



TADMOR & Co.

SHAREHOLDERS DISCRIMINATION AND CLASS ACTIONS

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Dear clients and friends,

The Haifa District Court has recently ruled on issues concerning discrimination against minority shareholders in a public company, in the context of an application for the granting of class action status, which was denied.

The public company in question, Elscint Ltd. ("**Elscint**") a developer and manufacturer of medical equipment, had sold most of its assets, and had essentially become a cash holding company. Elscint had rejected its shareholders' request to distribute dividends to them, reasoning that its future obligations were unclear.

Subsequently, control of Elscint was acquired by Europe Israel (MMS) Ltd. ("**Europe Israel**"), and Elscint used its funds to purchase real-estate assets from another company, which was (indirectly) controlled by both Elscint and Europe Israel, at what the plaintiffs viewed as an inflated price. In addition, Elscint's (direct) controlling shareholder, Elbit Medical Imaging Ltd. ("**Elbit**"), had notified Elscint that it was contemplating entering into a business combination with Elscint, in order to acquire full ownership of Elscint. This intention was later on revoked; however, the announcement (in the stock exchange and in the press) of a possible pending business combination caused Elscint's share price to fluctuate, rising at first, and then plunging.

A number of Elscint's minority shareholders, all "institutional investors", claimed that Elscint's minority shareholders were discriminated against, and that various fiduciary and other duties owed to them by various office holders and directors in Elscint, Elbit, Europe Israel and a number of other corporations involved, had been breached. These shareholders filed suit against Elscint, Elbit, Europe Israel and various other affiliated companies and office holders and directors therein, and applied for their suit to be granted class actions status.

As mentioned, the Haifa District Court denied the class action application, and provided its opinion on the merits of some of the plaintiffs' contentions, focusing on the issue of shareholder discrimination.

Section 191(a) of the Israeli Companies Law 5759-1999, provides courts with the authority to remove or prevent discrimination against shareholders. The Israeli Supreme Court, in CA 2773/04 **Nitsba – A company for Settlements Vs Meir Atar**, has ruled that discrimination of shareholders occurs where their legitimate expectations are harmed, taking into consideration the nature of the company.

In the Elscint case, the nature of the company had undergone several changes over the course of time. It had started off as a medical equipment company; then it became essentially a cash holding company, which later on transformed into a real-estate holding company. Thus, shareholders' legitimate expectations also changed and shifted over the course of event, or as the Haifa District court put it: "*Whoever purchased Elscint stock when it was essentially a cash holding company and a subsidiary of Europe Israel, a company that operated in the field of real-estate, was investing in a different company, in terms of its nature and the nature of its controlling shareholders, from whoever had purchased Elscint stock when Elscint was focused on medical imaging under the control of a company that operated in the same field. The first investor's expectations as to the use of the company's retained earnings ... were different from those of the second investor*".

In its analysis, the court focused on the plaintiffs' ability (or inability) to prove damages. As it turned out, a shareholder who bought Elscint stock before the business combination announcement and held it until after the real-estate acquisition transaction, had an average return of 28.4% per annum, no doubt a satisfying return even if the real-estate transaction was overpriced, and despite the business combination intention being revoked.

In summation, the Haifa District Court's decision (which may still be subject to appeal) indicates that contentions of shareholder discrimination must take into account the nature of shareholders' expectation considering the company's nature at any given time, and must also show actual damages caused by such discrimination.