

# Doing Business in the Ever-Changing Israeli Legal System

*Ezra Gross and David Osborne of Yigal Arnon & Co. highlight the fluidity of legislation related to investments and M&A transactions in Israel.*

**A** good lawyer knows the law but a great lawyer knows the judge". While this famous phrase is usually quoted, humorously, with a negative connotation, the "great lawyer" is in fact the expert who, not only knows the law, but also understands and is intimately familiar with its background, accepted interpretations and applicability by the local market, judges and relevant authorities.

The intention of this article is to focus on several areas which should not be overlooked by U.S. and other foreign lawyers when engaging Israeli law firms for specialist advice in the context of investments and M&A transactions involving Israeli targets.

This article will also highlight certain important new legislative changes which demonstrate the fluidity of the Israeli legislature and then refer to other aspects generally relevant for transactions in Israel.

## ANTITRUST

In any substantial acquisition, it is necessary to obtain antitrust advice both in connection with obtaining merger approval for the contemplated transaction as well as with respect to the legality and enforceability of non-competition provisions. Effective as of January 1, 2019, there have been significant amendments to the Economic Competition Law (formerly known as the Antitrust Law) which include increasing the threshold which requires the transacting parties to apply for approval, to an aggregate joint sales turnover of NIS 360 million (equivalent to approximately

US \$94 million) in place of the previous threshold of NIS 150 million. Other standards, such as the minimum NIS 10 million (equivalent to approximately US \$2.6 million) threshold for each of the merger parties remain unchanged but it is, of course, important to be aware of all aspects that can affect the deal.

Aside from the approval process for transactions, the Israeli Competition Authority (formerly known as the Antitrust Authority) is active in enforcing against companies and their officers for various offences such as cartels, insider trading and abuses of a monopoly position. Incidentally, a monopoly is now defined by "significant market power" with the respect to the supply or purchase of goods or services, and not just by virtue of its holding more than 50% of a particular market.

It is particularly important to note that laws have recently become more stringent in terms of directors' responsibility for compliance, not just with antitrust laws and regulations, but also with respect to compliance with other areas of the law, such as privacy/data protection, health & safety, sexual harassment and so forth.

## PRIVACY AND DATA PROTECTION

Another important recent focus is privacy and data protection law and regulations. Although the United States and European Union also have strict privacy regulation, to varying degrees, certain key obligations under Israeli law exceed even the European Union's recently effective General Data Protection Requirements (which, it is important

to note, can apply to Israeli companies with European data subjects). While companies that adopt a comprehensive GDPR compliance program may result in partial compliance with Israeli data protection laws, additional actions must be taken in order to be fully compliant.

For example, while the GDPR requires controllers and processors to take appropriate technical and organizational measures to ensure the level of security that is appropriate to the level of the risk, the Israeli Data Security Regulations (2017) impose specific, granular requirements with respect to personal data collected and maintained in databases. These Israeli regulations include detailed requirements for controlling, monitoring and recording database access. They also impose specific requirements and timeframes for performing “proper penetration testing” and rotating passwords.

In addition, while the GDPR permits, under certain circumstances, the export of data outside the EU to entities with adequate levels of protection, Israeli law imposes additional conditions such as specific consent from data subjects or a commitment from the data recipient to protect information in accordance with the law. Israeli law can also be stricter with respect to subsequent transfers of data to sub-processors, and in its requirement to appoint “data security officers” even in cases where no comparable obligation exists under the GDPR. A requirement to register certain types of databases is also unique to Israeli law, as well as additional terms that must be added to Israeli agreements for the outsourcing of data processing activities.

The importance of educating foreign clients, their general counsels and our partner-law firms with these recent and dynamic privacy regulations, is not only in the context of due diligence on Israeli target companies, but also for ongoing operations in Israel, as increased penalties for data protection violations are likely to come into effect. If passed, they will substantially increase the risk profile of non-compliance, and random audits by the Israeli authorities are expected to become a feature of the new environment.

It should also be noted that Israel has very strict export controls and license requirements for the export of encrypted data, which is beyond the scope of this article.



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## GOVERNMENT FUNDING

Many hi-tech companies in Israel receive funding from the government through the Israel Innovation Authority (formerly known as the Office of the Chief Scientist), and there is no such thing as a free lunch! Recently, the law has been amended to provide a formula containing a ceiling for compensating the Authority for transfers outside of Israel of IP/technology/products whose R&D was funded thereby. The IP transfer fee is now capped at six times the amount of the grant or, if the buyer will commit and maintains 75% of such R&D operations in Israel for three years, the multiple can be reduced to three times the amount.

We will focus the rest of this article on other unique, but not necessarily new, issues involving an Israeli target.

## TAX WITHHOLDING

Tax planning and strategy is always a key element. Israeli tax law imposes very broad tax withholding obligations upon a buyer until the selling parties provide tax exemption certificates issued by the Israel Tax Authority. A non-Israeli company managed and controlled from Israel or with significant assets in Israel can be considered an

Israeli resident company for Israeli tax purposes. Venture Capital Funds, if active in Israel, will most likely have a special tax pre-ruling exempting their non-Israeli investors; otherwise they may be subject to tax as well.

Other tax aspects that are common to Israeli acquisitions include the Israeli Tax Authority's treatment of founders' reverse vesting and holdback mechanisms and employees' "102 stock options" (referring to the provision in the Israeli Tax Ordinance which allows for the reduced capital gains rates).

## The dynamic nature of Israel, the 'Start-Up Nation', means that its laws are constantly being amended. Many of the leading firms are intimately involved in the drafting of new legislation.

### LABOR LAW ISSUES

Even an area of law as standard as Israeli labor law needs to be understood against the backdrop of the State of Israel's socialist origins. Employees in Israel receive considerable benefits in excess of their basic salary packages, for which employers bear the cost, including complex severance pay mechanisms. Any restructuring and downsizing of an Israeli company needs careful consideration and planning in the context of a transaction. There are rules and regulations contained in expansion orders that relate to certain industries that a foreign attorney would not be aware of, and there are even times when the local employer has not known about the relevant order and its implications. There are increasing numbers of plants where the employees are joining the trade union (*Histadrut*) and such a move will require the employer to negotiate and enter into a collective workers' agreement that, among other things, will provide for agreed salary increases over a

number of years, improved terms and conditions of employment, and providing for a workers' council.

### IP, ACADEMIA AND SERVICE INVENTIONS

Finally, one of the more important focuses for legal due diligence of an Israeli company with products developed by employees and consultants, is to ascertain whether such persons worked at any time in (or have any affiliations with) academia, government owned hospitals or the Israel Defense Forces. It is vital to check whether such persons had permission to engage in R&D in such private companies and verify that these institutions do not have any residuary IP ownership or royalty rights for the products.

With respect to all employees involved in R&D, it is always important for foreign buyers to note that, although Israeli law vests ownership of employees' "service inventions" (conceived in the course and as a result of their employment) with the employer, Section 134 of the Israeli Patents Law still grants employees the right to consideration/royalties from such inventions. An important part of diligence is to ascertain that the relevant employment agreements contain the necessary provisions protecting the company against such claims.

The above highlights certain aspects which US counsel and local Israeli lawyers should review in tandem. The dynamic nature of Israel, the 'Start-Up Nation', means that its laws are constantly being amended and it is perhaps worth mentioning that many of the leading firms, such as ours, are intimately involved in the drafting of new legislation and have not only an intimate understanding of the interpretation of the current law but also an awareness of draft proposals and discussions on the table for future legislation. Such knowledge and insight can be invaluable for the foreign lawyer. ■

### ABOUT THE AUTHORS

**Ezra Gross** is a partner in the International Corporate Department of Yigal Arnon & Co., specializing in M&A, High-tech, Life Sciences, VC, Private Equity, Banking and Finance.

His clients range from large multinational corporations, both privately held and publicly traded, to early-stage start-ups, as well as venture capital and private equity funds. Ezra has advised

clients in many of Israel's largest and most complex M&A transactions, addressing all aspects of those transactions, including intellectual property issues, tax aspects and regulatory matters. In addition, Ezra provides corporate counsel to many of the leading players in the Israeli and global venture capital scene to assist in investments in portfolio companies. He also advises high-tech and other privately held companies in their initial and developmental stages, including a significant number of clients from inception through their M&A exits.

Ezra's counsel is also sought-after in international real estate, complex joint ventures and other commercial transactions for global/international groups.

Ezra is a member of the firm's Hi-Tech, Real Estate, Family Wealth Management and Nonprofits Groups. He also represents high-net-worth private clients, in Israel and abroad, with issues involving the management of their family wealth and assets, and in handling their wills & estates and private property transactions.

Ezra's recognitions have included rankings by *The Legal 500* and *IFLR 1000*.

Ezra received his law degree from The Hebrew University of Jerusalem in 2006. He was admitted to the Israel Bar in 2007, joined the firm the same year and became a partner in 2015.

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**David Osborne** is a partner in the International Corporate Department of Yigal Arnon & Co., focuses on mergers and acquisitions and advises Israeli and international clients on a broad range of matters that involve commercial and property transactions. His areas of expertise include complex joint ventures, partnerships, competition law, investments and financings and assisting Israeli companies in setting up suitable corporate structures for their international activities.

A particular area of focus for David has been working with large private equity funds and international companies on acquisitions as well as emerging growth technology companies, for which he has undertaken many different



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corporate transactions. He also handles complex joint ventures and advises global/international hotel groups on their franchise and management agreements.

David also co-heads the firm's Family Wealth Management practice, advising high-net-worth private clients in Israel and abroad in regard to the management of their family wealth and assets.

David's recognitions have included rankings by *Chambers Global*, *The Legal 500* and *Legal Experts' Europe, Middle East & Africa* guide.

Prior to joining Yigal Arnon & Co in 1993, David worked in London at "Nabarro (now merged into the firm CMS Cameron McKenna Nabarro Olswang) and as a partner in a respected West End practice.

David earned an M.A., with honors, from St. John's College, Oxford University in 1978. He was admitted as a Solicitor of the Supreme Court of England and Wales in 1985 and to the Israel Bar in 1994. David joined the firm in 1993 and became a partner in 1999.

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