



Veto Rights Granted Under Shareholders Agreements

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Dear clients and friends,

The Supreme Court recently discussed and ruled on issues concerning the interpretation of a certain provision in a shareholders agreement between shareholders of a private company (CA 9636/06 Itai Bogner v. SofaWare Technologies Ltd. et al. (published in *Nevo*, ruling handed on November 18, 2009).

The shareholders agreement in question contained a provision whereby the Company was prohibited from taking certain actions "...without first obtaining the approval (by vote or written consent, as provided by law) ... of the Founders, acting as a group."

The main questions discussed by the Supreme Court were: (a) whether a Founder retained his "veto rights" with respect to actions that are subject to board approval after resigning from the board; and (b) which decision making mechanism within the Founders' group is implied by the use of the term "acting as a group".

The trial court (the Tel Aviv District Court) ruled that once a Founder resigns from the board, he loses "veto rights" granted under the shareholders agreement with respect to actions that are subject to board approval. The Supreme Court reversed the ruling of the Tel Aviv District Court, determining that a resigning Founder maintains such "veto rights" even following his resignation. The Supreme Court's ruling in this regard was based mainly on the language of the shareholders agreement, which provided for the execution of the "veto rights" either by vote **or by any other way of written consent**. The Supreme Court noted that had the parties to the shareholders agreement wished to limit the applicability of the "veto rights", they would have done so explicitly. The Supreme Court further noted that **a corporation, as an independent legal entity, may subject the decisions made by its authorized legal organs to third party's consents; and that there is no real difference whether such third party is external to the corporation or its shareholder.**

On the second question, regarding the interpretation of "acting as a group", the Supreme Court ratified the ruling of the Tel Aviv District Court, which determined that **"acting as a group" meant acting according to the rule of majority within such group**. The Supreme Court ruled that granting each individual Founder a "veto right" within the Founders' group would have created a "tyranny of the minority", would have put the Company in deadlock and would have prevented it from fulfilling its purposes. The Supreme Court also rejected the notion that a decision regarding the exercise of a "veto right" granted to the Founders had to be unanimous, and reverted to the "majority principle". The Supreme Court noted that "[t]he majority principle is a cornerstone of reaching decisions in a company in a wide array of subjects, and with lack of an explicit provision to the contrary, one may assume that this principle applies in our case".

By doing this, the Supreme Court applied central principles of the corporate law, including the analysis of the purpose of the corporation and the "majority rule", to an issue that was principally contractual in nature.