

Withhold the Vote 2018: Failure to Sunset Perpetual Dual-Class Stock

We encourage Red Rock Resorts shareholders to withhold authority to vote on their proxy card for all five of the company's director nominees – Frank J. Fertitta III, Lorenzo J. Fertitta, Robert A. Cashell, Jr., Robert E. Lewis, and James E. Nave, D.V.M. – at the upcoming annual stockholders meeting on June 14.

The many problems arising from the company's perpetual dual-class stock make it necessary for outside shareholders to withhold their votes, especially after the company has made no attempt to address the [significant shareholder discontent expressed at last year's annual meeting](#). Dual-class stocks give super voting insiders outsized influence, trade at a significant discount, risk index exclusion, and face opposition from prominent shareholder and investor groups. Despite these issues, Red Rock's board of directors have not announced any plans to sunset its dual-class structure.

In a follow-up report, we will also examine how Red Rock's dual-class stock may be preventing the company from participating in recent M&A opportunities and diversifying its portfolio.

RED ROCK RESORTS' PERPETUAL DUAL-CLASS STOCK

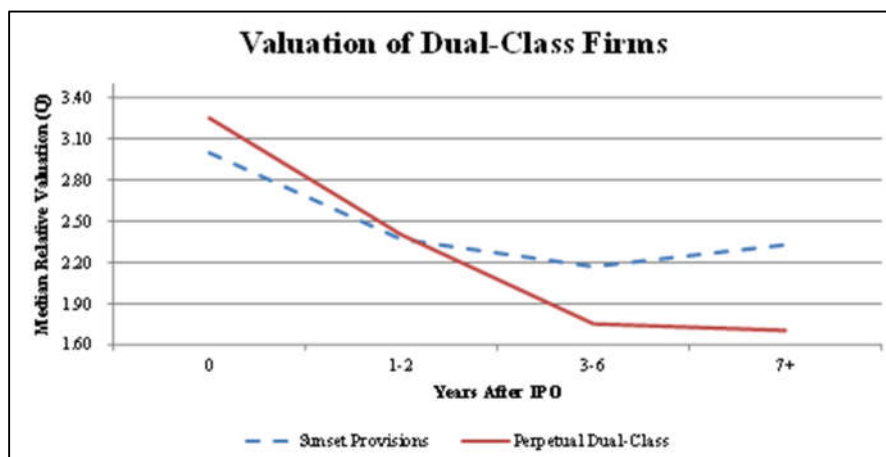
Red Rock went public in April 2016 with a perpetual dual-class equity structure that provides 10:1 super voting stock for Fertitta family insiders. The Fertitta family now owns only 39.1% of the equity in Red Rock, but with their super voting shares control 86.5% of the combined voting power (as of April 20, 2018).¹ Conversely, while public shareholders own over 60% of the equity, they only have 13.5% of the combined voting power. The dual-class share structure is bolstered by other anti-shareholder devices, including:

- Supermajority (2/3) vote requirements to change sections of the company's certificate of incorporation and bylaws when the company is no longer controlled.
- Limitations on stockholder action by written consent.
- Limitations on special meetings of stockholders.
- Fertitta family exemption from a Delaware antitakeover statute, while upholding the statute for all other "interested stockholders."
- Board's right to issue preferred stock without shareholder approval.
- Poison pill Tax Receivable Agreement with pre-IPO owners.

Dual-class equity structures have been on the rise in recent years. The number of companies with dual-class shares increased by 44% from 2005 to 2015.² This trend is particularly notable among high-tech firms (e.g. Google, Facebook, Snap, etc.), in which investors forego control and place their confidence in visionary founders. As a result of this increase, dual-class structures have come under increasing scrutiny by several key stakeholder groups in the capital market.

SEC: Perpetual dual-class shares trade at a significant discount. A recent review of 157 dual-class initial public offerings over the past 15 years by the SEC demonstrates the value-reducing effect of these structures. Commenting on the findings in a February 2018 speech, SEC Commissioner Robert Jackson Jr. said:

Seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions. We also found that, among the small subset of firms that decided to drop their dual-class structures later in their life cycles, those decisions were associated with a significant increase in valuations.³



Source: SEC website, speeches, "Perpetual Dual-Class Stock: The Case Against Corporate Royalty"

Index providers: Dual-class structures risk index exclusion. Index inclusion is important for public investors as it increases the liquidity and value of a stock, according to well-established research.^{4,5} In lieu of meaningful action by lawmakers, regulators, and exchanges on dual-class structures, three major index providers have taken the helm by setting restrictions on index inclusion.

FTSE Russell was the first index provider to take action, announcing on July 26, 2017 that it would bar companies in which public shareholders have 5% or less of the voting rights from all of its standard indexes.⁶ FTSE Russell reportedly plans to revisit, and potentially increase, its 5% threshold this summer.⁷ After consulting with index stakeholders, FTSE Russell reported: "Of the respondents who thought a minimum voting rights hurdle was sensible, 23% thought the rate should be set at 5%, and 55% thought it should be set at 25%."⁸ Notably, increasing the minimum voting rights hurdle to 25% would preclude Red Rock's inclusion in the Russell 3000 since its public shareholders collectively only control 13.5% of the combined voting power, despite holding 60.9% of the equity.

The S&P Dow Jones announced on July 31, 2017 its decision to stop adding companies with dual-class structures to the S&P Composite 1500 and component indices, which includes the S&P 500, MidCap 400, and SmallCap 600.⁹

MSCI has been considering this issue as well. First in June 2017, it proposed to ban companies whose listed shares comprised under 17% of total voting power (25% for new constituents), but the proposal was not adopted and MSCI extended the consultation period.^{10,11} Then it temporarily banned companies with “unequal voting structures” from being added to the MSCI ACWI Investable Market Index and MSCI US Investable Market 2500 Index in November 2017.^{12,13} While MSCI’s consultation process continues, the most recent proposal from the index provider states:

MSCI would continue to include stocks with unequal voting rights in the MSCI Equity Indexes, but would adjust the weights of these stocks to reflect both their free float and their company level listed voting power.¹⁴

Shareholder advocacy groups: Calls for one share, one vote standards and for companies to sunset dual-class structures. Major proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis, as well as the Investor Stewardship Group (ISG) and the Council of Institutional Investors (CII) recommend that companies with dual-class structures sunset these structures within a reasonable time period.^{15,16,17,18} CII identified Red Rock as a bad actor before it went public in 2016, saying:

Red Rock Resorts, a Las Vegas casino company pursuing an IPO, provides a perfect example of why CII’s Policies Committee and board of directors approved a statement that calls on young companies with corporate governance structures that insulate management from shareholders to sunset these structures within a limited time period.¹⁹

Companies ignore the positions of these influential shareholder advocates at their own risk. According to a 2016 report by the U.S. Government Accountability Office “ISS had about 1,600 institutional investor clients and executed more than 8.5 million ballots annually on behalf of those clients”²⁰ and Glass Lewis provides services “to more than 1,200 institutional investors that collectively manage more than \$20 trillion.”²¹ ISG describes itself as a “group of 50 U.S. and international institutional investors that in aggregate invest over \$22 trillion in the U.S. equity markets”²² and CII claims \$3.5 trillion in assets with non-voting members representing an additional \$25 trillion.²³

Some companies have taken action to align themselves with the mainstream position of these shareholder advocates. Zynga Inc.’s founder, Mark Pincus, recently converted all of his high voting shares into one share, one vote stock – reducing his voting rights from 70% to 10%.²⁴ Commenting on the decision, Pincus said:

Given our positive momentum, now is the right time to simplify our stock structure and transition to one share, one vote. I believe it’s in the best interests of our shareholders to establish voting rights parity for all.²⁵

Zynga's share price has increased 27% since the announcement (closing price May 1, 2018 to closing price June 1, 2018).²⁶

Withhold Votes on All Directors at Red Rock's Upcoming Annual Meeting

Public shareholders should send a clear message to Red Rock's directors that it is unacceptable for them to perpetuate the company's dual-class structure, which depresses the share price, risks index exclusion, and is out of alignment with mainstream corporate governance principles. The board should take immediate steps to sunset the company's dual-class structure.

Every director up for vote at Red Rock's annual stockholder meeting was on the board of Red Rock before the company went public and is culpable for implementing the company's anti-shareholder corporate governance. For these reasons we encourage Red Rock's shareholders to withhold their votes on the company's entire board of directors - Frank J. Fertitta III, Lorenzo J. Fertitta, Robert A. Cashell, Jr., Robert E. Lewis, and James E. Nave, D.V.M. – at the upcoming annual stockholders meeting on June 14, 2018.

Notes

¹ Red Rock Resorts, Inc. SEC Form DEFR14A, filed on April 20, 2018, pp. 2, 44.

² U.S. Securities and Exchange Commission, Investor Advisory Committee, "Discussion Draft Re: Dual Class and Other Entrenching Governance Structures in Public Companies," December 7, 2017, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/discussion-draft-dual-class-recommendation-iac-120717.pdf>

³ Commissioner Robert J. Jackson Jr., "Perpetual Dual-Class Stock: The Case Against Corporate Royalty," speech, U.S. Securities and Exchange Commission, February 15, 2018, https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty#_ftnref22

⁴ Prem C. Jain, "The Effect on Stock Price of Inclusion in or Exclusion from the S&P 500," Financial Analysts Journal, January-February 1987:58-65, <http://www.jstor.org/stable/4479002>

⁵ Shantaram P. Hegde, John B. McDermott, "The liquidity effects of revisions to the S&P 500 index: an empirical analysis," Journal of Financial Markets 6(3):413-459, May 2013, <https://www.sciencedirect.com/science/article/pii/S1386418102000460>

⁶ FTSE Russell, "FTSE Russell Voting Rights Consultation – Next Steps," July 2017, http://www.ftse.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf

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- ⁷ Andrea Vittorio, “FTSE Russell to Revisit Voting Power One Year After Snap IPO,” Bloomberg Law, March 13, 2018, <https://www.bna.com/ftse-russell-revisit-n57982089820/>
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- ⁹ S&P Dow Jones Indices, “S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules,” press release, July 31, 2017, https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/561162_spdjimulti-classsharesandvotingrulesannouncement7.31.17.pdf?force_download=true
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- ¹¹ Nick Baker, Benjamin Robertson, and Andrea Tan, “MSCI Extends Review of Whether to Ban Multiple-Class Stocks,” Bloomberg, November 2, 2017, <https://www.bloomberg.com/news/articles/2017-11-02/msci-extends-review-of-whether-to-ban-multiple-class-stocks>
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- ¹³ Meaghan Kilroy, “MSCI to temporarily block new companies with unequal voting structures from 2 indexes,” Pensions & Investments, November 3, 2017, <http://www.pionline.com/article/20171103/ONLINE/171109929/msci-to-temporarily-block-new-companies-with-unequal-voting-structures-from-2-indexes-governance?template=print>
- ¹⁴ MSCI, “Consultation on the Treatment of Unequal Voting Structures in the MSCI Equity Indexes,” January 2018, https://www.msci.com/documents/1296102/8328554/Consultation_Voting+Rights.pdf/15d99336-9346-4e42-9cd3-a4a03ecff339
- ¹⁵ Institutional Shareholder Services, “United States: Proxy Voting Guidelines,” January 4, 2018, pp. 14-15, <https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf>
- ¹⁶ Glass Lewis, “2018 United States Policy Guidelines,” pp. 1, 19-20, https://www.glasslewis.com/wp-content/uploads/2017/11/US_Guidelines_2018.pdf
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- ¹⁸ Council of Institutional Investors, “Issues & Advocacy: Dual-Class Stock,” website, https://www.cii.org/dualclass_stock
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