Drawing a line between Nochi Dankner and IDB

Uriel Procaccia, a pioneer in the economic approach to law, says issues in the controversy over tycoons, creditors and haircuts are often misunderstood.

Ido Baum
and Yasmin Gueta

Uriel Procaccia, one of the pioneers in using economic principles to develop law, says that the controversy surrounding the bailout of Israel’s tycoons at the expense of bondholders is replete with misconceptions. People must understand the distinctions between a limited liability company and its controlling shareholder; he says, with each dealt with by the law and investors in their own way.

Procaccia, 69, a professor at the Hebrew University of Jerusalem and the Herzliya Interdisciplinary Center, rejects the common perception that the economic approach to law only deals with legal issues that are business and economic in nature. “The economic approach deals with human desires, and wants to make people happier and more content,” he says.

In an interview with TheMarker he takes issue with laws on usury and asserts there is too much business regulation in Israel.

Can you give an example of a situation that the economic approach to the law would be opposed certain legislation?

“There are laws that constitute bad policy. The interest rate law, for example, which says that interest above a certain rate is usurious and therefore illegal. The objective of the interest rate law is noble: rescuing poor debtors from their exploiters lest they pay usurious sums. As a result, the interest rate law sets a ceiling on the price of money and restricts interest rates.

“Every economist knows that when a maximum price is set on something, demand outstrips supply. The moment there’s excess demand for money, one of two things must happen: If everyone respects the law some people won’t get loans because not all the demands can be met at the maximum permitted price. But generally not everyone adheres to the law, and then there’s a black market where people run into tragedy because in a really black market the loans are enforced.”

Thirty years ago, Procaccia was asked by the government to draft a new Companies Law, which still serves as the basis for the current law. It comes as no surprise, therefore, that he stands up in defense of its most basic principle: a company’s separate legal identity.

“I feel there’s a lot of misunderstanding about what’s termed a ‘haircut,’ ” says Procaccia. “People don’t understand the simple idea that when a company goes bankrupt the controlling shareholder doesn’t need to fork over money. They also don’t understand what a company restructuring is; that the bondholders can take over the business themselves and throw the controlling shareholder out.”

You view things through a neat and theoretical analysis of corporate law, but there are pyramids and abuse of the corporation’s separate legal identity. In such cases, shouldn’t controlling shareholders be obligated to inject their own money?

“Let’s take a well-known example published in TheMarker. There are those who say a debt restructuring by IDB Holding Corporation shouldn’t be accepted. Why? Because they claim Nochi Dankner was too slow and negligent: I don’t know about any of this, except what I read in the newspaper. If it’s true, he could be sued for these things, and then it doesn’t matter if he agrees or doesn’t agree to put money in.

“This whole discussion over whether or should be a wall between the owner of a controlling interest and the company isn’t the issue. Even if there’s a steel wall, the same company officer — who is also the key owner — has harmed the company and checks with some rabbi before making decisions and gives him exorbitant dividends and recklessly leverages the company, then he should pay not because there’s no wall but because of what he’s done.”

But there’s enough principle to private enforcement. The institutional investors don’t sue.

Perhaps they should also be sued. The current Companies’ Law says that any shareholder whose actions can affect the fate of the company has an obligation to be fair toward the company. Nobody knows exactly what that obligation is, but they do know that the remedies are like in a breach of contract, which are exactly like those for a violation of trust.

Too much regulation

There is criticism over how Israel’s corporate world looks today, especially in light of the problem of business concentration. Could you have seen this coming?

“My feeling is that there is too much regulation. There are many things that I believe damage the economy due to overregulation. For instance, the majority required of shareholders is inclined to oppose insider deals in order to cover themselves: If you objected to something nobody can come complaining, but they can if you approved something that turned out a failure.

“We’ve seen many cases where it was hard to obtain one-third approval. The practice that’s evolved isn’t healthy. Why are there general shareholders’ meetings? So that people can listen to each other and perhaps persuade one another. The institutional investors would show up, appointing an agent without the power to vote as he chooses. You could persuade him completely, but he’s required to vote according to his instructions and you can’t change his mind.

Good deals

I think many transactions with controlling shareholders have been good deals, and the switch to one half is onerous: It makes it almost impossible to do business with the controlling shareholder and many beneficial transactions are blocked because of this.

There are those who think the problem is the reverse and call for the complete elimination of business with controlling shareholders.

But what would a concern like Israeli Chemicals, for example, do? The parent company and subsidiaries do business with each other. Their strength lies in the synergies stemming from one transferring raw materials to the other. There are always transactions with the controlling shareholder in a company like this. There are many such cases. The controlling shareholder can often provide his company with the best deal, too, compared to what the market has to offer because he knows it better.

“I don’t think completely banning transactions with controlling shareholders is a good solution, but this is a feeling that I can’t prove. I feel there are a number of regulatory stringencies that are beneficial, and quite a few that are unduly restrictive.”

Uriel Procaccia: ‘Bondholders can take over the business themselves and throw the controlling shareholder out.’

Eyal Yossef