



## Insight #2: Making Sure that You Have Ownership of Your Shares - Part II

**When Purchasing Existing Shares, Check for Security Interests with the Shareholders – Not the Company.** The Israeli Corporations Authority's information on charges is constitutive, in the sense that registration is required in order to ensure the binding effect of the charge against uninformed third parties. Companies are also required to maintain an internal charge registry. These registrations relate, however, only to charges on a company's assets – not its shares. If you are purchasing existing issued shares from their current owners, check under their names to see if they have security interests registered on their shares. For Israeli individual shareholders check with the Israeli Registrar of Liens. For Israeli company shareholders check with the Corporations Authority under their name. For non-Israeli shareholders check in their country of residence/incorporation.

- Note: many Israeli private companies do not maintain an internal registry of charges. Make sure this is corrected before you acquire shares.

**When Purchasing Newly Issued Shares, Check for Security Interests with the Company – Particularly if it has Loans from Institutional Lenders.** Institutional lenders will sometimes request the registration of a security interest on the company's authorized share capital in order to control issuances of new shares by the company. This will be registered as a charge with the company as if the authorized share capital is an asset of the company. If you are being issued new shares of an Israeli company that has institutional financing, check its records to see if there is a charge on its authorized share capital. If so, you will need the consent of the financial institution in order to be issued new shares that are free and clear of this charge.

**Check the Company's Articles of Association.** Israeli companies often do not distinguish between the articles of association, investors' rights agreements, right of first refusal and co-sale agreements, voting agreements etc. and instead include all shareholder arrangements in their articles of association. Review the articles of association in order to verify if existing shareholders (and sometimes even third parties) have preemptive rights, rights of first refusal, tag along rights, are subject to no sale obligations etc. Make sure all such rights either do not apply to your purchase of shares, are duly waived, or that the required procedure is strictly followed.

**Watch Out for Contractual Rights.** While provisions related to issuance and sale of shares are often included in the articles of association, they may also be included in shareholders agreements or in agreements with third parties. These agreements are usually not filed with the Corporations Authority and do not need to be mentioned in the company's share certificates (if issued) in order to be valid and binding legal obligations of the parties thereto. Make sure your due diligence and the company's representations and warranties cover contractual restrictions on issuances or transfers of shares.

**Review Award Plans.** Israeli companies often adopt award plans under which employees, officers or third parties are granted options or shares of the company. Many private companies implement plans that provide the grantees significant tax advantages but require filing with the Israeli tax authority as well as that the options or shares be held by a trustee for a certain period of time. Check for this arrangement; if it exists, it will provide you with an effective mean to ascertain the number of shares or options reserved and issued under the plan. Note that options or shares can also be promised or granted outside the framework of an award plan, whether or not one was adopted by the company.

**Review Board and Shareholder Resolutions.** In many companies, grants or promises of options or shares will be made by the board of directors and sometimes require shareholder approval. Review board and shareholder resolutions, both in order to compare with information provided by the company to the tax authorities, to the trustee (if there is one) and to you in your due diligence review, and in order to locate grants or promises to grant which are external to any plan.

**Make Sure you are Covered by Representations, Warranties and Indemnities.** Someone out there can always claim to have a written or even oral valid right to receive shares or options which will be virtually impossible to locate during due diligence. Make sure you are adequately covered for this scenario. If you are investing in an Israeli company and are being issued shares of preferred stock, this may be easily addressed by agreeing that the conversion ratio into ordinary shares will be automatically adjusted to compensate you for any adverse discrepancies in the cap table on a fully diluted basis as presented to you by the company.

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