite have stronger long-term merits.

However, this resurgence has brought forward a slew of questions about the convention of corporate governance. These conventions are settled for the default system, but their application to dual voting structures are hazy. The most pressing of these issues are the concerns around fiduciary duty and its impacts on the founder. The concern is, should there be more done in order to address growing concerns that these types of structures have a negative impact on the outside shareholders?

Question and Scope

The purpose of the research is to determine the role of fiduciary duty in dual voting structures. From there, determine what if anything needs to be done moving forward. The scope of the dual-voting structures is that of public companies. The analysis of the dual-voting structure is broken into the following parts: (1) an overview of the history of the structure, (2) defining a dual voting structure, (3) a case study, (4) fiduciary duty and its effects on dual-voting structures, and (5) recommendation.

[8] The dual voting structure is also called a multi-class stock structure, dual-class ownership, and several others. This paper will generally use a dual-class structure.

Boundaries of Research & Analysis

This paper has several limitations in order to answer the questions described in the preceding paragraph. The paper is, primarily, focused on the corporate entity known as a corporation as defined by 26 U.S.C sub-chapter C (C-Corporation).[9] This is a corporation that is tax separate from its owners and the default method for major corporations.[10] This definition excludes limited liability companies and other entities that may adopt dual-voting structures. While many of the findings of this paper may have universal application to both corporations and other kinds of business structures, the focus has been limited to C-Corporations.

Additionally, there are special cases and exceptions that are either briefly mentioned or omitted from the paper unless those cases or exceptions would materially change the outcome of the paper. The purpose of this restriction is to see if dual- voting structures as a concept and not certain cases would meet the obligation of fiduciary duty. For more information, the sources contained within the footnotes of the paper cover exceptions or special cases.

Also, this paper will only look at the duty that a shareholder with superior voting rights has to a minority shareholder.[11] Any obligations that minority shareholders may have to a shareholder with superior voting rights or any obligations to the corporate entity will be ignored under this analysis.[12] Also, the issue of common stock versus preferred stock will be ignored for the purposes of this paper.[13]

Additionally, the research in this paper is primarily, but not exclusively, limited to Delaware, the capital of most corporate formation, and New York, the heart of the American financial system. The reasoning is that these two states have an outsize effect on corporate

[9] 26 U.S. Code § 301
[10] Gregory Holmes, Definition of a Subchapter C Corporation, Chron, https://smallbusiness.chron.com/definition-subchapter-c-corporation-25936.html.
[11] A minority shareholder, in this case, refers to shares that limited or zero voting rights unless otherwise stated.
[12] These shareholders with inferior voting rights may also be referred to in this paper as majority shareholders.
[13] For the purpose of this paper, shares and shareholders will only refer to common stock and common shareholders.

governance. Delaware Chancery Court is the preeminent authority on corporate governance and a hub for corporate governance litigation. Additionally, New York is home to the New York Stock Exchange, NASDAQ, and have many corporations headquarters.

Historical Perspective of Business Entity Selection

Business in America

The standard for most of business history was for a business to structure itself like what is modernly called a sole proprietorship.[14] A sole proprietorship is a type of structure where the owner and the business are the same entity.[15] These types of structures only allowed for one owner of the business.[16]

However, there were a few outliers that resemble a modern-day business structure. The first business in the world to issue shares to people was the Dutch East India Company.[17] The Dutch East India Company effectively had the first initial public offering in the early 1600s, despite that concept not develop until later.[18] As time progressed, this corporate entity structure continued to develop and be refined.

The key turning point for American Business was the Revolutionary War, which left the country with many questions about how to structure its affairs moving forward.[19] The business community was engaging in a similar conversation. As earlier as 1784, companies were tackling

[14] Andrew Beattie, What was the First Company to Issue Stock?, (Oct 23, 2019), https://www.investopedia.com/ask/answers/08/first-company-issue-stock-dutch-east-india.asp. See also, Investopedia, What is the History of Corporations in America? (Updated Aug 02, 2019), https://www.investopedia.com/ask/answers/041515/what-history-corporations-america.asp.

[15] Alexandra Twin, Sole Proprietorship, Investopedia, (Nov 7, 2019), https://www.investopedia.com/terms/s/soleproprietorship.asp

[16] Id.

[17] Beattie supra note 8.

[18] Id.

[19] See generally, Various, The Federalist Papers (1787-1788).

the problem of ownership and voting rights.[20] Of particular interest was when there were multiple owners, and each owner would have different percentages of ownership in the company.[21] At the time, there was not a default system of corporate governance for business owners to rely on.

In these early years of the country, the prevalent norm for adopting a corporate entity was performed only by banking institutions.[22] The landscape of the laws at this time for corporate governance was void of controlling precedents or statutes.[23] This vacancy left businesses the option of creating their systems of governance. These rules were mostly created and recorded in corporate charters.[24] In Maryland, around 1819 companies were gradually moving towards a system of one vote per share.[25] In 1834, a New Jersey Appellate Court ruled that each shareholder is entitled to one vote regardless of ownership unless a statute or other rules state otherwise.[26] Other companies used a complex set of equations to determine a person's voting rights and determine the maximum amount of control that was allowed to be allotted to one person.[27] In the end, most companies moved towards a default of one vote per share.[28]

However, that did not prevent the companies from using an uneven voting structure. One of the first companies to employ a dual-voting structure was the International Silver Company,

[20] Stephen Bainbridge, *Understanding Dual-Class Stock Part I: An Historical Perspective*, Professor Bainbridge, (Sept. 09, 17) https://www.professorbainbridge.com/professorbainbridgecom/2017/09/understanding-dual-class-stock-part-i-an-historical-perspective.html#_ftn4.
[21] Id.
[22] Investopedia, What is the History of Corporations in America, (Updated Aug 03, 2019), https://www.investopedia.com/ask/answers/041515/what-history-corporations-america.asp.
[23] Bainbridge supra note 13.
[24] Id.
[25] Id.
[26] Taylor v. Griswold, 14 NJL 222 (New Jersey 1834)
[27] Bainbridge supra note 13.
[28] Id.

which maintained that type of structure up to 1902. [29] The use of this kind of structure came to a head in the 1920s with the attempted IPO of Dodge Brothers and several other companies.

The Dodge Brothers and The Creation of a Monster

In 1897 the Dodge brothers, John and Horace Dodge, opened a small bike store in Detroit, Michigan.[30] That store later became the foundation of a premier American car line, Dodge, Inc. In 1900, the Dodge Brothers founded the Dodge Brothers company, which at the time sold parts for cars.[31] The company's first products were engines and chassis components, which they sold to companies like Ford Motor Company and the Olds Motor Vehicle Company.[32] The company was even a shareholder of Ford during this time.[33] However, Ford's desire to build its cars internally eventually caused the two companies to end all dealings together, and Dodge sold its stake in Ford.[34]

In 1913 while continuing to make parts for the other companies, the Dodge Brothers started to build its first independently made car.[35] In the same year, the company was rechristened as the Dodge Brothers Motor Company in honor of its beginning to sell cars.[36] As early as 1916, the company cars were listed as the second-largest car company in terms of sales.[37] In 1920, John and Horace Dodge both passed away from unrelated illnesses.[38]

The loss of the founders caused the company to slowly lose its position as a top tier car company.[39] In 1925, Dillon, Read & Company brought the Dodge Brothers company for $146

[29] Id.
[30] History.com Editors, Dodge Co-Founder Dies, (Jul 28, 2019), https://www.history.com/this-day-in-history/dodge-co-founder-dies.
[31] Id.
[32] Id.
[33] Dodge V. Ford Motor Co., 204 Mich.459, (Mich. 1919).
[34] Id.
[35] History.com Editors supra note 23.
[36] Id.
[37] Id.
[38] Id.
[39] Id.

million.[40] Under the new ownership, Dodge restructured its governance system into a dual voting structure.[41] Dillon, Read & Company made its intention clear that they planned to take the company public.[42] However, in 1926, the New York Stock Exchange banned business with a dual voting structure from being able to go public.[43] The ban was in response to the public outcry about Dodge's attempt to go public with a dual voting structure.[44] Then in 1928, the company was sold to the Chrysler for $170 million.[45]

America's Response to Dodge

The public and Congress responded negatively to companies like Dodge and their desire to going public during the time without equal voting right for shareholders.[46] The opposition included people like Harvard Professor of Economics, William Z. Ripley, who made it his mission to roll back this growing pattern among corporations.[47] Professor Ripley led President Calvin Coolidge (Republican) and the Republican-controlled Congress to consider taking legislative or executive action against these types of companies.[48] However, both the President and Congress were unable to make a definitive legislative or executive action against these types of business.[49]

In 1926, the New York Stock Exchange (NYSE) announced a new listing requirement that effectively banned companies with dual-voting structures from listing on the

[40] Id.
[41] Zoe Condon, A Snapshot of Dual-Class Share Structures in the Twenty-First Century: A solution to Reconcile Shareholder Protections with Founder Autonomy, Emory L. J. Vol 68.
[42] Id.
[43] Id.
[44] Id. See also, Peter N. Flocost, Toward A Liability Rule Approach to the "One Share, One Vote" Controversy: An Epitaph for The Sec's Rule 19c-4?, U. Pa. L. Rev. Vol. 138:1761
[45] History.com Editors supra note 23.
[46] Flocost supra note 36.
[47] Id.
[48] Id.
[49] Id.

exchange.[50] The NYSE new listing requirement was that every company must have a "one share one vote" system going forward.[51] Companies already listed were expected to either convert into this governance system or delist from the exchange. [52] President Coolidge and the Republican Congress lauded the NYSE's decision to stem the growth of dual-voting structures. [53]

However, the new listing rule was not without its detractors. [54] Some companies, in efforts to maintain their control over their businesses, took their companies private to avoid the growing discomfort with dual-voting structure. [55] Additionally, the listing requirement was only for the NYSE.[56] However, as one of the oldest and most prestigious stock exchanges in the country, this placed tremendous pressure on companies to adopt the "one vote per share" rule.

In 1971, the National Association of Securities Dealer Automated Quotation System or NASDAQ was founded.[57] NASDAQ never formally adopted the listing requirement of one vote per share. In the 1980s, NASDAQ led other exchanges not to employ a similar listing requirement.[58] The presence of NASDAQ put pressure on the NYSE to follow suit with removing the listing requirement or risk losing companies to the new competition. In 1984, the NYSE determined that they would no longer keep the listing requirement in order not to lose companies to its competition.[59] Many people in the American public were critical of the idea of allowing these types of businesses to exist and were against the change of the rule.[60]

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[50] Id. See also, Condon supra note 33.
[51] Louis Lowenstein, *Shareholder Voting Rights: A Response to SEC Rule 19c-4 and Professor Gilson*, 89 Colum. L. Rev. 979, 979–85 (1989).
[52] Id.
[53] Id.
[54] Id.
[55] Id.
[56] Id.
[57] Ellen Terrell, History of the American and NASDAQ Stock Exchanges, (Oct 2012) https://www.loc.gov/rr/business/amex/amex.html.
[58] Condon supra note 33.
[59] Flocost supra note 36.
[60] Id.

That left the states, state regulators, Congress, and the Security and Exchange Commission (SEC) to regulate these types of businesses. Many state Legislative adopted a hands-off approach to regulations of these types of businesses.[61] A few state regulators attempted to use "Blue sky" laws in order to make rules that would either limit or eliminate these types of structures.[62] [63] However, the states mostly had little to no effect on these types of structures.[64] The reasoning that the states' attempts failed is likely because businesses could incorporate in a state that did not have the listing requirement and skirt the law despite being physically located in the state. Congress twice attempted to pass statutes on the subject, but both times the statute was defeated.[65] That left the SEC.

The SEC Response and Following Backlash

In July of 1988, the SEC promulgated and then shortly later adopted Rule 19c-5.[66] The rule called for a ban on any corporate action that had the effect of "nullifying, restricting, or disparately reducing the per-share voting rights of existing [common stockholders]."[67] In practice, the new rule was an attempt to effectively banned all businesses from employing a dual voting structure with a few exceptions.[68]

In 1989, Business Roundtable sued the SEC from being able to enforce the rule in the Washington DC courts under the theory that the SEC did not have the statutory authority to make such a rule.[69] The DC Circuit Court of Appeals rendered final judgment for Business Roundtable, stating that the rule exceeds the statutory authority in the creation and enforcement

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[61] Condon supra note 33.
[62] Blue sky laws are state securities laws.
[63] Condon supra note 33.
[64] Id.
[65] Id.
[66] Flocost supra note 36.
[67] Condon supra note 33.
[68] Id. The exceptions to the rule are beyond the scope of the paper.
[69] Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

of Rule 19c-5. [70] The ruling made the Rule 19c-5 an ultra vires act of the SEC and as such void. The case was never heard before the US Supreme Court. The DC Circuit Court effectively ushered in an era of unregulated control of the dual voting structure.

The Current Landscape of Business in America

The court's decision in Business Roundtable v. SEC, to overrule the SEC Rule19c-5 allowed many companies to take the opportunity to carry forth a dual voting structure. Now, these companies on the aggregate have a market capitalization (M Cap) that exceeds 3 trillion dollars.[71] M Cap is the dollar amount of the value of all of a company's outstanding share.[72] So, the combine M Cap of all dull voting structures exceeds 3 trillion dollars. This M cap is about 10% of the market capitation of the US.[73] This valuation is equal to that of the entire stock market of France, who is ranked 5th in the world.[74]

However, by no means are these structures the majority of American businesses. These businesses make up between 6%-10% of major US stock exchanges. [75] The majority of the growth of these businesses has occurred since the rapid growth of the technology industry in the US.[76]

Many of the companies, but not exclusively, that employ this method are technology companies from Silicon Valley. Some of the most prominent examples of this are Google and

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70 Id.
71 Condon supra note 33.
72 James Chen, Market Capitalization, Investopedia, Feb 3, 2020, https://www.investopedia.com/terms/m/marketcapitalization.asp
73 The word banks state that the market capitation for the US is 32.12 in 2017. The Global Economy, Stock Market Capitalization, in dollars-country ranking, Global Economy, https://www.theglobaleconomy.com/rankings/stock_market_capitalization_dollars/ (citing World Bank)
74 Id.
75 Id.
76 Chen supra 6.

Facebook. These dual-class voting structures make up about 19% of the tech companies founded between 2012-2016, which was a two-times increase from the previous five years. [77]

However, these companies are not without their detractors. The Council of Institutional Investors (CII) has become an outspoken critic of these structures.[78] One of the organization's current goals is to limit the power of these structures. [79] One of the ways that CII is seeking to achieve this goal is by have stock exchanges make listing rules that mandate that these companies have a sunset provision, that over time removes the superior voting rights.[80]Also, the S&P Dow Jones has banned the addition of any new dual voting structures on the exchange, while the Russel Exchange has mandated that the free float of voting power be at least 5%.[81] Free-float is a calculation that takes the mt cap of a company calculated by taking the equity's price and multiplying it by the number of shares readily available in the market.[82]

Dual Voting structures

"Nobody decided one day to remove the element of democracy from corporations. While the corporation laws of every state, solemnly recite that the shareholders" hold the ultimate power in the corporation, "shareholders [have been] relegated to a rubber-stamp process of affirmation." [83] In no place else is that sentiment stronger than in dual voting structure. In contrast to the default system where shareholders are a check on insiders and directors, the dual voting structure enables a system of entrenchment of insiders where the majority of shareholders have been regulated to a near powerless class. The power of the corporation rests in the hands of

[77] Id.
[78] Council of Institutional Investors supra note 5.
[79] Id.
[80] Id.
[81] Id. See also, Martin Chang, Dual Voting Structures, (Aug. 26, 2019), https://sites.duke.edu/thefinregblog/2019/08/26/661/.
[82] James Chen, Free-Float Methodology, Investopedia, (Apr 4, 2019), https://www.investopedia.com/terms/f/freefloatmethodology.asp.
[83] Les Greenberg and James McRitchie, Request for Rulemaking to Amend Rule 142-8(i) To Allow Shareholder Proposals to Elect Directors, August 1, 2002.

the founders, who are officers, directors, and shareholders with the majority of the voting power. This combination that removes the threat of their ousting also makes their word law.

Legal Definition of Dual Voting Structure

The default system for corporate governance is that each share grants the owner of the "one share one vote."[84] A dual voting system is an alternative system that allows a company to rearrange the governance system more favorably for founders and other insiders. A dual-class voting structure has multiple classes of stock.[85] The difference between the classes of shares would be voting rights and dividend payments.[86] The only relevant one for this paper is voting rights. The voting difference creates a superior class and inferior class of stock.

The superior class

The superior class of shares has a scheme that grants them more voting rights per share than that of the inferior class in terms of voting.[87] The number of votes per share could range from two to ten votes per share; however, no law caps the highest number of votes one share can be allowed. For example, WeWork once had a scheme that grants 20 votes per share.[88] These types of schemes create situations like Echostar, where the Chief Executive Officer (CEO) owns only 5% of the total shares outstanding but has 90% of the voting power.[89] Often a feature of these classes is that they convert into the inferior class after a specific condition is met, generally that condition is that the founder no longer owns the stock. Some companies have adopted sunrise provisions to achieve that conversion.[90] A sunrise provision (also known as sunset provision) is a provision that converts the shares automatically after a specific time

[84] Bainbridge, supra 13.
[85] Condon supra note 33.
[86] Id.
[87] Id.
[88] See, We Company, Draft Registration Statement (Jun 06, 2019), https://www.sec.gov/Archives/edgar/data/1533523/000162827919000233/0001628279-19-000233-index.htm.
[89] Chen supra 6.
[90] Andrew Winden, Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures, (Rock Center for Corporate Governance at Stanford University Working Paper No. 228).

period.[91] Other companies like Facebook, for example, have a reversion clause.[92] These reversion clauses mandate that once the share leaves the hand of that person, the shares automatically reverts to an inferior class.[93]

The inferior class

The inferior class has either limited rights or no voting rights at all.[94] A limited voting right would be a share that has fewer votes per share than that of the superior class of stocks.[95] An example of this may be that the superior class has five votes per share, then the inferior may have anywhere between one and four votes per share. These shares have at least one vote per share. The other way to be an inferior share is if the shares do not have voting rights in decisions or elections of members of the Board of Directors. [96] Companies may employ a combination of inferior with limited voting rights and no voting rights. Google's parent company, Alphabet, has one superior class and two inferior, one class that has limited voting rights and the other class with no voting rights.[97]

The Corporate Desire for Dual Voting Structure

The adoption of a dual-voting structure is generally a business decision. The primary factor behind that decision is control.[98] These types of structures allow an entrepreneur and other insiders to give away a large portion of the business without losing control of the business.[99] In theory, this structure allows entrepreneurs to focus on long term goals and allow for these

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91 Id.
92 See Facebook Articles of Incorporation § 3.8 (b).
93 Id.
94 Condon supra note 33.
95 Chang, supra 75.
96 Id.
97 Alphabet Articles of Incorporation Art IV § 2(a)(i)-(iii).
98 Ryan Roberts, Dual-class Common Stock Structures for Founders, (Dec. 10, 2015) https://startuplawyer.com/incorporation/dual-class-common-stock-structure-for-founders.
99 Id.

executives to more often take moderately risky options that have more significant long term benefits.[100] Or they just take the view that is geared towards some other view.

Another critical part is who has these shares with superior voting rights. These structures provide the company with one or a few dedicated owners.[101] Generally, these are the entrepreneurs who founded the company and selected current officers and directors whose "livelihoods" are at stake. Also, these types of structures allow a business to move quickly in response to new business opportunities when they know that the person with the most voting rights will ratify their actions.[102]

Additionally, some believe that these structures provide other valuable benefits. One such (debatable) benefit would be that these structures allow the company to provide greater returns for all investors.[103] These structures also provide managers with an extra layer of protection from being removed for making unpopular but otherwise necessary decisions.[104] These structures are also a useful tool to hamper hostile takeovers from rival companies or private equity companies looking for a quick dollar.[105]

However, in the legal, economic, and business fields, the supposed benefits of the corporations are highly debated. A key finding among these companies is that they produce lower returns, lower trading prices, higher management entrenchment, higher executive total compensation, and lower overall valuations and trading price as compared to single-class

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[100] Condon supra note 33.
[101] Chang, supra 75.
[102] CFA Institute, Dual-Class Shares: The Good, The Bad, And The Ugly, https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx.
[103] Condon supra note 33.
[104] Deloitte, Dual-class Share Structure: Weighing the Risk and Rewards (Apr 09, 2014) https://deloitte.wsj.com/riskandcompliance/2014/04/09/dual-class-share-structure-weighing-the-risks-and-rewards/.
[105] Id.

firms.[106] In addition to the increased scrutiny from the public, these businesses also face scrutiny Non-government organizations that are historically and currently devoted to eliminating this business practice.

The Financial Reality of Dual Voting Structures

Dual-voting structure currently makes up about $3.35 trillion in m cap.[107] Moreover, these companies make up just less than a fifth of the companies that went public between 2012-2016.[108] As a whole, these companies have granted the public less than one percent total voting rights.[109]

The Case Study of Dual Voting Structure

A feature of many tech startups is the fact that they employ a dual voting structure.[110] Another commonality among many of these businesses, particularly noticeable around the initial public offering, is their corporate governance red flags.[111] The red flags run the gambits of bad decisions, excess, and potentially breaking laws. Dual-voting structures allow the entrenchment of founders, officers, and directors that commit these acts. The problems of this structure are considered to be "a feature of their model" and not as "a bug" to work out.[112] The prime example is We Company, better known by its wholly-owned subsidiary WeWork. The problems with WeWork are "an indictment against the dual-class structures as opposed to" Mr. Neumann (the Founder and now former CEO) or WeWork.[113]

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106 Vijay Govindarajan, Shivaram Rajgopal, Anup Srivastava, and Luminita Enache, Should Dual-Class Shares Be Banned?, (Dec. 03, 2018), https://hbr.org/2018/12/should-dual-class-shares-be-banned.
107 Condon supra note 33.
108 Id.
109 Id.
110 Examples of such structures are Facebook, Lyft, Google, WeWork, Pinterest, Zynga, Snap, Uber, etc.
111 Ellen Florian, One Bright Spot in the WeWork Debacle: Turn Out Investors Actually Care About Corporate Governance, (Sept 25, 2019) https://fortune.com/2019/09/25/wework-adam-neumann-we-co-corporate-governance-investors/.
112 Id.
113 Id.

Who is We?

Founded in 2010 in New York, New York, WeWork was created to be a "disruptor in the commercial real estate industry."[114] WeWork is a wholly owned subsidy of the We Company (We Co.). The company was founded by Miguel McKelvey, Adam Neumann, and Rebekah Neumann.[115] The mission of the company is to "create a world where people work to make a life, not just a living."[116] The company operates under the business model of working to "monetize [their] global platform through a variety of solutions, mainly by selling memberships but also by providing ancillary value-added products and services to [their] members and extending [their] platform beyond offering workspace."[117] The company currently has 527,000 memberships as of the second quarter of 2019.[118] Additionally, the company has a capacity of 604,000 workstations as of the second quarter of 2019.[119]

However, the company is not without its risks. One of the key risks listed in the prospectus is the fact that Mr. Neumann's voting power is not necessarily tied to the benefit of the company but that he has the right to vote on manners as he sees fit even if it may harm other investors.[120] While WeWork markets itself as a tech company, in reality, the company is a middleman between sub-leasee and commercial landlords. More importantly, the company has 34 billion dollars of future debt tied to its realty operations.[121] For a better perspective of the financial condition of the company, We Co. had a loss of $3,614,152,000 (approximately) between Jan 01, 2016, to the second quarter of 2019.[122]

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[114] WeWork, Mission Page, https://www.wework.com/mission.
[115] Id.
[116] We Company, Draft Registration Statement pg. 46 (Jun 06, 2019).
[117] Id.
[118] Id.
[119] Id.
[120] Id.
[121] Id.
[122] Id.

The company attempted to go public in the third quarter of 2019. However, the company was forced to withdraw its registration statement. [123] Additionally, Mr. Neumann stepped down as the CEO of the We Co. [124] Also, Mr. Neumann voluntarily had his voting rights reduced from ten votes to three per share. [125] However, Mr. Neumann is still the chairman of the board and has many business relations with the company. [126] The primary reason that this result is the red flags allowed to prosper under their dual-voting structure.[127]

Founders' Control and Influence on We

Mr. Neumann is the key to setting the company's vision, strategic direction, and execution of priorities.[128] Despite that, there are several critical concerns about Mr. Neumann. One of them is that the company does not have an employment agreement in place with Mr. Neumann. [129] More so, the company does not have any guarantee that Mr. Neumann will continue his business relationships with the company in any capacity. [130] That was such a vital concern that it was listed in the prospectus as a risk before Mr. Neumann stepped down. [131] The concern is stronger considering his resignation as an officer despite still holding a strong voting interest in the company and the position as chairman of the board of directors. Moreover, the companies have a host of transactions that involved Mr. Neumann in a multitude of different capacities.[132] A large part of their business model still depends on the services of Mr. Neumann. [133]

[123] Florian supra note 110.
[124] Id.
[125] Id.
[126] Id.
[127] Florian supra note 110.
[128] Draft Registration Statement § Risk.
[129] Id.
[130] Id.
[131] Id.
[132] Florian supra note 97.
[133] Draft Registration Statement § Risk.

The We company and the fact that We is not Working out

In August of 2019, WeWork, under its parent company The We Company, pulled its registration statement from the SEC and determine that it is no longer able to go public.[134] However, the company plans to go public at some undisclosed later date. Much of the blame has been placed at the feet of the former CEO, Adam Neumann. Mr. Neumann is a co-founder, nonexecutive chairman, and benefits from a dual voting structure.[135] Many of the things that Mr. Neumann has done that caused him to create a valuable company are now casting a shadow over that every company's future.[136]

One such example is that Mr. Neumann created a tax scheme that shifted the burden of future profits from his class of shares to that of other investors.[137] This shift means that when the company starts to make profits, the tax liability imposed onto shareholders under corresponding tax law would require that inferior shareholders pay the lion share of the taxes. More so, "We," the name of the parent company, was a registered trademark of an entity not affiliated with We Co. but that of an entity control by Mr. Neumann outside of his capacity as part of We Co. and is only leased to We Co.[138] That separate entity had no relations with We. Co. Initially, the trademark was going to be sold to We Co. for a total of $6 million, but after investors place some pressure on the company, that the deal was unwound. [139] Mr. Neumann has now transferred the trademark to We Co. free of charge due to complaints. [140] Mr. Neumann also has an ownership

[134] Florian supra note 97.
[135] Florian supra note 97.
[136] Eliot Brown, How Adam Neumann's Over the Top Style Built WeWork. 'This is Not the Way Everybody Behaves,' (Sept 18, 2019), https://www.wsj.com/articles/this-is-not-the-way-everybody-behaves-how-adam-neumanns-over-the-top-style-built-wework-11568823827.
[137] Troy Wolverton, Firing Adam Neumann doesn't solve WeWork's biggest problem: The underlying business stinks, https://www.businessinsider.com/firing-adam-neumann-wont-solve-flaws-in-wework-business-model-2019-9/.
[138] Id.
[139] Id.
[140] Id.

interest in several of the buildings from where We Co. currently lease office space.[141] After pressure, Mr. Neumann will now turn over any profit that he receives from those properties over to We Co.[142] Additionally, Mr. Neumann had the company buy him a $60 million private jet for his personal use. [143]

Also, Mr. Neumann has a reputation of spending corporation money on drinks, such as when the company has handed out bottles of Rosé (retail price $50) and Don Julio (retail price $110) for free to employees on numerous occasions. [144] This splurging on drinks even occurred in a meeting where the company had fired 7% of its total workforce to cut costs. [145] Until recently, Mr. Neumann's wife had exclusive control to determine the next CEO of We Co. if Mr. Neumann ever became incapacitated or died. [146]

Mr. Neumann's management style has raised questions, as well. One of the more public decisions was Mr. Neumann's decision to ban meat-eating by employees on the premises. [147] After consulting with executives- who were not involved in the creation of the ban nor were aware of the ban when it was announced- the company decided that it will no longer reimburse for meals that contained meat as a part of the meal. [148] The supposed reasoning behind this decision is supposedly part of the company's goal of building a more sustainable environment. [149] Another part of Mr. Neumann's management style was to fire 20% of employees to decrease the number of "B players" in the company. [150] "B players" refers to an

[141] Brown supra note 121.
[142] Wolverton supra note 122.
[143] Brown supra note 121.
[144] Id.
[145] Id.
[146] Id.
[147] Id.
[148] Id.
[149] Id.
[150] Id.

employee who is a capable and steady performer but is not a star employee.[151] This mass layoff was completely separate from the 7% of the workforce fired.

Mr. Neumann also has an unrealistic expectation of where the company should be going and what it could reasonably be doing. [152] To note, some people believe that this unrealistic expectation is part of the reason the company was able to expand at its pace. [153]

We Co. also has a host of potential conflicts of interest. These include the fact that two of Mr. Neumann's brother-in-law's work as an executive for the company along with his wife, Rebekah Neumann (Ms. Neumann is credited as one of the founders of We Co.). [154] Also, the company has used the parents of a member of the board of directors as brokers for several real estate deals. [155] The parents were both licensed brokers but only had a small practice and typically did not handle transactions of that scale. [156]

Additionally, many of the construction companies, vendors, and contractors are related to or friends of either Mr. Neumann or other insiders. [157] Lastly, the company has paid millions of dollars in loans between the company and the executive and lower-level employees. [158]

The Buffett way

In contracts to We Co., Warren Buffet has implemented the same system with a vastly different outcome, is Berkshire Hathaway. Berkshire Hathaway is a preeminent American business. Today the company is a holding company that allows Warren Buffet to invest in

[151] Thomas J. DeLong, Vineeta Vijayaraghavan, Let Hear It for the B Players, (June 2003), https://hbr.org/2003/06/lets-hear-it-for-b-players.
[152] Brown supra note 121.
[153] Id.
[154] Id.
[155] Id.
[156] Id.
[157] Id.
[158] Id.

business freely. [159] The company has invested in companies such as Geico and Duracell.[160] However, the company traces its history to the late 1880s when Hathaway Manufacturing and Berkshire Cotton Company combined. [161] Berkshire Hathaway employs a dual-voting structure. [162] That the company is a success can be boiled down to the fact that in 2018, the company net profits were $4.02 billion, which was down from a five year high the previous year of $44.94 billion. [163] The company has been relatively scandal-free, and most news reports center on Warren Buffets' business acumen. Mr. Buffets' use of a dual-voting system is an ideal example of the success that this system can bring when it is not marred by scandal.

Fiduciary duty

The task of the fiduciary is to act in the interest of the principal and fulfill the needs of the principal over that of others and even the interest of fiduciary, themselves. Yet, "'[n]o man can serve two masters, for either he will hate the one and love the other, or else he will hold to the one and despise the other.'" [164] The competing self-interest and the interest of the principal can cause a tensed interaction that has been remedied by robust jurisprudence.[165]

The Creation

Corporate entities are fictitious persons that are unable to act on their own behalf. The purpose of the organization is to maximize shareholder returns.[166] Generally, actions are taken either by a corporation's employees or their agents. An employee is a person who works for hire

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[159] The Editors of Encyclopaedia Britannica, Berkshire Hathaway, Encyclopaedia Britannica, https://www.britannica.com/biography/Warren-Edward-Buffett.
[160] Zack Fredman, Yes, Warren Buffet really owns 7 of your favorite companies, Forbes, Jan. 22, 2019 https://www.forbes.com/sites/zackfriedman/2019/01/22/warren-buffett-owns-these-7-companies/#4e2280185f6d
[161] Id.
[162] Id. See also, Greenberg supra note 76.
[163] Corporate MarketWatch, BBK.b, (Financials), MarketWatch, https://www.marketwatch.com/investing/stock/brk.b/financials.
[164] Beasley v. Swinton, 46 S.C. 426 (S.C. 1896) (quoting Matthew 6:24).
[165] James Chen, Agency Problem, Investopedia, (Jul 14, 2019), https://www.investopedia.com/terms/a/agencyproblem.asp.
[166] Ford Motor Co., 204 Mich.459.

and receives compensation.[167] An agent is a person that has the authority to affect the legal relations and create obligations and burdens by their acts on behalf of another.[168] While often, these two (employee and agent) can both apply, that is not always the case. The principal duty of an agent is to act for the benefit of the principal.[169]

Often, an agent is also an employee, but that is not exclusively the case.[170] Shareholders are the principal in the relationship, and officers and directors are their agents.[171] The courts have expanded the definition of who has fiduciary duties to include more people in corporate settings.[172]

Defining the Role of the Principal

To note, these situations are not the traditional definition of principal-agent situations but are roughly similar.[173] The courts have expanded the jurisprudence to include these cases. For officers and directors, the company and shareholders as a whole are the principal in all matters.[174] However, that answer is not always so simple when asking about the relationship between different stockholders.

In most cases, a shareholder does not have a duty to the company or other shareholders.[175] However, in select cases, that is not true. For the majority shareholder and

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[167] Charles J. Muhl, "What is an employee?" The answer depends on the Federal Law, (Jan. 2002),https://www.bls.gov/opub/mlr/2002/01/art1full.pdf (citing dictionary). This explanation is a simplified definition that excludes considerations of independent contractors and the impact of where an employee is both agent and employee.

[168] Restat 3d of Agency.

[169] Legal Information Institute, Fiduciary Duty, https://www.law.cornell.edu/wex/fiduciary_duty.

[170] Restat 3d of Agency.

[171] Deborah A. DeMott, Shareholders as Principals, *Key Developments in Corporate Law and Equity: Essays in Honour of Professor Harold Ford* 105-129 (2002).

[172] The notion that shareholders are principals is a contentious issue but not relevant for the sake of this paper. More so, the courts have affirmatively ruled that officers, directors, and select others in some instances have a fiduciary duty to both the company and minority owners.

[173] The traditional principal-agent duty is a person who hires someone to acts on their behalf. A prime example would be lawyers to clients.

[174] Rocket Lawyer, Corporate Law: What is Fiduciary Duty?, https://www.rocketlawyer.com/article/corporate-law-what-is-fiduciary-duty-cb.rl.

[175] Contra Id.

controlling shareholders, the principal is the minority shareholder.[176] Fiduciary duty also has implications that shareholders are also the principal to directors.[177]

For this paper, there will be the assumption that the principal interest follows the traditional business maxim and legal purpose of a business of maximizing the return for shareholders.[178] This maxim means that the principal is primarily looking for the agent to create the most profitable business possible. However, this assumption is not always valid.[179]

Defining the Role of the Agent

This section is exclusively focused on the situations where a shareholder would have an obligation to another shareholder, and that share then becomes an agent of the other shareholder(s). While other cases are relevant and will be used for the analysis later, the focus of this selection is when that obligation derives from their position as shareholder and not as an officer or director. Lastly, the term principal will refer to inferior shareholders moving forward.

Types

Fiduciary Duty by Virtue of Majority Owners Status

The simplest way to become an agent is as a majority shareholder. A majority shareholder is a person or entity that owns or controls more than fifty percent of the outstanding shares.[180] Absence of any super-voting clause, unanimous voting requirements, or the separation of voting rights from ownership interest, a majority shareholder generally has the power to make all decisions.[181] Companies like Dell, Inc., a large and public company that has a majority

[176] Id.
[177] DeMott supra note 148.
[178] Ford Motor Co., 204 Mich.459.
[179] There is a growing movement in the business community of business, taking up the triple bottom line approach. This kind of approach has business place value on things outside of just profit, such as people and the environment.
[180] Mitchell Cory, Majority shareholder (Updated Apr 11, 2019) https://www.investopedia.com/terms/m/majorityshareholder.asp. See also, Black's Dictionary, Majority Shareholder.
[181] Cory supra note 157.

shareholder, a rare phenomenon.[182] This case of majority status is more common in small or private companies than large public companies.[183] Lastly, the notion of dual-voting structure makes this an outdated model because a person can have a majority votes while owning only a small percentage.

Fiduciary Duty by Virtue of Controlling Shareholder Status

The Stringer is a legal standard that obligates a person to act as a fiduciary despite having a minority stake in the company. Under Stringer, there are two ways to be a controlling shareholder: (1) exercise actual control over the business and affairs of the company or dominate the company board of directors or (2) a member of a small group of shareholders who collectively own a majority of shares or otherwise have that domination or control.[184] At the heart of the issue is that control is derived from "virtue of the person's position as a shareholder."[185]

The first part of the Stringer test is to exercise actual control over the business and affairs of the company or dominate the company board of directors.[186] Actual control means that they have control over the day to day operations of the business.[187] The starting point would be the percentage of shares of the business. However, a large percentage without more is not enough to be a controlling shareholder if that percentage is short of majority status (more than 50%).[188] Other things to look at would be domineering the board of directors. This result generally happens either by placing the board in the hands of people under their control or by the

182 Id.
183 Id.
184 Locati v. Johnson, 160 Or. App. 63, 69, (1999) (citing Stringer v. Car Data Systems, Inc., 841 P.2d 1183 (Or. 1992)).
185 Id (citing *Principles of Corporate Governance* § 1.10(a) (1994)).
186 In re W. Nat' l Corp. S'holders Litig., CONSOLIDATED CA No. 15927, 2000 Del. Ch. LEXIS 82, at *4 (Ch. May 22, 2000).
187 Id.
188 Id.

ability to elect the members. [189] Another factor is the right to veto decisions or contractual rights that grant more power than under the statute. [190]

The second part of Stringer is the membership as part of either: (1) an individual belongs to a group of shareholders that make up a majority or (2) a person belongs to a group such as a consortium or family that have control.[191] Generally, the minimum amount of share needed to call a shareholder's meeting is enough.[192]

Fiduciary Duty Existence in Dual Voting Structure

The threshold issue is, are shareholders with majority voting interest in dual voting structures a controlling shareholder or a majority shareholder that owe the other shareholder a fiduciary duty? To owe a fiduciary duty, the person must either own a majority of the outstanding shares or meet either category of the Stringer test.

The first question is, do dual voting structure meet the definition of majority shareholder? As a preliminary matter, an outright majority of outstanding shares is not a concern of dual voting structures. While that is often the case at the beginning of a business's life, however, as they mature and raise capital, the stake in the company is spread among a larger group of people. Typically, a founder, in this case, will be left with a minority stake as the company grow into its business model. The issue with dual-voting structures is the separation between ownership and control. A shareholder can holder as little as 5% of the share outstanding but retain 90% of the voting power; thus, as a whole dual voting structure fails to meet this definition.

The next question is, does a shareholder meet the definition of the stringer test? Under Stringer, there are two ways to be a controlling shareholder: (1) have exercise actual

[189] Id.
[190] Id.
[191] Stringer v. Car Data Systems, Inc., 841 P.2d 1183 (Or. 1992).
[192] See, UpCounsel, Controlling Shareholder, https://www.upcounsel.com/controlling-shareholder. See also, In re Crimson Exploration Inc. S'holder Litig., C.A. No. 8541-VCP (Del. Ch. Oct. 24, 2014). See also, *Corwin VKKR* Financial, 125 A.3d 304 (Del 2015).

control over the business and affairs of the company or dominate the company board of directors or (2) a member of a small group of shareholders who collectively own a majority of shares or otherwise have that domination or control.[193] At the heart of the issue is that their control interest is derived "by virtue of the person's position as a shareholder." [194]

The first issue under this test is, do these shareholders with superior voting rights belong to certain groups that make up a majority? These groups are either: (1) an individual belongs to a group of shareholders that make up a majority or (2) a person belongs to a group such as a consortium or family that has control.[195]

In the case of dual voting structures, these shareholders do not belong to a group of shareholders that make up a majority. The reason that this structure exists is that they grant control of a corporation without the need to have majority ownership. As already stated, the issue with dual-voting structure is that they remove voting rights from ownership interest. These shareholders, even as a group, do not need to make up a majority interest, nor do they belong to a group, consortium, family, or other groups to have control of the company via the shareholder interest. More importantly, in many cases, these shareholders only have a minority interest by a percentage of the numbers of shares. The courts have not yet determined that mere membership as a director or officer is a functional equivalent for this test. Lastly, their ability to call for a meeting derived more often from their position as an officer/director. Thus, a dual voting structure fails this part of the disjunctive test.

The last issue is, do they have actual control or domination of the board of directors? Control is a function of power over the day-to-day and big picture objectives. As a conceded

[193] Johnson, 160 Or. App. 63.
[194] Id.
[195] See, UpCounsel supra note 169. See also, In re Crimson Exploration Inc. S'holder Litig.,. See also, VKKR Financial, 125 A.3d 304.

point, these shareholders have a significant level of control over the company. However, the question turns on whether that control is a result of their status as a shareholder?

Under Del Corporation Code § 141(a), the business and affairs of the corporation is vested in the officers and directors. In most cases, a shareholder with superior voting rights is either an officer or a director, if not both, which means that their veto power and control of the company is primarily derived from the statutory authority for this position in the company and not as a shareholder.

The next question is, do these dominating shareholder effect of control over the board of directors? The problem with dual voting structures is the entrenching effects of management and directors. Typically, management and directors already have control over the board of directors nominating committee by making up the committee despite the type of structure employed.[196] Moreover, management generally has shareholder support, abject absence, and blind support, even in the case of electing boards, even in a single class system.[197] So again, the selection and makeup of the board of directors is a function of the position in the company and not as a matter of their voting power. Also, in many cases, the board of directors is made up of independent directors. That only leaves their ability to fire the board, but the mere ability to do so is not enough alone. It would require threats or something more.[198] Thus, a dual voting structure fails this part of the disjunctive test.

On balance, a shareholder with superior voting rights in a dual voting structure are neither majority shareholders nor a controlling shareholder, which means that they do not owe the minority shareholder a fiduciary duty.

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[196] James Chen, Defining a Nomination Committee, (Mar 19, 2018). https://www.investopedia.com/terms/n/nominationcommittee.asp.
[197] James Chen, Proxy Fight Definition, (Apr 29, 2019) https://www.investopedia.com/terms/p/proxyfight.asp.
[198] Kahn v. Lynch Commc'n Sys., 638 A.2d 1110 (Del. 1994).

Breakdown of The Responsibility Under Fiduciary Duty

The remainder of this paper will act as if fiduciary do apply to these cases. In general, majority owners and controlling shareholders have a fiduciary duty to the minority shareholders.[199] The reasoning behind this shift is to show the difference the application of fiduciary duty would have on these kinds of structures.

A fiduciary is "to act loyally for the principal's benefit in all matters connected with the agency relationship."[200] The fiduciary can be broken down into sub duties of loyalty, good faith, and care.[201]

The Applicable Standards for Judging Breach

The default rule for a business agent is the business judgment rule.[202] This rule is favorable to officers and directors because the courts will defer to their judgment.[203] To meet the business judgment rule, there are three elements: the agent must have acted "(1) in good faith, (2) with the care that a reasonably prudent person would use, and (3) with the reasonable belief that the director is acting in the best interests of the corporation."[204] The burden is on the plaintiff when an agent pleads this standard.[205]

The standard that would apply under fiduciary duty for these bad faith and disloyal actions is the entire fairness standard.[206] This standard is a heightened standard that is more favorable to the principal because it is more fact-intensive and places less deference on the

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[199] For ease of reference, agents will refer the majority shareholder and principal minority shareholders.
[200] Restat 3d of Agency, § 8.01.
[201] Id at comments.
[202] Robert B. Little, Determining the likely Standard of Review in Delaware M&A Transactions, https://corpgov.law.harvard.edu/2017/04/28/determining-the-likely-standard-of-review-in-delaware-ma-transactions-2/.
[203] In re Trados Inc. S'holder Litig., 73 A.3d 17, 36 (Del. Ch. 2013).
[204] In re Crimson Exploration Inc. See also, Legal Information Institute, Business Judgement Rule, https://www.law.cornell.edu/wex/business_judgment_rule.
[205] Id.
[206] Id.

agent's actions.[207] The standard shifts the burden from the plaintiff and forces the defendant to prove that the deal was fair on the stakeholders' side.[208] This fact means that the agent must show both the process in which the result was fairly done as well as the substantive results of the process.[209]

Duty of loyalty

An agent is "not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal or otherwise through the agent's use of the agent's position."[210] The material benefit is defined as "explicit, direct, and pecuniary in nature" or "indirectly if the benefit is acquired through the agent's use of position or in connection with a transaction conducted on behalf of the principal." [211]

The reasoning behind this rule is the expectation that an agent is a substitute for the principal, and they must act in the principal's best interest. [212] It would be unjust for the agent to force the principal to be a party to a deal that benefits the agent at the expense of the principal, barring consent by the principal.[213]

Next, an agent must not "deal with the principal as or on behalf of an adverse party in a transaction connected with the agency relationship."[214] An agent has an adverse interest in the deal when (1) the agent has a substantial economic interest or (2) the deal involves a close friend or family member of the agent.[215] The reasoning of this rule is that an agent working in an

[207] Id.
[208] Kahn v. Lynch Communication Systems ,638 A.2d 1110 (Del. 1994).
[209] Legal Information Institute, Duty of care, https://www.law.cornell.edu/wex/duty_of_care.
[210] Restat 3d of Agency, § 8.02.
[211] Id at comments.
[212] Id.
[213] Id.
[214] Restat 3d of Agency, § 8.03.
[215] Id at comments.

adversarial way creates conflict between the agent and the principal, barring the consent of the principal.[216]

Additionally, "[a]n agent has a duty[:] (1) not to use property of the principal for the agent's own purposes or those of a third party; and (2) not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party."[217] Generally, an agent who has actual possession is limited to using the property of the principal only for uses that benefit the principal.[218] When an agent uses the property to cause the harm to the principal, competes with them, or the agent's use benefits only the agent, this would violate the agent's duty.[219]

Lastly, "an agent has a duty to refrain from competing with the principal and from taking action on behalf of or otherwise assisting the principal's competitors." [220] Actions by an agent that directly compete or assist the principal's competition even when the agent refrains from using confidential information violates the duty.[221]

Duty of Care

An additional duty that an agent has is a duty of care. The duty of care requires that the agent "act with the care, competence, and diligence normally exercised by agents in similar circumstances."[222] In essence, the duty requires that an agent must perform their duties in a manner customary in line with someone in the same profession or role. This rule requires that the agent take actions that are financially, ethically (within the mission of the business), and legally

[216] Id.
[217] Restat 3d of Agency, § 8.05.
[218] Id at comments.
[219] Id.
[220] Restat 3d of Agency, § 8.04.
[221] Id at comments.
[222] Restat 3d of Agency, § 8.08.

sound.[223] This duty requires that the agent seek out the advice of those with superior knowledge. This duty also requires that an agent avail themselves of all material information before deciding.[224] The agent must also have sufficient opportunity to acquire and access the knowledge.[225] Lastly, the agent cannot only accept the information presented to them by other people.[226]

Duty of good faith

Lastly, the agent must act in good faith.[227] The essential part of the duty of good faith is that the agent must act for the benefit of the corporation and fulfill their duties without violating the law.[228] The duty of good faith requires that the agent act in a manner that is conscious of their responsibilities as a fiduciary.[229]

Will "We" Be Sued?

Mr. Neumann and We Co. have faced intense backlash for many of the actions and decisions that the company has made since their founding in New York. However, the shareholders have not rectified the decisions of the former CEO because of the uneven power dynamics. That dynamic is true even with the company's largest shareholder Softbank who owned about 30% of the outstanding shares.[230] So far, these investors' only option is a campaign to put pressure on Mr. Neumann and the company to force change. The pressure and need for an

[223] Will Kenton, Duty of Care, (Updated Sep. 25, 2019), https://www.investopedia.com/terms/d/duty-care.asp.
[224] *Smith v. Van Gorkem,* 488 A.2d 858 (Del. 1985).
[225] *Moran v. Household Intern., Inc.,* 490 A.2d 1059 (Del. 1985).
[226] *Van Gorkem,* 488 A.2d 858.
[227] Restat 3d of Agency, § 8.06.
[228] *In re The Walt Disney Co. Derivative Litig.,* 906 A.2d 27 (Del. 2006).
[229] Legal Information Institute, Duty of care, https://www.law.cornell.edu/wex/duty_of_care.
[230] Anirban Sen Joshua Franklin, WeWork's financing lifeline hinges on SoftBank talks, (Oct 07, 2019) https://www.reuters.com/article/us-wework-restructuring-idUSKBN1WN00Q.

influx of cash have caused Mr. Neumann to step down as CEO and reduce his voting power from a high 20 votes to the current 3 votes per share.[231]

Another avenue that should be available to investors is suing for breach of fiduciary duty. At "the heart of the fiduciary duty is an attitude of seeking" the interest of the principal over that of the agent, "which might suggest that failing to seek the interest of the minority is sufficient to show a breach of duty."[232] Since dual voting structure showed be considered the functional equivalent to that of controlling shareholders, they should have the same obligations that are controlling shareholders have. This section will analyze the acts of Mr. Neumann and We Co. to see if violations have occurred.[233]

The shifting of tax burden from Class to Class

Mr. Neumann had the business implement a tax scheme that shifted the burden of future profits on to a specific stock class.[234] The basis of the tax scheme was to places the burden of paying taxes on profits onto the inferior shareholders. The issue is, does creating a tax scheme that explicitly benefits Mr. Neumann at the expense of the other shareholder breach his fiduciary duty? At issue here is the duty of loyalty and does the act of creating a tax scheme that benefits himself over that of the principal violates a fiduciary duty of loyalty?

The nature of creating a tax scheme that exclusively grants Mr. Neumann's stock, a tax benefit, specifically paying a lower tax bill, while simultaneously transferring the tax burden on the others, violates the duty. The creation of this kind of scheme allows Mr. Neumann a material benefit of increasing his monetary value in capital stock while also deriving the other shareholder of value. The act is a result of Mr. Neumann's authority as an agent, officer, and superior

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[231] Florian supra note 97.
[232] Johnson, 160 Or. App. 63, 68.
[233] This section is going to ignore the possibility of any misuse of nonpublic information.
[234] Wolverton supra note 122.

shareholder. This act is also self-dealing from his position as an agent because the scheme solely creates benefits for him while stealing wealth and money away from the other shareholders. The agent's act diminishes the return that the principal would otherwise be entitled to if not for the wrongful act of enriching himself. This act is a violation of the fiduciary duty of loyalty.

The profiteering off the "We®" Trademark

Mr. Neumann registered the trademark of "We" with a company that he controls but is not affiliated with WeWork, which he then attempted to sell to WeWork.[235] The issue is whether independently creating a trademark that We Co.'s desires while an officer for WeWork, then selling the mark to We Co. would be a violation of his duty? At issue here is the duty of loyalty. The duty of loyalty is violated when an agent creates a trademark derivative of the principal's work and then selling the mark back to the company.

The act of registering the mark was a violation because the act created a conflict of interest. When the CEO of the company acquires a trademark in a capacity outside of his corporate role for a mark that is derivative of the company name, he is stealing economic opportunity from the principal. The company would have a valuable benefit from the use of the trademark because of the nature of the mark's connection to the brand of the organization, especially the use of the mark "We," which is the name of the parent company.

Moreover, the act of trying to sell the asset to the company violates the duty because it put Mr. Neuman in the position where he is a hostile party to the principal. Arguably, the company has a right to the mark due to the agent creating it, but in order to get it back, the company must use people under that agent control to do so. Mr. Neumann has the personal interest to see that the principal pays as much as possible and the ability to ensure that outcome

[235] Id.

by virtue of his position as an agent. Since there is substantial economic interest for the agent and it is averse to the principal, this is a violation of the duty of loyalty.

Mr. Neumann's Soaring Issue

Mr. Neumann had We Co. purchase a $60 million jet that would primarily be for his personal use.[236] The issue is, does an agent purchase an asset that is primarily the agent's benefit a violation of fiduciary duty? The act of having the principal purchase a jet for his personal use is a violation of the duty of loyalty and care.

The duty of loyalty requires that the agent not use the property for the principal in a manner that is exclusively beneficial to the agent. Additionally, the duty of care requires that an agent act in a reasonable manner on behalf of the agent. In this case, the fact that Mr. Neumann brought a jet that the company could not afford (the company has not yet made a profit), primarily for personal use, shows an issue.[237] This act is a violation because the principal would likely use the money in a manner more consistent with the purpose and mission of the business. The jet takes money away from that mission and serves no purpose. While a principal may consent to such an arrangement, however, public records show that the officers and directors exclusively made the decision of the company. None of them are independent people from Mr. Neumann that can look out for the principal's interest. On balance, this is likely a violation of Mr. Neumann's fiduciary duty.

Drinking We's Problems Away

Mr. Neumann has a habit of purchasing a copious amount of expensive alcoholic beverages for the company's functions.[238] At issue here is the duty of care. For this duty, the

236 Brown _supra_ note 121.
237 Draft Registration Statement § Financial.
238 Brown _supra_ note 121.

standard is the business judgment rule. The purchase of drinks on the company dime and the specific situation is a violation of the duty of care.

The issue is, does Mr. Neumann's continued delivery of alcohol to his employee conflict with the best interest of the principal? While free alcohol is a common perk among startup communities, the fact that Mr. Neuman provides expensive bottles of alcohol while the company is losing money is a concern.[239] This act violates the duty of care because if the interest of the principal is to maximize returns, then this perk should be either eliminated in order to reduce cost or reduced to lower brands of alcohol and less frequent. The fact that Mr. Neumann continues the perk of purchasing expensive drinks after firing a significant portion of the workforce in order to cut costs not only defeats the purpose of the move but may open the company up to liability. While Mr. Neumann may argue that the company is keeping with the industry norms of providing drinks, that argument is ultimately defeated by the callous decision to provide these drinks after a layoff to save cost. This reduction would have been money that the company could have to save or use in a manner that would increase revenue. Mr. Neumann would have difficulty in arguing that the layoff was in the best interest of the company because keeping this initiative while layoff personnel that brings in revenue or operates the business shows that Mr. Neumann did not consider others more effective means to control costs. Overall, this act is a violation of the duty.

We's Insider Track to Contract Selection

Mr. Neumann personally has an ownership interest in serval of the buildings that WeWork currently leases office space from.[240] More so, the company also has a host of

[239] Draft Registration Statement § Financial.
[240] Wolverton supra note 122.

transactions that involve friends and family of Mr. Neumann and other insiders.[241] These transactions raise the question of whether there is a conflict of interest that breached a fiduciary duty. At issue here is the duty of loyalty.

Again Mr. Neuman is in a duty of loyalty conflict by the fact that he is on two sides of a transaction. Mr. Neumann has a substantial economic benefit as the owner of the building of WeWork paying top rental dollars while simultaneously having an interest in the company paying as little as possible.

Additionally, We Co. is stacked with vendors, executives, and employees that got their job or contracts through a personal connection to Mr. Neumann or other insiders in the company. Typically, the presence of these kinds of action is not an issue for corporations; however, it can be when these transactions are the corporate norm for the business instead of a rare event.

If the goal of the principal is the creation of a profitable company, then that would require hiring the best people and getting good contractors for low prices. The mere presence of signs of nepotism is not proof that a violation has occurred. However, it supports the belief that a violation may occur. When the contractor or deal involves a friend of the boss, it is harder to reject the contract, and it is inherently more natural to be chosen than a potentially better contractor. Based on the public information available, there is a case to be made that We Co. have violated its duty of loyalty.

Lawsuit Pending?

In reality, We Co. have faced little consequence for the numerous corporate governance missteps. The consequence for the company has been limited to public backlash, Mr. Neumann stepping down from being CEO (but remains chair of the board and superior shareholder), and

[241] Brown supra note 121.

the company pulling their registration statement for their IPO. These acts are all a result of the fact that Mr. Neumann does not have a fiduciary duty to inferior shareholders.

However, when that standard is applied, We Co. missteps are harder to ignore. Under a fiduciary duty standard, the minority shareholders would be able to sue the company for the actions of Mr. Neumann. This ability would allow We Co. to fire Mr. Neumann as both an officer and director. Additionally, the inferior shareholders would be able to put more caps on his power as a superior shareholder and make the company implements policies that would prevent future violations of a similar nature.

As the law stands now, there is little to no recourse for shareholders against actions like Mr. Neumann's. The fact remains that Mr. Neumann does not have a fiduciary duty to these shareholders. For the shareholders, this means the company is not obligated to prevent these actions from recurring. While Mr. Neumann is no longer CEO, and some deals have been undone that does not assure shareholders in any meaningful way. Mr. Neumann could be reinstated as CEO like Steve Jobs has been in the past, and a similar violation can occur in the future. This fact would all lead a reasonable shareholder of We Co. to have doubts about the company's future.

Next Steps

"There no better way to overpower a trickle of doubt than with a flood of naked truth."[242] The truth of the matter is that is, while WeWork was the focus of the analysis of this paper, the company is not alone in its corporate governance concerns. As stated above, many people see this as a feature of a dual voting structure system and not a simple bug or one-time occurrence. Similar findings can be made for Uber, Lyft, Snap, and many others.

[242] Frank Underwood, House of Cards

However, this paper is not meant to be an indictment against the structure or a call for action for the abolition of the structure. There are companies like Berkshire Hathaway that have to utilize this same structure without similar violations. The issues raised in this paper calls in question what, if anything, should be done to address the concern. As a country, the U.S. has several options available in order to address the concerns raised by this kind of structure, which will be outlined in the following pages.

The Roundtable response

In Business RoundTable V. SEC, the organization fought the SEC against the implementation of a ban on dual voting structures.[243] The organization argued that the regulation of these entities was outside the scope of the SEC.[244] The organization's approaches to dual voting structures were that investors should operate under the notion of *caveat emptor*, meaning that it is on the investor to be aware of bad business operations and governance schemes of the businesses that they invest in.

The case set the status quo for a regulatory scheme for the last 29 years of a hands-off approach to these businesses. While these structures allowed for great success, such as Warren Buffet's Berkshire Hathaway, they also have allowed for the excess described in WeWork. However, this case takes away a large part of investors' rights away to correct misdeeds. The investor is unable to fire the transgressor and may not have any legal rights to sue for the transgression. This fact leaves investors' only option to sell their shares, and that may not always be possible for a company like WeWork, who is still a privately held company. Not only is this type of approach a lousy investment for the average investor, but it is also harmful to society at large because there are fewer methods to correct adverse business action even if influential

[243] SEC, 905 F.2d 406.
[244] Id.

investors like large institutional investors support the changes. Therefore, this approach is not the best one to continue.

The Council of Institutional Investor approach

The Council of Institutional Investor (CII) approach is the reduction of these types of businesses.[245] The goal of the CII is that all corporations should have one vote per share. The CII has advocated for these companies to be required to have a sunset provision that would bring them in line with one share one vote after a specific time period.[246] The CII and other group's advocacy have caused a couple of stock exchanges to consider the elimination of these types of business from their listings. While this may remove the excesses of companies like WeWork, it would also remove the successes of companies like Berkshire Hathaway.

This approach eliminates the notion that people are capable of picking investments that they believe are right for them. The whole approach behind the SEC was that sunshine (disclosure of material information) is the best approach and not regulatory red tape that dictates what investment is right for the American public. More so, some investors are ok with a dual voting structure solely because they support the founder and are willing to accept the risk associated with the structure. The risk of this approach is not wholly advantageous because this could cause companies to be underfunded for founders fearing to lose complete control of the business.[247] Alternatively, these businesses could choose not to go public in order to skirt these laws. The last option they have is the Manchester United approach.[248] Manchester United is a UK soccer team that decided to list on the NYSE in order to have a dual voting structure.[249]

[245] Council of Institutional Investors supra 5.
[246] Id.
[247] Condon supra note 33.
[248] Id. See also, New York stock exchange ticker MANU.
[249] Condon supra note 33

Manchester United approach is where a company lists in a country that allows it to have dual voting structures. [250]

This option would be a drag on the U.S. economy because companies are not reaching their full potential. Also, it would go against the notion that people have the right to make the deal even if the deal may be a bad one. This approach of determining that these structures are always bad goes against a person's right to make that decision for themselves. Therefore, this approach is not the best one to continue.

Recommendation

Former U.S. Supreme Court Justice Louis Brandeis is noted for saying that "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[251] In the case at hand, the fiduciary duty is "the best of disinfectants," and the entire fairness doctrine is "the most efficient policeman.".

This approach allows for companies like Berkshire Hathaway to exist while limiting the excessive of companies like WeWork. This result is possible because it is not the complete abolition approach as advocated by the CII, nor is it the status quo of a hands-off approach. This middle ground bounds the excess by bringing dual-voting structures in line with the traditional business structure by using litigation and shareholder rights to force change. This approach also does not cap the ability of a company like Berkshire Hathaway to operate like other businesses where that approach may not work.

Additionally, these shareholders with superior rights are already beholden to the shareholder and the company at large because of their roles as officers and directors. To add on, the obligations of fiduciary duty to minority shareholders would be limited in cost and time to

[250] Id. See also, New York stock exchange ticker MANU.
[251] Louis D. Brandeis *Other People's Money—and How Bankers Use It* (1914)

implement. This approach can be effective. The Delaware Chancery has already adopted this approach for the majority shareholder by the number of shares and controlling shareholders. Additionally, many other states apply the rule in similar situations.

If the problem with the Business RoundTable approach reduces the rights of investors, then this approach restores investors' options. A shareholder has legal remedies to go after the transgressor. This approach is specifically helpful when the companies are still private, and they do not have the option of selling their shares. Last it would be in line with stare decisis. In the past, controlling and majority shareholders had been subjected to fiduciary duty obligations to minority shareholders in order to limit their power.[252]

Conclusion

A dual-voting structure is a corporate strategy that allows founders and management to retain control of the business. Alone this has many practical business advantages like the ability to make a long-term decision. This feat is done by splitting the voting power from the economic interest in a share. However, this structure has not been without its issues. This split has allowed companies like WeWork to get away with things that would ordinarily be a violation of their fiduciary duty to inferior shareholders. The unique nature of being both shareholders with majority voting interest and officer/directors grants them relief from the fiduciary duty to the minority shareholders because they are not clearly majority shareholder by economic interest or controlling shareholder. Also, the outsize voting interest prevents the company from revolting against them. The best approach to remedy this situation would be by applying fiduciary duty obligations, specifically to controlling shareholders in dual voting structures.

[252] See, Mitchell Cory, Majority shareholder (Updated Apr 11, 2019). See also, Johnson, 160 Or. App. 63, 69, (1999) (citing Stringer 841 P.2d 1183 (Or. 1992))