



Insight #9: Specific Matters for Investors in Israeli Companies

Note the Local Variations of US Standard Investment Terms. Although Israeli investment standards and practices closely follow the US market, certain variations do exist. For example, Israeli holders of preferred shares will usually not be limited to receiving only their agreed preference amount. Instead, they will be entitled to their pro rata share of any distributions made on an as-if-converted to ordinary share basis, either in addition to or (more often) instead of their agreed preference amount (in the latter case, if the resulting pro rata payment is greater than the preference amount). Israeli companies also do not typically grant non-cumulative dividend distribution preferences, and instead tend to grant a dividend distribution preference which is complementary to the liquidation preference and applies whenever dividends are distributed until the full liquidation preference amount is paid to the investors. Another example is minimum holding requirements as a condition to enjoying certain shareholder rights, which in Israel are usually based on a minimum percentage holdings rather than on holding a minimum number of shares. The dilutive effects of additional investment rounds might accordingly adversely affect a shareholder's rights even if such shareholder continues to hold the full number of shares originally acquired. Check local market standards and practices when negotiating your investment terms.

Check if the Founders' Shares are Subject to Reverse Vesting. Until June 2017 applying a reverse vesting to shares held by Israeli resident founders in Israeli private companies resulted in materially adverse tax consequences upon sale of the shares. As a result, reverse vesting or buy back mechanisms were frowned upon by Israeli founders and less frequently used. As of June 2017 this has changed, and reverse vesting mechanisms can be applied to shares held by founders without adverse tax consequences assuming that certain conditions are met. When investing in the shares of an Israeli company, especially companies founded before June 2017, check if a reverse vesting mechanism applies to the shares of the founders. If not, consider asking the company and the founders to adopt one.

- Note that repurchase of shares by an Israeli company is considered as a dividend distribution and accordingly is subject to various conditions such as having profits which may be distributed as dividends. Make sure that the repurchase mechanism takes this into account.

Do Not Rely on Founder Non-Compete Obligations. The employment agreements of founders and other key employees will often include non-compete obligations for periods of up to 12 months following termination of employment with the company, but these are seldom enforced by Israel courts. Freedom of occupation is considered a constitutional right under Israeli law and Israeli courts take a strong position against contractual provisions limiting freedom of occupation. If you want to have a fair chance of enforcing a non-compete obligation against a former employee, try one of two options: imposing a non-compete obligation with a very limited scope – geographical, time and essence – which will leave the employee reasonable employment opportunities, or paying the employee a separate consideration for the non-complete obligation. Some companies grant options or bonuses as specific consideration for the non-compete obligation. Others will agree to continue to pay the employee a certain amount, e.g. pay for a post-termination “adjustment period”, during part or all of the required non-compete period.

Make Sure your Rights are Included in the 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, with very few exceptions (if at all). Make sure that your rights as a shareholder are included in the company’s articles of association. This will make them both easier to enforce if necessary and easier to transfer – they are simply attached to your shares and automatically transfer to any purchaser of your shares (unless they are subject to a minimum holding requirement not met by such purchaser).

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