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JUDICIAL DECISION CHANGING THE RULES OF CORPORATE GOVERNANCE

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A controlling shareholder of a public company wants to take the company private, whereby it shall ultimately hold 100% of the company. What are the alternatives for doing so? This was the question examined by Judge Ruth Ronen of the Economic Court in the Tamda Ltd. Case.
In her judgment, Judge Ronen ruled that an arrangement approved by the court under Section 350 of the Companies Law is a legitimate way for taking a company private, which adds to the other alternatives (full tender offer and reverse triangular merger), while each alternative has its own set of breaks and balances; and that the extent of the court's examination with respect to the conditions of the transaction depends on the procedure initiated by the company and on the information presented to the court and the general meeting for understanding the fairness of the consideration.

This ruling is most welcome, as it recognizes the advantages of allowing flexibility in transaction structuring, while protecting minority rights.
The court had recognized the possibility of substituting a full tender offer and reverse triangular merger more than a decade ago.

The full tender offer is a process conducted "above the public company": the controlling shareholder offers to purchase the shares held by the public. The advantage – speed; the difficulty – the necessary majority (95% must be reached. For example, if a controlling shareholder holds 50.01%, it must have 45% sold to it. Effectively this means approximately 90% of the minority), and the public also has an "option" in the form of the "valuation relief" whereby should it be proven that the fair value has not been paid, the public shall receive an additional amount without the buyer being able to cancel the transaction.

The reverse triangular merger is another alternative for taking a company private. The merger decision is adopted by the organs of the company, and not "above the company", and if the buyer is also the controlling shareholder the transaction shall be subject to the "triangular approval" – by the audit committee, the board of directors and the general meeting, including a majority vote from amongst the minority shareholders.
The advantage: the required majority – a majority vote from amongst the minority shareholders participating at the general meeting. Only the voting shareholders affect the results (for example: when a controlling shareholder holds 50%, and only 20% from amongst the public participate at the meeting, it is sufficient to have approval of just over 10%); the difficulty: the extended period of time, the additional approvals that are necessary (audit committee, and in practice until recently – also an approval form Entropy) and exposure of the directors and controlling shareholder to derivate actions asserting breach of fiduciary duty and oppression, should it be proven that the consideration that was paid is lower than fair value.

However, Judge Eitan Orenstein of the District Court in Tel Aviv had already determined that an arrangement under the Companies Law can be used for taking a company private only when two conditions are satisfied: that the process is amicable to the company (in contrast to a hostile takeover), and proving a difficulty to meet the conditions of a full tender offer (other than for reasons related to the necessary majority).

For some time the courts have been at odds on the question whether an arrangement under the Companies Law can be a possible alternative. The Israel Securities Authority and the Ministry of Justice have expressed their opinions whereby such process can be used even when a possibility exists to conduct a full tender offer.

In her decision, Judge Ronen ruled that a process under the Companies Law is a legitimate alternative even when it is possible to conduct a full tender offer, since the court's approval is an adequate protection mechanism. However, due to the conflict of interests between the minority shareholders and the controlling shareholder with respect to a transaction of such magnitude, pursuant to which the shareholders shall no longer be shareholders in the company, an approval shall only be granted once the court has been convinced, in reliance upon the entirety of information which was also available to the board of directors, that the price to be paid to the minority is fair, and this while exercising the stringent standard of judicial review ("complete fairness"). Judge Ronen recommends supporting such motion by a valuation establishing the fair price.

Another important determination was that should the company establish an independent committee to conduct negotiations vis-à-vis the controlling shareholder, such would alleviate the judicial review standard with respect to the price of the transaction. In her decision, Judge Ronen rejected the motion for assembly of meetings and asked the company to explain how it determined the price being offered to the minority.
This judgment constitutes an important development in creating certainty with respect to the available alternatives for going private.
It would also be appropriate to increase certainty even further with a ruling whereby in case the triangular approval including majority from amongst the minority shareholders is obtained in the framework of a process under the Companies Law, in addition to a majority of 75% from amongst all shareholders, then a "class meeting" – which means a majority of 75% from amongst the minority forces the minority opinion on the majority – shall not be required. Such would be in line with the decision of Judge Danya Kereth-Meyer in the Telkoor Telecom Case.

The above review is a summary, provided for informative purposes only and does not constitute legal advice. For more details please contact Adv. Shirel Guttman Amira, partner and head of the Capital Markets Department

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