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DARDIK GROSS & CO.
L A W F I R M

Doing Business In Israel

Table of Contents

Israel – Introduction	2
Forming a company in Israel	4
Taxation - monthly and annual tax filings	6
Privileged and approved enterprises	8
Research & Development (R&D)	12
Employment	14
Work Permits	15
Venture Capital & Private Equity.....	17
Competition Law	24
Intellectual Property (IP)	26

Israel - Introduction

The State of Israel is a small, parliamentary democracy of 8,002,300 people, situated on the eastern shore of the Mediterranean Sea. The major urban centers are the capital, Jerusalem with a population of approximately 801,000 people, the metropolitan area of Tel Aviv with 3,405,000 and Haifa with 268,000.

Important industries are software, telecommunications, hi-tech, bio-tech, tourism, precision instruments, chemicals, pharmaceuticals and textiles.

Until recently, Israel's natural resources were limited to potash, phosphates, bromine and salts, found in the Dead Sea area. In the last few years, Israel has begun developing off-shore gas fields such as the Tamar and Leviathan Fields, and it is expected that the country has enough gas reserves to be a net energy exporter for many years to come.

Free Trade Agreements

Israel has signed free trade agreements with the European Union, the USA and the European Free Trade Association (EFTA). Israel has also signed free trade agreements with Canada and Turkey.

Israel-European Union Free Trade Agreement

In 1975, Israel and the EU signed an agreement providing for the establishment of a Free Trade Area for industrial and some agricultural products. According to the agreement, and subject to rules of origin, Israel's industrial exports to the EU are exempt from customs duties and other import restrictions. Israel has eliminated all duties on industrial imports from the EU.

Israel-USA Free Trade Agreement

Israel and the USA signed a Free Trade Agreement which was fully implemented on January 1, 1995. The agreement, subject to rules of origin (which are different from those of the EU agreement), eliminates all import duties and trade restrictions between the two countries.

Israel-OECD Membership

On May 2010, the Organization for Economic Co-operation and Development (OECD) accepted Israel as a full member in the organization.

Land

The Israel Lands Administration (ILA) is responsible for managing land owned by the State of Israel, Keren Kayemet Le'Yisrael (Jewish National Fund, KKL), and Rashut Pituach (Development Authority), comprising 93% of the land in Israel. Land managed by the ILA is considered to be State-owned and is generally sold or leased on the basis of issuing tenders.

Forming a company in Israel

For most enterprises, a company is the preferred way of doing business in Israel.

A company generally has limited liability, where the company may be sued to the extent of its capital and resources. It is possible to be self-employed or to form a partnership or limited partnership under Israeli or foreign law.

Limited partnerships usually enable foreign individual investors to credit Israeli taxes (or utilize any Israeli losses) for tax purposes in their home country.

Subsidiary of a non-Israeli company

In the past, many Israeli hi-tech companies were formed as subsidiaries of a US (or other foreign) parent corporation in order to avoid Israeli capital gains tax upon any exit at rates of up to 50% .

Israel now offers passive foreign investors exemption from capital gains tax in most cases upon exit - see below.

Furthermore, the use of a US parent corporation is particularly problematic as the US may tax undistributed profits under complex provisions in Subpart F of the US Internal Revenue Code.

An Israeli company may enjoy tax breaks on its profits - see below.

It is possible to operate a business operation in Israel as a branch of a foreign corporation. In this way, it may be possible to avoid dividend withholding tax (up to 25%) in most cases, but company tax (see below) will still be payable on Israeli source profits. The Israeli Tax Authority may request to see the overseas accounting records of the foreign corporation to check how much income and expenses are allocable to its Israeli branch for company tax purposes. US investors occasionally use US LLCs with no other activity to conduct Israeli operations that do not qualify for Israeli tax breaks.

Most Israeli businesses tend to be conducted by an Israeli company as this is easier when dealing with Israeli suppliers, customers and banks.

Dual listings

The Securities Law enables Israeli companies traded on foreign exchanges to dual-list, and it empowers the Israel Securities Authority to allow foreign companies traded in U.S. markets to dual-list under the law as well.

The Securities Law enables companies to list easily and at almost no cost, and offers many benefits for U.S.-traded companies, their founders and investors, as well as for the Israeli securities industry.

Companies trading on the NASDAQ, New York Stock Exchange or London Stock Exchange for at least a year since their IPO's, or for less than a year if they maintain a market value exceeding \$150 million, are eligible to dual-list under the Securities Law.

Incorporating in Israel and registering for tax purposes

Companies may be either public or private. A private company must have at least one shareholder and one director. A public company is a company whose shares are traded on a stock exchange (in Israel or abroad) or have been offered to the public pursuant to a prospectus under the Securities Law and are held by the public. It usually takes 1-2 days to incorporate an Israeli company. A foreign company must be registered at the Israeli Companies Registry as a foreign company if it has a place of business or an office for share transfers in Israel.

Separate registrations of a new business in Israel are needed for:

(1) income tax (2) Value Added Tax (3) payroll and other withholding taxes (4) national insurance (social security).

Non-residents are required to appoint an Israeli tax representative and VAT representative if any part of their activities is conducted in Israel. The tax representative is empowered to pay Israeli tax from the foreign resident's assets.

Taxation - monthly and annual tax filings

The Israeli tax year is normally the calendar year. Subsidiaries of foreign publicly traded companies may sometimes be allowed to use a different fiscal year.

Companies are generally required to file audited annual tax returns and financial statements within five months of the end of their fiscal year, but extensions may be obtained. Israeli certified public accountants are usually allowed to spread the filing of the tax returns over a period of up to 13 months after the end of the tax year.

Companies must file monthly returns on account (bi-monthly sometimes if the business is small) accompanied by tax payments. The filings and payments are made by the 15th day after the end of the month at a local post office or bank. If a taxpayer is a few days late, a computer-generated penalty is usually issued.

Officially, books and returns should be in Hebrew or Arabic, although English is usually accepted by most tax offices.

Payments for expenses

For most domestic Israeli expenses, withholding tax rates of up to 50% are prescribed unless the recipient has received confirmation from the Israeli Tax Authority allowing a lower rate. For remittances from Israel, the Israeli banks

must withhold tax, generally at rates of 25%-31%, unless the remittances relate to imported goods. A withholding tax exemption or a reduced withholding rate may be obtained from the payor's tax office when a treaty applies or when the payments are for services that are rendered entirely abroad. Failure to withhold will result in a denial of the relevant expense and lead to possible penalties.

Capital Gains

With regard to capital gains, subject to any tax treaty, foreign residents are taxable on Israeli source "real" (inflation adjusted) capital gains at varying rates (individuals: 20-49%; companies: 25-31%). Foreign residents not doing business in Israel may enjoy an exemption from Israeli capital gains tax (tax only in the investor's home country) where:

- the investors reside in a country that had a tax treaty with Israel during the 10 years before their investment and report it within 30 days to the Israeli Tax Authority.
- shares in a research-intensive company were issued to the foreign resident investor on or after January 1, 2003.
- venture capital funds obtained an advance tax ruling from the Israeli tax authorities.
- securities are traded on the Tel Aviv Stock Exchange.
- securities of Israeli companies are traded on a recognized foreign stock exchange.
- exemption under any applicable tax treaty (restricted to under 10% shareholders in the US-Israel tax treaty).

Privileged and approved enterprises

The Law for Encouragement of Capital Investments (the "Law"), the main goal is to increase the attractiveness of the Israeli economy in the face of international competition for investment and development. The Law promotes a more geographically balanced distribution of the population across the country and aims to strengthen the peripheral areas. The law includes two main schemes of government incentives: the grant scheme which allows up to 30% government grant on qualified investments for establishing or expanding an industrial enterprise in preferred areas; and the tax incentive scheme.

The Law applies to industrial enterprises which qualify as an "International Competitive Enterprise", which is defined as including industrial enterprises that own Productive activities including: textiles, food, electronics, chemicals, pharmaceuticals, computer software, biotechnology, nanotechnologies, etc. In order to meet the International Competitive Enterprise rule, 25% of the enterprise's revenues should be driven by exporting to large international markets

Location

The government grants scheme is affected by the location of the company's activities.

Several regions in Israel have been declared National Priority Regions (Priority Area A), among them:

- The Galilee
- Jordan Valley
- The Negev
- Jerusalem (for hi-tech enterprises)

The Grant Scheme

An industrial enterprise located in "Priority Area A" fulfilling the terms of the Law, may be eligible for grants to be calculated as a percentage of the approved investment. The grants may be 20% of the actual investments of the enterprise for the follow assets:

- Buildings, machinery and other equipment (not including private vehicles) owned by the enterprise and used according to the approved program (by the Incentive Center).
- Expenses made for land development.
- Expenses made for renovation of the building.

The grant scheme is only applicable for enterprises located in Priority Area A. Enterprises from other areas do not qualify for the grant scheme, but may be entitled to tax benefits under the Law.

Enterprises complying with the requirements of the Law may benefit simultaneously from both the tax benefits (lower corporate tax rate) as well as applicable non refundable grants (only relevant for Area A).

The tax benefits scheme

Enterprises located in Priority Area A are eligible for a reduced corporate tax of 8% on all preferred income. Corporate tax rate on other regions is 12%.

Preferred Enterprises

As mentioned, the tax benefits scheme will apply only to Preferred Income (as defined below) of a Preferred Enterprise. According to the law, a Preferred Enterprise is one of the following:

- Engaged mainly in biotechnology or nanotechnology, and has obtained the approval of the Head of Industrial R&D Administration;
- At least 25% of its Preferred Income was produced from exporting to international markets; or
- Engaged mainly in the field of renewable energy.

Preferred Income

The Preferred Income is the gross income of a Preferred Enterprise (not including discounts) which was produced or which accrued during the course of business activities of the enterprise in Israel, as follows:

- Income from products manufactured in Israel, including components manufactured by subcontractors. Income derived from natural resources (Gas, Minerals, Oil) would not be calculated as part of the Preferred Income.
- Income from the sale of semiconductors manufactured by independent subcontractors, as long as the IP belongs to the Preferred Enterprise.
- Income derived from royalties for the use, or the right to use, a patent or knowhow which was developed by the Preferred Enterprise.
- Income derived from industrial research and development made for a foreign resident, as long as an approval of the head of the R&D center has been provided.

Tax Benefits

Preferred Enterprise is eligible for tax benefits for each tax year on which it has fulfilled a 25% export condition.

Investments Incentives

Corporate Income Tax of a Preferred Enterprise is 6% if the enterprise is located in "Priority Area A", and 12% if it is located in other regions.

However, a transitory provision for the years 2011 to 2014 determine the following tax rate as described in the following table (ordinary tax rate is shown for convenience):

Tax Year	Priority Area A	Other Areas	Ordinary Tax Rate
2011	10%	15%	24%
2012	10%	15%	25%
2013	7%	12.5%	25%
2014	7%	12.5%	25%
2015	6%	12%	25%

Tourism Projects

The law for encouragement of capital investments also applies to tourism enterprises.

"Tourism Enterprise" is defined as a tourism facility which includes at least 11 hotel rooms and which provides sleeping arrangements services and additional services such as catering, recreation and leisure. Unique tourist attractions have also been included as Tourist Enterprises.

The Grant Scheme

Tourist Enterprises which are located in Priority Area A will be eligible for a non refundable grant of up to 20% of approved investments. Tourist Enterprises which are located in the Negev will be entitled to a 30% grant.

Tourist Enterprises which are located in Priority Area B will be eligible for a non refundable grant of up to 10% from approved investments.

In addition to the grants, Tourism Enterprises are eligible for tax benefits, including: reduced corporate income tax rates, and accelerated depreciation on related assets.

Research & Development (R&D)

The Office of the Chief Scientist (OCS) of the Ministry of Economy and Trade is responsible for implementing government policy regarding the support and encouragement of industrial research and development in Israel. Research & development grants are available from the OCS at rates ranging from 20% to 85% of the approved budget. R&D grants of up to 50% may also be available from a number of bilateral funds signed between Israel and: Maryland, New York, Wisconsin, Massachusetts, Colorado, Oregon and Virginia, USA; UK, Belgium, France, Germany, Italy, the Netherlands, Portugal, Spain, Sweden, Canada, Hong Kong, India, Korea, China, Australia, Singapore and Taiwan.

Development of Novel Product

A single or multi-year program that will provide know-how, processes or methods for the manufacture of a new product or the major improvement of an existing one or a new process or a major improvement in an existing process. The product must have a sizeable potential for export sales. Support is in the form of a conditional grant amounting to 30-50% of the approved R&D budget.

Support for Start-Up Company

Support is in the form of a conditional grant of 66% of the approved R&D budget up to a maximum of \$250,000 per year for up to two years. Any approved R&D expenditure above \$250,000 may receive a conditional grant of 50%. The R&D support includes beta-site testing as well as patent registration.

Companies in Special Geographic Areas

Any approved R&D program taking place in "Development Area A" is entitled to a conditional grant of 60% of the approved budget.

For a border area delineated as a "Front Line" area, the conditional grant amounts to 70-75% of the approved budget with the higher figure for companies that also manufacture in that area.

Royalty Payments

Any income deriving from an R&D program that has enjoyed government support is liable for the payment of royalties to the OCS. The royalty payments are based upon a percentage of sales up to the repayment of the grant.

Technological Incubators

Technological incubators provide a supportive framework enabling entrepreneurs with innovations to develop their ideas into a commercial product, and to reach the point at which they can attract capital investments from the private business sector. R&D activities conducted in technological incubators are entitled to grants of up to 85% of the approved program or 100% in peripheral incubators. The grant is limited to NIS 2.1 million for a two-year period.

Biotechnological Incubators

Biotechnological incubators are aimed at supporting biotech research, given the specific nature and needs of that sector. In line with the current tendency for privatization, the private sector, in the form of franchisees, plays a key role in the project. The government's participation in such projects is through a convertible bond, while the incubators are actually managed by the franchisees.

The franchisee obtains, for each project, a government loan of up to 85% of the approved budget in the 1st year, up to 80% in the 2nd year and up to 75% in the 3rd year. The approved budget for up to 3 years shall not exceed NIS 8,100,000. The franchisee is responsible for raising supplementary funding to cover the rest of the approved budget.

For each incubator project, the franchisee negotiates with the entrepreneur the percentage of control in the company running the project.

The franchisee provides a physical plant with adequate infrastructure for biotechnological R&D, administrative staff and accessibility to consulting services. In return for covering the operating costs of the biotechnological incubator, the franchisee receives up to 5% of the shares of each company accepted by the incubator.

Aid to Individual Technology Entrepreneurs

TNUFA- The Israel Idea Promotion Center is a non-profit Israeli, government-supported organization, dedicated to helping individual entrepreneurs successfully commercialize their new product ideas by providing seed money grants of 85% or up to NIS 200,000 in addition to free legal, marketing and business-management consultations. Most of TNUFA's budget is based on royalties from successful projects.

Trade Unions and Workers Councils

There is no legal requirement for employers to recognize any trade union unless a majority of the work force votes in favor of such recognition. Agreements between employers and trade unions over pay and conditions are not binding by law and unions may not take industrial action without first securing a majority vote in a secret ballot of their members. There is no legal requirement for employees to be represented on the board of directors of companies.

Labor Related Costs

The Israeli employee's labor and social security costs include the following:

- **National Insurance (Social Security)**
Employees pay up to 10.92% and employers 5.48% for a total of 16.4% of employees' salaries monthly. Cover includes unemployment insurance, maternity benefits, work injury, child allowances, old age pensions, medical care costs and reserve military duty compensation.
- **Paid Vacation**
Employees are entitled to yearly paid vacations of from 2 to 4 weeks depending on length of employment. They are also entitled to a recreational allowance based on length of service.
- **Severance Pay and Pension Funds**
Employees are entitled to severance pay on dismissal or reaching retirement age (67 for men and 64 for women) but not on voluntary resignation. However some employers are required to pay severance pay on resignation under terms of specific labor agreements.
Severance pay amounts to one month's salary for every year of employment based on the last month's salary received. Many employers provide for this by monthly payments to a provident fund.
In addition, most employers are required by labor agreements to make monthly payments to pension funds, at the rate of 5% of salaries, for employees' retirement pension.
- **Sick Leave**
Employees are entitled to paid sick leave.
- **Education Fund**
Some employers make provision for the ongoing education of senior and academic employees by monthly payments, at the rate of 5 - 7.5 % of employees' salaries, to a provident fund.

Foreign employees, have no vested right to enter Israel for the purpose of employment. A foreigner, who wishes to perform work in Israel, regardless of duration, must first obtain a work permit (B-1) from the Ministry of Interior, the Department of Foreign Workers.

A foreign worker will be deported from Israel if he works without a work permit and he will further be subjected to fines and possible imprisonment. In addition the employer will be prevented from sending other employees to Israel and will be subjected to criminal offences if he employs a foreigner under a tourist visa.

Obtaining a work permit entails completing a four-step process.

1. The first step involves receiving a recommendation from the Ministry of Interior to work in Israel. This is possible only after convincing the Ministry that the employee is an expert in his field, earning more than twice the average salary in the market and proving that there is no other local Israeli citizen who can perform the same task.
2. The second step includes submitting a request to the Ministry of the Interior to invite the worker to Israel.
3. The third step involves having the visa stamped in the worker's passport.
4. The fourth step involves the stamp of multiple entries, after entering the country.

Reviewing a working permit application usually take up to 90 days. Permits approved will usually be given for 1 year but they may be extended for up to 5 years depending on the uniqueness of the worker in question. It is not possible to convert a tourist and business visitor's visa (B-2) to a working visa (B-1) while the foreigner is in Israel. Therefore an employee who wishes to work in Israel is required to obtain a work permit **before** entering Israel.

The Ministry of the Interior has started to conduct periodic inspections ensuring that companies comply with local law concerning the employment of expats in Israel. The inspectors intend to make sure that foreign employees are lawfully being employed and have a valid B1 working visa. There is an increasing trend to

initiate criminal proceedings against employers and their managers (personally) that unlawfully employ foreign employees.

According to the Law of Entry into Israel, 1952, a person entering Israel without a permit, or committing a breach of one of the conditions of his entry permit, is committing an offense and the punishment is one year of imprisonment. Such a person may be deported.

A person entering Israel without a permit, providing false information to obtain for himself or another a visa or a license to reside, committing a breach of one of the conditions of his entry permit, or who violates any other instructions or regulations of this law commits an offense and the punishment is one year of imprisonment. The offender may be deported.

Employing a foreign worker who is not permitted to work in Israel according to the Law of Entry will be subject to a fine of ILS 75,300 (approx \$ 20,350) or two years imprisonment.

Further to the Foreign Workers Law (Unlawful Employment) – 1991, an employer who employs a foreign worker who does not have a work permit will be liable to pay fines of ILS 58,400 (approx \$ 15,780) and an additional fine of ILS 5,600 (approx \$1510) **per worker** for each day that the offense continues.

In the event that the foreign worker is employed unlawfully, the punishment may be up to one year's imprisonment or a fine of ILS 116,800 (approx \$ 31,568) and an additional fine of ILS 5,600 (approx \$1510) **per employee** for every day the offense continues.

The fines are subject to future changes.

Israeli VCs are focused on technology companies, mainly in the fields of communications and components, software, semiconductor chip design and manufacture, Internet and e-commerce, Bio-tech, Cleantech and medical devices.

Types of target company

In VC transactions, target companies may be seed/pre-seed stage companies or later-stage companies. The companies may be registered in Israel or be corporations registered in Delaware with Israeli subsidiaries.

Investors

In recent years, several foreign venture funds and venture lending companies have opened offices in Israel and have invested in local Israeli companies.

Tax Incentives

Foreign investors are generally exempt from Israeli capital gains tax on the realization of their investment in Israeli high-tech companies 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. The exemption does not apply to shares in publicly-traded companies.

VC Fund management

VC funds typically establish a management company in Israel, and pay an annual management fee of approximately 2.5% of total fund commitments. This fee may decrease after an investment.

VC Fund as Limited Partnerships

VC funds are not regulated and do not require a license. VC funds are usually limited partnerships and are subject to securities legislation restricting the offering

of limited partnership units to no more than 35 persons, excluding certain qualified investors consisting primarily of financial institutions.

Investor Protection

The VC fund's limited partnership agreement governs the relationship between investors and the fund. Investors usually seek: confirmation of limited liability; restrictions on the use of proceeds; Employee Retirement Security Act 1974 (ERISA) restrictions; restrictions on recourse borrowing; financial reporting; key man provisions; non-competition restrictions preventing promoters from setting up a competing fund until certain time periods have passed; conflicts of interest provisions.

Investment Objectives

Long term capital appreciation from high growth, technology companies. VC funds generally have a 7-10-year term with the ability to extend this term by a number of one-year periods (usually two to three extensions). VC funds usually aim to complete their investment period (deploy capital in new portfolio investments) within 3-4 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 3-5 years of investment. Since 2001, the average period between investment and exit has lengthened. VC funds in Israel now usually extend their investment periods (sometimes to 6-7 years).

Investments

VC 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. 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 increased over the last few years.

Investor Protection

Investors in a company typically receive the following protections: dividend and liquidation preferences; anti-dilution protection; pre-emptive rights to participate in subsequent financing rounds; rights of first refusal and co-sale; information rights, including rights to financial information and visitation and inspection rights; registration rights; representation on the board of directors; protective voting provisions (veto rights); restrictions on the use of proceeds; directors' and officers' and key man insurance.

Preferred Shareholders

Holders of preferred shares typically have 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 private companies in practice do not pay dividends.

Liquidation preference

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. The liquidation preference applies both to actual liquidation of the company and to most exit events including a sale of all or substantially all of the assets of the company.

Anti-dilution protection is 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 to broad-based weighted average.

Right to representation on the board of directors. Protective voting provisions, requiring fund approval for various actions including the creation of a class of shares with rights superior to those held by the VC Fund, as well as other corporate activities.

Board Representation

Typically, investors 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 investor 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 (mergers and acquisitions and initial public offerings); 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 to the business of the company; management type activities including, hiring and firing of key executives; bank signature rights; establishment of an annual operational budget.

Management rights letter

Funds that require a management rights letter for ERISA purposes typically receive one providing 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.

Right of first refusal

Investors usually 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. This right is usually 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. There are exceptions for transfers of shares for estate planning purposes.

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 recognize 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.

Minority Shareholder Protection

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 (tag-along right or right of co-sale) may be exercised if the investor elects not to exercise its right of first refusal. The rationale is that the investors are investing in the founders, and if the founders decrease their shareholdings, the investors have the right to exit with the founders.

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 coordination with the investors. It is very uncommon for founders to have tag-along rights in relation to sales of shares by VC funds.

Drag-along (bring-along) rights

Drag-along rights (also referred to as bring-along rights) facilitate the sale of the company in the face of opposition from minority shareholders. The articles of association often 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, all shareholders must then sell.

The Companies Law 1999, 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 exercise of these clauses to ensure that they do not find themselves providing representations, warranties and indemnities that expose them to excessive liability.

Pre-emption rights

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; and also certain issuances of warrants to strategic partners in transactions not primarily intended as financing transactions.

Consents

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 Economy and Trade, consent from the department providing the tax incentives or grant is also required.

VC Funds Costs

Investment agreements typically provide that, on closing, the portfolio company covers the VC 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 VC fund's costs.

Share Options

Israeli companies usually provide incentives to employees (including founders) by granting share options which are subject to vesting over a number of years.. Employees typically receive share options, which are exercisable if the employee continues to be employed during the relevant vesting period.

Redemption rights

Redemption rights are designed to enable a VC fund to recover its investment in an unsuccessful company.

These rights allow the VC 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. It is uncommon to find redemption rights provisions in investments due to Israeli corporate law limiting the ability of an Israeli company to repurchase its own shares.

Exits

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 sale price, this is the most efficient and perhaps the most successful exit for a VC fund, since 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 approval of the transaction may require class votes, giving certain shareholders the ability to frustrate the transaction.

The Antitrust Law, 1988, is enforced by the Israeli Antitrust Authority. Under the Law, a restrictive arrangement is an agreement made between parties conducting business, where at least one of the parties restricts itself in a way that could obviate or reduce the business competition between that party and part or all of the other parties to the agreement, or between that party and an entity that is not a party to the agreement.

An agreement that determines prices, market share, profit margins, or quotas will be deemed to be a restrictive agreement. However, the law excludes some agreements from its general definition and they are not considered restrictive agreements (e.g. entitlement to use proprietary rights, international transport, etc.).

Participation in any restrictive agreement is prohibited unless the agreement has been approved by a court of law, received a temporary permit from the Director-General of the Antitrust Authority or was granted an exemption.

In recent years, enforcement of this law has become more evident, in view of the expansion of the Antitrust Authority and the growing awareness of the advantages of competitive markets in Israel.

Block exemption

In 2000, the Director-General of the Antitrust Authority defined block exemptions that exempt specific agreements from the need for a permit.

These block exemptions include R&D agreements, joint ventures and franchises.

According to the Restrictive Business Practices Law, the following mergers and acquisitions require the approval of the Antitrust Authority:

- Subsequent to the merger or acquisition, the share of the merged parties in the production, sale, marketing, or purchase of a single product or a group of products or services will exceed 50%.
- The combined turnover of the merged companies (domestic turnover only) in the fiscal year prior to the merger exceeded NIS 150 million (approximately US\$ 39 million), and at least two of the merged companies have a turnover of more than NIS 10 million (approximately US\$ 2.62 million) each.
- One of the parties is already a monopoly.

Israel is a member of international agreements regarding intellectual proprietary rights. The Patent Act, 1967, regulates the protection of patents in Israel.

Regular patents are protected for 20 years from the date of application, while “patents of addition” are protected for the unexpired terms of the main patent.

The Trademarks Ordinance, 1972, regulates the protection of trademarks in Israel.

Protection is granted for an initial period of ten years, and may subsequently be renewed for further periods of ten years each, indefinitely. A third party may request the revocation of registered trademarks that have not been in use for three years or more.

The Israel Copyrights Law regulates the protection of original literary, musical, artistic, and dramatic works. The protection is granted for the lifetime of the creator plus 50 years for musical and artistic works, and 70 years for literary and dramatic works.

The Commercial Torts Law incorporates several commercial torts, such as unfair interference to a business, passing-off and false description.

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The firm enjoys a strong reputation in handling both local and international cases and is characterized by wide international activity based on foreign language speaking lawyers, and on providing services to local and multinational corporations.

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