TOWARD RELATIVE CORPORATE GOVERNANCE REGIMES: RETHINKING CONCENTRATED OWNERSHIP STRUCTURE AROUND THE WORLD

Abstract

It is ordinary to distinguish between two types of ownership structures of publicly traded corporations in different countries around the world. According to the diffuse ownership structure—which exists in England and the United States—the share capital of publicly traded corporations is distributed widely. In the past, due to the rational indifference of shareholders control and management of each company was ceded to a small group of managers, who pursued their own private interests that were often incompatible with the interests of the shareholders. For this reason, in recent years Anglo-American law has introduced new arrangements, designed to give shareholders greater authority and powers than the board of directors. The second type of cost structure, which pertains in the rest of the world, is the concentrated ownership structure. In this scheme, the controlling shareholder has the incentive and the authority to oversee the conduct of the company's officers. In corporations of this sort, therefore, the main concern is that the controlling shareholder's conduct may harm the interests of the minority shareholders.

This article seeks to challenge this sharp distinction between the two cost structures. A study of the economic and legal reality of Anglo-American law and continental law indicates that the traditional ownership structure in both legal systems has significantly weakened. In the continental system there has a significant decline in concentrated control of commercial corporations by banks and financial institutions, and a significant rise in holdings by public shareholders, while in the Anglo-American system, there has been a significant rise in the equity holdings of publicly traded corporations by institutional investors—to the extent that most of them are now controlled by sophisticated investors. In addition, in a significant number of publicly traded corporations in the United States there is now a range of voting rights attached to the rights of capital that allows the controlling shareholder to consolidate his control of the company.

In this paper, I discuss the normative implications of the weakening of the traditional ownership structure in countries with a concentrated ownership structure. In particular, I propose that the rules of corporate governance be redrawn, so that they regulate the new balance of power between the controlling shareholder and the minority shareholders through an innovative model that I call a relative corporate governance regime. According to this model, in view of the increasingly diffuse nature of concentrated markets, the rules of corporate governance are redesigned to protect minority shareholders in a manner that takes into account the ratio of holdings between the controlling shareholder and the minority shareholders; the size and scope of the company's activity; the activity that the company is engaged in; and its ramifications for the market's overall financial stability. For many years, lawmakers, courts and jurists have been debating how to protect the rights of minority shareholders in transactions involving controlling shareholders in related party transaction. In this paper, I show how the relative corporate governance model helps to decide between protecting the rights of minority shareholders by means of a property rule and protecting a liability rule.

INTRODUCTION

It is ordinary to distinguish between two types of ownership structures of publicly traded corporations in various countries around the world. In the diffuse ownership structure that pertains in England and the United States, there is extensive dispersion of share capital in publicly traded corporations.[1] The widespread dispersal of equity and the rational indifference of shareholders resulted in shareholders ceding control and management in favor of a small group of managers who seek to promote their own personal interests at the expense of the interests of the shareholders.[2] For this reason, in recent years Anglo-American law has established new arrangements aimed at giving shareholders greater authority and power than the board of directors. The alternative structure—which is in force in the rest of the world—is the concentrated ownership structure,[3] whereby there is a sharp divergence of interest between the controlling shareholder and the minority shareholders. Under this structure, the concern is that the controlling shareholder may pursue special interests that are at odds with the interests of minority shareholders.[4]

This article seeks to challenge this sharp distinction between the two ownership structures. A study of the economic and legal reality in Anglo-American law and continental law points to a significant weakening of the traditional ownership structure in each of the legal systems. Thus, for example, in continental law, there has a significant decline in the incidence of concentrated control of banks and financial institutions of commercial corporations. For example, the ownership structures of public companies in Germany have undergone significant changes in recent years, inter alia by reducing the extensive network of connections between financial institutions and these companies—known as Deutschland AG—and the international variation in the identity of their shareholders.[5] Moreover, many European countries—such as Italy,[6] France,[7] Belgium[8] and Sweden[9]—have adopted "Say on Pay" arrangements, even

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[1] William T. Allen, Reiner Kraakman & Guhan Subramanian, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 204-208 (3d ed. 2009).

[2] Adolf A. Berle & Gardiner C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[3] Stijn Claessens et al., *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81, 82 (2000) ("[M]ore than two-thirds of [East Asian] firms are controlled by a single shareholder."); Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365 (reporting that only 37% of companies in western Europe have a diffuse ownership structure).

[4] Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy,* 119 HARV. L. REV.1641, 1651 (2006) ("[A] controlling shareholder may police the management of public corporations better than the standard panoply of market-oriented techniques employed when shareholdings are widely held.").

[5] Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63(2) AMERICAN JOURNAL OF COMPARATIVE LAW 493 (2015).

[6] See text pertaining to note 68.

[7] Alain Pietrancosta, *Say on Pay: The New French Legal Regime in Light of the Shareholders' Rights Directive II* (November 5, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3065673

[8] Law of April 6, 2010, M.B., April 23, 2010, 22709 (Belg.); C.SOC art. 96, § 3 (Belg.)

[9] 7ch.61§ Aktiebolagslagen [ABL] [The HE Swedish Companies Act] (Svensk författningssamling [SFS] 2005:551)

though it was commonly claimed IN THE PAST that controlling shareholders can control the salary levels paid to company executives. The adoption of such arrangements of Anglo-American provenance in continental law attests to the decline of the concentration in Continental countries.

By the same token, in Anglo-American law there has been a significant rise in the holdings of institutional investors in the share capital of publicly traded corporations—such that most of these are now effectively controlled by sophisticated investors, such as pension funds, insurance companies, provident funds, and so forth. For example, in 2011 these investors held an average of 70% of the share capital of public companies.[10] These investors employ mechanisms of supervision and control over the conduct of office holders in the corporation that are similar to those of controlling shareholders in a concentrated ownership structure.[11] Therefore, the phenomenon of the discrepancy between ownership and control—first noted by Berle and Means—may no longer characterize the American market. Moreover, in many publicly traded corporations in the United States there is now a different class of voting rights attached to the rights of capital.[12] This diversification of voting rights enables controlling shareholders to entrench their control of the company.[13] In the past decade, there has been a sharp increase in the number of S&P 1500 companies traded with a variation of voting rights: from 87 in 2002 to 114 in 2012—most in the technology, communications and food sector.[14]

In this article I would like to discuss the normative implications of the weakening of the traditional ownership structure in countries with a concentrated ownership structure. In particular, I would like to redraw the rules of corporate governance that regulate the new balance of power between controlling shareholders and minority shareholders through an innovative model that I call relative corporate governance regimes. According to this model, in view of the emergence of clearly diffuse characteristics in concentrated markets, the rules of corporate governance in relation to the protection of minority shareholders should be designed so as to reflect the following criteria: the ratio of holdings between the controlling shareholder and the minority shareholders; the size and scope of the company's activity; the type of activity that the company is engaged in; and its ramifications for the market's overall financial stability.[15] For many years now, lawmakers, courts and jurists have been debating the question of how to protect the rights of minority shareholders in transactions involving controllong shareholders such as related party transaction and going private transaction. Within this framework, I will show how this model assists to choose between protecting

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[10] INVESTOR RESPONSIBILITY RESEARCH CENTER, CONTROLLED COMPANIES IN THE STANDARD & POOR'S 1500: A TEN-YEAR PERFORMANCE AND RISK REVIEW 9–10 (2012).

[11] See text pertaining to notes 88–98 below.

[12] Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States,* 23 REV. FIN. STUD. 1051, 1051 (2010) ("about six percent of the publicly-traded companies in the United States have more than one class of common stock, and these companies are virtually immune to a hostile takeover").

[13] See text pertaining to note 102 below.

[14] Investor Responsibility Research Center, Controlled Companies in the S&P 1500, *supra* note 10.

[15] See text pertaining to notes 162–185 below.

the rights of minority shareholders through a property rule versus protection by means of a liability rule.[16]

This article is divided into the following sections. In Section I, I lay the theoretical foundation regarding the traditional distinction between markets with a concentrated ownership structure and those with a diffuse one. The conclusion of this section is that there is no consensus in the economic literature as to which ownership structure is preferable, and therefore the legislator's task is to design rules of corporate governance that enable proper oversight of the individuals of authority in the public companies (be they controlling shareholders or directors). In Part II, I shall discuss the background led to the adoption of the traditional ownership structure in continental law (Germany, France and Italy) and Anglo-American law and examined various factors that might weaken it in the foreseeable future. Part III shows that a similar development of the weakening of the traditional ownership structure also exists in Canada and Israel due to legislative, judicial and institutional developments. In Part IV, I lay the theoretical foundation for a model of relative corporate governance regimes in corporations with a concentrated ownership structure. Also, in Part IV I discuss how the proposed model may assist in regulating related party transactions with controlling shareholder and Going Private transactions. In addition, in this part, I will discuss various arguments that may be cited against the model—and refute them. I will then summarize my conclusions.

I. CONCENTRATED AND DIFFUSE OWNERSHIP STRUCTURE AROUND THE WORLD: THEORETICAL PERSPECTIVES

In the late 1990s, economists began to conduct extensive comparative examinations of the control structure of publicly traded corporations around the world. These examinations revealed that in most of the countries in the world, the ownership of publicly traded corporations is concentrated—that is, featuring a single controlling shareholder with the ability to make decisions about the company's business activities. In contrast, Anglo-American law is characterized by diffuse control by a large number of public shareholders.[17]

In the legal and financial literature, there is disagreement over the factors that created the differences in the structure of control in publicly traded corporations in various countries around the world. One group of scholars argued that concentrated control is common in continental law jurisdictions because it provides relatively weak protection of the rights of minority shareholders.[18] Conversely, the low incidence of concentrated control in Anglo-American jurisdictions is the result of broad protection granted by common law to the rights of minority shareholders[19]—specifically, broad regulation of transactions with stakeholders and securities disclosure laws in the

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[16] See Part IV below.

[17] The most important research in this regard is Rafael La Porta et al., *Corporate Ownership around the World*, 57 J. FIN. 471 (1999);

[18] Rafael La Porta et al., *Law and Finance*, 106(6) JOURNAL OF POLITICAL ECONOMY 106 1113 (1998).

[19] Rene M. Stulz, *The Limits of Financial Globalization*, 60(4) JOURNAL OF FINANCE 1595 (2005).

financial markets of the United States and England.[20] Another group of researchers have argued that the change in ownership structure came about due to political, cultural, or social variables.[21] According to the path dependence theory, various historical reasons led to differences in the adoption of given ownership structures in public companies in different countries around the world—differences that have persisted to this day, although corporation laws in most countries of the world are now similar.[22]

It is generally accepted that corporate structure has a direct bearing on what is known in financial markets as the agency problem—which modern corporate law sets out to resolve. In Anglo-American law, the common agency problem in corporations of diffuse structure is the balance of power between the company's management and its shareholders. The shareholders are the owners of the corporation in the sense that they are entitled to the residual profit from its business activity and to the remaining retained earnings after it is dismantled. In this context, the concern is that the managers will manage the corporation in a manner that promotes their personal interests at the expense of those interests of the shareholders. This conflict of interest is exacerbated by the disparities between the two communities.[23] The problem of oversight of the conduct of corporate directors does not exist in markets with a concentrated ownership structure, because in those markets the controlling shareholders themselves have the means to monitor the corporation's management to ensure that it acts in the interests of the controlling shareholders:[24] having invested a considerable sum of their capital and holding a large share of the rights in the company, they are incentivized to do so.[25] However, in such corporations there is a different agency problem—namely, the risk of

[20] For empirical evidence, see Rafael La Porta, et al., *What Works in Securities Laws?,* 61 JOURNAL OF FINANCE 1 (2006); Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 JOURNAL OF ECONOMIC LITERATURE 285 (2008); Donghui Li et al., *When Financial Institutions Are Large Shareholders: The Role of Macro Corporate Governance Environments*, 61 JOURNAL OF FINANCE 2975 (2006); Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460 (2006); Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88(3) JOURNAL OF FINANCIAL ECONOMICS 430 (2008). Conversely, it has recently been argued that there no significant correlation was found between 16 measures of legal protection of minority shareholders and the prevalence of concentration in 32 countries around the world. Moreover, even in countries where a legislation was changed to provide greater protection to the rights of minority shareholders, the concentration of ownership of public companies remains the same and, in some cases, has even increased. See Clifford G. Holderness, *Law and Ownership Reexamined*, 5 CRITICAL FINANCE REVIEW 41 (2016).

[21] Mark J. Roe, *Political Preconditions to Separating Ownership from Control*, 53 STAN. L. REV. 539 (2000) (that social democracies seek to adopt a concentrated ownership structure in order to contend with the power of the workers' organizations in the corporate regime). See also Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459 (2001).

[22] Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999) (arguing that the variation of regimes in different countries over time should be expected given two important factors in determining the type of regime and structure: the typical ownership structure of companies in Structure Driven Path Dependence countries, and the legal norms governing the relations between the company and all its players in Rule Driven Path Dependence countries).

[23] For a detailed analysis, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

[24] Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1281 (2009) (arguing that standards of corporate governance should be adapted to reflect whether or not there is a controlling shareholder in the company).

[25] See Gilson, Controlling Shareholders and Corporate Governance, *supra* note 4.

conflict of interest between the controlling shareholder and minority shareholders. Specifically, where these interests are not aligned, the concern is that the controlling shareholder may exploit his position to harm the corporation or the minority shareholders when it suits his interests to do so. This is especially true when the controlling shareholder is himself a party to a transaction with the corporation or has a direct interest in a third party that the corporation is transacting with.[26]

In the literature there is a wide-ranging debate over the relative pros and cons of concentrated and diffuse ownership structures of modern corporations. Since very early on, legal and economics scholars have argued that a concentrated capital structure enables controlling shareholders to engage in tunneling—i.e. gaining private benefits at the expense of the minority shareholders.[27] This can occur when the controlling shareholder—either personally or through a company under his control— transfers resources to other companies under his control where he has a greater share of ownership capital.[28] In this context, it has been argued that the use of various legal means of entrenching control by the controlling shareholder should be curbed—such as the issue of various types of shares and granting preferred voting rights to the controlling shareholder (dual-class shares), or a control pyramid characterized by a chain of corporations ultimately headed by the controlling shareholder (Stock Pyramids), and a cross-holdings (whereby Company A holds shares of Company B, which holds shares of Company A).[29]

Recently, however, it has been argued in the literature that a concentrated capital structure enables a company to adopt a viewpoint that promotes its long-term interests for the benefit of all the shareholders of the company, and not only for the benefit of the controlling shareholders.[30] In this context, Goshen and Hamdani have argued that while it is usual to believe that a concentrated structure allows the controlling shareholder to pocket private benefits from the company, against the interests of the minority shareholders, it also enables the controlling shareholder to realize his vision regarding the long-term interests of the company—to the benefit of all shareholders.[31] Thus, entrepreneurs and shareholders may agree on the distribution of cashflow and control rights in such a way as to balance the entrepreneur's desire to ensure the

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[26] REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 29-48 (2017).

[27] Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* (Nat'l Bureau of Econ. Research, Working Paper No. 7203, 1999), available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/260.pdf.

[28] Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, *Unbundling and Measuring Tunneling*, 2014 U. ILL. L. REV. 1697 (2014).

[29] For an extensive discussion of these legal provisions, see Lucian Bebchuk, Reiner Kraakman & George Triantis, Stock Pyramids, *Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in CONCENTRATED CORPORATE OWNERSHIP 295 (Randall K. Morck ed., 2000).

[30] Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L. J. 560 (2016). In this context, Gilson & Schwartz have argued that in order to encourage entrepreneurs to invest private capital in public corporations, they should be allowed to enter into contracts with the company regarding their allowable extent of the exploitation of private benefits, while stipulating the duty of corporate trust. See Ronald Gilson and Alan Schwartz, *Corporate Control and Credible Commitment*, 43 INTERNATIONAL REVIEW OF LAW AND ECONOMICS 119 (2015).

[31] Goshen & Hamdani, Corporate Control and Idiosyncratic Vision, *Id.,* at 576–583.

realization of his vision and the desire of investors to protect against the representative costs.[32] Moreover, it has been argued that the reduction of private benefits to the controlling shareholder may weaken his commitment to act in favor of the company's long-term interests even if this may directly harm the company's reputation in the product market.[33] Therefore, policies that completely preclude legal measures that entrench control by controlling shareholders are no longer appropriate. Instead, a more lenient policy should be adopted that enables the courts to examine, in retrospect, whether or not techniques that allow a controlling shareholder to derive too much private benefit that are at odds with the company's long-term goals.[34]

In the literature there is extensive discussion of the relationship between the structure of ownership of a corporation and its performance. Barley & Means have argued that there is a positive correlation between concentrated holding structures and company performance. However, empirical studies on this question are not conclusive. Early studies suggested that the association between the structure of ownership of the corporation and its performance is complex: while low levels of concentration may increase a company's value, beyond a certain degree the cost of concentration of control exceeds its benefits.[35] Kirchmaier & Grant found that in Germany, France and Spain, the ownership structure of a public company is not necessarily the most effective one, because in those countries corporate performance was found to be negatively correlated with concentrated structure of corporate capital and positively correlated with diffuse capital structure.[36] However, another economic study sought empirical evidence of the advantages and disadvantages of concentrated ownership structure in Germany, and found that it had a positive effect on the value of the company's shares to the benefit of all its shareholders.[37] Similarly, other empirical studies have found that corporations where the controlling shareholder is also the company founder tend to perform better than similar corporations with a distributed ownership.[38]

Another empirical study found only partial evidence of a correlation between ownership structure and company performance. But even in the absence of unequivocal evidence, researchers believe that there is a certain positive correlation between diffuse ownership structure and company performance.[39] These empirical studies indicate that

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[32] Goshen & Hamdani, Corporate Control and Idiosyncratic Vision, *Id.*, at 598–611.
[33] Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, HARV. BUS. L. REV. (forthcoming, 2018), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2619462
[34] Id., 12–19.
[35] Harold Demstz & Belen Villalonga, *Ownership Structure and Corporate Performance*, 7 JOURNAL OF CORPORATE FINANCE 209 (2001).
[36] Thomas Kirchmaier & Jeremy Grant, *Corporate Ownership Structure and Performance in Europe*, 2(3) EUROPEAN MANAGEMENT REV. 231 (2005).
[37] Jeremy Edwards & Alfons J. Weichenrieder, *Ownership Concentration and Share Valuation: Evidence from Germany* (July 1999). CESifo Working Paper Series No. 193. Available at SSRN: https://ssrn.com/abstract=272627.
[38] Ronald C. Anderson & David M. Reeb, *Founding Family Ownership and Firm Performance: Evidence From the S&P 500,* 58 J. FIN 1301 (2003). For similar findings in Europe, see: Roberto Barontini & Lorenzo Caprio, *The Effect of Family Control on Firm Value and Performance: Evidence from Continental Europe*, 12 EUR. FIN. MANG. 689 (2006).
[39] Leif Anders Fronningen & Nico van der Wijst, *Ownership Structure and Performance of the Largest German Companies* (February 12, 2009). Available at SSRN: https://ssrn.com/abstract=1341615 or http://dx.doi.org/10.2139/ssrn.1341615. For a study that

both concentrated and diffuse ownership structure have comparative advantages and disadvantages, and it is not possible to point to either type of structure as having an unequivocal advantage over the other.[40] In the absence of a clear preference between these two ownership structures, the purpose of the law therefore should be to shape the rules of corporate governance in a manner that facilitates proper oversight of the power holders in a publicly listed company—be they its management or controlling shareholders.[41]

In the Part II, I will argue that the prevailing dichotomous distinction in the comparative literature between continental law and Anglo-American law with regard to the type of ownership structure of capital does not exist in practice. In light of various economic and legal arguments, we will predict the weakening of the traditional ownership structure that characterizes these legal systems. These factors may lead to a reduction of the concentrated capital structure in favor of diffuse capital in continental countries, and a commensurate reduction of diffuse capital structures in favor of concentrated capital structures in Anglo-American countries.

II. Towards a Transformation in Ownership Structures around the World

As explained above, the traditional ownership structure of common law and continental law is different. In general, whereas in common law there is a structure of diffuse ownership, in continental law the concentrated ownership structure is what characterizes the capital structure of publicly traded corporations. In this section, I will discuss the background that led to the adoption of the traditional ownership structure in each of the legal systems and see how different factors could lead to a weakening of the traditional ownership structure in each of the legal systems.

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examined the relationship between the ownership structure of public corporations in Brazil and the performance of the company and did not find any effect. See Almir Ferreira de Sousa, C*orporate Governance and Ownership Structure in Brazil: Causes and Consequences,* 5(2) Journal of Corporate Ownership & Control 36 (2008), Available at https://ssrn.com/abstract=976198/. For a study that found a positive link between concentration of control and the performance of the company in Asian countries, see Rizal Adhari & D., Viverita, *The Effect of Capital Structure and Ownership Structure on Firm Performance: A Test of the Reverse Causality Hypothesis in ASEAN Countries* (February 15, 2015). Available at SSRN: https://ssrn.com/abstract=2565415 or http://dx.doi.org/10.2139/ssrn.2565415. For similar findings in the Swiss market, see Dušan Isakov & Jean-Philippe Weisskopf, *Are Founding Families Special Blockholders? An Investigation of Controlling Shareholder Influence on Firm Performance*, 41 Journal of Banking & Finance 1 (2014). For a study of this association in the Italian market, see Francesco Perrini et al., *Does Ownership Structure Affect Performance? Evidence from the Italian Market,* 16(4) Corporate Governance: An International Review 312 (2008).

[40] However, in the legal literature it has been argued that the the ddiffuse ownership structure should be adopted worldwide—see Renier Kraakkman & Henry Hannesman, *End of History of Corporate Law*, in Convergence and Persistence in Corporate Governance 33 (Mark Roe ed., 2004).

[41] Gilson, Controlling Shareholders and Corporate Governance, *supra* note 4, at 1647–48. See also Asaf Hamdani, Concentrated Ownership Structure in Israel: Legal aspects 24 (2009) [in Hebrew].

(A) *Traditional Ownership Structure in Continental Law and the Reasons that likely to Weaken it*

(1) *The Background to the Traditional Ownership Structure under Continental Law*

The empirical study on the development of a concentrated capital structure in the continental countries links the low protection of the rights of the minority shareholders to the growth of the said ownership structure.[42] In this section, however, I would like to redirect the discussion to the question of how the historical development of the local economy in the continental countries led to the adoption of a concentrated ownership structure. This will highlight the importance of economic and social factors in the formulation of a concentrated ownership structure that does not necessarily depend on the extent of the protection afforded to minority shareholders. The following discussion focuses on Germany, France and Italy.

Since the latter half of the twentieth century, the German economy has been characterized by close cooperation between various corporations in various economic sectors—to the extent that in some instances they appeared to be different arms of a single corporation ("Deutschland AG").[43] This close cooperation is manifested, in part, in a network of cross-ownerships between the large banks and the commercial corporations. Cross-holdings of this sort now number over 168 different connections between the one hundred largest corporations in Germany.[44] Empirical studies of the German market point to a clearly concentrated capital structure. For example, it was found that the concentration rate in the German market is not only particularly high (82% of the publicly traded corporations in Germany have a controlling shareholder, holding more than 25% of the share capital), but the share of minority shareholders is particularly low (only 20% have more than two large shareholders)—whose average holding rate is particularly low (7.4%).[45] It was also found that a large proportion of the controlling shareholders in commercial corporations are banks and financial institutions—mainly because many of these corporations preferred to receive the financing they needed for their activity through agreements with banks, rather than by raising capital on the stock market.[46]

Since the early nineteenth century, banks and financial institutions have been very dominant. They contributed significantly to the process of industrialization by providing a direct flow of capital to fund development of the German economy. This

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[42] La Porta et al., The Economic Consequences of Legal Origins, *supra* note 20.

[43] For more information, see Sophia Dai & Christian Helfrich, *Structure of Corporate Ownership and Control, Comparative Corporate Governance and Financial Regulation* 27-28 (2016). Available at http://scholarship.law.upenn.edu/ sch_2016/9.

[44] Id., 30.

[45] Marco Becht & Ekkehart Boehmer, *Ownership and Voting Power in Germany*, in THE CONTROL OF CORPORATE EUROPE 128 (Fabrizio Barca & Marco Becht eds., 2001); Marco Becht & Ekkehart Boehmer, *Voting Controlling German Corporations*, 23 INT'L. REV. L. ECON. 1 (2003).

[46] Ekkehart Boehmer, *Who Controls German Corporations?*, in CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY 268 (Joseph A. McCahery, Piet Moerland, Theo Raaijmakers & Leon Renneboo eds., 2002); Stefan Prigge, *A Survey of German Corporate Governance*, in COMPARATIVE CORPORATE GOVERNANCE – THE STATE OF THE ART AND EMERGING RESEARCH 943, 974-978 (Klaus J. Hopt, Hideki Kanda, Mark J. Roe, Eddy Wymeersch & Stefan Prigge eds., 1998) .

inflow of capital resulted in banks and financial institutions taking an active part in the ownership and control of commercial corporations—even to the extent of deciding whom to appoint as directors of the supervisory board. The close relationship between the banks and corporations under their control allowed the former to oversee all financial aspects of the corporations‘ activities—including capital injection, trading services, brokerage, and securities underwriting (Hausbank). The banks' close oversight of the corporations they control—in some cases, over decades—ensures that the capital investment in these corporations generates many profits. From a macroeconomic perspective, the prosperity of these corporations contributes to the overall growth of the German economy and helps to secure the financial stability of the financial institutions themselves. Therefore, many believe that the German economy operates as one particularly large corporation, with mutual cooperation and supervision relationships that allow it to grow over time.[47]

In France, in the past three hundred years, various historical events have resulted in a relatively weak banking system. This system did not inject the required capital for the development of the local economy, which relied mainly on self-financing by individuals and families.[48] This led to the establishment of a concentrated ownership structure, which is reflected in the fact that a large proportion of the publicly traded corporations in France are still held by individuals and families. Among the historical factors that led to the consolidation of the concentration of control by individuals and families is that France played a major role in many wars in the past three hundred years, between the French Revolution of 1792 and the German invasion of France in the two world wars. The banking system directly helped to finance these wars, rather than channel its resources to develop the local economy through direct investment in commercial corporations, as was done in Germany. Consequently, entrepreneurs and businessmen have had to use their own equity to invest, develop and research various ventures, instead of raising capital from the banking system or the local stock market. Due to this high level of capital investment by individuals and families, a concentrated capital structure naturally evolved, to ensure that they had continued control of the decision-making in the company.[49]

Another factor that facilitated the adoption of a concentrated ownership structure in France is the change in its inheritance laws. Before the Napoleonic rule, primogeniture was the rule—i.e., it was customary for the eldest son to inherit the father's entire estate—or most of it, at least—with nothing being left to the other siblings. This changed with the adoption of the Napoleonic Code in France, which guaranteed equal division of the estate of the deceased among all children. This strengthened control by families as a whole over publicly traded corporations stronger, since the only way to sever the relationship between the family and control of the

[47] For a comprehensive review, see Caroline Fohlin, *The History of Corporate Ownership and Control in Germany*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 223 (Randall K. Morck ed., 2005).
[48] For more information, see Antoine Murphy, *Corporate Ownership in France: The Importance of History*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 185 (Randall K. Morck ed., 2005).
[49] *Id.,* at 187.

corporation is by selling the company's holdings before the death of the controlling individual and dividing the proceeds between the heirs by law.[50] Moreover, this change in inheritance law is consistent with the existing cultural norm in France, whereby property owners are responsible for transferring their property to the welfare of future generations upon their death.[51]

In Italy, too, it is commonly believed that concentrated ownership structure reigns supreme.[52] As in Germany, the banking system in Italy also significantly contributed to the country's industrialization. In the early twentieth century, the banking system injected financial and human capital for projects in the transport and mining industry. Besides the contribution of capital by the banking system, the Italian economy was also boosted by direct capital injections by the central government. The involvement of the Italian government in the local economy was particularly evident in the Great Depression of the 1930s—and since that time, the Italian government has had a prominent presence in the local economy, in particular by being a controlling shareholder in various business corporations.[53] This is reflected in the fact that the Italian government created an administrative authority (Instituto per la Ricostruzione Industriale [IRI]), which is responsible for managing the portfolio of state-controlled corporations.[54] However, in the 1990s the state began privatizing the corporations under its control, in a bid to reduce the high level of government debt. This also provided more opportunities to raise capital from the general public, which were not possible when the government owned many publicly traded corporations.[55]

(2) *Factors that may Lead to a Weakening of Concentrated Ownership Structure in Continental Law*

Recent studies indicate that in many continental countries the traditional ownership structure is likely to weaken. In Germany, for example, it is argued that three factors are expected to reduce concentrated ownership structure in the domestic economy.[56] Recent economic data indicates that in Germany there has been a significant decline in the rate of concentrated control in commercial corporations. The average level of control of corporations included in the German stock index—the DAX30—is16.5%, with the median at only 9.92%.[57] An empirical study found a significant decline in the levels of holdings by financial institutions of various publicly traded corporations—in particular, in the ownership held by the five largest financial institutions, which dropped

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[50] *Id.,* at 189–190.
[51] *Id.,* at 205–206.
[52] Alexander Aganin & Paolo Volpin, *History of Corporate Ownership in Italy*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 325 (Randall K. Morck ed., 2005).
[53] For a broad discussion of the economic and legal implications of the state as controlling shareholder in a public company (in Italy and elsewhere), see Mariana Pargendler, *State Ownership and Corporate Governance,* 80 FORDHAM L. REV. 2917 (2012).
[54] Aganin & Volpin, History of Corporate Ownership in Italy, *supra* note 52, at 328–330.
[55] Aganin & Volpin also present an empirical study supporting some of the conclusions of La Porta et al. that in Italy poor protection of the rights of minority shareholders is linked to concentrated ownership structure. See *Id.,* at 343–350.
[56] See Ringe, Changing Law and Ownership Patterns in Germany, *supra* note 5.
[57] *Id.*, at 508.

from 128 corporations in 1998 to only 20 corporations in 2006.[58] Second, in the 1990s central banks in Germany suffered a severe crisis following the entry of international competitors into the local banking system. In response, many financial institutions decided to diversify their portfolio by reducing their holdings of German corporations' share capital in favor of international investments in foreign corporations.[59] Deutsche Bank, for example—one of Germany's largest banks—significantly reduced its regulatory capital and cooperation with local firms in order to invest in foreign corporations. Thirdly, studies show that there has been a consistent increase in the level of holdings by international financial institutions and entities in commercial corporations in Germany. International institutional investors such as pension funds, insurance corporations and hedge funds are increasingly interested in investing in German corporations. These investors, who represent large savers in various countries, are also causing a shift in the type of major shareholders in the German economy.[60]

Regarding France and Italy, various studies point to a clearly concentrated structure of ownership at present. In a recent groundbreaking study, Aminadav & Papaioannou examined the ownership structure of 40,000 publicly traded corporations 127 countries in the years 2004–12. Their comprehensive data shows that the rate of the concentrated ownership structure in the French and Italian economies is among the highest among all the countries examined, and their incidence of diffuse ownership structure is among the lowest. A study of the descriptive statistics of the study shows that of the 788 French publicly traded corporations included in the sample, 520 were held by controlling shareholders—of these, 226 were controlled by individuals or families, and only 40 were controlled by the general public. The study also shows that of 266 Italian publicly traded corporations included in the sample, 180 were held by controlling shareholders—while only 12 Italian corporations in the sample had a diffuse ownership structure.[61] The authors of the study believe that the dominant concentration of ownership in France and Italy is not the result of economic development or their industrial structure in relation to Anglo-American countries, but rather an expression of a legal tradition that was created and preserved against a historical background, as explained above.[62]

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[58] Christian Andres, André Betzer & Ingavanden Bongard, *Das Endeder DeutschlandAG*, 44 KREDIT UND KAPITAL 185 (2011). See also Randall S. Thomas, *International Executive Pay: Current Practices and Future Trends,* in LABOR AND EMPLOYMENT LAW AND ECONOMICS 197–98 (Kenneth G. Dau-Schmidt, Seth D. Harris & Orly Lobel eds., 2009) (citing evidence that over time, shareholder ownership in Sweden and Germany has become less concentrated and executive incentive compensation—and overall pay levels—is rising).

[59] Ringe, Changing Law and Ownership Patterns in Germany, *supra* note 5, at 522–24.

[60] *Id.,* at 524–26.

[61] Gur Aminadav & Elias Papaioannou, *Corporate Control Around the World* (December 2016), NBER Working Paper No. w23010. Available at SSRN: https://ssrn.com/abstract=2892434

[62] In their words (Id., 1):

> [O]wnership concentration is considerably higher in French civil-law (and to a lesser extent in German civil-law) countries as compared to common-law countries. These patterns apply to very large, big, medium-sized and small listed firms and are not driven by regional differences, the level of economic development, or industrial structure, suggesting that legal origin has sizable long-lasting consequences on corporate structure.

The current data indicates that ownership structure in France is still concentrated.[63] However, this may well weaken in the future (even if only to a comparative degree) following the adoption of corporate governance rules that better protect the rights of minority shareholders. One example of this is the adoption of the Say on Pay arrangements in European countries, where the central agency problem is not between the company's managers and its shareholders, but between the controlling shareholders and the minority shareholders.[64] The adoption of these arrangements in markets with a concentrated capital structure is also due to the fact that the control exercised by controlling shareholders over the salary levels of the company's directors has proven to be particularly ineffective.[65] In June 2013, the French Code of Corporate Governance first introduced the Say on Pay arrangements. According to Principle 24.3 of the said Code, corporations are required to disclose to the shareholders all remuneration components given to directors—including options, "golden parachutes" and other pending retirement benefits—and to bring them for their approval in an advisory vote. If the shareholders do not approve the proposed remuneration, the company's board of directors must convene a special meeting in which it must discuss the implications of the shareholders' objection to the proposed remuneration, and publish the steps that it intends to take on the company's website.[66] However, on December 9, 2016, France adopted particularly far-reaching Say on Pay arrangements following the adoption of the Sapin II Law. Under these new arrangements, publicly traded corporations are required to submit all components of the remuneration to the company's officers for the approval of the shareholders through a binding, ex-ante, forward-looking vote. In addition, at the end of the calendar year, the shareholders are required to approve the remuneration paid to officers in the past year, in an ex-post, backward-looking vote. The new arrangements adopted in France are stricter than those in Anglo-American countries.[67]

Similar regulation was also adopted in Italy in 2010, following recommendations made by the EU Commission in 2004 and 2009 (2004/913/CEu and 2009/385/CE). Under the new regulations, the company must publish a two-part remuneration report. In Part I, it must detail the principles by which it intends to compensate the company's senior officers for their work in the coming year—including

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According to another view, a concentrated ownership model is directly linked to the industrial and political structure of democratic social countries. See: MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, Corporate Impact (2003).

[63] However, another study that examined the concentration rate in companies listed in the CAC 40 index (an index of the discount weight index of the 40 most actively traded shares among the 100 leading shares on the Paris Stock Exchange) found that there was a significant decline in the concentration rate between 1999 and 2012. See Christoph Van der Elst, *The Influence of Shareholder Rights on Shareholder Behavior,* 5 CORP. FIN. & CAP. MKTS. L. REV. 50 (2010).

[64] Randall S. Thomas & Christoph Van der Elst, *Say on Pay Around the World,* 92 WASH. U. L. REV. 653 (2015).

[65] In this context, Kobi Kastiel has argued that given the friendship and business relationships between controlling shareholders and managers, the controlling shareholders may pay company managers higher than optimal salaries so that the controlling shareholders may pocket private benefits. See Kobi Kastiel, *Executive Compensation in Controlled Companies*, 90(3) INDIANA L. J. 1131 (2015).

[66] Thomas & Van der Elst, Say on Pay Around the World, *supra* note 64, at 680-688.

[67] Pietrancosta, Say on Pay: The New French Legal Regime, *supra* note 7.

how the company intends to implement and adopt the remuneration policy. Part II includes details of the remuneration (in all its components) to the company's directors and management. The shareholders are then required to approve the remuneration policy in an advisory vote.[68]

It should be emphasized that these arrangements originate in Anglo-American law, where ownership structure is diffuse.[69] Therefore, the extent to which these arrangements are adopted in continental countries, where the agency problem is different, is an indirect indication that concentrated corporate ownership in those countries is on the wane (in part by a decline in the holdings by controlling shareholders in publicly traded corporations)[70]—while diffuse corporate ownership is on the increase (inter alia, through increased public holdings of share capital of publicly traded corporations). A complex picture emerges from the collection in connection with the weakening of the concentrated ownership structure in the continental countries. While in Germany there is direct evidence of a consistent decline in the holding of financial institutions in publicly traded corporations and a commensurate increase in holdings by institutional investors, in France and Italy the incidence of concentration is still prominent. However, as the protection of the rights of minority shareholders expands—through arrangements similar to those of Say on Pay that have already been adopted in those countries—we expect to see a weakening of concertation and strengthening of diffusion in the ownership structures of publicly traded corporations.[71]

(B) *The Traditional Ownership Structure in Anglo-American Law and the Factors that are likely to Weaken it*

(1) *The Background to the Traditional Ownership Structure in Anglo-American Law*

The conventional wisdom is that the tension between company executives and public shareholders that characterizes the diffuse corporate ownership structure in the United States is identified in particular with the writings of Berle & Means in the early 1930s.[72]

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[68] Massimo Belcredi, Stefano Bozzi, Angela Ciavarella & Valerio Novembre, *Say-on-Pay in a Context of Concentrated Ownership: Evidence from Italy*, available at www.papers.ssrn.com/sol3/papers.cfm?abstract_id=2403886#. In this empirical study, the authors found that the opposition among public shareholders to the compensation packages offered to corporate officers are more or less similar to those of public shareholders in countries with diffuse capital structure (England and the United States). This last statement is consistent with the spirit of the text.

[69] Fabrizio Ferri, *Say on Pay*, in RESEARCH HANDBOOK ON SHAREHOLDER POWER 319 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

[70] See Thomas & Van der Elst, Say on Pay Around the World, *supra* note 64, at 716:

> While it would be a mistake to draw too-broad conclusions from the experience of these three countries, it does appear that shifts in ownership concentration levels, particularly at large listed companies, are an important factor behind at least some countries' adoption of the Say on Pay vote. However, even in countries where control shareholders continue to reign supreme, Say on Pay may provide control shareholders with an additional mechanism to control executive pay, and allow family-run companies to claim that they are taking action against negative social reactions to "too high" levels of executive pay. "No" votes on Say on Pay proposals may also provide minority shareholders with a mechanism for expressing their opposition to executive pay practices".

[71] As previously noted, this argument is in line with the research by La Porta et al., What Works in Securities Laws?, *supra* note 20,

[72] BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 47–65, 112–116 (1932)

They argued that while in theory the law in the United States views all shareholders as owners of a publicly traded company, in practice the management of any given company is left to a small group of managers who do not necessarily act in the interests of the shareholders.[73] They presented empirical data showing a sharp increase in the rate of shareholdings in corporations by the general public—from 2.4 million people in 1924 to around 10 million people in 1930 (a fourfold increase). They also found that, when no shareholder held more than 5% of a company's share capital, 44% of the 200 largest publicly traded corporations in the United States were under the effective control of their management.[74] With regard to the English market, Brian Cheffins argued that a diffuse ownership structure developed in England and reached its peak only after 1970. In his view, one of the main reasons for this was for tax considerations: in the wake of World War II, legislation was adopted that imposed high taxes on corporate profits, and at the same time did not recognize for directors' remuneration as a tax-deductible expense. These two measures effectively eliminated the incentive of controlling shareholders to serve as officers in the company, and prompted them to distribute their shares on the open market.[75]

Since the 1970s, various economists have argued that diffuse ownership structure allows for a trade-off between the costs of the shareholders' oversight over the company's management and the benefits of diversifying their investment portfolio, which reduces the risk inherent in capital investment.[76] The paradigm of separation between ownership and control dominated corporate law research throughout the twentieth century.[77] However, over the past few years, several studies have challenged

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[73] *Id*., at 46:

> The economic power in the hands of the few persons who control a giant corporation is a tremendous force which can harm or benefit a multitude of individuals, affect whole districts, shift the currents of trade, bring ruin to one community and prosperity to another. The organizations which they control have passed far beyond the realm of private enterprise—they have become more nearly social institutions.

[74] Id., at 93–94. Notably, the authors made another claim that sounded revolutionary at the time (but now turns out to be accurate) that international public companies will take the place of the civil state as the most dominant institutions in the Western world. In their view (Id., 356)—

> The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state - economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more powerful, makes every effort to avoid such regulation... The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization.

This argument is, in part, one of the reasons for the subordination of multinational corporations to the international legal system. See: MARKOS KARAVAIS, CORPORATE OBLIGATIONS UNDER INTERNATIONAL LAW (2013).

[75] Brian R. Cheffins, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED (2008). For a historical survey of the development of the concentrateddiffuse ownership structure in the United States and England, see: John C. Coffee, *Dispersed Ownership: The Theories, the Evidence, and the Enduring Tension between "Lumpers" and "Splitters,"* (ECGI Law Working Paper Group, Paper No. 144, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532922 .

[76] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,* 3 J. FIN. ECON. 305 (1976); Frank H. Easterbrook & Daniel R. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW 40-72 (1991).

[77] William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737 (2001).

the accepted tenet of separation of ownership and control in the American economy.

For example, one study examined the ownership structures of publicly traded corporations in the early twentieth century in the railways, infrastructure and industry sectors in the United States, England, France, and Germany.[78] It found that the number of corporations in the United States with diffuse ownership was significantly lower than in England, France, or Germany. Another study examined the current holdings by banks in publicly traded corporations in the United States, and found that 100 large banks hold an average of 10% of the voting rights of corporations listed in the S&P 500 index—a significant percentage that attests to sizable concentration in the US economy.[79] Another study examined a random sample of 375 publicly traded corporations on the New York stock exchanges in 1995 and found that about 96% of them had shareholders with more than 5% of the company's share capital (the average holding being 39%).[80]

Conversely, recent economic-historical research shows that until the mid-twentieth century, the US economy was highly concentrated and characterized by pyramids and business groups that operated in the fields of transportation and infrastructure. However, between the 1940s and the early 1950s, comprehensive regulation was adopted with the aim of eliminating concentrated ownership structures in the United States, as these were perceived as being directly detrimental to competition in the local economy. In this context, research points to a link between the adoption of various reforms in the field of infrastructure, taxation and protection of investors, and the elimination of a structure of concentrated ownership in the American economy in favor of diffuse ownership structures.[81] Thus, although some studies point to some concentrated trends in the American economy, the prevailing view is that these do not warrant a rethinking of the rules of corporate governance in the United States. The separation of ownership and control still serves as a good reference point to describe the historical development of corporate law there.[82]

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[78] Leslie Hannah, *The 'Divorce' of Ownership from Control from 1900 Onwards: Re-calibrating Imagined Global Trends*, 49 BUSINESS HISTORY 404 (2007).

[79] Joao A.C. Santos and Adrienne S. Rumble, *The American Keiretsu and Universal Banks: Investing, Voting and Sitting on Nonfinancials' Corporate Boards*, 80 JOURNAL OF FINANCIAL ECONOMICS 419 (2006).

[80] Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22(4) REVIEW OF FINANCIAL STUDIES 1377 (2009).

[81] Eugene Kandel, Konstantin Kosenko, Randall Morck & Yishay Yafeh, *The Great Pyramids of America: A Revised History of US Business Groups, Corporate Ownership and Regulation, 1930-1950*, available at: http://bschool.huji.ac.il/.upload/staff/yishai/Pyramids.pdf. In their words:

> We provide evidence linking the disappearance of business groups to reforms that targeted them explicitly — the Public Utility Holding Company Act (1935) and rising intercorporate dividend taxation (after 1935); the evidence on the impact of enhanced investor protection (after 1934), escalating estate taxes (starting in the 1930s) and the Investment Company Act (1940) is mixed. Banking reforms and rejuvenated antitrust enforcement cannot be directly linked to the demise of groups, but may have had an indirect effect. Thus, a combination of reforms, sustained in a lasting anti-big business climate, promoted the dissolution of existing groups, discouraged the formation of new ones, and created an economy of freestanding firms.

[82] See Brian Cheffins & Steven Bank, *Is Berle and Means Really a Myth?,* 83 BUSINESS HISTORY REVIEW 443 (2011). For the assertion that various structures of concentrateddiffuse ownership in the United States and England should be distinguished from their respective regulatory implications, see: John Armour & Jeffrey N. Gordon, *The Berle-Means Corporation in the 21st Century*, Available at: https://law.yale.edu/system/files/documents/pdf/Intellectual_Life/Armour_BerleMeansCorp091021.pdf

The separation of ownership and control is particularly evident in the fact that Anglo-American law reduces the ability of shareholders to initiate various decisions in connection with the management of the company's internal affairs.[83] In this matter, it is argued in the literature that the existing law—which shields directors from pressures from the shareholders—facilitates the promotion of the long-term interests of the company and of shareholders alike.[84] According to this line of thinking, giving greater power to public shareholders may cause them to pursue short-term interests with a view to generating profits in the short term, but harming the company's ability to invest in research and development that will generate profits for the company and its shareholders in the long term.[85] This argument, however, which has repeatedly been put forward for many years in the legal literature in the United States, is inconsistent with empirical studies of this issue, which show that involving shareholders in the management of the company's internal affairs is often likely to benefit it in both the short and the long term.[86] Both schools of thought do agree that separation of ownership and control as first mooted by Berle & Means creates a moral hazard for the company's management. Where they disagree is over whether this risk can be minimized by empowering the board of directors, or the shareholders. This controversy has divided corporate practice and research in the United States for decades and is not likely to be decided in the foreseeable future.[87]

(2) *The Factors that may Lead to the Weakening of the Diffuse Ownership Structure in Anglo-American Law*

In this section, I discuss various developments in Anglo-American law that may weaken the diffuse ownership structure there. These trends—which hitherto have not received

[83] Stephen M. Bainbridge & M. Todd Henderson, *Board-R-US: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1053 (2014).

[84] On the question of whether shareholders should be allowed to make their voices heard frequently regarding the management of the company's internal affairs, see Stephen Bainbridge, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE (2008) (which calls for strengthening the status of the board of directors and reducing the ability of shareholders to voice their views about the management of the company's internal affairs, and how the existing law supports this position). See also: Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance,* 97 NW. U. L. REV. 547, 559-74 (2003); Jack B. Jacobs, "*Patient Capital": Can Delaware Corporate Law Help Revive It?,* 68 WASH. & LEE L. REV.1645, 1657-61 (2011). Conversely, advocates of shareholder activism argue that the powers and rights of shareholders in particular should be expanded with regard to the appointment of directors and directors of the company. They also claim that the presence of institutional investors reduces the information gaps between shareholders and company managers, allowing shareholders to express views on the company's internal affairs. See: Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 851–75 (2005); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 694-711 (2007).

[85] LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC, 63-73 (2012); Stephen M. Bainbridge, *Response, Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1744-1751 (2006); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 653-654, 657-659 (2010).

[86] Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113(6) COLUM. L. REV. 1637 (2013).

[87] To reconcile these two streams of thought, it has been argued that the rules of corporate governance should be designed such that the company's board of directors be given broad powers regarding short-term decisions, and the shareholders given broad powers regarding long-term decisions. See: Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101(4) MINN. L. REV. 1377 (2017).

much attention—are now widely discussed among researchers and policymakers.

(a) *The Concentrated Ownership of Institutional Investors and the Activism of Shareholders*

In recent years, the view in the United States is that the diffuse ownership structure that has characterized publicly traded corporations in the United States, as highlighted by Berle & Means, is no longer accurate.[88] Gilson & Gordon have noted that today, institutional investors hold, on average, over 70% of the share capital of publicly traded corporations in the United States. The authors believe that the high levels of ownership of publicly traded corporations by institutional investors are due to the decision to privatize pension funding (beyond the regular funding of the national welfare program), and to a diversified approach to investment which enables members of the general public to reduce the risk involved in direct investment in the stock market by using the services of intermediaries with diversified investment portfolios.[89] The authors also point out that this new state of affairs has given rise to agency problems of a different nature from that raised by Berle & Means in their book. The first is reflected in the discrepancy in interests between the general public and the institutional investors who hold their money. Due to various business models, it has been argued that institutional investors have no incentive to oversee the activities of the corporations in which their clients' money is invested. In other words, these institutional investors may often prefer to opt to exit an investment rather than actively seeking to improve corporate governance in the invested company. The second agency problem lies in the small incentive of the institutional investors to ensure that the management of an invested corporation act in a manner that advances the long-term interests of the shareholders (Agency Capitalism).[90]

One way to address these agency problems is to impose direct obligations on institutional investors. For example, in England, following the Walker Commission report, it was determined that institutional investors should be viewed as stewards of the corporations in which they invest the public funds.[91] The stewardship code sets out a long list of principles designed to induce such investors to intervene in the management of the company's internal affairs on behalf of the investing public.[92] It is

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[88] Ronald J. Gilson & Jeffrey N. Gordon, *Agency Costs of Agency Capitalism: Activist. Investors and the Revaluation of Governance Rights,* 113 COLUM. L. REV. 863 (2013); Gerald F. Davis, *The Twilight of the Berle and Means Corporation,* 34 SEATTLE U. L. REV. 1121 (2011).

[89] *Id.,* at 874–886.

[90] *Id.,* 874–878. For a more recent discussion of these agency problems, see Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31(3) JOURNAL OF ECONOMIC PERSPECTIVES 89 (2017). The authors explain that investment managers do not have an incentive to oversee the operations of companies because they will only benefit partially from such oversight, while bearing the full costs involved. In addition, investment managers seeking to secure additional business with the company that the institutional investors are investing in will not act counter to the position of the company's management).

[91] REPORTING COUNCIL, THE UK STEWARDSHIP (2012), available at http://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx.

[92] For a review of the code's provisions, see Lee Roach, *The U.K. Stewardship Code*, 11(2) J. CORP. L. STUD. 463 (2011); BO GONG, UNDERSTANDING INSTITUTIONAL SHAREHOLDER ACTIVISM: A COMPARATIVE STUDY OF THE UK AND CHINA 48 (2013).

an expression of the English government's desire to delegate (if only partially) oversight over publicly traded corporations to the private sector.[93] In addition, there are other types of investors to be considered, such as hedge funds. These funds use aggressive measures to force a company's management to act in the interests of their shareholders[94]—such as raising various suggestions on behalf of shareholders, conduct proxy contests and negotiating privately with the board of directors to promote the interests of the shareholders.[95] Therefore, although it is generally thought that hedge funds hold relatively low share capital in publicly traded corporations, they function like controlling shareholders in corporations with a concentrated ownership structure inasmuch as they closely monitor the activities of the company's management.[96] From all the above, it is apparent that while pension funds, provident funds and insurance corporations hold very large proportions of the share capital of publicly traded corporations—to a degree similar to a concentrated capital structure—they do not necessarily wield control. Nonetheless, the legislators have sought to impose upon them the duties of trust that encourage them to take an active part in the management of the internal affairs of corporations they invest in. Conversely, while hedge funds hold relatively low rates of share capital (as in a diffuse ownership structure regime), they control the company in a manner similar to a concentrated capital structure.[97] The role of policymakers, therefore, is to design more sophisticated corporate governance rules than those that were required under the Berle & Means paradigm.[98]

(b) *Dual Class Stocks*

In a significant number of publicly traded corporations in the United States, there is a

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[93] Iris H - Y Chiu, *Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance*, 6 BROOK. J. CORP. FIN. & COM. L. 387 (2011). For the argument that it is doubtful whether the code will achieve its purpose as along as the law avoids tackling the problematic incentives of investment managers, see: Iris H - Y Chiu, *Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK*, 38 DEL. J. CORP. L. 983 (2013). For the claim that the activity of institutional investors in England depends on their equity holdings in public companies in England (which is currently in continuous decline) and the implementation of the stewardship code, see Paul Davies, *Shareholders in the United Kingdom*, in RESEARCH HANDBOOK ON SHAREHOLDER POWER 355 (Randall Thomas & Jennifer Hill eds., 2015).

[94] For a comprehensive empirical study that found that hedge fund activism promotes the long-term interests of the company, see Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1155 (2015) ("We find no evidence that interventions are followed by declines in operating performance in the long term; to the contrary, activist intervention are followed by improved operating performance during the five-year period following the intervention").

[95] For a discussion of how hedge funds intervene in the internal management of the company, see Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007).

[96] Dai & Helfrich, Structure of Corporate Ownership and Control, *supra* note 43, at 24:

> Even though hedge funds rarely hold a controlling bloc of shares, their power and influence in a given corporation can be equivalent to that of a majority or controlling shareholder. So although they might in quantitative measurements be minority shareholders, in practice and in analysis of their consequence on corporate governance matters, activists are arguably more comparable to controlling shareholders.

[97] Matthew Denes, Jonathan M. Karpoff & Victoria McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 JOURNAL OF CORPORATE FINANCE 405 (2017) (reviewing 67 previous studies of shareholder activism and finding that hedge fund activism is linked to improvement in the company's performance and an increase in its share price).

[98] Dai & Helfrich, Structure of Corporate Ownership and Control, *supra* note 43, at 26–27.

variation of voting rights attached to capital rights. For example, giant corporations such as CBS, Facebook, Alibaba, Ford, Google, News Corp. and Nike have a dual class shares.[99] Dual class shares exists in 9% of the corporations listed in the S&P index, whose combined market cap is $2.26 trillion.[100] In 1926, the New York Stock Exchange (NYSE) banned share issues with varied voting rights—stipulating that every security issued on the stock exchange will have equal voting rights[101]—in a bid to promote corporate democracy and protect the rights of minority shareholders. Today, although the rules of the United States stock exchanges prohibit registered corporations from making a change in the type of voting rights attached to their capital shares, there is no such prohibition on corporations issuing shares for the first time, which are allowed to issue shares with different types of voting rights.

Variation in voting rights enables the controlling shareholder to entrench their control and may protect it from possible hostile takeovers—even when the company performs poorly. It also allows the controlling shareholder to direct the company's activity without having to hold a higher percentage of the company's share capital. The controlling shareholder with a low equity holding may seek to channel private benefits into his pocket at a comparatively small cost of ownership.[102]

Bebchuk & Kastiel recently claimed that these costs may increase over time after the issuance of an initial public offering (IPO) on the primary stock market. At the time of the IPO, protection of the company founders' control might be justified on the grounds that the founders possess special business skills that enabled the company to be established and successfully managed to that point[103]—but years after the IPO, the justification for the founders to continue to maintain control of the company through dual class shares is significantly diminished. There is little evidence that controlling

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[99] EDWARD KAMONJOH, INVESTOR RESPONSIBILITY RESEARCH CTR. INST., CONTROLLED COMPANIES IN THE STANDARD & POOR'S 1500: A FOLLOW-UP REVIEW OF PERFORMANCE & RISK 84–87 (2016), https://irrcinstitute.org/wp-content/uploads/2016/03/Controlled-CompaniesIRRCI-2015-FINAL-3-16-16.pdf. See also: Floyd Norris, The Many Classes of Google Stock, N.Y. TIMES: ECONOMIX (Apr. 2, 2014), http://economix.blogs.nytimes.com/2014/04/02/the-many-classes-of-google-stock

[100] For a breakdown of the figures, see Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 594-595 (2017), 595. The authors also note that while in 2005 only 1% of the companies traded on various stock exchanges in the United States had variation of voting rights, in 2015 the percentage had reached 13.5% of all companies.

[101] *Id.,* at 596.

[102] *Id*., at 597–99. It should be noted that although variation of voting rights is not common in England due to the opposition of institutional investors, the FSA is interested in examining the possibility of allowing it. See FSA, REVIEW OF THE EFFECTIVENESS OF PRIMARY MARKETS: THE UK PRIMARY MARKETS LANDSCAPE 7 (February 2017), available at: https://www.fca.org.uk/publication/discussion/dp17-02.pdf . Excerpt:

> The key components for inclusion in the premium listing segment are broad equivalence between economic ownership and voting rights (typically expressed through single-class share structures), pre-emption rights and the need to demonstrate an independent business. Our discussions with stakeholders have provided strong endorsement for the existing regime. It is widely regarded as having evolved in line with market feedback to serve the interests of investors and issuers. It is also seen as an example of high corporate standards leading to high levels of investor confidence and, in turn, a vibrant market. However, we have identified some important questions about whether the boundary of the premium listing regime is appropriately drawn, and whether re-drawing that boundary might improve effectiveness for issuers and investors

[103] *Id.,* at 604.

shareholders possess superior skills in promoting the interests of the company.[104] Moreover, as Bebchuk & Kastiel point out, after the IPO in which the variation of voting rights was guaranteed, company founders tend to significantly reduce their holdings in the company without losing control. Over time, this only intensifies the interests disparity and the agency problems between the controlling shareholder and the company and its minority shareholders.[105]

In conclusion, it is important to emphasize that even if most publicly traded corporations in the United States do not have dual class shares, this is a quintessential feature of concentrated ownership structures that is particularly gaining momentum among technology companies.[106] Moreover, the adoption of variation of voting rights by corporations outside the technology sector will significantly challenge the conventional Anglo-American tenet of separation of ownership and control.[107]

(C) *Interim Summary*

In this section I discussed the factors that led to the adoption of the concentrated and diffuse ownership structure in continental law and Anglo-American law (respectively). I also discuss the reasons for the assertion that legal and economic developments have led to the weakening of the traditional ownership structure in each of these legal systems, in favor of features of the alternative ownership structure. In Part III I will discuss how a similar weakening of the traditional ownership structure has occurred in Israel and Canada, as well—based, in part, on preliminary data—and their normative ramifications for the design of relative corporate governance rules.

III. RETHINKING THE CONCENTRATED OWNERSHIP STRUCTURE IN THE CANADIAN AND ISRAELI ECONOMIES

In this section I show that the weakening of traditional ownership structure in comparative law extends to Canada and Israel as well.[108] To this end, I will focus on the following aspects of the structure of ownership: the percentage of public holdings in the share capital of publicly traded corporations; the level of the controlling premium in the Israeli economy; and the extent of the protection given to the rights of the minority shareholders.

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[104] *Id.,* at 605–06.

[105] *Id.,* at 607-09.

[106] Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 101, 110 (2016).

[107] See also the empirical study that found clear concentrated ownership structure patterns in the American capital market: Ronald C. Anderson et al., Founders, *Heirs, and Corporate Opacity in the United States,* 92 J. FIN. ECON. 205, 207 (2008). It found that over 20% of the 2000 largest companies in the United States have concentrated control.

[108] Canada and Israel are mixed legal systems in the sense that in Canada, the Anglo-American law prevails everywhere except for the province of Quebec, which adheres to the continental tradition. In Israel, the legislature shaped the private law based on continental law, while corporate law follows mainly the Anglo-American tradition. See Aharon Barak, *The Israeli Legal System: Its Tradition and Culture* 40 HAPRAKLIT 197, 209 (1993) [in Hebrew]:

> [...] Our method was influenced by the common law tradition, but is not part of it; similarly, our system was influenced by the Romano-German family but is not part of it [...] We can say that we belong to the tradition of methods, each of which is partly influenced by the common law tradition and partly by the Romano-German one [...].

(A) The Characteristics of Concentrated Ownership Structure in Canada & Israel

(1) *Decrease in Holdings of Stakeholders*

(i) *Canada.*

Various scholars have offered various explanations for the concentrated ownership structure in Canada. For example, Daniels & Iacobucci point out that in the twentieth century, banks and financial institutions were allowed to invest directly in corporations they were lending to, as a means of protecting their investment rather than for profit. They argue that the regulation that allowed the banks to maintain high equity holdings in these corporations contributed to the development of a concentrated ownership structure in the country.[109] Morck et al. Argued that the increase in concentration rates in Canada was mainly due to a significant decline in local tax rates on inheritances and trusts, and the existence of various restrictions on the ability of international investors to invest in local corporations. However, recent research casts doubt on the existence of distinctly concentrated characteristics in this country.[110] For example, a Valsan study of thousands of corporations listed on the Toronto Stock Exchange shows that although some of them do have a concentrated ownership structure, there has been a sharp decline in such companies over the past decade. While other studies found that the average level of concentration is about 60% of the share capital of publicly traded corporations, Valsan's study found that this rate currently stands at only 41%.[111]

(ii) *Israel.*

It is common to conclude that the Israeli capital market is characterized by a concentrated ownership structure that is reflected in the phenomenon of business consortiums that control other publicly traded corporations through a a two-layer, three-layer, and even more.[112] In most publicly traded corporations, a controlling shareholder holds a significant share of the company's shares and is capable of directing the corporation's activity and influencing its conduct.[113] However, in recent years we have witnessed a clear trend of changes in the composition of shareholders in publicly traded corporations. According to the publications of the Tel Aviv Stock Exchange,[114] the level

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[109] Ronald Daniels & Edward M. Iacobucci, *Some of the Causes and Consequences of Corporate Ownership Concentration in Canada* in CONCENTRATED CORPORATE OWNERSHIP 81 (Randall Morck ed., 2000).

[110] Randall Morck, Michael Percy, Gloria Yuan Tian & Bernard Yin Yeung, *The Rise and Fall of the Widely Held Firm – History of Corporate Ownership in Canada*, in HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 65 (Randall Morck, ed., 2005).

[111] Calin Valsan, *2007: A Canadian Corporate Ownership Survey*, 7(2) THE EUROPEAN JOURNAL OF COMPARATIVE ECONOMICS 285 (2010).

[112] Hamdani, CONCENTRATED OWNERSHIP STRUCTURE IN ISRAEL: LEGAL ASPECTS, *supra* note 41, at 18–34.

[113] Odelia Minnes, *The Legal Arrangement Governing Pyramids Control of the Concentration Law and its Impact on the Israeli Capital Market and Economy: Preliminary Findings*, 31 LAW STUDIES 1, 1 (2016) [in Hebrew].

[114] Kobi Abramov, *The sale of shares by stakeholders in the first half of 2014 continues* (TASE, Research Unit, February 2015) Accessible: https://www.tase.co.il/Heb/Statistics/StatRes/2014/Stat_141_Research_2014_07_221916.pdf; Kobi Abramov, Stakeholders sold shares worth NIS 5.5 billion in 2014 (TASE, January 2015) accessible: www.tase.co.il/Heb/Statistics/ResearchReviews/2015/Pages/Stat_141_Research_2015_01_234326.asp; In 2016, public shareholders sold NIS 6 billion worth of shares, an increase of more than 80% compared to the year 2015 (TASE, Research Unit, December 2016)

of holdings by the general public in the share capital of publicly traded corporations on the stock exchange rose from 53% in 2004–08 to 57% in 2009–13, and 61% during 2014.[115] These figures are surprising in light of global trends, whereby the proportion of countries with a concentrated ownership structure increased from 22% in 1998 to 41% in 2012, to while the percentage of countries with diffuse ownership structure declined from 57% to 41%.[116] Fig. 1 presents the data on the distribution of holders of shareholders in publicly traded corporations in Israel in the years 2007–17, according to data in the annual reviews published by the Tel Aviv Stock Exchange at the end of each year in that period.[117] Fig. 1: Average level of shareholders' equity in publicly traded corporations in Israel, in the years 2007–17

Fig. 2 indicates a consistent and significant decline in the levels of holdings by stakeholders, and concurrently, a steady increase in the levels of holdings by the general public in the equity of publicly traded corporations between 2002 and 2017.[118] It also shows that apart from 2017,[119] the level of holdings by Israeli institutional investors in the share capital of publicly traded corporations in the domestic capital market remained more or less stable throughout the period in question.

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https://www.tase.co.il/Heb/Statistics/ResearchReviews/2016/Pages/Stat_141_Research_2016_12_287236.aspx; Kobi Abramov, Stakeholders sold shares worth NIS 4.5 billion in 2017 (TASE: Research Unit, December 2017), accessible: https://www.tase.co.il/Heb/Statistics/ResearchReviews/2017/Pages/Stat_141_Research_2017_12_313312.aspx [in Hebrew]

[115] Minnes, The Legal Arrangement Governing Pyramids, *supra* note 113, at 17.

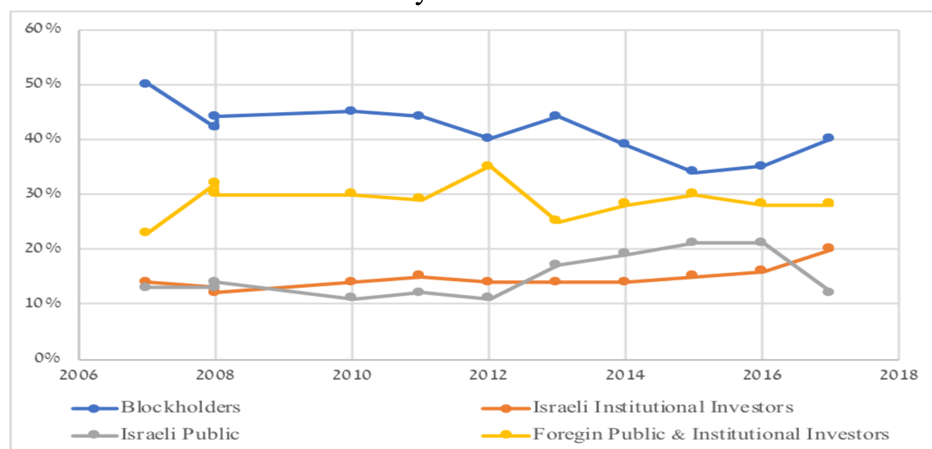
[116] OECD, CORPORATE GOVERNANCE FACTBOOK Fig. 1.1 (2015), available at http://cecga.org/wp-content/uploads/OECD-Corporate-Governance-Factbook.pdf.

[117] See www.tase.co.il/Eng/statistics/annualreviews/Pages/annualreviews.aspx.

[118] Due to the sharp drop in the share price of Teva in 2017 (with a public holding rate of over 90%), the overall share of holdings by the general public in the stock market fell by approximately 3%, to 60% compared with the end of 2016—while the total public holdings in the stock market rose by 1.5% compared to the end of 2016. For further details, see: TASC, ANNUAL REVIEW 10 (2017) https://www.tase.co.il/Eng/Lists/gen_res/0133_annual_review/2017_annual_review_eng.pdf.

[119] The increase in holdings by Israeli institutional investors in 2017 is due in part to the distribution of stakeholder shares following the implementation of the provisions of the Law for the Promotion of Competition and Reduction of Concentration, 5774-2013, and their acquisition by institutional investors.

Fig. 2: Changes in levels of holdings by stakeholders in publicly traded corporations in the years 2007–17



Contrary to these figures, it may be argued that the sharp decline in the level of holdings by stakeholders in publicly traded corporations in Israel is the result of the provisions of the Law for the Promotion of Competition and Reduction of Concentration, 5774-2013. Even if the effect of the provisions of the Concentration Law on the levels of holding by stakeholders cannot be ruled out, Figs. 1 and 2 show that this trend began well before that law was enacted—and even before parliamentary discussions about it. As Odelia Minnes points out: "This may therefore be a trend that is not a direct outcome of the law, but is nonetheless consistent with its enactment, or reaffirmed by it."[120]

(2) *The Size of the Control Premium*

Control of publicly traded corporations gives controlling shareholders certain private benefits that minority shareholders do not share. Generally, in a concentrated ownership structure, the amount paid for the purchase of control of a corporation by a new controlling shareholder from the present one—over and above the market value of its shares—is known as the company's control premium,[121] and represents the value of the control to the controlling shareholder. In both the theoretical and the empirical literature, a direct association has been found between the concentrated ownership structure and the ability of controlling shareholders to enjoy private benefits in the form of a control premium.[122]

In a comparative international study, Dyck & Zingales assessed the private value of control in 39 countries based on data from 393 core control transfer transactions in

[120] Minnes, The Legal Arrangement Governing Pyramids, *supra* note 113, at 45.

[121] For a wide-ranging discussion of the Israeli literature concerning the regulation of control premiums, see Moran Ophir, *Controlling Premium in Going Private Transactions*, 20 LAW AND BUSINESS, 417 (2017) [in Hebrew].

[122] It should be noted that the text does not rule out the possibility that in certain circumstances a premium paid to the current controlling shareholder for the transfer of control to a new controlling shareholder may be justified. See Goshen & Hamdani, Corporate Control and Idiosyncratic Vision, *supra* note 30, at 604–05.

the years 1990–2000.[123] They found that the premium paid in Israel is among the highest in the world—some 27% of the purchased company's capital, or almost twice the average control premium in the entire sample. In addition, the researchers found a positive correlation between the control premium and the concentrated ownership structure in the Israeli capital market.[124] In another study, by Barak and Lauterbach, the authors estimated the private value of control based on the data from 54 large transactions in Israel for the sale of blocks of shares, in the years 1993–2005.[125] They found that the premium paid in these transactions averaged 32% of the capital.[126] The prevailing view, therefore, among many researchers was that the high control premium that exists in the Israeli market is indicative of a clearly concentrated ownership structure with little protection for the rights of minority shareholders.[127]

However, a new study by Sharon Hannes and Eilon Blum shows that the control premium in Israel has diminished following legislative and regulatory changes that curb the power of controlling shareholders in publicly traded corporations in Israel.[128] Seeking to estimate the control premium in Israel between 2000 and 2015, based on the Dyck & Zingales methodology, they found that today there is no significant control premium in Israel, and controlling shareholders who sell their holdings in the company do so at market value.[129] In other words, the salient characteristic of concentrated ownership structure in Israel which research literature has alluded to in the past is no longer valid. This important change should be taken into account when considering further proposals—as put forward by various players in the local market—that are aimed at constraining the actions of controlling shareholders.[130] The new reality requires a rethinking of the premises regarding the degree of concentration market in Israel and Europe.[131]

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[123] Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN 537 (2004).
[124] Id., 590.
[125] Ronen Barak & Beni Lauterbach, *Estimating the Private Benefits of Control from Partial Control Transfers: Methodology and Evidence*, 2 INT'L J. CORP. GOV. 183 (2011).
[126] It should be noted that in the Barak and Outerbach studies, a different estimation method was used than the one used by Dyck & Zingales—as were the periods on which the two samples were based.
[127] Lucian Arye Bebchuk, Expert Opinion, THE COMMITTEE FOR INCREASING COMPETITIVENESS IN THE ECONOMY Part II 16 ("The evidence that private benefits in Israel are high relative to international levels, and are higher than in other advanced OECD countries, indicates that agency problems and extraction of private benefits are especially significant in Israel").
[128] Sharon Hannes and Eylon Blum, *Does Law Matter? Private Benefits of the Controlling Shareholder Following Legal Reform*, available at http://www.law.columbia.edu/sites/default/files/microsites/law-economics-studies/control_premiun_cls.pdf.
[129] *Id.,* at 8–9.
[130] Interestingly, in this context, Bebchuk writes:

> Moreover, evidence about the levels of control premium will be useful to Israeli authorities in the future as a barometer for the effectiveness of whatever reforms are adopted. As long as control premium in Israeli public firms do not substantially decline from their high levels, public officials should remain concerned about agency problems and the extraction of private benefits in such firms.

See Bebchuk, Expert Opinion, *supra* note 127; Hannes and Blum, Does Law Matter?, *Id*., at 7; Minnes, The Legal Arrangement Governing Pyramids, *supra* note 113, at 45.
[131] Findings similar to those of Hannes and Blum have also been found in the Italian market. Thus, for example, Intrisano found a significant decline in the control premium in Italy's concentrated market (only 5% of the capital) and a correlation between this low rate and various reforms in Italian law that have

(3) *Intensive Protection for the Rights of Minority Shareholders*

The concentrated ownership structure in the Canadian and Israeli capital markets gave rise to the far-reaching protection of the rights of minority shareholders in those two countries in the past decade. The following discussion will examine the legal developments that have clearly curbed the powers of controlling shareholders and provided broader protection to minority shareholders.

(i) *Canada.*

According to World Bank surveys, Canada's economy provides optimal protection for the rights of minority shareholders from possible exploitation by a controlling shareholder and associated parties.[132] In Canada, the Ontario Securities Commission Rule 61-501 regulates procedures for approving transactions with related parties and tender offers. This rule stipulates that the minority shareholders are entitled to receive an expert opinion regarding the fairness of the transaction, which is also subject to the approval of a majority of the minority shareholders. In addition, in Canada, the courts have acted to systematically develop the cause of action in relation to opperession of minority shareholders.[133] According to section 241 of the Canada Business Corporations Act 1985 (CBCA), any interested party in the company—be it a shareholder, creditor or office holder—may file a claim on grounds of deprivation. The significant expansion of the grounds for opperession is reflected in the court's decision in the matter of BCE Inc. v. 1976 Debentureholders.[134] In that case, a leveraged buyout transaction was discussed, which, according to the company's debentureholders, caused them damage in the form of a sharp decline in the value of their holdings. The Supreme Court determined the nature of the claim of deprivation and its constituent elements. A remedy for opperession based on the principles of honesty: it provides the courts with broad jurisdiction to examine not only the company's compliance with the procedural requirements of the law, but also the fairness of the transaction itself. In the case in question, the court determined that the claim of opperession comprised two elements: (1) the reasonable expectations that the plaintiff had that were ostensibly violated, and (2) a demonstration that these expectations were violated due to behavior set out in section 242—i.e., conduct that constitutes opperession, unlawful injury or unlawful disregard of the interests of the interested party. The court reached the conclusion that the debenture holders' claim was unwarranted and that there was no call to intervene in the discretion of the directors in approving the proposed transaction.[135] It further noted that the courts must grant greater scope of action to directors of small corporations in deviating from the provisions of the law under certain circumstances—in contrast to directors of large publicly traded corporations, who must comply with the provisions of

strengthened the protection of the rights of the minority shareholders. See Carmelo Intrisano, *Have the Private Benefits in Italian Firms Decreased?* 11 CHINESE BUSINESS REVIEW 911 (2012).

[132] WORLD BANK GROUP, ECONOMY PROFILE OF CANADA: DOING BUSINESS 2018 INDICATORS 37-41 (2018), available: ww.russian.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Profiles/Country/CAN.pdf

[133] DAVID S MORRITT, SONIA L BJORKQUIST & ALLAN D COLEMAN, THE OPPRESSION REMEDY (2004).

[134] BCE v 1976 Debenture-holders, 2008 SCC 69, [2008] 3 SCR 560.

[135] *Id.,* para 77–88.

the law.[136]

Another reform that underlines the power of shareholders is expressed in tender offers laws. Under these laws, tender offers are subject to a binding vote by a majority of the shareholders in the target company (where the holdings of the bidder and related parties are not taken into account).[137] Another indication of the power of minority shareholders is the widespread availability of Say on Pay arrangements in various publicly traded corporations in Canada. While in the United States and England these arrangements are statutory, in Canada they have yet to be enshrined in legislation. Nonetheless, approximately 80% of Canada's largest publicly traded corporations have voluntarily adopted these arrangements to enable shareholders to make more informed decisions when assessing remuneration to the company's officers.[138]

(ii) *Israel.*

Amendment No. 16 to the Corporations Law, 5759–1999 (the "Corporations Law") titled "Improving Corporate Governance," is the most important and significant amendment since its enactment. The amendment includes a detailed reference to the functioning and independence of the company's board of directors and Audit Committee, with emphasis on proper supervision of the board of directors and the minority shareholders on transactions with a controlling shareholder.[139] This amendment tightened the mechanisms for approving transactions with a controlling shareholder. Section 275 of the Corporations Law regulates the approval mechanism and determines that a tripartite approval of the transaction is required by the Audit Committee, the board of directors and the General Meeting by a majority of at least 50% of the shareholders who have no personal interest in the said transaction. (Prior to this amendment, approval by only a third of the shareholders with no personal interest was required to approve the transaction.)[140]

In August 2011, the Knesset approved Amendment No. 17 to the Corporations Law, which deals with the rules of corporate governance in corporations that have

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[136] For a critical discussion of the ruling, see Anthony J. VanDuzer, *BCE v. 1976 Debentureholders: The Supreme Court's Hits and Misses in Its Most Important Corporate Law Decision since Peoples*, 43 UBC L. REV. 2015 (2010). For the implementation of the BCE ruling by the Canadian Supreme Court, see Mennillo v. Intramodal Inc., 2016; SCC 51, [2016] 2 SCR 438.

[137] NI62-104-Take-Over Bids and Issuer Bids (2016). For a discussion, see: Anita Anand, *Implications of Shareholder Activism*, in GLOBAL CAPITAL MARKETS: A SURVEY OF LEGAL AND REGULATORY TRENDS 17, 19-22 (P.M. Vasudev & Susan Watson eds., 2017).

[138] INSTITUTE FOR GOVERNANCE OF PRIVATE AND PUBLIC ORGANIZATIONS, EXECUTIVE COMPENSATION: CUTTING THE GORDIAN KNOT 38 (2017), available at https://igopp.org/wp-content/uploads/2017/11/IGOPP_PP_Remuneration_PP9_EN_vf_WEB.pdf; THE CANADIAN COALITION FOR GOOD GOVERNANCE, 2016 BEST PRACTICES FOR PROXY CIRCULAR DISCLOSURE 48 (2016), available at https://www.ccgg.ca/site/ccgg/assets/pdf/2016_best_practices.pdf

[139] For a discussion, see Joseph Gross, SEA CHANGE IN CORPORATE GOVERNANCE IN PUBLIC COMPANIES FOLLOWING AMENDMENT NO. 16 TO THE CORPORATIONS LAW AND PROPOSED AMENDMENT NO. 15 (H / 2 (2011) 3); Hadara Bar-Mor CORPORATE LAW (Vol. III) 458-439 (2009) [in Hebre]); HADAS AHARONI BARAK, TRANSACTIONS WITH A CONTROLLING SHAREHOLDER: PUBLIC ENFORCEMENT, CONCENTRATION OF CONTROL AND THE PROTECTION OF THE MINORITY SHAREHOLDERS 115-91 (2014) [in Hebrew].

[140] Michal Agmon Gonen, *The Good (minority shareholders)?!, the Bad (controlling shareholders)?! and the Court - Intervention by the Courts in Transactions of Interested Parties that Have Passed the Approval Process in the Company*, in GROSS BOOK: STUDIES IN CORPORATE LAW AND BUSINESS LAW 47, 54-59 (Aharon Barak et al. eds., 2015) [in Hebrew]

issued bonds in the secondary market without issuing shares in the primary market. According to the provisions of the amendment, as with publicly traded corporations, controlling shareholders in bond corporations are also required to disclose their personal interest in any existing or proposed transaction. In addition, this amendment includes comprehensive provisions about the manner in which the Audit Committee and board of directors of the company supervise the approval of transactions with a controlling shareholder.[141] In 2012, the Israeli legislature adopted Amendment No. 20 to the Corporations Law, which introduced the adoption of the Say on Pay mechanisms in Israeli law.[142] This amendment deals with three main issues: 1) the obligation of the company's institutions to establish a clear remuneration policy for officers; 2) special procedures for approving policies of remuneration of the company's officers; and 3) special procedures for approving remuneration of office holders, the CEO, directors and controlling shareholders.[143] These legislative steps have indeed reduced the benefits that controlling shareholders can derive from their control of a corporation.[144]

However, the court's ruling also determined that even transactions that have been approved under the new approval mechanisms set forth in the Corporations Law are subject to judicial review by the courts.[145] In the cases of the corporations Makhteshim Agan[146] and Elscint,[147] the court considered transactions that had been approved and validated. In the case of Makhteshim Agan, the sale of the company to Chemchina was reviewed. In the class action lawsuit, the plaintiff claimed that the controlling shareholder Coor Corporation had deprived the public shareholders by seeking to receive an excess control premium in the amount of NIS 900 million relative to the rest of the shareholders in the company. The court ruled that the law allows for restrained judicial intervention in order to examine the fairness of a transaction, even in the case

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[141] Another legislative development that took place in 2011 was the enactment of the Enforcement Procedures Law of the Israel Securities Authority (Legislative Amendments) 5771-2011, which regulates an administrative enforcement mechanism for violation of securities laws in parallel with the criminal enforcement mechanism.

[142] For a discussion, see Yosef Gross, *Road Map of the Sea Change in Senior Wages*, CORPORATIONS (1) 88 (2013) [in Hebrew].

[143] For a discussion, see Avi Licht, Ronnie Talmore & Haim Sachs, *Israel's Executive Compensation Reform* (HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., Jan. 7, 2013), available at www.blogs.law.harvard.edu/corpgov/2013/01/07/israels-executive-compensation-reform/#3b.

[144] Minnes, The Legal Arrangement Governing Pyramids, supra note *113, at 46.*

[145] Aharoni Barak, TRANSACTIONS WITH A CONTROLLING SHAREHOLDER, *supra* note 139, at 127 (arguing that although the legislature has set strict rules of approval, the courts must still be allowed to examine these transactions on their merits). See also Asaf Hamdani and Sharon Hannes, Fairness? Controlling Shareholders, Obligations of the Board of Directors and Judicial Review, 9 LAW AND BUSINESS 75 (2008) [in Hebrew], arguing that the mechanisms for approval by the company's institutions are in fact a property rule, while judicial review conducted retroactively on transactions with a controlling shareholder is a liability rule. See also: Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CAL. L. REV. 393 (2003); J. Maria Glover, *The Structural Role of Private Enforcement Mechanism in Public Law*, 53 WM. & MARY L. REV. 1137, 1140 (2011): "[American] system often relies heavily and explicitly on enforcement by private parties to achieve public regulatory objectives. Whereas European nations regulate the conduct of their citizens largely using ex ante regulations promulgated by a concentrated bureaucracy." For a more recent presentation of the distinction between protection of property rules and liability rules in the corporate context, see KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 26, at 31–35.

[146] Tel Aviv District Court 26809-01-11 Kahana v Makhteshim Agan (Nevo, Aug 3, 2011) [in Hebrew].

[147] CA 2718/09 Gadish Provident Funds Ltd. v. Elsint Ltd. (Nevo, 28.5.2012) [in Hebrew].

of transactions that received all the approvals required by the company's institutions. In the case of Elscint,[148] the Supreme Court ruled that for the purpose of approving transactions with a controlling shareholder, both procedural and essential mechanisms—i.e., approval by the company's institutions and court oversight that the controlling shareholder has not breached his obligation of trust—are required.[149]

(B) Evaluation of the Findings

Up to this point, we have pointed out that continental countries, Canada and Israel have significant diffuse ownership patterns—as evident, in part, in broader protection of the rights of the minority shareholders. Against this assertion, it can be argued that even if the law there gives broad protection to the rights of minority shareholders, it should be welcomed. As this helps to transform the concentrated ownership structure into a diffuse ownership structure. Given the fact that the law there adopted legal mechanisms derived from Anglo-American law, such as the Say on Pay agreements, there should be no impediment to the local ownership structure giving full expression to the legal developments.

I believe that this claim is wrong. As I wrote in the Part I of this paper, the economic literature there is no conclusive indications as to the which of the two ownership structures— concentrated or diffuse—is superior.[150] Thus, some studies show that in corporations with concentrated structure there is no obvious association between greater independence of the board of directors and the company's value,[151] but that there is a positive correlation among publicly traded corporations between a certain degree of concentrated control and profitability.[152] Other studies, however, have shown that corporations that are managed by their owners tend to be managed less efficiently,[153] and that the existence of dominant shareholders leads to erosion of company value.[154] Therefore, the legislature's work should focus not on designing legal policies that weaken the traditional ownership structure in a concentrated capital market, but rather to create precise regulations aimed at minimizing the agency

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[148] 26809-01-11 Kahana v Makhteshim Agan, para 21 of ruling.

[149] 26809-01-11 Kahana v Makhteshim Agan, para 28 of ruling. For a discussion, see Gonen, The Good, *supra* note 140, 60–63. For a similar view in Canada, see BCE v. 1976 Debentureholders, para 136–37:

> Section 192(3) specifies that the corporation must obtain court approval of the plan. In determining whether a plan of arrangement should be approved, the court must focus on the terms and impact of the arrangement itself, rather than on the process by which it was reached. What is required is that the arrangement itself, viewed substantively and objectively, be suitable for approval. In seeking approval of an arrangement, the corporation bears the onus of satisfying the court that: (1) the statutory procedures have been met; (2) the application has been put forward in good faith; and (3) the arrangement is fair and reason.

[150] See text pertaining to notes 35–41 above; and Minnes, The Legal Arrangement Governing Pyramids, *supra* note 113, at 47–50.

[151] John Erickson, et al, *Board Composition and Firm Value under Concentrated Ownership: The Canadian Evidence*, 13(4) PACIFIC-BASIN FINANCE JOURNAL 387 (2005).

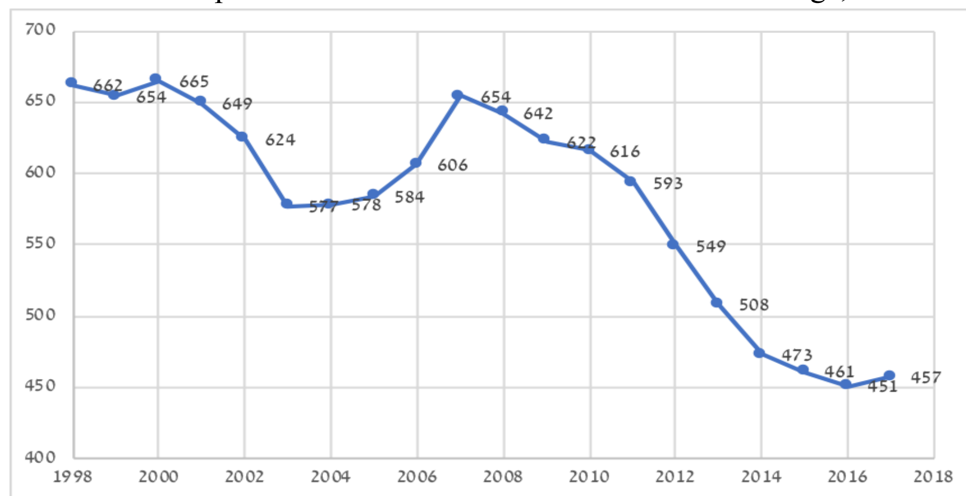
[152] Steen Thomsen & Torben Pedersen, *Ownership Structure and Economic Performance in the Largest European Companies*, 21(6) STRATEGIC MANAGEMENT JOURNAL 689 (2000).

[153] Beni Lauterbach & Alexander Vaninsky, *Ownership Structure and Firm Performance: Evidence from Israel,* 3 J. MAN. & GOV. 189 (1999).

[154] Jeremy Grant & Thomas Kirchmaier, *Corporate Ownership Structure and Performance in Europe* (CEP Discussion Paper No. 0631) available at papers.ssrn.com/sol3/papers.cfm?abstract_id=61620. For a discussion of such studies, see Minnes, The Legal Arrangement Governing Pyramids, *supra* note 113, at 47–50.

problems involved in such a ownership structure.[155] It should be noted that in Israel, the prevailing opinion in legal and business practice is that the heavy regulation that was implemented following the financial crisis of 2007–09 led to a decline in the volume of issues in the primary market of the Tel-Aviv Stock Exchange, and a decrease in trading volumes.[156] Fig. 3 shows the sharp decline in the number of corporations traded on the Tel Aviv Stock Exchange between 1998 and 2017 (the vertical axis representing the number of corporations listed at the end of each calendar year).[157]

Fig. 3: Number of corporations traded on the Tel Aviv Stock Exchange, 1998–2017



In light of the sharp drop in the volume of trade on the Tel Aviv Stock Exchange, the Securities Authority made two main changes: an easing of regulation of securities laws in Israel, through a long list of amendments regarding the scope of the disclosure obligations;[158] and demutualization of the stock exchange by separating its ownership from the management of its trades, by turning it into a public company.[159] Similar picture can be observed in Canada. Over the past two decades, the Canadian IPO market has declined significantly, whether measured by the number of new businesses going public or the amounts raised. Furthermore, the decline persisted even in years when financial conditions for new listings were exceptionally favorable.[160] One explanation

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[155] Minnes, *Id.,* summarizes:

> In light of this, it is appropriate to ask whether the steps taken by the Israeli legislator and regulator over the past decade—all aimed at curtailing the steps of the controlling shareholder—are not liable to tip the scales too sharply in the opposite direction, without ensuring first that distributing the holdings in public companies will lead to benefits, and while ignoring the costs involved.

[156] See, for example, THE COMMITTEE FOR IMPROVING TRADE AND ENCOURAGING LIQUIDITY ON THE STOCK EXCHANGE 6 (2014):

> In the course of its discussions, the Committee heard arguments from various sources that one of the main reasons for the decline in activity in the capital market in general, and in the stock exchange in particular, is the increased and tightened regulation in the past few years.

[157] The data was collected from the annual reviews published by the Tel Aviv Stock Exchange, *supra* note 117.

[158] See the Law for Easements in the Capital Market and Encouragement of Its Activity (Legislative Amendments), 5764/2014 [in Hebrew]

[159] THE ISRAEL SECURITIES AUTHORITY ROAD MAP: GOALS AND PLANS FOR THE COMING YEARS (2012). accessible at: http://www.isa.gov.il/Download/IsaFile_7038.pdf

[160] Bryce Tingle, Ari J. Pandes & Michael J. Robinson, *The IPO Market in Canada: What a Comparison with the United States Tells Us About a Global Problem*, 54 CAN. BUS. L. J. 321 (2013);

for this phenomenon lies in the fact that legal and regulatory apparatus surrounding public companies have evolved in a way that provides strong disincentives to managers to take their businesses public.[161]

In Part IV, I propose a new approach to shaping the rules of corporate governance, which I call Relative Corporate Governance Regimes. This approach seeks to shape corporate governance in a market with a concentrated ownership structure in a way that will reconcile with the new reality that these characteristics are weakened, and the diffuse characteristics are strengthened.

IV. Toward Relative Corporate Governance Regimes

This part is divided into two sections. First, I will present the model of relative corporate governance regimes, and how it offers a new method of regulating the relationship between the controlling shareholder and the minority shareholders. Second, I will present various policy considerations that support the adoption of the model, such as: encouraging the cooperation of all shareholders to promote the common good; reducing opportunism on the part of minority shareholders; and rethinking the (traditional) role of the company's board of directors in managing the company's activity with a view to bringing value to all shareholders.

(A) *Presenting the Model*

As previously noted, the prevailing view in the fields of law and finance is that a concentrated ownership structure is associated with a low level of protection of the rights of minority shareholders.[162] In previous sections we saw how the concentrated ownership structure in Europe, Israel and Canada has significantly diminished, while the protection of minority shareholders has strengthened. Accordingly, it is necessary to redraw the rules of corporate governance to reflect the fact that in a concentrated ownership structure there is an inherent risk that the controlling shareholder will seek to promote his own personal interests that may not accord with those of other shareholders, while also recognizing that there is a significant increase in the holdings by the general public in the share capital of publicly traded corporations and therefore there is a less need for broad protection of minority shareholders.[163]

Moreover, the new model assumes that there is considerable variation in the balance of power between the controlling shareholders and the minority shareholders in a wide range of publicly traded corporations with a concentrated ownership structure. This variability is evident in various aspects—be it the diverse levels of holdings by stakeholders and the general public; the market value of companies (ranging from international corporations to small service companies); and the fields in which they operate—some of which can impact the stability of the economy as a whole (e.g., banks and financial institutions). This variety of characteristics indicate that a "one size fits

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Jason Kirby, Public Companies in Canada are Going the Way of the Dodo (Aug 2, 2016), available at: http://www.macleans.ca/economy/economicanalysis/public-companies-in-canada-are-going-the-way-of-the-dodo/ .

[161] *Id.,* at 361 .

[162] La Porta et al., Law and Finance*, supra* note 18.

[163] See text pertaining to notes 110–120 above.

all" application of strict rules on all corporations should be avoided.[164] Therefore, the purpose of the proposed model is to create regulation that reflects this variation by establishing balanced and especially more flexible rules.[165] It should be ensured that they do not impose onerous financial costs on publicly traded corporations, and that they encourage the registration of corporations in the primary stock market and enable them to devote their time to promoting their core business without having to invest excessive time to comply with the provisions of the law.[166] In view of the emergence of clearly diffuse characteristics in concentrated markets, the rules of corporate governance with regard to protection of minority shareholders should be designed so as to reflect the following criteria: the ratio of holdings between the controlling shareholder and minority shareholders; the size and scope of the company's operations; the field in which the company operates; and its impact the proposed transaction on the market's overall financial stability. We will discuss each of these separately.

(1) *Ratio of Holdings Between the Controlling Shareholder and the Minority Shareholders*

According to this criterion, policymakers should examine the ratio of holdings between the controlling shareholder and the minority shareholders in an attempt to design appropriate corporate governance rules. This means creating a scale of regulation that varies according to the relative holdings by the controlling stakeholder in the company. Specifically, a distinction should be made between corporations in which the controlling shareholder holds over half the equity and voting rights, and those in which the controlling shareholder holds less than half, with the general public and institutional investors holding the balance. Arguably, a controlling shareholder with less than half the company's equity a rate lower than half the share capital of the company, his control of the company wields less control than a controlling shareholder with more than half the company's equity. The wide variation in the levels of control in publicly traded corporations must also be reflected in the design of the rules of corporate governance that govern the relations between a controlling shareholder and minority shareholders. On the other hand, it may also be argued that—due to retail shareholders' rational apathy—even a controlling shareholder with less than half of the company's equity may

[164] See, e.g., Barry Baysinger & Henry Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431, 457 (1985) (arguing "[...] any imposition of uniformity–either liberal or strict–on the system of corporate law will be Pareto inefficient").

[165] Recently, Goshen & Squire argued that corporate governance of every public company seeks to reduce two different costs: the costs involved in maintaining control by the principal (principal costs) and the costs involved in controll by the company's managers (agency costs). In their view:

> But the inescapable tradeoff between principal costs and agent costs cautions against such one-size-fits-all regulations. It suggests that lawmakers should permit a range of governance structures, enabling each firm to allocate control rights in the manner that minimizes total control costs.

See Zohar Goshen, Zohar & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 826 (2017)

[166] Valentina Bruno & Stijn Claessens, C*orporate Governance and Regulation: Can There Be Too Much of a Good Thing?*, 19(4) JOURNAL OF FINANCIAL INTERMEDIATION 461 (2010) (finding that companies with rigid corporate governance practices performed less well than companies with flexible corporate governance regulations, and that over-supervision of stakeholder conduct could involve various costs and impair managers' ability to initiate long-term business plans.)

exert effective control over the business activity of the company.[167] Ostensibly, a cost-benefit analysis suggests that any given shareholder will take active action in relation to the company's conduct only when the benefits that accrue from such action exceed the costs involved.[168] Since a single shareholder cannot prevent other shareholders from sharing in the benefits of such action,[169] rational shareholders will hope that another shareholder will bear the costs of activism so that he may enjoy its benefits at not cost to themselves (the free rider problem). However, the legislators in countries with a concentrated ownership structure have given minority shareholders various tools to help them express their views at shareholder meetings (e.g., by raising items for the agenda at general meetings,[170] or by imposing obligations on institutional investors to speak on their behalf at shareholder meetings).[171] The regulation in these countries also covers the private and public discourse between the minority shareholders and the management of the company.[172] Moreover, in 2007 the EU recommended that its member states promote the implementation of electronic voting systems, to enhance the participation of shareholders in annual meetings[173] (as in the Bombay Stock Exchange

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[167] Bernard S. Black, *Shareholder Passivity Reexamined,* 89 MICH. L. REV. 520, 526-529 (1990).

[168] Dov Solomon, *The Voice: The Minority Shareholder's Perspective*, 17 NEVADA L. REV. 739, 748-755 (2017)

[169] Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups 55 (1965).

[170] European corporate law recognizes that in order to protect minority shareholders, they must be allowed to submit proxy proposals for the approval of the shareholders' meeting. For example, the German Stock Corporation Act (Aktiengesetz) states that shareholders holding more than 5% may act to convene a special shareholder meeting. In addition, the Austrian corporate laws allow a shareholders' meeting to be convened by those holding more than 5%. These laws also allow shareholders holding more than 1% of the company's share capital to submit resolution proposals for the approval of the shareholders' meeting. In Switzerland, shareholders holding a share capital of more than SFr 1 million may submit resolutions for the approval of a meeting of shareholders unless the Company's Articles of Association prohibit this. For a broad discussion, see Peter Cziraki, Luc Renneboog & Peter G. Zilagyi, *Shareholder Activism through Proxy Proposals: The European Perspective*, 16 (5) EUROPEAN FINANCIAL MANAGEMENT 738 (2011).

[171] In Israel, the Committee for Increasing the Involvement of Institutional Bodies in the Capital Market (Hamdani Committee) recommended linking the circumstances in which mandatory participation in the vote is imposed and the decisions regarding which the legislator confers special status upon the minority shareholders. See the MINISTRY OF FINANCE REPORT OF THE COMMITTEE TO EXAMINE THE MEASURES REQUIRED TO INCREASE INSTITUTIONAL BODIES' PARTICIPATION IN THE ISRAELI CAPITAL MARKET (2008) at 2013/06/entropy-frs.co.il/wp-content/uploads Hamdani.pdf [in Hebrew].

[172] In April 2014, the European Commission proposed to amend Shareholder Rights Directive to encourage active participation of shareholders in the management of the Company's internal affairs. See European Commission, Proposal for a Directive of the European Parliament and of the Council Amendment Directive 2007/36 / EC. In Germany, to encourage the participation of shareholders, the legislator has imposed a duty on the Chairman of the Board to discuss various issues related to corporate governance with the shareholders on a regular basis. Similar regulation exists in Norway, Holland, Belgium and France. For a comprehensive discussion, see Klaus J. Hoppt, *The Dialogue between the Chairman of the Board and Investors: The Practice in the UK, the Netherlands and Germany and the Future of the German Corporate Governance Code Under the New Chairman* (Law Working Paper N 365/2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3030693).

[173] European Council Directive 2007/36, 2007 O.J. (184) 17-24 (EC) at § 8. Italy and Sweden are examples of European countries that have adopted Directive 2007/36 / EC in their internal corporate laws. See Espen B. Eckbo and Giulia Paone, *Reforming Share-Voting Systems: The Case of Italy* (Tuck School of Business Working Paper No. 2011-93). Available at https://ssrn.com/abstract=1822287;Espen B. Eckbo, Giulia Paone & Runa Urheim, *Efficiency of Share-Voting Systems: Report on Sweden* (Tuck School of Business Working Paper No. 2010-79; ECGI- Law Working Paper No. 173/2011). Available at SSRN: https://ssrn.com/abstract=1651582.

in India, where electronic voting is now mandatory).[174] In Israel, Amendment No. 53 to the Securities Law, 5728-1968 adds the option of online voting system to the existing voting mechanisms, which came into operation in June 2015, and now serves investors in publicly traded corporations in Israel. Moreover, recent years has witnessed a significant rise in the activity of proxy advisors who advise institutional investors on voting methods at general meetings in relation to items on the agenda of publicly traded corporations. These entities often exert severe pressure on the controlling stakeholders and management to improve their corporate governance mechanisms.[175] In view of the availability of such effective tools that minimize the costs involved in allowing the voice of minority shareholders to be heard, it may be argued that the relative holding in a company's equity should be taken into account when shaping the balance of power between the controlling shareholder and minority shareholders.

In my view, a sliding scale of regulation should be created to reflect the relative holdings of the parties in the share capital of the company: specifically, when the controlling shareholder holds over 50% of the share capital of the company the minority shareholders should be given the maximum possible protection—and when the controlling shareholding is under 50%, a lower level of protection should apply—i.e. as long as the company's officers comply with the procedural legal requirements, their discretion with regard to the company's management should not be contested in court on the grounds that it is unfair or unreasonable. (That said, corporations that choose to offer greater protection to their minority shareholders may still be allowed to do so through the use of "adopt or disclose" mechanisms. In other words, the market itself will price the shares of corporations that choose not to adopt strict corporate governance rules.[176] Only corporations who believe that regulation will yield an economically efficient outcome will choose to adopt it. Notably, each country may choose to tailor its regulatory regime to reflect the ratio of equity holdings between controlling and minority shareholders in any given corporation and to suit the particular conditions of the local market. This may result in a legislative protective framework for minority shareholders that is more nuanced than currently in place.

This proposal to create a hierarchy of regulation with regard to corporate governance is consistent with advanced approaches in the study of regulation that seek to strike the right balance between over-regulation and insufficient regulation.[177] Thus,

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[174] See Solomon, The Voice: The Minority Shareholder's Perspective, *supra* note 168, at 750–55.

[175] For more information, see Stephen Choi, Jill E.Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649 (2009); Stephen J Choi, Jill E Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?,* 59 EMORY L. J. 869 (2010). For a description of the significant activity of European consulting firms and their regulation, see Holger Fleischer, *Proxy Advisors in Europe: Reform Proposals and Regulatory Strategies*, 9 (1) EUROPEAN COMPANY LAW 12 (20112). For a comprehensive empirical study of the activities of consulting firms in 14 European countries that found that they play an important role in the European economy, see: Joerg-Markus Hitz & Nico Lehmann, *Empirical Evidence on the Role of Proxy Advisors in European Capital Markets*, 27 EURO. ACCOUNT. REV.1 (2017).

[176] Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521, 1595-1597 (2005).

[177] CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION 19-20 (2003); Robert H. Frank & Cass R. Sunstein, *Cost-Benefit Analysis and Relative Position*, 68 U. CHI. L. REV. 323, 323-24 (2001).

the Better Regulation Approach seeks to enhance the rationality of government regulation through cost-benefit analysis to ensure optimal regulation.[178] This approach has gained ground in the United States, Europe and even in Israel, with a view to reevaluating the costs and benefits of existing regulation.[179]

(2) *The Size of the Company*

This criterion seeks to link the size of a company with the scope of protection given to its minority shareholders. To date, the empirical literature has not discussed the association between the size of the company and the desirable scope of the rules of corporate governance. However, there is extensive discussion regarding the association between a company's size and its willingness to disclose information in accordance with the securities laws.[180] Arguably, corporations with a particularly large scope of activity have an incentive to promote effective protection of minority shareholders because of concerns over the lengthy legal proceedings involved with such protection. Such corporations are particularly sensitive to concerns about damage to their reputation that may have a directly adverse impact on their business performance.[181] Since these corporations receive continuous media coverage, the risk that they might infringe the rights of their of minority shareholders is lower, and therefore broad legal provisions to protect he rights of minority shareholders is uncalled for. Conversely, in small corporations whose operations are not often reviewed by analysts and the media, the information disparities between the controlling shareholder and the minority

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[178] Robert Baldwin, *Better Regulation: The Search and the Struggle*, in THE OXFORD HANDBOOK OF REGULATION 259 (Robert Baldwin, Martin Cave & Martin Lodge eds., 2010); Robert Baldwin, *Better Regulation: Tensions Aboard the Enterprise*, in BETTER REGULATION 27 (Stephen Weatherill ed., 2007).

[179] In the United States, this policy was enshrined in Presidential Order No. 12,291, which defined principles for determining and reexamining the rules of governmental regulation, see 12,291, Exec. Order, 46 FR 13193 (Feb. 17, 1981). At the center of the optimal regulatory method is the Regulatory Impact Assessment (RIA)—a methodological tool for conducting systematic examination of the effect of the regulations. In the UK, the term Regulatory Impact Survey was defined as: "A tool which informs policy decisions. It is an assessment of the impact of policy options in terms of the costs, benefits and risks of a proposal." See CABINET OFFICE, BETTER POLICY MAKING: A GUIDE TO REGULATORY IMPACT ASSESSMENT (2003). The EU urges its member countries to adopt this method of assessing regulation, see CAUDIO M. RADAELLI & FABRIZIO DE FRANCESCO, REGULATORY QUALITY IN EUROPE: CONCEPTS, MEASURES & POLICY PROCESSES 2 (2007). In Israel, in December 2011, the government instructed the head of the Policy Planning Department of the Prime Minister's Office to develop a theory of government regulation, including "methods for evaluating regulation, including cost benefit analysis, assessment of social indicators, risk assessment and comparison of alternatives." For further details, see: Governmental Regulation Website, http://regulation.gov.il [in Hebrew]. For a comprehensive discussion in Israel, see Yuval Roitman, *The Regulatory Reform: Between the Disclosed and the Concealed*, in REGULATING REGULATION: LAW AND POLICY 425 (Yishai Blank, David Levy-Faur and Roy Kreitner, eds., 2016) [in Hebrew].

[180] This literature points to a positive correlation between the size of the company and the extent of the disclosure—i.e., the larger the company, the greater its willingness to comply with securities laws and to disclose a great deal of information to the investing public. The reason for this is that large companies have more resources to invest in disseminating information to the general public than small companies. It also helps to reduce the costs of future legal proceedings and can enhance the Company's reputation and its competitiveness. See Kamran Ahmed & John K. Courtis, *Associations between Corporate Characteristics and Disclosure Levels in Annual Reports: A Meta-analysis,* 31(1) THE BRITISH ACCOUNT. REV. 35 (1999); Pankaj M. Madhani, *Firm Size, Corporate Governance and Disclosure Practices: Inter-Relations*, 13(2) SCMS JOURNAL OF INDIAN MANAGEMENT 17 (2016).

[181] For a discussion, see: Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1 (2015).

shareholders are more pronounced, which means that the rights of the minority shareholders warrant greater protection.[182] To use company size as a relevant criterion, policymakers must create suitable indices that match the scope of corporate governance rules to the size, scope of business operations and profitability of any given corporation.

(3) *Area of Activity, Business Environment and Financial Stability of the Capital Market*

This criterion links the business environment and the company's contribution to the overall financial stability of the capital market to the level of protection provided to minority shareholders. In other words, the greater impact of a proposed transaction on the financial stability of the economy as a whole, the greater the restrictions that should be placed on the controlling shareholder, and the broader the protection that should be afforded to the minority shareholders. Thus, for example, it is clear that banks and financial institutions must comply with strict adherence to the rules of good corporate governance.[183] It is commonly accepted today that the absence of such of appropriate corporate governance rules contributed significantly to the economic crisis of 2007–09.[184] Empirical studies conducted in emerging markets found a direct association between better protection of the rights of minority shareholders and the financial stability of the economy as a whole.[185] Therefore, with regard to transactions that may have problematic ramifications for the market's overall financial stability there is substantial justification for comprehensive protection of the rights of minority shareholders.[186] To this end, the rules of corporate governance should be governed by balancing these considerations by means of thresholds that link the relative strength of shareholders to the extent of their protection. Since legal systems may differ from one another in the rules that they formulate based on the relative power of shareholders and the economic and business environment that the company operates in, the proposed model may lead to the design of more sophisticated legislation than at present.

Before continuing, three caveats are in order. *First*, implementation of the above criteria may lead to conflicting conclusions. For example, a level of protection warranted by the criterion of the ratio of holdings between the controlling shareholder

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[182] On the other hand, it may be argued that small companies can find that the cost of adopting corporate governance rules that provide extra protection for shareholders' rights amounts to hundreds of thousands of dollars a year—and sometimes more. These impacts, inter alia, the value of their shares, so that those most affected are the shareholders whom the law is intended to protect. This is the assertion heard in the United States in relation to the hierarchy of regulation in securities law. See: Nathan Wilda, *David Pays for Goliath's Mistakes: The Costly Effect Sarbanes-Oxley has on Small Companies*, 38 J. MARSHALL L. REV. 671, 684 (2004); Ginger Carroll, *Thinking Small: Adjusting Regulatory Burdens Incurred by Small Public Companies Seeking to Comply with the Sarbanes-Oxley Act*, 58, ALA. L. REV. 443 (2007).

[183] DEMETRA ARSALIDOU, RETHINKING CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS (2015).

[184] ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT (2013); Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991 (2014).

[185] INTERNATIONAL MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT, OCTOBER 2016: FOSTERING STABILITY IN A LOW-GROWTH, LOW-RATE ERA 81-103 (2016).

[186] JOHN ARMOUR ET AL, PRINCIPLES OF FINANCIAL REGULATION 64 (2016). Recently, Armour and Gordon have argued that when it comes to companies that have a significant effect on overall financial stability, promoting only the welfare of shareholders can have negative consequences. See: John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6(1) JOURNAL OF LEGAL ANALYSIS 35 (2016).

and the minority shareholders may be different from the level of protection called for based on the company's size—nonetheless, that protection may be warranted with regard to a transaction that affects the stability of the financial markets. In these cases, low protection of the rights of the minority shareholders does not necessarily tally with the importance of ensuring the financial stability of the capital market as a whole.

Second, in many countries the concetrated of control is reflected in business groups that each consist of several corporations under one business control. Such a business group may feature a pyramidal control structure or cross ownership structure, which allows the controlling shareholder to control a large number of corporations without incurring the capital costs involved. In this condition, the lower the equity held by the controlling shareholder, the weaker his incentive to pursue the interests of the minority shareholders of the corporations at the bottom of the pyramid.[187] It should be noted that the model proposed in this article does not apply to business groups of this sort. Business groups that control several publicly traded corporations through a two-tiered or three-tiered hierarchy control structure have a low level of transparency. The interrelationships between the corporations in the control pyramid make it difficult for analysts to gather reliable information about the financial condition of the various corporations within the group.[188] In the absence of such reliable information, the tools provided by the legislature to institutional investors are not enough to mount effective challenges to the controlling shareholder's ability to reap private benefits from the firm. Moreover, a pyramidal maintenance structure may have a detrimental impact on competition and the mechanisms of the free market and overall financial stability.[189] This may be doubly true with regard to the protection of the minority shareholders in corporations at the bottom of the pyramidal holding structure.[190] Therefore, in such a corporate ownership structures of this sort there is no call for a hierarchy of regulation based on the criteria detailed above, and broad protection must be granted for the rights of the minority shareholders in the corporations at the bottom of the pyramid holding structure.[191]

Third, the ratio of holdings between the controlling shareholder and the minority shareholders proposed for the regulatory hierarchy is simple and easy to measure.

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[187] Countries differ as to how to protect minority shareholders within business groups. In some countries this protection is based on traditional corporate law (England and the United States). In somes countries it is founded on special laws (Germany, Portugal, Hungary, the Czech Republic and Slovenia), and in other countries (e.g. Israel) it is offered through appropriate regulation in other branches of the law, such as competition law, banking law and taxation law. For more information, see Klaus J. Hopt, *Groups of Companies – A Comparative Study on the Economics, Law and Regulation of Corporate Groups*, in OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey Gordon & Georg Ringe, eds., 2018).

[188] Hang J. Chang, Turan Khanna & Krishna Palepu, *Analyst Activity Around the World* (Harvard Strategy Unit Working Paper No. 01-061, 2000), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=204570. See also HAMDANI, CONCENTRATED OWNERSHIP STRUCTURE IN ISRAEL, *supra* note 41, at 27.

[189] Randall Morack, Daniel Wolfenzon & Bernard Yeung, *Corporate Governance, Economic Entrenchment and Growth*, 43 J. ECON. LIT. 655 (2005).

[190] See IMF GLOBAL FINANCIAL STABILITY REPORT, *supra* note 185.

[191] Kang Sang Yop, *Rethinking Self-Dealing and the Fairness Standard: A Law and Economics Framework for Internal Transactions in Corporate Groups*, 11 VA. L. & BUS. REV. 95 (2016).

However, we are aware that at times, significant control may also be expressed below the rate proposed by us. In this context, there is concern that the proposed model will encourage controlling shareholders holding more than 50% of the company's share capital to lower their holdings below this threshold, in order to reduce the protection of minority shareholders.[192] However, we believe that a rather simple quantitative rule should be preferred, which prevents the possibility of biased interpretation by the institutions of the comany regarding the nature of control over the company, even if the result of this rule may sometimes lead to over-inclusion or inclusion of a deficiency in relation to the actual state of affairs.

(B) *Policy Considerations*

(1) *Encouraging Cooperation Between Shareholders and Promoting Mutual Interests*

According to this argument, a more fine-tuned regulation of the relationship between the controlling shareholder and minority shareholders in accordance with the model of relative corporate governance may significantly promote the cooperation between the parties and the promotion of the company's long-term interests.[193] In this regard, it is important to understand the link between the existence of a controlling shareholder in the company and the promotion of long-term interests. Albert Choi argued that controlling owners must contend with two opposing incentives. On the one hand, the existence of a controlling shareholder with a significant share of the company's equity may prompt the company to act in its long-term interests—since his significant investment in the company motivates him to do so. However, this means that his control premium rate may be relatively low and may induce him to prefer to sell his shares in the short term rather than to pursue the company's long term interests.[194] Since the two incentives are mutually contradictory, most controlling shareholders choose an optimal rate of capital investment and control premium that help to advancing the company's long-term interests.[195] Therefore, the regulation of corporate governance must recognize the possibility that the controlling shareholder gains private benefits of control—and encourage this as long as the optimal rate is necessary to promote the company's good.

In the absence of relative corporate governance rules, the far-reaching protection of the rights of the minority shareholders means that controlling shareholders

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[192] It should be noted that in cases where the controlling shareholder reduces his holdings below 50% just before the approval of a transaction with him or with parties related to him, a full judicial review that examines the fairness of the transaction—rather than just its procedural aspects—is still warranted.

[193] Kraakkman & Hannesman, END OF HISTORY OF CORPORATE LAW. John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law,* 78 MINN. L. REV. 1443, 1448 (1994) (arguing that managers should focus their efforts on maximizing value for long-term shareholders); Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389 (2014). For the argument that promoting the long-term interests of society is not necessarily preferable to promoting short-term interests or other interests, see: Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L.J 1554 (2015); Oliver Hart & Luigi Zingales, *Should a Company Pursue Shareholders Value?* (ECGI - Finance Working Paper No. 521/2017) Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3004794.

[194] Choi, Concentrated Ownership, *supra* note 33, at 12–19.

[195] *Id*., at 13.

may prefer the exit option over cooperation with other shareholders to promote the company's long-term goals. Assuming that the controlling shareholder holds superior expertise and skills relative to the minority shareholders with regard to the management of the company,[196] this situation may also be harmful to all constituencies related to the company's operations.[197] For this reason, a relative corporate governance regime is required, that adjusts the degree of protection of minority shareholders in accordance with the aforementioned criteria, to ensure that the controlling shareholder ties his fate to the company's long-term prospects.

(2) *Preventing Opportunism of Minority Shareholders*

It is commonly believed that corporate governance rules that empower minority shareholders help reduce the agency problem: greater protection of the rights of minority shareholders, it is argued, helps to ensure the promotion of the interests of all shareholders.[198] However, not all minority shareholders are alike, and they often have distinct conflicts of interest that are incompatible with the long-term interests of the company.[199] For example, shareholders differ in the length of time of their investment in the company: some shareholders hold long-term securities, and some hold short-term securities only; some shareholders have a diversified onusinvestment portfolio, while others do not; and shareholders differ in the timing of their investments and the type of securities that they hold.[200] Due to diverging interests between different types of shareholder, a simple across-the-board strengthening of their power will not necessarily lead to an increase in the company's value. In particular, there is concern that minority shareholders might seek to promote individual interests that benefit them in excess of the costs imposed on them by virtue of being shareholders in the company. For this reasons, some scholars argue that strengthening the power of shareholders does not necessarily accord with the good of the company, and may warrant the imposition of various legal obligations on them.[201] Thus, for example, it is argued that minority shareholders should be subject to fiduciary duties similar to those imposed on the controlling shareholder, to preclude situations where minority shareholders reject decisions made by the company, to the detriment of all shareholders (the but for test).[202]

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[196] Bebchuk & Kastiel, The Untenable Case, *supra* note 100; Goshen & Hamdani, Corporate Control, *supra* note 30 at 577–79.

[197] Margaret M. Blair & Lynn Stout, *A Team Production Theory of Corporation Law*, 85 VA L. REV. 247 (1999).

[198] Bebchuk, A Rent-Protection Theory, *supra* note 27.

[199] Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity,* 30 CARDOZO L. REV. 445 (2008); Emeka Duruigbo, *Tackling Shareholder Short-Termism and Managerial Myopia,* 100 Ky. L.J. 531 (2011).

[200] Steven L. Schwarcz, *Temporal Perspectives: Resolving the Conflict between Current and Future Investors*, 89 MINN. L. REV. 1044 (2005).

[201] Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006); Roberta S. Karmel, *Should A Duty to the Corporation Be Imposed on Institutional Investors?,* 60 BUS. LAW 1 (2004).

[202] For an adoption of the but for test with regard to the fiduciary duties of activist investors, see Inam Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008). See also: James Chang, *Activist Shareholders: Does Shareholder Fiduciary Duty Change Them from Potential Victims of Corporate Values to the "White Knight" of Corporate Reform?,* 1 (2) L. & POL'Y REV. 159 (2010). (Applying fiduciary duties to an activist investor undermines the incomplete contract

Thus, an indiscriminately broad defense of minority shareholders' rights does not necessarily lead to a promotion of the interests of all shareholders. From a prior point of view, a more precise regulation would be more cost-effective than having standards of conduct formulated by the courts retroactively.[203] It would provide minority shareholders with the authority to act against the controlling shareholder only when this is necessary to promote better corporate governance. Controlling shareholders who know that the rights of minority shareholders reflect the company's distinctive characteristics (in terms of size, the controlling shareholder's share of equity, etc.) are more likely to cooperate with minority shareholders to enhance corporate governance in order to promote the company's long-term benefit.[204]

(3) *Rethinking the Traditional Role of the Company's Board of Directors*

It is common to conclude that the company's board of directors has two main functions: supervision and management.[205] While the supervisory function is thoroughly discussed in the legal literature, the management function has received less attention, so I will focus on it. The company's board of directors, unlike its management, is not responsible for the day-to-day management of the company.[206] However, it does determine a variety of issues concerning the company's business activities, such as: filing legal claims; selling the company to third parties; investing in research and development; distributing dividends; and determining the company's capital structure. Informed decisions on these issues are essential to secure company value for the shareholders—and yet, in the wake of the economic crisis of 2007–09 and the ensuing measures taken by the legislator in response—today's directors devote most of their time to resolving issues of corporate governance.[207] Often required they are called upon to reconcile the rights of the controlling shareholder with those of minority shareholders and other groups, such as creditors and employees.[208] I believe that the priority given to the board of directors' supervisory function over its management function is likely to have an adverse impact on the company's business and profitability. The model of relative corporate governance regimes seeks to minimize such harm by adapting the corporate governance regime to the company's particular attributes. Through such precise tailoring of the rules of corporate governance, the disputes between controlling

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theory of corporate governance, which states that the board of directors of the company alone is required to remedy the conflicts of interest between the shareholders).

[203] Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 DUKE L. J 557 (1992).

[204] For research that links better corporate governance to the any's performance in structurally concentrated markets, see Jackie Krafft, et al, *Corporate Governance, Value and Performance of Firms: New Empirical Results on Convergence from a Large International Database*, 23(2) INDUSTRIAL AND CORPORATE CHANGE 361 (2013); Maria Maher & Thomas Andersson, *Corporate Governance: Effects on Firm Performance and Economic Growth, in Convergence and Diversity*, in CORPORATE GOVERNANCE REGIMES AND CAPITAL MARKETS 386 (Joseph A. McCahery et al., 2002).

[205] Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 WASH. & LEE L. REV. 91, 98-104 (1997).

[206] Stephen M. Bainbridge, *Why A Board? Group Decisionmaking in Corporate Governance,* 55 VAND. L. REV. 1, 49-54 (2002).

[207] Renee M. Jones & Michelle Welsh, *Toward a Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343, 346 (2012) ("The monitoring model forms the basis of the Sarbanes-Oxley reforms that sought to strengthen the hand of independent directors vis-à-vis corporate management").

[208] Blair & Stout, A Team Production Theory, *supra* note 197, at 280-81.

shareholder and minority shareholders can be kept to a minimum, thereby reducing the supervisory costs involved in mediation by the board of directors. Minimizing the costs of supervision in this way will enable the company's management to focus on the management function to the benefit of the company's performance.[209]

(C) *Implications of the Proposed Model*

(1) *Re-examination of Related-Party Transactions*

In this section, I show how the model of relative corporate governance is relevant to the regulation of transactions with controlling shareholders. In transactions of this kind, the controlling shareholder may sell the company a private asset at an exorbitant price, or receive higher than usual market benefits for his position as an officer in the company. Generally, there are three ways of regulating transactions with a controlling shareholder.[210] One method is to ban outright the acquisition of any private benefits by the controlling shareholder from acquiring through such transactions. This approach is not accepted by the various legal systems, because it precludes efficient transactions that are expected to benefit the company and contribute to the development of the capital market.[211]

A second method is to arrange transactions with controlling shareholders through preliminary mechanisms. These mechanisms focus on the level of disclosure and the special procedures required for approving any given transaction. They allow investors to object to transactions that are incompatible with the company's best interests. For example, in recent years the EU has established more stringent requirements about the disclosure of transactions with a controlling shareholder. In accordance with the International Financial Reporting Standards (IRFS) rules, all publicly listed European companies are required annually to disclose to the investing public full information about transactions with directors, company management and controlling shareholders.[212] In Italy, listed companies are required to disclose to the investor public comprehensive information about transactions with all stakeholders within seven days. Germany has a more lenient policy: the German Corporate Governance Code recommends that registered corporations inform the annual meeting of all conflicts of interest involving members of the supervisory board. However, companies are required to report their share of profits and losses in subsidiaries. The information that minority shareholders are entitled to receive regarding a company's subsidiaries is limited to the summary of the annual report on inter-group

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[209] Faleye Olubunmi, Rani Hoitash & Udi Hoitash, *The Trouble with Too Much Board Oversight*, 54(3) MIT SLOAN MANAGEMENT REVIEW 53 (2013). In their view—

> [C]ompanies with intense oversight in invested less in R&D, received fewer patents overall and received fewer influential patents as measured by the frequency of citations of the patents they received. In addition, company value was lower when the board devoted greater time to oversight.

[210] Luca Enriques, *Related Party Transactions: Policy Options and Real- World Challenges (with a Critique of the European Commission Proposal)*, 16 EUROP. BUS. ORG. L. REV. 1 (2015); María Gutiérrez & María Isabel Sáez, *A Contractual Approach to Disciplining Self-Dealing by Controlling Shareholders*, 2 J. L. FIN. & ACCT. 173 (2017).

[211] KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 26, at 146–47.

[212] International Accounting Standard (IAS) 24 (part of the International Financial Reporting Standards). Art. 5(4) Transparency Directive (Directive 2004/ 109/ EC, 2004 O.J. (L 390) 38).

transactions.[213]

As far as approval mechanisms of such transactions are concerned, countries with a concentrated ownership structure differ as to the approval procedures that are required.[214] For example, in France, approval is required by all disinterested directors of any transaction that is outside the normal course of business between the company and its directors, management or controlling shareholder—in the case of transactions of this kind with a controlling shareholder, the approval of an ex post general meeting of the shareholders is also required. In Canada, a company's board of directors is required to submit to the company's auditors regarding any transaction with a party related to the controlling shareholder. The auditors are then required to examine the transaction and report on it to the board of directors; and then it is subject to approval of a majority of all shareholders with no personal interest in the proposed transaction. In Italy, shareholder approval is required only when a director of the company also wishes to serve as a director in a competing company.[215] In Israel, following Anglo-American law, Amendment No. 16 to the Corporations Law stipulates that transactions with stakeholders require the approval of the Audit Committee, the board of directors and a majority of the shareholders with no personal interest in the transaction.[216] In addition, Section 117 of the Corporations Law in Israel establishes another, unique, requirement to conduct a competitive process under the supervision of the Audit Committee, with the aim of strengthening the company's ability to conduct independent negotiations.[217]

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[213] KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 26, at149.

[214] A recent example is the proposed amendment of the Shareholder Rights Directive, which states that all transactions with related parties are subject to approval by a majority of the minority shareholders. 9c, para. 2 of the Proposal for a Directive of the European Parliament and of the Council amended Directive 2007/36 / EC. For a discussion, see Andreas Tarde, *The Upcoming European Regime on Related Transaction in Light of Agency Problem*, available at https://www.law.ox.ac.uk/research-subject-groups/commercial-law-centre/blog/2017/03/upcoming-european-regime-related-party.

[215] OECD REPORT, RELATED PARTY TRANSACTIONS AND MINORITY SHAREHOLDER RIGHTS 30-35 (2012); available at http://bit.ly/2EaLc9U

[216] The Corporations law (Amendment No. 16), 5771-2011, p. 2281, p. 390 [in Hebrew]. It should be noted that prior to Amendment 16, a third (1/3) of the shareholders with no personal interest in the transaction was required. For empirical research of the effectiveness of majority approval by minority shareholders versus only 33% approval, see Jesse Fried, Ehud Kamar & Yishay Yafeh, *Empowering Minority Shareholders and Executive Compensation: Evidence from a Natural Experiment* (working paper), available at http: /bschool.huji.ac.il/.upload/staff/yishai/Empowering%20Minority%20Shareholders%20and%20Executive%20Compensation%20August%2017%202016.pdf (reviewing the remuneration of officers who are controlling shareholders before and after Amendment 16, and finding that the legislative change had a significant impact on the scale of compensation to officers—provided the Company did not choose the time of the vote at the shareholders' meeting).

[217] Amendment No. 22 to the Corporations law added two new powers to the powers of the Audit Committee set out in section 117 of the Corporations law. First, in accordance with the requirements of the amendment, the Audit Committee is required to classify each transaction as being one of the following: an exceptional transaction; a non-exceptional transaction; negligible; or non-negligible. This classification can be conducted either broadly or specifically for each transaction. In accordance with the classification, the Audit Committee is required to determine how the Company's non-negligible transactions are to be approved vis-à-vis a controlling shareholder or concerning a matter that a controlling shareholder has a personal interest in. Prior to this amendment, the Corporations law only offered provisions regarding the manner of approving an exceptional transaction with a controlling shareholder. Non-exceptional transactions require the approval of the Board of Directors only. Second,

A third method of regulating transactions with a controlling shareholder is by having the courts decide on whether the terms of a given transaction are fair—as in the case of arm's length transactions. In the United States, transactions of conflict with the controlling shareholder are subject to rigorous appraisal to ensure that both the transaction and its approval process meet the standard of entire fairness.[218] Proof of fairness of the transaction normally rests with the controlling shareholder (or the board of directors)—but the burden of proof may be transferred to the plaintiff if the transaction is approved by a majority of the minority shareholders, or if the negotiations were properly conducted by a special committee of the board of directors that is made up exclusively of disinterested directors.[219] The European approach is narrower: when the controlling shareholders are not actively involved in the management of the company's business, they do not bear the responsibility of proving a transaction's FAIRNESS. However, with regard to irregular transactions between a parent company and a subsidiary within corporate groups, the accepted approach in Europe (Germany, France and Italy) is to examine whether the transaction in question meets the standard of fairness.[220]

In Israel, the emerging trend is to emulate the entire fairness requirement under American law[221]—namely, that the courts must confirm retroactively that the terms of a given transaction are fair and do not harm the good of the company.[222] This position was recently discussed in Israel's Supreme Court in the matter of Vardnikov v. Alovitz[223]—on whether the directors of the Bezeq corporation had violated their duties of trust and due care by approving a series of dividend distributions, capital reductions and debt raisings to help a controlling shareholder to repay loans that he had taken out

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the Audit Committee is required to determine, in relation to transactions with controlling shareholders, the obligation to hold a competitive process or other proceedings prior to entering into the transactions, in accordance with the type of transaction. The significance of this requirement is that the Audit Committee must in practice determine a process that must be carried out in the company before the transaction is brought for final approval of the authorized body (board of directors, audit committee, or other board of directors). The purpose of this requirement is to reduce the risk of harm to the interests of the minority shareholders or the controlling shareholder's abuse the power.

[218] For a description of the law in the United States, see Goshen, The Efficiency of Controlling Corporate Self-Dealing, *supra* note 145, at 426–29. For the guiding rules in this matter, see Weinberger v. UOP, 457 A.2d 701, 711 (Del. 1983); Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997).

[219] Gilson and Schwartz argue that an efficient court is capable of reviewing the terms of the transaction, the contractual price and market prices, and therefore is able to oversee transactions with a controlling shareholder. See Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review*, 169 J. INSTITUTIONAL & THEORETICAL ECON. 160, 167 (2016). Goshen and Hamdani argued that to protect minority shareholders, the terms of the transaction must be examined by the legal system retrospectively, so as not to infringe the right of the controlling shareholder to exercise control in accordance with his personal vision, which they propose to protect under a property rule. As they put it:

> [T]he tradeoff between minority protection and controller rights supports a liability-rule protection for minority shareholders to better balance minority protection against agency costs and preservation of idiosyncratic vision. [...] Given Delaware's ecosystem of specialized courts and vibrant private enforcement, we find this approach desirable.

See Goshen & Hamdani, Corporate Control, *supra* note 30, at 610–11.

[220] KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 26, at 157–58.

[221] See text pertaining to notes 146–49.

[222] BCE v. 1976 Debentureholders, para 134.

[223] CA 7735/14 Vardnikov v. Alovitz (published in Nevo, December 28, 2016).

in order to acquire a controlling interest in the company. Referring to the principle of "entire fairness", Justice Amit ruled that while a court should generally refrain from examining legally approved transactions, in exceptional cases, it is authorized to examine whether a given transaction is in the company's best interests. When there is a concern that the directors' independent discretion may be compromised—as in the case of a significant change in the structure of the company's capital in the context of a leveraged acquisition—the potential disparity between the interests of the controlling shareholder and those of the company should be subject to "enhanced scrutiny."[224]

Recently, in the matter of Osem Investments Ltd., an application for a disclosure order was heard before the approval of a class action concerning Nestle's proposed acquisition of all public shares in Osem (a major Israeli food manufacturer and distributor) in a bid to turn it into a wholly owned private company.[225] In that matter, Justice Ronen ruled that—

> *conducting a procedure in the manner of an independent and proper committee does not necessarily protect the company from judicial intervention in its decisions*. There are three possible approaches [in such cases]. One is that the approval procedures set out in the Corporations Law are enough to prevent a transaction from judicial intervention. Another approach—as adopted in the state of Delaware in the United States—is that judicial review can be avoided if the transaction has secured all necessary statutory approvals and has subjected to due process by an independent committee. A third approach is that even after all such procedures are carried out, the transaction terms should be subject to judicial review. To date, it has not been decided which of these three approaches will apply in Israeli courts.

Accordingly, Justice Ronen saw fit to grant a wide-ranging order to allow for a proper appraisal of the propriety of the proceedings of approval of the transaction and of the fairness of the consideration received by the public.[226]

All of the above indicate that legal systems are divided over whether the rights of the minority shareholders should be protected by stipulating that transactions must be pre-approved by a majority of the minority shareholders, or approved ex post by the courts. I believe that the model of relative corporate governance may mitigate this dilemma. Since relative corporate governance rules more accurately reflect a company's unique characteristics, the question of whether the terms of a given transaction should be subject to judicial review may be linked to the balance of power between the controlling shareholder and the minority shareholders in the company. In

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[224] For a discussion of the judgment and the argument that the adoption of the standard of entire fairness in Israeli law is a clearly regressive measure, see Amir N. Licht, *Be Careful What You Wish for: How Progress Engendered Regression in Related Party Transaction Regulation in Israel* (January 2018). European Corporate Governance Institute (ECGI) - Law Working Paper No. 382/2018. Available at or http://dx.doi.org/10.2139/ssrn.3104062 (arguing that judicial review of substantive fairness does not work to the benefit of the Company or minority shareholders—even when that is the court's intention—but to their detriment, because the controlling owner will always have an informative advantage over the courts).

[225] CA 40404-03-16 Atzmon v. Osem Investments Ltd. et al. (Nevo, January 26, 2018).

[226] On the matter of Osem Investments Ltd., Id., at paras. 29-28.

my opinion, in this context, procedural judicial review must be distinguished from substantive judicial review. Procedural judicial review focuses on whether the process of approving the transaction and disclosing the information to the investing public was PROCEDURALLY correct and meets the requirements set out in corporate law. Substantial judicial review seeks to examine whether, even if the transaction has received the necessary approvals required by corporate law, it is unfair to the company or was prepared with its benefit in mind. In other words, the court's role should be to examine whether the transaction in question was conducted for the benefit of the company or to promote the exclusive interests of the controlling shareholder.[227]

Thus, when the controlling shareholder holds less than 50% of the company's equity, procedural judicial review should focus exclusively on the approval process of the transaction—since in such cases, the relative power of the minority shareholders enables them to employ internal control mechanisms that will ensure that the controlling shareholder does not procure undue private benefits from his holdings—for example by directly influencing the selection of the company's external directors,[228] or by extensive use of consulting firms.[229] Conversely, when the controlling shareholder holds more than 50% of the company, a more stringent judicial review is in order, for a substantive appraisal of the fairness of the transaction. Similarly, with regard to particularly propsed transaction in large corporations that has a significant impact on the stability of the economy as a whole, that transaction should be subject to substantial judicial review of their terms—and not procedural judicial review—to ensure better protection of the interests of minority shareholders.[230] Thus, by taking into account the unique characteristics of a company and the balance of power between its shareholders, relative corporate governance regimes offer an additional layer to the regulation of transactions with stakeholders.

(2) *Going Private Transactions*

Occasionally, the controlling shareholder may decide to acquire all the share capital of

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[227] AHARONI-BARAK, TRANSACTIONS WITH A CONTROLLING SHAREHOLDER, *supra* note 139, at 243–52.

[228] Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271 (2017) (arguing that "enhanced-independence" directors should be accountable only to investors from the general public—which may be achieved by empowering public shareholders to elect or at least influence the election of said directors).

[229] See text pertaining to notes 182–185.

[230] Hamdani and Hannes have recently argued that the entire fairness test applies in principle to any exceptional transaction with the controlling shareholder, or which the controlling shareholder has a personal interest in—but that the burden of proving the fairness of the transaction must be tailored to the details of the transaction on the agenda. In their view, the differences between the types of transactions should be reflected in the requirements concerning the composition of the committee and the nature of its procedure. When dealing with a significant transaction for the company, it is expected that the committee will conduct the negotiations, with the help of independent external consultants and with no active involvement of members of management. The authors propose a quantitative rule whereby the transaction in question exceeds 25% of the equity of the company or 10% of its assets (whichever is higher), a thorough and complete procedure must be conducted, basedon external advice. They further suggest that as part of the submission for approval, the court must gauge the effectiveness of the independent committee, the quality of the disclosure to the shareholders, and approval of the transaction by all disinterested shareholders. However, if the court finds that an effective negotiation process has taken place, it must only intervene in exceptional cases. See Assaf Hamdani and Sharon Hannes *Entire Fairness: Further Examination of Judicial Review of Transactions in Conflict of Interest*, MISHPATIM (2018) [in Hebrew].

company and cancell it from trading. This may be prompted by the belief that the share price of the company does not reflect its true value,[231] or because of the high costs involved in complying with the securities laws,[232] or (when the controlling shareholder is the founding entrepreneur) to sever the long partnership with the minority shareholders in order to realize an idiosyncratic vision.[233]

One way to go private is to merge a public company with a private company that is wholly owned by the controlling shareholder. Another way is to approach the minority shareholders with a tender offer to acquire their full holdings from them. The acquisition of the minority shares poses a danger to the public's shareholders—for two main reasons. One is that the controlling shareholder is clearly in a conflict of interests with the remaining shareholders, since he wishes the purchase price to be as low as possible, while the investor public wishes to receive the maximum possible consideration for the sale of the shares. Second, by virtue of his status in the company, the controlling shareholder may have a better approach to information about the company's financial condition and its future prospects, so may acquire minority shares at a price lower than their real value.[234]

Because of this concern, the US Securities and Exchange Commission (SEC) requires special and extensive disclosure requirements with respect to Going Private transactions, and subjects them to greater scrutiny.[235] Many judgments in the United States have discussed the question of what is the proper judicial discretion in relation to the regulation of such transactions.[236] Prior to the case law in *M&F Worldwide Corp*,[237] the accepted position in the Delaware courts' rulings was that such transactions are subject to retroactive judicial review based on the "entire fairness" rule. Moreover, even in cases where procedural protection of the rights of minority shareholders was complied with—such as a transaction approved by a majority of minority shareholders and examined by a special committee of independent directors—these could only result in transfer the burden of proof to the plaintiff.[238]

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[231] Joshua M. Koening, *A Brief Roadmap to Going Private*, 2004 COLUM. BUS. L. REV. 505, 509 (2004).
[232] Ehud Kamar at al., *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis,* 25 J. L. ECON. & ORG. 107 (2009) (arguing that enactment of the Sarbanes-Oxley Act has increased the costs and risks of going public, and positively affected Going-Private decisions).
[233] Goshen & Hamdani, Corporate Control, *supra* note 30, at 611-14.
[234] For a discussion of these considerations, see: Guhan Subramanian, Fixing Freezouts, 115 YALE L. J. 2 (2005).
[235] Securities Exchange Act of 1934. 15 U.S.C. § 13E-3.
[236] For a comprehensive discussion of the retroactive regulation of such transactions in the United States, see Kenju Watanabe, *Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex-post Policing*, 36 NORTHWESTERN JOURNAL OF INTERNATIONAL LAW & BUSINESS 45 (2016). For a discussion of how these transactions are regulated in Europe, see Christoph Van der Elst & Lientje Van den Steen, *Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-Out and Sell-Out Rights*, 6 EUR. CO. & FIN. L. REV. 391 (2009); Marco Ventoruzzo, *Freeze-Outs: Transcontinental Analysis and Reform Proposals*, 50 (4) VIRGINIA JOURNAL OF INTERNATIONAL LAW 841 (2010).
[237] In re MFW S'holders Litig., 67 A. 3d 496 (Del. Ch 2013); Kahn v. M&F Worldwide Corp, 88 A.3d 635, 641 (Del. 2014).
[238] Lynch Commc'n Sys., Inc., 638 A.2d at 1100; Rosenblatt v. Getty Oil, 493 A.2d 929, 937 (Del. 1985). Historically, the Delaware courts have applied various standards of judicial review in relation to the types of acquisition transactions by the controlling shareholder and the holdings of minority shareholders. In other words, the manner in which the transaction was designed was directly related to type of judicial

Recently, in the case of *M&F Worldwide Corp*. it was ruled that in such transactions, the standard of judicial review of all business judgment shall apply if the following cumulative conditions are met: (a) the controlling shareholder makes the execution of the transaction contingent upon approval by a special committee and a majority of the minority shareholders; (b) said special committee is independent; (c) the special committee is authorized to choose its advisors and to oppose the transaction; (d) the committee meets the criterion of due care when negotiating a fair price; (e) the shareholder vote is carried out in an informed manner; (f) no coercion or constraint was applied to the minority shareholders.[239] Recently, the MFW ruling has been extended to all activities of a company in which the controlling shareholder has a personal interest, and not only to Going Private transactions in which the controlling shareholder acquires the holdings of the minority shareholders.[240]

Thus, the ruling in the United States faced a choice between protecting the rights of minority shareholders through a property rule or liabilty rule. In a relative corporate governance model, the choice between property and liability rule would be determined based on the minority shareholders' relative power. The ruling of *Re MFW S'holders Litig* cites the sharp rise in the holdings by institutional investors in publicly traded corporations and their ability to block tend offers that are contrary to the public interests of the shareholders as a whole. In other words, given the considerable relative power of such investors in relation to the controlling shareholder, the court believes that it would be justifiable to rely on a general liability that binds Going Private transactions be subject to a vote by the minority shareholders.[241] Furthermore, the court mentions the Internet as a source of an abundance of information about the company as a means of reducing the information gap between the controlling shareholder and the minority shareholders.[242] These arguments are consistent with the relative corporate governance model proposed above.[243]

Moreover, recently, an empirical study by Lauterbach & Mugerman shows that there is a correlation between the existence of institutional investors in a company and their ability to protect the rights of minority shareholders and to reject proposed tender offer that are not in the benefits of the shareholders. In addition, they found that the size

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review exercised by the courts. See Fernan Restrepo & Guhan Subramanian, *The Effect of Delaware Doctrine on Freezeout Structure and Outcomes: Evidence on the Unified Approach*, 5 HARV. BUS. L. REV. 205 (2015); Guhan Subramanian & Fernan Restrepo, *Freezeouts: Doctrine & Perspectives*, in RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 285 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

[239] Recently, Restrepo examined the impact of the MFW rule on how transactions with a controlling shareholder should be designed. His empirical study found that controlling shareholders sought to put forward transactions for the approval of a majority of the minority shareholders to gain immunity from judicial review of the fairness of the transaction. In his view, "The results, therefore, suggest that deferred judicial review is an efficient way to incentivize procedural safeguards in freezeout transactions and that the increase in shareholder approval conditions did not come at the cost of higher frustration rates." See Fernán Restrepo, *Judicial Deference, Procedural Protection, and Deal Outcomes in Freezeout Transactions: Evidence from the Effect of MFW*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3105169.

[240] IRA Trust FBO Bobbie Ahmed v. Crane, C.A. No. 12742-CB (Del. Ch. Dec. 11, 2017).

[241] In re MFW S'holders Litig., 530.

[242] Id., 533.

[243] See text pertaining to notes 179–181 above.

of the company has a significant impact on the size of the premium received by the shareholders: in large corporations that are subject to continuous media coverage, the information gaps between the controlling shareholders and the minority shareholders are narrower, and therefore the premium paid to them for the acquisition of their holdings is higher than in small corporations with little media coverage. It was also found that there is a direct association between the size of the company and the chances of accepting the tender offer by the minority shareholders: in large corporations where the information gaps are insignificant, the minority shareholders are more likely to accept the tender offer. The authors conclude their research by asserting that, to avoid appearing weak in the eyes of the controlling shareholder, institutional investors may use their power to secure a fair sale offer for the benefit of the general public.[244] This study has policy implications for our purposes. With regard to large corporations with significant holdings by institutional investors, the conditions set out in M&F Worldwide Corp suffice to ensure compliance with due diligence. In such cases, the function of the court can be limited to ensuring that the approval of the transaction and information disclosures were properly conducted and met statutory requirements. In small corporations, however, with no significant holdings of equity by institutional investors, action should be taken to provide broader protection of minority shareholders' rights in Going Private transactions. In these corporations—which typically do not receive comprehensive media coverage—there are significant information gaps between the controlling shareholder and the minority shareholders, which may adversely affect the rights of these shareholders. Accordingly, such transactions should be subject to judicial review ex post facto, to verify the entire fairness of the transaction.

(D) *Criticism of the Relative Corporate Governance Model*

In this section I will address three criticisms that may be leveled against the

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[244] Beni Lauterbach & Yevgeny Mugerman, *Institutional Investors' Impact on the Outcome of Freezeout Tender Offers* (working paper), available at http://ecgi.global/sites/default/files/Institutional%20Investors%26%23039%3B%20Impact%20on%20the%20Outcome%20of%20Freezeout%20Tender%20Offers.pdf In their view—

> Institutional investors do not want to appear weak in the eyes of controlling shareholders. They have to exercise their power from time to time. A strategic display of arbitrary power assures that controlling shareholders would not ignore them. Watching institutional investor reputation and deterrence is a repeated game strategy, and it requires that institutional investor would reject fair or even slightly beneficial freezeout offers.

On the other hand, it is important to mention Hamdani and Yaffa's study, that found that institutional investors in Israel support most (78%) proposed transactions with controlling shareholders. The only instance when the institutional investors are relatively resistant is with regard to approving remuneration of controlling shareholders and their associates. However, the study shows that these wage arrangements are approved nonetheless, despite the shareholders' opposition. The authors explain that the low rate of institutional support for compensation for controlling shareholders may be due to two reasons: first, the fear that controlling shareholders are exploiting wage arrangements in order to exploit the minority, and the other is the public attention paid to wage arrangements in the company. Institutional investors associated with one of the 20 largest groups in the economy tend to support interest-rate transactions at a higher rate than independent institutional investors. See Assaf Hamdani & Yishay Yafeh, *Institutional Investors as Minority Shareholders*, 17 REV. FIN. 691 (2013). However, it should be emphasized that Hamdani and Yaffa's research relates to voting patterns prior to Amendment 16 to the Corporations law. See, for example, Fried, Kamar & Yafeh, Empowering Minority Shareholders (*supra* note 216), which found that Amendment No. 16 led to a significant reductions in the compensation paid to controlling shareholders by public companies.

relative corporate governance model proposed in this article—namely, that it harms the certainty and stability of existing corporate law; that it reduces the protection afforded to minority shareholders; and that it is insufficiently sensitive to the changes in internal power structure among the company shareholders.

(1) *Damage the Certainty and Stability of Corporate Law*

The accepted view among scholars and courts alike is that the stability of the law is of paramount importance.[245] The legislature and the courts must ensure certainty both with regard to the factual background that the law seeks to regulate, and with to the substance of the law itself.[246] For this reason, the concern is that relative corporate governance regimes may compromise the certainty and stability of the corporate law that is necessary for the effective regulation of the domestic capital market.

I believe that this concern is overstated. Regulation in general—and the regulation of the capital market in particular—cannot, by its very nature, guarantee absolute certainty regarding legal rulings. It must be recognized that the law itself bears unavoidable features of uncertainty and clarity.[247] The proposed model merely seeks to offer more flexible mechanisms for a more accurate regulation of issues of modern corporate governance in view of the special characteristics of every given company. Thus, relative corporate governance actually facilitates the certainty that the law seeks to realize.[248] Moreover, there is no evidence that uniform corporate governance rules are necessarily always beneficial. Thus, empirical studies show that corporations that chose not to adopt corporate governance practices in light of their special circumstances—and presented explanations to investors—performed better than other corporations.[249] Moreover, flexibility in corporate governance systems of publicly traded corporations has been found to help improve their competitiveness.[250]

(2) *Reducing the Protection of Minority Shareholders*

According to this argument, the relative corporate governance model reduces the protection afforded to minority shareholders under existing law and may allow controlling shareholders to increase their concetration in the domestic capital market.

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[245] H.W. R. Wade, *The Concept of Legal Certainty: A Preliminary Skirmish*, 4 MOD. L. REV. 183, 189 (1941) ("As law exists for security, confidence and freedom, it must be invested with as much certainty and uniformity as can be provided by the wavering structures of human institutions.")

[246] For more details on the uncertainties involved in regulating and shaping the law, see Adam I. Muchmore, *Uncertainty, Complexity, and Regulatory Design*, 53 HOUS. L. REV. 1321, 1337-1351 (2016); Kaplow, Rules versus Standards, *supra* note 203, at 559-560. For a discussion of the relationship between legal certainty and financial reforms, see Joanna Benjamin, *The Narratives of Financial Law*, 30 OX. J. LEG. STUD. 787, 807-810 (2010).

[247] Shawn J. Bayern, *Against Certainty*, 41 HOFSTRA L. REV. 53, 61-62 (2012).

[248] Diane Lourdes Dick, *Confronting the Certainty Imperative in Corporate Finance Jurisprudence*, 2011 UTAH L. REV. 1461, 1482-1484 (2011) (criticizing the courts' preference of inflexible rules in regulating financial markets).

[249] Sridhar Arcot & Valentina Bruno, *One Size Does Not Fit All, After All: Evidence from Corporate Governance* (Jan 15, 2007) (unpublished manuscript), http://ssrn.com/abstract=887947 (finding a link between improved corporate performance and adapting and clearly explaining to investors the provisions of the Code of Corporate Governance to the company's special circumstances. In the authors' words: "Flexibility in corporate governance regulation plays a logical role, because companies are not homogenous entities."

[250] Arunima Haldar et al., *Can Flexibility in Corporate Governance Enhance International Competitiveness?* 17(4) GLOBAL JOURNAL OF FLEXIBLE SYSTEMS MANAGEMENT 389 (2016).

In this context, it may be argued that in companies where there is no broad protection of the rights of minority shareholders, these may choose the exit option over speaking out in favor of improved corporate governance. In other words, investors may divert their investments toward corporations that offer stronger protection of their minority shareholder rights.

It is important to note that although this is a possible outcome, in practice it is not necessarily problematic, because when the controlling shareholder engages in excessive profiteering from his equity in the firm, investors may choose to take their investments elsewhere due to the low protection of minority shareholders' rights, which may harm the company and the ability of the controlling shareholder to realize business plans that may benefit all its shareholders. By linking the relative power of the company's controlling shareholder with the scope of protection given to the rights of the minority shareholders, the relative corporate governance model may motivate the controlling shareholder to act in accordance with the company's long term interests.[251] This is not to say that the phenomenon of controlling shareholder taking undue advantage of their holdings in the company does not occur, but that its incidence varies from one legal system to another, and therefore regulation through the application of a single set of rules is ill-suited for the task. The job of policymakers is to protect minority shareholders, but not under any circumstances—that is to say, it must establish rules that accurately reflect the true power relations within each company, in light of the distinctive attributes of the local legal system.

(3) *The Model is Insensitive to the Implications of Changes in the Company's Circumstances*

The relative corporate governance model links the characteristics of a company to the scope of the applicable rules of corporate governance. Therefore, it might be argued that managers and shareholders alike would be unable to properly assess the existing law and anticipate it in the wake of significant changes in the company's circumstances. However, it is important to remember that even if the company's circumstances do occur during its lifetime, significant changes in the balance of power between the shareholders or the various groups associated with the company's operations may be regulated through other laws, such as insolvency laws. In such instances, the law addresses the radical change in the balance of power within the company, by removing control from management or its controlling shareholder and transferring to a trustee.[252] Furthermore, it is should be noted that the deregulation proposed under the relative corporate governance model already exists with regard to the regulation of securities in many countries around the world. These laws recognize that regulation that is indiscriminate and not tailored to the size of the company is likely to cause a decline in

[251] VINCENZO BAVOSO, EXPLAINING FINANCIAL SCANDALS: CORPORATE GOVERNANCE, STRUCTURED FINANCE AND THE ENLIGHTENED SOVEREIGN CONTROL PARADIGM 32 (2014) ("The assumption traditionally associating concentrated corporate ownership with "bad law" and unsophisticated corporate governance could in light of the above be revisited…if not all controlling shareholders regimes lead necessarily to private benefits of control at the expense of minority shareholders … the issue at stake is rather normative one and it points to the quality of law in disciplining controlling shareholders (as controllers of the firm) in each country.")

[252] KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 26, at 109–44.

the volume of its activity on the capital markets, since active investors in the market—or those considering entering it—may choose to invest elsewhere. Such a recognition, therefore, must be extended to modern corporate law, where it can promote the development of the capital market and increase value to all investors.[253]

CONCLUSIONS

In theory, there is no theoretical reason to prefer a concentrated ownership structure over a diffuse one—or vice versa—so legislators must shape the internal power relations within corporate governance in a manner that curbs the ability of power holders to derive private benefits from their holdings.[254] In this article, I have discussed various findings that show that both the Anglo-American legal system and the continental legal system have witnessed a weakening of the traditional ownership structures that characterized their respective jurisdictions for many years. This trend has also affected mixed legal systems such as Canada and Israel. In other words, it is no longer possible to draw a clear distinction between concentrated markets and diffuse markets because all markets now bear both concentrated and diffuse features. These findings may not fully reconcile with Krakkman & Hannesman's famous claim about regarding the end of corporate history—namely, that in the near future all legal systems will converge toward a diffuse ownership structure for the benefit of all shareholders.[255] Given that all legal systems have certain features in common, policymakers must work to shape the law that strikes the right balance between these. In this paper I discussed the normative implications of these findings for legal systems with a concentrated ownership structure. Specifically, I argued that the legislature and the courts must adapt the protection of minority shareholders to reflect the particular power relations that exist between controlling shareholders and the minority shareholders in each case. I further argued that the protection of the rights of shareholders of the general public may also depend on the size of the company and its particular characteristics, and on whether the proposed transaction has a profound impact on the stability of the economy as a whole. Making the scope of the protection of minority shareholders contingent upon the aforementioned criteria is currently at odds with the efforts of legislatures and the courts to expand this protection as much as possible. In my view, tailoring the legal provisions

[253] Knight Thaya Brook, *A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis* (Policy Analysis No. 790, CATO Institute), available at https://www.cato.org/publications/policy-analysis/walk-through-jobs-act-2012-deregulation-wake-financial-crisis; ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION, *supra* note 186, at 168–173.

[254] See text pertaining to notes 35–41.

[255] Kraakkman & Hannesman, END OF HISTORY OF CORPORATE LAW, *supra* note 26, at 48–49:

> [A] final source of ideological convergence on the standard model is a fundamental realignment of interest group structures in developed economies. At the center of this realignment is the emergence of a public shareholder class as a broad and powerful interest group in both corporate and political affairs across jurisdictions…In the United States, this diffusion of share ownership has been underway since the beginning of the twentieth century…. Similarly, in Europe and Japan, and to some extent elsewhere, we have begun to see parallel developments, as markets for equity securities have become more developed.

See also: Jeffrey N. Gordon, *Convergence and Persistence in Corporate Law and Governance*, in OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Georg Ringe eds., 2018).

to the special characteristics of each company and the market in question may allow the formation of a more nuanced law than at present, which may also spur controlling shareholders to align their interests more closely with the long-term benefit of the company, in the interests of all shareholders.