

# 2017 Considerations for Israeli Companies That are Listed in the United States

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In addition to our general update for foreign private issuers for the 2017 proxy season, Israeli companies that are listed in the United States are subject to a number of specific corporate governance and regulatory considerations from a US compliance perspective.

## ISS/Glass Lewis

Institutional Shareholder Services (ISS) and Glass Lewis continue to impact how Israeli companies that are listed in the United States approach their annual and special shareholder meetings. Neither ISS nor Glass Lewis has published new Israeli company guidelines for 2017; therefore, at this time, companies should continue to take into consideration the guidelines that each issued in 2016. Three key areas for Israeli companies last year were:

- *Director Independence.* ISS and Glass Lewis director independence guidelines are more stringent than Nasdaq and NYSE requirements. For example, a director associated with a 10% shareholder is not considered independent under ISS or Glass Lewis guidelines even though such director would not be disqualified under Nasdaq and NYSE rules. Israeli companies need to focus on these distinctions if they wish to garner support for their board nominees from ISS and Glass Lewis.
- *Equity Incentive Plan Dilution.* ISS maintains a strict policy that potential dilution from equity incentive plans of Israeli companies cannot exceed 10% (calculated by taking into account shares reserved for future awards as well as shares underlying any outstanding awards) unless the three-year average burn rate is equal to or less than 1%. If the three-year average burn rate is equal to or less than 1%, then the cap is increased to 15%. There is little logic to these levels, which are not adjusted based on a company's industry, stage of growth or location of employees. These levels are also lower than those that apply to comparable US growth companies. A significant number of Israeli companies exceed these levels and, as a result, ISS has recommended against voting in favor of equity grants by those companies. Israeli companies seeking shareholder approval for equity plan-related matters may need to engage actively with shareholders to gain their approval if their plan dilution levels are above those recommended by ISS.
- *Compensation Policies.* In this context, proxy advisors focus on the level of disclosure of the proposed compensation policy to ensure that it is sufficient for shareholders to make an informed decision and that it is in line with local market best practice standards. According to ISS guidelines, a company's executive compensation policy, among other things, must avoid guaranteed or discretionary compensation, provide for caps on any short- or long-term compensation component and avoid disproportionate focus on short-term variable elements.

Israeli listed companies have been able to overcome negative ISS and/or Glass Lewis recommendations, including with respect to compensation matters. First, the tone of the ISS or Glass Lewis report can help, even

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if the recommendation is negative. In this context, some Israeli companies seeking shareholder approval for equity plan-related matters have engaged with ISS Corporate Solutions (ICS) to design equity plan proposals and craft careful disclosures, including meaningful explanations of rationales behind equity grants for which shareholder approval is being sought. For example, some companies have argued that they could not compete with others in their industry to attract qualified directors to their boards or retain senior executives if they had to rely solely on cash compensation in structuring such individuals' fees and compensation arrangements. Second, active engagement with shareholders throughout the year and at the time of the annual meeting can make a material difference. In this context, a proxy solicitation firm can provide useful insights into the voting practices of institutional shareholders.

## External Directors

As a reminder, pursuant to the recent amendments in 2016 to regulations under the Israeli Companies Law, an Israeli public company whose shares are listed on Nasdaq or the NYSE may, subject to certain conditions, opt out of the requirements under the Israeli Companies Law concerning the composition of its audit committee and compensation committee and the appointment of external directors. There is no impact from a US perspective of the changes introduced by the amendments. Individuals who are "external directors" generally also satisfy NYSE and Nasdaq independence requirements. Given the significant challenges involved in compensating external directors and ensuring their presence on board committees, companies that have not opted out should consider whether to do so in 2017.

## Shareholder Activism

Israeli companies have historically not experienced shareholder activism in the same way as their US counterparts. This is beginning to change. An activist hedge fund sought to block Mellanox's acquisition of EZchip (which closed at the start of 2016) by soliciting proxies in opposition and nominating a "short slate" of two directors to the board. In the ordinary course of their annual meeting cycles, Israeli companies are more frequently experiencing the use, or a threat of the use, of Israeli corporate mechanics that permit shareholders holding a relatively small percentage of shares to nominate directors or include items on the meeting agenda.

Israeli law governs the mechanics of these actions and companies should review their articles of association with US and Israeli counsel in order to identify where opportunities for activists might exist. In the final analysis, the Israeli Companies Law contains more shareholder-friendly provisions than Delaware law, making it likely that the nascent activist trend will continue in the future. Companies would be advised also to hold their annual meetings early enough in the year to allow time to postpone until later in the year if the need arises.

## Acquisition Trends and Readiness

A detailed discussion of acquisitions is beyond the scope of this short memorandum, but a few considerations are worth noting. In 2016, there were two completed acquisitions of Israeli companies that were public in the United States: EZchip and RR Media. Companies should be prepared for a larger volume of acquisitions in 2017, particularly if the capital markets continue to strengthen and valuations reach levels where sales become more attractive:

- *Readiness: Review Change of Control Arrangements.* Instituting appropriate change of control arrangements for the CEO of an Israeli listed company is more challenging and time-consuming than it would be for its US counterpart because of the need for shareholder approval. It is worth reviewing these arrangements now by calculating the compensation that will be paid to senior management upon a change of control and deciding whether additional awards or other adjustments are advisable in order to provide appropriate incentives should such a transaction arise. Compensation consultants are increasingly being engaged by the compensation committees of Israeli companies to advise on this topic and on routine compensation matters generally.
- *Trends: Interest from Private Equity and Chinese Acquirers.* Private equity acquirers have taken a more active interest in the Israeli market and, with the US\$1.6 billion acquisition of Keter Group by BC Partners in 2017, it has been demonstrated that an acquisition of an Israeli company using significant leverage raised in the international debt markets is possible. We expect private equity firms to show continued interest in Israeli companies with foreign revenue and reach and strong cash flow that could service debt.

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We note also that Chinese asset managers, along with other Chinese acquirers, have also shown strong interest in Israeli assets.

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