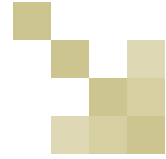


Israel



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MARKET

1. Please describe briefly the venture capital market in your jurisdiction, in particular:

- How it is distinguished from private equity.
- The sources from which early stage companies obtain funding.
- The types of companies that attract venture capital investment.
- Market trends (for example, levels of investment, the type of companies invested in and where those companies are located).

Venture capital and private equity

Despite Israel's small population and limited geographic size, the Israeli venture capital market is one of the largest in the world in absolute terms and has had a profound effect on the Israeli economy. Israeli venture capital is more focused on seed and early stage companies and on technology-oriented companies than most other comparable markets. Private equity in the form of buyout funds or private equity funds that provide growth capital to companies that are not high tech is relatively small, although it is growing, together with small hedge funds. Venture capital remains by far the largest segment of private risk investment. Venture capital in Israel is very similar in attitude and substance to US venture capital as practised in Silicon Valley or Boston, with similar deal terms and documents.

Sources of funding

Israeli seed and early stage companies may receive funding from a wide variety of sources including:

- Bootstrapping entrepreneurs who fund themselves.
- Friends and family.
- Angel investors (particularly entrepreneurs who have had exits and have money to invest).
- Israeli venture capital funds.
- Non-Israeli venture capital funds (some of which have offices in Israel).

A rapidly expanding source of funding is venture lending, with a number of non-Israeli venture lending firms entering the market over the last few years. An additional important source of funding is the Office of the Chief Scientist (OCS) which provides grants for participation in research and development (R&D) programmes. The grants are repaid with royalties from sales and require undertaking to uphold the R&D Law 1984, which sets limitations on the transfer of IP developed with the grants outside of Israel.

Types of company

Companies receiving funding from venture capital firms are from all sectors of high technology, but there is an emphasis on the fields of:

- Communications and components.
- Enterprise software.
- Semiconductor chip design and manufacture.
- Internet and e-commerce.
- Bio-tech.
- Medical devices.
- Increasingly, cleantech.

Venture-backed companies tend to be in technology-heavy fields with high technological barriers to entry. The companies range from seed/pre-seed stage companies to growth/late-stage companies. Seed-stage companies often receive some form of venture capital funding. The companies themselves are typically either companies registered in Israel or corporations registered in Delaware with Israeli subsidiaries.

Market trends

Venture capital investment rebounded following the trough years of 2001 to 2003 after the technology bubble burst, recording investments at levels substantially higher than the level before the bubble of 1999 to 2000. Venture capital investments in the first half of 2008 reached US\$1.08 billion (about EURO0.8 billion), the highest level since 2001, according to the Israel Venture Capital Research Center (IVC). The IVC further reported that the capital raised in this period consisted of investments in:

- The communications sector: 26%.
- Software: 22%.

- Life sciences: 17%.
- Internet companies: 11%.

A shake out among venture capital firms has been in progress for a number of years since the bubble burst, with numerous firms not succeeding in raising follow-on funds, while other firms raised substantial funds. Non-Israeli venture funds (particularly US firms) continue to open offices and invest in Israeli companies joined over the last few years by a number of venture lending firms.

2. What tax incentive schemes exist to encourage investment in venture capital companies? At whom are the schemes directed? What conditions must be met?

Generally, tax incentives to encourage investment in venture capital funds are aimed at foreign (non-Israeli) investors, and often result in the non-Israeli investor being exempt from Israeli capital gains tax on the realisation of their investment in Israeli technology companies.

Individual tax rulings

A venture capital fund with non-Israeli investors can apply to the Israel Tax Authority for a tax ruling providing that the non-Israeli investors are exempt from Israeli capital gains tax on the realisation of the fund's investments in Israeli companies. The ruling is subject to a number of requirements with respect to:

- The size of the fund.
- The nature of the investments.
- The place of management of the fund.

Generally, these restrictions do not interfere with the reasonable operation of funds focusing on Israeli investments. However, they are generally not appropriate for non-Israeli funds making one-time or limited investments in Israeli companies.

Typically, the rulings apply to funds:

- Which have raised a minimum of US\$10 million (about EUR7.9 million) (with at least half of that amount from non-Israeli investors).
- With ten different investors, with no single investor being entitled to more than 20% of the fund's gains (although this ceiling is sometimes subject to negotiation if it is necessary to attract a particular "anchor" investor).
- In which at least half of the invested capital is in Israeli companies engaged in a qualifying activity (broadly defined to include virtually all high-tech sectors).
- With at least 30% of the capital invested directly or indirectly in Israeli companies which themselves own the IP which they developed.

The rulings often contain restrictions concerning the concentration of investment in any given portfolio company. Special provisions in the rulings also deal with the taxation and exemption of

carried interest gains in the hands of fund general partners. It is sometimes possible to obtain more favourable rulings.

Tax treaties

Israel has an extensive network of over 40 treaties for the prevention of double taxation. Treaties are in force with almost all major North American, European and Asian jurisdictions. Under many of those treaties (but not all), residents of the other country are generally exempt from Israeli capital gains taxation on the sale of shares in an Israeli-resident company.

General capital gains exemption for non-residents

Under a recently expanded provision of the Income Tax Ordinance 1961, non-resident shareholders in Israeli private companies are exempt from Israeli capital gains tax on the sale of their shares if the following conditions are met:

- The shares were purchased on or after 1 January 2009.
- The shares were not held through a permanent establishment maintained by the non-resident shareholder in Israel.
- The shares are not in a company whose assets consist primarily of real estate.
- The shares were not purchased from a related party.

This broad exemption applies to all non-resident investors, regardless of whether they are resident in a country which has a tax treaty with Israel. The exemption does not apply to shares in publicly-traded companies and exemption for non-residents on gains from listed securities is covered by a separate provision.

The expanded scope of this exemption represents a major development in the treatment of capital gains derived in Israel by foreign investors, although the requirement that the gains not be derived through a permanent establishment in Israel precludes the availability of the exemption for funds and other entities which establish an active office in Israel for the purpose of locating and monitoring Israeli investments.

3. From what sources do venture capital funds typically receive funding?

Venture capital funds typically raise the large majority of their funding from non-Israeli sources, particularly institutional investors in North America, but also from Europe and East Asia, notably Japan and Singapore. Investors include:

- Pension funds.
- Endowment funds.
- Corporate or strategic investors.
- High net-worth individuals.

Israeli pension funds, insurance companies and banks also invest in venture capital funds, but usually they constitute a relatively small portion of the overall investment. In addition, there are a

small number of venture capital funds that raised money from the public on the Tel Aviv Stock Exchange (TASE).

4. Can the structure of the venture capital fund impact on how investments are made?

In general, the structure of the fund does not impact on how investments are made.

5. Do venture capital funds typically invest with other funds?

It is common, particularly in later stage deals, for a number of venture capital funds to invest together, particularly in capital intensive companies (for example, communications and components companies) where substantial follow-on funding is likely to be required. At one point, non-Israeli venture capital funds preferred to invest in tandem with a local Israeli venture capital fund, but recently non-Israeli venture capital funds have occasionally been setting up their own Israeli offices or investing directly in Israeli companies without any local co-investors.

FUND FORMATION AND REGULATION

6. What legal structure(s) are most commonly used as vehicles for venture capital funds in your jurisdiction?

Venture capital funds are generally formed as one or more limited partnerships investing in parallel. The partnerships are generally registered in the Cayman Islands (for non-Israeli investors) and in Israel (for Israeli investors) for tax reasons. Other jurisdictions where partnerships are sometimes formed are the British Virgin Islands (BVI), Delaware and Jersey.

To a far lesser extent, funds can be organised as limited liability companies (LLCs) or as publicly traded companies.

Regardless of the structure and jurisdiction of the organisation, venture capital funds typically establish a management company in Israel, and pay an annual management fee of approximately 2.5% of total fund commitments. This fee often decreases after a defined investment period (usually five or six years). The management company employs the investment professionals who locate promising investments, negotiate investment terms, and monitor investments.

The fund also pays carried interest at the rate of 20% of profits to the general partner (or, in the case of an LLC, to the managing member). The exact formula for calculating the carried interest is often subject to intense negotiation.

7. Do a venture capital fund's promoter, manager and principals require licences?

A venture capital fund's promoter, manager or principals do not require a licence.

8. Are venture capital funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions? Include, in the answer, any restrictions on how a venture capital fund can be marketed or advertised (for example, under private placement or prospectus rules).

Venture capital funds are not regulated. As the venture capital funds are generally limited partnerships, the marketing and sale of interests in the partnerships is subject to applicable securities legislation. The securities legislation in Israel restricts the offering of limited partnership units to no more than 35 persons, excluding certain qualified investors consisting primarily of financial institutions. There is no exemption for high net-worth individuals.

9. How is the relationship between investor and fund governed? What protections do investors typically seek?

The relationship between the investors and the fund is governed by the terms of the fund's limited partnership agreement (and subject to the law of the jurisdiction of the partnership). Investors typically seek the same type of protections that they would be looking for in a US fund, including:

- Confirmation of limited liability.
- Restrictions on the use of proceeds.
- Employee Retirement Security Act 1974 (ERISA) restrictions, where appropriate.
- Restrictions on recourse borrowing.
- Financial reporting.
- Key man provisions.
- Non-competition restrictions preventing the promoters from setting up a competing fund until certain time periods have passed.
- Provisions governing potential conflicts of interest.

10. What are the most common investment objectives of venture capital funds (for example, what is the average life of a fund, what return will a fund be looking for on its investments and what is the time frame within which a fund would seek to exit its investment)?

The most common investment objective of venture capital funds is to achieve long term capital appreciation through the investment in, and exit from (generally through mergers, acquisitions and initial public offerings) high growth, innovative technology companies.

Venture capital funds generally have a seven- to ten-year term (ten years being the norm) with the ability to extend this term by a number of one-year periods (usually two to three extensions). Venture capital funds usually strive to complete their investment period (that is, deploy capital in new portfolio investments) within three

to four years of the fund's initial closing (while retaining capital for management fees and follow-on investments until exit) and to exit most of its investments within three to five years of investment.

Following the change in market dynamics resulting from the bubble bursting in 2001, venture capital funds in Israel have tended to extend their investment periods (sometimes to as long as six or seven years). At the same time, the average period between investment and exit lengthened. It is expected that those funds, many of which were set up 1999 to 2001, may require a term of more than ten years to liquidate their portfolios.

INVESTMENTS

11. What form of investment do venture capital funds take? (For example, equity, debt or a combination.)

Venture capital funds generally invest in equity in the form of preferred shares. The use of convertible debt is also very common before an investment round, both as bridge financing for immediate use and as a means to circumvent the need to set a company valuation when no third party investors are available to set a valuation.

In the last few years, venture lending, where lenders provide secured loans to portfolio companies and receive an equity component in the form of warrants or an option to invest in the next round, has also grown considerably.

12. How do venture capital funds value an investee company?

The valuation of investee companies is one of the most sensitive and secretive issues. In the majority of cases, particularly in seed and early stage companies, the investee company's valuation is set based on a sensitivity analysis that takes into account some or all of the following:

- The percentage holding in the company the fund aims to hold following the investment.
- The percentage holding the fund aims to hold at exit.
- The amount of capital the company is projected to require until the next round of financing.
- The amount of capital the company is projected to require until the exit.
- The reasonable (or possibly, conservative) expectation for an exit valuation.

The result of the sensitivity analysis should provide for a projected internal rate of return (IRR) greater than the minimal IRR the fund has set for itself. An additional benchmark for valuation often used is market comparables, whether in the public markets or, to the extent available, in the private markets.

Discounted cash flow and price to earnings ratios are rarely effective for valuing start-up companies except possibly in the case of mature, expansion-stage companies with substantial revenue and a broad customer base.

Valuations are effected by competition among funds for what are conceived of as high quality deals. Additional factors that affect valuation include the amount of capital the fund must deploy before the end of its investment period and the size of the investing fund, with both factors pushing the funds to deploy larger amounts of capital, causing an inflation of valuations.

13. What investigations will venture capital funds carry out on potential investee companies?

On a business level, before investing in potential portfolio companies, venture capital funds typically conduct a thorough investigation of the company's (proposed) business (including, where relevant, calls with customers) and of the (potential) market, particularly with respect to the size of the market, potential for dynamic growth and barriers to entry.

Venture capital funds also typically invest a substantial amount of time in evaluating and sizing up the entrepreneurs and the potential portfolio company's management team. Some venture capital funds carry out preliminary legal due diligence at the term sheet stage to find any obvious fundamental problems from a legal perspective. Once venture capital funds have resolved to invest in a company, as part of the investment process they usually conduct a legal due diligence review in which they examine:

- The company's capital structure.
- Commercial relationships.
- Employment relationships.
- Other legal rights and obligations.

For those companies with an operating history and a more robust technology portfolio, venture capital funds typically retain an accounting firm to investigate the company's financial condition and a law firm to investigate the company's intellectual property portfolio. The nature and extent of the due diligence investigation vary considerably from fund to fund. Major issues that arise in legal due diligence in relation to the company's capital structure or its intellectual property rights may be deal breakers. Otherwise, legal due diligence serves primarily as an opportunity for reorganisation in the company particularly in relation to capital structure and keeping proper corporate records.

14. What are the principal legal documents used in a venture capital transaction?

Typically, the investment includes a minimum of the following:

- **Share purchase agreement.** This contains the commercial agreement of the parties, including the amount of investment and valuation of the target company, as well as the representations and warranties of the parties, the closing conditions and certain post-closing covenants.
- **Articles of association (or certificate of incorporation if a Delaware corporation).** These typically set out the rights

conferred by the preferred shares, including dividend and liquidation preferences, anti-dilution protection and protective provisions.

- **Investor rights agreement.** This contains those rights which may be of more general, on-going application to shareholders of the company, including registration and information rights, and sometimes composition of the board of directors.

Some investments also include additional documentation, including shareholders' agreements, and a large number of ancillary documents such as indemnification agreements, management rights letters, IP assignments and so on.

15. What form of contractual protection does an investor receive on its investment in a company?

Funds investing in a company typically receive the following protections:

- Dividend and liquidation preferences (*see Question 17*).
- Anti-dilution protection (*see Question 17*).
- Pre-emptive rights to participate in subsequent financing rounds (*see Question 21*).
- Rights of first refusal and co-sale (*see Questions 19 and 20*).
- Information rights, including rights to financial information and visitation and inspection rights (*see Question 18*).
- Registration rights.
- Representation on the board of directors.
- Protective voting provisions (veto rights).
- Restrictions on the use of proceeds.
- Directors and officers' (D&O) and key man insurance.

16. What form of equity interest does a fund commonly take (for example, preferred or ordinary shares)?

Funds always take preferred shares. Angel investors may take ordinary shares.

17. What rights does a fund have in its capacity as a holder of preferred shares (for example, what rights to capital and/or to interest)?

Holders of preferred shares typically have the following rights:

- The right to receive a dividend in priority to the payment of a dividend to any other class of shares. Although this right is very common, most high-tech companies do not pay dividends.

- The right to a liquidation preference, typically a participating preference entitling the holder to some kind of preferred return (in Israeli companies, with an annual interest component, typically 6% to 8%), followed by the right to participate with the holders of ordinary shares on an "as converted" basis in any remaining proceeds (this is sometimes capped). The liquidation preference applies both to actual liquidation of the company and to most exit scenarios, including a sale of all or substantially all of the assets of the company.
- Anti-dilution protection, typically implemented by adjustments to the conversion rate under which the preferred shares may be converted into ordinary shares. The protection ranges from full ratchet (this is considered very pro-investor) to broad-based weighted average (this is considered more reasonable).
- The right to representation on the board of directors.
- Protective voting provisions, requiring fund approval for a variety of actions including the creation of a class of shares with rights superior to those held by the fund, as well as numerous other corporate activities.

18. What rights are commonly used to give a fund a level of management control over the activities of an investee company (for example, board representation, certain acts of the company subject to investor consent)?

Board representation

Typically, funds receive representation on the board of directors and/or the right to appoint a non-voting observer to the board. This right may be conditional on the fund maintaining a certain level of ownership in the investee company.

Protective provisions

As holders of preferred shares, the fund also benefits from protective provisions, requiring the approval of the fund (occasionally of a director appointed by the fund, and occasionally of a specified majority of all holders of preferred shares) for a variety of actions, often including:

- Creation or issuance of a class of securities equal or senior to those held by the fund.
- Approval of exit events (that is, mergers and acquisitions (M&A), and initial public offerings (IPOs)).
- The payment of dividends.
- The repurchase of ordinary shares.
- Adverse changes to the rights of the shares.
- Increasing the size of the board of directors.
- Incurring indebtedness in excess of a specified amount.
- Material changes in the business of the company.

Sometimes the protective agreements deal with management-type activities and include:

- Hiring and firing of key executives.
- Bank signature rights.
- Establishment of (and any material deviations from) an annual operational budget.

Management rights letter

Funds that require a management rights letter for ERISA purposes typically receive one providing them with certain information and consultation rights in the event that they have not appointed a board member, and sometimes even if they have appointed a board member.

Information rights

Funds also commonly obtain information rights which allow them to obtain information about the company so as to enable the fund to prepare financial reports to the fund's limited investors as well as to facilitate an intelligent exercise of veto rights. Information rights usually include the right to:

- Audited annual financial statements.
- Reviewed quarterly financials and monthly reports.
- Inspection and visitation rights.

19. What restrictions on the transfer of shares by shareholders are commonly contained in the investment documentation?

Right of first refusal.

Often investors have a right of first refusal in relation to the sale of shares by other shareholders. Sometimes this right is limited to the holders of a certain minimum number of shares (for example, 2% of the outstanding share capital) and is exercised on a pro rata basis. Often this right is not reciprocal, that is, the holders of ordinary shares do not have a right of first refusal in relation to sales of shares by the fund.

Exercise of the right of first refusal is often conditional on the purchase by the shareholders of all the shares being offered. Typically, there are exceptions for transfers of shares for estate planning purposes and so on.

No sale

Often founders are completely barred from, or severely limited in, selling their shares for a specific period of time (often at least three years, but occasionally until exit). Typically, exceptions are made for transfers of shares to family members or for other bona fide estate planning purposes. These restrictions are intended to ensure that the founders recognise their economic interests as being linked with the success of the company.

Securities laws

Transfers of shares are also governed by applicable securities laws, and the investment documents typically contain provisions ensuring that such laws are followed (for example, by marking share certificates).

20. What protections do the investors, as minority shareholders, have in relation to an exit by way of sale of the company (for example, drag-along and tag-along rights)?

Tag-along (co-sale) rights

Generally, the investors have the right to sell shares together with the founders (or other holders of ordinary shares), if and when the founders sell shares to third parties. This right (known as either a tag-along right or right of co-sale) can be exercised if the investor elects not to exercise its right of first refusal. The underlying rationale is that the investors are investing in the founders, and if the founders decrease their shareholdings, the investors require the right to exit with the founders. However, the tag-along rights also serve to make it more difficult for founders to sell their shares and, in practice, force any such sale to be made in full co-ordination with the investors. It is very uncommon for founders to have tag-along rights in relation to sales of shares by funds.

Drag-along (bring-along) rights

Drag-along rights (more commonly referred to as bring-along rights in Israel) exist to facilitate the sale of the company in the face of opposition from minority shareholders. The articles of association commonly provide that where a specific percentage of shareholders (often including the holders of a specific percentage of preferred shares) agree to a bona fide third party purchase offer, then all shareholders must sell.

There is also a statutory bring-along right in the Companies Law 1999, that provides that if the holders of 80% (90% in the case of companies established before 1999) of shares wish to sell, then all shareholders can be forced to sell. "Deep pocket" strategic investors often attempt to impose restrictions on the operation of these clauses to make sure that they do not find themselves providing representations, warranties and indemnities that expose them to liability which they deem to be excessive.

21. Do investors typically require pre-emption rights in relation to any further issues of shares by an investee company?

Investors almost invariably require pre-emptive rights to participate in future financing rounds. Sometimes the right is limited to participation on a pro rata basis; other times the investor obtains a right of over allotment to take up shares that other participating shareholders elect not to purchase. Companies typically attempt to resist the request for over-allotment rights. These rights are generally subject to certain standard exclusions, such as:

- Issuances on exercise of employee share options.
- Issuance on conversion of preferred shares.
- Occasionally, certain issuances of warrants to strategic partners in transactions not primarily intended as financing transactions.

22. What consents are required to approve the investment documentation?

Approval by the company's shareholders and board of directors is required to complete the investment. In addition, if the company has already raised funds in an earlier investment round, approval by the earlier investor is also likely to be required. If the company has received tax incentives or a grant from the Ministry of Trade and Industry, consent from the department providing the tax incentives or grant is also required.

23. Who covers the costs of the venture capital funds?

Investment agreements typically provide that, on closing, the portfolio company covers the venture capital fund's costs in connection with the investment, up to a certain agreed cap. These costs usually include legal costs arising from the legal due diligence, and drafting and negotiating the investment agreements and often also include financial and technical due diligence.

If the closing does not occur, the portfolio company does not cover the venture capital fund's costs.

FOUNDER AND EMPLOYEE INCENTIVISATION

24. In what ways are founders and employees incentivised (for example, through the grant of shares, options or otherwise)? What are the resulting tax considerations?

Israeli companies usually incentivise their employees (including founders) by granting share options which are subject to vesting over a number of years. Founders of Israeli companies sometimes receive shares that are subject to repurchase by the company at par value if the founder ceases to be employed by the company (sometimes known as reverse vesting), but it is rare for an Israeli company to issue shares subject to repurchase to its employees.

Employees typically receive share options, which are exercisable if the employee continues to be employed during the relevant vesting period. Section 102 of the Tax Ordinance 1961, provides a mechanism for ensuring that these options are only taxed (at capital gains rates) on the sale of the underlying security (that is, the shares obtained on exercise of the option). To benefit from the beneficial tax treatment, the share option plan must comply with the requirements of section 102, including holding the options in trust for two years.

25. What protections do the investors typically seek to ensure the long-term commitment of the founders to the venture (for example, good leaver/bad leaver provisions and restrictive covenants)?

Investors typically use a combination of methods to ensure the founders' long-term commitment to the company:

- Investors often prohibit the founders from selling any of their shares for a period ranging from a number of years (at the earliest) to the closing of a sale of the company or its IPO (at the latest) (*see Question 19*).

- The investors typically require that the founders' shares are subject to a reverse-vesting mechanism, so that if the founder ceases to be employed by the company, the founder loses a portion of his shares (*see Question 24*).
- Investors often require that founders enter into non-competition undertakings, restricting competition with the business of the company for some period of time following the termination of the founder's employment. The enforceability of these undertakings under Israeli law is uncertain.

The no-sale and reverse-vesting provisions tend to be heavily negotiated in transactions, with founders often taking the position that they are entitled to all of their shares if their employment is terminated by the company without cause or if the company closes an IPO or M&A transaction.

EXITS

26. What forms of exit are typically used to realise a venture capital fund's investment in an unsuccessful company? What are the relative advantages and disadvantages of each?

Venture capital funds typically attempt to realise their investment in unsuccessful companies by selling those companies. However, any proceeds received by the venture capital funds in these transactions are likely to fall short of the amount they invested. In addition, the ability to sell unsuccessful companies often depends on the willingness of the company's management to co-operate in the sale. Some venture capital funds insert redemption rights into the investment agreements.

Redemption rights are designed to enable a venture capital fund to recover its investment in an unsuccessful company. These rights allow the venture capital fund to require the portfolio company to repurchase the fund's shares if the company has not closed an M&A transaction or IPO within a specific number of years following the investment. However, due to the negotiating environment as well as Israeli corporate laws limiting the ability of an Israeli company to repurchase its own shares, it is uncommon to find redemption rights provisions in Israeli companies.

27. What forms of exit are typically used to realise a venture capital fund's investment in a successful company (for example, trade sale, initial public offering and secondary buyout)? What are the relative advantages and disadvantages of each?

The typical forms of exit of a successful portfolio company, and the relative advantages and disadvantages, are:

- **Sale of the portfolio company's shares by all shareholders of the portfolio company's shareholders.** Depending on the sales price, this is the most efficient and perhaps the most successful exit for a venture capital fund, in that it involves a sale of all of the fund's shares in the company, typically in return for cash or tradable securities. A potential disadvantage is that, depending on how the transaction is structured, approval of the transaction may require class votes, giving certain shareholders the ability to complicate and occasionally frustrate the transaction.

- **Sale of the portfolio company's assets.** While a sale of the company's assets has the advantage of not requiring shareholder approval, it often has the disadvantage of being inefficient from a tax perspective. On a sale of its assets, the portfolio company is subject to capital gains tax, and when the resulting proceeds are distributed by the company to its shareholders, the distribution is often subject to a dividend tax.
- **IPO.** Flotation of a company's shares on a recognised stock exchange brings liquidity to the venture capital fund by enabling it to begin selling its shares on the public market. However, sales of shares on certain stock exchanges are subject to time and quantity restrictions, which limit a fund's ability to sell all of its shares simultaneously. In addition, the share price is subject to volatility.
- **Sale of the portfolio company's shares in a private transaction by the venture capital fund.** A venture capital fund may sell its shares in a portfolio company to a third party. Often these sales are subject to a right of first refusal of other shareholders in the company. However, the price to be received by the venture capital fund is likely to reflect a discount due to the fact that the third party would be purchasing a minority interest in the company, and such sales are relatively uncommon.

28. How can this exit strategy be built into the investment?

The venture capital fund's exit strategy is built into the investment documents by the inclusion of tag-along and drag-along rights (see Question 20) as well as registration rights (the right to force the listing of the fund's shares on the exchange where an IPO has taken place) and, occasionally, the inclusion of redemption rights (see Question 26).

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YIGAL ARNON & CO.

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Venture Capital and Private Equity

Yigal Arnon & Co. has acted as counsel in Israeli and international private equity and venture capital fund formations and in venture capital portfolio company financings that have raised hundreds of millions of dollars. We have helped established dozens of funds and helped those funds make hundreds of investments.

Fund Services

Yigal Arnon & Co. provides practical and timely corporate and tax advice to enable general partners and other fund promoters to raise funds as quickly as the market will allow. We customize our involvement to the needs of the client: sometimes we work in conjunction with U.S. or European legal counsel to provide advice on Israeli tax and legal issues in establishing funds; other times we manage the entire fund formation process from Israel, employing overseas counsel to the extent needed. Our goal is always to provide prompt and reliable corporate, tax, securities and regulatory advice to those seeking to raise private equity or venture capital funds.

Portfolio Investments

Yigal Arnon & Co. represents many prominent Israeli and overseas venture capital funds in their portfolio investments in Israeli and "Israel-related" companies, from small seed-stage deals through large mezzanine-stage rounds. Many of our lawyers have substantial prior experience in venture transactions at leading law firms in the United States and Europe, ensuring that clients enjoy the highest international standard of professionalism and responsiveness.

We pride ourselves in looking 'beyond the legal issues' to assist our clients in achieving their business objectives, which we believe, among other things, distinguishes us from our competitors and provides added value to our clients. As a result, we have become a dominant figure in the Israeli venture capital arena. In recent years, Yigal Arnon & Co. has been the only Israeli law firm listed as one of the most active VC and private equity law firms by Private Equity Analyst. The firm's attorneys have extensive understanding of both the process and the documentation involved in venture capital financing, ensuring our ability to assist clients in achieving their business objectives. In addition, some of our lawyers have worked in house at venture capital funds and thus have a clearer understanding of the business and legal needs of VC funds.

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