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# Thoughts for Board and Senior Management of Israeli Public Companies

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We have set out below observations for board members and senior management of Israeli companies based on our experiences of the last year.

## Activism

Israeli companies cannot discount the risk of shareholder activism which, for a second straight year, has reared its head in a variety of contexts.

### Board representation

Activists have sought, and obtained, seats on the boards of a number of Israeli companies. Companies face a difficult decision whether to negotiate and settle with activists in order to avoid a proxy fight or to engage in a costly fight that may not have a clear outcome. We tend to think that boards of Israeli companies are more comfortable than their US counterparts in settling and allowing activist representatives onto their board. We pass no judgment on this since it is ultimately a business judgment of the board. We just note two points:

- The immediate savings achieved in a quick settlement are only as valuable as the time and protections that are enshrined in the settlement agreement. That agreement should ideally give the company respite from future attack for one to two years, ending on a date before the deadline by which the investor must provide notice of its intent to nominate new directors.
- Israeli law remains less friendly than its US counterparts (*e.g.*, Delaware). Israeli companies are given little notice of potential nominees and little disclosure about the proposing party (contrast with the US requirements where bylaws typically require 90 – 120 days' advanced notice and detailed information about the proponent and the proposed nominees). Israeli companies are required to include the activist nominees on the company proxy card (contrast with the US requirements where the activist has to mail its own proxy card and statement and bear the costs of such solicitation). It would be worthwhile for each company to consider its defenses now since it will be too late once an activist becomes active.

### Hostile acquisition

In 2017, investors witnessed one of the few examples of an Israeli company being acquired in what started as an unsolicited (hostile) transaction (Frutarom's acquisition of Enzymotec)[1]. The transaction was completed as a negotiated deal. We understand that the ability of an Israeli company to adopt a shareholder rights plan (frequently called a "poison pill") is significantly constrained (if it exists at all). A typical poison pill adopted by a US target company prevents a potential acquirer from acquiring more than 15% of the target's shares without negotiating with the target's board. We also understand that Israeli law gives shareholders the decision whether a potential acquirer of a company's shares can exceed the 25% and 45% levels by mandating a pro

1 White & Case served as US counsel to Enzymotec and we offer no comment here on that specific transaction.

rata tender offer to all shareholders in order to exceed those specific levels. Conversely, Israeli law makes it significantly harder to acquire the remaining minority interest after a hostile acquirer has exceeded the 50% ownership level. Our takeaway from all this: just because Israeli companies are listed on a US securities exchange and often seek to look as American as possible in their governance practices, it does not change the fact that Israeli law governs key life cycle events of the company. Boards and senior executives of Israeli companies would be well advised to understand these differences.

## Shareholder Meetings

A growing number of Israeli companies continue to pay significant attention to the risk that proposals on their annual meeting agenda will not receive the necessary support. ISS and Glass Lewis continue to apply their Israel voting guidelines to Israeli companies even though this can result in very skewed outcomes when those guidelines are compared to those that would apply to identical US domestic companies. Nowhere is this more pronounced than in the hard 10% potential dilution cap that ISS imposes on equity incentive plans of Israeli companies. Many of these companies are tech/growth companies that can only compete for talent with US companies operating in Israel if they can grant meaningful equity incentives. Points to consider in this circumstance, and generally in connection with shareholder meetings, are as follows:

- Focus intently on the disclosure that is included in the proxy statement. Clear and cogent disclosure supporting a position that is objectively reasonable will sometimes be sufficient to overcome a negative ISS or Glass Lewis recommendation.
- Consider engaging a proxy advisor to help you understand what your major investors care about. Absent a proxy fight, the cost is relatively low compared to the benefits accrued.
- Time your annual meeting so that you have flexibility—if needed—to delay the entire process or to adjourn the meeting to a later date. Holding a meeting at the latest possible time reduces that flexibility. We note also that US investors would expect the annual meeting to be held a relatively short time after the publication of the annual report.

In the last resort—and this has not yet occurred to our knowledge—a foreign private issuer could voluntarily adopt US domestic filing obligations and thereby become eligible to be treated by ISS and Glass Lewis as a US domestic issuer.

## Class Actions

Last year has seen an increase in securities class actions filed against foreign private issuers. This trend is not limited to Israeli companies, but resulted in five claims being filed in the first half of 2017 against Israeli companies compared to an average of one claim during the same semi-annual period from 1997 through 2016. Points to consider with respect to this phenomenon are as follows:

- Ultimately, such class actions are a “cost of doing business” in the United States. The US has a highly entrepreneurial plaintiff bar that is paid via contingency. Approximately 50% of these claims do not survive a motion to dismiss and 49% settle before a trial verdict. Unless they are accompanied by regulatory investigation, they should generally be viewed as manageable (if highly undesirable).
- Robust disclosure can lower the risk of a claim being filed. When releasing bad news, it is highly advisable to have a litigator review that disclosure and advise the company on steps it can take to avoid being “low-hanging fruit” for plaintiffs’ lawyers. Risk factor and MD&A disclosure in the Form 20-F can play a meaningful role.
- It is worthwhile for companies to review carefully and understand their D&O insurance coverage. Note that such coverage often does not cover the expenses that will be incurred in fulfilling indemnification obligations to underwriters. Also, given caps in the amount of indemnification that Israeli companies can offer their directors and officers, insurance should be sufficient to give directors and officers full comfort that they will not be subject to personal exposure in connection with such claims.

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