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

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This article aims to challenge the clear distinction between the diffuse ownership structure—which exists in England and the United States—and the concentrated ownership structure which exists in the rest of the world. A study of the economic and legal reality of Anglo-American law and Continental law shows that the traditional ownership structures in both legal systems have significantly weakened. I discuss the normative implications of the decreasing concentrated ownership structure and argue that the current corporate governance rules are outdated because the distinction between diffuse and concentrated ownership structures is no longer valid. In particular, I propose that the rules of corporate governance in markets with concentrated ownership structure should be redesigned to represent the new balance of power between the controlling shareholder and the minority shareholders through an innovative model that I call the Relative Corporate Governance Regime. This model suggests rearticulating corporate law and governance in a manner that considers 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 consequences 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 this paper, I show how the Relative Corporate Governance Regime model contributes to the choice between protecting the rights of minority shareholders through a property or liability rule.

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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 exists 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 results 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 compared to the board of directors. The alternative structure—which exists in the rest of the world—is the "concentrated ownership structure,"[3] which is characterized by 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 the 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 been a significant decline in the use of concentrated control of banks and financial institutions of commercial corporations. For instance, the ownership structures of public companies in

1. WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 204-08 (3d ed. 2009).

2. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 121-25 (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, 378 (2002) (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.").

Germany have undergone significant changes in recent years, by reducing the extensive network of connections between financial institutions and these companies—known as "Deutschland AG"—and increasing the international variation in the identity of their shareholders.[5] For example, many European countries—such as Italy,[6] France,[7] Belgium[8] and Sweden[9]—have adopted "Say on Pay" arrangements which involve a mandatory vote on the compensation of the top executives of the company. These arrangements were adopted even though it was widely believed that controlling shareholders can control and monitor the compensation levels paid to company executives. The adoption of such arrangements of Anglo-American provenance in Continental law attests to declining 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 publicly traded corporations are now effectively controlled by sophisticated investors, such as pension funds, insurance companies, provident funds, and so forth. The amount of institutional ownership of U.S. public traded companies is extensive. It is estimated that institutional investors own about 70-80% of all stock in S&P 500 companies.[10]

As major institutional investors—such as BlackRock, Vanguard, State Street Advisors and Fidelity—have significant and large holdings in different firms across the United States, they 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. Therefore, the discrepancy between ownership and control—first noted by Berle and Means—may no longer characterize the American market. Currently, a small but significant percentage of publicly traded corporations in the United States use dual class shares, which strengthen the power of controlling shareholders to direct the company's activities and resolutions.[11] Moreover,

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5. Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63 AM. J. COMP. L. 493, 493 (2015).

6. Massimo Belcredi et al., *Say-on-Pay in a Context of Concentrated Ownership: Evidence from Italy* 11-13 (CONSOB, Working Paper No. 76, 2014), https://ssrn.com/abstract=2403886.

7. Alain Pietrancosta, *Say on Pay: The New French Legal Regime in Light of the Shareholders' Rights Directive II*, REVUE TRIMESTRIELLE DE DROIT FINANCIER [R.T.D.F.] 105, 105-07 (2017) (Fr.).

8. *Loi relative aux pratiques du marché et à la protection du consommateur* [Law on Market Practices and Consumer Protection], Apr. 6, 2010, MONITEUR BELGE [M.B.] [Official Gazette of Belgium], Apr. 12, 2010, 20803.

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

10. Eric A. Posner, Fiona Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 ANTITRUST L. J. (forthcoming 2019) (manuscript at 5) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2872754).

11. Paul A. Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States,* 23 REV. FIN. STUD. 1051, 1052 (2010) ("About 6%

between 2010 and 2017, the number of newly-public companies adopting dual-class share structures increased substantially. In 2010, just 12% of U.S. companies went public with dual class shares, yet in 2017, 18% of U.S. companies going public employed a dual-class share structure. Others suggest that although only 1% of US companies went public with dual class shares structures in 2005, close to 20% of US companies adopted such ownership structures as they went public in 2017.[12]

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. I argue that the corporate governance rules in those legal systems are outdated because the sharp distinction between the diffuse and concentrated ownership structures no longer characterizes the exact reality of the Anglo-American and Civil legal systems. Therefore, I would like to redraw the rules of corporate governance that regulate the 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.[13] 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 controlling shareholders such as "related party" and "going-private" transactions. Within this framework, I will show how this model contributes to the choice between protecting the rights of minority shareholders through a property rule versus through a liability rule.[14]

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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.").

12. These studies are featured in the report of CFA INSTITUTE, DUAL CLASS SHARES: THE GOOD, THE BAD AND THE UGLY 37 (2018), https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx. For a recent study discussing the current trend of dual class share use among many public companies in the United States, see e.g., Bernard S. Sharfman, *A Private Ordering Defense of a Company's Right to Use Dual Class Share Structures in IPOs*, 63 VILL. L. REV. 1, 10 (2018).

13. *See infra* notes 162-85.

14. Property rules, as the name suggests, secure entitlements as property. As such, they effectively prohibit others from taking or damaging their entitlements without first gaining the consent of the owner. Liability rules, on the other hand, do not seek to provide the security of a property rule. Liability rules do not attempt to force those who would take or damage an entitlement from first gaining consent. Instead, liability rules seek merely to require the party taking or destroying the entitlement to pay a damage assessment determined by a court. *See* Guido Calabresi & Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1089 (1972). *See also infra* Part IV.

This article is divided into the following sections. In Section I, I lay out 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) regardless of which structure is used. In Part II, I shall discuss the factors that led to the adoption of the traditional ownership structure in Continental (Germany, France and Italy) and Anglo-American law and examine various factors that might weaken the traditional ownership structure in the foreseeable future. Part III shows that the traditional ownership structures in Canada and Israel have similarly weakened due to legislative, judicial and institutional developments. In Part IV, I lay out the theoretical foundation for Relative Corporate Governance Regimes in corporations with a concentrated ownership structure and propose a model of what this looks like. I also discuss how this model may assist in regulating related party transactions with controlling shareholder and going-private transactions. Lastly, in this part, I will discuss various arguments 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 structures 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, these companies have a single controlling shareholder who can 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.[15]

In the legal and financial literature, academics disagree over which factors created different control structures in publicly traded corporations in different countries around the world. One group of scholars argued that the diffuse ownership structure common in Anglo-American jurisdictions developed from historically greater protection for minority shareholders, while concentrated ownership structures generally found in Continental jurisdictions evolved from relatively weak protection of the rights of minority shareholders.[16] Under this theory, the low incidence of concentrated control in Anglo-American jurisdictions is related to the broad protection granted by common law to the

15. The most important research in this regard is Rafael La Porta et al., *Corporate Ownership Around the World*, 57 J. FIN. 471, 492 (1999).

16. *See* Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1113 (1998).

rights of minority shareholders[17]—specifically, broad regulation of transactions with interested parties and securities disclosure laws in the financial markets of the United States and England.[18] Another group of researchers have argued that the change in ownership structure came about mainly due to political variables.[19] 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 despite the fact that corporation laws in most countries of the world are now fairly similar.[20]

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.[21] An agency problem arises whenever one individual (the agent) directs the interests of another individual (the principal) in a manner that impacts the latter's property. The concern is that the agent will act in her own best interests rather than in the best interests of the principal. Agency problems are defined by information asymmetries and conflicts of interest between the agent and principal. The asymmetry of information is usually moderated through oversight (such as monitoring), and conflicts of

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17. *Id.* at 1129-1131.

18. For empirical evidence, see e.g., Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 462-63 (2008); Donghui Li et al., *When Financial Institutions Are Large Shareholders: The Role of Macro Corporate Governance Environments*, 61 J. OF FIN. 2975, 2977 (2006); Rafael La Porta et al., *The Economic Consequences of Legal Origins,* 46 J. ECON. LITERATURE 285, 285-86 (2008); Rafael La Porta et al., *What Works in Securities Laws?,* 61 J. FIN. 1, 1-2 (2006); Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 491 (2006). Conversely, Holderness recently argued that there is no significant correlation between sixteen measures of legal protection generally provided for minority shareholders and the prevalence of concentration in thirty-two countries around the world. Moreover, even in countries where legislation has been 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 FIN. REV. 41, 68-69 (2016).

19. Mark J. Roe, *Political Preconditions to Separating Ownership from Control*, 53 STAN. L. REV. 539, 539 (2000) (arguing 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, 460 (2001) (providing some evidence on the extent to which legal regulation in fact does matter in the corporate governance context in the UK).

20. Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance,* 52 STAN. L. REV. 127, 129 (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).

21. 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, 305 (1976).

interest are hindered by incentive arrangements that encourage the agent to follow with the principal's interests (such as bonding).[22]

In Anglo-American law, the common agency problem in corporations with a 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, shareholder concerns are that managers will operate the corporation in a manner that promotes management's personal interests at the expense of shareholders.

This agency problem requiring oversight over 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:[23] 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.[24] However, in such corporations there is a different agency problem—namely, the risk of conflict of interest between the controlling 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.[25] 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

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22. *Id.* at 308.

23. 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).

24. *See* Gilson, *supra* note 4, at 1651.

25. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 30 (3d ed., 2017) ("The second agency problem involves the conflict between, on one hand, owners who possess the majority or controlling interest in the firm and, on the other hand, the minority or noncontrolling owners. Here the noncontrolling owners can be thought of as the principals and the controlling owners as the agents, and the difficulty lies in assuring that the former are not expropriated by the latter.").

26. *Id*. at 145-46. Kraakman explains:

> In traditional self-dealing, the law's concern is that an influential manager or a controlling shareholder will transact with the company on terms less favorable for the company than could be obtained in an arm's length negotiation. Self-dealing typically refers to purchases or sales of assets, goods, or services by related parties, as when a controlling shareholder supplies components to the controlled company . . . Related- party transactions fall under the broader category of 'tunneling,' which covers all forms of misappropriation of value (assets, cash flows, or the company's equity itself) by corporate insiders.

Id. at 145-46.

concentrated capital structure enables controlling shareholders to engage in "tunneling," which means gaining private benefits at the expense of 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, there are divergent regulatory policies in relation to the ability of controlling shareholders to leverage control over the firm through control-enhancing mechanisms.[29] This includes curbing the use of "dual class shares," where companies issue different tiers of shares that hold different voting rights and using that tiered system to grant preferred voting rights to the controlling shareholder, Stock Pyramids, where companies create pyramids of ownership characterized by a chain of corporations ultimately headed by the controlling shareholder, and "cross-holdings," situations where Company A holds shares of Company B, which holds shares of Company A.[30]

Recently, however, it has been argued that a concentrated capital structure enables companies to adopt viewpoints that promote their long-term interests for the benefit of all the shareholders of the company, and not only for the benefit of the controlling shareholders.[31] In this context, Goshen and Hamdani have argued that while it is common 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.[32] Thus, entrepreneurs and shareholders can come to agreement on the distribution of cashflow and control rights in such a way as to balance the entrepreneur's desire to ensure the realization of his vision and the desire of investors to protect against the

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27. *See* Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* 1 (Harvard Law Sch. Ctr. for Law, Econ., & Bus. Discussion Paper Series, Paper No. 260, 1999), 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, 1700-01 (2014).

29. Yu-Hsin Lin, *Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control*, 2017 COLUM. BUS. L. REV. 453, 462-69 (2017).

30. For an extensive discussion of these legal provisions, see Lucian Bebchuk, Reinier 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, 297-301 (Randall K. Morck ed., 2000).

31. Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 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 determining to what extent they may be allowed to exploit private benefits, while stipulating the duty of corporate trust. *See* Ronald Gilson & Alan Schwartz, *Corporate Control and Credible Commitment*, 43 INT'L REV. L. & ECON. 119, 119 (2015).

32. Goshen & Hamdani, *supra* note 31, at 576-83.

representative costs.[33] Moreover, it has been argued that reducing private benefits the controlling shareholder can accumulate may weaken his commitment to act in favor of the company's long-term interests even if his weakened commitment may directly harm the company's reputation in the product market.[34] 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 some private benefit are at odds with the company's long-term goals.[35]

There is extensive discussion in the literature of the relationship between the structure of ownership of a corporation and its performance. Berle and Means have discussed the inverse relationship between the diffuseness of shareholdings and firm performance.[36] 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.[37] Kirchmaier and Grant found that in Germany, France and Spain, concentrated ownership structures were not necessarily the most effective, because in those countries corporations with concentrated capital structures were negatively correlated with corporate performance, while those with diffuse capital structures were positively correlated.[38] However, another economic study measuring empirical evidence of the advantages and disadvantages of concentrated ownership structure in Germany found that the concentrated capital structure had a positive effect on the value of a company's shares to the benefit of all its shareholders.[39] Similarly, other empirical studies have found that corporations where the controlling shareholder is also the

33. *Id.* at 598-611.

34. Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53, 53 (2018).

35. *Id.* at 79.

36. BERLE & MEANS, *supra* note 2, at 342 ("Even though [the owner] employs a manager to carry on the immediate activities of the business, his desire for profits presumably induces him to select the most efficient manager available and to require of him a high standard of performance."); *see also, e.g.*, George J. Stigler & Claire Friedland, *The Literature of Economics: The Case of Berle and Means*, 26 J.L. & ECON. 237, 237-40 (1983).

37. Steen Thomsen & Torben Pedersen, *Ownership Structure and Economic Performance in the Largest European Companies*, 21 STRATEGIC MGMT. J. 689, 705 (2000).

38. Thomas Kirchmaier & Jeremy Grant, *Corporate Ownership Structure and Performance in Europe*, 2 EUR. MGMT. REV. 231, 241 (2005).

39. Jeremy Edwards & Alfons J. Weichenrieder, *Ownership Concentration and Share Valuation: Evidence from Germany* 33 (CESifo, Working Paper No. 193, 1999), https://ssrn.com/abstract=272627.

company founder tend to perform better than similar corporations with a distributed ownership.[40]

Another empirical study by Fronningen and Wijst found only partial evidence of a correlation between ownership structure and company performance.[41] The researchers believe that even in the absence of unequivocal evidence, there is a certain positive correlation between diffuse ownership structures and company performance.[42] These empirical studies indicate that both concentrated and diffuse ownership structures have comparative advantages and disadvantages, and it is not possible to point to either type of structure as having an absolute advantage over the other.[43] 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 management or controlling shareholders.[44]

In Part II, I will argue that the prevailing dichotomous distinction in the comparative literature between Continental and Anglo-American law with regard to the types of capital ownership structure does not exist in practice. In light of various economic and legal arguments, it is clear that the ownership

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40. Ronald C. Anderson & David M. Reeb, *Founding Family Ownership and Firm Performance: Evidence From the S&P 500,* 58 J. FIN 1301, 1324 (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. MGMT. 689, 720-21 (2006).

41. Leif Anders Fronningen & Nico van der Wijst, *Ownership Structure and Performance of the Largest German Companies* 15 (Norwegian Univ. Sci. & Tech., Working Paper, 2009), https://ssrn.com/abstract=1341615.

42. *Id.* at 14-15. For a study that found no association between ownership structures of public corporations in Brazil and company performance, see Pablo Rogers et al., *Corporate Governance and Ownership Structure in Brazil: Causes and Consequences,* 5 J. CORP. OWNERSHIP & CONTROL 36, 59 (2008); *see also* Dušan Isakov & Jean-Philippe Weisskopf, *Are Founding Families Special Blockholders? An Investigation of Controlling Shareholder Influence on Firm Performance*, 41 J. BANKING & FIN. 1, 15 (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 CORP. GOVERNANCE: AN INT'L REV. 312, 323 (2008). Conversely, for a study that 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, *Corporate Governance and Ownership Structure in Brazil: Causes and Consequences*, 5 CORP. OWNERSHIP & CONTROL 36 (2008).

43. However, in the legal literature it has been argued that the diffuse ownership structure should be adopted worldwide. *See* Reinier Kraakman & Henry Hannesman, *End of History of Corporate Law*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 33, 44 (Mark Roe ed., 2004).

44. *See also* Gilson, *supra* note 4, at 1647-50. Gilson raises the following dilemma: "Recognizing the various types of control shareholders and their potential for impacting minority shareholders differently gives rise to a second, and as yet more tentative, theme in the new generation of controlling shareholder scholarship: what, after all, is wrong with controlling shareholder systems?" *Id. See also* ASAF HAMDANI, CONCENTRATED OWNERSHIP STRUCTURE IN ISRAEL: LEGAL ASPECTS 24 (2009), https://www.idi.org.il/media/3453/pp_78.pdf.

structures that have historically characterized these legal systems has weakened. I note that certain factors may lead to a further 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 structures of common law and Continental law are different. In general, Anglo-American and common law jurisdictions tend to have diffuse capital ownership, Continental countries such as, Germany, France, and Italy, generally have more concentrated capital ownership. In this section, I will discuss what led to the adoption of the traditional ownership structures in each of the legal systems and see how different factors could lead to a greater decline of these structures in each system.

A. *The Traditional Ownership Structure in Continental Law and the Reasons that May Contribute to Its Decline*

1. *The History and Development of the Traditional Ownership Structure Under Continental Law*

Empirical studies on the development of the concentrated capital structure in Continental countries, such as Germany, France, and Italy, demonstrate a correlation between the growth of concentrated ownership structures and low legal protection provided for minority shareholder rights.[45] In this section, however, I would like to redirect the discussion to the question of how the historical development of the local economy in 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. Specifically, I will focus my discussion on the evolution of the concentrated ownership structure in the German, French, and Italian economies from a historical point of view.

Germany. 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 these corporations appeared to be different arms of a single company.[46] For

45. La Porta et al., *The Economic Consequences of Legal Origins, supra* note 18, at 285-86.

46. For more information, see Sophia Dai & Christian Helfrich, *Structure of Corporate Ownership and Control, Comparative Corporate Governance and Financial Regulation*

example, the Deutschland AG's close cooperation is manifested, in part, in a network of cross-ownership between the large banks and the commercial corporations which at its peak consisted of more than 168 different cross-ownership connections between the one hundred largest corporations in Germany.[47]

Early empirical studies of the German market point to a clearly concentrated capital structure. For example, one study 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). Moreover, the percentage of minority shareholders is particularly low, since only 20% of companies have more than two large shareholders whose average holding rate is 7.4%.[48] The study 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.[49]

Since the early nineteenth century, banks and financial institutions have been very dominant in the Continental system. They contributed significantly to the process of industrialization by providing a direct flow of capital to fund development of the German economy. This 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 the 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).[50] The banks' close oversight—in some cases, over decades—ensures that the capital investment in these corporations generate many profits.[51] From a

27-28 (Penn. Law, Comparative Corp. Governance & Fin. Regulation, Paper No. 9, 2016), https://pdfs.semanticscholar.org/cf2c/5f1e12207e8d3fa5246b11795b22d2b12d37.pdf.

47. *Id.* at 30.

48. Marco Becht & Ekkehart Boehmer, *Ownership and Voting Power in Germany*, *in* THE CONTROL OF CORPORATE EUROPE 128, 137-44 (Fabrizio Barca & Marco Becht eds., 2001); Marco Becht & Ekkehart Boehmer, *Voting Controlling German Corporations*, 23 INT'L. REV. L. ECON. 1, 7, 26 (2003).

49. Ekkehart Boehmer, *Who Controls German Corporations?*, *in* CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY 268, 283 (Joseph A. McCahery et al. eds., 2002).

50. *See* Dai & Helfrich, *supra* note 46, at 27-29.

51. *Id.* at 29. Dai and Helfrich write:

> The general idea behind the concept of 'Deutschland AG' has been a system of cooperation and control in opposition to a solely market driven one. Within said system, the financial sector provides financial support for German companies while the capital markets did not play an important role . . . Companies benefitted from their 'Hausbank,' meaning that there are a mere one or two financial institutions providing the financial support for any activity without the need of acquiring money from the financial markets. Additionally, the

macroeconomic perspective, the prosperity of these corporations contributes to the overall growth of the German economy and helps 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 that allow it to grow over time.[52]

France. In the past three hundred years, various historical events have resulted in relatively weak cooperation between banking and financial institutions and privately held companies. Specifically, the banking system did not historically inject capital necessary for the development of the local economy, which relied mainly on self-financing by individuals and families.[53] 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.[54] The banking system directly helped 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, as well as other factors (such as historical antibanking sentiment), a concentrated capital structure has eventually developed.[55]

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 made family control over publicly traded corporations stronger, since the only way to sever the relationship between the family and control of

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> 'Hausbank' has a substantive inside in the company's business which speeds up the process. The trade unions supported the system of 'Deutschland AG' as its stakeholder approach supported them in claiming their slice of the pie.

Id.

52. *Id.* at 27-28.

53. 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, 186 (Randall K. Morck ed., 2005).

54. *See id.* at 190 (noting that a history of repeated invasions was one factor differentiating France from the United Kingdom, which developed a more diffuse ownership structure).

55. *Id.* at 217.

the corporation is to sell the company's holdings before the death of the controlling individual and divide the proceeds between the heirs by law.[56] Moreover, this change in inheritance law is consistent with the existing cultural norm in France, whereby property owners are responsible for transferring their property for future generation's welfare upon their death.[57]

Italy. It is also commonly accepted that Italy's economy generally features concentrated ownership structures in public companies.[58] 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 from the central government. The Italian government's involvement in the local economy was particularly strong 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 operating as a controlling shareholder in various business corporations.[59] This is reflected in the fact that the Italian government created an administrative authority (Instituto per la Ricostruzione Industriale), which was responsible for managing the portfolio of state-controlled corporations.[60] 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 provided more opportunities to raise capital from the general public, which were not available when the government owned many publicly traded corporations.[61]

2. *Factors that May Lead the Decreasing of Concentrated Ownership Structure in Continental Law*

In the previous section, I elaborated on the socio-economic factors that contributed to the development of the concentrated ownership structures in

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56. *Id.* at 205.

57. *Id.* at 206.

58. *See* Alexander Aganin & Paolo Volpin, *The History of Corporate Ownership in Italy, in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 325, 325 (Randall K. Morck ed., 2005).

59. For a 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).

60. Aganin & Volpin, *supra* note 58, at 328-29.

61. *Id.* at 330. They explain:

> Effectively, Italy remained in an autarkic regime until 1958, when it joined the European Economic Community (EEC). Since then, product markets and capital markets have slowly liberalized, allowing foreign competition. The EEC directives first imposed a liberalization of product markets, and later a liberalization of the capital markets as well . . . Not until 1990 had all constraints on cross-border transactions effectively been lifted.

Id. 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 a concentrated ownership structure. *See id.* at 343-50.

Germany, France, and Italy. In this part, I wish to discuss recent studies indicating that the traditional concentrated ownership structure in several Continental countries is weakening. Moreover, I show that even though these developments are mainly taking place in Germany, we should expect to see developments in other Continental legal systems as they have broadly adopted legal arrangements designed to provide further protection to the rights of minority shareholders derived from the Anglo-American laws.

In *Germany*, for example, Wolf-Georg Ringe argues that three factors are expected to reduce concentrated ownership structure in the domestic economy.[62] Recent economic data indicates that in Germany there has been a significant decline in the rate of concentrated control in commercial corporations. The average stake of the largest shareholder of corporations included in the German stock index (the DAX30) is 16.5%, with the median at only 9.92%.[63] 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 from 128 corporations in 1998 to only 20 corporations in 2006.[64] 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.[65] 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.[66]

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 composition of the traditional major shareholders in the German economy.[67]

However, at least one study points to a still clearly concentrated structure of ownership in France and Italy. In a recent groundbreaking study, Aminadav and Papaionnou examined the ownership structure of 40,000 publicly traded

62. *See* Ringe, *supra* note 5, at 517-22.

63. *Id.* at 508.

64. Christian Andres et al., *Das Endeder Deutschland AG*, 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 et al. eds., 2009) (citing evidence that over time, reduced concentrated ownership patterns in Germany is associated with higher executive compensation).

65. Ringe, *supra* note 5, at 523.

66. *Id.* at 524.

67. *Id.* at 524-25.

corporations in 127 countries from 2004 to 2012. 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 controlled by a wide-held public firm.[68] 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 is an expression of a legal tradition that was created and preserved through their historical background, as explained above.[69]

The current data indicates that ownership structure in France is still concentrated.[70] However, I believe that the concentrated ownership patterns in France and Italy may well weaken in the near future (even if only to a comparative degree) following the adoption of corporate governance rules that provide better protection for the rights of minority shareholders. One example of this is the adoption of the "Say on Pay" arrangements in European countries. As you may recall, the main agency problem in those countries is not between the company's managers and its shareholders, but between the controlling shareholders and the minority shareholders.[71] The adoption of these

68. *See generally* Gur Aminadav & Elias Papaioannou, *Corporate Control Around the World* tbl.1 (Nat'l. Bureau of Econ. Research, Working Paper No. 23010, 2016), https://www.nber.org/papers/w23010.pdf.

69. *See id.* at 1-2. *But see* MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 8 (2003) (arguing that a concentrated ownership model is directly linked to the industrial and political structure of democratic social countries).

70. However, another study found some decline in the concentrated ownership of a large sample of companies listed in 1999 and 2007 in six European countries. *See* Christoph Van der Elst, *The Influence of Shareholder Rights on Shareholder Behavior,* 5 CORP. FIN. & CAP. MKTS. L. REV. 50, 57 (2010). Van der Elst's explains:

> Whilst there was a slight decrease of the largest voting block in France from 47 per cent to 43 per cent, in Italy from 46 per cent to 44 per cent, in Germany from 45 per cent to 44 per cent and in Belgium from 39 per cent to 35 per cent, this voting block increased in Spain from 33 per cent to 36 per cent. The median voting blocks fell in France from 50 per cent to 43 per cent, in Germany from 46 per cent to 40 per cent and in Belgium from 39 per cent to 34 per cent and remained unchanged in the three other countries. This first finding sheds some doubt on the "law and finance" theory as, in all countries, shareholder protection rights increased whilst the ownership concentration only decreased in some civil law member states. If any change is due to changes in shareholders rights, the different kinds of shareholders respond differently to the new shareholder rights

Id.

71. *See* Randall S. Thomas & Christoph Van der Elst, *Say on Pay Around the World,* 92 WASH. U.L. REV. 653, 655-56 (2015).

arrangements in markets with a concentrated capital structure is not consistent with the assumption that controlling shareholders can monitor the remuneration levels of the company's directors effectively.[72] In June 2013, the French Code of Corporate Governance first introduced the Say on Pay arrangements. According to Principle 24.3 of the 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.[73] 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.[74]

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 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 even broader than those currently in practice at the UK which provide shareholders with less rigid mechanisms to express their dissent on executive pay.[75]

A similar Say on Pay regulation was also adopted in Italy in 2010, following recommendations made by the EU Commission in 2004 and 2009 (2004/913/CE and 2009/385/CE). Under the new regulation, the company must publish a two-part remuneration report. In the first part, it must detail the principles by which it intends to compensate the company's senior officers for their work in the coming year—including how the company intends to implement and adopt the remuneration policy.[76] The second part includes

72. *Id.* at 713-15. *But see* Kobi Kastiel, *Executive Compensation in Controlled Companies*, 90 IND. L.J. 1131, 1134-35 (2015) (arguing that given the friendship and business relationships between controlling shareholders and managers, controlling shareholders may pay company managers higher than optimal salaries so that the controlling shareholders may pocket private benefits).

73. Thomas & Van der Elst, *supra* note 71, at 683.

74. *Id.*

75. Pietrancosta, *supra* note 7, at 108 ("Nonetheless, other countries, such as the United Kingdom, even in their efforts to enhance the ability of shareholders to hold to account companies that experience significant investor dissent on executive pay, will certainly try to avoid introducing such a binding vote and to favour less rigid remedies.").

76. Massimo Belcredi et al., *Say-on-Pay in a Context of Concentrated Ownership: Evidence from Italy* 12 (CONSOB, Working Paper No. 76, 2014), http://www.consob.it/documents/11973/204072/qdf76.pdf/7332c57e-a332-48c2-8966-7acd994a2c4c. In this empirical study, the authors found that opposition among public shareholders to the compensation packages offered to corporate officers is more or less similar to that of public shareholders in countries with more diffuse capital structures (England and the United States). *Id.*

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.[77]

It should be emphasized that these arrangements were adopted in light of similar arrangement in the United Kingdom and the United States, where the typical ownership structure is diffuse.[78] 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 because of a decline in the holdings by controlling shareholders in publicly traded corporations)[79]—while diffuse corporate ownership is on the increase (for example, through increased public holdings of share capital of publicly traded corporations).

A complex picture emerges from the above discussion concerning the weakening of the concentrated ownership structure in certain Continental countries. In Germany there is direct and conclusive evidence of a consistent decline in the holding of financial institutions in publicly traded corporations and a commensurate increase in holdings by institutional investors. Though, 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 the Say on Pay regulations that have already been adopted in those countries—we should expect to see less concentration and more diffuse patterns of ownership structures in publicly traded corporations.

B. *The Traditional Ownership Structure in Anglo-American Law and the Factors that Are Likely to Decrease it*

1. *The History and Development of the Traditional Ownership Structure Under in Anglo-American Law*

The conventional wisdom is that the agency problem between company executives and public shareholders characterizes the diffuse corporate

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77. *Id.*

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

79. *See* Thomas & Van der Elst, *supra* note 71, at 716. Thomas and Van der Elst argue:

> 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.

Id.

ownership structure in the United States and it is particularly identified with the writings of Berle and Means in the early 1930s.[80] 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.[81] During the decade after the end of the First World War, retail investment in stocks and bonds grew dramatically, and the number of shareholders increased from 2.4 million in 1924 to 10 million in 1930.[82] Berle and Means describe the broad dispersion of stock ownership among the public and show the consequences for the corporation: 44% of the largest 200 corporations were under effective management control, with no single entity holding more than 5% of the voting stock.[83] With regard to the English market, Brian Cheffins argued that a diffuse ownership structure developed in England and reached its peak only after 1970.[84] In his view, one of the main reasons for this was tax policy; in the wake of World War II, England adopted legislation that imposed high taxes on corporate profits, and which did not recognize directors' remuneration as a tax-deductible expense.[85] These developments eliminated the incentive of controlling shareholders to serve as officers in companies, and prompted them to distribute their shares on the open market.[86]

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80. BERLE & MEANS, *supra* note 2, at 47-65, 122.

81. *Id.* at 46. Berle and Means note:

> 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

Id.

82. EDWIN BURK COX, TRENDS IN THE DISTRIBUTION OF STOCK OWNERSHIP 33 (1963).

83. BERLE & MEANS, *supra* note 2, at 93, 94. Notably, Berle and Means made another claim that sounded revolutionary at the time that international public companies will take the place of the civil state as the most dominant institutions in the Western world:

> 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.

Id. This argument is, in part, one of the reasons for the subordination of multinational corporations to the international legal system. *See* MARKOS KARAVIAS, CORPORATE OBLIGATIONS UNDER INTERNATIONAL LAW 6-16 (2013).

84. BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED 321-28 (2008). For a historical survey of the development of the concentrated diffuse 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'* (Eur. Corp. Governance Inst. Law Working Paper Grp., Paper No. 144, 2010).

85. Cheffins, *supra* note 84, at 323-24.

86. *Id.* at 321.

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.[87] The paradigm of separation between ownership and control dominated corporate law research throughout the twentieth century.[88] However, over the past few years, several studies have challenged 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 United States, England, France, and Germany.[89] It found that the number of corporations in the United States with listed equity on a major national stock exchange was significantly lower than in England, France, or Germany.[90] 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 a sizable concentration in the US economy.[91] Another study examined a representative sample of 375 publicly traded corporations on the New York Stock Exchange 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%).[92]

Conversely, recent economic-historical research by Kandel et al. 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.[93] 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.[94] In this context, research points to a link between reforms in the field of infrastructure,

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87. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 40-72 (1991).

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

89. Leslie Hannah, *The 'Divorce' of Ownership from Control from 1900 Onwards: Re-calibrating Imagined Global Trends,* 49 BUS. HIST. 404, 405 (2007).

90. *Id.* at 406.

91. João A.C. Santos & Adrienne S. Rumble, *The American Keiretsu and Universal Banks: Investing, Voting and Sitting on Nonfinancials' Corporate Boards*, 80 J. FIN. ECON. 419, 423 (2006).

92. Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1378 (2009).

93. Eugene Kandel et al., *The Great Pyramids of America: A Revised History of US Business Groups, Corporate Ownership, and Regulation, 1930-1950* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 1691, 2015), https://www.hec.ca/finance/Fichier/Morck2015.pdf.

94. *Id.* at 3-5.

taxation and protection of investors, and the elimination of a structure of concentrated ownership in the American economy in favor of diffuse ownership structures.[95] Thus, although those 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. Therefore, the separation of ownership and control still serves as a good point of reference to describe the historical development of corporate law in the United States and the United Kingdom.[96]

The separation of ownership and control is particularly manifested in the fact that Anglo-American law reduces the ability of shareholders to manage a company's internal affairs.[97] In this matter, some argue in the literature that existing law—which shields directors from shareholder pressure—promotes the long-term interests of the company and of shareholders alike.[98] According to this line of thinking, giving greater power to public shareholders may cause them to pursue short-term interests to generate short-term profits, which reduces the company's ability to invest in research and development that would generate long-term profits for the company and its shareholders.[99] Recently,

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95. *Id.* at 1. The authors write:

> The data link 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), or indirectly—enhanced investor protection (after 1934), the Investment Company Act (1940) and escalating estate taxes. Banking reforms and rejuvenated antitrust enforcement may have indirectly contributed too. These reforms, sustained in a lasting anti-big business climate, promoted the dissolution of existing groups and discouraged the formation of new ones. Thus, a multi-pronged reform agenda, sustained by a supportive political climate, created an economy of freestanding firms.

Id.

96. *See* Brian Cheffins & Steven Bank, *Is Berle and Means Really a Myth?*, 83 BUS. HIST. REV. 443, 445 (2011); *see also* John Armour & Jeffrey N. Gordon, *The Berle-Means Corporation in the 21st Century* 2 (Oct. 21, 2009) (unpublished manuscript) (available at https://law.yale.edu/system/files/documents/pdf/Intellectual_Life/Armour_BerleMeansCorp091021.pdf) (asserting that the various structures of concentrated/diffuse ownership in the United States and England should be distinguished from their respective regulatory implications).

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

98. *See e.g.*, STEPHEN BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 20-22 (2008) (calling for a stronger board of directors and reduced ability of shareholders to voice their views about the management of the company's internal affairs, and drawing upon existing law to support 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). *But see* Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 835, 851-75 (2005) (arguing that the powers and rights of shareholders in should be expanded with regard to the appointment of directors and directors of the company); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 694-711 (2007).

99. LYNN A. STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC, ch. 5 (2012); *see also* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735,

however, Bebchuk showed that this argument is not an absolute fact but a contestable claim and that often greater shareholder involvement in a company's management benefits it in both the short and the long term.[100] Both schools of thought do agree that separation of ownership and control as first recognized by Berle and Means creates a moral hazard for the company's management.[101] Where they disagree is over whether this risk can be minimized by empowering the board of directors, or the shareholders.[102] 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.

2. *The Factors that May Lead to the Decreasing 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 have not yet received much attention—are now widely discussed among researchers and policymakers.

a. *The Concentrated Ownership of Institutional Investors and Shareholder Activism*

In recent years, the view that the diffuse ownership structure which has characterized publicly traded corporations in the United States, as highlighted by Berle and Means, is no longer accurate.[103] Gilson and Gordon have noted that today, institutional investors hold, on average, over 70% of the share capital of the 1,000 largest publicly traded corporations in the United States.[104] They believe that the high levels of institutional ownership of publicly traded corporations are due to the decision to privatize pension funding (beyond the regular funding of the national welfare program). Moreover, the sharp rise in

1744-51 (2006) (observing that shareholders may have short-term time horizons); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 657-59 (2010) (arguing that greater shareholder power may increase companies' risk-taking).

100. *See* Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1685-86 (2013) (finding that board insulation from shareholder pressure is detrimental to companies' long-term interests).

101. Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101 MINN. L. REV. 1377, 1379 (2017).

102. To reconcile these two streams of thought, some argue 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 shareholders given broad powers regarding long-term decisions. *See id.* at 1384.

103. *See, e.g.*, Gerald F. Davis, *The Twilight of the Berle and Means Corporation*, 34 SEATTLE U. L. REV. 1121, 1121-22 (2011); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 864-65 (2013).

104. *Id.* at 865.

the holdings of institutional investors is a result of 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.[105] 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 and 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. A significant percentage of these institutional investors have business models that limit their incentives and capacity to monitor the business choices of their portfolio companies except through assessing stock market performance. In other words, these institutional investors may often prefer to exit an investment rather than actively improve corporate governance in the invested company. The second agency problem lies in the small incentive of the institutional investors to ensure that corporate managers act in a manner that advances the long-term interests of the shareholders.[106]

One way to address these agency problems is to impose direct obligations on institutional investors. For example, in England, following the Walker Review, the government determined that institutional investors should be viewed as stewards of the corporations in which they invest the funds of the public.[107] The U.K. 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.[108]

b. *Dual-class Shares*

Several publicly traded corporations in the United States use a variation of voting rights known as dual-class shares. Some prominent examples of corporations using dual-class shares include CBS, Facebook, Alibaba, Ford, Google, News Corp. and Nike.[109] Dual-class shares exists in 9% of the

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105. *Id.* at 874-86.

106. *Id.* at 874-78. For a more recent discussion of these agency problems, see Lucian A. Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 90 (2017) (arguing that investment managers do not have an incentive to oversee the operations of companies because they will only benefit partially from such oversight while still bearing the full costs involved, and because 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).

107. FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE (2012).

108. For a review of the code's provisions, see BO GONG, UNDERSTANDING INSTITUTIONAL SHAREHOLDER ACTIVISM: A COMPARATIVE STUDY OF THE UK AND CHINA (2014); Lee Roach, *The U.K. Stewardship Code*, 11 J. CORP. L. STUD. 463 (2011).

109. See EDWARD KAMONJOH, INV'R 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/ControlledCompanies-IRRCI-2015-FINAL-3-16-16.pdf; *see also* Floyd Norris, *The*

corporations listed in the S&P index, and have a total combined market cap of $2.26 trillion.[110]

In 1926, the New York Stock Exchange banned dual-class share issuances—stipulating that every security issued on the stock exchange will have equal voting rights[111]—in a bid to promote corporate democracy and protect the rights of minority shareholders. Although today the rules of the United States stock exchanges still prohibit registered corporations from changing the 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 dual-class shares.[112] Dual-class shares enable the controlling shareholder to entrench their control and may protect them 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.[113]

Bebchuk and Kastiel recently claimed that these costs may increase over time after the issuance of an Initial Public Offering (IPO) on the primary stock

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Many Classes of Google Stock, N.Y. TIMES (Apr. 2, 2014), http://economix.blogs.nytimes.com/2014/04/02/the-many-classes-of-google-stock.

110. 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, 594-95 (2017). The authors also note that while in 2005 only 1% of the companies traded on various stock exchanges in the United States used dual class shares, by 2015 this had increased to 13.5%. *Id.*

111. *Id.* at 596.

112. *See id.* at 597 n.35; *see e.g.*, NYSE LISTED COMPANY MANUAL § 313.00 (1992) (prohibiting dual-class recapitalizations for listed companies but states several exceptions for the listing of multiple classes of stocks, including the issuance of various classes before an IPO which remains secured after the company has gone public); *see also* NASDAQ STOCK MARKET RULES § 5640 (restricting the reduction of voting rights of common-stock shareholders but permitting companies to issue additional shares of already "existing super-voting stock").

113. *Id.* at 597-99. It should be noted that although dual class shares are not common in England due to opposition to institutional investors, the Financial Conduct Authority is interested in examining the possibility of allowing it. *See* FINANCIAL CONDUCT AUTHORITY, REVIEW OF THE EFFECTIVENESS OF PRIMARY MARKETS: THE UK PRIMARY MARKETS LANDSCAPE 7 (2017), https://www.fca.org.uk/publication/discussion/dp17-02.pdf. Their report states:

> 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

Id.

market. At the time of an IPO, protection of a company founders' control might be justified on the grounds that the founders established the company and successfully managed it up to that point.[114] But years after an IPO, the justification for founders to continue to maintain control of the company through dual-class shares is significantly diminished. There is little evidence that controlling shareholders possess superior skills in promoting the interests of the company.[115] Moreover, as Bebchuk and Kastiel point out, after an IPO in which dual-class share arrangements were guaranteed, company founders tend to significantly reduce their holdings in the company without losing control. Over time, this only intensifies the agency problems between the controlling shareholder and the company and its minority shareholders.[116]

In conclusion, it is important to emphasize that even if most publicly traded corporations in the United States do not have dual-class shares, they are a quintessential feature of concentrated ownership structures that are gaining momentum among technology companies.[117] 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.[118]

C. *Interim Summary*

In this section I will discuss the factors that led to the adoption of the concentrated and diffuse ownership structure in Continental and Anglo-American law (respectively). I also will 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 decline in traditional ownership structure has occurred in Israel as well—based, in part, on preliminary data—and the normative ramifications for the design of relative corporate governance rules.

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114. Bebchuk et al., *The Untenable Case*, *supra* note 110, at 604.

115. *Id.* at 605-06.

116. *Id.* at 607-09.

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

118. For an empirical study that found clear concentrated ownership structure patterns in the American capital market, see 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 some form of concentrated control.

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

In this section I will show that the weakening of traditional ownership structures in comparative law extends to Canada and Israel as well.[119] 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.

A. *The Characteristics of Concentrated Ownership Structure in Canada and Israel*

1. *Decrease in Holdings of Interested Parties*

a. *Canada*

Scholars offer various explanations for the development of concentrated ownership structures in Canada. For instance, Daniels and Iacobucci point out that in the twentieth century, banks and financial institutions "were permitted to invest in corporations of which they were creditors, ostensibly in order to protect their investment in the debt rather than to make a profit on the security itself."[120] They argue that regulations allowing banks to maintain high equity holdings in these corporations contributed to the development of a concentrated ownership structure.[121] Morck and others argue 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 Canada.[122] For example, Valsan's study of thousands of

119. 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) ("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.").

120. Ronald Daniels & Edward M. Iacobucci, *Some of the Causes and Consequences of Corporate Ownership Concentration in Canada*, *in* CONCENTRATED CORPORATE OWNERSHIP 81, 86 (Randall Morck ed., 2000).

121. *Id.* at 87.

122. Randall Morck, Michael Percy, Gloria Yuan Tian & Bernard Yin Yeung, *The Rise and Fall of the Widely Held Firm: A History of Corporate Ownership in Canada*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 65, 113-15, 131-35 (Randall Morck ed., 2005).

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. Compared to previous studies, Valsan found that the incidence of ownership stakes of 20% or larger has decreased from 60% to 41% of the total population of publicly listed Canadian firms.[123]

b. *Israel*

Some could conclude that the Israeli capital market has a concentrated ownership structure, which is reflected in the phenomenon of business pyramids that control other publicly traded corporations through at least two layers pattern.[124] 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.[125] 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,[126] the level 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.[127] 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, while the percentage of countries with diffuse ownership structure declined from 57% to 41%.[128] Figure 1 presents the data on the distribution of holders of shareholders in publicly traded corporations in Israel

123. Calin Valsan, *2007: A Canadian Corporate Ownership Survey*, 7 EUR. J. OF COMP. ECON. 285, 285 (2010).

124. Hamdani, *supra* note 42, at 18-34.

125. 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 L. STUD. 1, 1 (2016).

126. KOBI AVRAMOV, TEL-AVIV STOCK EXCHANGE (TASE) RESEARCH UNIT, THE SALE OF SHARES BY INTERESTED PARTIES IN THE FIRST HALF OF 2014 CONTINUES (Feb. 2015), https://www.tase.co.il/Heb/Statistics/StatRes/2014/Stat_141_Research_2014_07_221916.pdf ; Kobi Avramov, *Principal Shareholders Sold Shares Worth NIS 2.7 Billion in the First Half of 2017*, TEL-AVIV STOCK EXCHANGE, https://info.tase.co.il/Eng/Statistics/ResearchReviews/2017/Pages/Stat_141_Research_2017_06_301240.aspx (last visited Jan. 29, 2019); TASE Research Unit, *In 2016, Public Shareholders Sold NIS 6 Billion Worth of Shares, an Increase of More Than 80% Compared to the Year 2015*, TEL-AVIV STOCK EXCHANGE (Dec. 2016), https://info.tase.co.il/Heb/Statistics/ResearchReviews/2016/Pages/Stat_141_Research_2016_12_287236.aspx.

127. Minnes, *supra* note 125, at 17.

128. ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, CORPORATE GOVERNANCE FACTBOOK 1 fig.1.1 (Mar. 2015), http://cecga.org/wp-content/uploads/OECD-Corporate-Governance-Factbook.pdf.

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.[129]

FIGURE 1: Average level of shareholders' equity in publicly traded corporations in Israel, in the years 2007-17

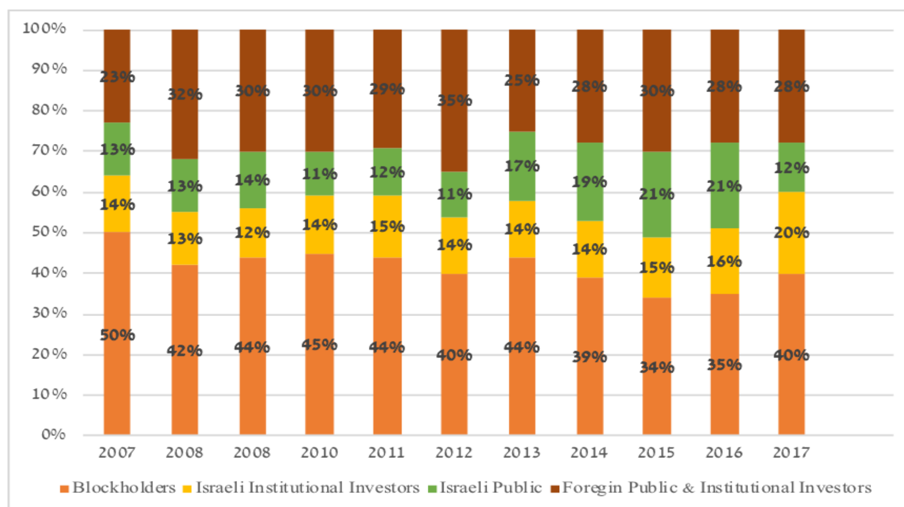


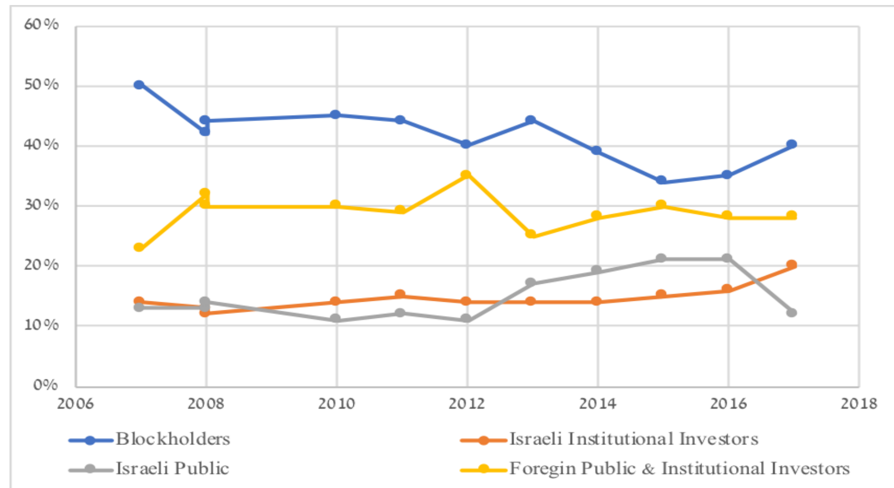
Figure 2 indicates a consistent and significant decline in the levels of holdings by interested parties, and concurrently, a steady increase in the levels of holdings by the general public in the equity of publicly traded corporations between 2002 and 2017.[130] It also shows that apart from 2017,[131] 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.

129. *See*, BRIGHTMAN AMALGOR ZOHAR & CO., THE TEL-AVIV STOCK EXCHANGE CONSOLIDATED FINANCIAL STATEMENTS (2007-17), https://info.tase.co.il/Eng/Lists/gen_res/1310_tase_finacial_reports/2017_tase_reports_eng.pdf.

130. Due to the sharp drop in the share price of Teva in 2017 (with a free-float rate of over 90%), the overall share of holdings by the general public in the stock market fell by approximately 3% to 60%, compared to 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 TEL-AVIV STOCK EXCHANGE, ANNUAL REVIEW 10 (2017), https://info.tase.co.il/Eng/Lists/gen_res/0133_annual_review/2017_annual_review_eng.pdf.

131. 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, 2013, and their acquisition by institutional investors.

FIGURE 2: Changes in levels of holdings by interested parties in publicly traded corporations in the years 2007-2017



Contrary to these figures, it may be argued that the sharp decline in the level of holdings by interested parties in publicly traded corporations in Israel is the result of the provisions of the Concentration Law (2013). Even if the effect of the provisions of the Concentration Law on the levels of holding by interested parties 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 began. 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."[132]

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,"[133] 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 concentrated ownership structures and the

132. Minnes, *The Legal Arrangement Governing Pyramids*, *supra* note 125, at 45.

133. 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 L. & BUS. 417 (2017).

ability of controlling shareholders to enjoy private benefits in the form of a control premium.[134]

In a comparative international study, Dyck and Zingales assessed the private value of control in 39 countries based on data from 393 core control transfer transactions in the years 1990-2000.[135] 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.[136] In another study, by Barak and Lauterbach, the authors estimated the private value of control based on data from fifty-four large transactions in Israel for the sale of blocks of shares, from 1993-2005.[137] They found that the premium paid in these transactions averaged 32% of capital.[138] 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.[139]

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.[140] 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.[141] In other words, the salient characteristic of concentrated ownership

134. Bebchuk, A Rent-Protection Theory of Corporate Ownership and Control, *supra* note 27, at 8; Luigi Zingales, *Insider Ownership and the Decision to Go Public*, 62 REV. ECON. STUD. 425 (1995). 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, *supra* note 31, at 604-05.

135. Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004).

136. *Id.* at 551, 589-90.

137. Ronen Barak & Beni Lauterbach, *Estimating the Private Benefits of Control from Partial Control Transfers: Methodology and Evidence*, 2 INT'L J. CORP. GOVERNANCE, 183, 184, 189 (2011).

138. It should be noted that Barak and Lauterbach used a different estimation method and sample period than that used by Dyck & Zingales.

139. LUCIAN ARYE BEBCHUK, THE COMMITTEE FOR INCREASING COMPETITIVENESS IN THE ECONOMY (PT. 2) 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.").

140. Sharon Hannes & Eylon Blum, Does Law Matter? Private Benefits of the Controlling Shareholder Following Legal Reform 9 (unpublished manuscript), http://www.law.columbia.edu/sites/default/files/microsites/law-economics-studies/control_premiun_cls.pdf.

141. *Id.* at 8-9.

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.[142] The new reality requires a rethinking of the premises regarding the degree of concentration market in Israel and Europe.[143]

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.

a. *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.[144] In Canada, the Ontario Securities Commission Rule 61-501 regulates procedures for approving transactions with related parties and tender offers. This rule stipulates that 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 oppression of minority shareholders.[145] According to section 241 of the Canada Business Corporations

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142. BEBCHUK, *supra* note 139, at 15; Minnes, *supra* note 125, at 45. 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[s] 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.

BEBCHUK, *supra* note 139; *see* Hannes & Blum, *supra* note 140, at 8-9; Minnes, *supra* note 125, at 45.

143. 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 capital) and a correlation between this low rate and various reforms in Italian law that have strengthened the protection of the rights of the minority shareholders. *See* Carmelo Intrisano, *Have the Private Benefits in Italian Firms Decreased?,* 11 CHINESE BUS. REV. 911, 920 (2012).

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

145. *See* DAVID S MORRITT, SONIA L BJORKQUIST & ALLAN D COLEMAN, THE OPPRESSION REMEDY 5-47-56 (2005).

Act 1985, 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 oppression is reflected in the decision of *BCE Inc. v. 1976 Debentureholders*.[146] In that case, the Supreme Court of Canada discussed a leveraged buyout transaction which, according to the company's debenture holders, 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. Since the remedy against an oppression of any interested party is 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 oppression 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—for example, by conduct that constitutes oppression, 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 reason to question the discretion of the directors in approving the proposed transaction.[147] It further noted that the courts must allow directors of small corporations greater discretion to deviate from the textual provisions of the law under certain circumstances. This is in contrast to directors of large publicly traded corporations, who must always comply with the provisions of the law.[148]

Another reform that underlines the power of shareholders is expressed in tender offer law. 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).[149] 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

146. BCE v. 1976 Debentureholders, [2008] 3 S.C.R. 560 (Can.).

147. *Id.* ¶¶ 77-88.

148. For a critical discussion of the ruling, see generally Anthony J. VanDuzer, *BCE v. 1976 Debentureholders: The Supreme Court's Hits and Misses in Its Most Important Corporate Law Decision Since Peoples, 43* U.B.C.L. REV. 205 (2010). For the implementation of the BCE ruling by the Canadian Supreme Court, see generally Mennillo v. Intramodal Inc., [2016] 2 S.C.R. 438 (Can.).

149. Take-Over Bids and Issuer Bids, SOR/2016-162-104 (Can.). 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).

arrangements to enable shareholders to make more informed decisions when assessing remuneration to the company's officers.[150]

b. *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.[151] 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 those shareholders who have no personal interest in that specific transaction. Prior to this amendment, approval by only a third of the shareholders with no personal interest was required to approve the transaction.[152]

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 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.[153] In 2012, the Israeli legislature adopted Amendment

150. INSTITUTE FOR GOVERNANCE OF PRIVATE AND PUBLIC ORGANIZATIONS, EXECUTIVE COMPENSATION: CUTTING THE GORDIAN KNOT 38 (2017), 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), https://www.ccgg.ca/site/ccgg/assets/pdf/2016_best_practices.pdf.

151. *See* HADAS AHARONI BARAK, TRANSACTIONS WITH A CONTROLLING SHAREHOLDER: PUBLIC ENFORCEMENT, CONCENTRATION OF CONTROL AND THE PROTECTION OF THE MINORITY SHAREHOLDERS 91-115 (2014).

152. 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).

153. For an analysis of Amendment No. 17 to the Corporations Law, see e.g., Keren Bar-Hava & Roi Katz, *Regulation and Corporate Governance in Private Companies—An Empirical Analysis: Amendment 17 to the Companies Law—A Light Unto the Nations or a Bureaucratic Burden* (Working Paper, 2014), https://ssrn.com/abstract=2507160. Another legislative development that took place in 2011 was the enactment of the Enforcement Procedures Law of the Israel Securities Authority, 5771-2011, (as amended) (Isr.), which

No. 20 to the Corporations Law, which introduced the adoption of Say on Pay mechanisms in Israeli law.[154] 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 for the company's officers; and (3) special procedures for approving remuneration for office holders, the CEO, directors and controlling shareholders.[155] These legislative steps have indeed reduced the benefits that controlling shareholders can derive from their control of a corporation.[156]

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.[157] In the cases of the corporations Makhteshim Agan[158] and Elscint,[159] 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 of NIS 900 million more than the rest of the company's shareholders. The court ruled that the law allows for restrained judicial intervention in order to examine the fairness of a transaction, even in the case of transactions that received all the approvals required by the company's institutions. In the case of

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regulates an administrative enforcement mechanism for violation of securities laws in parallel with the criminal enforcement mechanism.

154. For a discussion, see generally Yosef Gross, *Road Map of the Sea Change in Senior Wages*, *in* CORPORATIONS 88 (2013).

155. 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), http://blogs.law.harvard.edu/corpgov/2013/01/07/israels-executive-compensation-reform/#3b.

156. Minnes, *supra* note 125, at 46.

157. AHARONI BARAK, *supra* note 151, 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* J. Maria Glover, *The Structural Role of Private Enforcement Mechanism in Public Law*, 53 WM. & MARY L. REV. 1137, 1140 (2011) ("[The 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."); Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CAL. L. REV. 393, 403 (2003); Asaf Hamdani & Sharon Hannes, *Fairness? Controlling Shareholders, Obligations of the Board of Directors and Judicial Review*, 9 L. & BUS. 75, 93 (2008) (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). 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 25, at 31-35.

158. DC (TA), Kahana v. Makhteshim Agan Aug 3, 2011, Nevo Legal Database (by subscription, in Hebrew) (Isr.).

159. CA 2718/09 Gadish Provident Funds v. Elsint Ltd. (2012), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

Elscint,[160] the Supreme Court ruled that for the purpose of approving transactions with a controlling shareholder, both procedural and essential mechanisms—such as approval by the company's institutions and court oversight ensuring that the controlling shareholder has not breached his obligation of trust—are required.[161]

B. *Evaluation of the Findings*

Up to this point, this article has noted that unlike others, some Continental countries, like Canada and Israel, have diffuse ownership patterns—as evidenced, in part, by broader protection of minority shareholder rights. However, it can be argued that such broad protection should be welcomed since it contributes to the transformation of a traditionally concentrated ownership structure into a diffuse one. For example, Israel and Canada adopted legal mechanisms derived from Anglo-American law, such as Say on Pay arrangements, which may lead these countries to having a more diffuse ownership structure.

I believe that this claim is wrong. As I wrote in Part I of this paper, the economic literature doesn't provide conclusive indications as to which of the two ownership structures—concentrated or diffuse—is superior.[162] Thus, some studies show that in corporations with a concentrated structure there is no obvious association between greater independence of the board of directors and the company's value.[163] Also, there is a positive correlation between publicly traded corporations falling within a certain range of concentrated control and profitability.[164] Other studies, however, have shown that corporations that are managed by their owners tend to be managed less efficiently in some circumstances,[165] and that the existence of dominant shareholders can erode

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160. Kahana v. Makhteshim Agan, No. 26809-01-11, Nevo Legal Database, at ¶ 21.

161. *Id.* ¶ 28. For a discussion, see *Gonen*, *supra* note 152, at 60-63. For a similar view in Canada, see BCE v. 1976 Debentureholders, [2008] 3 S.C.R. 560 (Can.). In that case, the court stated:

> 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.

162. *See* Minnes, *supra* note 125, at 47-50; Thomsen & Torben Pedersen*, supra* note 37, at 689-90 (emphasizing the importance of owner identity over ownership structure).

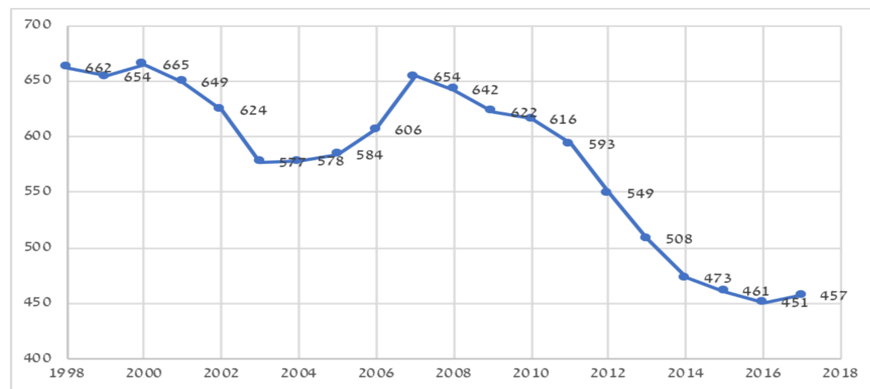
163. John Erickson et al., *Board Composition and Firm Value Under Concentrated Ownership: The Canadian Evidence*, 13 PAC. BASIN FIN. J. 387, 408 (2005).

164. Steen Thomsen & Torben Pedersen, *Ownership Structure and Economic Performance in the Largest European Companies,* 21 STRATEGIC MGMT. J. 689, 700-01 (2000).

165. Beni Lauterbach & Alexander Vaninsky, *Ownership Structure and Firm Performance: Evidence from Israel,* 3 J. MGMT. & GOVERNANCE 189, 196-97 (1999).

company value.[166] Therefore, rather than focus on designing legal policies to weaken concentrated ownership structures, legislators should be motivated to create appropriate regulations aimed at minimizing agency problems involved in each ownership structure.[167] 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.[168] Figure 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).[169]

FIGURE 3: Number of corporations traded on the Tel Aviv Stock Exchange, 1998-2017



166. *See* Jeremy Grant & Thomas Kirchmaier, *Corporate Ownership Structure and Performance in Europe* (CEP Discussion Paper No. 0631), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=616201 (finding that companies with concentrated control in three out of five European companies faced worse returns than those with diffuse ownership). For a discussion of such studies, see Minnes, *The Legal Arrangement Governing Pyramids*, *supra* note 125, at 47-50.

167. *See id.* at 50 (noting that as of now, there is no comprehensive regime in place ready to deal with different corporate structures). Minnes 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 [sic] while ignoring the costs involved.

168. *See, e.g.*, THE COMMITTEE FOR IMPROVING TRADE AND ENCOURAGING LIQUIDITY ON THE STOCK EXCHANGE, FINAL REPORT 11 (2014) ("Various entities argued before the committee. It was repeatedly argued that activity reduction in the capital market and particularly in TASE, was mainly caused by the recently expended regulatory supervision.").

169. The data in Figure 3 was collected from the annual reviews published by the Tel Aviv Stock Exchange, *supra* note 126.

In light of the sharp drop in the volume of trade on the Tel Aviv Stock Exchange, the Securities Authority made two main changes: it eased regulation of securities laws in Israel, through a long list of amendments regarding the scope of the disclosure obligations;[170] and it demutualized the stock exchange by separating its ownership from the management of its trades, by turning it into a public company.[171]

A 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.[172]

Recently, Caperntier and Suret analyzed the Canadian IPO market over three decades (1986-2016) and illustrated the market's sharp decline, producing potentially substantial negative effects on the economy.[173] Their study indicates that since 1986, there is a larger decrease in IPOs on the TSX Venture Exchange than on the Toronto Stock Exchange (TSX), largely driven by a strong reduction in the number of non-natural resources issuers. However, on the TSX, the annual average number of IPOs reported between 1970 and 1985 by previous studies is lower than that reported since 2006.[174]

To figure out the extent of this phenomenon, I collected data from the official website of the TSX on the number of corporations which registered their stocks to trade. Figure 4 shows the sharp decline in the number of corporations which registered their stocks to trade at the TSX between 2008 and 2017.

170. *See* Law for Easements in the Capital Market and Encouragement of Its Activity, 5774-2014 (as amended) (Isr.).

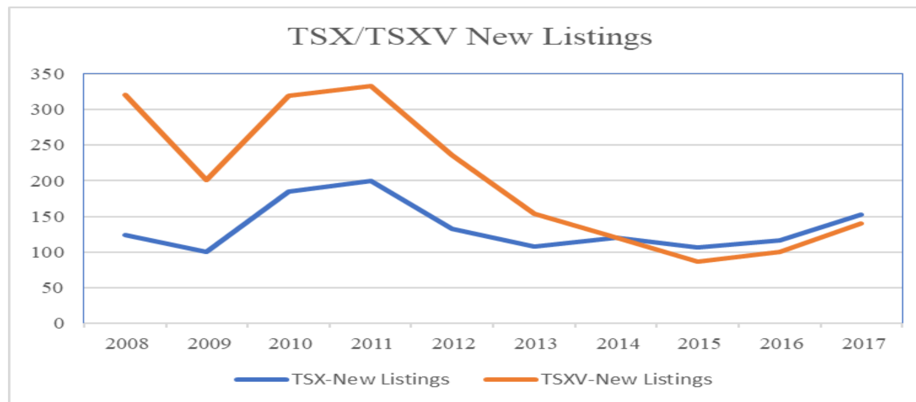
171. Leon Yehuda Anidjar, *Strengthening Trust in Israeli Financial Markets: The Case of the Demutualization of the Tel Aviv Stock Exchange*, 19 GLOB. JURIST (2018).

172. Bryce Tingle et al., *The IPO Market in Canada: What a Comparison with the United States Tells Us About a Global Problem*, 54 CAN. BUS. L. J. 32, 330 (2013); Jason Kirby, *Public Companies in Canada Are Going the Way of the Dodo*, MACLEAN'S (Aug. 2, 2016), http://www.macleans.ca/economy/economicanalysis/public-companies-in-canada-are-going-the-way-of-the-dodo.

173. Cécile Carpentier & Jean-Marc Suret, *Three Decades of IPO Markets in Canada: Evolution, Risk and Return* 2 (CIRANO, Working Paper No. 2018S-04, 2018).

174. Carpentier and Suret believe that the lemon market characteristics of the Canadian IPO market can probably explain why it is vanishing. The lemon market hypothesis suggests that, in a context of extensive information asymmetry, the incentive for entrepreneurs to sell overvalued stocks becomes huge. However, unskilled investors are unable to detect such overvalued stocks, which leads to the lemon problem: Entrepreneurs essentially offer bad projects when asymmetry is large and regulation lenient. *Id.* at 11.

FIGURE 4: TSX/TSXV New Listings



Tingle et. al. suggested explanations for this phenomenon.[175] One account indicates that Sarbanes-Oxley reforms are a primary cause of the IPO drought in the Canadian IPO markets. In other words, by raising the costs of compliance and the risk of criminal and civil liability, Sarbanes-Oxley provided a significant disincentive to go public.[176] Moreover, one alternative explanation asserts that "it is possible that America's litigation climate combined with, say, the growing availability of private equity or increasing M&A opportunities, might account for the decline of IPOs."[177] Whether such factors provide adequate explanations for this phenomenon is questionable. However, we cannot negate the possibility that legal and regulatory apparatus surrounding public companies have evolved in a way that provides strong disincentives to managers to take their businesses public.[178]

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 concentrated ownership structures in a way that will reconcile the new reality that these characteristics of concentrated ownership are weakening while characteristics of diffuse ownership is strengthening.

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

175. Tingle et al., *supra* note 172.
176. *Id.* at 339.
177. *Id.* at 343-44.
178. *Id.* at 361.

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, La Porta et al. argued that concentrated ownership structures are associated with lower levels of protection of the rights of minority shareholders.[179] In the previous sections I described how concentrated ownership structures in Europe and Israel have significantly declined, while patterns of diffuse ownership structure have significantly increased. It is necessary to redraw the rules of corporate governance to reflect the idea that in a concentrated ownership structure there is inherent risk that the controlling shareholder will seek to promote his own personal interests that may not coincide with those of other shareholders. However, such rules should also recognize that the general public holds an increasingly significant share of capital in publicly traded corporations, therefore raising questions of whether the government should provide broad protection to minority shareholders.[180]

Moreover, this new model assumes that there is considerable variation in the balance of power between controlling shareholders and minority shareholders in different types of publicly traded corporations with a concentrated ownership structure. This variability is demonstrated in several ways—be it the diverse levels of holdings by interested parties 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 suggests that a "one size fits all" application of strict rules on all corporations should be avoided.[181] Therefore, the purpose of the proposed model is to create regulation that reflects this variation by establishing more balanced and flexible rules.[182] Regulations should not

179. La Porta et al., *Law and Finance*, *supra* note 16, at 1129-31.

180. *See* Ringe, *supra* note 5, at 531; Avramov, *supra* note 126.

181. *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, 456 (1985) (arguing "any imposition of uniformity—either liberal or strict—on the system of corporate law will be Pareto inefficient.").

182. Recently, Goshen and Squire argued that the corporate governance of every public company seeks to reduce two different costs: those involved in maintaining control by the principal (principal costs) and those involved in control by the company's managers (agent costs). In their view, "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 & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 826 (2017).

impose onerous financial costs on publicly traded corporations, but instead should encourage the registration of corporations in the primary stock market and enable shareholders to devote time to promoting their core business without having to spend excessive time complying with the law.[183] In view of the emergence of clearly diffuse ownership patterns 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. I 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 of 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 of the company's equity holds less control of the company's decision-making process 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 corporate governance rules that govern the relationship 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 exert effective control over the business activity of the company.[184] 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 of

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183. Valentina Bruno & Stijn Claessens, *Corporate Governance and Regulation: Can There Be Too Much of a Good Thing?*, 19 J. FIN. INTERMEDIATION 461, 463 (2010) (finding that in any legal regime a few specific governance practices improve performance. Companies with good governance practices operating in stringent legal environments, however, show a valuation discount relative to similar companies operating in flexible legal environments. At the same time, a stronger country-level regime does not reduce the valuation discount of companies with weak governance practices. The authors suggest a threshold level of country development above which stringent regulation hurts the performance of well governed companies or has a neutral effect for poorly governed companies).

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

such action exceed the costs involved.[185] Since a single shareholder cannot prevent other shareholders from sharing in the benefits of such action,[186] rational shareholders will hope that another shareholder will bear the costs of activism so that he may enjoy its benefits at no cost to themselves (the free rider problem). However, legislators in countries with high rates of concentrated ownership have given minority shareholders various tools to express their views and exert some power at shareholder meetings (e.g., by raising items on the agenda at general meetings,[187] or by imposing obligations on institutional investors to speak on their behalf at shareholder meetings).[188] The regulation in these countries also covers the private and public discourse between the minority shareholders and the management of the company.[189] Moreover, in 2007 the EU recommended that its member states begin using electronic voting systems to increase the participation of shareholders in annual meetings,[190] (like the Bombay Stock Exchange in India, where electronic

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185. Dov Solomon, *The Voice: The Minority Shareholder's Perspective*, 17 NEV. L. REV. 739, 748-755 (2017).

186. MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 55 (1965).

187. 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 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 one 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 EUR. FIN. MGMT. 738 (2011).

188. In Israel, the Committee for Increasing the Involvement of Institutional Bodies in the Capital Market recommended linking the circumstances in which mandatory participation in the vote is imposed and the decisions where the legislator confers special status upon minority shareholders. *See* MINISTRY OF FINANCE REPORT OF THE COMMITTEE TO EXAMINE THE MEASURES REQUIRED TO INCREASE INSTITUTIONAL BODIES' PARTICIPATION IN THE ISRAELI CAPITAL MARKET 9-15 (2008), https://mof.gov.il/hon/information-entities/hashkaot/documents/review%20committee%20report%20measures%20-%20greedy%20committee.pdf.

189. 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* Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies, 2007 O.J. (L 184) 17. In Germany, to encourage the participation of shareholders, the legislature has imposed a duty on Chairmen of the Board to discuss various issues related to corporate governance with the shareholders on a regular basis. A similar regulation exists in Norway, Holland, Belgium and France. For a comprehensive discussion, see Klaus J. Hopt, *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* (ECGI, Law Working Paper No. 365, 2017).

190. Council Directive 2007/36/EC, 2007 O.J. (L 184) 17, 22. Italy and Sweden are examples of European countries that have adopted Directive 2007/36/EC in their internal

voting is now mandatory).[191] 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 shareholders and management to improve their corporate governance mechanisms.[192] Under such effective mechanisms which minimize the costs involved in allowing the voice of minority shareholders to be heard, it may be argued that the balance of power between the controlling shareholder and minority shareholders should be redesigned.

In my view, legislatures should adopt a sliding scale of regulation 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 a company, minority shareholders should be given the maximum possible protection, and when the controlling shareholding is under 50%, a lower level of protection should apply. This means that so 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 provide greater protection to their minority shareholders, under such circumstances may still be allowed to do so through the use of "adopt or disclose" mechanisms. Consequently, the companies' shares price in the stock exchange will eventually reflect the fact that certain corporations chose not to adopt strict corporate governance rules.[193] Under these regulations, only corporations that believe 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

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corporate laws. *See* Espen B. Eckbo & Giulia Paone, *Reforming Share-Voting Systems: The Case of Italy* (Tuck Sch. of Bus., Working Paper No. 93, 2011); Espen B. Eckbo, Giulia Paone & Runa Urheim, *Efficiency of Share-Voting Systems: Report on Sweden* (Eur. Corp. Governance Inst., Law Working Paper No. 173, 2011).

191. *See* Solomon, *supra* note 185, at 750-55.

192. 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 EUR. COMPANY L. 12 (2012). For a comprehensive empirical study of the activities of consulting firms in fourteen 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. ACCT. REV. 713 (2018).

193. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1595-97 (2005).

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.[194] Thus, the "Better Regulation Approach" seeks to enhance the rationality of government regulation through cost-benefit analysis to ensure optimal regulation.[195] 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.[196]

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.[197]

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194. 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).

195. 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).

196. In the United States, this policy was enshrined in Presidential Order No. 12291, which defined principles for determining and reexamining the rules of governmental regulation. *See* Presidential Order No. 12291, 3 C.F.R. 46 Fed. Reg. 13,193 (1981). At the center of the optimal regulatory method is the Regulatory Impact Assessment—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." CABINET OFFICE, BETTER POLICY MAKING: A GUIDE TO REGULATORY IMPACT ASSESSMENT 5 (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 2-3 (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.

197. This literature points to a positive correlation between the size of the company and the extent of the disclosure. Large companies have more resources to invest in disseminating information to the general public than small companies. Disclosure 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 BRITISH

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.[198] These corporations receive continuous media and analyst coverage that actively and consistently track and publish opinions on the company's business activity and decision making (including its stock performance). Under such circumstances, the risk that, corporations might infringe on the rights of minority shareholders is arguably lower, and therefore broad legal provisions to protect the rights of minority shareholders may be unnecessary. However, in small corporations whose operations are not often reviewed by analysts and the media, the information disparities between the controlling shareholder and the minority shareholders are more pronounced, which means that the rights of minority shareholders warrant greater protection.[199] 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 the impact a proposed transaction will have 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.[200] Some believe that the absence of appropriate

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ACCT. REV. 35 (1999); Pankaj M. Madhani, *Firm Size, Corporate Governance and Disclosure Practices: Inter-Relations*, 13 SCMS J. INDIAN MGMT. 17, 17 (2016).

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

199. 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 or more per year. This impacts, inter alia, the value of their shares, so that those most affected are the shareholders whom the law is intended to protect. Some scholars in the United States have made this assertion in relation to the hierarchy of regulation in securities law. *See* 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); Nathan Wilda, *David Pays for Goliath's Mistakes: The Costly Effect Sarbanes-Oxley has on Small Companies*, 38 J. MARSHALL L. REV. 671, 683-84 (2004).

200. DEMETRA ARSALIDOU, RETHINKING CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS 1-9 (2015).

corporate governance rules contributed significantly to the economic crisis of 2007-2009.[201] 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.[202] Therefore, with regard to transactions that may have problematic ramifications for the market's overall financial stability there is substantial justification for providing comprehensive protection of minority shareholder rights.[203] 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 can contribute to a more sophisticated legislative design regarding this matter.

However, three caveats are in order. First, implementation of the above criteria may sometimes lead to conflicting conclusions. For example, the level of protection warranted by the ratio of holdings between the controlling shareholder and the minority shareholders may be different from the level of protection required according to 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 accord with the importance of ensuring the financial stability of the capital market as a whole.

Second, this model does not apply to business group which use a pyramidal control structure. In many countries the concentration of control is reflected in business groups that each consist of several corporations under one business's control.[204] Such a business group allows the controlling shareholder to control a large number of corporations without incurring the capital costs involved.[205] 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.[206] Business groups that control

201. Simon Deakin, *Corporate Governance and Financial Crisis in the Long Run*, *in* THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOR, AND FINANCE CAPITALISM 15, 17 (Cynthia A. William and Peer Zumbansen eds., 2011).

202. IMF, FOSTERING STABILITY IN A LOW-GROWTH, LOW-RATE ERA, GLOBAL FINANCIAL STABILITY REPORT 81-103 (2016).

203. JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION 64 (2016).

204. 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 603 (Jeffrey Gordon & Georg Ringe, eds., 2018).

205. Bebchuk, Kraakman & Triantis, *supra* note 30, at 297.

206. 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 some 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,

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.[207] In the absence of such reliable information, the legislature may not be able to provide the right tools to institutional investors to effectively challenge the controlling shareholder's ability to reap private benefits from the firm. Moreover, a pyramidal governance structure may have a detrimental impact on competition, free market mechanisms and overall financial stability.[208] A pyramidal governance structure may be especially detrimental to minority shareholders in corporations at the bottom of the pyramid.[209] Therefore, within such a corporate ownership structure, there is no need to regulate based on the criteria detailed above, and broader protection should be granted for the rights of the minority shareholders according to the law of business groups, for instance.[210]

Third, the ratio of holdings between the controlling shareholder and the minority shareholders proposed for the regulatory hierarchy is simple and easy to measure. One issue that may arrive, however, is that at times, significant control may also be expressed at levels of control below the rate proposed above. 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.[211] However, a rather simple quantitative rule should be preferred, because it prevents the possibility of biased interpretation by the members of the company's board of directors regarding the nature of control over the company's decision making process. This conclusion holds even if the result of it may sometimes lead to over-inclusion or under-inclusion of the

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banking law and taxation law. *See* Hopt, *supra* 204, at Part II, in which he discusses three regulatory models to address agency problems within business groups.

207. *See* HAMDANI, CONCENTRATED OWNERSHIP STRUCTURE IN ISRAEL, *supra* note 44, at 27.

208. Randall Morck, Daniel Wolfenzon, & Bernard Yeung, *Corporate Governance, Economic Entrenchment and Growth*, 43 J. ECON. LITERATURE 655, 713 (2005) ("Many countries effectively entrust the corporate governance of substantial parts of their corporate sectors to the large pyramidal groups of a few extremely wealthy families. This can potentially magnify poor governance by a few family patriarchs into inefficient economywide capital allocation, reduced investment in innovation, and retarded economic growth.").

209. *See* Hopt, *supra* note 204, at 607-09.

210. *Id.* at 612-14; 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, 103-31 (2016).

211. 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.

condition of control in relation to the actual state of affairs in the specific company.

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 Regimes may significantly promote cooperation between them and the promotion of the company's long-term interests to the benefit of all shareholders.[212] In this regard, it is important to understand the link between the existence of a controlling shareholder in the company and their contribution to 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 sell his shares in the short term rather than pursue the company's long term interests.[213] Since the two incentives are mutually contradictory, most controlling shareholders choose an optimal rate of capital investment and control premium that help to advance the company's long-term interests.[214] Therefore, legislators must recognize that controlling shareholders may gain private benefits of control because of their increased ownership. But instead of trying to eliminate this, they should encourage it so long as it occurs at an efficiently optimal rate and incentivizes controlling shareholders to promote the company's best interests.

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

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212. John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443 (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, 394-99 (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, 1567-75 (2015).

213. Choi, *Concentrated Ownership*, *supra* note 34, at 12-19.

214. *Id.* at 13.

minority shareholders with regard to the management of the company,[215] this situation may also be harmful to all constituencies related to the company's operations.[216] For this reason, a Relative Corporate Governance Regime that adjusts the degree of minority shareholder protection 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 and ensure the promotion of all shareholders' interests.[217] However, not all minority shareholders are alike, and they often have interests that are incompatible with the long-term interests of the company.[218] For example: shareholders differ in the length of time of their investment in the company; some shareholders hold long-term securities, and some hold only short-term securities; some shareholders have a diversified investment portfolio, while others do not; and shareholders differ in the timing of their investments and the type of securities that they hold.[219] Due to diverging interests between different types of shareholders, a simple across-the-board increase 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 reason, at least one scholar has argued that strengthening the power of shareholders does not necessarily accord with the good of the company, and the extent of their control may warrant imposing various fiduciary obligations on them.[220] Thus, for example, some argue that minority shareholders should be subject to fiduciary duties similar to those imposed on the controlling shareholder in situations where minority shareholders place impediments to the implementation of decisions that benefit all shareholders (the "but for" test).[221] Thus, an indiscriminately broad defense

215. Bebchuk & Kastiel, *The Untenable Case*, *supra* note 110, at 610-11; Goshen & Hamdani, *Corporate Control and Idiosyncratic Vision*, *supra* note 31, at 577-79.

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

217. MATHIAS M. SIEMS, CONVERGENCE IN SHAREHOLDER LAW 174 (2007).

218. Emeka Duruigbo, Tackling Shareholder Short-Termism and Managerial Myopia, 100 KY. L.J. 531, 536-47 (2011); Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445 (2008).

219. Steven L. Schwarcz, Temporal Perspectives: Resolving the Conflict between Current and Future Investor*s*, 89 MINN. L. REV. 1044, 1044-59 (2005).

220. *See* Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1257-58 (2008).

221. As explained by Anabtawi & Stout: "[W]e would say that a shareholder 'controls' corporate conduct whenever its action is a determinative, or 'but for,' cause of particular corporate decision in issue." *Id.* at 1295.

of minority shareholders' rights does not necessarily promote the interests of all shareholders. Therefore, I believe a more precise regulation of the power relation between controlling shareholder and minority shareholders would be more cost-effective than having standards of conduct formulated by the courts retroactively.[222] 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 are designed in accordance with 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.[223]

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.[224] While the supervisory function of the board of directors received extensive discussion in the legal literature, the management function has received much less attention. The company's board of directors, unlike its management, is not responsible for the day-to-day management of the company.[225] 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 securing company value for the shareholders—and yet, in the wake of the economic crisis of 2007-09 and the ensuing measures taken by legislators in response—today's directors devote most of their time to resolving issues of corporate governance.[226] They are often called upon to reconcile the rights of the

222. *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 608-16 (1992).

223. For research that links better corporate governance to the company'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 INDUS. & CORP. CHANGE 361 (2014); 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. eds., 2002).

224. 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) (distinguishing between the board's monitoring and "relational" roles).

225. Stephen M. Bainbridge, *Why A Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 41 (2002).

226. 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

controlling shareholder with those of minority shareholders and other groups, such as creditors and employees.[227] 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 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 management to the benefit of the company.[228]

C. *Implications of the Proposed Model*

In this section, I will show how the model of relative corporate governance designs related party and going-private transactions. In particular, I will demonstrate how we should regulate those transactions to reflect the ratio of holdings between the controlling shareholder and minority shareholders. Furthermore, I will discuss the implication of the size and scope of the company's operations and whether there are significant institutional investor holdings in the company that can protect the rights of minority shareholders against the likelihood that the controlling shareholder will tunnel assets from the company to the controlling shareholder's pocket.

1. *Re-examination of Related-Party Transactions*

In related party transactions, a controlling shareholder may sell the company as 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.[229] One method is to completely ban the controlling shareholder from acquiring any

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model forms the basis of the Sarbanes-Oxley reforms that sought to strengthen the hand of independent directors vis-à-vis corporate management.").

227. Margarett M. Blair & Lynn Stout, *A Team Production Theory of Corporation Law*, 85 VA L. REV. 247, 280-81 (1999).

228. Olubunmi Faleye, Rani Hoitash & Udi Hoitash, *The Trouble with Too Much Board Oversight*, 54 MIT SLOAN MGMT. REV. 53, 54-55 (2013). In their view:

> [C]ompanies with [intense board oversight] 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. Moreover . . . company value was lower when the board devoted greater time to oversight.

Id.

229. Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)* 13-25 (Univ. Oxford & ECGI, Working Paper No. 267/2014, 2015).

private benefits during such a transaction. This approach is not generally accepted, however, because it precludes efficient transactions that may benefit the company and contribute to the development of the capital market.[230]

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, all publicly listed European companies are required to annually disclose to the investing public full information about transactions involving directors, company management and controlling shareholders.[231] In Italy, listed companies are required to disclose to the investor public comprehensive information about transactions with all interested parties 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.[232] However, companies are required to report their share of profits and losses in subsidiaries.[233] The information that minority shareholders are entitled to receive regarding a company's subsidiaries is limited to the summary of the annual report on intra-group transactions.[234]

As far as approval mechanisms of such transactions are concerned, countries with a concentrated ownership structure differ as to the approval procedures required.[235] 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

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230. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 25, at 146-47 (2017).

231. INTERNATIONAL ACCOUNTING STANDARD no. 24, 13-24 (INTERNATIONAL FINANCIAL REPORTING STANDARDS); Transparency Directive 2004/109/EC, 2004 O.J. (L 390) 38.

232. *Id.* at 149

233. *Id.*

234. *Id.*

235. 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*, UNIV. OXFORD (Apr. 5, 2017), https://www.law.ox.ac.uk/research-subject-groups/commercial-law-centre/blog/2017/03/upcoming-european-regime-related-party.

controlling shareholder. The auditors are then required to examine the transaction and report on it to the board of directors; even then it is subject to approval of a majority of all shareholders with no personal interest in the proposed transaction. In Italy, the Commissione Nazionale per le Società e la Borsa introduced a new regulatory regime at the start of 2010 covering both ad hoc and periodic disclosure of related party transaction and general principles for procedural steps companies must comply with in order to ensure the entire fairness of a given transaction. The general principle is that any related party transaction has to be reviewed by a committee of independent directors. For a material related party transaction, a committee of independent directors must be involved in the negotiations about the transaction and must receive adequate information from executives for its members to express their views. The direct involvement of shareholders is, however, limited and constrained. Provided that bylaws allow for it, a material related party transaction which has been rejected by the committee of independent directors can be submitted to the approval of non-interested shareholders.[236] In Israel, following Anglo-American law, Amendment No. 16 to the Corporations Law stipulates that transactions with interested parties require the approval of the Audit Committee, the board of directors and a majority of the shareholders with no personal interest in the transaction.[237] In addition, Section 117 of the Corporations Law in Israel establishes another unique requirement that competitive processes must be conducted under the supervision of the Audit Committee, with the aim of strengthening the company's ability to engage in independent negotiations.[238]

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236. OECD, RELATED PARTY TRANSACTIONS AND MINORITY SHAREHOLDER RIGHTS 115-16 (2012), http://bit.ly/2EaLc9U.

237. The Companies Law (Amendment No. 16), 5771/2011, 2281, 390. It should be noted that prior to Amendment 16, a third 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 et al., *Empowering Minority Shareholders and Executive Compensation: Evidence from a Natural Experiment* (Bionat'l Sci. Found., Working Paper No. 2012/071, 2016), 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).

238. For a detailed overview, see Gonen, *supra* note 152, at 54-57. Amendment No. 22 to the Companies Law, which was included in the Concentration Law, added two new powers to the powers of the Audit Committee set out in section 117 of the Companies 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 Companies 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, the Audit Committee is required to determine, in

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".[239] 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.[240] 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 France and Italy is to examine whether the transaction in question meets the standard of fairness.[241]

In Israel, the emerging trend is to emulate the entire fairness requirement under American law[242]—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. This position was recently discussed in Israel's Supreme Court in *Vardnikov v. Alovitz*[243]—which decided whether the directors of the Bezeq corporation had violated their duties of trust and due care by approving a series

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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.

239. For a description of the law in the United States, see Goshen, *supra* note 157, 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).

240. 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 argue 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. They propose protecting this vision under a property rule. Goshen and Hamdani, *supra* note 31, at 610-11. 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.

Goshen & Hamdani, *supra* note 31, at 610-11.

241. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW, *supra* note 25, at 157-58.

242. Goshen, *supra* note 157, at 426-29.

243. CA 7735/14 Vardnikov v. Alovitz (December 28, 2016), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

of dividend distributions, capital reductions and debt raisings to help a controlling shareholder repay loans that he had taken out 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."[244]

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 shareholders, or approved ex post by the courts. I believe that the model of Relative Corporate Governance Regimes 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 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

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244. 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* (Eur. Corp. Governance Inst., Working Paper No. 382, 2018) (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). 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. 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 [satisfied] due process by [receiving review from] 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." *See* CA 40404/03/16 Atzmon v. Osem Investments Ltd. paras. 28-29 January 26, 2018), Nevo Legal Database (by subscription, in Hebrew) (Isr.).

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.[245]

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 independent directors.[246] 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 proposed 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.[247] 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 interested parties.

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245. HADAS AHARONI BARAK, TRANSACTIONS WITH A CONTROLLING SHAREHOLDER: PUBLIC ENFORCEMENT, CONCENTRATION OF CONTROL AND THE PROTECTION OF THE MINORITY SHAREHOLDERS 243-52 (2014).

246. Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1278-84 (2017) (arguing that to induce independent directors to perform their oversight role, some independent directors should be accountable to public investors).

247. 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, based on 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 & Sharon Hannes, *Entire Fairness: Further Examination of Judicial Review of Transactions in Conflict of Interest*, 47 MISHPATIM 761, 813 (2018).

2. *Going-Private Transactions*

Occasionally, the controlling shareholder may decide to acquire all the share capital of company and cancel it from trading. This may be prompted by the belief that the share price of the company does not reflect its true value,[248] or because of the high costs involved in complying with the securities laws,[249] 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.[250]

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 shareholders—for two main reasons. One is that the controlling shareholder clearly has a conflict of interests with the remaining shareholders, since he wishes the purchase price to be as low as possible, while the public investor 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.[251]

Because of this concern, the SEC in the United States requires special and extensive disclosure requirements with respect to going-private transactions, and subjects them to greater scrutiny.[252] 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.[253] Prior to the case law in *Kahn v. M&F Worldwide Corp*, the accepted position in the Delaware courts' rulings was that such transactions are subject to retroactive judicial review based on the "entire

248. *See* Joshua M. Koening, *A Brief Roadmap to Going Private*, COLUM. BUS. L. REV. 505, 509 (2004).

249. Ehud Kamar et al., *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis,* 25 J.L. ECON. & ORG. 107, 107-12 (2009) (arguing that enactment of the Sarbanes-Oxley Act has increased the costs and risks of going public, and positively affected Going-Private decisions).

250. Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 611-14 (2016).

251. For a discussion of these considerations, see Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 30-34 (2005).

252. Rule 13E-3, 14 and Schedule 14A under the Securities Exchange Act of 1934.

253. 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 NW. J. INT'L L. & BUS. 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 VA. J. INT'L L. 841 (2010).

fairness" rule.[254] 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 transferring the burden of proof to the plaintiff.[255]

The Delaware Supreme Court in *M&F Worldwide Corp* (*MFW*) adopted a new standard of review for controlling-shareholder mergers. It held that business-judgment, not entire-fairness, review would be available upon dual approval (by both the company's independent directors and a majority of the company's minority shareholders). The Court adopted this new standard for several reasons. First, the strict entire fairness review standard should not be necessary if the controlling shareholder withdraws control by irrevocably requiring director and shareholder approval. Second, requiring dual-approval mergers by affording them business-judgment review should "optimally protect the minority stockholders in controller buyouts." Third, business-judgment review of dual-approved mergers is compatible with Delaware's attitude of deferring to informed and independent business decisions. Fourth, both entire-fairness review and the dual-protection merger structure have the same goal: promoting a fair price to the minority shareholders.[256]

Recently, in the case of *MFW*, it was ruled that in such transactions, the business judgment standard of review 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.[257] Recently,

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254. Kahn v. M&F Worldwide Corp, 88 A.3d 635, 641 (Del. 2014); *In re* MFW S'holders Litig., 67 A.3d 496, 500 (Del. Ch. 2013).

255. Kahn v. Lynch Comm. Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994); 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 the level of judicial 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, 208-14 (2015); Guhan Subramanian & Fernan Restrepo, *Freezeouts: Doctrine & Perspectives*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 285, 296-97 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

256. *MFW*, 88 A.3d. at 644-45.

257. *Id.* Recently, Fernan 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, "[t]he results therefore suggest that deferential judicial review is an efficient way to incentivize procedural safeguards in freezeout transactions and that the

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.[258]

Thus, the ruling in the United States considered whether to protect the rights of minority shareholders through a property rule or by a liability rule. Specifically, a property rule provides that following the implementation of specific preliminary mechanisms which focus on disclosure and special procedures required for approving given transaction with controlling shareholders, the business judgment standard of judicial review shall apply and the court will not consider whether terms of a given deal are fair. In contrast, a liability rule suggests that even if the company's institutions have examined and approved the transaction with the controlling shareholder properly and adequately, it does not necessarily protect the company from judicial intervention in its decisions. Under the Relative Corporate Governance Regimes model, the choice between a property and liability rule would be determined based on minority shareholders' relative power. As explained in details above, when the controlling shareholder holds less than 50% of the company's equity, 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 terms of the deal are fair to the company and its minority shareholders. However, when the controlling shareholder holds more than 50% of the company, a more rigorous judicial review should be required for a substantive assessment of the fairness of the transaction.

In addition, the ruling of *In re MFW Shareholders Litigation* cites the sharp rise in institutional investor holdings in publicly traded corporations and their ability to block bid 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 rule that requires going-private transactions be subject to a vote by the minority shareholders.[259] 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.[260] These arguments are consistent with the guidelines of the Relative Corporate Governance Regimes model discussed in this article.

increase in shareholder approval conditions did not come at the cost of higher frustration rates." Fernan Restrepo, *Judicial Deference, Procedural Protection, and Deal Outcomes in Freezeout Transactions: Evidence from the Effect of MFW* 1 (Mar. 5, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3105169.

258. IRA Trust FBO Bobbie Ahmed v. Crane, No. 12742-CB, 2017 WL 7053964, at *6 (Del. Ch. Dec. 11, 2017).

259. *In re* MFW S'holders Litig., 67 A.3d at 530.

260. *Id.* at 533.

Furthermore, a recent empirical study by Lauterbach and Mugerman affirms the court's conclusions from *In re MFW Shareholders Litigation*.[261] The study documents several major findings. First, freeze-out offers are rejected more frequently when institutional investors hold the firm. Second, in accepted offers, the offer premium is higher when institutional investors hold the firm and where there appear to be pre-negotiations between controlling and public shareholders. Interestingly, in both these findings the effect is due to the mere presence of institutional investors. Second, the exact level of institutional holdings and the concentration of their holdings have insignificant coefficients and negligible economic effects. The presence of an institutional investor constraints controlling shareholders and forces them to be more considerate of the public or else offer will fail. Third, the researchers found that sometimes institutional investors reject fair freezeout offers and hurt other public shareholders of these stocks just because they want to demonstrate their power in their continuous contest with controlling shareholders. Nevertheless, such actions are rational and be profitable only in the long-term and thus may also serve the interests of retail investors.[262]

The study also found 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 assert that, among other reasons, institutional investors may use their power to secure a fair price for the benefit of minority shareholders to avoid appearing weak in the eyes of the controlling shareholder.[263]

This study has policy implications for our purposes. With regard to large corporations where institutional investors have significant holdings, the

261. Beni Lauterbach & Yevgeny Mugerman, *Institutional Investors' Impact on the Terms and Outcome of Freeze-out Tender Offers* (2018), https://ecgi.global/sites/default/files/working_papers/documents/finallauterbachmugerman1.pdf.

262. *Id.* at 33-34.

263. *Id.* at 25. On the other hand, it is important to mention Hamdani and Yafehs study, that found that institutional investors in Israel support most (78%) proposed transactions with controlling shareholders. The only instance when institutional investors are relatively resistant to proposed transaction with controlling shareholders is with regard to approving remuneration of controlling shareholders and their associates. *See* Assaf Hamdani & Yishay Yafeh, *Institutional Investors as Minority Shareholders*, 17 REV. FIN. 691, 704-05 (2013). However, Hamandi and Yafeh's study shows that these wage arrangements are approved nonetheless, despite the institutional 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 twenty largest groups in the economy tend to support interest-rate transactions at a higher rate than independent institutional investors. *See id.* at 704. However, it should be emphasized that Hamdani and Yafeh's research relates to voting patterns prior to Amendment 16 to the Companies Law. *See e.g.*, Jesse Fried et al., *supra* note 237 (finding that Amendment No. 16 led to a significant reduction in the compensation paid to controlling shareholders by public companies).

conditions set out in *MFW* 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 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 Relative Corporate Governance Regimes 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 law is of paramount importance.[264] The legislature and the courts must ensure certainty both with regard to the factual background that the law seeks to regulate, and with regard to the substance of the law itself.[265] 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

264. 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.").

265. For more details on the uncertainties involved in regulating and shaping the law, see Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559-60 (1992); Adam I. Muchmore, *Uncertainty, Complexity, and Regulatory Design*, 53 HOUS. L. REV. 1321, 1337-51 (2016). 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, 807-10 (2010).

the law itself bears unavoidable features of uncertainty and clarity.[266] 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 Regimes actually facilitate the certainty that the law seeks to realize.[267] 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.[268] Flexibility in corporate governance systems of publicly traded corporations has been found to help improve their competitiveness.[269]

2. *Reducing the Protection of Minority Shareholders*

According to this argument, the Relative Corporate Governance Regime model reduces the protection afforded to minority shareholders under existing law and may allow controlling shareholders to increase their concentration in the domestic capital market. In this context, it may be argued that in companies where there is no broad protection of the rights of minority shareholders, those minority shareholders may choose to exit over speaking out in favor of improved corporate governance. In other words, investors may divert their investments from companies which provide a weak protection to minority rights toward corporations that offer stronger protection of their 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 shareholder rights, which may harm the company and the ability of the controlling shareholder to realize business plans that may benefit all 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 Regimes model may motivate the controlling shareholder to act in accordance with the company's long term

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266. *See* Shawn J. Bayern, *Against Certainty*, 41 HOFSTRA L. REV. 53, 61-62 (2012).

267. Diane Lourdes Dick, *Confronting the Certainty Imperative in Corporate Finance Jurisprudence*, 2011 UTAH L. REV. 1461, 1482-84 (2011) (criticizing the courts' preference towards inflexible rules in regulating financial markets).

268. Sridhar Arcot & Valentina Bruno, One Size Does Not Fit All, After All: Evidence from Corporate Governance 1 (Jan. 15, 2007) (unpublished manuscript) (available at 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).

269. Arunima Haldar et al., *Can Flexibility in Corporate Governance Enhance International Competitiveness? Evidence from Knowledge-Based Industries in India,* 17 GLOB. J. FLEXIBLE SYS. MGMT. 389, 392 (2016).

interests.[270] This is not to say that the phenomenon of controlling shareholders 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 task of policymakers is to protect minority shareholders, but not under circumstances in which empowering those shareholders may deter controlling shareholders from binding their activities with the long-term interest of the company. Therefore, policymakers and jurists must establish rules that accurately reflect the true power relations within each company, in light of the distinctive attributes of the local market.

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 change 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 it to a trustee.[271] Furthermore, it should be noted that the deregulation proposed under the Relative Corporate Governance Regimes model already exists with regard to the regulation of securities in the United States. For example, After the 2010 financial crisis, President Obama signed the Jumpstart Our Business Startups Act (JOBS Act) into law in 2012 as one approach of encouraging the economy. The JOBS Act deregulated securities laws for small businesses to create jobs and spur the economy. These changes allow small businesses more access to capital by reducing reporting

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270. VINCENZO BAVOSO, EXPLAINING FINANCIAL SCANDALS: CORPORATE GOVERNANCE, STRUCTURED FINANCE AND THE ENLIGHTENED SOVEREIGN CONTROL PARADIGM 32 (2012) Bavoso explains:

> The assumption traditionally associating concentrated corporate ownership with "bad law" and unsophisticated corporate governance could in light of the above be revised . . . 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.

Id.

271. REINIER KRAAKMAN ET AL., *supra* note 25, at 136-44.

requirements for certain entities and increasing access to shareholders.[272] These laws recognize that indiscriminate regulation that is not tailored to the size of the company is likely to cause a decline in 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. I believe that 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.[273]

CONCLUSION

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. In this article, I have discussed various findings that show that both the Anglo-American and Continental legal systems have witnessed a decline in their respective traditional ownership structures over 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 Kraakman and Hansman's famous claim 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.[274] Given that all legal systems have certain features in common, policymakers must work to shape the law that

272. Benjamin P. Siegel, *Note, Title III of the Jobs Act: Using Unsophisticated Wealth to Crowdfund Small Business Capital or Fraudsters' Bank Accounts?,* 41 HOFSTRA L. REV. 777, 779 (2013) (explaining the objective of the JOBS Act as rescuing the economy, creating jobs, and improving business funding); Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising,* 98 CORNELL L. REV. 1573, 1574 (2013) (noting that the JOBS Act's goal is job creation).

273. *See* JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION 168-73 (2016); Knight Thaya Brook, *A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis*, CATO INST. (May 3, 2016), https://www.cato.org/publications/policy-analysis/walk-through-jobs-act-2012-deregulation-wake-financial-crisis.

274. Reinier Kraakman & Henry Hansman, *The End of History for Corporate Law*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 48-49 (Jeffrey N. Gordon, Mark Roe eds., 2004). Kraakman and Hansman write:

> [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.

Id. See also Jeffrey N. Gordon, *Convergence and Persistence in Corporate Law and Governance*, *in* OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 28 (Jeffrey N. Gordon & Georg Ringe eds., 2018).

strikes the right balance between various interests. 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 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 provided for 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 to the special characteristics of each company and the market in question may allow the formation of 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 interest of all shareholders.