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Foreign Corporations Listing in the U.S. – Does Law Matter? Testing the Israeli Phenomenon

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Abstract

This Article attempts to discover the reasons behind the decision of Israeli corporations to go public in the U.S. To find the reasons behind this unique phenomenon, we use two hypotheses that we borrow from the current debate on the reasons for cross-listing of corporations in foreign countries. Under the first hypothesis, law does not matter for Israeli corporations that choose to go public in the U.S. and their decision was motivated by reasons such as liquidity of the U.S. markets, openness of markets to early stage corporations, and image concerns. The second hypothesis is that law does matter and the decision of Israeli corporations to migrate to the U.S. was motivated by their desire to opt into better investor protective laws. Therefore, under this hypothesis, Israeli corporations chose to go public in the U.S. to bond their insiders from expropriating the corporate assets. To decide which hypothesis represents the actual reasons behind the decision of Israeli corporations to migrate to the U.S., we compare the relevant Israeli and U.S. laws. If the U.S. laws provide a better protection for investors and therefore better bond insiders, then the second hypothesis, under which law does matter, is the correct hypothesis. However, if the differences between the two laws are insignificant and cannot justify incurring the high costs of going public in the U.S., then the first hypothesis under which law does not matter, is the more accurate hypothesis. The comparison between the Israeli and the U.S. securities law shows that there are insignificant differences between those laws. Those insignificant differences cannot justify incurring the high costs of going public in the U.S. To support this conclusion we use two sets of data. Both a quantitative data, on the number, industry and year of initial public offerings of Israeli corporations in the U.S., and a qualitative data that includes information collected from investors and

attorneys who took part in conducting the initial public offerings of Israeli corporations in the U.S., supports the conclusion that law does not matter. According to this data, Israeli corporations chose to go public in the U.S. mostly in order to enjoy the liquidity of the U.S. markets and the openness of U.S. markets for early stage corporations.

FOREIGN CORPORATIONS LISTING IN THE UNITED STATES - DOES LAW MATTER? TESTING THE ISRAELI PHENOMENON

By

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ABSTRACT

This Article attempts to discover the reasons behind the decision of Israeli corporations to go public in the U.S. To find the reasons behind this unique phenomenon, we use two hypotheses that we borrow from the current debate on the reasons for cross-listing of corporations in foreign countries. Under the first hypothesis, law does not matter for Israeli corporations that choose to go public in the U.S. and their decision was motivated by reasons such as liquidity of the U.S. markets, openness of markets to early stage corporations, and image concerns. The second hypothesis is that law does matter and the decision of Israeli corporations to migrate to the U.S. was motivated by their desire to opt into better investor protective laws. Therefore, under this hypothesis, Israeli corporations chose to go public in the U.S. to bond their insiders from expropriating the corporate assets. To decide which hypothesis represents the actual reasons behind the decision of Israeli corporations to migrate to the U.S., we compare the relevant Israeli and U.S. laws. If the U.S. laws provide a better protection for investors and therefore better bond insiders, then the second hypothesis, under which law does matter, is the correct hypothesis. However, if the differences between the two laws are insignificant and cannot justify incurring the high costs of going public in the U.S., then the first hypothesis under which law does not matter, is the more accurate hypothesis. The comparison between the Israeli and the U.S. securities law shows that there are insignificant differences between those laws. Those insignificant differences cannot justify incurring the high costs of going public in the U.S. To support this conclusion we use two sets of data. Both a quantitative data, on the number, industry and year of initial public offerings of Israeli corporations in the U.S., and a qualitative data that includes information collected from investors and attorneys who took part in conducting the initial public offerings of Israeli corporations in the U.S., supports the conclusion that law does not matter. According to this data, Israeli corporations chose to go public in the U.S. mostly in order to enjoy the liquidity of the U.S. markets and the openness of U.S. markets for early stage corporations.

I. INTRODUCTION

Mostly in recent years, a large number of Israeli corporations chose to migrate to the U.S. by going public in U.S. stock exchanges. A relatively small economy, Israel is second only to Canada in exporting corporations to the U.S. securities markets. Between the years 1958 and 2003, more than 140 Israeli corporations chose to list their securities with U.S. stock exchanges or NASDAQ by conducting initial public offerings ("list" or "go public"). Israeli corporations seem to prefer the NASDAQ as the place to list their securities. The vast majority of Israeli corporations chose to go public in the U.S. between the years 1991 and 2002.

As of today, no study extensively examined whether law matter for Israeli corporations that chose to go public in the U.S. Thus, it is unclear what motivates Israeli corporations to go public in the U.S., however, commentators agree that the Israeli phenomenon is unique and requires a separate discussion.[1] In this Article we examine the motivation behind the decision of Israeli corporations to list their securities in the U.S. The decision to list in the U.S. could be motivated by several reasons, some are related to the law and some are motivated by non-legal incentives. To find what motivated Israeli corporations to list their securities in the U.S., we ask whether law matter. Generally, law matters when corporations wish to bond their insiders from expropriating the corporate assets. When the laws of a certain country do not adequately protect outside investors, outside investors[2] will choose not to invest in corporations that are listed in that country. The reluctance of outside investors to invest in those corporations will raise the cost of new capital for those corporations. Corporations listed in a country that offers weak investor protection can wait for the legislative body of that country to amend the law so it will better bond insiders, or simply opt into a more protective legal regime by listing securities in a country that offer outside investors a better protection from expropriation of corporate assets by corporate insiders. Commentators argue that due to political, cultural and legal impediments,[3] the latter option in which businesses leap frog into a different legal regime (i.e. list or incorporate in a different country with better investor-protective laws,) is more likely to occur.[4]

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[1] Amir Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 Chi. J. Int'l. L. 141, 161 (2003) (noting that "of the numerous origin countries of cross-listing firms, Israel stands out as a case that may deserve special attention"); John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 Nw. U.L. Rev. 641 (1999) (arguing that "the clearest example of this pattern has been the extraordinary phenomenon of Israeli firms effecting IPO's on NASDAQ…in the words the NASD's chief executive officer, NASDAQ has become 'a capital-raising engine for the Israeli economy.'")

[2] Outside investors are those who do not have any connection to the corporation other than being shareholders. Those investors do not hold any position in the corporation and have no affiliation to the management or the controlling shareholders of the corporations. Thus, outside investors are the most vulnerable shareholders of the corporation.

[3] See e.g., Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. Rev. 127 (1999).

[4] See e.g., Larry E. Ribstein, *Cross-Listing and Regulatory Competition,* Review of Law & Economics: Vol. 1: No. 1, Article 7.

If the Israeli law provides a weaker investor protection than the U.S. law does, than it is possible that instead of waiting for the Israeli legislator to amend the Israeli laws, Israeli corporations chose to rent the U.S. laws by going public in the U.S.[5] If, however, the Israeli law adequately protect investors, it is possible that non legal issues, such as, improving image or enjoying the better liquidity of the U.S. stock markets, motivated Israeli corporations to go public in the U.S. We are also aware that there could be a third possibility according to which, some Israeli corporations chose to migrate to the U.S. to bond their insiders while other Israeli corporations were motivated by non-legal issues.

This Article includes a theoretical analysis and an empirical study. The theoretical analysis examines the possible reasons behind the decision of Israeli corporations to go public in the U.S. In this part, we compare the U.S. federal securities laws[6] and regulations with the Israeli securities law[7] and regulations and discuss issues, such as, image concerns, liquidity, and the efficiency of the judiciary. The empirical study part of this Article presents data (i) on the number, industry and dates of the initial public offerings of Israeli corporations in the U.S. and (ii) data collected from Israeli and American attorneys and of Israeli investors who took part in listing Israeli corporations in the U.S. Those lawyers and investors were interviewed on a confidential basis in which each of them was presented with a similar set of questions and provided his own perspective on the reasons behind the decision of Israeli corporations to list in the U.S. Although this data is inconclusive, it supports the conclusion we reach in the theoretical discussion.

In Chapter II, we discuss the definition of the phenomenon of Israeli corporations' migration to the U.S. and the hypotheses we use. In Chapter III we discuss previous research involving the phenomenon of Israeli corporations listing in the U.S. In Chapter IV, we explore whether law mattered for Israeli corporations that chose to go public in the U.S. Chapter V presents the empirical study that includes quantitative and qualitative data. In Chapter VI the data from the empirical study is analyzed and compared with the results of the theoretical discussion. Chapter VII concludes this Article.

II. THE PHENOMENON, KEY QUESTIONS, AND THE TWO HYPOTHESES USED

In this Article, we examine the phenomenon of Israeli corporations' migration to the U.S. The Israeli phenomenon is defined as the decision of some Israeli corporations to conduct initial public offerings and to list their securities in the U.S. The central question of this Article is does law matter? By testing *why* Israeli corporations chose to go public in the U.S. we will be able to find whether and how law matters. If law matters, Israeli corporations chose to go public in order to bond their insiders. If law does not matter, then we should examine what other non-legal reasons motivated Israeli corporations to migrate to the U.S. The next question to be answered is *what* type

[5] We compare the securities laws of Israel and the U.S. to determine which of them provides a better investor protection. We do not compare corporate laws because the Israeli corporations we examine here are incorporated in Israel and thus, are still subject to the Israeli corporate law.
[6] Securities Act of 1933, 15 USCA §77 (2005) ("Securities Act"); Securities and Exchange Act of 1934, 15 USCA §78 (2005) ("Exchange Act").
[7] Securities Law, 1968, S.H. 234 ("Israeli Securities Law ").

of corporations chose to migrate to the U.S. and *when*, in order to find whether the phenomenon is industry related or if it was related to a specific time period.

To answer *why* Israeli corporations chose to list in the U.S., we use two hypotheses. One is a null hypothesis under which law does matter. Under this null hypothesis, Israeli corporations chose to go public in the U.S. because they were interested in opting into the U.S. laws and to bond their insiders. Under the competing hypothesis, law does not matter and Israeli corporations chose to go public in the U.S. for reasons, such as, liquidity, image or information costs.

III. PREVIOUS RESEARCH

The Israeli phenomenon was discussed in several articles. Thus far, the most significant work on the migration of Israeli corporations to the U.S. was conducted by Professor Edward Rock, Amir Licht, and Asher Blass and Yishay Yafeh.

1. Rock's analysis.

In his article, *Coming to America? Venture Capital, Corporate Identity and U.S. Securities Law*,[8] Rock discusses the migration of Israeli high-tech corporations to the U.S. Rock argues that Israeli corporations chose to list in the U.S. because the U.S. capital markets are used as an exit option for venture capitalists[9] who invested in Israeli high-tech corporations in their early stage development. Rock adds that Israeli corporations chose to migrate to the U.S. to be closer to investors and to present themselves as American entities.[10] In their annual reports filed with the U.S. Securities and Exchange Commission ("SEC"), Israeli corporations hide the fact that they are Israeli corporations and therefore hope to be treated as American corporations. Rock explains that it was important for Israeli corporations to be seen as American corporations because "many of the target investors – large U.S. institutions – may invest in 'technology companies' but not in 'Israeli' companies."[11]

Rock's argument does not answer why the vast majority of Israeli corporations that listed their securities with the U.S. stock markets did not also choose to incorporate in the U.S. and therefore completely to hide their Israeli identity. Additionally, Rock explains that Israeli high-tech corporations choose to migrate to the U.S. in order to raise capital, and that one of the reasons could be the 1994 crash of the Tel-Aviv Stock

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[8] Edward B. Rock, *Coming to America? Venture Capital, Corporate Identity and U.S. Securities Law*, in GLOBAL MARKETS, DOMESTIC INSTITUTIONS 476 (2003).

[9] The "exit option" is defined as: venture capitalists (who raise capital from various investors) invest their capital in high-tech private startups in return for a bloc of shares of the startup. Once the startup venture can be presented as an investment to the public, venture capitalists ask the corporation to fulfill its part of the deal by conducting an initial public offering. In that initial public offering the venture capitalists sell their bloc of shares to the public and cash out their investment.

[10] By creating the image that the Israeli corporation is an American company, Israeli venture capitalists could market their corporation as if it was a Silicon Valley corporation and thus, can attract more investors and sell their securities for higher prices.

[11] Edward B. Rock, *Coming to America? Venture Capital, Corporate Identity and U.S. Securities Law*, *supra* Note 8, at 23.

Exchange from which Rock claims it has never quite recovered. Although markets performance could also have an impact on the decision to come to America, and although the 1994 crash of the Tel Aviv stock exchange still affects the Israeli market, it is important to note that the Tel Aviv stock exchange has also had its good times after the 1994 crash. Since 1994, the Tel Aviv Stock Exchange indexes recovered and even today, after the burst of the high-tech bubble, those indexes are much higher than they were prior to the 1994 crash.[12] Also, Rock does not explain why Israeli corporations did not choose to go public in Israel and then to register ADRs[13] or to cross-list in the U.S., exactly as other corporations from around the world had chosen to do, and thus to eliminate some significant costs.[14]

In Rock's second article, *Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets*,[15] Rock again focuses on Israeli high-tech companies in the context of coming to America to use the U.S. stock markets as an exit option for venture capitalists.[16] Rock, however, does not discuss the decision of other Israeli corporations from other industries to go public in the U.S.

2. <u>Licht's avoiding theory</u>.

Amir Licht discussed the Israeli phenomenon in number of important articles. In *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, Licht argued that one of the reasons that can lead corporation to list or to cross-list abroad is managerial opportunism and that foreign corporations' listing in the U.S. is considered as piggybacking on a superior regulatory system to bond managers and insiders of the corporation. However, U.S. laws offer Israeli and other foreign issuers several exemptions from important disclosure requirements. Consequently, those exemptions create a situation under which the legal requirements imposed on Israeli corporations in the U.S. are more lenient than those that are imposed under the Israeli law. Therefore,

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[12] Until March, 2004 "Tel Aviv 100" Index gained 117 points from its 1995 level of 566.07. Until March, 2004 "Tel Aviv 25" Index gained 103.7 points from its 1995 level of 522.75. Until March, 2004 "Tel Aviv Surplus" Index gained 107.3 points from its 1995 level of 463.35. Tel Aviv Stock Exchange, *Indexes of yield from stocks and convertible instruments for the years 1990-2004*, available at http://www.tase.co.il/portal/pdf/pdf-m/l7.pdf.

[13] American Depository Receipts are defined as: "[a] receipt issued by an American bank as a substitute for stock shares in a foreign-based corporation. ADRs are the most common method by which foreign companies secure American shareholders. Companies that offer ADRs maintain a stock listing in their domestic market in their domestic currency, while the ADRs are held in U.S. dollars and listed on a U.S. stock exchange, usually the New York Stock Exchange." BLACK'S LAW DICTIONARY (8th ed. 2004.)

[14] By registering ADRs, Israeli corporations could have saved the costs of listing their securities and conducting a full public offering in the U.S. Such costs are high due to the need to hire Israeli and U.S. lawyers, and to the limited number of U.S. underwriting firm that are willing to sell Israeli corporation's stocks.

[15] Edward B. Rock, *Greenhorns, Yankees and Cosmopolitans: Venture Capital, IPOs, Foreign Firms & U.S. Markets*, 2 Theoretical Inquiries in Law 711 (2001).

[16] In this article, Rock discusses "the phenomenon of Israeli high-tech companies going public on the NASDAQ as a case study to explore the connection between the venture capital industry and domestic capital markets in a world of global capital and product markets." *Id*. at 717.

by listing in the U.S., Israeli corporations do not better bond their insiders but rather avoid the more stringent Israeli law.[17]

Licht further explained this avoiding theory in his seminal article *Cross-Listing and Corporate Governance: Bonding or Avoiding?* In this article, Licht critically examined the bonding hypothesis as a cause for cross-listing and argued that corporations are interested in cutting corners on corporate governance issues related to corporate insiders and that the SEC has cut such corners by exempting foreign issuers from several securities laws provisions. According to the evidence surveyed in his article, Licht argued that cross-listing in the U.S. does not create an effect that could be attributed to corporate governance improvements. With respect to the Israeli phenomenon, Licht argues that Israeli corporations chose to list in the U.S. in order to avoid the strict securities laws in Israel and not in order to bond their corporate insiders in the U.S.[18]

3. <u>Blass and Yafeh's signaling theory</u>.

In their article *Vagabond shoes longing to stray: Why foreign firms list in the United States*[19] Blass and Yafeh argued that Israeli corporations that went public in the U.S. are young, innovative firms, "in need of certification of their value."[20] They further argue that those Israeli corporations were willing to pay costs such as, under-pricing and selling of large blocs of their stocks in order to access NASDAQ, to have their firm value revealed, and to signal that they are high quality firms. Thus, Blass and Yafeh suggest that signaling was the reason behind the decision of Israeli corporations to list in the U.S.

The foregoing articles discussed the Israeli phenomenon and suggested several explanations for the decision of Israeli corporations to go public in the U.S. This Article examine all those suggested explanations and explicitly compare the relevant Israeli and U.S. laws to better determine if law does matter and thus, if there is a basis for the bonding hypothesis in the context of the Israeli phenomenon.

IV. DOES LAW MATTER? A COMPARATIVE THEORETICAL ANALYSIS

In this chapter we theoretically test whether the law matter for Israeli corporations that chose to go public in the U.S. In this theoretical analysis, we follow the basic comparative law principles. We explicitly compare the two laws and examine the differences and similarities between the two laws and the possible reasons for such differences or similarities.[21]

[17] Amir Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U. Pa. J. Int'l. Econ. L. 325, 346 (2001) (arguing that "[b]y listing, and remaining listed, only in the American market officers and controlling persons of Israeli issuers were able to take advantage of its more lenient disclosure regime.")

[18] Amir Licht, *Cross-Listing and Corporate Governance: Bonding or Voiding?*, 4 Chi. J. Int'l L. 141 (2003).

[19] Asher Blass and Yishay Yafeh, *Vagabond shoes longing to stray: Why foreign firms list in the United States*, 25 J. Bank. & Fin. 555 (2001).

[20] *Id.* at 570.

[21] John C. Reitz, *How to Do Comparative Law*, 46 Am. J. Comp. L. 617 (1998).

A. COMPARATIVE ANALYSIS FRAMEWORK

The decision of Israeli corporations to go public in the U.S. could have two basic reasons, one is a law related and the other is a non-law related. The law related reason is that Israeli corporations seek to escape from a weak investor-protective legal regime and opt into a more investor-protective regime offered in the U.S. In such case, law matter for Israeli corporation that chose to migrate to the U.S.[22] The non-law related reason for the decision of Israeli corporations to migrate to the U.S. is, for example, the more liquid capital markets in the U.S., the desire to be recognized as an American business (i.e., image concerns), or the desire of Israeli corporations to "signal" to investors that they are a safe and promising investment. In order to lay down the foundations for the following theoretical analysis, we first explain several core theoretical issues such as, the importance of the level of investor protection, the bonding hypothesis, private benefits, and the signaling theory.

1. Level of Investor Protection.

Strong investor protection is an essential factor in determining the quality of corporate governance. Investor protection is defines as "the extent of the laws that protect investors' rights and the strength of the legal institutions that facilitate law enforcement."[23] In the comparison between the Israeli and the U.S. laws, we examine both how the law protects investors and how the judiciary protects investors' rights. A high level of legal protection for investors creates (i) more valuable stock markets, (ii) larger number of listed corporations, (iii) larger listed firms in terms of their sales or assets, (iv) grater dividend payouts, (v) lower concentration of ownership and control, (vi) lower private benefits of control, (vii) higher correlation between investment opportunities and actual investments, and (viii) higher valuation of listed firms relative to their assets.[24] Several commentators examined the level of investor protections in different countries including Israel and the U.S. One example of such examination of the level of investor protection in different countries is the seminal article *Investor Protection and Corporate Valuation* by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny ("LLSV"). In this article, LLSV studied the effect of investor

[22] Generally, law matters because it protects investors from expropriation by insiders (i.e., managers and controlling shareholders) of corporate assets. Thus, the level of investor protection can affect the attractiveness of the corporation to investors and therefore can affect the cost of new capital for the corporation. See Karl V. Lins & Francis E. Warnock, *Corporate Governance and the Shareholder Base*, European Corporate Governance Institute (ECGI) – Finance, Working Paper No. 43/2004, available at www.ssrn.com. For a discussion on how insider's expropriation of corporate resources lower the value of shares (and thus makes it more expensive to raise capital), see Ruti Dahan & Shmuel Hauser, *The Linkage Between the Quality of Supervision, Voting Rights in Shares and the Control Structure in a Corporation*, The Israeli Securities Authority Publication (1997).

[23] Defond Mark L. & Hung Mingyi, *Investor Protection and Corporate Governance: Evidence from Worldwide CEO Turnover*, 42 J. Acct. Res. 269 (2004).

[24] Andrei Shleifer & Daniel Wolfenzon, *Investor Protection and Equity Markets*, Harvard Institute of Economic Research, Discussion Paper Number 1906, available at http://post.economics.harvard.edu/hier/2000papers/2000list.html.

protection on the valuation of corporations from twenty seven economies.[25] LLSV found that the Israeli legal system provides less protection for investors than the U.S. legal system does.[26] Another study that examined some aspects of the level of investor protection in different countries is Hail and Leuz's *International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?* In this article, Hail and Leuz found that Israel has a lower "index of rule of law" than the U.S. and thus, in Israel the cost of capital is higher than in the U.S.[27]

2. Functional or Formal Convergence.

Investors are usually reluctant to invest in corporations from countries that offer a low level of investor protection. Corporations from such countries will find it harder and more expensive to raise external capital. To correct this problem, countries can amend their laws to follow other legal regimes that provide a higher level of investor protection and therefore, to better protect investors. Amending the laws in order to follow the laws of another country is called "formal convergence".[28] If the country with the low level of investor protection decides not to amend its laws or if the law reform in that country is not made within a reasonable period of time, corporations from that country will be forced to opt into a different legal regime that offers a better investor protection. The migration of corporations to a different legal regime in order to opt into the laws of that regime is called "functional convergence".[29]

Commentators argue that in order to achieve formal convergence, a country must overcome political, cultural[30] and legal impediments.[31] Some of the impediments are, for example, the objection of interest groups, such as controlling shareholders and labor groups to the legal reform, the need to adopt a large network of shareholder rights, or even different cultural preferences. When it is difficult to achieve formal convergence, corporations that compete in the global markets will find it beneficial to engage in

[25] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, *Investor Protection and Corporate Valuation*, NBER Working Paper Series, Working Paper 7403, available at http://www.nber.org/papers/w7403.

[26] Investors' protection was measured by using the number of "anti director rights" each country offers. For "anti director rights" see Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Visny, *Law and Finance*, 106 J. Pol. Econ. 1113 (1998); LLSV used Tobin's Q to measure the level of investor protection in each legal system. To compute the Tobin's Q, LLSV used the book value of assets minus the book value of common equity and deferred taxes plus the market value of common equity as the numerator, and the book value of assets as the dominator. The result from this calculation was that Tobin's Q in Israel is 1.1672 while in the U.S. it is 1.3950.

[27] Luzi Hail & Christian Leuz, *International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?*, European Corporate Governance Institute Law Working Paper No. 15/2003, available at http://ssrn.com/abstract=437603. In this study, the Israeli legal system's "index of rule of law" score is 0.48, while in the U.S. it is 1.00; the cost of equity capital is Israel is 10.95% while in the U.S. it is 9.75%.

[28] Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 Am. J. Comp. L. 329 (2001).

[29] *Id.*

[30] Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 Berkeley J. Int'l L. 195 (2004).

[31] Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence In Corporate Ownership And Governance*, 52 Stan. L. Rev. 127 (1999).

functional convergence and to opt into the laws of a different country by, for example, incorporating or listing their securities in that country. Professor Gilson argues that "functional convergence is likely the first response to competitive pressure because changing the form of existing institutions is costly."[32]

By engaging in a functional convergence, corporations can raise the level of confidence of investors to invest in them, can better attract external capital, and can increase their value.[33] Commentators argued that foreign firms that migrate to the U.S. are able to overcome their home country's weak legal system.[34] Professors Hansmann and Kraakman mentioned in that regard that "to the extent that domestic law or domestic firms fail to provide adequate protection for public shareholders, other jurisdictions can supply the protection…domestic companies may be able to reincorporate in foreign jurisdiction or bond themselves to comply with the shareholder protection offered by foreign law by listing on a foreign exchange (as some Israeli firms now do by listing on NASDAQ)".[35]

3. <u>The Bonding Hypothesis</u>.

Under the bonding hypothesis, corporations choose to opt into a different legal regime in order to increase the level of protection they offer to their investors. The issue of bonding begins with the central characteristic of the modern corporation which is the separation of ownership and control.[36] This separation of ownership and control shifts the daily management of the corporation from the shareholders to the managers. Shareholders are less involved in managing the corporation and therefore can invest in different corporations and diversify their portfolio. At the same time, shareholders enjoy the performance of a professional management.[37] By diversifying their portfolio, shareholders enjoy a lower risk associated with their investments. The result is that the corporation runs efficiently while the shareholders' ability to invest in risky business activities, improves.[38] The separation of ownership and control has also a negative side known as the "agency problem". The managers who run the corporation have a basic

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[32] Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, *supra* Note 28, at 338.
[33]*Id.* at 337. La Porta et al. argue that Functional convergence might play a role in improving investor protection. If a country with a weak investor protection will not change its laws in order to better protect investors, corporations will opt into other legal regimes, for example, by listing the corporation's securities on an exchange that protects minority shareholders through disclosure or other means. La Porta et al., *Investor Protection and Corporate Governance*, *supra* Note 25.
[34] John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, *supra* Note 1. In a recent Article, Jordan Siegel "agrees with the path dependency perspective that formal convergence faces too many obstacles to be predicted" and "that functional convergence can be facilitated by a much more feasible and largely voluntary route. That route runs through the international securities markets and, in particular, involves the growing migration of foreign firms to the U.S. equity markets." Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, 75 J. Fin. Econ. 319 (2005).
[35] Henry Hansmann and Reinier Kraakman, *The End of History for Corporate Law*, 89 Geo. L. J. 439, 464 (2001).
[36] See, Adolf A. Berle & Gardener C. Means, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).
[37] Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. Pol. Econ. 288 (1980).
[38] Zohar Goshen, *Controlling Corporate Agency Costs: A United States – Israeli Comparative View*, 6 Cardozo J. Int'l & Comp. L. 99 (1998).

instinct to promote their own interest instead of the interest of the shareholders.[39] Another type of agency problem is created when controlling shareholders take advantage of their position and expropriate private benefits from the corporation on the expense of the outside investors and other constituencies of the corporation.[40]

Expropriation by managers or controlling shareholders can take different forms. The managers or controlling shareholders can simply steal the assets of the corporation, conduct transfer pricing, asset stripping or dilution of the minority shareholders' holdings, install unqualified family members in managerial positions and overpay those managers.

Recent studies found that a corporation will find it considerably more difficult to raise external capital where the legal protection for minority shareholders is weak.[41] Therefore, in order to make it easier for the corporation to raise external capital there is a need for stricter laws that will deter controlling shareholders and managers from expropriating the resources of the corporation. The stricter laws can be achieved by changing the laws of the corporation's home country or by opting to a stricter legal regime by listing securities at the host country.[42] Adopting into stricter laws is, in fact, bonding.

Several commentators support the bonding hypothesis for various reasons while others oppose it. John Coffee argues that "those firms seeking to grow in size to a global scale are likely to elect into the "higher" governance standards already largely observed in the United States, and such bonding should minimize the social friction and even unrest that formal convergence could cause."[43] Reese and Weisbach examine whether the issue of bonding "at least partially explains the recently observed rise in cross-listing." They find that "overall, the desire to protect shareholders rights appear to be

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[39] For a general discussion and international perspective of the agency problem, see Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737 (1997).

[40] See Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 395 (1976).

[41] See for example, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Visny, *Legal Determinants of External Finance*, Journal of Finance, 52, 1131-1150 (1998); La Porta et al, *Law and Finance*, *supra* Note 26; Rafael La Prota, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, *Investor Protection and Corporate Governance*, 58 J. Fin. Econ. 3 (2000) (arguing that outside investors choose to invest in a corporation because their rights are protected by law).

[42] "[T]he bonding hypothesis suggests that firms from countries with poor protection of minority shareholders signal their desire to respect the rights of shareholders by listing in a jurisdiction with higher scrutiny, tougher regulation, and better enforcement", Michael R. King & Dan Segal, *International Cross-Listing and the Bonding Hypothesis*, Bank of Canada, Working Paper 2004-17, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=555953; Edward B. Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 Cardozo L. Rev. 675 (2002). Other than by law, bonding can be achieved also through the use of courts or other intermediaries, such as, underwriters, auditors, analysts, or stock markets.

[43] John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, *supra* Note 1. See also, John C. Coffee, Jr., *Racing Toward the Top?: The Impact of Cross-listing and Stock Market Competition on International Corporate Governance*, 102 Colum. L. Rev., 1757 (2002) (arguing that "[l]aw matters most to those firms needing access to external finance. To the extent that these firms are incorporated under legal regimes that do not protect minority rights, private action becomes the necessary (if partial) substitute for stronger law. Cross-listing is ultimately a form of private action and is most likely to be undertaken by firms seeking access to equity capital and needing to compensate for weak law in their jurisdictions of incorporation.")

one reason why some non-U.S. firms cross-list in the United States."[44] Benos and Weisbach test the implications of the bonding hypothesis on cross-listing. They argue that "the desire to protect shareholders' rights so as to facilitate access to equity markets is one of a number of reasons why firms choose to cross-list their stocks in the United States."[45] Oren Fuerst argued that "in contrast to the claim that the strict regulatory environment deters firms from listing on that market… large differential between markets with respect to the regulatory strictness may, in fact, increase the number of firms listing on the market with stricter regulations. The implications of the model are consistent with the empirical evidence regarding global cross-listing."[46] Hail and Leuz argue that "cross listing on U.S. exchanges are associated with a significant decrease in firms' cost of equity capital" and that in this regard "companies from countries with weak legal institutions benefit the most from cross-listing on U.S. exchanges. This finding supports the bonding hypothesis and the notion that firms use cross-listing to opt out of their institutional system by submitting themselves to the U.S. institutional environment."[47]

The opposition to the bonding hypothesis is based on the argument that foreign corporations choose the U.S. not in order to bond their insiders but rather to enjoy cheaper sources of finance, to enhance their visibility, to enjoy better liquidity offered by the U.S. capital markets, or to avoid the stringent laws of the home country (the "avoiding theory"[48]).

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[44] William A. Reese, Jr. & Michael S. Weisbach, *Protection of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings*, NBER Working Paper Series, Working Paper 8164, available at http://www.nber.org/papaers/w8164.

[45] Evangelos Benos & Michael S. Weisbach, *Private Benefits and Cross-Listings in the United States*, NBER Working Papers Series, Working Paper 10224, available at http://www.nber.org/papers/w10224;

[46] Oren Fuerst, *A Theoretical Analysis of the Investor Protection Regulations Argument for Global Listing of Stocks*, Working Paper, Yale International Center for Finance, available at http://ssrn.com/abstract=139599

[47] Luzi Hail & Christian Leuz, *Cost of Capital and Cash Flow Effects of the U.S. Cross-Listings*, European Corporate Governance Institute, Finance Working Paper No. 46/2004, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=549922; See also, Craig Doidge, G. Andrew Karolyi, & René M. Stulz, *Why are foreign firms listed in the U.S. worth more?*, J. Fin. Econ. 71(2) 205 (2004) (arguing that "at the end of 1997, the foreign companies listed in the U.S. have a Tobin's q ratio that exceeds by 16.5% the q ratio of firms from the same country that are not listed in the U.S." and that "controlling shareholders of firms listed in the U.S. cannot extract as many private benefits from control compared to controlling shareholders of firms not listed in the U.S., but that their firms are better able to take advantage of growth opportunities. Consequently, the cross-listed firms should be those firms where the interests of the controlling shareholder are better aligned with the interests of other shareholders. The growth opportunities of cross-listed firms will be more highly valued than those of firms not listed in the U.S. both because cross-listed firms are better able to take advantage of these opportunities and because a smaller fraction of the cash flow of these firms is expropriated by controlling shareholders.")

[48] Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, *supra* Note 1, at 142 (arguing that "[t]he dominant factors in the choice of cross-listing destination markets are access to cheaper finance and enhancing the issuer's visibility. Corporate governance is second-order consideration whose effect is either to deter issuers from accessing better-regulated markets or to induce securities regulators to allow foreign issuers to *avoid* some of the more exacting domestic regulations.")

4. Private Benefits and the Signaling Theory.

Private benefits is another issue to consider when examining the decision of Israeli corporations to list in the U.S.[49] Private benefits occur to managers or controlling shareholders who control the corporation. Private benefits can be both pecuniary and non-pecuniary.[50] The level of private benefits of managers or controlling shareholders directly affects the value of the corporation because corporations will be worth less to investors if the corporations' managers or controlling shareholders can extract significant private benefits. Benos and Weisbach estimate the private benefits in different countries around the world. Using the Dyck-Zingales raw measure of private benefits,[51] they argue that the estimate of private benefits in Israel exceed those in the United States. While Israeli managers and controlling shareholders enjoy an estimate of 25.4%, their American counterparts enjoy an estimate of only 3.7%.[52]

If Israeli managers or controlling shareholders lose some of their private benefits when the corporation goes public in the U.S., they will tend to object to the idea of listing in the U.S. However, those managers will support listing in the U.S. if it will allow them to enjoy a higher level of private benefits than what they currently enjoy.[53] Doidge, Karolyi and Stulz argue that foreign corporations listed in the U.S. have a larger listing premium than corporations from the same country that chose to go public in their home country.[54] Such listing premium can be an incentive for managers and controlling shareholders to list in a jurisdiction in which their can extract less private benefits. Firms from jurisdictions where the agency costs are high do not list in the U.S. because it poses a threat to private benefits. As a result, only in firms with high growth opportunities, controlling shareholders and managers will have an incentive to give up their private benefits and to list in the U.S. In their study, Doidge, Karolyi and Stulz found that Israeli corporations that chose to go public in the U.S. have a higher cross-listing premium than Israeli corporations that chose to go public in Israel.[55]

Another explanation for the decision of managers and controlling shareholders to list in the U.S. and therefore to give up some of their private benefits is that they wish to

[49] See Craig Doidge, G. Andrew Karolyi, Karl V. Lins, Darius P. Miller & Rene M. Stulz, *Private Benefits of Control, Ownership, and the Cross-Listing Decision*, Dice Center Working Paper No. 2005-2, available at http://ssrn.com/abstract=668424 (testing and suggesting empirical evidence to the proposition that when private benefits are high, controlling shareholders are less likely to list their corporation in the U.S.).

[50] Evangelos Benos & Michael S. Weisbach, *Private Benefits and Cross-Listings in the United States*, *supra* Note 45. For an international analysis (not including Israel) of the value of control benefits, see Tatiana Nenova, *The Value of Corporate Votes and Control Benefits: A Cross-country Analysis*, available at http://ssrn.com/abstract=237809.

[51] Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, NBER Working Papers Series, Working Paper 8711, available at http://www.nber.org/papers/w8711.

[52] Evangelos Benos & Michael S. Weisbach, *Private Benefits and Cross-Listings in the United States*, *supra* Note 45.

[53] The form of private benefits manages can get after incorporating or listing in a more protective legal regime is, for example, higher premiums on their securities, higher value to the corporation, etc.

[54] Craig Doidge, G. Andrew Karolyi, & René M. Stulz, *Why are foreign firms listed in the U.S. worth more?*, supra Note 47.

[55] *Id.* (Measuring cross-listing premium (q) as follows: for the numerator they take the total assets, subtract the book value of equity, and add the market value of equity. For the denominator they use the total assets).

"signal" investors that they will, from now on, act under a new legal system that provides better protection to investors that creates a higher future profitability.[56] Oren Fuerst found that "managers of foreign firms may credibly convey their private information regarding their firm's future prospects through the decision to list in a market with strict regulatory environment. Specifically, by assuming additional regulatory exposure (related to investor protection), these manages separate their firms from firms with lower future profitability. As a result, they are compensated by higher market values."[57] Blass and Yafeh argue that signaling plays an important role in attracting foreign corporations to the U.S. markets however, they argue, opting into a stronger laws is not necessarily the only explanation for that.[58]

B. GOING PUBLIC IN THE U.S. – DOES LAW MATTER?

1. Cross-Listing in General.

Unlike most of the foreign corporations cross-listed in the U.S., most of the Israeli corporations chose to list their shares for the first time in the U.S. by conducting their initial public offering in the U.S.[59] We use cross-listing principles as a tool to examine Israeli corporations' motivation to list in the U.S., because most of the incentives associated with cross-listing in the U.S. can also affect foreign corporations' decision to conduct their initial public offerings in the U.S.

Cross-listing is a worldwide phenomenon that started approximately 20 years ago. Many foreign corporations chose to cross-list in the U.S. As of December 31, 2003 there were approximately 1,200 foreign firms reporting with the SEC.[60] There are four major reasons why corporations choose to cross-list. One is based on the bonding hypothesis.[61] The second reason includes issues, such as, liquidity of markets,[62] increase

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[56] Oren Fuerst, *A Theoretical Analysis of the Investor Protection Regulations Argument for Global Listing of Stocks*, *supra* Note 46; C. Sherman Cheung & Jason Lee, *Disclosure Environment and Listing on Foreign Stock Exchanges*, Journal of Banking and Finance 19, 347 (1995) (arguing that disclosure standard set by securities exchanges or their agencies are used as signaling mechanism that enable firms to differentiate themselves in the global market).

[57] Oren Fuerst, *A Theoretical Analysis of the Investor Protection Regulations Argument for Global Listing of Stocks*, *supra* Note 46; Additionally, abnormal returns on the securities of cross-listing corporations that chose to list in a more restrictive exchange (i.e. NASDAQ, NYSE) are higher then those of corporations that chose to list under a less restrictive system (i.e. PORTAL). This shows that the increase in value is positively related to the level of investor protection provided by the hosting regime and to the signaling hypothesis. See, Darius P. Miller, *The Market Reaction to International Cross-Listing: Evidence From Depository Receipts*, J. Fin. Econ. 51, 103 (1999).

[58] Asher Bless & Yishay Yafeh, *Vegabond Shoes Longing to Stray: Why Foreign Firms List in the United States*, *supra* Note 19.

[59] i.e., list their securities with U.S. securities markets prior to or instead of listing them with the Tel Aviv Stock Exchange.

[60] Larry E. Ribstein, *Cross-Listing and Regulatory Competition*, supra Note 4.

[61] See for example, John C. Coffee, Jr., *Racing Toward the Top?: The Impact of Cross-listing and Stock Market Competition on International Corporate Governance*, *supra* Note 43. Empirical studies on cross-listing shows that as a result of bonding the corporate insiders, cross-listing reduces the cost of capital for the corporation. Rene M. Stulz, *Globalization, Corporate Finance, and the Cost of Capital*, J. App. Corp. Fin. 12(3), 8 (1999). Firms that announced listing in the U.S. documented a significant abnormal stock return and

in the number of investors, segmentation,[63] and image.[64] The third reason for cross-listing is that corporations choose to avoid their home country's stringent laws.[65] The fourth reason is that corporations cross-list to signal investors that they are a safe and good investment.

2. Going public in the U.S. – Theoretical analysis.

There are two possible reasons for the decision of Israeli corporations to go public in the U.S. One is law-related and the other is non-law-related. The law-related reasons for choosing to go public in the U.S. are supported by the bonding hypothesis or conversely by the avoiding theory under which corporations decide to go public in another jurisdiction in order to escape their home country's stringent rules and to opt into a more lax legal system. The non-legal reasons for going public in a different jurisdiction include better liquidity or openness for early stage corporations offered by the host country's markets, improvement of image, and visibility. We compare the laws and regulations of the U.S. and Israel to determine whether law has anything to do with the decision of Israeli corporations to list in the U.S.

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therefore, their shareholders' wealth increased. Darius P. Miller, *The Market Reaction to International Cross-Listing: Evidence From Depository Receipts*, *supra* Note 57; Dong W. Lee, *Why Does Shareholder Wealth Increase When Foreign Firms Announce Their Listing in the U.S.?*, available at http://ssrn.com/abstract=422960; Warren Baily, G. Andrew Karolyi & Carolina Salva, *The Economic Consequences of Increased Disclosure: Evidence from International Cross-Listings*, Dice Center Working Paper No. 2002-4, available at http://ssrn.com/abstract=304560 (arguing that return and volume reactions to earning announcements increases significantly once the stock is cross-listed in the U.S.).

[62] Amihud and Mendelson argue that, in the U.S. domestic level, "the liquidity-increasing motive may explain the desire of many firms to list on the large and organized securities exchanges despite the costs and restrictions associated with such listing…", Yakov Amihud & Haim Mendelson, *Liquidity and Asset Prices: Financial Management Implications*, 17 Fin. Mgmt. 5 (1988). For further discussion on liquidity see Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread,* 17 J. Fin. Econ. 223 (1986).

[63] Under the market segmentation hypothesis, corporations cross-list to overcome regulatory restrictions, cost, taxes, and information problems. See Stephen R. Foerster & Andrew G. Karolyi, *International Listing of Stocks: The Case of Canada and the U.S.*, 24 J. Int'l Bus. Stud. 763 (1993). See Stephen R. Foerster & Andrew G. Karolyi, *The Effects of Market Segmentation and Investor Recognition on Asset Prices: Evidence from Foreign Stocks Listing in the U.S.*, Dice Center for Research in Financial Economics Working Paper No. 98-11, available at http://ssrn.com/abstract=136713 (arguing that stock prices of firms that cross-list from segmented markets are expected to rise and expected return will fall). Additionally, "international asset pricing model suggest a lowering in the cost of capital for firms from segmented economies that can access the international capital market." Vihang R. Errunza & Darius P. Miller, *Market Segmentation and the Cost of Capital in International Equity Markets*, 35(4) J. Fin. & Quant. Ana. 577 (2000).

[64] Marco Pagano, Ailsa A. Roell & Josef Zechner, *The Geography of Equity Listing: Why Do Companies List Abroad?*, 57(6) J. Fin. 2652 (2002) (arguing that the advantages in listing in the U.S. markets, at least for European corporations, are visibility, image and liquidity).

[65] Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, *supra* Note 1. For further discussion on cross-listing, see Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, supra Note 30 (arguing that corporations choose to cross-list in order not to bond but to avoid their home country's stringent laws).

2.1 Hypothesis A: Law does not matter.

There are several possible non-legal reasons behind the decision of Israeli corporations to go public in the U.S. rather than in the Tel Aviv Stock Exchange or anywhere else in the world.

2.1.1 Liquidity.

Liquidity measures how quickly and cheaply an asset can be converted into cash. Conversely, assets that can only be sold after a long exhaustive and costly search for a buyer are illiquid. Liquidity is measured in the bid-ask spread, an expansion of trading hours within the 24 hours period, an increase in trading volume, and a shift in shareholder base.[66] Liquidity of securities is defined as "the characteristic of having enough units in the market that large transactions can occur without substantial price variations."[67] Thus, markets with better liquidity are more favorable to investors and therefore attract more corporations.[68]

Just by comparing the number of corporations quoted on the NASDAQ and listed with the Tel Aviv stock exchange and on daily average of the dollar volume in each of those stock markets, it is obvious that the stock markets in the United States offer better liquidity. The NASDAQ alone quotes more than 3,300 corporations,[69] while in the Tel Aviv Stock Exchange, which is the only securities market in Israel, there are approximately 620 listed corporations.[70] As a result, the number of investors who invest in securities quoted on the NASDAQ is much greater than the number of investors who invest in securities traded on the Tel Aviv Stock Exchange.[71] Additionally, the average daily dollar volume in the NASDAQ is over $25 billion while in the Tel Aviv Stock Exchange it is only over $50 million.[72]

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[66] G. Andrew Karolyi, *Why Do Companies List Shares Abroad?: A Survey of the Evidence and Its Managerial Implications*, Financial Markets, Institutions & Instruments, V. 7, N. 1 (1998).
[67] BLACK'S LAW DICTIONARY (8th Edition 2004).
[68] Marco Pagano, Otto Randl, Ailsa A. Roell & Josef Zechner, *What Makes Stock Exchanges Succeed? Evidence from Cross-Listing Decisions*, 45 Euro. Econ. Rev. 770 (2001) (arguing that European corporations, for example, are more likely to cross-list in a more liquid markets such as the U.S. markets. Brian J. Henderson, Narasimahn Jegadeesh & Michael S. Weisbach, *World Markets for Raising New Capital*, NBER working paper w10225, available at http://ssrn.com/abstract=466540 (arguing that liquidity is one of the reasons for the U.S. and U.K. markets' attractiveness for firms).
[69]Source: http://www.nasdaqnews.com/MarketData/News_mrktdata_home.htm.
[70] The Tel Aviv Stock Exchange Annual Summary for the Year 2002, publication number 4, December, 2002.
[71] Craig Doidge, G. Andrew Karolyi, & René M. Stulz, *Why are foreign firms listed in the U.S. worth more?*, *supra* Note 47 (describing a hypothesis advanced by Stephen R. Foerster & G. Andrew Karolyi, *The Effect of Market Segmentation and Investor Recognition on Assets Prices: Evidence from Foreign Stocks Listing in the United States*, 54 J. Fin. 981 (1999). Under this hypothesis, because there are more investors who invest in securities listed with the U.S., markets the shareholder base of a corporation increases by listing in the U.S. and as a result, the firm's risk is shared among more shareholders and the firm's cost of capital decreases).
[72] The Tel Aviv Stock Exchange Annual Summary for the Year 2002, *supra* Note 70.

Several issues were identified as reasons for the low liquidity of the Tel Aviv Stock Exchange.[73] First, mostly as a result of concentrated ownership of Israeli corporations, in average, the number of floating stocks[74] is only 30% of the total number of registered stocks[75]; second, most of the corporations listed in the Tel Aviv Stock Exchange are small corporations that do not attract institutional investors; third, the market value of the corporations listed in the Tel Aviv Stock Exchange is one of the lowest between developed countries; fourth, the trading volume in the Tel Aviv Stock Exchange is one of the lowest in the world; fifth, the number of trades in listed stocks are low[76]; sixth, institutional investors' participation in trading in the Tel Aviv Stock Exchange is low because investors trade more in non-listed securities[77]; seventh, the absence of market makers as creators of liquidity; and eighth, the vast majority of the activity in the market is made by banks and their trust funds and by provident funds.[78]

Commentators argue that the greater liquidity of the United States securities markets increase both the access to external capital and the value of foreign corporations that list in the United States.[79] Thus, liquidity could be the reason, or at last of the reasons, behind the decision of Israeli corporation to go public in the U.S.

2.1.2 Image, Visibility and Product Marketing.

Visibility is the extent in which analysts follow a firm's security and the amount of news coverage the firm gets. Increased visibility increases credibility. Better visibility and exposure were found to be important in the decision of foreign firms to list abroad.[80] Commentators argue that listing in the U.S. increases the visibility of corporations.[81] By listing in the U.S., firms also enjoy better image and greater exposure to new markets for their products. Pagano, Roell and Zechner argue that foreign listing

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[73] Moshe Terri, *The Capital Market in Israel: Problems and Solutions*, Lecture by the Chairman of the Israeli Securities Authority, The Association of Provident Funds, Eilat, Israel, December 10, 2003.

[74] Floating Stock is defined as "the number of outstanding shares available for trading", BLACK'S LAW DICTIONARY (8th ed., 2004).

[75] Less than 8% of the total number of corporations listed in the Tel Aviv Stock Exchange do not have a controlling shareholder who owns more than 50% of the outstanding shares.

[76] For example: in 2002 there was, on average, less then one transaction per day in each of more then 300 of stocks listed in the Tel Aviv Stock Exchange (more then 50% of the total number of stocks listed in the Tel Aviv Stock Exchange).

[77] For example: in 2002, institutional investors invested NIS260 billion in non tradable securities and only NIS20 Billion in listed securities and NIS110 Billion in listed bonds (mostly government bonds).

78 For a full discussion on the Israeli market structure, see Ehud Ofer, *Glass-Steagall: The American Nightmare that Became the Israeli Dream*, 9 Fordham J. Corp. & Fin. L. 527 (2004).

[79] Craig Doidge, G. Andrew Karolyi, & René M. Stulz, *Why are foreign firms listed in the U.S. worth more?*, *supra* Note 47; Karl Lins, Deon Strickland & Marc Zenner, *Do non-U.S. firms issue equity on U.S. stock exchanges to relax capital constraints?*, AFA 2001 New Orleans, available at http://ssrn.com/abstract=206288.

[80] Shahrokh M. Saudagaran, *An Empirical Study of Selected Factors Influencing the Decision to List on Foreign Exchanges*, 19 J. Int'l Bus. Stud. 101 (1988).

[81] H. Kent Baker, John R. Nofsinger & Daniel G. Weaver, *International Cross-listing and Visibility*, available at http://ssrn.com/abstract=142287 (2002).

may increase the corporation's reputation in the product markets and can assist in reaching foreign investors.[82]

By listing in the U.S., Israeli corporations can market their success as being a member in an elite club, the world's most attractive stock markets. The change in image can disassociate the Israeli corporations from their Israeli identity and therefore to decrease barriers to potential investors and stock behavior due to political and economic events in Israel. A recent study found that Israeli firms listed only in the U.S. escape stock variability as a result of political events in Israel while Israeli firms listed in Israel or dually listed both in Israel and in the U.S. experience such stock variability.[83]

With better visibility, image and access to product markets, Israeli corporations listed in the U.S. gain the garment of the U.S. markets and thus become an interesting target for investors from around the world. Thus, image, visibility and product marketing can be the reason behind the decision of Israeli corporations to list in the U.S.

2.1.3 Reducing Information Costs for Investors and the Home-Bias Hypothesis.

By listing in the U.S., Israeli corporations are reaching closer to American investors. An Israeli corporation listed in the U.S. files its registration statement and its annual reports[84] with the S.E.C. Those reports are written in English and are in accordance with the U.S. laws and regulations. This reduces information costs for American investors who do not need to translate documents written in Hebrew, to understand the Israeli laws, or to hire Israeli legal counsels.[85] Less information cost creates an incentive for American investors to treat the Israeli corporations as if they were domestic corporations.[86]

Additionally, listing in the U.S. can attract more U.S. investors who would not otherwise invest in Israeli corporations if they were listed in Israel, or invest in Israeli corporations only if they get a significant value discount.[87] The fear of investors from the difference in ownership structure in Israel and from asymmetric information might make them prefer investments in domestic corporations rather than in Israeli corporations. This situation is known as the "home-bias hypothesis". Home-bias is created when investors are unwilling to diversify their portfolio internationally.[88] Tesar

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[82] Marco Pagano, Ailsa A. Roell & Josef Zechner, *The Geography of Equity Listing: Why Do Companies List Abroad?*, *supra* Note 64.

[83] Tzachi Zach, *Political Events and the Stock Market: Evidence from Israel*, 8 Int'l J. Bus. 243 (2003).

[84] Form 20-F, Registration of securities of foreign private issuers pursuant to section 12(b) or (g) and annual and transition reports pursuant to sections 13 and 15(d), 17 C.F.R. § 249.220f (2005).

[85] Investors of Israeli corporations listed in the U.S. will still have to understand the Israeli Companies Law because the internal affairs of Israeli corporations listed in the U.S. and incorporated in Israel is still governed by the Israeli Company Law.

[86] Alan G. Ahearne, William L. Griever & Francis E. Warnock, *Information Costs and Home Bias: An Analysis of U.S. Holdings of Foreign Equities*, Federal Reserve System, International Finance Discussion Paper number 691, available at http://www.federalreserve.gov/pubs/ifdp (arguing that listing in the U.S. reduces the information costs for investors because complying with the stringent SEC rule and the U.S. securities laws alleviates a significant information cost to the U.S. investor).

[87] See, Joshua D. Coval & Tobias J. Moskowitz, *The Geography Of Investment: Informed Trading And Asset Prices*, CRSP Working Paper No. 502, available at http://ssrn.com/abstract=214138.

[88] Michael R. King & Dan Segal, *Corporate Governance, International Cross-Listing and Home Bias*, available at http://ssrn.com/abstract=441760.

and Werner found that investor holdings are systematically biased toward domestic assets despite the potential gain from international diversification.[89] However, a firm may be able to overcome portfolio bias of foreign investors by listing in the investors' home market.[90] According to the home-bias hypothesis, Israeli corporations that will choose to list in Israel will attract less U.S. investors than those who will list in the U.S. Consequently, reducing investors' information costs and avoiding the home-bias hypothesis can be have an impact on the decision of Israeli corporations to list in the U.S.

2.1.4 Openness of Capital Markets to Early-Stage Corporations.

The U.S. securities markets are the world's leading markets with respect to investing in early-stage corporations, namely from the high-tech industry. High-tech and other early stage corporations can raise large amount of capital if they choose to list in the U.S.[91] The large amounts of capital and the openness of investors to invest in early-stage corporations encourage corporations to list in U.S. It is possible that the wave of listings of Israeli corporations in the U.S. was initially created by early-stage corporations and that those early stage corporations created a "herd affect" which made non-early-stage corporations to follow suit. Thus, the openness of the capital market to early-stage corporations can also be the reason for the decision of, at least some,[92] Israeli corporations to list their securities on the U.S. markets.

2.2 (Null) Hypothesis B: Law does matter.

In the following lines, we compare the relevant U.S. and Israeli laws and regulation in order to determine whether the Israeli laws and regulations provide more or less protection for investors than the U.S. laws do. Next, we discuss whether the Israeli judiciary is efficient in enforcing investors' rights. If the Israeli legal system provides a low level of investor protection that is less than the level of investor protection offered by the U.S. laws, then it is possible that law mattered for Israeli corporations that chose to go public in the U.S. However, if the Israeli legal system provides an adequate protection for investors, then non-legal reasons can explain why Israeli corporations chose to go public in the U.S.

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[89] Linda L. Tesar & Ingrid M. Werner, *Home Bias and High Turnover*, 14 J. Int'l Money & Fin. 467 (1995); Gur Huberman, *Familiarity Breeds Investment*, available at http://ssrn.com/abstract=199314.

[90] H. Kent Baker, John R. Nofsinger & Daniel G. Weaver, *International Cross-listing and Visibility*, *supra* Note 81; Sergei Sarkissian & Michael J. Schill, *The Overseas Listing Decision: New Evidence of Proximity Preference,* available at http://ssrn.com/abstract=267103.

[91] See Israeli Securities Authority, *The Dual Listing of Securities Commission Report*, available at www.isa.gov.il.

[92] Not all the Israeli corporations that chose to go public in the U.S. were early stage corporations.

2.2.1 The Relevant U.S. Laws and Regulations Providing Investors' Protection.

The laws of public corporations have two basic objectives, informed market pricing and effective corporate governance.[93] To define the scope of the comparison between the Israeli and U.S. laws we examine several aspects related to disclosure and corporate governance that were mentioned by commentators in the context of listing of foreign corporations in the U.S. Professor John Coffee discusses six provisions of the U.S. securities laws that "are likely to surprise the foreign issuer," because they go well beyond the provisions that are typically found in other countries in the degree they aid small investors.[94] Professor Ribstein discusses several provisions of the Sarbanes-Oxley Act that increase the requirements from U.S. issuers.[95] The following analysis does not examine corporate laws because the Israeli corporations we examine here are incorporated in Israel and thus, are still subject to the Israeli corporate law.[96]

2.2.2 Who Provides a Higher Level of Investor Protection?

(i) <u>Section 13(d) of the Exchange Act</u>.[97] This section requires any person or group owning more than five percent of any class of equity security registered pursuant to section 12 of the Exchange Act to file a Schedule 13D report within ten days after the five percent threshold is crossed. This provision ensures the disclosure of the identity of the large shareholders of the corporations that will enable the investor to make an informed investment decision.[98] The Israeli law requires similar reports and

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[93] Gerard Hertig, Reinier Kraakman & Edward Rock, *Issuers and Investor Protection*, in THE ANATOMY OF CORPORATE LAW A COMPARATIVE AND FUNCTIONAL APPROACH 193 (2004) (arguing that mandatory disclosure can perform up to three distinct governance functions "which might be termed the *enforcement*, *educative*, and *regulatory* functions…" The enforcement function of the mandatory disclosure helps investors to control the agency problem. Investors who are provided with all the relevant information on a corporate transaction, are able to make an informed decision and therefore to overcome any possible agency problem. The educative function of mandatory disclosure helps to inform investors when the law requires them to make corporate decisions, and therefore to encourage investors to take part in corporate governance. The regulatory function of mandatory disclosure forces corporations to commit themselves to follow norms of good governance that exceed the minimum requirements of corporate law. Additionally, the authors argue that major jurisdictions protect their investors with "rules that regulate what securities can trade on exchanges and how voting rights and other features of public stock must be structured; standards in the form of antifraud provisions; and…the trusteeship strategy in the form of merit regulation.")

[94] John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, *supra* Note 1, at 643 (discussing sections 13(d), 13(e), and 14(d) of the Exchange Act, Rule 10b-5 under section 10(b) of the Exchange Act, corporate governance issues, and Foreign Corrupt Practice Act issues).

[95] Larry E. Ribstein, *International Implications of Sarbanes-Oxley: Raising the Rent on US Law*, 3 J. Corp. L. Stud. 299 (2003).

[96] There are hundreds of Israeli businesses that chose to incorporate in the U.S. However, most of those businesses remained private companies after incorporating in the U.S.

[97] 15 U.S.C. § 78m(d) (2005).

[98] Section 13(d) together with sections 14(d) and 14(e) of the Exchange Act, were adopted by Congress in 1968. Those sections are collectively referred to as the "Williams Act" amendments. *Florida Commercial Banks v. Culverhouse*, 772 F.2d 1513 (11th Cir. 1985) (noting that "[t]he Williams Act was adopted in 1968 in response to the growing use of cash tender offers as a means for achieving corporate takeovers. The

even more. Section 33 of the Israeli Securities Regulations (Periodical and Immediate Reports)[99] requires that an immediate report will be filed within few hours or, at most, one day from the occurrence of an event in which any person becomes (a) the owner of more than five percents of the equity securities or of the voting rights, (b) the owner of the right to nominate one or more directors or the chief executive officer, or (c) a director or executive office of the corporation. Additionally, both Israeli and U.S. laws provide a private right of action in case of violation of this requirement.[100] Therefore, with respect to this requirement, the Israeli law and the U.S. law provide similar protection for investors.

(ii) <u>Section 14(d) of the Exchange Act</u>.[101] This is a broad antifraud provision, proscribing misleading or fraudulent conduct, statements, or omissions in connection with tender offers. Section 14(d) requires any person who makes a tender or exchange offers for more than five percent of any class of equity securities of a target corporation to file a statement containing the information specified in section 13(d) of the Exchange Act and to comply with the procedural requirements of section 14(d) of the Exchange Act.[102] This provision ensures the disclosure of the identity of the large shareholders of the corporations that will enable the investor to make an informed investment decision.[103] The Israeli law requires the same disclosure in order to alert investors that someone is trying to acquire a large bloc of securities and possibly to take over the corporation. Sections 3 and 20 of the Israeli Securities Regulations (Tender Offer)[104] requires every person who makes a tender offer for more than five percent of the listed securities of the corporation to file a specified offer with the Tel Aviv Stock Exchange, the Securities Authority and the target corporation and to publish the offer in two newspapers at the day of the offering. Under both laws there is a private right of action.[105] Hence, with respect to this requirement, the Israeli and U.S. laws provide similar protection to investors.

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purpose of the Williams Act was to protect the investors in target corporations from takeover bidders who up to that point had been able to operate in secrecy.")

[99] Securities Regulations (Periodical and Immediate Reports), 1970, K.T. 2591, 2037 ("Periodical and Immediate Reports Regulations").

[100] In Israel a private right of action is statutory. Israeli Securities Law, sections 38B, 38C, 52(11). In the U.S., a private right of action was recognized by courts. *Florida Commercial Banks*, 772 F.2d at 1519 (holding that "under the Williams Act an issuer has a private right of action to seek the remedy of corrective disclosures."); *General Aircraft Corp. v. Lampert*, 556 F.2d 90 (1st Cir. 1977); *GAF Corp. v. Milstein*, 453 F.2d 709 (2d Cir. 1971); *Dan River, Inc. v. Unitex, Ltd.*, 624 F.2d 1216 (4th Cir. 1980).

[101] 15 U.S.C. § 78n (d) (2005).

[102] Section 14(d) of the Exchange Act and Regulation 14D promulgated thereunder, 17 C.F.R. § 240.14d-1 et seq. (2005), require any person making a tender offer for more than five per cent of a class of equity securities of a company to file a Schedule TO Statement with the SEC which discloses certain specified information about the tender offer. This specified information includes the identity of the bidder, the identity of the subject company, the amount and class of securities being sought and the type and amount of consideration being offered, the scheduled expiration date of the tender offer, whether the tender offer may be extended and if so, the procedures for such extension.

[103] Purpose of the requirements under Section 14(d) is to alert the marketplace about every large, rapid aggregation or accumulation of securities which might represent potential shift in corporate control. See *GAF Corp. v Milstein* 453 F.2d 709 (2nd Cir. 1971).

[104] Securities Regulations (Tender Offer), 2000, K.T. 6019, 314.

[105] See *supra* Note 100.

(iii) Corporate governance. This issue refers to requirements listed in the agreement between the issuer and the stock exchange ("listing agreements"). Listing agreements apply U.S. corporate governance provisions on every issuer, domestic or foreign. The standard NYSE requirements requires every listed company to: (a) have at least two outside directors on its board, (b) establish and maintain an audit committee composed of independent directors, and (c) set an appropriate quorum requirement for shareholder meetings.[106] Those requirements protect investors from a possible conflict of interest by the management. The Israeli law sets similar requirements. According to the Israeli law, Israeli corporations listed in the Tel Aviv Stock Exchange are subject to the Israeli corporation laws that provide the corporate governance requirements for listed corporations. The Israeli Companies Law applies not only on Israeli public corporations listed in Israel but also on any Israeli corporation listed in any stock exchange around the world.[107] Additionally, the Israeli Companies Law requires from every public corporation to have at least two outside directors on its board,[108] to establish and maintain an audit committee composed of no less than three members[109] and that will include all the independent directors,[110] as well as to have a quorum of at least two shareholders who own at least twenty-five percent of the voting rights in every shareholder meeting.[111] Thus, with respect to the corporate governance requirements, the Israeli and the U.S. legal regimes provide similar protection to investors.

(iv) Section 13(e) of the Exchange Act.[112] This section, which was enacted as part of the Williams Act amendments, authorizes the SEC to adopt appropriate rules and regulations to bar fraudulent, deceptive or manipulative acts when an issuer commences a tender offer for or repurchases its own stock. Section 13(e) authorizes the SEC, in the going private context, to adopt rules and regulations to define acts and practices which are fraudulent, deceptive, or manipulative, and to prescribe means reasonably designed to prevent such acts and practices. This section provides further that "such rules and regulations may require such issuer to provide holders of equity securities of such class with such information relating to the reasons for such purpose, the source of funds, the number of shares to be purchased, the price to be paid for such securities, the method of purchase, and such additional information, as the Commission deems necessary or appropriate in the public interest or for the protection of investors, or which the Commission deems to be material to a determination whether such security should be sold."[113] The SEC's authority also extends to purchases of the issuer's securities by a controlling person or an affiliate

106 Those requirements are now anchored in the Sarbanes-Oxley Act.
107 Israeli Companies Law, section 1, definitions of "Public Corporation" and "Stock Exchange".
108 Israeli Companies Law, sections 239-249.
109 The Chairman of the board, any other director who is employed by the corporation, the controlling shareholder and his relatives will not be members of the audit committee.
110 Israeli Companies Law, sections 114-118.
111 Israeli Companies Law, sections 78-81.
112 15 U.S.C. § 78m(e) (2005).
113 15 U.S.C. § 78m(e)(1) (2005).

of the issuer. Pursuant to this authority, the SEC has promulgated Rule 13e-3[114] that protects investors in the event of a "going private" transaction by requiring the issuer to disclose information related to the transaction,[115] such as, fairness of the transaction,[116] purpose of tender offer, effect of tender offer upon other shareholders' rights, and the basis for tender offer price.[117] Rule 13e-3's triggering test is when the proposed transaction would result in the issuer losing its listing on a stock exchange or no longer being held by more than three hundred persons. This rule assures that shareholders are provided with sufficient time and information about those planning takeover bids so as to make informed investment decisions.[118] The Israeli law provides a similar protection for investors from fraudulent, deceptive, or manipulative "going private" transactions. Section 328 of the Israeli Companies Law prohibits the purchase of securities if such purchase will make the purchaser a controlling shareholder of the corporation or if such purchaser will hold more than forty-five percent of the voting rights of the corporation[119] unless such purchase is conducted as a tender offer. Such tender offer will offer to purchase the securities of all the shareholders of the corporation and will therefore protect the smaller shareholders in the event that any person decides to take the corporation private. Additionally, under sections 336 of the Israeli Companies Law, no person can acquire more than ninety percent of the shares of the corporation unless such person conducts a tender offer in which all the shareholders of the corporation have the right to participate. The Israeli Securities Regulations (Periodical and Immediate Reports) require the issuer to report any change in the number of securities of the issuer held by the issuer[120] and any transaction that is not in the regular course of business of the corporation.[121] The issuer also has to file an immediate report when the corporation "went private".[122] Thus, the Israeli and the U.S. laws provide similar protection to investors from fraudulent, deceptive, or manipulative "going private" transactions.

(v) <u>Foreign Corrupt Practice Act</u>.[123] This Act requires all issuers to make and keep books, records, and accounts, which accurately and fairly reflect the transactions and dispositions of the assets of the issuer. Those issuers also have to devise and maintain a system of internal accounting controls sufficient to provide reasonable

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114 17 C.F.R. § 240.13e-3.

115 See, Schedule 13E-3, 17 C.F.R. § 240.13e-100 (2005).

116 *Howing Co. v Nationwide Corp.* 826 F2d 1470 (6th Cir. 1987).

117 *In re FSC Corp.* (1981) 47 SEC 597 (majority stockholder violated Section 13(e) of the Exchange Act by making tender offer for common stock of corporation for purpose of making corporation privately held company, where stockholder failed to adequately disclose purpose of tender offer, effect of tender upon other shareholders' rights, basis for tender offer price, and fact that independent appraiser retained by corporation to pass upon fairness of tender offer has been indemnified by majority stockholder and corporation for liability which may result from issuance of its opinion).

118 *In re Herbert Moskowitz* (2000) SEC LEXIS 813.

119 If there is no other shareholder who holds more than fifty-percent of the voting rights at that time.

120 Regulation 30(b) of Periodical and Immediate Reports Regulations.

121 Regulation 36 of Periodical and Immediate Reports Regulations.

122 Regulation 31Z of Periodical and Immediate Reports Regulations.

123 15 U.S.C. § 78m (2005); 15 U.S.C. § 78dd-1 *et seq.* (2005).

assurances that certain specified standards will be satisfied. The purpose of those statutory obligations is to preclude the use of corporate funds to make bribes or questionable payments and therefore to protect corporate assets. The SEC rules promulgated under the Act also prohibit any corporate officer or other person from directly or indirectly falsifying any book, record or account.

Although the Israeli law requires the maintaining of accounting controls,[124] it does not require keeping records, books and accounts for the purpose of tracking the assets of the corporation, but rather only to prepare financial reports.[125] Thus, the U.S. better protect investors with respect to tracking questionable transactions in the assets of the corporation.

(vi) Section 10(b) of the Securities Act[126] and Rule 10b-5 promulgated thereunder.[127] These anti-fraud section and rule protect investors from manipulative and deceptive devices in connection with the purchase or sale of any security (e.g., the employment of any device, scheme or artifice to defraud, and any untrue statement or omission of a material fact).

The Israeli law provides a similar protection from manipulative or deceptive devices in connection with the purchase or sale of any securities. Section 54 of the Israeli Securities Law imposes five years imprisonment on such offense and section 52(11) imposes liability on the issuer, its directors, chief executive officer, and its controlling shareholder for any violation of the law or the regulations promulgated under it. Both the Israeli and the U.S. laws provide a private right of action for violation of these antifraud provisions,[128] and both laws require the plaintiff to prove "connection" between the losses suffered by the plaintiff to the fraud.[129] Thus, the Israeli law provides at least the same level of protection offered by the U.S. law.

(vii) Section 102 of the Sarbanes-Oxley Act.[130] This section requires that corporations listed in the U.S. will be audited only by accounting firms that are registered with the Public Company Accounting Oversight Board.[131] This requirement was adopted in order to deal with the problems created by the fact that the accounting industry is self-regulated. The Israeli law does not have a similar

[124] Israeli Companies Law, sections 154-159.
[125] Securities Regulations (Editing Annual Financial Reports), 1993, K.T. 5505, 466.
[126] 15 U.S.C. § 78j(b) (2005).
[127] 17 C.F.R. § 240.10b-5 (2005).
[128] Under section 52(11) of the Israeli Securities Law there is a statutory private right of action. In the U.S. there is an implied private right of action. See *Superintendent of Ins. v. Bankers life & Casualty Co.*, 404 U.S. 6 (1971); *Herman & Maclean v. Huddleston*, 459 U.S. 375 (1983) (noting that "[i]n addition to the private actions created explicitly by the 1933 and 1934 Acts, federal courts have implied private remedies under other provisions of the two laws. Most significantly for present purposes, a private right of action under §10(b) of the 1934 Act and Rule 10b-5 has been consistently recognized for more than 35 years. The existence of this implied remedy is simply beyond peradventure.")
[129] Israel: CA 4474/97 *Rami Tezet et al. v. Abraham Zilbershatz et al.*, 49(5) P.D. 774. U.S.: *SEC v. Texas Gulf Sulphur*, 401 F.2d 833 (1968); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).
[130] 15 U.S.C. § 7212 (2005).
[131] See Stephen C. Gara & Craig J. Langstraat, *The Sarbanes-Oxley Act of 2002: A New Ballgame for Accountants*, 34 U. Mem. L. Rev. 73 (2003).

requirement mostly because accounting firms are regulated by regulations promulgated by the Minister of Justice.

(viii) Section 302 of the Sarbanes-Oxley Act.[132] This section requires the principal executive and financial officers to certify in the annual or quarterly reports of the corporation that they are responsible for maintaining internal control and that the officers of the corporation have disclosed to the auditors and to the audit committee all the significant deficiencies in the design and operation of the internal control of the corporation.[133] This provision was adopted in order to increase the accountability of corporate managers with respect to reports made by the corporation. The Israeli Securities Law imposes criminal liability on any person who is responsible for not filing reports or for filing reports containing false facts. If the violation was made by the corporation, the chief executive officer and the directors of the corporation are also held responsible.[134] Additionally, the Israeli law imposes civil liability on directors, chief executive officer, and any person who owns more than five percent of the equity of the corporation for any misstatement or omission in the corporation's reports.[135] The Israeli courts also imposed a duty on managers to supervise the corporation actions in an "active" manner.[136] The general rule made by the Israeli courts is that managers are responsible for the actions of the corporation although the managers claimed that they were not "actual management."[137] The court held that a manager of a corporation is not a "member in a club" but rather a person who has a duty to supervise the corporation. Thus, both the Israeli law and the U.S. law impose similar a responsibility for the accuracy of the reports of the corporation on the managers.[138]

(ix) Section 304 of the Sarbanes-Oxley Act.[139] This section requires the chief executive officer and the chief financial officer of the corporation to reimburse any incentive-based or equity-based compensation they received from the corporation or any profit from stock sales they made due to the material noncompliance of the corporation, as a result of misconduct, with any financial reporting requirement

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[132] 15 U.S.C. § 7241 (2005).

[133] For a general discussion on Section 302 of the Sarbanes-Oxley Act, see Christopher Wyant , *Executive Certification Requirements in the Sarbanes-Oxley Act of 2002: A Case for Criminalizing Executive Recklessness*, 27 Seattle Univ. L. R. 561 (2003); Timothy J. Welsh, *CEO/CFO responsibility after the "Sarbanes-Oxley Act": Drowning the "reasonable investor" in details to escape civil liability*, 12 Digest 35 (2004); Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability under the Sarbanes-Oxley Act*, 55 Rutgers L. Rev. 1 (2002).

[134] Israeli Securities Law, section 53.

[135] Israeli Securities Law, section 38B.

[136] Cr.C (TA) 400/89 *The Official Receiver as the Liquidator of North American Bank v. Halperin et al.*, P.M. 54(2), 3 (holding that managers cannot avoid liability by stating that they were not involved in the conduct of the corporation).

[137] *Id.*

[138] See, Moshe Terri, *The Supervision of the Board of Directors on the Financial Reports, Lecture by the chairman of the Israeli Securities Authority*, The Annual Convention of Directors in Israel, Hertzelia, Israel, July 15, 2003.

[139] 15 U.S.C. § 7243 (2005).

under the securities laws.[140] This provision was adopted in order to increase managers' accountability for the corporation's failure to comply with securities laws or disclosure requirements.

The Israeli law does not have a similar provision. However, Section 38B of the Israeli Securities Law imposes civil liability on any person who owns more than five percent of the equity of the corporation, directors, and the chief executive officer for any misstatement or omission in the corporation's reports. Under this civil liability, the corporation can ask for reimbursement of any profits made by the officer. The Israeli law, however, does not require an automatic reimbursement of any benefits received by the officer. Although the U.S. law requires an automatic reimbursement, usually such reimbursement will be made only under a court order. Thus, this single difference between the Israeli and the U.S. laws is insignificant.

(x) Section 307 of the Sarbanes-Oxley Act.[141] This section deals with the professional responsibility of lawyers. Under this provision, lawyers have the duty to report any evidence of a material violation of the securities laws or a breach of a fiduciary duty or any similar violation by the corporation or its agent. The lawyer must report first to the chief executive officer or to the corporate counsel. If they do not respond appropriately, the lawyer must report to the independent directors. This provision was adopted in order to provide investors protection from the inside of the corporation. By requiring lawyers to become "whistle blowers", investors are more protected from corporate misconduct.[142]

The Israeli legal system also allows lawyers to blow the whistle on corporate misconducts. Under the Israeli law, the attorney-client privilege is absolute insofar as it is within the parameters of Section 90 of the Bar Law and Section 48 of the Evidence Ordinance.[143] Under section 90 of the Israeli Bar Law,[144] matters and documents exchanged between an attorney and his client, which materially relate to

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[140] See, Lyman P.Q. Johnson & Mark A. Sides, *Corporate Governance and the Sarbanes-Oxley Act: The Sarbanes-Oxley Act and Fiduciary Duties*, 30 Wm. Mitchell L. Rev. 1149 (2004) (noting that "[u]nder section 304, the officers must reimburse certain compensation. The misconduct need not be that of the incumbent officer(s), but could be that of a predecessor. The enforcement mechanism is unclear. The Supreme Court clearly disfavors implied causes of action, but the statute, by imposing an obligation on these officers, may contemplate a correlative right in the corporation to sue and collect.")

[141] 15 U.S.C. § 7245 (2005).

[142] Karl A. Groskaufmanis, *Climbing "Up the Ladder": Corporate Counsel and the SEC's Reporting Requirement for Lawyers*, 89 Cornell L. Rev. 511, 526 (2004) (arguing that "[i]n-house lawyers arguably add the most value when they are embedded in the organization and, through that proximity, help manage risks and exercise judgment when it matters most. Immeasurable harm to the company's franchise and tremendous cost may be avoided when a prescient counsel avoids a protracted dispute, resolves an employment situation, or presses the issuer to make a prudent but unpopular disclosure."); Richard W. Painter, *Toward a Market for Lawyer Disclosure Services: In Search of Optimal Whistleblowing Rules*, 63 Geo. Wash. L. Rev. 221 (1995) (analyzing social costs and benefits of lawyers "whistelblowing").

[143] Gross, Kleinhendler, Hodak, Halevy, Greenberg & Co., *Letter to the United States Securities and Exchange Commission, Re: Application of Section 307 of the Sarbanes - Oxley Act of 2002 and the Rules Promulgated Thereunder to Foreign Law Firms and Foreign Lawyers*, SEC File No. S7-45-02, Ref. No. 10,000/1010, available at http://www.sec.gov; Cr.C (TA) 11444/97 *La Nacional Israel Insurance Company Ltd. v. The Securities Authority* (1997) (1) Takdin District Court 15971.

[144] Israel Bar Association Law, 1961, S.H. 178.

the professional service, shall not be disclosed by the attorney in any legal proceeding, investigation or search, unless the client waived the privilege of such matters and documents. Section 48 of the Evidence Ordinance[145] provides that an attorney is not required to provide as evidence matters and documents exchanged between an attorney and his client or someone acting on the client's behalf and which have a substantive relationship to the professional service, unless the client waived the privilege. This privilege survives the ending of the attorney-client relationship.

In the case of *La Nacional v. Securities Authority*[146] the Tel Aviv District Court addresses the issue of confidentiality and attorney-client privilege in the context of securities laws. In that case, the court noted that the attorney is prohibited from providing evidence under Section 48 of the Evidence Ordinance also when the investigation is conducted by the Securities Authority. However, the court held that the attorney-client privilege does not protect against disclosure by an attorney of information relating to a future criminal offense or tortious fraudulent act. Thus, although the Israeli legal system allows lawyers to blow the whistle on corporate misconduct, it does not require it.

Consequently, there is a significant difference between the Israeli and the U.S. laws with respect to the duty of lawyers to report corporate misconduct. As a result, investors of U.S. listed corporations are better protected because the lawyers representing those corporations have an affirmative duty to act as gatekeepers. However, it is unlikely that the lawyers' affirmative duty to report corporate misconduct created an incentive for Israeli corporations to go public in the U.S. If anything, such duty could have created a disincentive for Israeli corporations to list in the U.S. because the managers of those corporations will fear personal liability as a result of reports made by their attorney.

(xi) <u>Section 402 of the Sarbanes-Oxley Act</u>.[147] This section prohibits the corporation from making loans to officers or directors of the corporation. This provision is intended to eliminate a possible agency problem that is created when managers are able to approve their own loan.[148] The Israeli law does not have a similar provision. The Israeli law allows such a loan only if it will be approved as an "interested party transaction".[149] Under the Israeli Companies Law, if such a loan is defined as an "unusual transaction"[150] it requires the approval of the audit committee and the

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145 The Evidence Ordinance (New Version), 1971, 5731 L.S.I. 421 (1971).

146 *La Nacional Israel Insurance Company Ltd. v. The Securities Authority*, *supra* Note 143.

147 15 U.S.C. § 78m(k) (2005).

148 Kathryn Stewart Lehman, *Executive Compensation Following the Sarbanes-Oxley Act of 2002*, 81 N.C. L. Rev. 2115, 2117 (2003) (noting that "[i]n July 2002, Congress passed the Sarbanes-Oxley Act in an attempt to remedy corporate abuses. With this legislation, Congress intended to calm a volatile market, inspire investor confidence, and stop the flood of corporate scandals."). Sean A. Power, *Sarbanes-Oxley Ends Corporate Lending to Insiders: Some Interpretive Issues for Executive Compensation Surrounding the Section 402 Loan Prohibition*, 71 UMKC L. Rev. 911 (2003).

149 Israeli Companies Law, sections 268-284.

150 i.e. transaction which is not in the normal course of business, not in regular market prices, or that could materially affect the corporation's profits, assets or obligations. See Israeli Companies Law, section 1, definition of an "unusual transaction".

board of directors and if the transaction is with a director of the corporation it also requires the approval of the general assembly. If such transaction is defined as a "non unusual transaction" it will require only the approval of the board of directors.

(xii) Section 806 of the Sarbanes-Oxley Act.[151] This section prohibits the corporation, its agent, or its employees from taking actions against an employee of the corporation who lawfully provided information or assisted a federal or in-house investigation or in a securities law case regarding a conduct that the employee reasonably believed constitutes a violation of the securities laws.[152] This provision was enacted in order to encourage whistle blowers from inside the corporation and consequently to better protect investors from management misconduct.

The Israeli law does not have a similar provision and the only way the employee can protect himself from an unlawful termination of their job is by filing a suit against the employer with the employment court. This requirement creates an advantage for the U.S. law over the Israeli law in protecting investors.

(xiii) Immediate reports. According to the Israeli law,[153] a public corporation which securities are held by the public[154] must file an immediate report on any event that occurred not in the regular course of business and that materially influences, or could materially influence the corporation's profit, assets, or obligations. The report must be filed immediately after the corporation learns about the occurrence of the event. Furthermore, a public corporation that is engaged in negotiations that are not in the regular way of business, and have or might have a material influence on the corporation, must inform immediately the Israeli Securities Authority which can demand filing an immediate report by the corporation. The Israeli regulations also require different other immediate reports, such as, replacement of auditor, mergers, hiring or dismissing directors and officers, and dissolution or bankruptcy.[155]

In the U.S., the events that require filing an immediate report are listed in Form 8-K. There are also requirements for immediate reports set forth by the NASDAQ. The requirements set forth in Form 8-K and by the NASDAQ are similar to those required in Israel and therefore, with respect to immediate reports both laws provide similar protection for investors.

(xiv) Disclosure requirements in the prospectus. Although there are some differences between the disclosures requirements under the Israeli and U.S. laws, those differences are insignificant and could not justify opting out of the Israeli laws and bearing the high costs of listing securities in the U.S. In Table 1, *infra*, we

[151] 18 U.S.C. § 1514 (2005).
[152] See, Miriam A. Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes-Oxley Act for Employment Law*, 79 Wash. L. Rev. 1029 (2004).
[153] Israeli Securities Law, section 36; Periodical and Immediate Reports Regulations.
[154] i.e., more then 35 shareholders.
[155] The Israeli Securities Authority has the power to require any issuer to make an immediate report on any issue that could be material for the decision of a reasonable investor to purchase or sell securities. Regulation 30A, Periodical and Immediate Reports Regulations.

compare the disclosure requirements in the prospectus under the Israeli and U.S. legal systems.

(xv) Self-interested transactions. Interested parties, such as, shareholders or managers can engage in business activities with the corporation. Corporation laws usually set up the corporate internal mechanisms for approving such transactions. Both Israeli and U.S. states' corporate laws provide such a mechanism to approve self interested transactions. To protect those who invest in public corporation, who are usually not involved in the operation of the business of the corporation and do not have sufficient voting power to block self interested transactions, the law should also include a requirement for full disclosure of the self interested transactions. The U.S. law requires such disclosure. Section 16 of the Exchange Act[156] requires disclosure of the self interested transaction within days from the occurrence of such transaction or from the day that the transacting party became beneficial owner,[157] director or officer of the corporation. Regulation S-K[158] provides the information that is required to be included in the reports in which the corporation discloses the self interested transaction.[159] The Israeli securities regulations[160] requires disclosure of self interested transactions within days, or even hours, from the occurrence of the self interested transaction or from time the transacting party became an interested party.[161] Thus, the Israeli and the U.S. legal systems provide a similar level of protection for investors with respect to alerting investors on the occurrence of self interested transactions.

2.2.3 Exemptions for Foreign Issuers from U.S. Laws.

Host country's stringent rules can have a detriment effect on the decision of the foreign issuers to list their securities in that country. In order to attract foreign issuers, that country can grant foreign issuers exemptions from some of its stringent rules. The U.S. chose to exempt foreign issuers from some of its strict securities laws and regulations in order to attract more foreign issuers to list their securities in the U.S.

In light of the stock markets competition of the 1970s and 1980s, the SEC promulgated Form 20-F Annual Report for foreign issuers which exempts foreign issuers from several disclosure provisions required from domestic corporations in Form 10-K.[162] Form 20-F alleviates the requirements for disclosure of conflict of interest from foreign issuers. The U.S. also exempts foreign issuers from disclosing the identity of

[156] 15 U.S.C. § 78p (2005), enacted as Section 403 of the Sarbanes-Oxley Act.
[157] Owner of more than 10% of any class of equity securities of the issuer.
[158] 17 C.F.R. § 229.10 *et seq.* (2005).
[159] See especially Items 401-406, Regulation S-K, 17 C.F.R. § 229.401 *et seq.* (2005).
[160] Securities Regulations (Corporate Transactions with Controlling Person), 2001, K.T. 6087, 430; Periodical and Immediate Reports Regulations.
[161] Interested party is a director of the corporation, its chief executive officer, owner of more than 5% of the outstanding equity securities of the corporation, person who has the power to appoint director or the chief executive officer of the corporation, owner of more than 25% of the voting rights, or person who has the power to appoint more than 25% of the directors of the corporation. Israeli Securities Law, section 1.
[162] Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, *supra* Note 1, at 151.

individual directors and officers or any material transactions with them and requires foreign issuers to disclose only aggregate remunerations and options.[163] Additionally, the U.S. requires foreign issuers to disclose the names of shareholders who own more than ten percent of their securities. Foreign issuers are also exempted from disclosing the identity of their directors and officers who own securities of those issuers. All that those foreign issuers need to disclose in that regard is the aggregate number of securities owned by their directors and officer. Conversely, domestic corporations must disclose the identity of every shareholder who owns more than five percent of the securities of the corporation and the identity of each director or officer who owns securities of the corporation.[164]

Furthermore, Rule 3a12-3,[165] promulgated under the Exchange Act, exempts foreign issuers from sections 14(a), (b), (c), and (f), and from section 16 of the Exchange Act.[166] The outcome of this Rule is that foreign issuers are exempted from the prohibition on short sales and short-swing profits by corporate insiders and from certain reporting requirements of interested transactions by beneficial owners, officers, and directors,[167] as well as from several disclosure requirements regarding proxy statements.[168] Foreign issuers are also exempted from Regulation FD which prohibits issuers from preferential distribution of nonpublic information.[169] The SEC also made some accommodations to foreign issuers on the requirements of the Sarbanes-Oxley Act.[170] Under Rule 12g3-2(b)[171] promulgated under the Exchange Act, certain foreign issuers are exempted from complying with Section 12(g) of the Exchange Act.[172]

Thus, although the U.S. laws provide a high level of investor protection, such protection does not necessarily extends to investors of foreign issuers because foreign issuers are exempted from various provisions of the U.S. securities laws and regulations that are important to the protection of investors.

2.2.4 The Enforcement of U.S. Laws on Foreign Issuers.

Rule 10b-5 protects investors from fraud by imposing serious liability for fraudulent misrepresentation or omission of a material fact in connection with the purchase or sale of securities. With the broad application of the Rule and the large number of foreign

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[163] *Id.*
[164] *Id.* Citing 17 C.F.R. § 229.403(A) (2002).
[165] 17 C.F.R. § 240.3a12-3 (2005).
[166] 15 U.S.C. § 78n(a), (b), (c), (f) (2005); 15 U.S.C.§ 78p (2005).
[167] Exchange Act, section 16.
[168] Exchange Act, section14.
[169] One justification for exempting foreign issuers from Regulation FD was that the possibility of selective disclosure by the foreign issuers was known to the investors at the time they made their investments and therefore the price they paid reflected the appropriate discount for this risk. Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization's Strains and Opportunities*, 41 Va. J. Int. L. 653 (2001).
[170] Support of exemptions for foreign issuers was offered by Kanji Taneda, *Sarbanes-Oxley, Foreign Issuers and United States Securities Regulation*, 2003 Colum. Bus. L. Rev. 715 (2003) (noting that "as a general matter, the SEC has attempted to accommodate foreign issuers not through outright exemptions, but through a compromise approach, designed primarily to ensure that a similar outcome (i.e. restraints on management) would be achieved under one mechanism or another.")
[171] 17 C.F.R. § 240.12g3-2(b) (2005).
[172] 15 U.S.C. § 78l(g) (2005).

issuers listed in the U.S., one would expect that the SEC had prosecuted foreign issuers, especially those from weak investors-protective jurisdictions, for violations of Rule 10b-5. However, in a recent study, Jordan Siegel suggested exactly the opposite. According to his study, U.S. laws are not strictly enforced on foreign issuers.[173] Siegel reaches his conclusion by examining the number of legal actions taken by the SEC against foreign issuers. Siegel argues that "[f]urther evidence shows that the SEC has rarely acted effectively to enforce the law against any cross-listed foreign firm."[174] Additionally, most of the legal actions taken against foreign issuers were against firms that also had significant business ties to the U.S. Thus, although the U.S. laws provide a high level of protection for investors, the U.S. laws are not necessarily enforced on foreign issuers.

2.2.5 Protection of Investors' Rights by the Judiciary and Government Agencies.

Strong legal enforcement could substitute for weak rules because courts and government agencies can step-in and provide the required level of investor protection.[175] Thus, Israeli courts and government agencies, such as the Israeli Securities Authority's ability to complement the Israeli Securities laws and regulations could increase the level of investor protection offered by the Israeli legal system. Although Israeli courts are accessible for plaintiffs, they are extremely busy handling numerous cases and therefore very slow in issuing judgments. Because of the large cases load, judges are unable to develop expertise or case law on securities laws matters. Conversely, in the U.S. judges have developed sufficient expertise and case law to deal efficiently with securities law cases.

The gap between the level of enforcement of securities laws by the judiciary in Israel and the U.S. is closed by the active role and efficiency of the Israeli Securities Authority[176] in enforcing securities laws and regulations and the not-so-active role taken by the SEC in enforcing U.S. securities laws and regulations on foreign issuers. Thus, with respect to the role of the judiciary and government agencies in protecting investors, the Israeli legal system provides an adequate protection to investors, which is not inferior to the protection offered by the U.S. legal system.

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[173] Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively By Renting U.S. Securities Laws?*, *supra* Note 34.

[174] *Id.* at 335.

[175] La Porta et al., *Law and Finance*, *supra* Note 26, at 1140. LLSV examine six estimates of "law and order" to determine the efficiency of the legal system: (i) efficiency of judicial system, (ii) rule of law, (iii) corruption, (iv) risk of expropriation by the government, (v) the likelihood of contract repudiation by the government, and (vi) accounting standards. The data in LLSV's study shows that the efficiency of the judicial system is equal in Israel and the U.S. However, in total, the Israeli legal system receives a lower score and hence considered to be less efficient. Although the LLSV study can show some of the differences between the Israeli and the U.S. legal system, it cannot answer whether law matter for Israeli corporations that chose to go public in the U.S. because Israeli corporations that went public in the U.S. are still subject to the Israeli legal system (e.g., corporate law still applies and the Israeli courts still have jurisdiction on corporate law matters).

[176] In the past five years, the Israeli Securities Authority investigated 78 cases of possible violation of securities law and regulations and submitted 72 cases for prosecution by the Department of Justice. The Department of Justice prosecuted 44 cases during the past five years. *Israeli Securities Authority Annual Report for the Year 2004*, available at
http://www.isa.gov.il/download/pirsum/a302_ISA_annual_report_2005.pdf.

2.2.6 The Outcome of the Comparison.

The comparison between the Israeli and U.S. laws demonstrates that the Israeli law provides an adequate level of investor protection that is not significantly different from the level of investor protection offered by the U.S. laws. The lack of material difference between the two laws also relates to the fact that the Israeli Securities Law constitutes a short version of the U.S. securities laws. The Israeli Securities Law adopts the supervisory structure and the philosophy behind the U.S. laws.[177]

Furthermore, the SEC does not enforce the U.S. securities laws on foreign issuers in the same rigorous way that it enforces those laws on domestic issuers. If the SEC is adopting a "hands off" policy with respect to prosecuting foreign issuers, it could be another reason why the bonding hypothesis does not apply and law does not matter for Israeli corporations that chose to go public in the U.S.

Additionally, the Sarbanes-Oxley Act that increases the level of investor protection in the U.S. was enacted after the vast majority of Israeli corporations already listed in the U.S. Thus, for the vast majority of the Israeli corporations listed in the U.S. the investor protection offered by the Sarbanes-Oxley Act could not have been an incentive to go public in the U.S.

The theoretical analysis provided us with enough information to determine that law did not matter for Israeli corporations listed in the U.S. The following empirical study and its implication on the theoretical analysis will allow us to confirm whether indeed law does not matter for Israeli corporations that chose to go public in the U.S.

V. EMPIRICAL STUDY

The first part of the empirical study includes quantitative data. In this part, we explore from what industries and when Israeli corporations chose to go public in the U.S. The second part of the empirical study includes qualitative data. We use this qualitative data to determine why Israeli corporations chose to go public in the U.S.[178]

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177 In various occasions, the Israeli Supreme Court used the U.S. securities laws principles in order to interpret the Israeli Securities Law : Cr.A. 5383/96 *Tempo Beer Industries Ltd. et al. v. The State of Israel*, Takdin SC 2000(1), 179; C.A. 3654/97 *Kartin Yehezkel et al. v. Ateret Securities (2000) Ltd.*, Takdin SC 99(2), 231; Cr.A. 8710/96 *Ofer Holdstein et al. v. The State of Israel*, (unreported decision); L.C.A. 4474/97 *Rami Tezet et al. v. Abraham Zilbershatz et al.*, 49(5) P.D. 774; L.C.A. 378/96 *Sagie Vainblat v. Moshe Burenshtein et al.*, Takdin SC 2000(2), 341; L.C.A. 8332/96 *Moshe Shemesh v. Dan Ricart et al.*, 55(5) P.D. 276; L.Cr.A. 8472/01 *Yoshef & Yuval Maharshak v. The State of Israel*, (unreported decision); C.A. 5187/01 *Yosef Barnea v. The State of Israel*, (unreported decision); Cr.A. 1027/94 *Aharon Zilberman v. The State of Israel*, Takdin SC 1999(3), 323;

178 The qualitative data was collected by interviewing Israeli and American investors and lawyers who took part in listing Israeli corporations in the U.S.

A. QUANTITATIVE DATA

This part of the empirical study provides us with the actual numbers and industry of Israeli corporations that chose to go public in the U.S.[179] This data assists us in better understanding the full scale and special characteristics of the Israeli phenomenon. The data we found is as follows:

1. Israel is the second large exporter of corporations for the purpose of listing in the U.S. (second only to Canada).
2. The vast majority of Israeli corporations listed in the U.S. decided to do so during the 1990's (most of the listing activity took place between the years 1996-2000).[180]
3. Although Israeli corporations can be found in securities exchanges around the world, the vast majority are listed in the U.S.[181]
4. The majority of Israeli corporations listed in the U.S. are from the high-tech industry (122 out of 147).[182]
5. The majority of corporations chose to list their securities with the NASDAQ.[183]
6. Since 2002 (the year of enactment of the Sarbanes-Oxley Act) there are less Israeli corporations that choose to go public in the U.S.[184]

B. QUALITATIVE DATA

This part of the empirical study includes data collected from Israeli and American investors and lawyers who took part in listing Israeli corporations in the U.S. These investors and lawyers based their answers to the question they were presented with during an interview on their personal experience.

This study is based on 20 interviews that were conducted during a period of two weeks. Half of the interviewees are lawyers who represented Israeli corporations in their listing process in the U.S. The second half of interviewees includes investors who had stakes in Israeli corporations that went public in the U.S. Those interviewees represent the businesses and legal community that actually created the Israeli phenomenon. The lawyers had a role in advising and conducting the listing of Israeli corporations in the U.S., while investors had the role of deciding whether to incur the high costs and to conduct the initial public offering of their corporations in the U.S.

The selection of the interviewees was based on their level of experience with taking Israeli corporations public in the U.S. All interviewees had significant experience with representing or acting on behalf of Israeli corporations that were listed in the U.S. All the interviews were conducted in a confidential basis and therefore, the data does not include the identity of any interviewee or their affiliation.

Although the data collected from the interviews supports the conclusion we reached in the theoretical analysis, the data is not conclusive. We take into account the possibility that some of the data could be inaccurate and that it could affect the results

[179] Due to the objective difficulty to collect the data, all the numbers in this study are approximate.
[180] See, Table 2.
[181] See, Chart 2.
[182] See, Table 3.
[183] See, Chart 2.
[184] See, Table 2.

of this study. Some of the potential inaccuracies of the data are related to the possibility that interviewees could be unfamiliar with all the exact reasons that led Israeli corporations to go public in the U.S.[185] or that interviewees could be biased in their answers.[186] Also, it is possible that the lawyers did not reveal all the information in their knowledge due to the attorney-client privilege.

The data shows that the vast majority of interviewees believe that the Israeli securities law provides an adequate protection for investors and that the level of investor protection provided by the U.S. laws is not superior to the level of protection provided by the Israeli law.[187] The interviewees also believe that the U.S. laws are much friendlier to foreign issuers than they are to domestic issuers. However, the interviewees believe that the lenient enforcement of U.S. securities laws on foreign issuers or the friendlier laws were not the reason for attracting Israeli corporations to go public in the U.S.[188]

The interviewees also agree that Israeli corporations did not choose to list in the U.S. in order to rent the U.S. laws, and thus that law does not matter for Israeli corporations that chose to go public in the U.S. The interviewees offered other reasons, that they believe, contributed to the decision of Israeli corporations to list in the U.S. Most of the interviewees agree that better liquidity offered by the U.S. securities markets,[189] improvement of image,[190] better visibility, opening new markets for products, reducing investors' information costs,[191] signaling to investors that the corporation is of a high quality or has a better potential, and the openness of the U.S. markets to early stage corporations[192] were the reasons behind the decision of Israeli corporations to go public in the U.S.[193]

VI. THE IMPLICATIONS OF THE DATA ON THE THEORY

In this Chapter we discuss the implication of both the quantitative and qualitative data on the theoretical comparison between the Israeli and the U.S. laws. The

[185] i.e., at least in the case of lawyers who are not always being disclosed by the client of all the reasons behind the transaction.

[186] i.e., the fact that they believe that a specific reason led Israeli corporations to go public in the U.S. does not necessarily say that it was the actual reason.

[187] As one interviewee described it: "the laws provide the same protection, this could not be the reason for coming to America…"

[188] One of the interviewees said in that regard: "…these were not part of the reasons for coming to the U.S. After all, the costs of coming to the U.S. upset such benefits…"

[189] However, one of the interviewees argued that "…none of those companies are large enough to consider liquidity as such an important factor. They could all go public in Israel. The liquidity of the Israeli market is sufficient for them…"

[190] One interviewee described it as "…being part of an elite group…"

[191] One interviewee said in that regard: "…institutional investors found it very convenient and more attractive to invest in Israeli corporations since they started to go public in the U.S."

[192] As it was described by one interviewee: "the fact that they can get money before they had to show profits was an important reason for their decision to go public in the U.S."

[193] Less than half of the interviewee believes that being exposed to investors from around the world influenced the decision of Israeli corporations to list in the U.S.

implication of the data on the theory is used to check whether and how the conclusions from the theoretical analysis settle with the conclusions from the empirical study.

A. IMPLICATION OF THE QUANTITATIVE DATA ON THE THEORY

The quantitative data coincides with the conclusion we reached in the theoretical analysis that law does not matter. According to this data, Israeli corporations chose to go public in the U.S. mostly in the 1990's. Most of those Israeli corporations were from the high-tech industry. The 1990's were the years when investors worldwide were very interested in investing in corporations from the high-tech industry. Investors were not looking on the financial performance of those corporations but rather on analysts' reports describing the prediction for profits once the corporation's products are marketed. The first place to offer a financial paradise for those early stage corporations was the U.S. markets. Thus, Israeli early stage corporations chose to use the U.S. markets to raise the capital they needed for their future development. Only after a few years that the U.S. markets open their doors to early stage corporations, other countries started to offer stock exchanges that specialized in early stage corporations. The United Kingdom offered the AIM exchange and Germany offered the Neuer Market that later closed. Some Israeli corporations indeed chose to raise capital at those other countries, however, the vast majority of the Israeli corporations continued to believe in the U.S. markets as the only markets suited for early stage corporations.

As the data shows, the profile of Israeli corporations going public in the U.S. fits that 1990's high-tech phenomenon. It is hard to ignore the fact that most of those corporations went public during the 1990's high tech bubble and that there is almost no activity of Israeli companies going public in the U.S. after the burst of the high tech bubble. Thus, it seems inevitable to conclude that law does not matter for Israeli corporations that chose to go public in the U.S.

There are several factors which supports the hypothesis under which law does not matter and that Israeli corporations did not choose to go public in the U.S. in order to opt into the U.S. laws and to bond their insiders. If law was the reason behind the decision to go public, then we would have expected to see Israeli corporations going public during a longer period of time and not just during the 1990's. We would also expect to see Israeli corporations continue to list with the U.S. markets after the burst of the high-tech bubble. Additionally, since the enactment of the Sarbanes-Oxley Act in 2002, we see less Israeli corporations listing in the U.S. The decrease in the number of Israeli corporations going public in the U.S. after the enactment of the Sarbanes-Oxley Act also supports the conclusion that law does not matter. If law did matter then we would expect to see more Israeli corporations going public in the U.S. because the Sarbanes-Oxley Act improved the level of investor protection in the U.S.

Although it seems clear that law does not matter, the exact reasons behind the decision of Israeli corporations to go public in the U.S. are still unclear. Israeli corporations might have chosen to go public in the U.S. because they followed the heard of early stage high-tech corporations that chose to go public in the U.S., or because they wanted to enjoy the better liquidity the U.S. markets offer, to improve their image, or even to get closer to U.S. investors. The application of the results of the qualitative study on the theoretical analysis will assist us in finding the specific non-legal reasons behind the decision of Israeli corporations to go public in the U.S.

B. IMPLICATION OF THE QUALITATIVE DATA ON THE THEORY

The implication of the qualitative data on the theory supports the conclusion that law does not matter. As it seems, Israeli corporations did not choose to go public in the U.S. in order to opt into the U.S. laws or to better bond their insiders. The vast majority of interviewees believed that the Israeli securities law provides an adequate protection for investors, that the level of investor protection provided by the U.S. laws is not superior to the level of protection provided by the Israeli law, and thus that law does not matter. Additionally, the qualitative data shows that Israeli corporation chose to go public in the U.S. not simply as part of the 1990's high-tech phenomenon or just in order to provide an "exit" option to their investors.[194] Israeli corporations considered issues, such as, better liquidity offered by the U.S. securities markets, improvement of image, better visibility, opening new markets for products, reducing investors' information costs, signaling to investors that the corporation is of high quality or has a better potential, and the openness of the U.S. markets to early stage corporations, as important for their decision to go public in the U.S.

Therefore, although the qualitative data presented in this Article is inconclusive, we can conclude with high level of confidence that the decision of Israeli corporations to go public in the U.S. was not motivated by the law, and that Israeli corporations chose the U.S. in order to benefit from all those elements we have just mentioned.

VII. CONCLUSIONS

The reasons behind the decision of so many Israeli corporations to go public in the U.S. are unclear. To find these reasons, we offer two hypotheses. One hypothesis is that law does matter and Israeli corporations chose to migrate to the U.S. in order to opt into the U.S. laws and to better bond their insiders. The second hypothesis is that law does not matter and Israeli corporations chose to migrate to the U.S. for reasons, such as, liquidity of the U.S. markets, openness of the U.S. market to early stage corporations, image concerns, or opening new markets for products.

This Article tests those two hypotheses by examining the differences between the Israeli and the U.S. securities laws. The comparison between the U.S. and the Israeli securities laws reveals that both countries provide an adequate protection for investors. The minor differences between the two legal systems with respect to protecting investors of public corporations cannot justify incurring the high costs of listing in the U.S. The empirical study presented in this Article supports the conclusion that law did not matter for Israeli corporations that went public in the U.S.

[194] This conclusion is opposed to the reasons offered by Rock for the decision of Israeli corporations to go public in the U.S. See Rock, *supra* Notes 8 and 15.

TABLE 1

Disclosure Requirements in a Prospectus under the Israeli and U.S. Legal Systems.[195]

Issue	U.S. laws	Israeli laws
Incorporation of documents by reference	The U.S. laws allow the incorporation by reference of documents containing information known to the public (e.g. periodical reports) or that was disclosed to the SEC (e.g. contracts). Incorporated document become part of the prospectus.	The Israeli laws do not allow incorporation by reference of documents into the prospectus.
Information on costumers	The corporation must disclose the name of any client when the income from this client exceeds 10% of the total income of the corporation and when the corporation believes that losing this client will have a material effect on the business of the corporation.	The corporation must disclose the name of any client when the income from this client exceeds 10% of the total income of the corporation. The corporation must disclose if it has a dependence on a certain client.
Information on sales and profit	The corporation must describe its products in groups of products without disclosing the profit it derives from each group of products.	The corporation must describe its products in groups of products or groups of income and must disclose the profit it derives from each group if there is a material difference in the profit it derives from each group.
Information on officers	The corporation must disclose the names of the four officers (other then the CEO) who has the highest salary and must disclose each one's salaries and benefits separately.	The corporation must disclose collectively the salaries and benefits of the CEO and the directors if they are do not deviate from the customary salary. In practice, the salaries are disclosed separately.
Option Plans	The corporation must disclose the current and the future values of the benefits and the differences between the price of the benefit plan to the employee and its market value.	The corporation must disclose the option plan and the value of such plan at the day it was granted. However, the level of disclosure is less than what is required in the U.S.
Information on transactions with interested parties	The corporation must disclose any transaction with an interested party that its value exceeds $60,000 and that was made in the past two years. The sale of purchase of assets not in the regular course of business, the corporation must disclose the cost incurred by the seller for purchasing the asset (if the asset price had to be evaluated the corporation must disclose the identity of the evaluator and how he made the evaluation).	The corporation must disclose *all* the transactions made with interested parties, except if the transaction was made in the regular course of business. Additionally, the corporation must disclose the terms of such transactions.
Information on shareholders	The corporation must disclose the names of all the related parties.	The corporation must disclose the names of all the related parties. In case of chain holdings, the corporation must disclose the name of the *individual* at the end of the chain of holdings.
Financial reports	The profit and loss reports must compare the figures to the last two years. The prospectus must also include selected financial data from the past five years. The prospectus must include financial reports not more than three to four and a half months prior to the publication of the prospectus (the exact timeframe depends on whether it is an annual or quarterly financial report that is included in the prospectus).	The profit and loss reports must compare the figures to the last 3 years. The prospectus must include financial reports from not more than 5 months prior to the publication of the prospectus.

[195] Source: Israeli Securities Authority, *The Dual Listing of Securities Commission Report*, Jerusalem Sep., 1998 (citing Dr. Shmuel Hauser, Yael Tanhuma, Ruti Dahan, Aviva Ben-Moshe, Sasi Meir, Arye Bubis, *Dual Listing – Economic Aspects, Registration, Disclosure, and Reporting*, Israeli Securities Authority Working Paper, 1997).

TABLE 2

Distribution by Years of the Initial Public Offerings of Israeli Corporations in the U.S.:

Years	Israeli Corporations listed in the U.S.
1958	0
1961	1
1968	0
1969	0
1972	0
1974	0
1975	0
1978	0
1979	0
1980	0
1981	0
1982	2
1983	0
1984	3
1985	2
1986	2
1987	2
1988	0
1989	3
1990	4
1991	2
1992	3
1993	9
1994	7
1995	5
1996	15
1997	22
1998	15
1999	23
2000	20
2001	4
2002	3
2003	0

TABLE 3

Distribution by Industry of Israeli Corporations Listed in the U.S.

Industry	Number of Corporations
High-Technology[196]	112
Services	1
Bio Technology	4
Construction	2
Consulting	2
Entertainment	2
Real Estate	1
Old Industry[197]	2
Food	2
Chemicals	1
Defense and Security	1
Healthcare	1
Designing	1
Pharmaceuticals	1
Banking	3
Investment[198]	11

[196] Including businesses from the following industries: computers software, computers hardware, telecommunication, Internet, computer networks, aircrafts electronic systems, electronics, etc.
[197] Including businesses from the following industries: steel, automotive, wood, paper, rubber, etc.
[198] Including businesses from the following industries: investment banking, holdings corporations, etc.

TABLE 5

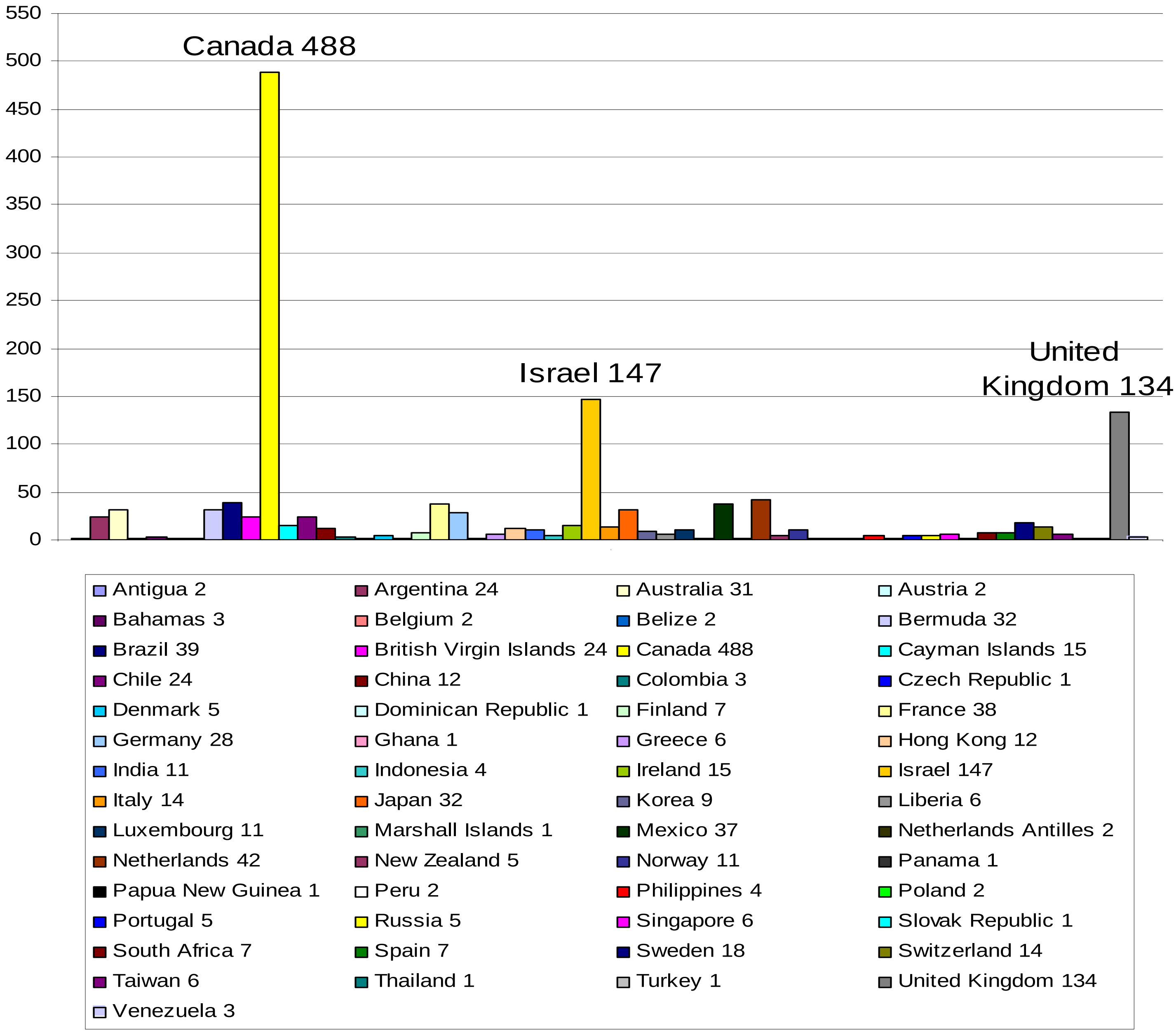
Qualitative Data: The Motivations to List in the U.S.

The answers of the interviewees are represented, as follows: the score of "1" is given to a "yes" answer, and a score of "0" is given to a "no" answer.

Interview	The Israeli and the U.S. laws provide the same protection for investors	Law matter for Israeli corporations that listed in the U.S.	Israeli corp. chose to go public in the U.S. to rent the U.S. laws	The lenient enforcement of the U.S. securities laws on foreign issuers motivated Israeli corporations to list in the U.S.	The U.S. laws are friendlier to foreign issuers than to domestic issuers	Better liquidity influenced the decision of Israeli corporations to list in the U.S.	Better valuation influenced the decision of Israeli corporations to list in the U.S.	Image concerns influenced the decision of Israeli corporations to list in the U.S.	Better visibility influenced the decision of Israeli corporations to list in the U.S.	Attracting foreign investors influenced the decision of Israeli corporations to list in the U.S.	Opening new markets for their products influenced the decision of Israeli corporations to list in the U.S.	Reducing investors' information costs influenced the decision of Israeli corporations to list in the U.S.	Signaling investors was a reason for the decision of Israeli corporations to list in the U.S.	The openness of the U.S. capital markets to early stage corporations motivated Israeli corporations to list in the U.S.
1	1	0	0	0	1	1	1	1	1	1	1	1	1	1
2	1	0	0	0	1	1	1	1	1	0	1	1	1	1
3	1	0	0	0	1	1	1	1	1	0	1	1	1	1
4	1	0	0	0	1	1	1	1	1	0	1	1	1	1
5	1	0	0	0	1	1	1	1	1	0	1	1	1	1
6	1	0	0	0	1	1	1	1	1	0	0	1	1	1
7	1	0	0	0	1	1	1	1	1	0	1	1	1	1
8	1	0	0	0	1	1	1	1	1	0	1	1	1	1
9	1	0	0	0	1	1	1	1	1	1	1	1	1	1
10	1	0	0	0	1	1	1	1	1	1	1	1	1	1
11	1	0	0	0	1	1	1	1	1	0	1	0	0	1
12	1	0	0	0	1	1	1	1	1	1	1	1	1	1
13	1	0	0	0	1	1	1	1	1	1	0	1	1	1
14	1	0	0	0	1	1	1	1	1	0	0	1	1	1
15	1	0	0	0	1	1	1	1	1	0	0	1	1	1
16	1	0	0	0	1	1	1	1	1	1	0	1	1	1
17	1	0	0	0	1	1	1	1	1	1	1	1	1	1
18	1	0	0	0	1	1	1	1	1	1	1	1	1	1
19	1	0	0	0	1	1	1	1	1	0	1	1	1	1
20	1	0	0	0	1	1	1	1	1	0	1	0	0	1
TOTAL	20	0	0	0	20	20	20	20	20	8	15	18	18	20

CHART 1

The Number of Foreign Corporation Listed with U.S. Stock Exchanges[199]



[199] Source: U.S. Securities and Exchange Commission, *Foreign Companies Registered and Reporting with the U.S. Securities and Exchange Commission*, December 31, 2002; STANDARD & POOR'S, DIRECTORY OF PUBLIC COMPANIES & FINANCIAL INSTITUTIONS – ISRAEL (2003).

CHART 2

Israeli Corporations Listed in Stock Exchanges Around the World.

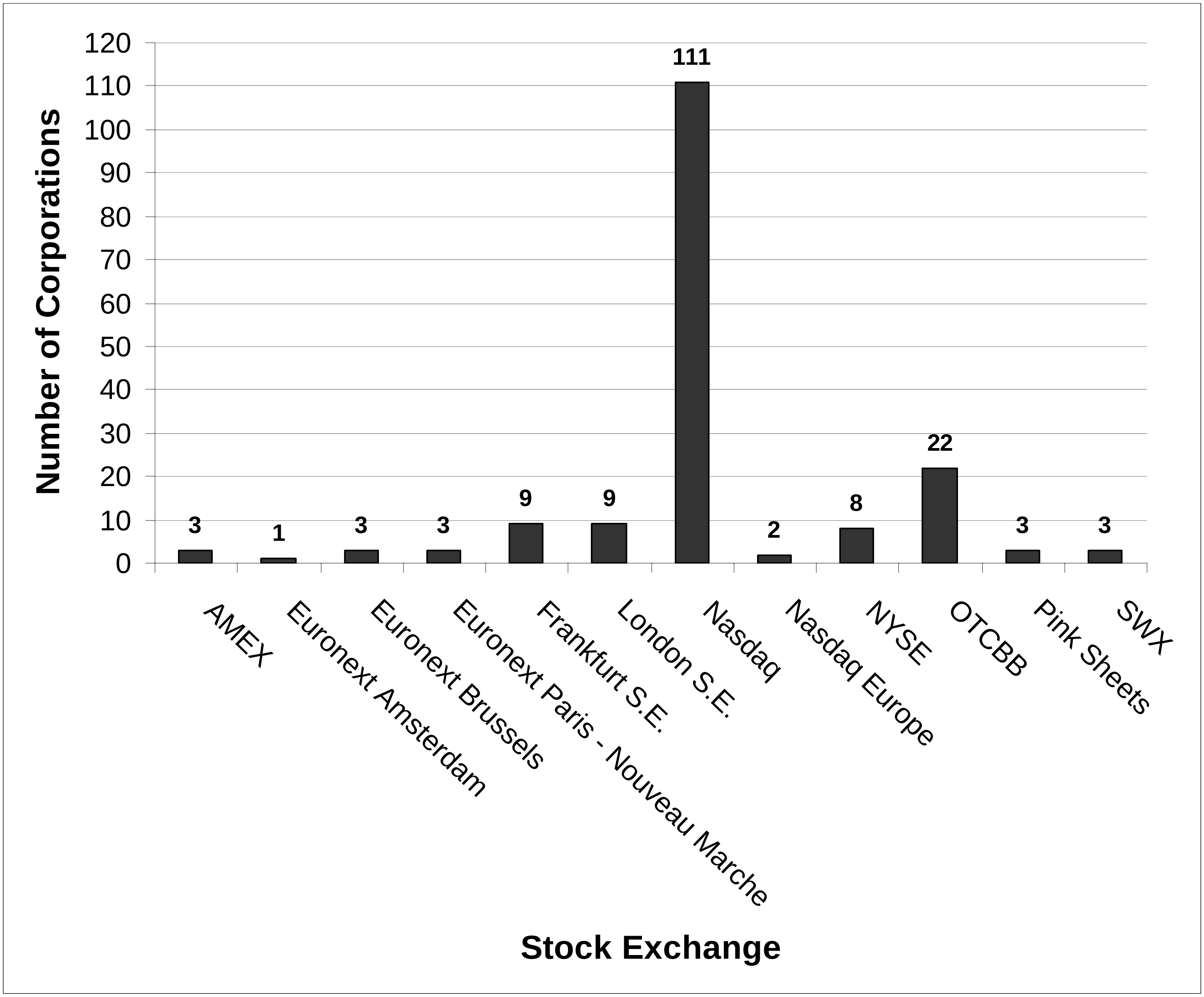


CHART 3

Distribution by Years of Israeli Corporations IPO's in the U.S.

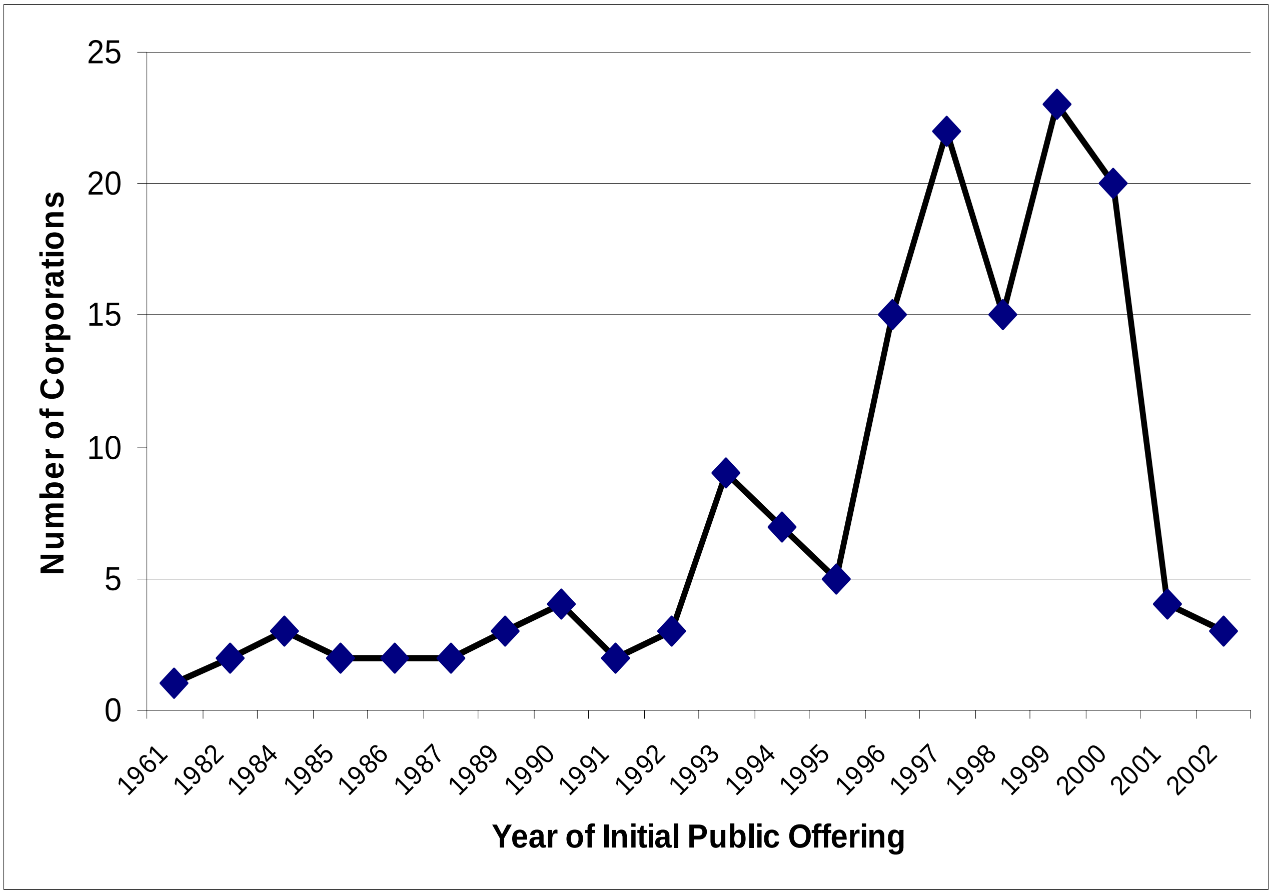


CHART 4

Distribution by Industry of Israeli Corporations Listed in the U.S.