



## AMENDMENT NO. 16 TO THE COMPANIES LAW (IMPROVING CORPORATE GOVERNANCE) - 2011

### 1. General

On March 8, 2011, the Israeli Knesset enacted Amendment No. 16 to the Companies Law - 1999 (the "**Amendment**" and the "**Companies Law**", respectively). The Amendment primarily addresses corporate governance rules and incorporates, among others, recommendations of a committee established a few years ago by the Israeli Securities Authority (the Committee for the Review of a Corporate Governance Code, also known as the Goshen Committee). This memo summarizes the main provisions of the Amendment and our initial recommendations with respect thereto.

The Amendment will become effective on **May 14, 2011** (the "**Effective Date**"), which is 60 days after its official publication in the "Rashumot", except for certain provisions which shall become effective 6 months after its publication (i.e., on **September 15, 2011**).

For your convenience, attached is an [unofficial marked version of the Companies Law \(in Hebrew\)](#), prepared by us, reflecting the changes the Amendment introduces to the Companies Law.

If you have any questions regarding the matters in this legal update, please contact the following attorneys or call your regular Meitar contact.

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### 2. The Independence of the Board of Directors

#### 2.1. External Directors' Appointment and their Relationship with the Company

**2.1.1.** The Amendment reinforces the power of non-controlling shareholders and shareholders that do not have a personal interest in the approval of certain corporate resolutions. Pursuant to the Amendment, the election of an external director will require the vote of a **majority** of the shares voted at the meeting that are held by non-controlling shareholders and shareholders who do not have a personal interest in such election (the "**Non Interested Shareholders**"), as opposed to **one-third** of the shares held by non-controlling shareholders voted at the meeting, as required under the Companies Law prior to the Effective Date. The Amendment also provides that an external director may be appointed even if the majority of shares held by the Non Interested Shareholders was not obtained, provided that the total number of shares held by the Non Interested Shareholders that voted against the election of the external director does not exceed **2%** of the aggregate voting rights in the company, as opposed to **1%** required under the Companies Law prior to the Effective Date.

**2.1.2.** The Amendment further provides that where a company does not have a controlling shareholder or a holder of 25% or more of the voting power, then a person may not be appointed as an external director if he or she has, as of the date of such person's appointment, any affiliation with the then chairman of the board of directors, the chief executive officer, a holder of 5% or more of the issued share capital or voting power, or the most senior financial officer in the company.

**2.1.3.** The Amendment broadens the definition of the term "affiliation" such that after the external director's appointment, such term shall include also business or professional relationship with the company or its controlling shareholders, even if such relationship is not maintained on a regular basis (but excluding insignificant relationship). The definition of the term "affiliation" prior to the Effective Date refers only to relationships that exist prior to the appointment and are maintained on a regular basis.

**2.1.4.** The Amendment provides that an external director may be elected for three consecutive terms of three years each (as opposed to two terms of three years each prior to the Effective Date). However, while the initial term of office requires a majority vote and, effectively, the vote of the controlling shareholder, the extension of the external director's office for the two subsequent terms may be approved even if the controlling shareholder

opposes the appointment, under either of the following alternatives: (i) the external director is nominated by one or more shareholders holding at least 1% of the voting power and at the general meeting of shareholders such reelection is approved by a majority of those shares present and voting that are held by shareholders who are Non Interested Shareholders, and provided that such shares represent at least 2% of the total voting power in the company; or (ii) the external director is nominated by the board of directors, and his/her reelection was approved by the same majority as required for the election for the first term of service (see section 2.1.1 above). The Amendment permits companies to provide in their articles of association that their external directors will be appointed for two terms of office only (i.e., that the aggregate term of office shall not exceed six years). To the extent such provision is adopted by a company, it shall apply only to external directors who are appointed after such provision is adopted, however, a transitory provision in the Amendment enables companies to include such a provision in their articles of association within 60 days of the Effective Date, in which case such provision shall apply also to external directors then in office. Therefore, we recommend companies that wish to limit the term of office of their external directors to make appropriate arrangements in this respect.

**2.1.5.** The Amendment broadens the prohibition on a company to employ or engage the services of an external director (or his or her relatives) during a period of two years following the termination of his/her services, such that after the Effective Date also a controlling shareholder and any entity controlled by such shareholder shall be prohibited to employ or engage an external director, and not only the company. As such, the Amendment prevents external directors from favoring the controlling shareholders in expectation to receive in return certain benefits following termination of their services. In case of a relative who is not a spouse or child of the external director, the foregoing prohibition applies for a period of one year following termination of the director's services.

## **2.2. Chief Executive Officer as Chairman of the Board**

The Amendment purports to broaden the provision that separates between the position of a Chief Executive Officer and the position of the Chairman of the board of directors. The Amendment provides that the appointment of a Chief Executive Officer and a Chairman of the board who are relatives will require a special majority vote at the shareholders' meeting. In addition, the authorities of the Chief Executive Officer may not be vested with a relative of the Chairman (unless the approval of a special majority has been obtained) and the authorities vested with those subordinated to the Chief Executive Officer may not be vested with the Chairman of the Board of Directors. The Chairman of a public company may not serve in any other position in the company or in a company controlled thereby, but may serve as a director or chairman of the board of a controlled company. Therefore, by way of example, the Chairman may not serve as the Chief Executive Officer of a subsidiary of the company. The foregoing amendment will become effective 6 months from the official publication of the Amendment (i.e., on **September 15, 2011**), and, therefore, we recommend making the appropriate arrangements in this respect.

## **2.3. A Corporation as a Director**

The Amendment provides that a corporation may be appointed as a director only in private companies. Such amendment shall become effective 6 months after the official publication of the Amendment (i.e., on **September 15, 2011**), and, therefore, we recommend public companies, in which a corporation currently serves as a director, taking the appropriate measures in this respect.

## **2.4. The Judgment of the Director**

The Amendment provides that a person shall not serve as a director if he/she was not duly appointed and that a director shall exercise independent judgment when exercising its voting rights in the board of directors. Any non-independent judgment shall be deemed a breach of the duty of loyalty. The person providing instructions to a director in violation of this provision shall be subject to the duties and responsibilities that apply to directors (namely, the duty of care and duty of loyalty). There is a strong basis to argue that the foregoing amendment does not actually constitute a change in the substance of the current law and it appears that the main significance of the Amendment in this respect is by emphasizing and codifying the matter.

## **3. The Independence of the Audit Committee**

### **3.1. The Audit Committee - Composition**

**3.1.1.** The Companies Law currently provides that the audit committee should consist of at least three directors, including all of the external directors. The Amendment seeks to guarantee the independence of the audit committee and therefore requires that the majority of the members of the audit committee shall be "Unaffiliated Directors"<sup>1</sup> and that the chairman thereof shall be an external director.

**3.1.2.** The Amendment further provides that the Chairman of the board and any director employed by a company or by the company's controlling shareholder, directly or indirectly, or who provides services to any of the foregoing on a regular basis, may not serve as a member of the audit committee. In addition, a person who is not qualified to serve as a member of the audit committee shall not be present at the committee's meetings and at the time resolutions are adopted thereby, unless such person's participation is required in order to present to the committee a particular matter.

**3.1.3.** The Amendment also provides that the chairman of the audit committee in a private company shall not be the controlling shareholder or his/her relative and that a director who is employed by the company or provides to it services on a regular basis shall not be a member of the audit committee.

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<sup>1</sup> An "Unaffiliated Director" is an external director or a director that is appointed or classified as such, and that: (i) meets the qualifications of an external director under the Companies Law as determined by the audit committee; and (ii) does not serve as a director in the company for more than 9 consecutive years (and for such purpose, a cessation of office of less than two years shall not be viewed as cutting off the continuance of service).

### **3.2. The Audit Committee - Roles**

**3.2.1.** The Amendment broadens the authorities and roles of the audit committee. It provides, among others, that the audit committee is expected to identify irregularities in the management of the company's business and for such purpose, it is required to hold a meeting at least once a year to discuss such irregularities in the presence of the internal auditor or the independent auditors of the company, and without the presence of officers who are not members of the committee.

**3.2.2.** The approval of extraordinary transactions and material actions that involve conflicts of interests, or interested parties transactions, requires the approval of the audit committee. The Companies Law currently does not define the organ authorized in the company for determining what is an "extraordinary transaction" or a "material action". In this respect, the Amendment provides that the audit committee shall be the organ authorized to define these terms. It further requires the audit committee to specify the reasons for its classification of a transaction as extraordinary or material, or as a non-extraordinary or non-material transaction. The committee may also classify certain transactions or actions as extraordinary transactions or material actions, as applicable, based on certain criteria determined by the committee in advance, once a year.

## **4. Procedures in Board Meetings**

The Amendment sets forth certain provisions regarding the procedures for convening board meetings. For example, the Amendment provides that a **public** company may not impose any conditions or restrictions in its articles of association on the requirement to provide the directors with reasonable prior notice before convening a meeting, and it also would not be permitted to hold board meetings without prior notice, other than under urgent circumstances and subject to the approval of the majority of the board members. In addition, board committees will now be required to submit their resolutions or recommendations that require board approval at least a reasonable time prior to the contemplated board meeting. The commentary to the Amendment emphasize that the recommendations of the committee should be brought to the board together with the reasons which are the basis therefor, noting whether there were majority and minority votes at the meeting.

## **5. Transactions of a Company with its Officers and Controlling Shareholders**

### **5.1. Approval of Compensation Arrangements of Officers and Controlling Shareholders**

**5.1.1.** Prior to the Effective Date, approval of the compensation arrangements of officers who are not directors required the approval of the board (unless the articles of association provided otherwise), and to the extent that such arrangement constituted an extraordinary transaction, also the approval of the audit committee. The Amendment provides that the compensation arrangements of an officer (who is not a director) require the approval of the audit committee and the board, regardless whether such engagement is in fact an extraordinary transaction.

**5.1.2.** Such a transaction may be approved by the compensation committee of the board, in lieu of the audit committee; to the extent such committee exists and complies with all provisions relating to the audit committee. In addition, in case of an amendment to an existing compensation arrangement, then only the audit committee approval will be required, if the audit committee determines that the amendment is not material in relation to the existing arrangement.

## **5.2. Transactions with Controlling Shareholders**

**5.2.1.** The Amendment provides that the requisite majority for approving transactions with controlling shareholders as set forth in Section 270(4) of the Companies Law<sup>2</sup> will increase from one-third to a majority of the Non Interested Shareholders (as defined above) and that the alternative approval method that considers the percentage of the shareholders voting against the transaction will be increased from 1% to 2%.

**5.2.2.** The Amendment further provides that if the term of such a transaction extends beyond three years, the approval is required once every three years. However, if such transaction does not relate to a compensation arrangement, the audit committee may approve the transaction for a longer duration, provided that the committee determines that such duration is reasonable under the circumstances.

**5.2.3.** The Amendment provides for a transitory provision relating to existing transactions with respect to which more than 3 years have lapsed since their commencement. For such transactions, approval shall be obtained until the later of: (i) the lapse of six months from the Effective Date, or (ii) the first general meeting following the Effective Date; or (iii) the lapse of three years from the previous approval. As this provision requires the re-affirmation of transactions with controlling shareholders, we recommend making the appropriate arrangements for the approval of transactions relating to compensation arrangements in accordance with Section 275 of the Companies Law and, with respect to other transactions, to consider the possibility of approval by the audit committee that the duration of said transactions is reasonable under the circumstances.

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<sup>2</sup> An extraordinary transaction of a public company with a controlling shareholder, or in which a controlling shareholder has a personal interest, including a private placement in which the controlling shareholder has a personal interest; and a transaction of a public company with a controlling shareholder or with his or her relative, directly or indirectly, including through an entity in the control of the controlling shareholder, for the receipt of services by the company therefrom, and if he/she is also an officer of the company - with respect to the terms of office and service, and if he/she is an employee of the company but not an officer thereof - with respect to his/her employment.

## **6. Personal Interest**

In order to reinforce the power of minority shareholders, the definition of "personal interest" has been broadened to include also the personal interest of a person voting by a proxy granted to him/her by another person, even if the person so granting the proxy does not have a personal interest in the transaction. In addition, the vote of a person who was granted a proxy from another person who has a personal interest shall be deemed the vote of a person having a personal interest, regardless of whether the proxy holder has discretion on how to vote. Therefore, we recommend making appropriate arrangements for granting voting ballots or proxies to persons who do not have a personal interest and not to officers of the company, as is currently customary.

## **7. Tender Offer**

**7.1.** According to the Companies Law prior to the Effective Date, a full tender offer may be consummated only if the percentage of the offerees failing to accept the offer is less than 5% of the issued share capital. The Amendment supplements the foregoing condition by an additional requirement, pursuant to which one of the following conditions is also required to be met: (1) at least a majority of the offerees who have no personal interest in the offer shall have accepted the offer, or (2) the percentage of the offerees who fail to accept the offer shall be less than 2%.

**7.2.** In addition, according to the Companies Law prior to the Effective Date, any offeree in a full tender offer is entitled to appraisal rights, regardless if such offeree has accepted or rejected the offer. The Amendment provides that the offeror shall be entitled to determine in the tender offer document that appraisal rights shall not be available to an offeree who accepted the offer. However, if the offeror or the target company have not disclosed prior to the acceptance date of the offer information that was required to be disclosed by them when announcing the full tender offer, then the foregoing provision denying appraisal rights in the tender offer document shall be void.

**7.3.** According to the Companies Law prior to the Effective Date, a compulsory sale is available only with respect to sale of shares. The Amendment allows an offeror to effect a compulsory sale also with respect to other securities of the company (such as options or other convertible securities), under the same circumstances and terms that apply to shareholders that are forced to sell their shares (i.e., the Amendment applies sections 337 (compulsory sale) and 338 (appraisal rights) to all securities of a public company).

## **8. The Adoption of Dispositive Principles of Corporate Governance**

## **8. The Adoption of Dispositive Principles of Corporate Governance**

**8.1.** Generally, the Companies Law includes mandatory provisions as well as dispositive provisions. The Amendment provides that a company shall be entitled to include in its articles of association corporate governance rules from a list of recommended rules set forth in the First Addendum to the Companies Law. We note that it is the intention of the Israeli Securities Authority to apply certain disclosure obligations to public companies with respect to such rules, such that a company that shall elect not to adopt such corporate governance rules shall be required to disclose such fact to the public.

**8.2.** The recommended rules in the First Addendum deal with, among others, the appointment of independent directors, the diversity of the composition of the board of directors, limiting the appointment of an officer as a director, the qualification of directors, holding meetings of the board without the presence of the chief executive officer and subordinates thereof, the appointment of external directors, and the mechanism of voting via the internet.

## **9. Derivative Claims and Defenses**

**9.1.** A derivative claim is, in general, the right to file a claim in the name of the company, by a shareholder, director or, in case of a prohibited distribution, a creditor. The Amendment includes certain provisions facilitating the process of such claims. According to the Companies Law prior to the Effective Date, the filing of a derivative claim requires the plaintiff to first approach the company in a request to consider the possibility of filing the claim in the company's own name. The Amendment provides, among others, that a plaintiff is no longer required to first approach the company if the company's authorized organ for filing such a claim has a personal interest in taking the decision of whether to file the claim, or if there is a reasonable concern that such approach will affect the possibility of obtaining the requested remedy.

**9.2.** In addition, similarly to class actions, the Amendment provides that a person who wishes to file a derivative claim, or the plaintiff in a derivative claim, are entitled to request the Israeli Securities Authority to bear a portion of their expenses. The Amendment also provides for a documents discovery procedure as part of the process of classifying a claim as a derivative claim.

## **10. Monetary Sanctions**

The Amendment authorizes the Israeli Securities Authority to impose monetary sanctions on a public company that is a 'reporting corporation' in the following cases (among others):

- no minimum number of directors having "accounting and financial expertise" has been determined;
- no chairman has been appointed to the board of directors for over 60 days;
- no audit committee has been established for over 90 days;
- no chief executive officer has been in office for over 90 days;
- no internal auditor has been in office for over 90 days;
- there has been in office a director or an officer that a committee for administrative enforcement has prohibited his/her office (no sanction shall be imposed if the director or the officer have not notified the company of such prohibition);
- less than two external directors have been in office for over 90 days;
- no external director having an "accounting and financial expertise" has been in office for over 90 days; or
- there has not been appointed at least one external director to a committee that has been delegated any of the powers of the board of directors.

A monetary sanction shall not be imposed in case an external director was not appointed due to the fact that the requisite majority in the general meeting was not obtained.

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