CERF Fellowship Report
March 2022

Overview

My research has continued to focus on attracting listings to the UK equity markets and boosting the growth of the British tech-industry. In particular, I have been researching the use of dual-class stock by listed companies. Dual-class stock is a capital structure which enables founders to retain control through holding shares with disproportionately high voting rights, and issuing shares with lower voting rights, but equal cash-flow rights, to the public. Thereby, dual-class stock can allow a founder to divest of its investment in a company that he or she controls, and raise further equity funding on the public markets, while maintaining control.

My book on the subject of dual-class stock – 'Founders Without Limits: Dual-Class Stock and the Premium Tier of the London Stock Exchange' – was published at the end of 2021. It scrutinises the adoption of dual-class stock around the world and applies the evidence in the context of the premium tier of the London Stock Exchange. My research has additionally led to three articles on dual-class stock. The first relates to the UK's tech-industry and the erstwhile prohibition of dual-class stock from the premium tier. The second reviews the empirical evidence on dual-class firms in the US, where, in modern times, tech-companies have been adopting the structure in droves. The third article centres on recent changes to the UK's listing regime making the premium tier more open to the use of weighted voting rights structures. The subject of dual-class stock has generated significant publicity in recent months and is front-and-centre of current corporate governance debates in the UK. I have engaged, and will seek to continue to engage, with the regulators on this topic. The three articles are described further below.

My research has also moved beyond dual-class stock to more holistic aspects of the London Stock Exchange and other methods of potentially attracting tech companies. I recently published an article on special purpose acquisition companies (SPACs). SPACs are shell companies incorporated and listed with the singular purpose of acquiring another company or business. They have been viewed as a mechanism through which private companies can more easily float. However, my paper, using the US market as a foundation, critically analyses the use of SPACs and the manner in which the UK market will develop following revisions to the Main Market's Listing Rules. I have also co-authored a paper evaluating the recent round of primary markets reforms in the UK, and the propensity for those reforms to resuscitate the London Stock Exchange. The paper additionally investigates the reasons for the secular decline of the London Stock Exchange and the potential for a renaissance.

I have also completed research, unrelated to dual-class stock, into the UK's Stewardship Code. The Stewardship Code encourages asset managers and asset owners to, *inter alia*, steward and engage with the firms in which they invest. The Stewardship Code was substantially up-dated in 2020, after the previous version of the Code attracted significant criticism, and my research assesses the propensity for the new version to more effectively encourage the issuer-specific engagement originally envisaged by the Code. The research scrutinises the Code by focusing on the legal, regulatory and commercial incentives, or lack thereof, for asset managers to undertake issuer-specific engagement. The paper also discusses hedge fund activism, and the likelihood for asset managers generally to exercise holistic-risk engagement of portfolio companies, including in relation to ESG factors.

Finding the British Google: Relaxing the Prohibition of Dual-Class Stock From the Premium-Tier of the London Stock Exchange

Abstract: There is a dearth of British tech-companies listing on the London Stock Exchange (LSE), and the LSE lacks a large, innovative tech-company such as Google. The UK Government, concerned as to the loss of UK tech-companies to foreign acquirors, views the encouragement of UK tech-firm listings as a policy priority. Dual-class stock, currently prohibited from the LSE Main Market's premium-tier, allows founders to list their firms, and retain majority-control, while holding significantly less of the cash-flow rights in the company. This article will broach the potential for dual-class stock to attract UK tech-company listings, and explore the benefits that dual-class stock can engender for UK tech-companies and their public shareholders. The risks of dual-class structures will also be discussed, but it will be shown that in a UK regulatory context, in relation to high-growth tech-companies, the risks may not be as severe as presumed, and easily moderated through judicious controls.

Progress: I have published my research in the Cambridge Law Journal (B. Reddy, 'Finding the British Google: Relaxing the Prohibition of Dual-Class Stock form the Premium-Tier of the London Stock Exchange' (2020) 79 *CLJ* 315), available at: <https://www.cambridge.org/core/journals/cambridge-law-journal/article/finding-the-british-google-relaxing-the-prohibition-of-dualclass-stock-from-the-premiumtier-of-the-london-stock-exchange/3D2E2F2CCFBF653D3151F7B2AC6E681F>

I presented the paper in March 2021 at the Faculty of Law's (Cambridge University) conference on 'Funding Innovation: Current Issues in Corporate Finance'.

The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code

Abstract: John Kingman's review of the Financial Reporting Council (FRC) doubted the effectiveness of the UK's Stewardship Code in encouraging informed and engaged stewardship by institutional investors of the companies in which they invest (issuers). Accordingly, the FRC published the Stewardship Code in 2020 in a final opportunity to prove its effectiveness and relevance, and, in particular, enhance issuer-specific engagement by institutional investors. The up-date has enhanced the reach and substance of the code. However, the legal, regulatory, contractual and competitive environment in which institutional investors exist will constantly forestall soft-law attempts to foster greater issuer-specific engagement, a point perhaps tacitly acknowledged by the 2020 Stewardship Code with its wider scope. Instead, in relation to engagement, stewardship disclosure should focus on the types of engagement that institutional investors are motivated to exercise in practice, such as engagement in response to hedge fund activism, and engagement on systemic risks.

Progress: I have published my research in The Modern Law Review (B. Reddy, 'The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code' (2021) 84 *MLR* 842), available at: <https://www.modernlawreview.co.uk/july-2021/emperors-new-code-time-re-evaluate-nature-stewardship-engagement-uks-stewardship-code/>

More Than Meets the Eye: Reassessing the Empirical Evidence on US Dual-Class Stock

Abstract: Some of the largest and most successful publicly traded companies, such as Alphabet and Facebook, have implemented a capital structure known as dual-class stock. Dual-class stock enables a company's controller to retain voting control of a corporation while holding a disproportionately lower level of the corporation's cash-flow rights. Dual-class stock has led a tortured life in the US, and is perhaps the most controversial area of corporate governance today. Between institutional investor derision and the exclusion or restriction of dual-class stock from certain indices, one may assume that dual-class structure must be harmful to outside stockholders. However, in this article, the existing empirical evidence on US dual-class stock will be reassessed by contrasting studies that use different measures of performance. It will be shown that although dual-class firms are generally valued *less than similar one-share, one-vote firms, they perform as well as, and, in many cases, outperform, such firms from the perspective of operating performance and stock returns. When it comes to dual-class stock, more than meets the eye, and a presumption that dual-class stock is harmful for outside stockholders should not guide policy formulation.*

Progress: I have published my research in the University of Pennsylvania Journal of Business Law (B. Reddy, 'More Than Meets the Eye: Reassessing the Empirical Evidence on US Dual-Class Stock' (2021) 23 U. Penn. J. Bus. L. 955), available at <https://scholarship.law.upenn.edu/jbl/vol23/iss4/3/>

Up the Hill and Down Again: Constraining Dual-Class Shares

Abstract: The headline recommendation of Jonathan Hill's 2021 UK Listing Review was that dual-class shares structures be permitted on the London Stock Exchange's premium tier. The aspiration was to encourage more high-quality UK equity listings, particularly of high-growth tech-companies, for which dual-class shares are especially beneficial. Dual-class shares allow founders to list their companies, and retain majority-control, while holding significantly less of the cash-flow rights in the company. However, in the UK, dual-class shares are usually discussed in qualified terms, in an attempt to placate sceptical institutional shareholders. Using the UK Listing Review as a platform, this article explores the constraints commonly proposed to be attached to dual-class shares, and argues that, although it is important to protect public shareholders, constraints must not be too severe. A balance must be respected, otherwise UK initiatives to relax rules on dual-class shares could deter the very companies they are intended to attract.

Progress: I have published my research in the Cambridge Law Journal (B. Reddy, 'Up the Hill and Down Again: Constraining Dual-Class Shares' (2021) 80 CLJ 515), available at: <https://www.cambridge.org/core/journals/cambridge-law-journal/article/up-the-hill-and-down-again-constraining-dualclass-shares/9247F7EE2EE16CD93B32B4540EBE7B15>

I presented an early version of this paper in May 2021 at the CERF Cavalcade.

I will be presenting this paper at CERF in the City in June 2022.

Founders without Limits: Dual-Class Stock and the Premium Tier of the London Stock Exchange

Big Tech has flourished on the US public markets in recent years with numerous blue-chip IPOs, from Google and Facebook to new kids on the block such as Snap, Zoom and Airbnb. A key trend is the burgeoning use of dual-class stock. Dual-class stock enables founders to divest of equity and generate finance for growth through an IPO, without losing the control they desire to pursue their long-term, market-disrupting visions. Bobby V. Reddy scrutinises the global history of dual-class stock, evaluates the conceptual and empirical evidence on dual-class stock and assesses the approaches of the London Stock Exchange and ongoing UK regulatory reforms to dual-class stock. A policy roadmap is presented that optimally supports the adoption of dual-class stock while still protecting against its potential abuses, and which will more effectively attract high-growth, innovative companies to the UK equity markets, boost the economy and unleash the true potential of 'founders without limits'.

Progress: My book was published with Cambridge University Press (2021), available at: <https://www.cambridge.org/core/books/founders-without-limits/CC6CD8B75ACBC6C0FC7201FE836B9B3F>

I presented on my book at a seminar on dual-class stock for the International Trade Law Research Circle and Institute of Advanced Legal Studies at the University of Macau in January 2022.

I will be presenting on the book at the Max Planck Institute for Comparative and International Private Law Conference in Hamburg in May 2022.

Warning the UK on Special Purpose Acquisition Companies (SPACs): Great for Wall Street but a Nightmare on Main Street

Abstract: Special Purpose Acquisition Companies (SPACs) are non-operating entities seeking public listings with the sole intention of subsequently acquiring other companies. Once a target has been acquired, the SPAC de-lists and the newly enlarged group reapplies for listing as a, now publicly-owned, operating entity, thereby streamlining the process to IPO for the target. SPACs have surged in the US recently, with SPAC sponsors making concerted efforts to attract not only institutional, but also retail, investors. With a view to invigorating SPAC activity in the UK, new regulations have been introduced that will enable UK SPAC sponsors to mimic the structure of US SPACs. However, in this article, it will be discussed that unlike the more benign nature of traditional UK SPACs, the typical US-style SPAC is simply a financial instrument for institutional investors built upon the investment of retail investors, and promoting such an evolution in the UK may be misguided.

Progress: I have published my research in the Journal of Corporate Law Studies (B. Reddy, 'Warning the UK on Special Purpose Acquisition Companies (SPACs): Great for Wall Street but a Nightmare on Main Street' (2022) JCLS), available at: <https://www.tandfonline.com/doi/full/10.1080/14735970.2022.2036413?scroll=top&needAccess=true>

I presented my research at the Commercial Law Centre, Harris Manchester, Oxford Conference on 'Reform of the Listing Rues' in January 2022.

I presented this paper at the CERF Monday Lunchtime Talk Series in February 2022.

Will Listing Rule Reform Deliver Strong Public Markets for the UK? (with Brian Cheffins)

Abstract: There is a general consensus that the UK needs strong public markets. To help to ensure that Britain is well-positioned on this front, the Financial Conduct Authority reformed the London Stock Exchange's listing regime in 2021. This paper outlines and evaluates these reforms, assessing in so doing their potential to resuscitate the UK's public equity markets. The paper acknowledges that the reforms may increase UK initial public offerings to some degree but maintains concerns about strong public markets will continue to exist. This is because the reforms do nothing to address exits from the stock market and modest market capitalisations of companies that remain listed.

Progress: My co-author and I have completed a working draft of this paper, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4028930>

Bobby V. Reddy, March 2022