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CLIENT UPDATES

New Leniency Exempts Certain U.S.-Traded Companies from Obligation to Appoint External Directors Under Israeli Companies Law

Summary

On April 17, 2016, the Israeli Minister of Justice published an amendment to the Companies Law Regulations (Relief for Companies Whose Securities Are Listed for Trading on Foreign Stock Exchanges) (the "**Amendment**" and "**Regulations**" respectively) that exempts certain Israeli companies whose shares are traded on certain U.S. stock exchanges from the requirement under the Israeli Companies Law, 5759-1999 (the "**Companies Law**") to appoint external directors. The Amendment, which was effective immediately, also exempts the same category of companies from the related requirements under the Companies Law as to the composition of the audit and compensation committees of the board of directors.

Applicability

The exemptions provided by the Amendment apply to Israeli public companies whose shares are listed on any of the following U.S. stock exchanges: (1) New York Stock Exchange (NYSE); (2) NYSE MKT (formerly the American Stock Exchange); (3) NASDAQ Global Select Market, (4) NASDAQ Global Market and (5) NASDAQ Capital Market. The exemption applies regardless of whether a company's shares are listed solely on any such exchange, or listed dually on such exchange and on the Tel Aviv Stock Exchange. In order to qualify for the exemption, any such U.S.-traded company must lack a controlling shareholder (as defined under the Companies Law).

Prospective Conditions to be Met

Any company seeking to avail itself of the exemptions provided by the

Amendment must comply, on a going-forward basis, with the board independence, and audit and compensation committee composition requirements, of the U.S. exchange on which its shares are listed, as applicable to domestic U.S. companies. Those U.S. exchange requirements mandate that a majority of the members of the board and all members (at least three, in the case of the audit committee, and at least two, in the case of the compensation committee) of the audit and compensation committees be determined by the board to be "independent directors" under the exchange listing rules. The U.S. exchanges also require that members of the audit and compensation committees qualify as independent under Rules 10A-3 and 10C-1, respectively, of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"). Those latter rules disqualify "affiliates" (as defined under U.S. securities regulations) of the company or its subsidiaries from being independent for audit committee purposes, and require that the source of compensation, and "affiliate" status (if any), of any board member be considered in determining independence for compensation committee purposes.

While mandating compliance with the above U.S. rules, the exemptions under the Amendment nevertheless preserve the requirement under the Companies Law (which generally applies to external directors) that if, at the time of election of a director, all existing members of the board are of the same gender, a company must elect a board member of the opposite gender.

Election to be Governed by the Exemptions

Any company seeking to avail itself of the exemptions under the Amendment can do so by having its board of directors affirmatively elect for the company to be governed by the exemptions. Shareholder approval is not required for such an election. Such an election is furthermore not irrevocable under the Amendment, such that a company's board may later determine to subject the company to the Companies Law requirements related to external directors and the composition of the audit and compensation committees.

Transition Provisions

Existing external directors of a company that elects to be governed by the exemptions can, at the discretion of the board of directors, be transitioned immediately into a term of service that matches that of all non-external directors. Typically, that will result in the former external director serving until the next annual general meeting of shareholders, or, in the case of a company with a classified ("staggered") board of directors under its articles of association, until the annual meeting of the class into which the director is placed. In the alternative, the Amendment permits a company to allow the former external director to continue to serve until the earlier of (i) the end of his pre-existing term as an external director, or (ii) the second annual shareholder meeting following the company's election to be governed by the exemption.

Any external director serving at the time of a company's election to be governed by the Amendment may continue to serve as an ordinary

director (and be re-elected for multiple terms), despite the usual two-year "cooling off" period during which former external directors are prohibited from serving in any capacity for the company following external director service.

Implications of the Amendment

The Amendment is aimed to provide relief from excessive layers of corporate governance requirements that have burdened Israeli public companies that are traded in the U.S. It is part of a move by the current Israeli Justice Ministry and Israeli Securities Authority to ease regulation on Israeli public companies generally and pave the way for smoother access for them to the capital markets, whether in Israel or in major markets abroad, such as the U.S. The Amendment in particular will enable Israeli companies traded in the U.S. to have more of the "look and feel" of their domestic U.S. counterparts. While Israeli companies that elect to be governed by the exemptions will be bound by the U.S. stock exchange rules for key governance matters such as board independence and audit and compensation committee independence, this will not stifle their flexibility entirely. Israeli companies will still be able to elect to "opt out" from other stock exchange requirements applicable to domestic U.S. companies, such as quorum requirements, and shareholder approval requirements for certain transactions involving share issuances and equity compensation plan amendments and the like. For that reason, the Amendment seems like a win-win opportunity for U.S. traded Israeli companies. The one potential downside to keep in mind for a company that lacks a "staggered" board of directors is that the elimination of external directors will eliminate one quasi-takeover defense mechanism—the three-year term of external directors who, while technically independent, often bear certain loyalties to management and its allies on the board of directors in actuality. Therefore, a company that fears a hostile takeover may want to contemplate that factor before electing to be governed by the new leniencies.

Please feel free to contact us at any time with any questions that you might have concerning this alert.

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