CtW Investment Group

April 9, 2015

Mary Brienza
Chief Executive Officer
NYSE Regulation, Inc.
20 Broad St.
New York, NY 10005

Dear Ms. Brienza,

We write to urge you to investigate and, if appropriate, begin proceedings to delist the common stock of Arcos Dorados Holdings Inc. ("AD"), which currently trades on the New York Stock Exchange ("NYSE"). Available information suggests that AD's stock may be unsuitable for continued listing on the NYSE due to self-dealing conduct "not in keeping with sound public policy." We ask you to use your authority under the Listed Company Manual to obtain additional information on the matters described below in order to evaluate the suitability of AD's common stock for listing.

The CtW Investment Group works with pension funds sponsored by affiliates of Change to Win, a federation of unions representing over five million members to enhance long-term shareholder value through active ownership. These funds invest over $250 billion in the global capital markets and are investors in AD.

<u>Arcos Dorados' Corporate Governance</u>

AD is the world's largest franchisee of McDonald's restaurants, operating and sub franchising restaurants in Mexico, Central and South America and the Caribbean. AD is domiciled in the British Virgin Islands ("BVI"). AD has issued two classes of common stock, Class A and Class B. Class A common stock is traded on the NYSE and has one vote per share. Class B common stock, which is not publicly traded, has five votes per share. All of the Class B common stock is held by an entity whose sole owner is Woods Staton, AD's CEO and Chairman. In this way, Staton controls 76% of AD's voting power while holding only 40% of the outstanding shares of common stock.

As a foreign private issuer, AD is not required to comply with NYSE listing standards mandating that issuers have a majority-independent board as well as compensation and nominating committees made up solely of independent directors. These listing standards were adopted pursuant to Sarbanes-Oxley, which required the SEC to direct the national stock exchanges to adopt listing standards relating to board and committee independence.

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The NYSE elected to exempt foreign private issuers from these requirements out of concern for preserving "investment diversity" and avoiding conflicts with home country laws and customs. (Comment Letter from New York Stock Exchange, Inc. on Standards Related to Listed Company Audit Committees, SEC File No. S7-02-03 (Feb. 21, 2003)) BVI law does not mandate that boards or committees include independent directors. (AD Filing on Form 20-F filed on Apr. 28, 2014 (hereinafter, "20-F"), at 123)

AD's ten-member board includes only four independent directors, one of whom, audit committee member Michael Chu, has a business relationship with Staton (Chu co-founded an Argentina-based private equity firm with Staton). Staton serves as the board's chairman.(20-F, at 82) The compensation committee includes no independent directors, and Staton himself serves on it. There is no nominating committee.(20-F, at 87-88) The board is classified, so only a fraction of directors stand for reelection each year. (20-F, at 82)

The usual mechanisms that provide discipline and monitor management of a public company are absent at AD. The voting control held by Staton and the classified board ensure that a change of control or even the addition of an independently nominated director will not occur without Staton's agreement. This entrenchment is bolstered by provisions in AD's Master Franchise Agreement ("MFA") with McDonald's requiring that Staton control a majority of AD's voting power and granting McDonald's a call option on Staton's Class B shares under certain circumstances. (20-F, at 107-108) The lack of an independent board and committees, as well as Staton's dual service as chairman and CEO, undermine the board's ability to provide robust oversight of management.

<u>The Related Party Transactions</u>

Significant related party transactions involving Staton illustrate this problem. Axionlog, a subsidiary of Arcos Dorados which provided distribution services to its restaurants in Mexico, Venezuela, Argentina, Chile and Colombia, was split off from AD in 2011. Staton subsequently purchased control of Axionlog and is currently its sole shareholder. Following the split off, AD contracted with Axionlog to continue to provide distribution services. Although AD describes the arrangement as "arm's-length," it does not disclose the basis for this conclusion. Two directors, both long-time business associates of Staton, sit on the boards of both AD and Axionlog.

Publicly available information suggests that the arrangement between AD and Axionlog is very advantageous for Axionlog. First, AD and Axionlog agreed to change the currency in which a $13.7 million receivable from Axionlog was denominated from US dollars to Venezuelan bolivars just one month before AD remeasured its operations in Venezuela in March 2014 using a much less favorable exchange rate. AD booked a $13.3 million loss in 2014 as a result of the currency change and remeasurement of the Axionlog receivable. For reasons AD does not disclose, the receivable, whose nature has also not been disclosed, was cancelled altogether on December 31, 2014. (6-K filed on Mar.17, 2015, at F-44-48)

Second, "logistics services fees" paid by AD to Axionlog have increased by 27% between 2011 and 2014, despite the fact that the value of product AD acquired from Axionlog declined by over 63%. We have been unable to obtain data showing whether unrelated parties have entered into similar arrangements, or, in other words, whether these terms are indeed arm's length. The escalation of the logistics services fees under these circumstances raises questions, though, about the board's monitoring of this ongoing related party transaction. If the proportion of logistics services fees relative to the value of supplies purchased through Axionlog in 2011 had remained constant through 2014, AD would have paid Axionlog over $71 million less. Logistics costs are generally expressed as a percentage of total sales or as a percentage of a firm's cost of goods sold, suggesting that these costs should maintain some relationship with the overall economic value of goods delivered by the distributor.

AD has provided Axionlog with financing on attractive terms. In 2011 AD agreed to loan Axionlog $12 million at rates below those AD was paying at the time on its own debt. Axionlog has borrowed $11.5 million of that amount as of the end of 2014. The 2013 annual report for Axionlog's Netherlands subsidiary, Axionlog B.V. lists long-term liabilities of $9.6million. As of December 31, 2013, Axionlog had drawn $9 million of its loan from AD; AD therefore appears to have provided nearly all of Axionlog's debt financing through 2013.

Also in 2011, AD posted guarantee deposits on Axionlog's behalf that were intended to serve as collateral for Axionlog's obligations to its suppliers. If Axionlog failed to satisfy such an obligation by a certain date, the deposit would be paid to the supplier. AD did not charge Axionlog any fees or interest for this use of its funds. As of December 31, 2011, these deposits totaled $16.1 million. (Arcos Dorados Filing on Form 20-F, filed on Apr. 18, 2011, at 96). They had declined to $2.3 million at the end of 2012, (Arcos Dorados Filing on Form 20-F, filed on Apr. 26, 2013, at 92), and were not disclosed in AD's most recent 20-F or 6-Ks.

Similarly, in 2012, AD assumed and settled $1.6 million in Axionlog's obligations to its suppliers, collecting neither fees nor interest for doing so. As with the deposits, no explanation was given for why AD paid these obligations. (Arcos Dorados Filing on Form 20-F, filed on Apr. 18, 2011, at 96)

<u>Analysis</u>

The NYSE Listed Company Manual gives the NYSE broad discretion to make a determination regarding a security's continued listing even if no specific listing standard has been violated. The NYSE "may make an appraisal of, and determine on an individual basis, the suitability for continued listing of an issue in light of all pertinent facts whenever it deems such action appropriate," including when the company has engaged in "[o]ther conduct not in keeping with sound public policy" and when "[a]ny other event or condition which may exist or occur that makes further dealings or listing of the securities on the Exchange in advisable or unwarranted in the opinion of the Exchange."

The ongoing extraction of private benefits from AD by Staton, under these circumstances, constitutes potential "conduct not in keeping with sound public policy" supporting NYSE action. Traditional accountability mechanisms, such as replacing directors or a change of control, are not available at AD. In addition to the voting control exerted by Staton, McDonald's has significant control rights through the MFA, including the ability to repurchase Mr. Staton's stake in the company at 80% of its fair market value in the event of a material breach and the ability to veto the company's choice of CEO and COO. These provisions raise concerns that Staton may subordinate the interests of public shareholders, prioritizing his own relationship with McDonald's, when he negotiates (or renegotiates) key terms of the MFA.

Nor is litigation over Staton's related party transactions an accessible option for AD's public shareholders: Unlike Delaware law, it appears that BVI law does not require the fairness of a transaction between a director and a company to be shown if evidence suggests a breach of fiduciary duty. (20-F, at 99) The right of shareholders to inspect corporate books and records, which can provide shareholders with information necessary to evaluate and/or assert a derivative claim, is much more limited under BVI law, with board meeting minutes not among the documents available for shareholder inspection. (20-F, at 102-103)

A shareholder in a BVI company seeking to assert a derivative claim for breach of fiduciary duty must obtain permission from a court to bring the action. The court must consider whether the shareholder is acting in good faith; whether the derivative action is in the interests of the company, taking into account the directors' views on commercial matters; whether the proceedings are likely to succeed; the costs of the proceeding in relation to the relief likely to be obtained; and whether an alternative remedy is available. (Appleby, "Guide to Protection of Minority Shareholders in the British Virgin Islands," at 4-5(Mar. 2011)) A shareholder thus must make its case on the merits, or nearly so, just to be allowed to bring a claim derivatively.

We recognize that the NYSE is generally inclined to defer to home country laws and customs, rather than imposing US-style corporate governance on foreign private issuers.[1] But when a listed company affords shareholders no meaningful avenues for holding management accountable, even when self-dealing is involved, NYSE action is necessary to protect public shareholders.

AD emphasizes its NYSE listing in communications intended for shareholders or potential shareholders. AD states on the corporate governance splash page of its website (arcosdorados.com/ir.html) that "Arcos Dorados Holdings, Inc. is a publicly traded foreign private issuer listed on the New York Stock Exchange. The Company's corporate governance practices are regulated by the New York Stock Exchange and the Company's By-laws as well as the U.S. Securities and Exchange Commission (SEC), and British Virgin Islands law." Prominently displayed on the Investors splash page is a box containing the words "ARCO," "LISTED," and "NYSE" stacked one on top of another. "NYSE" is in larger font than "ARCO." The same box appears on the cover page of AD's most recent earnings presentation. These displays could be read to imply that ARCO meets the governance standards generally applied to NYSE-listed companies.

The Listed Company Manual reflects support for robust oversight of related party transactions. It states, "While the Exchange does not specify who should review related party transactions, the Exchange believes that the Audit Committee or another comparable body might be considered as an appropriate forum for this task. Following the review the company should determine whether or not a particular relationship serves the best interest of the company and its shareholders and whether the relationship should be continued or eliminated." AD's Audit Committee includes a nominally independent director, Michael Chu, who has a pre-existing business relationship with Staton, and AD uses the same auditing firm, Ernst & Young, as McDonald's does. Both of these facts might lead shareholders to question the oversight provided by the Audit Committee and its chosen auditors.

Given the unclear economic benefits to AD of several of the transactions between it and Axionlog, AD's Standards of Business Conduct may have been violated. They direct that employees "must avoid even the appearance of conflict of interest that might cause others to doubt our fairness or integrity." A conflict of interest is defined as, among other things, "when an employee receives improper personal gains as a result of his/her position in the Company." (Standards of Business Conduct, at 17 (arcosdorados.com/attached/pdf/codigo_eng.pdf) AD has not disclosed any waiver of the Standards in connection with the Axionlog transactions.

The Listed Company Manual envisions a role for the NYSE in reinforcing the importance of monitoring related party transactions. It provides that the "Exchange will continue to review proxy statements and other SEC filings disclosing related

[1] We note that BVI law does not prohibit a company from having an independent board or committees, but rather does not require such independence. Thus, no overt conflict would be created by requiring AD to comply with the independence listing standards.

party transactions and where such situations continue year after year, the Exchange will remind the listed company of its obligation, on a continuing basis, to evaluate each related party transaction and determine whether or not it should be permitted to continue.” In our view, AD would benefit from such a reminder regardless of what other actions the NYSE decides to take.

We would be pleased to discuss this matter further with your staff. My colleague Etelvina Martinez can be reached at etelvina.martinez@changetowin.org or by phone at 202-721-6077.

We look forward to your reply.

Sincerely,

Dieter Waizenegger
Executive Director, CtW Investment Group