Council of Institutional Investors®
The voice of corporate governance

October 24, 2018

John Zecca
Senior Vice President
General Counsel North America and Chief Regulatory Officer
NASDAQ Stock Market
805 King Farm Boulevard
Rockville, MD 20850

Sent via email

Dear Mr. Zecca:

We are writing on behalf of the Council of Institutional Investors (CII) to petition the NASDAQ Stock Market to amend its listing standards to require the following on a forward-looking basis for companies going public that seek to list with multi-class common stock structures with differential voting rights:[1]

> **The company's certificate of incorporation or equivalent document must specify provisions requiring the share structure to convert automatically to one-share, one-vote no more than seven years after IPO date, subject to extension by additional terms of no more than seven years each, by vote of a majority of outstanding shares of each share class, voting separately, on a one-share, one-vote basis.**

CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $25 trillion in assets under management.[2]

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[1] Multi-class common stock structures with differential voting rights means any capital structure through which any shareholder's voting rights, calculated as a percentage of the company's total voting power, do not equal his/her economic rights, calculated as a percentage of the company's total equity. This definition includes companies that have a single class of common stock but confer additional voting rights attached to share ownership, for example through time-phased voting structures. This also would include a Spotify-like structure, which should be deemed a multi-class company with differential voting rights as it went public with the following capital structure:

> "Each outstanding ordinary share entitles the holder thereof to one vote. In addition, we have issued 10 beneficiary certificates per ordinary share held of record to entities beneficially owned by our founders…. Each beneficiary certificate entitles its holder to one vote. Pursuant to our articles of association, our beneficiary certificates may be issued at a ratio of between one and 20 beneficiary certificates per ordinary share as determined by our board of directors or its delegate at the time of issuance. The beneficiary certificates carry no economic rights. The beneficiary certificates were issued to provide our founders with control of the Company through additional voting power."

[2] For more information about the Council of Institutional Investors ("CII"), including its board and members, see http://www.cii.org.

CII was founded in 1985 in part on concern that long-term investors in public companies were disadvantaged by voting structures that treated shareholders inequitably. At that time, effective stock exchange limitations on common equity with unequal voting structures, established following abuses in the 1920s, were deteriorating. Since then, more companies have gone public with unequal voting rights, and global competition between stock exchanges continues to erode standards in this area.

CII members believe that shareholder voting rights are critical to holding public companies accountable to shareholders.

Public shareholder voting rights perhaps reached a nadir in 2017 with the IPO of Snap, Inc., with zero voting rights for outside shareholders. Several other companies last year debuted with the authority to issue zero-vote shares.[3] In response, CII and many of our asset owner members asked leading providers of equity indexes (FTSE/Russell, MSCI and S&P Dow Jones) to take steps to limit companies with unequal voting structures in certain key indexes. From CII's perspective, this was particularly necessary for U.S.-listed companies owing to weak SEC regulatory authority in this area and what we view as inadequate U.S. stock exchange rules on voting rights. Some CII members note that index exclusion or underweighting is sub-optimal given the goal of breadth in core equity indexes, and are particularly keen to have regulators (the exchanges on this issue in the U.S. context) step up with appropriate rules. If regulators do step up, index providers would have more latitude to provide core indices that reflect the broadest market set. We expect that the adoption of stock exchange rules requiring time-based sunsets on multi-class structures would meaningfully mitigate the motivation for investors to ask index providers to factor voting rights into core index construction.

The following factors are creating a new dynamic among investors, companies and gatekeepers[4], with the potential for a high degree of consensus for time-based sunsets on multi-class structures:

- New academic evidence on the declining performance over time of multi-class stock companies (discussed below)
- Successful use of time-based sunsets on multi-class structures by a growing number of companies (also discussed below)

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[3] The trend toward unequal voting rights is of deep concern, but also should not be overstated. As of October 15, 2018, CII tracked 124 U.S.-based companies that went public on U.S. exchanges, excluding foreign private issuers, special purpose acquisition companies and master limited partnerships. Of these 124 companies, 88% went public as one-share, one-vote firms. Of the 15 U.S.-based IPO companies that used multi-class structures in that period, five included time-based sunsets that would phase out unequal voting rights after a specified period. In 2017, 19% of U.S.-based IPOs on U.S. exchanges were multi-class, and about one quarter of these had time-based sunsets. However, some of the largest companies on a market cap basis at IPO were multi-class, notably Snap and Altice USA, and multi-class companies accounted for about half of the market cap of newly IPO'd U.S. companies on U.S. exchanges in 2017. Moreover, even with modest debut of multi-class structures by U.S. IPOs in 2018, there has been an increase in the number of non-U.S. companies listing on U.S. exchanges with multi-class structures, particularly companies based in China. As of October 15, 56% of the 48 listings of non-U.S. companies on U.S. exchanges used multi-class structures. For more, see https://www.cii.org/files/2018Q3%20IPO%20Stats.pdf.

[4] See for example, WilmerHale's "2018 IPO Report" at https://www.wilmerhale.com/en/insights/publications/2018-ipo-report ("The board of a company considering the implementation of a multi-class capital structure needs to balance the intended benefits of the technique against…the potential for adverse investor sentiment (which could be partly mitigated by inclusion of a sunset provision of five years or less)."

- Negative investor reaction to Snap's IPO, as well as poor performance by Snap and two other 2017 IPOs with zero-vote share classes – Altice USA and Blue Apron
- Recent troubles at several established dual class stock public companies (notably CBS and Viacom) and even in a large private company context (Uber, which converted to one-share, one-vote)

It is critical that U.S. stock exchanges lead the way, because of (1) their size and leadership profile among global exchanges; (2) the significant regulatory role they play through listing rules, especially with regard to shareholder voting rights; and (3) the part played by U.S. exchanges over the last 30 years in eroding the concept of one-share, one-vote at public companies.[5]

CII in the past has requested that U.S. stock exchanges prohibit new listings of companies with multi-class structures that have unequal voting rights.[6] The exchanges have not responded to these requests.

Recent academic evidence suggests that the real problems with unequal voting rights develop in the medium to longer term, as SEC Commissioner Robert Jackson observed in a February 2018 speech.[7] In recent years, some new companies with dynamic leadership and innovative ideas have attracted capital on public markets with limited apparent valuation discount in the immediate post-IPO period related to unequal voting rights. But over time and on average, the valuation of these firms tends to decline, as the "wedge" between ownership and control widens, the agency costs of insider control and lack of shareholder accountability increase, founder's entrepreneurial skills and insights that initially propelled a company become dated, and

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[5] The Hong Kong Stock Exchange (HKEx) earlier this year, apparently under competitive pressure from the U.S. exchanges, decided to permit some multi-class listings with certain limitations and protections not provided by U.S. exchanges, including a requirement for an "event-based sunset" that prohibits transferring special voting rights to beneficiaries "not materially responsible for growth of the issuer." Notwithstanding these protections, which CII believes are less effective than a simple time-based sunset, HKEx early in its process ruled out a time-based sunset, in part because the U.S. exchanges lack such a rule. We believe the competitive concern was decisive for HKEx, HKEx also argued against the permission for a time-based sunset renewal feature, which we discuss in footnote 10 of this letter; and that a change in control at "an arbitrary date in the future" is not desirable. We note on the latter argument that transitions of U.S. companies with time-based sunsets have been smooth from a market perspective. Moreover, the controlling shareholder could cause the conversion earlier than the date stipulated in the company charter (which itself can be less than seven years), and a renewal feature would permit shareholders to extend the structure. See "Consultation Conclusions: A Listing Regime for Companies from Emerging and Innovative Sectors," at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Conclusions-(April-2018)/cp201802cc.pdf, pp. 41-42. See also CII's March 22, 2018 letter, to HKEx, at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/March%2022%20CII%20HKEX%20response%20FINAL.pdf.

[6] See, e.g., CII's letters dated October 2, 2012 to the New York Stock Exchange (https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_2_12_cii_letter_to_nyse_dual_class_stock.pdf) and Nasdaq (https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_02_12_cii_letter_to_nasdaq_dual_class_stock.pdf).

[7] See Commissioner Robert J. Jackson Jr., "Perpetual Dual-Class Stock: The Case Against Corporate Royalty," Feb. 15, 2018, at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty.

opportunities and risks change in ways not foreseeable by investors at IPO.[8] Moreover, as a key study demonstrates, "controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time."[9]

We believe the academic research and developing market practice suggest a logical compromise: to put in place a simple, effective sunset mechanism on common stock structures with unequal voting rights, so that markets do not suffer long-term damage from perpetual or long-lasting multi-class stock structures. We believe that time-based "sunsets" are the way forward, requiring multi-class structures with unequal voting rights to collapse to one-share, one-vote within a reasonable and specified period after IPO. A sunset of no more than seven years offers an appropriate period to harness whatever benefits of innovation and control a multi-class structure may provide while mitigating the agency costs it incurs over time.

The market has validated this approach. A limited but increasing number of multi-class companies are choosing to go public with time-based sunset provisions incorporated into their charters.[10] CII has tracked 25 U.S. companies that went public with simple, time-based sunsets since 2004, including 17 in 2015-18. The sunsets range from three to 20 years. Most are either seven or 10 years; five companies in 2004-2018 used sunsets of five years or less. The mean sunset so far in 2018 is 7.0 years, down from 9.5 years in 2017 and 10.3 years in 2016. Four of the companies that have such sunsets converted to one-share, one-vote, in smooth processes well-understood by the market. Time-based sunset language is simple, clear, and not subject to change by the controlling holder.

CII members approved a policy in 2016 suggesting that while companies should go public with one-share, one-vote, those that choose to IPO with unequal voting rights should sunset those structures within three to five years. In recognition both of evolving market practice and

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[8] See CII summary of six studies at https://www.cii.org/files/CII%20Summary%20of%20DC%20Studies.pdf. Bebchuk and Kastiel conduct an economic analysis indicating that the benefits of multi-class structures can be expected to decline, and the costs to rise, over time. Lucian A. Bebchuk and Kobi Kastiel, "The Untenable Case for Perpetual Dual-Class Stock, Virginia Law Review, Vol. 103, pp. 585-631, June 2017, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630. Bebchuk and Kastiel presented the first version of their paper in 2015. Empirical studies following this framework include: Martijn Cremers, Beni Lauterbach and Anete Pajuste, "The Life Cycle of Dual-Class Firms," at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895; Lindsay Baran, Arno Forst and M. Tony Via, "Dual Class Share Structure and Innovation", at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517; Robert Jackson, "Perpetual Dual-Class Stock: The Case Against Corporate Royalty," at https://www.sec.gov/files/case-against-corporate-royalty-data-appendix.pdf; Hyunseob Kim and Roni Michaely, "Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Structures," at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209. Notably, Cremers, Lauterback and Pajuste find that even at innovative companies where multi-class structures correlate to a value premium at the time of the IPO, that premium dissipates within six to nine years before turning negative. Baran, Forst and Via find that multi-class structures correlate with more innovation and value creation in the period shortly after an IPO, but within six to 10 years, the costs of unequal voting structures come to outweigh the benefits. Kim and Michaely find a similar result as multi-class structures become increasingly value destroying by 11 years after IPO. Importantly,

[9] See Bebchuk and Kastiel. Founders and insiders with super-voting rights have strong incentives to retain multi-class structures even after they become inefficient, and investors cannot rely exclusively on private ordering to eliminate multi-class structures that become inefficient with time.

[10] See a list of companies with time-based sunsets at https://www.cii.org/files/10-11-18%20Time-based%20Sunsets.pdf.

academic research suggesting that multi-class structures become problematic five to nine years after IPO, we request in this petition a sunset of seven years or less.

As a further compromise, we suggest that the exchange consider permitting (but not requiring) a mechanism to allow shareholders, with approval by each class voting separately on a one-share, one-vote basis, to extend the multi-class structure by terms of seven years or less. This accommodation provides an appropriate accountability moment. It also offers shareholders an opportunity to reassess any potential advantages of continued control by holders of super-voting shares for a reasonable period going forward. While such an extension mechanism has not been deemed necessary by the companies that have gone public with multi-class sunsets since 2004, we believe it should satisfy market participants who believe there should be a choice, without saddling markets with perpetual or long-lasting multi-class structures with negative repercussions years in the future.[11]

It is important that the exchange, in its regulatory role, concern itself with market dynamics in the near-term and in the longer-term. It is a mistake for the exchange to permit long-lasting or permanent multi-class structures that may do harm well beyond the time horizon that is reasonably foreseeable by investors.

We would like to meet with you to discuss this petition. We request that you contact Ken Bertsch (ken@cii.org; 202-261-7098) or Jeff Mahoney (jeff@cii.org; 202-261-7081) at your earliest convenience to set a time to discuss this.

Sincerely,

Ash Williams
Chair, CII

Jeff Mahoney
General Counsel, CII

Ken Bertsch
Executive Director, CII

[11] HKEx said in its April 2018 document permitting some multi-class listings that such a renewal mechanism would create "excessive uncertainty" as that date approached. We respectfully disagree. First, we expect that most companies that opt for multi-class shares at IPO would choose a simple sunset without a renewal provision, as a significant number of U.S. multi-class listings did in 2017-18. Second, we doubt that a time-based sunset with a renewal feature would create more uncertainty than HKEx's chosen required sunset provision, an "event-based" sunset that converts shares with super-voting rights when a company leader dies or resigns. The choice is between perpetual dual class, with the hazard that poses for companies and investors long-term, and some sunset that will create a change in control at some point in the life of a company. Time-based sunsets are simple and straightforward, and a renewal feature gives an option for shareholders to extend a structure. We expect that a shareholder who controls by virtue of special voting rights would have to make a highly compelling case to shareholders on the value proposition for continued control for a second period of time.