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## Third Party Going-Private Transactions

Mergers, Acquisitions and Judicial Review - Recent Developments  
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## Sale of 100% to a Third Party Buyer

- Unequal treatment of shareholders in taking private transactions in Israel - typical scenarios
- Does Israeli law allow payment of disparate consideration to shareholders?
- Transactions involving equal consideration but unequal benefits - form of approval and standard of judicial review

## When is Disparate Consideration to Shareholders Needed?

- **Different classes of shares** - not common in view of “One Share - One Vote” rule (but - recent introduction of preferred shares)
- **Control premium** - Section 328 of the Companies Law recognizes the value of a control block
- **Deal structure considerations that support unequal treatment in order to maximize consideration, such as:**
  - **Non-compete**
  - **Purchase Price Adjustments** (recent ISA positions on public earn-out mechanisms)
  - **Indemnification** (requires escrow / R&W liability insurance)
  - **Vendor loan**

⇒ **Allowing the controller to receive payment for these additional undertakings would help maximize value for shareholders**

Otherwise - sellers will most likely sell at a discount

### Pro-Rata Pay - Unequal Treatment

Question typically relates to the motives of the controlling shareholder in its acceptance of the offer, e.g. -

- Divestment obligations under the Concentration Law
- Insolvency / Liquidity problems

If the transaction requires a simple majority approval, controller would in many instances be able to approve it with only its own voting power

- **Companies Law - silent** (Tender Offer Regulations require “equal terms” for all offerees of the same class of shares)
- **“Disparate but Equal”** - court in *Dexia, Nitzba* (share purchase transactions) - substantive equality, as opposed to formal equality, in case of different classes of shares



Can this approach be applied to payment of a control premium for shares of the same class (following historic *Clal Industries* precedent)?

## *Machteshim Agan* decision

- **Acquisition through a merger is subject to duty of equality** => same pay to shareholders
- Israeli law only permits a control premium in either: (1) the first acquisition of control from the public; or (2) privately negotiated control transfers
- The **value of the additional benefits received by the controlling shareholder should be shared equally** with all shareholders.
- **“appropriate entrepreneur's fee”** can be paid to controller separately for facilitating the deal, subject to separate approval without conditioning the merger on such payment
- **Special majority approval** by shareholders is apparently **not sufficient** to remedy the unequal treatment

### Can shareholders approve the payment of a disparate consideration by special majority?

- ***Bezeq (Verdnikov)*** -
    - doubts as to whether the “Entire Fairness” doctrine applies in Israel
    - The court will rarely interfere in duly approved transactions
    - The controller’s duties under section 193 are owed to the company and not the shareholders
  - **“Fair Value” for appraisal rights - no control premium (*Kittal*)**
- ⇒ Potential implications on the possibility of an alternative two-tier deal structure (buyer first buys the control block and then buys out the public)

- **Types of potential inequality discussed in Israeli case law (not necessarily related to M&A transactions)**
  - **Unequal impact of the transaction on shareholders** - shares are moved to pink sheets (*Pinrus*), removal from indices (*Zolti*); spin-off involving changes in disclosure regime (*De Lange*)
  - **Matters concerning the motive for engaging in the transaction** - dividend distributions and capital reductions (*Partner; Bezeq*)
- Additional examples: duty to divest; liquidity needs
- *Bezeq* - although there is no “personal interest” to the controller in the transaction (in view of equal terms), the transaction is subject to an “Enhanced Scrutiny” standard of review, in view of the potential concern that it was approved only in view of the controller’s interests



### How should transactions in the “Zone of Inequality” be approved?

- **The controlling shareholder has the strongest incentive to seek the best terms and highest price possible for its shares => approval as related-party transaction should be required only when the unequal impact is material**
  - **Approval mechanism - depending on magnitude of potential conflict of interests => Assuming an independent committee is required (not certain post *Bezeq*) - the committee’s mandate should focus on the potential conflict of interests, e.g. -**
    - timing of the deal and adequacy of deal price (assuming significant concerns re the controller’s motives to approve the deal)
    - specific unequal terms
- No need for committee to independently negotiate the deal with the 3<sup>rd</sup> party buyer

# Thank You

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