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More Cos. Authorizing No-Vote Shares Despite Resistance

By **Tom Zanki**

Law360, New York (July 12, 2017, 8:37 PM EDT) -- More companies are establishing the right to issue nonvoting shares at their initial public offering through a triple-class stock structure, venturing beyond dual-class setups that already contain unequal voting rights favoring management's ability to maintain long-term control, despite objections from institutional groups who say the practice erodes accountability.

The two largest initial public offerings of June, a $1.9 billion IPO by cable giant Altice USA and a $300 million deal from meal-kit delivery startup Blue Apron, each established three classes of shares with varying voting power. Both deals authorized single-vote Class A shares for the public, plus super-voting Class B shares for key executives, and created potential Class C shares that carry no votes at all.

Unlike social media giant Snap Inc., which in March became to the first company to sell only no-vote shares in its IPO, neither Altice nor Blue Apron issued nonvoting shares in their IPOs. But both companies reserve the right to issue nonvoting shares in future transactions.

Some capital markets lawyers say they expect triple-class structures to spread on grounds that establishing the setup during the IPO prevents companies the headache of having to obtain subsequent shareholder approval if they want to issue a third set of nonvoting shares later.

"You will probably see more and more companies incorporate triple-class share structures at IPO so that they have optionality going forward," Kirkland & Ellis LLP Joshua Korff partner said.

Public companies often return to capital markets and issue new shares to raise additional money or finance acquisitions. If a company does so through issuing nonvoting shares, that helps prevent the already built-in voting advantage for founders and insiders from being diluted.

But some advocates for institutional investors are worried about the possibility of more triple-class arrangements. The Council for Institutional Investors, which represents pension funds and other groups that hold stakes in public companies, protested to Blue Apron just before its IPO, arguing that the structure "severely limits accountability to public shareholders."

"As long-term investors, we believe a decision by Blue Apron to go public with the triple-class structure will undermine confidence of public shareholders in the company," CII executive director Ken Bertsch wrote to Blue Apron, which declined to comment on the matter.

The triple-class structure is the latest wrinkle involving multiclass share structures, which historically have been defined by dual-class setups. In such arrangements, companies issue Class A shares carrying one vote each to the investing public while reserving supervoting shares, carrying 10 or more votes each, through separate Class B shares set aside for certain existing owners.

The idea behind dual-class structures is it provides management the flexibility to stick to its long-term vision without yielding to short-term pressures of the stock market, where activist investors often buy big stakes of companies they believe are underperforming and push for changes in direction. The more aggressive investors might seek to acquire large chunks of votes and elect friendly directors onto corporate boards or pressure the company into a sale.

But critics of the dual-class setup say it entrenches management. The CII has called for an end to dual-class structures, arguing the system insulates controlling shareholders and denies public investors an appropriate voice that should come with the risks of stock ownership.

With Blue Apron, its Class B shares retain 10 votes each compared with single-vote shares, while Altice's Class B shares carry 25 votes each. The Class B shareholders of both companies control about 98 percent of votes, according to their IPO prospectuses, though that percent could decline under certain sunset provisions where Class B shares convert to Class A.

By establishing a triple-class share structure that includes nonvoting shares, that "further complicates the entrenchment of the folks with supervoting stock and ... makes any kind of hostile takeover impossible," Baker Botts LLPpartner Sam Dibble said.

"It's essentially impossible to ever force a change in control if that voting structure remains in place," Dibble said.

Experts note that the appeal of multiclass stock arrangements is still mostly limited to companies run by iconic founders to whom shareholders are more likely to defer to additional control, such as Mark Zuckerberg of Facebook or Larry Page and Sergey Brin of Google parent Alphabet Inc. Both those companies have more than one class of voting stock.

Data shows that dual-class stocks remain a small, albeit slightly rising, component of public markets. Consultancy ISS Corporate Solutions says about 10.4 percent of 2,500 small to midcap companies it has studied since 2015 have such structures, up from 9.6 percent two years ago.

Triple-class structures are rarer. Before Snap, only a few companies authorized Class C nonvoting shares and did so after their IPO. Those include Alphabet, whose Class C shares are in circulation, and Facebook, which authorized nonvoting shares last year, though Facebook's plans are stalled by litigation from shareholders alleging the plan unfairly benefits Zuckerberg**.**

Absent pushback from the market, lawyers say there is nothing stopping more companies from issuing no-vote share structures or other uneven voting arrangements given the absence of regulatory obstacles. But it's an easier sell if shareholders trust the particular leader of a company.

"From a securities law standpoint, it's perfectly easy let to people know what the risks are, and people can make a decision whether they are willing to make a bet on that person," Orrick Herrington & Sutcliffe LLP partner Chris Austin said.

Both the New York Stock Exchange and Nasdaq permit multiclass voting arrangements, and despite calls by CII for the U.S. Securities and Exchange Commission to intervene and bar no-vote share structures, experts don't foresee any action by the current SEC.

SEC Chairman Jay Clayton, who in private practice worked on the IPO for e-commerce giant Alibaba Group Holding Ltd., a Hong Kong company that chose to list in the United States in part because of more flexible rules regarding multiclass voting structures, has stated his intent to encourage more public listings during an era of otherwise declining of IPOs.

The SEC declined to comment.

--Editing by Christine Chun and Catherine Sum.

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