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CII Urges Exchanges to Address Shareowner Rights, Corporate Accountability Concerns by Making New Multi-Class Stock Companies Ineligible for Listing

Washington, D.C, Oct. 2, 2012 — Concerned about the number of public multi-class stock companies and the resulting potential for harm to shareowners, the Council of Institutional Investors today urged the New York Stock Exchange and Nasdaq to make new companies that have two or more classes of common stock with unequal voting rights ineligible for listing.

So-called "dual-class" or "multi-class" stock companies typically have a superior class of shares with more votes per share than the inferior class with only one vote per share – or, in some cases, no vote at all. Company founders, their families or company insiders typically hold the superior class of shares, giving them majority voting rights even when they hold minority ownership and risk. That concentrates voting power into the insiders' hands, giving them effective control of board of director elections and other matters that are put before shareowners for a vote.

The vast majority of publicly traded U.S. companies adhere to the one-share, one-vote structure widely recognized as best practice. But a significant number of start-up companies are opting for the multi-class stock structure. Twenty of 170 initial public offerings (IPOs) between January 2010 and March 2012 were by companies with a multi-class, unequal voting stock structure.

"These structures are troubling because they pose greater risks to investors and foster less accountability from boards and company insiders," said Anne Sheehan, Council chair and director of corporate governance for the California State Teachers' Retirement System. "Not only is this multi-class structure inherently unfair, there is ample evidence that multi-class stock companies do not perform as well as one-share, one-vote companies, are more prone to abuses such as excessive CEO pay and related-party transactions and are more likely to take actions that conflict with the interests of their shareowners."

"When a company goes to the capital markets to raise money from the public, public investors are entitled to certain protections and basic rights, including a right to vote that's proportional to the size of one's holdings," said Ann Yerger, the Council's executive director. "Multi-class stock structures run counter to the broader trend in corporate governance over the last decade – to strengthen shareowner rights."

In letters today to NYSE and Nasdaq – the culmination of months of Council study and analysis – the Council pointed out that listing of multi-class stock companies is essentially

The Council of Institutional Investors (CII) is a nonprofit association of pension funds, other employee benefit funds, endowments and foundations, with combined assets that exceed $3 trillion. The Council is a leading voice for good corporate governance and strong shareowner rights. The Council strives to educate its members, policymakers and the public about corporate governance, shareowner rights and related investment issues, and to advocate on members' behalf.

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prohibited on major exchanges like the London and Tokyo Stock Exchanges. Until recently, there was little interest in multi-class stock structures by U.S.-listed companies.

That seemed to change in 2004, when Google went public with two classes of common stock – Class B shares held by founders Sergey Brin and Larry Page with 10 votes per share, compared to one vote for the publicly sold Class A stock. As a result, the two founders control a majority of the voting power despite holding only 16 percent of the outstanding shares. Earlier this year, Google announced plans to issue a third class of stock with no voting rights at all.

Recent high-profile multi-class IPOs include offerings from Facebook, Groupon, LinkedIn and Zynga. At each company, a share of the insider-controlled class of stock wields seven, 10 or more votes compared to one vote for each share of the widely-held class of stock. In Zynga's case, the company issued three classes of common stock, and the superior class of stock – owned entirely by founder Mark Pincus – has 70 votes per share.

The Council finds the principal rationale offered by registrants for the multi-class stock listing – that it allows management to concentrate on the long-term growth of the company without worrying about short-term performance or other interference – to be unconvincing.

"There is no evidence that a multi-class stock structure is imperative in order for a company to succeed," said Yerger. "For example, some of the most successful companies in the technology/Internet sector – including Apple and Amazon – are known for having visionary founders and yet they all operate as single-class stock companies."

There is evidence, however, that companies with a multi-class stock structure often do not perform as well as companies with a single class of stock. *Controlled Companies in the S&P 1500: A Ten-Year Performance and Risk Review*, a new study by the Investor Responsibility Research Center Institute (IRRCI) and Institutional Shareholder Services, Inc. (ISS), found that only LinkedIn's stock has increased in value since its initial public offering – by 138 percent as of August 31. On that same date, Zynga's stock price was down by 72 percent, Groupon's by 79.3 percent and Facebook's by 52.5 percent.

That study also found that multi-class stock firms exhibit more share price volatility, that multi-class and other control companies have more related-party transactions, and that multi-class stock and other control companies have more material corporate governance weaknesses.

"Prohibiting new public companies from adopting multi-class stock structures would go a long way toward enhancing public market integrity, safeguarding public investor rights and restoring investor confidence," said the Council's Yerger.

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