

ISRAEL



Tel Aviv

Transcending Borders

Once primarily a target destination for acquisitive companies, Israeli companies, investors and law firms are increasingly investing overseas.

By Howard Stock

Israel continues to cement its position as a focal point for technological development for global companies. With major new investment by U.S. technology giants Microsoft, Apple, Facebook and Google, “The market for high quality public offerings and private placement is thriving for the first time in years, and Israeli companies have wide access to funds,” says Morrison & Foerster Of Counsel Bruce Alan Mann.

Add to that a “remarkable increase” in inflows from Chinese investors, and it is clear that “despite the difficult geopolitical environment, Israel continues to attract substantial foreign investment,” says Herzog Fox and Neeman partner Alan Sacks.

But that’s only part of the story. Israeli businesses aren’t only attracting international partners, they’re

actively seeking opportunities outside of Israel’s borders. A number of Israeli companies have completed high profile public listings overseas, and “Israeli capital is increasingly seeking opportunity outside of Israel, which makes relationships two-way and stronger,” says Schwell Wimpfheimer & Associates partner Dov Schwell. “Israeli companies are often the buyer and the vehicle for aggregation rather than just a target to be gobbled up by outsiders.”

Israel’s economy is very much export-oriented. Specific areas that drive this environment include the high-tech industry, where in recent years the predominance of telecom and semiconductors has been replaced by cyber and internet, biotech and medical devices, defense and traditional industry. “Since the Israeli market is very small, the only real way a com-

pany is able grow to any substantial size is by focusing on international sales and global growth,” says Naschitz Brandes Amir partner Sharon Amir.

Policymakers have taken several steps to encourage the flow of business outside of Israel. The Law for Encouragement of Capital Investments can reduce Israeli tax rates for export-oriented “approved enterprises” by as much as 55% and, in certain areas of Israel by up to as much as 80%, compared to regular corporate tax rates, as well as providing grants to certain eligible approved enterprises. Likewise, the Research and Development Law provides matching funding and other incentives to research and development activities (mostly in the high-tech industry); various bilateral and multilateral funding programs co-sponsored by Israel; and government-sponsored public-private funds invest in or provide loans to certain targeted sectors or industries, such as small businesses, the biotech industry and the Arab sector, Amir says.

However, despite many positive structures to encourage business, some reforms are still necessary, Schwell says. Israeli tax treatment of non-Israeli investors in Israel continues to hinder the market and forces challenges in structuring Israeli companies and transactions, and the need to apply for and negotiate treatment on a case-by-case basis sets Israeli apart from other developed economies. “Further, there is a perception, partially deserved, that Israeli bureaucracy hinders establishing and managing Israeli entities,” Schwell says. On the whole, though, he says Israel’s legal system has kept pace with global developments.

EVOLVING MARKET

Advances in commercial law include the Concentration Law, which is an innovative socially driven law that, among other things, targets the over-concentration of power over multiple industries and the ability to control companies by use of multiple-layer pyramids. There have also been various changes to the Securities Law and the Companies Law dealing with shareholder supervision over compensation policies, and the establishment of a special court to deal with corporate matters and securities related offenses, which has brought a significant change to areas such as corporate governance, change of control transactions and fiduciary duties, Amir says.

Recent cases illustrate the changes in the corporate governance world, including the Financial Court’s decision in the 2011 Makhteshim Agan acquisition by ChemChina, where the court intervened in the formal approval procedure of the deal by the target’s audit committee, board of directors and shareholders in the manner prescribed by law, by introducing the requirement for an independent committee in certain transactions that would rely on independent advice. Another recent decision of the District Court Central District involved an application to approve a deriva-

tive suit against the directors of a company that had acquired a failing newspaper that had caused losses of several hundred million Israeli new shekels (one U.S. dollar is equivalent to roughly four shekels). The court refused to permit the reliance on the business judgment rule, ruling that the court would not protect directors in cases where they neglected to perform their basic duty to ask the required questions and seek adequate information about the deal.

Deal sizes and complexities are increasing as larger and more sophisticated non-Israeli players enter the market. Currently, the biggest deal involving an Israe-

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li company is Teva’s acquisition of Allergan’s generic division for over \$40 billion. Other big deals include Playtech’s \$750 million acquisition of Plus500.

Amir notes that Israel has seen a disproportionately large number of sizable exits for technology and startup companies of late. “Perhaps the greatest area of interest right now is the cyber area, where Israeli companies, as well as some non-Israeli companies founded by Israelis, leaning mainly on know-how gained in the military, have become world leaders in innovation,” he says.

Israel is also seeing some major deal activity in the energy space. “I think that the historical hot areas—high tech, green tech, biotech, medical devices, security and military—continue to take center stage,” Schwell says. “However, Israeli firms are using newly found natural resources as a springboard to bring their unique talents to new industries.”

STRENGTH TO STRENGTH

For Israeli law firms, all this business represents an opportunity to expand their own books, but successful players will likely prove more adept at adaptation and relationship-building with peers in other countries, Amir says. “Israeli law firms focusing on corporate matters have to be prepared to work internationally on the buy side of transactions where Israeli companies acquire foreign businesses. To do so, they have to establish a network of foreign firms which can assist them on local matters in various places around the world,” he says, adding that the rise of shareholder litigation on corporate matters would also necessitate firms dealing

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with corporate matters to have a litigation practice that is equipped to defend corporate actions.

"Staying abreast of changes in Israel as well as internationally is key to supporting increasingly sophisticated clients," adds Schwell. "Law firms need to make sure that they have the resources—internal or in some other seamless manner—to meet the increasingly complex

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needs of their clients. Law firms need to understand the issues of buyers in international transactions."

For international firms looking to get in on Israel's economic action, the best solution is to form connections with domestic firms in order to cooperate on cross-border activities. "I am not a big believer in the establishment of local offices by foreign firms since Israeli companies tend in most cases to rely on their Israeli counsel for overall advice and are unlikely to replace them for foreign firms," Amir notes.

Since Israel liberalized the rules regarding foreign law firms operating in Israel, a number of major international firms have established a presence in Israel, but few (if any) have indicated any interest in domestic activity within Israel, Sacks says. Rather, the inter-

national firms have established representative offices Israel with a view to servicing overseas clients investing in Israel and satisfying the demand for overseas legal work on the part of Israeli corporations operating around the world. "The liberalization of the Israeli bar has seen an increase in cooperation between international law firms and their Israeli counterparts rather than competition for local work," Sacks says.

U.S. law firms need to work closely with Israeli counsel and recognize that there are many tasks in M&A and capital raising transactions that should be handled by Israeli counsel because they can do them faster and with less expense to the client, adds Mann.

PUTTING CLIENTS FIRST

Either way, law firms need to ensure that their interests lie with their clients (and not with U.S. counterparts or with financial players if their clients are issuers and not sponsors), Schwell says. "They need to be on the ground and meeting face to face with their clients and available for counseling at all points in the life of a matter," Schwell says. "An international firm with many partners resident in Israel offers Israeli clients with the expertise they need in their own backyard. Lawyers also need to invest the time to understand their clients' businesses and not treat the transaction as an end in and of itself, but rather as a driver of success for the client."

As a U.S. lawyer, Schwell says he is most excited to be representing Israeli companies who are seeking increasingly significant and complex opportunities and transactions overseas. "Working with Israelis is always interesting, and guiding them through the way trans-



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& ASSOCIATES

actions are done overseas, when they are increasingly on the buy side, is particularly stimulating," he says. "While the clients learn fast and adapt well, it is one of the most exciting parts of my practice to help clients grow into new challenges."

Israel's international aspirations are not likely to tail off. The domestic market isn't large enough to support growth beyond a certain point, so expansion outside Israel's borders is a must for companies looking to reach the next level. "Since Israeli companies are dependent on global business for future growth, international expansion through mergers and acquisitions is the natural way to go," Amir says. "In recent years, we have been involved in almost as many acquisitions of foreign companies by Israeli companies as in acquisitions of Israeli companies by foreign companies. This is certainly a dramatic difference to the situation that prevailed in the past where inbound transactions were predominant."

EXPANSION THROUGH ACQUISITION

Expansion through acquisition looks set to be the preferred method since Israeli entrepreneurs and executives have seen that a U.S. or European initial public offering is not always the answer to their dreams, Schwell says. "While a rich exit is always nice, their companies may be of greater interest or command greater value with critical mass, and that can often be best accomplished through a combination of organic growth and acquisition," Schwell says. "Also, sponsors are driving this path to growth and more Israeli companies are being receptive. Of course, having Israeli capital available to fund purchases is always helpful." He says startups remain a key focus, but as more mature companies are also attracting interest, deal values are increasing thus driving a large part of the growth in investment.

Meanwhile, Israel's homegrown entrepreneurial spirit and culture of innovation is likely to ensure money flows toward Israel's domestic market, too. Even within the legal community itself, Amir reports seeing an increase in mergers between international

and domestic law firms, or business agreements that create "virtual" international law firms.

However, Amir stops short of predicting a revolution in Israel's legal market due to an influx of international firms. For one, Israel's legal market is somewhat liberalized, but it's nothing like the free zones found elsewhere in the Middle East region. Additionally, Israel also has a fam-

ously high ratio of lawyers, which means there is more competition for business than in other jurisdictions, creating downward pressure on the size of fee the market is prepared to bear.

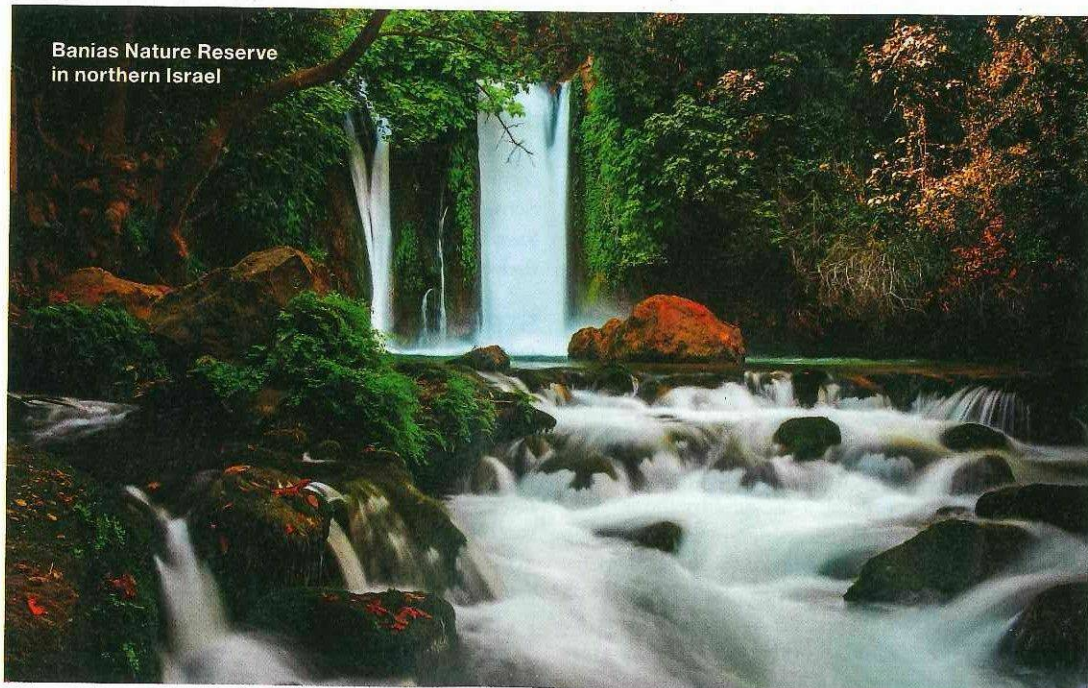
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That's why "I do not believe that the legal landscape will change dramatically in the near future," Amir says. "Very few foreign firms have opened representative offices in Israel and it I am not sure the presence of an office in Israel has contributed more to gaining Israeli business than visits and marketing trips conducted by these and other international firms." In general, other than very few notable exceptions, Israeli businesses rely on Israeli law firms as their principal legal advisor and look to them to coordinate their international work with assistance from local firms. "I don't see any reason why this trend would not continue."

Schwel suspects that the primary focus of non-Israeli firms in Israel for the next several years will remain as business development, where Israeli presences are used as a marketing tool to bring in Israeli clients for their U.S. offerings. "To a lesser extent, they may view an Israeli office as a talent reserve pool to support workflow from their primary jurisdictions," he says. "I see these goals as being a hard sell for most Israeli firms who might be seen as merger/takeover targets. However, I do see a strong role for firms providing advice on foreign laws that are of key import to Israelis, but who are on the ground in Israel."

For Israeli law firms and companies, future opportunities transcend borders. ■



Banias Nature Reserve
in northern Israel