Council of Institutional Investors®
The voice of corporate governance

Via Email

September 13, 2019

Laurie A. Smiley, Esquire
Chair, American Bar Association Corporate Laws Committee
Alta Advisers Ltd.
8 Lancelot Place
London, England
SW7 1DR

Dear Ms. Smiley:

We are writing on behalf of the Council of Institutional Investors (CII) to request that the Model Business Corporation Act (the "MBCA") be amended by the Corporate Laws Committee (the "Committee") to limit the authority of corporations listed on national securities exchanges to adopt multi-class common stock structures with differential voting rights ("multi-class voting structures").[1]

A proposed new Section 7.21(e) of the MBCA is attached as Annex A to this letter. Pursuant to that language, no multi-class voting structure would be valid for more than seven years after an initial public offering (IPO), a shareholder adoption, or an extension approved by the vote of a majority of outstanding shares of each share class, voting separately, on a one-share, one-vote basis. Such a vote would also be required to adopt any new multi-class voting structure at a public company. The prohibition would not apply to charter language already existing as of a legacy date.

The reasons for our request are explained below.

CII is a nonprofit, nonpartisan association of U.S. asset owners, primarily pension funds, state and local entities charged with investing public assets and endowments and foundations, with combined assets of approximately $4 trillion. Our associate members include non-U.S. asset

[1] Multi-class common stock structures with differential voting rights refers to 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 includes "golden share" and similar structures. It would not restrict the ability to issue preferred stock that elected a minority of the board upon default or that had protective class voting rights. The amendment also preserves the right to meet legal and regulatory requirements including provisions that preserve Real Estate Investment Trust status or tax assets.

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owners with more than $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. CII members also share a commitment to healthy public capital markets and strong corporate governance.[2]

CII was founded in 1985, in part, due to 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.

I. THE GROWTH OF MULTI-CLASS VOTING AND SUNSET PROVISIONS

Public shareholder voting rights reached a modern nadir in 2017 with the IPO of non-voting shares of Snap, Inc. (Snap), allowing insiders to maintain perpetual control, something we had not seen since the 1920s. Several other companies have since debuted with the authority to issue non-voting shares.[3] Because many of our members use passive investment strategies for significant portions of their portfolios, and because they are uncomfortable investing in shares with limited franchise rights, CII and many of our asset owner members asked leading providers of equity indexes (FTSE Russell, MSCI Inc. and S&P Dow Jones Indices) to take steps to exclude companies with multi-class voting structures from certain key indices. From CII's perspective, this was particularly important for U.S.-listed companies owing to weak U.S. Securities and Exchange Commission (SEC) regulatory authority in this area and what we view as inadequate U.S. stock exchange and corporate law rules on voting rights.

However, index exclusion is sub-optimal given the essential element of full diversification in passive strategies: excluding multiclass voting stock from core indices means they fail to reflect the broadest market set of equities available. The result is that the authorization of perpetual multi-class voting structures forces millions of American workers struggling to save assets for retirement to choose between the ability to hold managers accountable and the ability to apply the most effective diversification strategy. CII believes that American workers and other savers deserve better.

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

[3] The trend toward unequal voting rights is of deep concern, but also should not be overstated. As of June 24, 2019, CII tracked 101 U.S.-based companies that went public on U.S. exchanges this year, excluding foreign private issuers, special purpose acquisition companies and real estate investment trusts. Of these 101 companies, 74% went public as one-share, one-vote firms. Of the 15 U.S.-based IPO companies that used multi-class structures in that period, three included time-based sunsets that would phase out unequal voting rights after a specified period. In 2018, 11% of U.S.-based IPOs on U.S. exchanges were multi-class, and about one third of these had time-based sunsets. Since 2017, 6 IPOs (including Snap, Inc.) had nonvoting shares in their capital structures. For more information, see https://www.cii.org/files/issues_and_advocacy/DualClassStock/2019%20Dual%20Class%20Update%20for%20Website%20FINAL.pdf.

We recognize that shareholder voting rights can be perceived by some founders as creating negative short-term pressure in some circumstances, and we believe that a corresponding limited term exception to a one-share, one-vote rule may address these concerns without eliminating accountability. We expect that the adoption of corporate laws limiting the duration of multi-class voting structures would meaningfully mitigate the need for investors to ask index providers to exclude issuers, and would allow workers and other investors to fully diversify their passive portfolios without having to invest in companies where management was unaccountable.

II. ACADEMIC EVIDENCE AND MARKET PRACTICE

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);
- 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, Inc. and Blue Apron Holdings, Inc.;
- Recent troubles at several established dual class stock public companies (notably CBS Corporation and Viacom Inc.); and
- Growing public concern with the unchecked power of technology companies with multi-class voting structures.[5]

Recent academic evidence suggests that the negative effects of unequal voting rights develop in the medium to long term, as SEC Commissioner Robert J. Jackson Jr. observed in a February 2018 speech.[6] 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, founders' entrepreneurial skills and insights that initially propelled a company become dated, and

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[4] See, for example, ISS's "Dual-Class Shares: Governance Risks and Company Performance" at https://corpgov.law.harvard.edu/2019/06/28/dual-class-shares-governance-risks-and-company-performance/ (indicating that CII's time-based sunset proposal "may indeed be a viable way to address the concerns of the investment community") and 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")).

[5] *See, e.g.*, Troy Wolverton, "Facebook's Mark Zuckerberg Isn't Accountable to Anyone, So It's Time Congress Took Away the Source of Power," Bus. Insider, Nov. 17, 2018, https://www.businessinsider.com/congress-should-ban-facebooks-dual-class-stock-structure-2018-11.

[6] *See* Commissioner Robert J. Jackson Jr., Speech, "Perpetual Dual-Class Stock: The Case Against Corporate Royalty," (Feb. 15, 2018), 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.[7] Moreover, as a key study demonstrates, "controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time."[8]

We believe the academic research and developing market practice suggest a logical compromise: put in place a simple, effective sunset mechanism on multi-class voting structures, so that markets do not suffer long-term damage from perpetual or long-lasting unaccountability. We believe that time-based limits requiring multi-class voting structures to sunset within a reasonable and specified period after IPO will allow companies to address the alleged problem of short-termism without requiring shareholders to entirely surrender the ability to hold the managers of their assets accountable. A sunset of no more than seven years offers an appropriate period to harness whatever benefits of innovation and control a multi-class voting 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.[9] CII has tracked 28 U.S. companies that went public with simple, time-based sunsets since 2004, including 21 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 in 2018 was 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.

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[7] See CII summary of six studies at https://www.cii.org/files/CII%20Summary%20of%20DC%20Studies.pdf. Lucian A. Bebchuk and Kobi 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," 103 Va. L. Rev. 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; 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. Baran, Forst and Via conclude that "[o]ur findings lend credence to the recent call from shareholder advocacy groups that if dual class structures should be allowed at all, they should face rigorous sunset provisions and be eliminated in a certain period post-IPO."

[8] 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.

[9] See CII list of companies with time-based sunsets at https://www.cii.org/files/6-25-19%20Time-based%20Sunsets(1).pdf.

Despite these developments, U.S. stock exchanges have not responded to CII's requests that they prohibit new listings of companies with perpetual multi-class voting structures.[10]

III. THE ROLE OF THE MBCA

In light of regulatory failure by the U.S. exchanges,[11] it is critical that the MBCA address this issue because: (1) it is the model corporation act for most jurisdictions in the U.S.; (2) it is influential to thought leaders and lawmakers beyond the jurisdictions where it has been adopted; and (3) the reputation of corporate law is being put at risk through the growing lack of accountability of public companies.[12] The nation, and its capital markets, have much to lose if corporate law is used to create large aggregations of unaccountable economic power, leading to calls for federal regulation or other restrictions on states' chartering authority.[13]

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[10] See CII letters dated October 24, 2018 and October 2, 2012 to the New York Stock Exchange and the Nasdaq at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NASDAQ%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf; https://www.cii.org/files/issues_and_advocacy/correspondence/2018/20181024%20NYSE%20Petition%20on%20Multiclass%20Sunsets%20FINAL.pdf; https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_2_12_cii_letter_to_nyse_dual_class_stock.pdf; and https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_02_12_cii_letter_to_nasdaq_dual_class_stock.pdf.

[11] Of course, the issue, like modern capital markets, is global. The Hong Kong Stock Exchange (HKEx), 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 16 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. See also CII March 22, 2018 letter to HKEx, at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/March%2022%20CII%20HKEX%20response%20FINAL.pdf.

[12] *See, e.g.*, Jack Rund, "Delaware Should Limit Dual-Class Stock Use, SEC Commissioner Says," Bloomberg L. (Mar. 20, 2019) (on file with CII) ("Robert Jackson, Jr., a commissioner at the U.S. Securities and Exchange Commission, told a University of Delaware corporate governance event March 20 that 'it might be time' for Delaware to take action on companies' use of dual-class stock.").

[13] Legislation has been introduced in the U.S. House of Representatives and the U.S. Senate to impose corporate governance rules on corporations with more than $1 billion in sales. See Press Release, "Congressman Lynch Joins Representatives Luján, Pocan, Boyle, and Schakowsky to Introduce House Companion of Senator Warren's Accountable Capitalism Act" (Dec. 14, 2018), https://lynch.house.gov/Ppress-release/congressman-lynch-joins-representatives-pocan-luj%C3%A1n-boyle-and-schakowsky-introduce; Press Release, "Warren Introduces Accountable Capitalism Act" (Aug. 15, 2018), https://www.warren.senate.gov/newsroom/press-releases/warren-introduces-accountable-capitalism-act; *see also* Letter from Senator Elizabeth Warren to Mr. John Carey, Vice President—Legal, NYSE Regulation, NYSE Euronext & Mr. Edward Knight, Executive Vice President & General Counsel, NASDAQ OMX (June 5, 2013) (supporting CII's 2012 petitions to NYSE and Nasdaq to improve listing standards for dual class stock companies with unequal voting rights).

We recognize that the MBCA is designed to serve an "enabling" function in many areas, by providing a set of default rules that can be varied through private ordering. Nevertheless, it is also the case that the MBCA does include mandatory rules, which insure investors and others that corporation law does provide a minimum standard on certain critical issues.[14] We would urge the Committee to consider that the public policy question inherent in multi-class voting structures is no less critical than the policy concerns addressed by the indemnification and voting rules of the MBCA.

Currently, the MBCA provides for one-share, one-vote as the default, but does not restrict any variance that is included in the charter. There is a reason that the default rule is single class voting—it aligns governance with ownership, and power with responsibility. As the data indicates, the long-term economic performance of corporations with multi-class voting structures reflects the wisdom of the default rule, and variance should be approached with care. CII members believe that shareholder voting rights are critical to holding public companies accountable, and that when some corporations escape accountability, all corporations suffer reputational damage and the erosion of trust.

Moreover, public companies in particular are vital institutions in today's economy. They have broad responsibilities to stakeholders who may not be included in the private ordering that puts a multi-class voting system in place. The interests of those stakeholders are put at risk when large companies remain unaccountable for long periods of time. It is one thing to give a new company a runway to innovate without the pressure of short-term market demands. It is another to allow mature companies with significant market power to operate without accountability for an unlimited duration. Unrestricted private ordering in this instance has the potential to create significant stress on our economic system.

We thus believe that the Committee, as the premier body of corporation law experts in the U.S., has a responsibility to circumscribe the ability of public companies to have perpetually unaccountable leadership in order to protect investors, to enhance the reputation of the U.S. corporate form, and to limit the aggregation of unlimited and unaccountable power implicit in multi-class voting structures.

IV. OUR PROPOSAL

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 a multi-class voting structure should sunset those structures "over a reasonably limited period."[15] In recognition, both of evolving market practice and academic research suggesting that multi-class structures become problematic five to nine years after IPO, we request the MBCA to require a sunset of seven years or less.

As a further compromise, we suggest that the Committee consider permitting (but not requiring) a mechanism to allow shareholders, with approval by each class voting separately on a one-

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[14] See MBCA Section 8.51 (limiting indemnification obligations), MBCA Section 10.04 (establishing class vote protection for certain charter amendments), and MBCA Section 2.02(b)(2) (authorizing inclusion of permitted charter provisions "not inconsistent with law").
[15] CII policies, "Investor Expectations for Newly Public Companies," https://www.cii.org/ipo_policy.

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 into the future.[16]

It is important that the Committee recognize its national obligation, as a leading source of U.S. corporate law, to address market dynamics involving both corporations and the market for corporate charters in the near-term and in the longer-term. It is a mistake to permit long-lasting or permanent multi-class structures at public companies that may do harm to both individual companies and the reputation of the U.S. capital markets well beyond the time horizon that is reasonably foreseeable by investors.

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We would like to meet with you to discuss this request. Please contact either of us (ken@cii.org; 202-261-7098 or jeff@cii.org; 202-261-7081) at your earliest convenience to establish a time to discuss this important matter in more detail.

Sincerely,

Ken Bertsch
Executive Director

Jeff Mahoney
General Counsel

Annex A

[16] 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 it 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 compelling case to shareowners on the value proposition for continued control for multiple periods.

<u>Annex A: Proposed New Section 7.21(e) of the Model Business Corporation Act</u>

(e)(1) Notwithstanding any provision in the articles of incorporation other than an approved provision, and subject to Clause (3), each share of listed residual stock shall be entitled to one vote on all matters upon which shares of stock are generally entitled to vote, and no other share of stock shall be entitled to any votes; provided, however:

(a) other shares of residual stock may be entitled to up to one vote per equivalent residual unit to which such share is entitled;
(b) shares of stock convertible into shares of residual stock may be entitled to up to one vote (less any votes permitted pursuant to subclause (a)) per equivalent residual unit to which the residual stock into which they are convertible is entitled; and
(c) shares of any class or series of stock issued for legitimate financing purposes may have such voting rights as are required by this title or established in the articles of incorporation providing for separate class or series of votes to (i) approve specified corporate actions or (ii) elect directors in the event of any failure to pay dividends or otherwise satisfy the rights, preferences and powers of such class or series, provided such directors comprise less than a majority of the entire board of directors.

(2) As used in this section only, the term:
(a) "Approved provision" shall mean (i) any provision of the articles of incorporation approved as a separate matter (including any approval of the renewal of an existing provision) by a vote of the stockholders of the corporation taken no more than seven years prior to the record date for stockholder action, such approval having included the affirmative vote of a majority of the shares of each outstanding class or series of residual stock outstanding on the record date for such vote, including, if the articles of incorporation so provided, the votes of any classes or series of stock convertible into such classes or series of residual stock (with each voting share having one vote for each equivalent residual unit to which it is entitled), (ii) any provision that was included in the articles of incorporation at the time of the initial public offering of shares of residual stock of the corporation, as long as such offering closed on a date no more than seven years prior to such record date, or (iii) any provision included in the articles of incorporation prior to _________, 20__.
(b) "Equivalent residual unit" shall mean the proportion of proceeds of dividends and liquidation to which a share of listed residual stock is entitled after any preferences pursuant to provisions authorized in the articles of incorporation are satisfied.
(c) "Listed residual stock" shall mean residual stock listed on a national securities exchange.
(d) "Residual stock" shall mean any class or series of stock entitled to share in the proceeds of dividends or liquidation after any preferences authorized in the articles of incorporation are satisfied.
(e) "Separate Matter" shall mean a matter approved by shareholders by a vote upon which no other action of the corporation or any action under its articles of incorporation (including any exchange or conversion of shares) is contingent.

(3) Nothing in this subsection shall invalidate limitations on voting rights included in the articles of incorporation in order to preserve:

(a) a corporation's status as a Real Estate Investment Trust;
(b) the value of net operating losses under the Internal Revenue Code; and
(c) any other benefit granted under applicable law.