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Facebook and Family Business

Facebook is a founder-controlled firm, with Mark Zuckerberg controlling approximately 60% of the voting power and owning about 15% of the total economic interest. This has been accomplished by using a two-class stock structure – Class A and Class B – where the Class B shares have ten times the voting power of the Class A shares. Zuckerberg and other insiders own most of the Class B shares; the Class A shares are publicly owned. This two-class structure has become common for founder-led public technology companies across the globe – think Google and Alibaba, for example – and in most initial public offerings today.

The shareholders of Facebook were recently asked to approve the creation of a new Class C series of shares – non-voting shares that would be issued to current Class A and B shareholders via dividend. The Chan Zuckerberg Initiative – an LLC to which Zuckerberg plans to gift or otherwise direct all of his shares or the net proceeds and ultimately use to fund his family’s charitable giving – was announced in late 2015. This, plus the potential issuance of additional Class A shares to fund stock-based incentive compensation plans, might lead to the loss of founder control by Zuckerberg. The net effect of the new Class C shares would be to enable Zuckerberg to substantially reduce his economic interest in the company – by either outright sale or gifting the Class C shares – without relinquishing his voting control. Likewise, the company can use the Class C shares as an acquisition currency and for equity compensation grant programs without diluting the voting power of the other classes.

The Facebook board of directors established a committee to assess the fairness of this plan to all the other shareholders. The committee proposed several concessions regarding Zuckerberg’s control over the company should he cease to be CEO, either from death, disability, or ceasing to be employed there (for cause or voluntary). Prior to the proposed changes, Zuckerberg and his heirs are set to retain voting control over the company so long as they retain ownership of the Class B shares. This would be the case even if Zuckerberg no longer served as CEO, resigned, or was terminated for cause. That is, under the existing structure, Zuckerberg could retain control of the company even if he were to go to work for a competitor and use his talents to compete against Facebook.

The committee determined the following:

- Zuckerberg’s continued leadership role at Facebook is a substantial benefit to the company
- It is desirable to have Zuckerberg with the ability to determine the outcome of all matters submitted to shareholder vote
- The structure enables the company to continue emphasizing innovation and long-term growth, versus short-term performance pressures
- The ability to focus on the long term is a competitive advantage and avoids distraction of management
- The proposed changes will allow the company to continue to execute with speed and agility

Because Zuckerberg’s control of the company will be prolonged despite his plan to dispose of most of his economic interest, it will actually incent Zuckerberg to stay with Facebook longer.

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The critical beneficial change effected by the committee in connection with the creation of the Class C shares is that all of the Class B shares will automatically convert into Class A shares within specified periods (“sunset transitions”) following the death, disability, or termination (voluntary or involuntary) of Zuckerberg as an Executive Officer of Facebook.¹

Zuckerberg also agreed to enter into a “Founder’s Agreement” with the company that provides further justification for the Class C issuance. In it, he agreed to convert all of his Class B shares to Class A shares if his family ever owns less than a majority of the Class B shares. He also agreed to meet with the board of directors from time to time and, upon reasonable request by any board member, to discuss succession planning during any designated “sunset” transition period following the death, disability, or other termination of Zuckerberg as an executive officer of the company. During any such sunset period, the voting proxy for all of Zuckerberg’s Class B shares will be held by a senior officer of Facebook previously selected by Zuckerberg (after discussion with the independent directors of the board). These agreements effectively assure shareholders that CEO succession issues will be decided by the board, not Zuckerberg or his heirs.

The Facebook voting control example is fascinating vis-à-vis its similarity to family-controlled businesses. Many family-controlled businesses, including those publicly held, vest voting control in a family group in perpetuity. A great example of the pitfalls of this practice is the current controversy over the Redstone family’s control of Viacom and CBS. There, a perpetual voting trust owns roughly 80% voting control of both companies yet less than 12% of the economic interest. An epic legal battle is raging among the family members over who is in charge of the voting trust. The non-family shareholders of Viacom and CBS have no say in any of this despite owning over 88% of the economic interest in the companies.

The corporate governance future of the company appears to have improved dramatically by the deal the committee struck with Zuckerberg. The proof will be in just how great Zuckerberg is at running the company as the years go by. If his magic touch falters, the shareholders will only have themselves to blame. One thing that doesn’t change—Zuckerberg will run the company until he dies, becomes disabled, or steps down of his own volition. The termination-for-cause language in the Founder’s Agreement makes a “for cause” termination virtually impossible. Investors, beware!

¹It is noteworthy that Zuckerberg specifically negotiated a two year “carve out” from this conversion provision to enable him to take a leave of absence from the company for government service.

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