

## The Concerns Surrounding Snap's No-Vote Shares

By **Brian Shea, Mintz Levin Cohn Ferris Glovsky and Popeo PC**

Law360, New York (May 15, 2017, 12:01 PM EDT) -- Snap Inc., which debuted on the New York Stock Exchange on March 2, was the largest tech initial public offering since Alibaba went public in 2014. Initially priced at \$17 per share, the share price jumped to more than \$24 by the end of the first trading day, raising \$3.4 billion and beating market expectations.



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Beyond the magnitude of the offering and its implications for the broader deal pipeline, Snap's IPO has raised interesting governance issues around its nonvoting shares, which the U.S. Securities and Exchange Commission's Investor Advisory Committee (IAC)[1] tackled on March 9 at its quarterly meeting. The IAC's discussion centered on Snap's three-tiered capital structure: Class C shares with 10 votes per share for founders Evan Spiegel and Bobby Murphy, Class B shares with one vote per share for pre-IPO venture capital investors and other insiders, and Class A shares with no voting rights for public investors. Companies like Facebook and Google have employed similar structures in the past; in fact, a recent study by Institutional Shareholder Services noted that dual- and multiclass capital configurations are common, especially in the technology sector.[2] However, the notion of affording no voting rights whatsoever to public investors is unprecedented.

### Snap Raises Concerns From Investor Groups Around Governance Controls

Some have expressed concern that the issuance of no-vote shares weakens corporate governance controls. The same ISS study referenced above found that "controlled companies" — those with multiclass or unequal voting rights like Snap — tend to underperform relative to their noncontrolled peers in several key areas of assessment, including shareholder returns, revenue growth, and return on equity. The most critical investors' rights advocates argue that Snap's no-vote share class will be disastrous for the company's shareholders who will be left without a say while Snap is given the go-ahead to operate as a public company without being subject to traditional public company voting and disclosure requirements.[3]

Others who were not on the IAC's meeting agenda are less fatalistic in their assessment of Snap's potential impact on shareholder rights. Looking at industry trends, some of the most successful public technology companies have concentrated voting power among the company's founders, and shareholders appear to have benefited (or at least not to have been disadvantaged) as a result.[4] Facebook and Alphabet are prime examples. Others maintain that Snap is an anomaly — as a tech "unicorn" (one of a select group of private ventures valued at more than \$1 billion), Snap is able, by virtue of its rarefied status, to issue no-vote shares, whereas smaller-cap or less prestigious companies likely could not. As long as Snap continues to prosper, so will its Class A holders, even without a direct say in the company's decision-making.

### Snap's Disclosure Obligations to Class A Holders

Beyond the general governance concerns, Snap's IPO has also generated discussion around the company's disclosure obligations. Are Snap's no-vote shares entitled to the same degree of disclosure as voting shares? Technically no, though Snap has indicated in its SEC filings that it intends to afford Class A holders the same degree of transparency as those with voting rights.[5]

According to Snap's prospectus, the company plans to invite the Class A holders to attend the annual meeting and to submit questions to the management team. Snap simultaneously acknowledges that its Class A shares are its only class of stock registered under Section 12 of the Exchange Act, and therefore Snap is not required to file a proxy statement unless a vote of Class A holders is required by applicable law. The company promises, "[W]e will provide holders of our Class A common stock ... any information that we provide generally to the holders of our Class B common stock and Class C common stock, including proxy statements, information statements, annual reports, and other information and reports." [6]

Snap's promise comes with several important caveats. First, if the company doesn't deliver proxy statements or information statements to Class B holders, then it will not do so to Class A holders — that goes without saying. Second, Snap will be still obligated to comply with the ongoing periodic and current disclosure requirements of the Exchange Act, including Form 8-K, which may be filed up to four business days after a material event and which, by its nature, is less detailed and more open-ended in terms of content requirements than a proxy statement. This means that Snap's disclosures on executive compensation and related matters may include less information than would otherwise be required by a proxy statement. Lastly, because Snap is not bound by the proxy-filing requirements, any filing the company does make may not contain all the information that would otherwise be required of a public company with voting shares. Class A holders will essentially be reliant on the company's annual, quarterly and current reports, without the ability to refer to proxy statements for information on, for example, its compliance with proxy access rules. As a side note, Snap will not be required to comply with the Dodd-Frank Act's "say-on-pay" and "say-on-frequency" rules, by virtue of its status — for now — as an emerging growth company under the JOBS Act. [7]

## **Obligations of NYSE and Other National Exchanges**

Testifying before the IAC, Ken Bertsch of the Council of Institutional Investors questioned what Snap's IPO means for institutional asset owners, which hold the majority of publicly traded securities in the U.S. [8] He criticized the NYSE for being "asleep at the wheel" by allowing Snap to list a nonvoting class of securities on the exchange, which he argued were more akin to preferred stock or derivatives. Aside from Snap's ability to trade on the NYSE, Bertsch asserted that the company should not be permitted to participate in public company stock indices. Under his theory, an investment in an index fund pegged to the S&P or any other index carries with it certain expectations regarding the underlying disclosures of listed companies, and Snap's no-vote shares run afoul of those expectations by adding a layer of complexity that will not be adequately reflected in the price.

Given the SEC's regulatory power over national securities exchanges like the NYSE, a number of related questions emerge: How does allowing Snap to list on the NYSE impact exchanges outside the U.S. where listing requirements are generally less onerous? Should the SEC be concerned about a potential race-to-the-bottom amongst non-U.S. exchanges? [9] How should the SEC balance investor protection directives against the desire to entice private companies to go public?

None of these questions were answered on March 9. At most, the testimony amounted to a call by investor groups to revisit the rules surrounding multiclass common structures listed on U.S. domestic exchanges in light of Snap and the potential for other companies to replicate its offering structure. Those who are skeptical of CII's argument with respect to index funds will note that Snap is still subject to '34 Act reporting requirements, which generally puts it on par with other companies listed in the index (proxy rules excepted). Certainly, fewer or limited disclosures are of concern to any investor who wants to ensure the share price accurately reflects the totality of information available. Those concerns may be better directed at deregulatory efforts generally, rather than at Snap, which continues — at least as of this writing — to trade above its initial IPO price.

## **Conclusion**

It's unclear whether the SEC will address the topic of no-vote shares again in the near term, especially given its change in leadership and priorities. All parties would benefit to wait and see how Snap performs over time and whether the company endeavors in good faith to provide its Class A holders with a degree of transparency that resembles that of more traditional

shareholders.

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[1] The IAC is a mandate under Dodd-Frank, set up to advise the SEC on various regulations affecting investors. Here's a link to the agenda, as posted on the IAC's website:  
<https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac030917-agenda.htm>.

[2] See Rob Kalb and Rob Yates, "Snap Inc. Reportedly to IPO with Unprecedented Non-Voting Shares for Public," Harvard L. Sch. Forum on Corp. Governance and Financial Regulation (Feb. 7, 2017), <https://corpgov.law.harvard.edu/2017/02/07/snap-inc-reportedly-to-ipo-with-unprecedented-non-voting-shares-for-public/> (looking at post-IPO companies holding their first annual meetings, finding several instances of 10-1 voting structures between insiders and outsiders).

[3] See generally Testimony of Ken Bertsch before the IAC (Mar. 9, 2017), available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/bertsch-remarks-iac-030917.pdf>.

[4] See, e.g., Kurt Wagner, "One way Snapchat's IPO will be unique: The shares won't come with voting rights," Recode (Feb. 21, 2017), <http://www.recode.net/2017/2/21/14670314/snap-ipo-stock-voting-structure>.

[5] See, e.g., Preliminary Prospectus, filed with the SEC:  
<https://www.sec.gov/Archives/edgar/data/1564408/000119312517056992/d270216ds1a.htm>.

[6] Id. at 5.

[7] See Eleanor Bloxham, "Snap Shouldn't Have Been Allowed to Go Public Without Voting Rights," Fortune (Mar. 3, 2017), <http://fortune.com/2017/03/03/snap-ipo-non-voting-stock/>.

[8] See supra note 3.

[9] See generally "SEC Should Bar No-Vote Share Structures, Committee Told," Law360 (Mar. 10, 2017), [https://www.law360.com/capitalmarkets/articles/900042?utm\\_source=rss&utm\\_medium=rss&utm\\_campaign=section](https://www.law360.com/capitalmarkets/articles/900042?utm_source=rss&utm_medium=rss&utm_campaign=section).