David's Dilemma: A Case Study of Securities Regulation in a Small Open Market

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This article tells the story of an Israeli regulatory program aimed at luring back home Israeli companies listed only on U.S. stock markets, to facilitate dual listing of their stocks on the Tel Aviv Stock Exchange. Beyond documenting a piece of Israeli political economy, this article provides several lessons of general relevance to small or emerging markets as well as to large ones. In this story, the regulator of the small market finds itself a regulatory price-taker. In a mirror image, the U.S. market emerges as a global regulatory price-setter. This regulatory externality, or regulatory arbitrage, is disturbing because the standard with which Israeli regulation had to align is the watered-down version for non-U.S. issuers. Indeed, any effort to require an iota of additional disclosure beyond the American foreign issuer regime has failed due to vehement objections from the Tel Aviv Stock Exchange and business interest groups. The role of the stock exchange as regulator and the interplay between corporate law and securities regulation are also discussed in this context. This article thus casts some doubt on the desirability of piggybacking on foreign markets. Sometimes, it turns out, piggybacking can be a ride to the bottom.

> "How is it that a closely held high tech start up with its operations in a dusty industrial park in Northern Israel, and with customers and marketing facilities scattered around the world, can tap the U.S. capital markets?"[1]

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1 Edward B. Rock, Securities Regulation as Lobster Trap: A Credible Commitment

INTRODUCTION

This article tells the story of an Israeli regulatory program designed to lure back home Israeli companies listed only on U.S. stock markets by facilitating dual listing of their stocks on the Tel Aviv Stock Exchange ("TASE"). It is the story of a David market up against a Goliath market. As in the Biblical story, David's dilemma is whether to challenge Goliath or yield to the giant. Unlike the Biblical story, however, the modern David does not end up with the upper hand but, rather, learns he must come to terms with Goliath. To add insult to injury, the modern Goliath does not seem to care much about David's dilemma.

It is common knowledge that international equity markets are currently undergoing an unprecedented process of globalization. A prominent manifestation of this trend is the growing number of listings of stocks on markets outside the issuer's home country.[2] With this development, there has been a corresponding growth in academic interest in foreign listings. Some scholars have begun to consider the idea that companies might want to list their stocks on a foreign market with a view to improving their corporate governance and thereby increase shareholder value. In doing so, such issuers would be metaphorically piggybacking on the host country's legal infrastructure.[3]

As the biggest piggybacker of them all, Israel stands out as a case warranting special consideration. Israel is the second largest supplier of foreign stocks to U.S. markets, in complete disproportion to the size of its economy. Unlike Canada, which ranks first on the list, but like most other countries, no special international arrangement governs listings by Israeli firms on U.S. markets.[4] That is to say, Israeli issuers that wish to list their

Theory of Mandatory Disclosure (Univ. of Pa. Law Sch. Working Paper No. 1, 1999).

2 By "home country" I mean primarily the country of incorporation. One should bear in mind, however, that the issue of corporate nationality is more complex than this definition would imply. A more recent facet of the globalization trend that is related to foreign listing is the movement of entire stock markets across national borders. *See* Amir N. Licht, *Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation*, 41 Va. J. Int'l L. 583 (2001).

3 This, *inter alia*, is the thrust of Ed Rock's paper, *supra* note 1, cited in the epigraph. For extensive use of the piggybacking metaphor, see Bernard S. Black, *The Legal and Industrial Preconditions for Strong Stock Markets*, 48 UCLA L. Rev. 781 (2000).

4 Canadian issuers enjoy considerable exemptions from U.S. securities law requirements under the Multijurisdictional Disclosure System ("MJDS"). SEC,

stocks in the United States must comply with the general provisions of the securities acts and rules thereunder.

In July 2000, the Israeli legislature (the *Knesset*) enacted a pioneering unilateral recognition arrangement that allows issuers who comply with the reporting requirements under certain foreign laws to list their stocks in Israel as well. This project ("the dual listing project"), the focus of this article, is part of a massive reform that Israeli company law and securities law have been undergoing since 1999. The reform initiatives have included the enactment of a completely new, general Companies Law from scratch in 1999.

The dual listing project has had a shockwave effect on Israeli corporate law and securities law. While some of the lessons it has yielded may be relevant mainly for students of Israeli law and corporate governance, other lessons seem to have universal application. First, the Israeli project indicates the limits of regulatory leeway with respect to prescribing a securities regulation regime that deviates from that of the large securities markets. In the Israeli story, the regulator of the small market ends up a regulatory price-taker, much like a country with a small open economy in the global market. The role of the stock exchange as regulator and the interplay between corporate law and securities regulation have a significant role in the design of the desirable regime.

Second, by demonstrating the existence of regulatory externalities, the Israeli dual listing project also is instructive with regard to large securities markets. With the Israeli market as price-taker, the U.S. market emerges as a global regulatory price-setter. This regulatory externality, or regulatory arbitrage, is especially disturbing because the American regulatory standard is bifurcated. The standard with which the Israeli regulation has had to align is not the U.S. regulatory standard for American issuers, but, rather, the watered-down version for non-U.S. issuers.

Finally, the Israeli project provides direct evidence with regard to the on-going debate over the reasons that lead companies to list abroad and their choice of particular foreign markets. While it is a well-established fact that foreign listings are usually motivated by financial and business considerations to the benefit of shareholders, the part played by managerial opportunism, broadly defined, is yet unclear in this context. This article contributes to the existing literature by presenting evidence

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Multijurisdictional Disclosure and Modification to the Current Registration and Reporting System for Canadian Issuers, Release No. 33-6902, 49 SEC Doc. (CCH) 260 (June 21, 1991) (adopting MJDS).

that managerial opportunism can be a significant factor in international securities transactions. Sometimes, it turns out, piggybacking can be a ride to the bottom.

Part I of the article briefly reviews the common wisdom about piggybacking and considers it in the broader context of the foreign listing decision. Part II gives an account of the dual listing project after providing background on the Israeli corporate governance system. Part III draws on the Israeli experience to advance theories with regard to regulatory policy in small and large markets, the role of the stock exchange as securities regulator, and the interplay between securities regulation and corporate law.

I. THE COMMON WISDOM ABOUT PIGGYBACKING

A. Why Piggyback?

"Piggybacking is good for you." This is the message that emerges almost uniformly in recent scholarly writings on corporate governance. The starting point for understanding the rationale for piggybacking is the observation that considerable diversity exists among countries in the protection they afford to public shareholder rights.[5] This type of protection can derive specifically from legal rules, either statutory or judge-made; it can also derive from social or market institutions. The latter category of institutions encompasses all the non-legal protections, including shareholding structures and social norms, which are gaining growing attention.[6] These institutions together form what is known as "corporate governance systems."

Consider now a company incorporated in a country whose corporate governance system does not particularly excel at protecting minority or public shareholder rights. It can easily be assumed that publicly held shares would trade at some discount, reflecting the higher likelihood of such shareholders being harmed by insiders or controllers of the given company. The rationale for piggybacking is, thus, equally clear: by listing its shares

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5 *See, e.g.*, Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. Fin. 1131 (1997) (documenting the aforementioned diversity); Rafael La Porta et al., *Law and Finance*, 106 J. Pol. Econ. 1113 (1998) (same).

6 *See, e.g.*, Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 Colum. L. Rev. 1253 (1999); Symposium, *Norms and Corporate Law*, 149 U. Pa. L. Rev. (forthcoming 2001).

on a market with better shareholder protection, a foreign issuer would be able to increase the value of its public shares.[7]

Foreign listing may have this desired positive effect on share value because it subjects the issuer and its shares to a complex legal regime comprised of various elements of the home country's law (usually the country of incorporation), the securities laws of all the countries in which the company is listed, and the listing rules of all the markets on which it is listed.[8] The foreign securities laws and listing rules form additional layers of rules on top of the original core of the home-country company law. While company law has personal application—that is, it applies to a company's internal affairs no matter what its place of business—securities law typically has territorial application.[9]

Although countries can claim extraterritorial application of their laws,[10] for over a decade now, the SEC has preferred cooperative regulatory measures to unilateral assertion of extraterritorial authority,[11] and unmitigated

7 *See* John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 Nw. U. L. Rev. 641, 674 (1999).

8 For a detailed analysis of such complex legal regimes, see Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 Va. J. Int'l L. 563, 617-21 (1998).

9 Under traditional legal conventions, company law falls into the realm of private law, whereas securities law is classified as public law, and these laws tend to have, respectively, personal application and territorial application. For further analysis, see Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 Cardozo L. Rev. 227 (1998).

10 *See* Restatement (Third) of the Foreign Relations Law of the United States § 402 (1997); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1337 (2d Cir. 1972); Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968). For further discussion, see James D. Cox et al., Securities Regulation: Cases and Materials at ch. 18 (4th ed. 1991); Michael D. Mann et al., *Oversight by the U.S. Securities and Exchange Commission of U.S. Markets and Issues of Internationalization and Extraterritorial Jurisdiction*, 29 Int'l Law. 731 (1995).

11 Regulation of International Securities Markets—Policy Statement of the U.S. Securities and Exchange Commission, Securities Act Release No. 33,6807, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,341, at ¶ 89,576 (Nov. 14, 1988). *See also* Paul G. Mahoney, *Securities Regulation by Enforcement: An International Perspective*, 7 Yale J. Reg. 305, 310-20 (1990). The SEC's position reflects a diametrical shift from its previous regulatory policy, which championed unilateralism and non-compromising extraterritorial application of American law. The SEC, however, has found this policy increasingly difficult and politically costly to implement in the face of foreign regulators' objections. *See* Michael D. Mann et al., *Developments in International Securities Law Enforcement and Regulation*, 29 Int'l Law. 729, 730 (1995).

extraterritoriality has come under growing criticism.[12] In the present context, the legal situation with regard to extraterritoriality does not change the fundamental effect of the complex legal regime that governs foreign-listing companies. To illustrate, suppose that disclosure of a particular item of information is mandated only under the rules applying to one of the markets on which a company is listed. This single requirement is sufficient to make the disclosed information quickly available in all the markets on which the company's shares trade. In addition, arbitrage transactions help spread the price effect of that information throughout those markets.[13]

Another consideration is corporate governance. A major component of the rationale for securities regulation—some say the sole rationale—is to improve corporate governance in publicly traded companies.[14] John Coffee notes several arrangements under U.S. securities laws that extend beyond supplying investors with information in the primary and secondary securities markets and also have direct—and, arguably, positive—effect on corporate governance in publicly traded companies.[15] The crucial point is that all of

12 *See, e.g.*, Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 Nw. J. Int'l L. & Bus. 207 (1996); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 Yale L.J. 2359 (1998); Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 Mich. L. Rev. 2498 (1997); Merritt B. Fox, *Insider Trading in a Globalizing Market: Who Should Regulate What?*, 55 Law & Contemp. Probs. 263 (1992).

13 *See* Licht, *supra* note 8, at 627-33.

14 *See, e.g.*, Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 Colum. L. Rev. 1335 (1996) (securities regulation affects corporate governance); Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. Chi. L. Rev. 1047 (1995) (the agency problem (i.e., corporate governance) was the reason behind the enactment in 1933 of the U.S. Securities Act).

15 According to Coffee, these measures "seek in effect to impose substantive obligations on managers and controlling persons, essentially in order to minimize agency costs." Coffee, *supra* note 7, at 684. The following list follows and draws on Coffee's list, which, in turn, draws on Edward F. Greene et al., U.S. Regulation of the International Securities and Derivatives Markets (4th ed. 1998). (1) Shareholding Block Disclosure: Section 13(d) of the 1934 Exchange Act, 15 U.S.C. § 78m(d) (2001), requires beneficial owners of more than 5% of any class of equity security registered pursuant to section 12 of the Exchange Act to file a report about the exact shareholding structure of the issuer and, in particular, about looming control blocks. (2) Tender Offers: Section 14(d) of the Exchange Act, *id.* § 78n(d) (also known as the "Williams Act") provides that if any person makes a tender or exchange offer for more than 5% of any class of equity securities of a target that is registered under section 12 of the Exchange Act, that offer must comply with elaborate disclosure and procedural requirements. (3) Going Private Rules: SEC rules under

these provisions apply equally to U.S. issuers and non-U.S. issuers alike whose shares are publicly traded on U.S. markets and over three-hundred shareholders of record.[16]

The beauty of the piggybacking strategy lies in the fact that it seems to be relatively easy for an issuer to place itself under a superior foreign regulatory system simply by listing its shares on a foreign market. Ed Rock compares the U.S. foreign securities regulation system to a lobster trap in that it is very easy to get in, but very difficult to get out.[17] As a result, securities regulation enables issuers to make a credible commitment to investors—globally, it is important to bear in mind—to adhere to high standards of disclosure and corporate governance.[18] On closer examination, however, there are considerable difficulties in adopting such a strategy, both for individual issuers and for countries. Bernard Black recently suggested a thought-exercise in which he assessed the ease of piggybacking on foreign securities market institutions. His conclusions, with which I agree, are fairly gloomy. First, the institutions necessary for effective securities regulation are not easily transplantable. The primary problem, according to Black, is local enforcement and local culture in the receiving country, for even world-class laws need to be understood by those subject to them and enforced by state institutions. Second, while an individual company can "borrow" a reasonable

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section 13(e) of the Exchange Act, *id.* § 78m(e), in effect impose a substantial duty of fairness—the hallmark of state corporate law on transactions with interested parties—in going-private transactions. This is achieved by requiring disclosure of the factors upon which the issuer bases its belief that the transaction is fair to unaffiliated security holders. (4) Stock Market Listing Requirements: The national stock markets in the U.S. have found it necessary to supplant federal and state laws with additional requirements, intended to improve corporate governance in their listed companies. These requirements usually apply to foreign issuers as well and thus enhance their own corporate law regime. (5) Extraterritorial Antifraud Regulation: Under American jurisprudence, a foreign issuer listed on a U.S. exchange must realistically assume that it can be sued in the United States for any allegedly false statements made anywhere in the world. *See supra* note 10.

16 For the most part, these issuers would have securities registered with the SEC under section 12 of the 1933 Securities Act, 15 U.S.C. § 77l (1994). Below the 300-threshold, foreign issuers enjoy broad exemptions from the disclosure duties under the securities acts pursuant to Rule 12g3-2(b) of the Securities Exchange Act of 1934, 17 C.F.R. § 240.12g3-2 (1998).

17 Rock, *supra* note 1.

18 *See* Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function 26 (Columbia Law Sch. Ctr. for Law & Econ. Studies Working Paper No. 174 & Stanford Law Sch. John M. Olin Program in Law & Econ. Working Paper No. 192, May 2000).

number of institutions from the foreign country it is listed in, it is much harder for an entire country, and, thus, all its smaller firms, to piggyback on foreign institutions.[19]

B. Why List on a Foreign Exchange (and Where)?

"To piggyback or not to piggyback" is *not* the question an issuer contends with when contemplating listing on a foreign exchange. Indeed, a wide range of factors motivate a foreign listing decision, many of which in some way relate to increasing shareholder value. But the question of why list on a foreign exchange does not encapsulate the entire matter. Listing on a foreign exchange also entails preferring certain foreign markets and rejecting others. There is ample reason to believe that in addition to value-enhancement considerations, managerial opportunism also influences both the "whether" and "where" decisions involved in a foreign listing. This is the darker side of foreign-listing decisions. Below, I review briefly the commonly cited motives behind foreign listing and suggest possible motives relating to managerial opportunism.[20]

1. Equity Cost Motives

By diversifying their portfolios, investors can lower the risk, or variability, of the portfolios. International investment takes diversification one step further by allowing investors to diversify away even country-related systematic risk.[21] International investment also can enable investors to benefit from segmentation gains.[22] The corporate motive underlying a foreign listing is the mirror image of investors' motives with regard to international investment. If

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19 Black, *supra* note 3.

20 For a fuller discussion, see Amir N. Licht, *Genie in a Bottle? Assessing Managerial Opportunism in* International Securities Transactions, 2000 Colum. Bus. L. Rev. 51.

21 Alan Alford, *Assessing Capital Market Segmentation: A Review of the Literature, in* International Financial Market Integration 3 (Stanley R. Stansell ed., 1993). For a review, see Alasdair Lonie et al., *The Putative Benefits of International Portfolio Diversification: A Review of the Literature*, 15 Brit. Rev. Econ. Issue 1 (1993); Vihang Errunza et al., *Can the Gains from International Diversification Be Achieved without Trading Abroad?*, 54 J. Fin. 2075 (1999).

22 An often-quoted definition of segmentation is based on the condition where "two assets which belong to different countries but have the same risk with respect to some model of international asset pricing without barriers to international investment have different expected returns." Rene Stulz, *A Model of International Asset Pricing*, 9 J. Fin. Econ. 383, 383 (1981). In simple terms, segmentation gains can be obtained when investors have a special taste for foreign stocks due to their being foreign.

investors reveal a preference for foreign shares, then companies will provide the product. From a corporation's point of view, higher equity prices mean a lower cost of capital.

2. Other Financial Motives

By listing its shares on a foreign exchange, a firm can expand its potential investor base more easily than if it were to trade on only the domestic market. Studies have shown that multiple listing allows expected returns to increase for given levels of systematic risk, firm-specific risk, and relative market value and to decrease with the relative size of the firm's investor base.[23] By increasing stock liquidity, multiple listings can further augment share value by increasing stock liquidity.[24]

3. Marketing Motives

Foreign listing can contribute to corporate marketing efforts by broadening product identification among investors and consumers in the host country.[25] Similarly, listing on a foreign exchange may serve as a signal to the market about the firm's future prospects and its intentions to become a major player in international markets.[26]

4. Employee Motives

As already noted, listing on a foreign exchange signifies a firm's long-term commitment to the host market. Consequently, top managers and quality professionals in that market are attracted to such a firm. In addition, sometimes listing its shares on a foreign market is required to ensure

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23 Robert Merton, *Presidential Address: A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 J. Fin. 743 (1987). *See* Stephen R. Foerster & G. Andrew Karolyi, The Effects of Market Segmentation and Illiquidity on Asset Prices: Evidence from Foreign Stocks Listing in the US (Charles A. Dice Ctr. for Research in Fin. Econ. Working Paper No. 96-6, Feb. 1996).

24 *See* Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread*, 17 J. Fin. Econ. 223 (1986); Yakov Amihud & Haim Mendelson, *Liquidity and Asset Prices: Financial Management Implications*, 17 Fin. Mgmt. 5 (1988).

25 *See* Kent H. Baker, *Why U.S. Companies List on the London, Frankfurt, and Tokyo Stock Exchanges*, 6 J. Int'l Sec. Markets 219, 221 (1992); H. Kent Baker et al., International Cross-Listing and Visibility (NYSE Working Paper No. 99-01, Jan. 1999), *available at* http://papers.ssrn.com/paper.taf?ABSTRACT_ID=142287.

26 *See* Usha R. Mittoo, *Managerial Perceptions of the Net Benefits of Foreign Listing: Canadian Evidence*, 4 J. Int'l Fin. Mgmt. & Acct. 40 (1992).

an accessible exit mechanism when an issuer institutes employee stock ownership plans ("ESOPs").[27]

5. Political Motives

Political considerations may also underlie a firm's decision to list its stock on a foreign stock exchange. A multinational company ("MNC") may be able to preempt at least some of the common xenophobic animosity in the foreign country by listing its shares on its national market. As host-country ownership of the company's stock grows, the boundary between "us" and "them" becomes blurred.[28] Moreover, the commitment to continuous disclosure embodied in the listing can alleviate concerns of local bureaucrats and the public with regard to the MNC's relations with the host country.[29]

6. Global Strategy Motives

Foreign listing also can be a strategic tool for companies seeking to globalize themselves in the fullest sense. Foreign listing by a giant MNC often is accompanied by an open statement of its motive to bring its shareholder base more in line with its completely global customer base.[30] It is also not uncommon for such issuers to be listed on several markets.

7. Managerial Opportunism

Corporations make decisions through agents. Like many other types of decisions, the foreign listing decision can put management or controlling parties (hereinafter both referred to as "management") in a conflict of interests and thus sub-optimal from an investor welfare perspective. To take a few well-known examples, managers would prefer to list on a market without a duty to disclose executive compensation with a personal breakdown; controlling shareholders would prefer to list on a market with lax disclosure and approval requirements regarding interested party transactions; and insiders in general might prefer to list on a market with a lenient anti-insider trading regime or weak enforcement. Some managers might find these propositions offensive, and to be sure, I am not suggesting that all managers are constantly engaged in devising schemes to derive

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27 *See* Mary Jo Dieckhaus, *Should You List on a Foreign Exchange?*, 74 Chief Executive (US) 44 (1992).

28 *Compare* Robert B. Reich, *Who is Us?*, 68 Harv. Bus. Rev. 53 (1990); *with* Robert B. Reich, *Who Is Them?*, 69 Harv. Bus. Rev. 77 (1991).

29 *See* Edward M. Graham & Paul R. Krugman, Foreign Direct Investment in the United States 152-54 (3d ed. 1995).

30 *See* Licht, *supra* note 20.

private benefits from the company.[31] However, a large body of empirical evidence on listing and cross-listing supports the assumption that managerial considerations of just the kind mentioned here are a significant factor in the decision to list on a foreign market and the choice of the destination market.[32]

II. THE ISRAELI DUAL LISTING PROJECT

Ed Rock's depiction of the Israeli start-up company "in a dusty industrial park in Northern Israel" might convey an air of oriental romanticism. In reality, however, Israel's high-tech industries tend to concentrate around big cities with strong academic institutions and in office buildings that, at least until the market downturn of late 2000, got glitzier with each additional IPO on the Nasdaq or sell-off to a giant like Lucent, Inc.[33] Indeed, the virtual proximity to the American way of doing high-tech business has been the driving force behind Israeli foreign listings and, consequently, the dual listing project. This Part surveys the development of the dual listing project up until late 2000. Sections B and C set the stage with background on the Israeli stock market and Israeli corporate governance. Section D then recounts the story of the dual listing project.[34]

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31 *See* Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 Colum. L. Rev. 1461, 1505, 1513 (1989) ("[Managers may] have internalized the rules of social morality and corporate stewardship.").

32 For a detailed discussion of the evidence, see Licht, *supra* note 20. *See also* Gary C. Biddle & Shahrokh M. Saudagaran, *Foreign Listing Location: A Study of MNCs and Stock Exchanges in Eight Countries*, 26 J. Int'l Bus. Stud. 319 (1995); Bhagwan Chowdhry & Vikram Nanda, *Multimarket Trading and Market Liquidity*, 4 Rev. Fin. Stud. 483 (1991); James A. Fanto & Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 Stan. J.L. Bus. & Fin. 51 (1997); Steven Huddart et al., *Disclosure Requirements and Stock Exchange Listing Choice in an International Context*, 26 J. Acct. & Econ. 237 (1999); Asjet S. Lamba & Walayet A. Khan, *Exchange Listings and Delistings: The Role of Insider Information and Insider Trading*, 22 J. Fin. Res. 131 (1999); Marco Pagano et al., *The Geography of Equity Listing: Why Do European Companies List Abroad?* (1999), *available at* http://www.papers.ssrn.com/paper.taf?abstract_id=209313; Gwendolyn P. Webb, *Evidence of Managerial Timing: The Case of Exchange Listings*, 22 J. Fin. Res. 247 (1999).

33 *See, e.g.*, William A. Orme, Jr., *The New Israel: Land of Milk and Money*, N.Y. Times, Apr. 16, 2000, at C1. For a fascinating survey of the strategies Israeli companies and entrepreneurs take in order to "look" American, see Edward B. Rock, *Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets*, 2 Theoretical Inquiries L. 711 (2001).

34 I had the opportunity to serve as consultant to the ISA during the later stages of the

A. The Markets

The Tel Aviv Stock Exchange ("TASE") is the only stock market in Israel and is considered small to medium in size relative to other stock markets. With 654 listed companies and market capitalization of $63,472 million by the end of 1999, it is comparable to the stock markets of Dublin, Lisbon, and Oslo.[35] However, the TASE dwarfs in comparison to the largest stock exchanges of the world, namely, the NYSE, Nasdaq, and the London Stock Exchange ("LSE") (see Table 1 below). The latter markets boast thousands of listed companies, hundreds of foreign listings, and market capitalization and turnover numbers in trillions of U.S. dollars.

Table 1. Stock Exchange Comparative Statistics, End-1999[36]

Stock Exchange	Listed Companies Domestic	Listed Companies Foreign	Traded Volume[a] Domestic (US$M)	Traded Volume[a] Foreign (US$M)	Market Capitalization (US$M)
NYSE	2,619	406	8,222,849	686,637	11,437,597
Nasdaq	4,400	429	10,114,053	349,148	5,204,620
LSE	1,826	448	2,106,252	883,458	2,855,351
TASE	653	1	87,079	0	63,472

a. Stock exchanges use different definitions and calculation methods to compile turnover statistics. Comparisons between certain stock exchanges therefore may not be valid.

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dual listing project and to the Israeli Ministry of Justice on certain aspects relating to foreign-listed Israeli companies. Some of the details in the text thus reflect personal impressions of the events.

35 At the end of 1999, the latter exchanges had a market capitalization of $68,777.2 million, $68,147.4 million, and $63,695.3 million, respectively. International Fed'n of Stock Exchanges, Statistics, tbl. 1.3B (2000).

36 International Fed'n of Stock Exchanges, 1999 Annual Statistics, tbls. 1.1, 1.3.B, 1.4 (2000).

Against this backdrop, it is not difficult to see why Israeli companies may seek to tap foreign markets, particularly the American one. In addition to the reasons mentioned in Part I, such as market presence and visibility, these markets constitute an endless source of depth and liquidity—and, hence, value. Start-up companies with American venture capital financing also will tend to make their IPOs in the U.S. Table 2 provides a breakdown of the 127 known Israeli foreign and dual listings by destination market as of June 2000.[37] This type of information is notoriously difficult to come by,[38] as there is no international organization that publishes such data. With 99 listed companies, out of which 88 are listed on a major national market and 16 are dually listed, the United States is the undisputed leader.

Table 2. Destination Markets of Israeli Foreign Issuers[a39]

Country/Region	Market	Foreign Listings[b]	Dual Listings
United States	NYSE	5	2
	Nasdaq[c]	83	16
	OTC	11	—
United Kingdom	LSE	8	4
European Union	Euro NM[d]	16	—
	Easdaq[e]	2	—

37 Israeli issuers list both stocks and American Depository Receipts ("ADRs").

38 The data in Table 2 were hand-collected by the TASE research department from various sources. Data about Israeli issuers listed in the U.S. are available on-line at http://www.analyst.co.il/anl/StockPoint. However, they include companies that are based in Israel but incorporated abroad, often in Delaware.

39 Data provided to author by the TASE Research Department, June 7, 2000 (on file with author).

Canada	CDNX[f]	2	—
Total		127	22

a. Table does not include companies active in Israel, but incorporated abroad.
b. Including dual listings.
c. Including former AMEX stocks.
d. Including Switzerland. The (now-disbanded) Euro NM consisted of several markets.
e. Now Nasdaq Europe.
f. Canadian Venture Exchange, formed in late 1999 with the merger of the Vancouver and Alberta exchanges.

Like other national markets in this era of globalization, the Israeli and American stock markets are interconnected. This interconnection is a multifaceted one.[40] At the most basic level, an increasing proportion of the stocks listed on the TASE are held by foreign investors; in May 2000, it was estimated that 10.7% were held by foreign investors, with 6% held by interested parties.[41] Foreign investors are significant traders on the TASE, as is evidenced by the drop in trading volume on the TASE on Sundays.[42] While there is no public information as to the nationalities of the foreign investors, it is common knowledge among market participants that most, including institutional investors, are American.

Israeli foreign-listed stocks deepen the interconnection or, in more technical terms, market integration. By March 1999, about 27% of the TASE's market capitalization was also traded, directly or indirectly, on American stock markets. Of this percentage, 17.1% were dually traded in Israel and the U.S. and 9.7% stemmed from holdings of TASE-listed companies in U.S.-listed Israeli issuers.[43]

40 On the different facets of the phrase "internationalization of securities markets," see Licht, *supra* note 20.

41 Bank of Israel, Current Data on the Capital Market, tbl. A-4 (May 2000) (Hebrew). "Interested party" is defined in the 1968 Israeli Securities Law as, roughly, a person having beneficial ownership of at least 5% of a company's registered shares, or the power to nominate a director or the CEO, or a person serving as either director or CEO.

42 Kobi Avramov, *Foreign Investors' Sunday Break Decreases Turnover on the TASE*, 211 Hahodesh Babursa [Stock Exchange Monthly] 3 (1999) (Hebrew).

43 Hagit Mika, *The Linkage between Stock Markets in the United States and Europe and the TASE—March 1999*, 213 Hahodesh Babursa [Stock Exchange Monthly] 9 (1999) (Hebrew).

The Israeli dual-listed stocks present the most interesting case of market integration. The well-known economic "law of one price" holds that two assets with identical payoffs in all states of the world should sell for the same price, barring transaction costs.[44] In the context of capital market integration, markets are said to be perfectly integrated if the law of one price holds across all of them.[45] Any departure from the law of one price may lead to arbitrage profits, generated by the buying of the underpriced security and the selling of the overpriced security. Indeed, a considerable number of empirical studies have found that no arbitrage opportunities exist with regard to multiple-listed stocks.[46] Another important phenomenon relating to dual-listed stocks is dominant and satellite markets, where dominance and following describe the process of price formation or discovery. This is the process by which new information gets impounded into current market price.[47] This phenomenon has been well-documented with regard to international stock markets.[48]

It should be noted that in such markets, cross-market arbitrage does not operate or, more precisely, is not fully effective in the very short-term. The pattern of information arrival to the markets is such that more information is revealed in the dominant markets, while the satellites contribute to price discovery only occasionally. Market participants stand ready to close this gap in a short time interval, but since information keeps on arriving in such an asymmetrical manner, the satellite markets are perpetually "chasing" the dominant one.

Israeli dual-listed stocks—coined "the arbitrage stocks"—have been studied particularly extensively in this regard, and the empirical evidence points to the Israeli market as the dominant one for dual-listed stocks. A recent, comprehensive study[49] finds full correlation of prices in the long-run and a lack of systematic arbitrage opportunities, indicating full market

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44 Kiyoshi Kato et al., *Are There Arbitrage Opportunities in the Market for American Depository Receipts?* 1 J. Int'l Fin. Markets, Institutions & Money 73 (1991).

45 Zhiwu Chen & Peter J. Knez, *Measurement of Market Integration and Arbitrage*, 8 Rev. Fin. Stud. 287, 288 (1995).

46 *See* Licht, *supra* note 8, tbl. IV.

47 For a theoretical model, see Bhagwan Chowdhry & Vikram Nanda, *Multimarket Trading and Market Liquidity*, 4 Rev. Fin. Stud. 483 (1991).

48 David Nuemark et al., *After-Hours Stock Prices and Post-Crash Hangovers*, 46 J. Fin. 159 (1991). Stock market dominance was first documented in the domestic U.S. market. *See* Kenneth D. Garbade & William L. Silber, *Dominant and Satellite Markets: A Study of Dually-Traded Securities*, 61 Rev. Econ. & Stat. 455 (1979). *See also* Joel Hasbrouck, *One Security, Many Markets: Determining the Contributions to Price Discovery*, 50 J. Fin. 1175 (1995).

49 *See* Olga Sulla & Moshe Ben-Horin, *International Capital Market Integration: The*

integration. The study further finds that for most dual-listed stocks, a price change in Israel precedes such a change in the U.S. Finally, returns on these stocks depend more on returns in the Israeli market than on those in the American one.

An earlier study found that the domestic Israeli market acts as the dominant market and the foreign U.S. market acts as the satellite.[50] Another study found that a significant causal connection exists between stock price behavior on the TASE and the stock price in the United States. However, price behavior in New York affects prices on the TASE too, albeit in a limited manner.[51] Notably, where shareholding is more evenly divided between Israel and the U.S., this effect is attenuated, leading the researchers to conclude that in such cases, the stock is more "international" in nature. Other studies support the proposition that the dominant market tends to be where the majority of the shareholders reside.[52]

It is important to note that the trading volume of the dual-listed Israeli stocks is not evenly split between the markets on which they are listed. Most of the trading in these stocks currently takes place on the TASE.[53] Studies further indicate that only a handful of such stocks suit the tastes of American institutional investors and are widely followed by market analysts. These stocks enjoy large trading volume, while most of the others have only medium or even low trading volumes.[54] The downturn of the American stock market during 2000-2001 also affected Israeli stocks and likely decreased their analyst following as well.

Case of Israeli Stocks Traded in the U.S., 46 Rivon Lekalkala [Econ. Q.] 313 (1999) (Hebrew).

50 *See* Uri Ben-Zion et al., A Characterization of Price Behavior of International Dual Stocks: An Error Correction Approach (Ctr. for Econ. Studies, Univ. of Munich Working Paper No. 104, 1996).

51 *See* Shmuel Hauser et al., *International Transfer of Pricing Information between Dually Listed Stocks*, 21 J. Fin. Res. 139 (1998) (price causality in dually listed stocks is unidirectional from the domestic market to the foreign market). *See also* Merav Arlozorov, *One Quarter of the TASE Value Directly or Indirectly Influenced by U.S. Market*, Israel's Business Arena Globes, Mar. 6, 1997 (Hebrew), *available at* http://www.globes.co.il (citing a TASE study that distinguishes between the dominant markets of various Israeli multiple-listed stocks).

52 *See, e.g.*, Kenneth A. Froot & Emil Dabora, How Are Stock Prices Affected by the Location of Trade? (Nat'l Bureau of Econ. Research Working Paper No. 6572, 1998).

53 *See* Hagit Mika, *Most of the Trading in Dual Stocks Takes Place on TASE*, 220 Hahodesh Babursa [Stock Exchange Monthly] 3 (2000) (Hebrew).

54 *See* Ronit Harel Ben-Zeev, *Activity in Israeli Stocks in the U.S. in 1998*, 210 Hahodesh Babursa [Stock Exchange Monthly] 3 (1999) (Hebrew).

B. Israeli Corporate Governance

This article does not seek to provide a concise overview of Israeli corporate governance. However, it is essential to understand some of the more prominent characteristics of the Israeli regime in order to fully grasp the context in which the dual listing project emerged. In the description that follows, I take the liberty of using broad statements or disregarding certain details, even though at the risk of over-generalizing in some aspects. The critical feature of the Israeli system is the discrepancy between the Anglo-American nature of the legal regime and the Euro-Asian type of shareholding structure.

1. Laws and Regulations

The three pillars of Israeli corporate governance law are: the recently legislated Companies Law, 1999; the 1968 Securities Law; and judicial rulings. All three reflect and promote relatively modern insights, logic, and purposes. All three are informed and strongly influenced by doctrines and concepts that prevail in the English and, to an increasing extent, American laws of corporations and securities regulation. To illustrate, an American lawyer can argue a case before an Israeli court quite effectively based entirely on legal principles she is familiar with from home.[55]

Israeli company law traces its roots back to the 1929 English Company Act, which was enacted, with minor amendments, in Palestine by the British Mandate ruler in 1929 as the Companies Ordinance, 1929. While a regular pastime among Israeli lawyers was to mock the Ordinance as awkward and archaic, it did succeed in providing an adequate basis for the regulation of corporate affairs in Israel for seventy years.

The Ordinance's primary virtue was that by and large, it allowed the courts to interpret or supplement it with modern principles of corporate governance. Thus, Israeli courts had no difficulty declaring in the 1950s that company officers owe a duty of care[56] and a duty of loyalty[57] to the company. A groundbreaking decision in the mid-1980s extended the duty of loyalty to controlling shareholders.[58] Courts also have never hesitated to lift the corporate veil whenever justified by the factual circumstances,

55 For a comparative review, see Zohar Goshen, *Controlling Corporate Agency Costs: A United States-Israeli Comparative View*, 6 Cardozo J. Int'l & Comp. L. 99 (1998).

56 C.A. 33/59, Rotlevi v. Barshai, 14 P.D. 1156.

57 C.A. 365/54, Mann v. Ayyoun, 11 P.D. 1612; C.A. 211/53, Shimshon v. Ayyoun, 10 P.D. 1767; C.A. 413/59, Shimshon v. Mann, 14 P.D. 981.

58 C.A. 817/79, Kossoy v. Y.L. Feuchtwanger Bank Ltd., 38(3) P.D. 253.

much in line with American jurisprudence. The Ordinance was occasionally amended—either to legislate existing judge-made law or to modernize Israeli corporate governance.[59] An example of the latter case is the 1988 amendment to the Ordinance that created a duty to nominate at least two independent directors and establish an audit committee in a publicly traded company.

The new 1999 Companies Law is a model exercise in writing corporate law from scratch.[60] The Law was enacted following many years of preparatory work conducted by Professor Uriel Procaccia and a committee headed by current Supreme Court Chief Justice Aharon Barak. Procaccia's report was heavily influenced by contemporary views in the law and economics literature and by American corporate law in general.[61] Guiding his efforts was the objective to devise an enabling framework with a view to facilitating efficient arrangements.

In certain cases, the Law adopts mechanisms that were advocated in the academic literature, but have not been enacted anywhere else in the world. A prominent example is the mechanism proposed by Lucian Bebchuk for regulating hostile takeover bids,[62] an amended version of which is included in the Law.[63] For the most part, however, the Law retains the general principles that were in place in the Israeli regime before the Law's enactment. This is

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59 The overly formalistic English prohibition on decreasing a company's capital was the main item reflecting outdated policy that survived until the Ordinance was repealed.

60 *Cf.* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 Harv. L. Rev. 911 (1996) (*revising* Bernard Black et al., *Corporate Law from Scratch*, *in* 2 Corporate Governance in Central Europe and Russia: Insiders and the State 245 (Roman Frydman et al. eds., 1996)). *But see* Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. 1731 (2000).

61 *See generally* Uriel Procaccia, *Address: Crafting a Corporate Code from Scratch*, 17 Cardozo L. Rev. 629 (1996).

62 *See* Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 Harv. L. Rev. 1695 (1985); Lucian A. Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. Legal Stud. 197 (1988).

63 The Companies Law stipulates that in a publicly held company in which there is no control block entitling its holder to 25% or more of the votes, any purchase of shares, the outcome of which would be an emergence of such a control block, must be effected through a "special tender offer." To be accepted, a special tender offer must be approved by a majority of the responding votes (excluding shareholders who are affiliated with the offeror). Offerees who do not respond to an approved special tender offer are entitled to accept the offer within a short period of time following the offer's approval. Companies Law, 1999, §§ 328-35, S.H. 245-46.

not to say that the new Law is without peculiarities.[64] But this does not detract from its compatibility as a legal framework with both U.S. and U.K. corporate law.

Israel's Securities Law and the regulations thereunder should be similarly familiar to an American lawyer in terms of the disclosure and anti-fraud regime they prescribe.[65] However, in several instances, the Securities Law goes well beyond the disclosure duties set out in the U.S. federal securities acts. For example, whereas in the U.S., the requirement to file an immediate report of any material event is mandated by the stock exchanges' listing rules, in Israel, this requirement is mandated by the Securities Law and enforced by the Israel Securities Association ("ISA").[66] Since 1991, the Securities Law also has contained a very effective provision against dual-class common stock,[67] something that in the U.S., there was great difficulty establishing.[68]

Finally, it is noteworthy that the Israeli Supreme Court has acknowledged the special value of American corporate and securities laws as sources for comparative analysis.[69] Moreover, in the area of securities regulation, the

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64 For instance, the Law establishes a shareholder duty of fairness. The content of this duty is ambiguous and is yet to be interpreted by the courts. Companies Law, 1999, § 192, S.H. 224. Even this duty, which is not recognized in Anglo-American corporate law, can be claimed to be no more than a declarative provision that repeats the general duty of good faith under Israeli law and thus no innovation at all. Another peculiarity is the incorporation of a pro-women affirmative action mechanism into the duty to nominate external directors. Section 239(d) of the Law, *id.*, requires a company with directors of only one gender (in other words, men) to nominate an external director of the other gender. For a critique, see Amir Licht, *On the Slippery Slope of Affirmative Action*, Globes, June 6, 2000 (Hebrew).

65 The fact that the two laws are compatible was recognized by the Easdaq market when it announced its plan for dual listing of American and Israeli stocks. *See Easdaq Launches Dual Listing, Trading for European, U.S., Israeli Stocks*, AFX News, Nov. 6, 1999, LEXIS, Nexis Library, UPI file.

66 *See, e.g.*, Israeli Securities Regulations (Periodical and Immediate Reports), 1970, K.T. 2037.

67 Section 46B of the Securities Law, 1968, 22 L.S.I. 266 (1967-88), prohibits the stock exchange from listing new issuers with dual-class capitalization and requires already-listed issuers with dual-class shares to issue the higher-voting shares when raising new capital, thus denying the advantage of the dual-class structure.

68 For a concise account of this affair, see Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation: A Comment on Mahoney, The Exchange as Regulator*, 83 Va. L. Rev. 1509 n.30 (1997). On the adverse effects of dual-class capitalization, see Lucian A. Bebchuk et al., Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights (Harvard Law Sch., Olin Discussion Paper No. 249, 1999).

69 D.N. 29/84, Kossoy v. Y.L. Feuchtwanger Bank Ltd., 38(4) P.D. 505.

Court has explicitly adopted the concept of materiality—as it is interpreted and applied in American securities law—as the uniform standard for determining the scope of the duty to disclose[70] and the prohibition on insider trading.[71]

2. Shareholding Structures

In contrast to the relative similarity between the American and Israeli legal systems, Israel's typical shareholding structure substantially differs from that prevailing in the United States. While American publicly traded corporations are almost invariably widely held, their Israeli counterparts tend to have controlling shareholders, either a family or the state. As in most countries outside of the U.S., the Berle and Means model does not hold in Israel. Table 3 reproduces data presented by La Porta et al.[72] on control in the largest publicly traded firms in the United States, United Kingdom, and Israel. Data compiled by the Bank of Israel on the entire Israeli stock market show that as of May 2000, interested parties[73] held 70.1% of the registered share capital. The vast majority of those interested parties (75%) were from the private sector. A TASE study further shows that almost half of the TASE-listed companies belong to a group or pyramid of companies under common control. Over 40% of the entire market value was concentrated in the hands of five family-controlled groups.[74] Thus, Israeli shareholding structures bear quite a striking resemblance to those prevalent in Continental Europe[75] and East Asia.[76]

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70 C.A. 3520/90, Baranowitz v. Sec. Auth., 46(2) P.D. 818.

71 Cr.A. 4675/97, Rozow v. State of Israel (unpublished).

72 *See* Rafael La Porta et al., *Corporate Ownership around the World*, 54 J. Fin. 471 (1999).

73 See *supra* note 41 for a definition of interested party.

74 Kobi Avramov & Yuval Zuk, *Control Groups of Publicly Traded Companies*, 214 Hahodesh Babursa [Stock Exchange Monthly] 3 (1999) (Hebrew). For equally troubling data, see Asher Blass et al., *Corporate Governance in an Emerging Market: The Case of Israel*, 10 Bank Am. J. Appl'd Corp. Fin. 79 (1998).

75 *See* Marco Becht & Ailsa Roell, *Blockholding in Europe: An International Comparison*, 43 Eur. Econ. Rev. 1049 (1999); La Porta et al., *supra* note 72.

76 *See* Stijn Claessens et al., Who Controls East Asian Corporations? (World Bank Governance Working Paper No. 2054, Feb. 1999).

Table 3. Holders of Control in Large Publicly Traded Firms[77]

Country	20% Cutoff[a]					10% Cutoff[a]				
	Widely Held	Family	State	Widely Held Fin'l	Widely Held Corp.	Widely Held	Family	State	Widely Held Fin'l	Widely Held Corp.
United States	0.80	0.20	0.00	0.00	0.00	0.80	0.20	0.00	0.00	0.00
United Kingdom	1.00	0.00	0.00	0.00	0.00	0.90	0.05	0.00	0.05	0.00
Israel	0.05	0.50	0.40	0.00	0.05	0.05	0.50	0.40	0.00	0.05

a. The threshold holding of direct and indirect voting rights, which determines the existence of a controlling shareholder.

Israeli institutional investors such as mutual and pension funds play only a minor role in Israeli corporate governance. Certain types of such financial institutions are obligated to invest in non-tradable state-issued bonds or are prohibited from investing in the stock market beyond a certain (low) threshold. Furthermore, tax rules deter pension funds from crossing the five-percent threshold, since this would deny them certain tax exemptions.

In addition, a considerable proportion of institutional investors are held by the large banking conglomerates, which invest in industrial companies.[78] As a result, Israeli institutional investors are often in a conflict of interests between the interests of portfolio companies held by their controlling banks and the interests of their investors. Indeed, Israeli institutional investors do not demonstrate anything like the shareholder activism that some of their American and British counterparts engage in.[79] Institutional non-activism in

77 La Porta et al., *supra* note 72, at 492 tbl. II, 494 tbl. III.
78 *See* Blass et al., *supra* note 74.
79 For a critical review, see Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States, in* 3 The New Palgrave Dictionary of Economics and the Law 459 (Peter Newman ed., 1998).

Israel was so bad, that the law regulating mutual funds was amended in 1996 to require fund managers to appear and vote in general meetings of their portfolio companies when a decision is likely to affect their fund members.[80] But even with this amendment, the situation has not changed significantly, and institutional investors still do not function as monitors of company insiders.[81]

C. The Israeli Dual Listing Project

1. The Roots

Any businessperson in Israel can tell you that the purpose of the dual listing project is to bring the "boys" (that is, foreign-listed companies) back home. But in order to fully assess the challenges facing the project, one must first understand why these companies went abroad in such numbers to begin with. The beginnings of the story trace back to 1983, when the TASE was closed down for three weeks following the worst financial bubble-burst in Israel's history. This bubble was created over a period of several years, during which the shares of all the local banks were artificially inflated.

The Israeli stock market has yet to fully recover from the crash. But in 1993, it started to gather steam again, with the improvement in the public mood due to the promising peace process with the Palestinians. At the same time, the TASE started to ease listing conditions and to allow companies without clear business plans to tap the market. The inevitable crash came in 1994, when public investors realized that many of these "bubble companies" were no more than just that. Having completely lost all public confidence, the market became dormant again, until 1999.

Against this backdrop, the rapidly growing high-technology sector in Israel was unable to raise funds on the TASE that it needed for r&d in the mid-1990s. The venture capital industry was also largely undeveloped in Israel at that time, so start-up companies began to seek funding in the U.S. With the United States having just emerged from a recession, the timing was perfect; and with Silicon Valley VC fund managers on the boards of these start-up companies, the path to Nasdaq was the obvious one to take. Like other path-dependent processes, this situation was self-reinforcing, encouraged by a burgeoning bull market in the U.S.

In late 1996, TASE officials apparently realized that if they kept on losing business this way, they would end up losing the entire shop. In response,

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80 Section 77 of the Mutual Trust Investment Law.

81 *See, e.g.*, Zvi Zrachia, *Sammet: Institutional Bodies Do Not Function Properly*, Globes, May 23, 2000 (Hebrew).

they began to float the idea of fast-track dual listing of U.S.-listed Israeli companies—what later came to be known as "automatic dual listing."[82] With such an arrangement in place, it was argued, the dual-listed firms would jump-start the local market and provide the necessary trading volume to keep the local financial sector alive. The apocalyptic prophecy was that without such an arrangement, the local market would lose ground to foreign competition and eventually wither away. The TASE has repeated this mantra ever since.

It should be stressed that—putting aside all rhetoric—the TASE's basic assessment was not unfounded. However, the ISA, under Chairman Arye Mintkevitch, remained unimpressed with the TASE's dire predictions. In March 1997, Mintkevitch openly questioned the actual necessity of allowing dual listing on a special basis and rejected the idea of automatic dual listing altogether, while making no distinction between U.S.- and non-U.S.-listed companies.[83] A change in the ISA's approach vis-à-vis promoting dual listing on the TASE came only a year later.

2. The Brodett Committee

In February 1998, the new ISA Chairperson, Miri Katz, appointed an expert committee headed by David Brodett to examine whether exemptions should be given for dual listing of securities currently listed abroad. The appointment of this committee was part of a broader change in the style of running the ISA. While Mintkevitch had emphasized active, high-profile enforcement actions so necessary for improving market discipline, Katz had to deal with the growing backlog of legislative reforms for modernizing the law. Dual-listing regulation was only one such reform. Other major issues were issuing securities to employees, commercial paper offerings, disclosure of risk factors, and reforming the ailing underwriting method.

The Brodett Committee limited its analysis to the national U.S. markets, in light of their dominance as a destination for Israeli foreign listings. The Committee compared in detail the legal and accounting regimes under Israeli law to those applicable to foreign issuers under U.S. federal securities law and the listing rules of the national markets. The Committee also surveyed the managers of seventy foreign-listed Israeli firms and received twenty-five

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82 *See* Merav Arlozorov, *TASE: Dual Listing Will Contribute at least another US$100M to Trading Volumes*, Globes, Jan. 8-9, 1997 (Hebrew). For the sake of historical accuracy, the idea appeared in Saul Bronfeld, Foreign Investment in Israel via the Tel Aviv Stock Exchange (Israeli Int'l Inst. for Applied Econ. Policy Review Discussion Paper No. 2-11-90, 1990). Bronfeld later became CEO of the TASE.

83 Shlomo Friedmann, *Mintkevitch: If We Open the Door to Dual Listing, Why not Import Firms from Russia?*, Globes, Mar. 23-24, 1997 (Hebrew).

responses. Although the Brodett Committee had been authorized to "examine possibilities" for providing exemptions, its working assumption was that the situation was anomalous, unacceptable, and likely to lead to irreversible damage to Israel's high-tech sector and capital market.[84] At the fundamental level, therefore, the Committee adopted the TASE's view that things must be changed and quickly. Furthermore, the Committee expressed the hope that bringing "higher league" players into the local market would improve market discipline and trading norms.

The Committee Report did not include a section detailing factual findings, but the following central findings can be gleaned from the Report:

1. The U.S. integrated (i.e., legal and accounting) regime applicable to *American* issuers—based primarily on Form 10-K periodical disclosure under the Exchange Act—is equivalent to the Israeli one in terms of the investor protection it provides and therefore can be relied on for regulating dual-listed Israeli securities.[85]
2. In contrast, the U.S. regime applicable to *foreign* issuers—based primarily on Form 20-F—is inferior to the Israeli regime and the 10-K regime. Amongst other things, it fails to require equivalent disclosure on such issues as transactions with interested parties, top executive compensation, and securities holdings.[86]
3. Israeli issuers listed in the U.S. report using Form 20-F.[87] But in response to market demand and conventions, most of them supplement their reports with 10-K-like disclosures of business data, i.e., dependence on specific clients, aggregate orders, and competition and risk factors.[88]

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84 ISA, Committee Report on Dual Listing of Securities 14 (1998) (Hebrew) [hereinafter Brodett Committee Report].

85 *Id.* at 15-16, 25, app. H.

86 *Id.* at 25, app. G.

87 These issuers are deemed "foreign private issuers," as the term is defined in Rule 3b-4 under the Securities Exchange Act of 1934 (17 C.F.R. § 240.3b-4 (1994)). This status is granted to entities incorporated outside the United States, unless more than half of the corporation's shareholders are located in the United States and the entity's principal business activities are located in the United States under three alternative tests. The definition was amended in September 2000, *inter alia*, with regard to tests for determining the location of shareholders. Thanks to Howell Jackson for these details.

88 Brodett Committee Report, *supra* note 84, app. G; Letter from Tal Even-Zahav, Deputy Director, Israeli Securities Authority Legal Department, to author (June 7, 2000) (on file with author).

4. Surveyed officers ranked in the following order areas in which the Israeli disclosure regime should be relaxed:[89]
   1. Special disclosure requirements in a prospectus.[90]
   2. Timing of business results disclosure.
   3. Immediate report on pending negotiations.
   4. Disclosure about transactions with interested and controlling parties.
   5. Disclosure about private placements of securities.[91]

The Committee strongly recommended adopting a special dual-listing arrangement for Israeli securities listed on the national American markets. To list on the TASE, such issuers would be required only to publish and file a short registration document with the ISA, to which their SEC filings would be attached. Dual-listed issuers would be able to fulfill their periodical reporting duties under the Israeli regime by publishing and filing their American reports with the ISA and using the U.S. GAAP accounting standards. The ISA would retain its supervisory authority for such disclosures.[92]

The Committee, however, rejected the idea of relying on issuers' existing reports based on Form 20-F, notwithstanding the few voluntary supplements. Instead, it recommended requiring issuers wishing to take advantage of the arrangement to report under the more demanding American regime applicable to domestic American issuers. In the Committee's opinion, that regime alone is suitable for investor protection in Israel and would prevent discrimination against local issuers.[93]

During the Committee's deliberations, it also became apparent that it is impossible to separate the regulation of dual listing from many of the other issues awaiting reform. The Committee therefore recommended amending certain disclosure requirements with general application to all issuers. This category included doing away with the duty to disclose pending negotiations; setting a 20% (instead of 5%) threshold for private placements that necessitate special approval, thus bringing it in line with the U.S.

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89 Brodett Committee Report, *supra* note 84, app. C.

90 These requirements include: specification of main clients; product segmentation; benefits to interested parties; and names of main shareholders. Note, however, that these requirements are largely identical to public disclosures by American issuers registered under the securities acts and using Form S-1 thereunder.

91 Another special Israeli requirement complained about before the Committee was the prospectus requirement in employee offerings.

92 Brodett Committee Report, *supra* note 84, at 18-19.

93 *Id.* at 25.

threshold; allowing summary reporting of business results; and exempting employee offerings from a prospectus filing.[94]

3. Implementation Efforts

The Committee Report was received with great enthusiasm at first, and the ISA quickly moved to implement its recommendations by amending an existing bill that had already been tabled and adding several provisions to it. This effort never reached fruition, however, and the bill passed in the *Knesset* included no arrangement for dual listing. Instead, new developments occurred at both the securities regulation and company law levels, which took form in a glut of legislative measures.

When the Report was released in September 1998, its recommendations were innovative in terms of the regulatory paradigm they reflected, namely, unilateral recognition of a foreign securities regulation regime.[95] But the ISA and Ministry of Justice realized that implementing this model would be no small feat. Questions arose with regard to civil causes of action, whether Israeli investors who bought securities on the TASE could sue the issuer or its officers in the U.S., the legal ramifications of reporting in Israel under American law, and so on. At some point in February 2000, government officials, likely in a moment of despair, even toyed with the idea of dual-listed companies being regulated solely by the SEC under U.S. law and subject solely to the jurisdiction of U.S. courts. They quickly sobered up.

The securities industry had never really been overjoyed with the Brodett Committee Report, as it did not call for automatic dual listing. With the repeated delay of the implementation of the Report's recommendations, the ISA came under growing criticism from the TASE, on the one hand, representing the financial sector, and, on the other hand, the Public Companies Association ("PCA"), representing potential issuers and the Israeli industry in general. Anything short of automatic dual listing, they argued in both public and private forums, would render the project "dead on arrival." Eventually it became clear that the PCA and the TASE's primary concern was the addition of disclosure duties with regard to interested and controlling parties.[96]

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94 *Id.* at 18-19.

95 In July 1999, Belgium overtook Israel in adopting such a regulatory strategy, intended to assist Easdaq in its competition with other European stock markets. *See* Licht, *supra* note 2, at 599-601.

96 *See, e.g.*, Stella Korin-Lieber, *Doing Us a Favor*, Globes, Nov. 30-Dec. 1, 1999 (Hebrew); Yoram Gavison, *Bronfeld: Viability of Capital Market is in Danger without Approval of Dual Listing*, Ha'aretz, Dec. 31, 1999 (Hebrew); Motti Bassok,

To complicate things further, certain matters that had been covered by disclosure duties under the Securities Law—such as takeover bids, interested party transactions, and private placements—were about to become regulated under the new Companies Law, which was to enter into force in February 2000. Independent of the dual listing project, Israeli companies listed abroad demanded an exemption from duties they had not heretofore been subject to. During the discussions regarding the regulations under the Companies Law in the *Knesset* Sub-Committee for Legislation, business sector representatives argued generally that the foreign laws applicable to Israeli foreign-listed companies are sufficient for protecting public shareholders, without specifying which laws provide this protection. Concurrently, business sector representatives had been complaining that the new Law is generally overly hostile to corporate insiders and would drive them to incorporate in Delaware—a trend that was already apparent.

The conflict between the ISA, on the one hand, and the TASE and the PCA, on the other, reached a peak in mid-February 2000 in a meeting called by Finance Minister Avraham Shohat with representatives of all the parties involved as well as with David Brodett. The meeting was held under the shadow of the Nasdaq Chairman's visit to Israel that same week, during which it was announced in the press that Nasdaq was intending to open an extension in Tel Aviv.[97] Earlier that year, Easdaq announced a plan to start trading in four leading Nasdaq-listed Israeli securities.[98] The immediate threat to the TASE was evident. In the meeting with the Finance Minister, David Brodett reversed his position expressed in the Committee Report and instead came out in support of the TASE and PCA's demand to institute automatic dual listing. Shohat adopted this view and called for "maximum relaxation" in drafting the dual-listing legislation.[99]

The ISA read the writing on the wall and backed off from the original

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Public Companies Association: Without Drastic Change in Capital Market Hi-Tech Companies Will Flee Israel, Ha'aretz, Feb. 2, 2000.

97 There is good reason, however, to take Nasdaq's announcements about its plans with a grain of salt. Within two days, there were published reports of its plans to open an extension in Tel Aviv, of cooperation with the TASE, and of a joint platform connecting Nasdaq, the TASE, and the Cairo and Istanbul stock exchanges. *See, e.g.*, Keren Zuriel & Zeev Klein, *Tightening Connections between Nasdaq and Israeli Companies Listed on It to Be Examined*, Globes, Feb. 12-13, 2000 (Hebrew); Boaz Levi, *Capital Has No Passport*, Ha'aretz, Feb. 16, 2000 (Hebrew).

98 *See supra* note 95.

99 Merav Arlozorov, *David Brodett Changed His Mind*, Ha'aretz, Feb. 15, 2000 (Hebrew); Stella Korin-Lieber, *Just Like in America*, Globes, Feb. 20-21, 2000 (Hebrew).

requirement of 10-K-like periodical reporting. During the Spring of 2000, the ISA and the Justice Ministry managed to bring to completion long-awaited legislation with general application to all issuers.[100] Amongst other things, special regulations under the Companies Law provided for exemptions for foreign-listed companies in order to prevent subjecting them to conflicting requirements under Israeli company law, on the one hand, and foreign securities laws, on the other.[101]

In July 2000, the *Knesset* passed an amendment to the Securities Law that added a new chapter on dual listing, with its formulation agreed upon by the ISA and TASE.[102] The amendment allows Israeli issuers listed on national U.S. markets to list their stocks on the TASE based entirely on disclosures they make abroad under U.S. law and voluntarily. While the ISA still retains its regulatory authority over such issuers, it is understood that this authority is reserved for exceptional circumstances only. As of mid-2001, nine companies have taken advantage of this dual-listing arrangement. Its limited success can be partially explained by the downturn in Nasdaq since late 2000, which has led to a significant drop in the value of many Israeli companies. It is also noteworthy that foreign-listed companies have displayed little interest in listing on the TASE since the legislative amendment.[103]

III. Some General Lessons

The dual listing project is a fascinating model case, because beyond being an interesting piece of Israeli political-economy, many general lessons can be drawn from it. This Part offers several observations on the general regulatory aspects of the project that are relevant for small and large markets participating in today's global economy. A discussion follows on the recurring matter of relying on stock exchanges as regulators. Finally,

100 These issues include abolishing disclosure of pending negotiations, exemption from prospectus in employee securities offerings, exemptions and relaxation regarding interested parties transactions, etc. *See, e.g.*, Securities Law (Amendment No. 20), 2000, S.H. 161-66; Companies Regulations (Relaxation regarding Transactions with Interested Parties), 2000, S.H. 584-85.

101 Companies Regulations (Relaxations regarding Public Companies with Shares Listed on an Exchange outside of Israel), 2000, S.H. 298-99. *See supra* text accompanying note 8.

102 Securities Law (Amendment No. 21), 2000, S.H. 252.

103 *See* Ami Ginzburg, *Israeli Firms: "Will See", "Will Consider", "Will Check"*, Ha'aretz, July 27, 2000 (Hebrew); Boaz Levi, *Lukewarm Response by Israeli Companies Traded in New York to Dual Listing*, Ha'aretz, Feb. 25, 2000.

problems with designing securities regulation and corporate law in open securities markets are addressed.

A. Small Market Regulatory Policy

Markets and regulators all around the world are facing the same dilemmas that Israel has faced in its effort to implement its dual listing project. Indeed, these dilemmas are common to every stock market sufficiently smaller than the Goliaths of New York and London, be it an emerging market or a developed but small market. These dilemmas all boil down to whether such markets can pursue an independent regulatory policy (often for good reason) or whether they are led to behave as economic theory predicts they will, namely, as regulatory price-takers.

1. The Limits of Excellence

Advocates of regulatory competition between securities markets assume that competition will yield the best legal product or, according to some views, a line of products suitable to the different needs of issuers and investors.[104] Certain aspects of the Israeli experience, however, call these arguments into question, while other aspects may offer support. An encouraging lesson from the dual listing project is that some small markets, such as the Israeli and Belgian markets, do try to compete on the basis of regulatory quality. The unfortunate lesson from the project, however, is that regulators and lawmakers in small markets should not strive to excel.

Israel tried to construct the best corporate law in light of the most advanced views of the time. The 1999 Companies Law represents a great effort to protect public shareholders—who are explicitly assumed to suffer from rational apathy and collective action problems[105]—while preserving a largely enabling framework. Similarly, Israel's securities law exhibits features widely believed to provide a high level of investor protection.[106]

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104 *See* Romano, *supra* note 12; Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. Cal. L. Rev. 903 (1998).

105 The assumption that public shareholders are rationally apathetic is repeated in the explanatory comments to the Companies Law Bill, 1995, H.H. 2, and in Professor Procaccia's book, which summarizes the preparatory work on the Bill. Uriel Procaccia, Corporate Law in Israel: A Positive and Normative Analysis (1989).

106 Recall that Easdaq's dual listing project included issuers listed in the EU, the United States, and Israel—which reflects Easdaq's high opinion of Israel's securities law. *See infra* Section IV.A.3.

None of this was of any avail, however, when Israel sought to attract Israeli issuers listed in an inferior regulatory environment—namely, subject to the American foreign issuer regime. For such issuers, even the smallest addition of "good"—presumably shareholder-value-increasing regulation—meant only cost with no added value.

From the perspective of Israeli regulators, the American regime governing the coveted Israeli stocks in effect became the ceiling for any future regulatory reform. More generally, in equity markets that are fully globalized, small open markets will find it hard to challenge the bigger ones in terms of the regulatory regime they offer. This argument can be rephrased, instead of in absolute terms of "better" versus "worse" regulation, in relative ones—namely, regulation that is more suitable for a small market's special needs and policies. Specifically, Israel's securities law and company law are designed to cope with the pervasive problem of family-held control blocks in public companies—a feature that is uncommon in the United States. The dual listing project has proven, however, that this local policy could not be maintained with regard to issuers that enjoy the governance of a more lenient regime.

2. Piggybacking to the Bottom?

Did Israeli companies that listed on American stock markets do so in order to piggyback on a superior corporate governance infrastructure? Views differ on this. Blass et al. show that U.S.-listed Israeli issuers performed better than their TASE-listed counterparts. They argue that in addition to the standard motives mentioned for dual listing in the United States (better pricing, liquidity, visibility, etc.), many Israeli firms list their shares on Nasdaq partly in order to remove themselves from the realm of Israeli banks and to avoid the corporate governance problems associated with being listed on the TASE.[107]

I disagree with Blass et al.'s argument. To be sure, there is ample evidence that a U.S. listing can be value-enhancing for a foreign issuer whose home country law provides average investor protection. The benefits for a typical Israeli issuer of listing on a U.S. market seem to stem from financial and business factors—e.g., cost of capital, liquidity, and visibility—but less so from an improvement in the regulatory regime. In terms of corporate governance factors, Blass et al. are right in noting that on-going analyst coverage, which started to develop in Israel only recently, is a positive factor in a U.S. listing.[108] But in terms of how well the Israeli

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107 Blass et al., *supra* note 74, at 80.
108 Another positive factor is the larger float exhibited by U.S.-listed Israeli issuers,

and the U.S. foreign-issuer regimes contend with managerial opportunism, the Israeli regime is without a doubt stricter than the U.S. regime. As I have argued in a companion article,[109] the behavior of the TASE and the PCA during the implementation of the dual listing project is consistent with managerial opportunism being a motive for foreign listing by Israeli issuers. That is to say, at least some Israeli issuers went abroad in order to avoid the disinfecting sunlight of Israeli securities regulation. For such issuers, piggybacking on the U.S. market was a ride to the bottom.

3. Investor versus Capital Market Protection

In the late 1980s, the London and Tokyo stock exchanges appeared positioned to take over from the NYSE as the world's largest securities markets. Responding to pressure from the financial sector in the United States, the SEC promulgated Rule 144A and the F forms, pursuant to section 12 of the Exchange Act, in order to attract foreign issuers to the U.S. Both Rule 144A and the F forms require less disclosure in comparison to the level of disclosure regularly required in a U.S. public offering. While Rule 144A offerings are limited to Qualified Institutional Buyers, offerings using an F form are available to any public investor. This was not the first time the SEC had found it necessary to balance investor protection with market protection goals.[110]

In 1999, Easdaq was lagging well behind the Euro NM markets in the race to become the European Nasdaq. The Belgian Parliament quickly passed legislation allowing Belgian markets to list (and even quote without a listing) foreign securities without any additional disclosures under Belgian law. Compromise of investor protection was limited in this case by restricting the arrangement to issuers from "quality markets": the U.S., Israeli, and EU markets. In any event, any potential harm would be externalized to the entire European market rather than limited to Belgian investors.[111]

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compared with the average on the TASE, namely, a smaller level of controlling blocks.

109 *See* Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, U. Pa. J. Int'l Econ. L. 325 (2001).

110 Loss and Seligman argue that, "the adoption of the foreign integrated disclosure system ... required the Commission to balance the goal of investor protection, its 'primary mandate', ... with the 'free trade goal' of 'facilitating the free flow of capital among nations.'" 2 Louis Loss & Joel Seligman, Securities Regulation 763 (1991) (footnote omitted).

111 *Cf.* Joel P. Trachtman, Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation (1999), *at* http://www.papers.ssrn.com/paper.taf?abstract-id=193688 ("In the securities regulation context, it is possible that states would reduce their level of disclosure or insider trading regulation below

In implementing the dual listing project, the ISA—guided by the Brodett Committee's recommendations—originally chose to emphasize investor protection. As implementation of the project was repeatedly delayed and the competitive threat to the TASE from foreign markets intensified, the ISA, like its American and Belgian counterparts, had to cave in and give greater weight to protecting the local market. These anecdotes from the United States and Belgium join the Israeli dual listing project in illustrating how securities regulators are often torn between the need to protect investors in their jurisdictions and the desire to protect and promote their national securities markets. These two regulatory goals are often in conflict and not easily reconciled.[112]

B. Large Market Regulatory Policy

1. Regulatory Externalities and Responsible Regulation

Had the U.S. established a uniform periodical reporting regime for all issuers, the Israeli dual listing project probably would not have developed the way it did. The project clearly demonstrates both the positive and negative aspects of the concepts of regulatory externality and regulatory arbitrage exerted by large markets. On the positive side, the project served as a catalyst for several long-needed reforms in Israel's general securities regulation regime, for example: limiting the disclosure of pending negotiations; abolishing the prospectus requirement in employee offerings; and establishing safe harbors for non-public offerings. For all the areas that underwent reform, U.S. securities law served as more than just a source of inspiration, for the amended legislation had to be compatible with and not merely comparable to it.

The negative externality from the American market to the Israeli market stems from the unique bifurcated structure of American securities regulation, under which foreign issuers can tap the U.S. market under a more lenient regime than the one applicable to domestic U.S. issuers. To the best of my knowledge, a similarly bifurcated structure for foreign issuers existed only in London until recently. These two markets are the dominant ones in the world. The implications of this structure for American investors and issuers have been debated extensively. The dual listing project demonstrates the negative

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what they would otherwise deem optimal in order to attract issuers and thereby enhance the liquidity of their securities markets. Their interest in doing so might be increased if they knew that the costs of this regulatory subsidy would be borne to some extent by persons outside their political community." (footnotes omitted)).

112 For further details and analysis, see Licht, *supra* note 2.

implications of this bifurcated structure for small foreign markets and of the fact that the largest markets function as regulatory price-setters. In other words, this bifurcation can frustrate regulatory measures of small-market regulators whenever those measures exceed the standard set by the dominant market's regulatory regime, even if the measures are necessary for investor protection in the small, price-taking market.

An optimist would assert that this externality effect obliges dominant market regulators to behave responsibly, that is, to avoid creating too wide a gap between the regimes for domestic and foreign issuers. Reality, however, has proven that this is easier said than done. In this regard, the SEC can be commended for behaving "responsibly" in its dealings with the IASC and IOSCO over the International Accounting Standards ("IAS"). The SEC was resolute that the IAS must be sufficiently demanding for them to be approved for use in securities offerings in the United States.[113] This position clearly stemmed from American interests in retaining the market share of American securities markets, as it ensured that the regulatory burden in other markets would not be very low in comparison to the American market. The SEC's position might possibly also have stemmed from a hegemonic self-perception. Be that as it may, this position also led to the improvement of the IAS.

2. Dominance, Satellites, and Regulatory Cooperation

Being dominant in the global equity market does not necessarily entail dominance with respect to particular stocks. Dominance of the latter type means being the leader in the price-discovery process of multiple-listed stocks. In this context, the smaller market is often dominant and the larger one is the satellite, as is the case with many Israeli "arbitrage stocks." Should the integrity of price formation in the small market be compromised in some way (e.g., due to manipulation or insider trading), the adverse affects will quickly be felt in the large market as well due to arbitrage transactions. The implication for the larger market is that it should not ignore tiny markets, to prevent investors in the former from being harmed. In my view, this is one of the more compelling reasons in favor of regulatory cooperation,

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113 *See* Amir N. Licht, *Games Commissions Play: 2x2 Games of International Securities Regulation*, 24 Yale J. Int'l L. 61 (1999). In early 1999, the SEC expressed for the first time willingness to consider allowing issuers to use IAS instead of U.S. GAAP. In May 2000, IOSCO approved IAS for use in multinational offerings. Michael Peel, *Global Accounting Deal Agreed: Landmark Move as Stock Market Regulators Back New International Standards*, Fin. Times (London), May 18, 2000, at 27.

and at least with regard to U.S. and Israeli regulators, such cooperation is emerging.[114]

C. The Role of Stock Exchanges

Should stock exchanges be entrusted with authority over securities regulation? The debate over the appropriate role of stock exchanges refuses to fade away.[115] The polar positions in this debate, put simply, are the approach that stock exchanges know best what is good for their clients and the opposing view that what is good for stock exchange clients is often bad for public investors.[116]

The dual listing project demonstrates that stock exchanges are mostly concerned with their own survival and prosperity. It would be strange for things to be otherwise. But in order to ensure its survival and prosperity, the TASE took a strong position against any addition of investor protection measures to the regulatory regime applicable to potential dually listed companies. It did so even though such additions would result in a more level playing field for its own, original, domestic issuers. Indeed, for the most part, the TASE was spearheading the public campaign against the ISA in the press and in other forums, while the PCA took the back-seat. This should be a sobering lesson for commentators and policymakers who contemplate vesting stock exchanges with regulatory powers.

The story of the dual listing project in fact echoes quite strikingly an

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114 There is currently no bilateral agreement between the two countries akin to the MJDS or to the supranational regime in force in the European Union. The only formal bilateral measure is a memorandum of understanding ("MOU") between the SEC and ISA. The MOU was signed in Jerusalem in February 1996. It took another four years, however, for the ISA to be granted full authority under Israeli law to perform its obligations under the MOU. Securities Law (Amendment No. 19), 2000, S.H. 110 (Feb. 20, 2000). The SEC holds the necessary authority since the enactment of the International Securities Enforcement Cooperation Act of 1990, Pub. L. No. 101-550, § 201, 104 Stat. 2713 (codified as amended in scattered sections of 15 U.S.C. (1999)). *See also* Boaz Levi, *ISA Uncovers Insider Trading Offenses on Nasdaq*, Ha'aretz, May 24, 2000 (Hebrew).

115 *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 Va. L. Rev. 1453 (1998); Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation: A Comment on Mahoney, The Exchange as Regulator*, 83 Va. L. Rev. 1509 (1997); Adam C. Pritchard, *Markets As Monitors: A Proposal To Replace Class Actions With Exchanges As Securities Fraud Enforcers*, 85 Va. L. Rev. 925 (1999); Jonathan R. Macey & Maureen O'Hara, *Regulating Exchanges and Alternative Trading Systems: A Law and Economics Perspective*, 28 J. Legal Stud. 17 (1999).

116 *See, e.g.*, *supra* note 68.

American plot from several years ago. As already noted, the SEC had insisted that the IAS be strengthened in order to be deemed of sufficient quality. At the same time, the NYSE had constantly been advocating relaxation of disclosure standards for foreign issuers.[117] Another American example is the regulation of dual-class common stock. The SEC had tried to prohibit dual-class recapitalization in order to protect public shareholders from entrenchment of managers, since the major stock markets were willing to compromise public shareholder protection in order to prevent delisting by major issuers.[118] Today, however, stock exchanges around the world are more attentive to corporate governance and adopt corporate governance codes as part of their listing rules.[119]

D. Securities Regulation or Corporate Law?

Together, securities regulation and corporate law form the legal component of corporate governance systems. Shareholding structures complete these systems. The two bodies of law are interrelated and complement one another in that they both can, and do, achieve similar regulatory purposes.[120] One significant difference that was noted above is that corporate law has personal and, thus, international application, while securities regulation applies territorially.

In Israel, until the Companies Ordinance was replaced by the new Companies Law in February 2000, a considerable number of corporate governance issues were regulated by the Securities Law. There was no apparent logic to this arrangement since the Ordinance was amended every so often, including with regard to matters relevant only to publicly traded companies.[121] In any event, as a result of this situation, U.S.-listed Israeli issuers were not subject to any requirements prescribed by the Securities Law.

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117 *See* James L. Cochrane et al., *Foreign Equities and U.S. Investors: Breaking Down the Barriers Separating Supply and Demand*, 2 Stan. J.L. Bus. & Fin. 241 (1996); James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 Fordham Int'l L.J. S58 (1994).

118 *See supra* note 68.

119 *See, e.g.*, Brian R. Cheffins, *Corporate Governance Reform: Britain as an Exporter, Corporate Governance and the Reform of Company Law*, 8 Hume Papers Pub. Pol'y, Mar. 2000, *available at* http://www.papers.ssrn.com/paper.taf?abstract_id=215950.

120 For a detailed exposition of this argument, see Licht, *supra* note 9.

121 Issues governed by the Securities Law included tender offers, interested party transactions, private placements, and securities class actions. Issues governed by the Companies Ordinance included outside directors, audit committees, and disclosure of personal top executive compensation.

The Brodett Committee recommended making those requirements apply to such issuers, but the TASE and PCA objected.

One of the reasons for the ISA changing its original intention to implement the Brodett Committee's recommendations was that the Companies Law entered into force while the dual listing project was still dragging on. Under the new Law, some shareholder protection measures that had previously been governed by the Securities Law were shifted into its realm and became applicable to all Israeli companies, regardless of place of listing.[122] (In response, Israeli businesspeople have started to incorporate their companies in Delaware.) At the same time, because certain measures like tender offer regulation were given personal (international) application under the new Law, the Justice Ministry feared that they might conflict with the securities laws of important markets (such as the London Stock Exchange) and thus prevent Israeli companies from listing there. Hence, special exemptions for Israeli foreign-listed companies had to be provided in specific regulations under the Companies Law.[123]

Regulators should be aware of the interplay and tension existing between corporate law and securities law. They should be aware also of the great potential for remedying deficiencies in the law that applies to particular issuers, but also of the risk of creating unbearable regulatory burdens for others.

Conclusion

The Israeli dual listing project is a model case of the daunting challenges faced by regulators in small open markets. These markets lack depth and liquidity, and as result, regulators must find other means of attracting issuers

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122 One illustrative counter-example is worth mentioning. Regulations under the Securities Law allowed disclosure of top corporate officers on an aggregate basis. Due to historical accident, the Companies Ordinance was amended in 1992 to require publicly traded companies to disclose the compensation schemes of the top five executives with a personal breakdown. This provision applied to U.S.-listed Israeli issuers, who did not comply with it and fought tenaciously against a different provision on external directors. The 1999 Companies Law, however, does not include such a disclosure provision, so the ISA had to promulgate it in a regulation under the Securities Law at the eleventh hour before the Companies Law came into effect. As a result, Israeli foreign-listed issuers are not subject to this duty.

123 Companies Regulations (Exemptions for Public Companies whose Shares are Listed on an Exchange outside of Israel), 2000, K.T. 298.

and investors. They must somehow find a way to prevent the drain of domestic "quality merchandise" to more attractive markets abroad. Thus, they cannot impose a more demanding regulatory regime than what is offered by foreign markets. Indeed, we may well wonder what exactly they can do and still achieve their goal of investor protection.

This article has offered a rather disenchanted rendition of the dual listing project as it evolved until early 2001. The goal has been to use this project as a case study. The methodology requires the reader to delve into a lot of mundane, sometimes foreign factual details. The reward, it is hoped, is a picture rich enough to place the many interrelating factors that affect corporate governance regulation in today's global economy in a meaningful context.