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Moves by Shareholder Groups Revive Discussions About Voting

By Lindsay Frost April 18, 2016

Recent announcements from **T. Rowe Price Group** that it will vote against directors at companies that have a dual-class voting structure and from the **Council of Institutional Investors** recommending that all companies going public use a “one share, one vote” structure have thrust shareholder voting rights back into the conversation this proxy season.

T. Rowe Price and CII made their decisions partly because of the recent increase in the number of companies going public with dual-class shares. The dual-class voting system consists of different classes of stock with distinct voting rights and dividend payments. According to **Dealogic**, in 2015, approximately 14% of initial public offerings included some type of dual-class stock structure. A dual-class voting structure protects some investors while leaving others more vulnerable.

In an effort to enhance voting rights for long-term investors, governance experts are once again considering the impacts of tenure voting, a system that would give shareowners more votes per share the longer they hold their stake in the company. It is unclear whether there would be a set way to implement the system or if it would be left up to each company to determine how many votes per share each shareowner would earn after a set period of time, but proponents say tenure voting offers a system that could potentially be more fair than current alternatives.

Doug Chia, executive director of the **Conference Board**, says that at some companies with dual-class voting structures, the shares without voting power trade at a discount, which sets up a situation where shareholders are actually paying more for the right to vote. Chia says this is “a clear demonstration that certain investors care about the vote and others don’t.”

However, shareholder groups have long advocated for a one-vote-per-share structure. In fact, in 2015 nine shareholder proposals were submitted to companies requesting that the company adopt this type of structure, according to **Alliance Advisors**. All of these proposals failed.

So far in 2016, two one-vote-per-share proposals were put forward at **Viacom** and **Ford Motor**.

Advantages of Tenure Voting

University of California, Berkeley School of Law professor **Steven Davidoff Solomon**; **David Berger**, partner at **Wilson Sonsini Goodrich & Rosati**; and Wilson Sonsini Goodrich associate **Aaron Jedidiah Benjamin** co-authored “Tenure Voting and the U.S. Public Company,” a white paper addressing the idea of tenure voting that they released in early March. The paper proposes that more

votes be given to a shareholder each year that they continue to hold stock. For example, Solomon wrote, if you hold shares for three years at a company, you would receive three votes per share.

“Tenure voting has the potential to be a more palatable alternative to high-vote and no-vote shares while also addressing current arguments about long- and short-termism in U.S. markets,” wrote Berger in a **Harvard** corporate governance blog post. “By design, tenure voting rewards all shareholders who hold their shares for an extended period.”

The most important potential benefits, according to the paper, include providing companies with a core base of long-term investors while also giving shareholders who meet the provided thresholds greater input into voting decisions. The system also allows shareholders who are not as interested in the long-term future of the company to sell their shares without liquidity concerns.

“I think the concept is a good one,” says Chia. “It’s being put forward to incentivize investors to hold their shares for longer and therefore think about the long-term interests of the company and reward those by giving them a more powerful voice in how the company conducts themselves.”

Solomon sees tenure voting as a “middle ground” between the dual-class and one-vote-per-share systems, both of which he says are not perfect. However, governance experts say logistical concerns and other issues would halt adoption of tenure voting in the near term.

“Tenure voting could have some appeal for those concerned that markets can at times focus management and boards too strongly on short-term share price fluctuations,” says **Ken Bertsch**, executive director of the CII. “But in practice, tenure voting schemes in the United States and abroad, at least in the past, seem to have disproportionately empowered inside holders that can have interests that diverge from more general interests of the ownership base as a whole.”

Potential Drawbacks

Bertsch says a number of challenges await those looking to implement tenure voting, including the administrative burden involved with asserting long-tenure voting rights, the difficulty of using these “multiple vote shares” in acquisitions, and finding the right balance of shareholder control so that companies are not overly protected and entrenched.

Bradley Faris, global co-chair of **Latham & Watkins**’s mergers and acquisitions practice, writes in an e-mail that tracking and verifying the votes per individual shareholder is perhaps the toughest challenge.

“It is difficult, if not impossible, to track votes by shareholders that hold in ‘street name’ through a broker or dealer and, accordingly, excess votes may be cast to which shareholders are not entitled,” Faris says.

Equity derivatives and similar hedging issues also need to be considered, he adds. “Those strategies could allow a shareholder to retain beneficial ownership over the ownership period, without retaining economic risk in the shares, in a manner intended to facilitate excess voting.”

Companies That Have Used Tenure Voting*

Company	Status of Plan
Aflac Inc.	Intact
Carlisle Companies	Intact
CenturyTel Inc.	Rescinded 1991
Milacron Inc.	Rescinded 2003
Church & Dwight Co.	Rescinded 2003
J.M. Smucker Co.	Intact
Potlatch Corp.	Rescinded 2005
Pioneer Hi-Bred International, Inc.	Terminated when acquired by DuPont in 1999
Quaker Chemical Corp.	Intact
Roper Industries, Inc.	Rescinded 2006
Shaw Group Inc.	Rescinded 2007
Synovus Financial Corp.	Intact

*As of March 1, 2016

Source: "Tenure Voting and the U.S. Public Company"

The definition of "long-term" is also key if a system like this is to be successful, says **Bob Lamm**, co-chair of law firm **Gunster**'s securities and corporate governance practice.

"How do you define 'long-term'? Every once in a while investors will say they are long-term and their average holding period will be two years. So, how would you define this in terms of the types of securities owned? If they have a call [option], does that count, and how does it count?" Lamm says.

According to the white paper, over the last 30 years 12 U.S. companies have used a tenure voting system. Five of these companies still have the system, including **Aflac**, **Carlisle Companies**, **J.M. Smucker Co.**, **Quaker Chemical** and **Synovus Financial Corp.**

Aflac shareholders are entitled to 10 votes per share after holding for four years, but according to its 2016 proxy statement, stock held in street name are presumed to be held less than the four-year period. The board gives shareholders the option to refute that presumption by filling out an affidavit.

At Carlisle, shareholders that held stock before its string of acquisitions in March 1986 formed the new Carlisle Companies are entitled to five votes per share, and those who acquired shares after May 1986 must wait four years before they hold the same power, according to the company's most recent proxy statement.

"If it appears from experience that the present process is inadequate or is being abused, the company and its board of directors reserve the right at any time to require that a particular shareholder provide additional evidence that one of the exceptions is applicable," the company says.

In addition to these companies, Chia points to a paper released by the Conference Board late last year on the effects of short-termism in the U.S. that references loyalty shares, similar to tenure shares, at companies like **Fiat Chrysler Automobile** and **Ferrari** and restricted trading shares at **Toyota Motor Corp.** that have been adopted more in recent years as companies aim to thwart short-term investors.

According to Faris, systems like these would likely only be applied prior to a company's IPO, and "absent changes to existing **SEC** and stock exchange rules or other special circumstances, the structure is not likely to be available for existing public companies." But companies going public need to

consider their shareholder base and what voting system would work best for them before enacting a specific system.

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