LEXOLOGY®
Getting The Deal Through

Shareholder Activism & Engagement

in Israel

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Contributors

Israel

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GENERAL

Primary sources

What are the primary sources of laws and regulations relating to shareholder activism and engagement? Who makes and enforces them?

The primary sources of laws and regulations relating to shareholder activism and engagement are the Companies Law, 1999 (the Companies Law) (see question 7 for certain rights granted to shareholders under the Companies Law); the Companies Regulations (Written Voting and Position Statements), 1999; the Companies Regulations (Notification and Announcement of Public Company General Meeting and Special Meeting and Addition of Items to Agenda), 2000; the Securities Law, 1969 (the Securities Law); Securities Regulations (Periodic and Immediate Reports), 1970 and Securities Regulations (Transaction with a Controlling Shareholder), 2001.

The Companies Law applies to companies incorporated in Israel; companies incorporated outside Israel that have issued shares or bonds to the public in Israel will be subject to certain provisions of the Companies Law. The Companies Law, the Securities Law and the regulations of these laws have been legislated by the Israeli parliament (the Knesset), and are enforced mainly by the Israeli Securities Authority.

Additional sources of regulations that apply to institutional investors include: the Joint Investments in Trust Law, 1994; the Ordinance Supervision of Financial Services (Provident Fund) (Participation of Managing Company at a General Meeting), 2009 and the Circular for Financial Institutions of the Capital Market, Insurance and Savings promulgated by the Israeli Ministry of Finance. These sources determine, inter-alia, the mandatory duty of institutional investors to participate in shareholders meetings.

In addition, there are recommended rules of corporate governance and voting policies that have been drawn up by advisory bodies to institutional investors (such as Entropy Financial Research Services and Emda Financial Research) and also similar policies drawn by institutional investors. These rules and policies include reference to shareholder activism and engagement. The recommendations made by advisory bodies to institutional investors (especially Entropy) have a material influence on the outcome of the votes taken at general meetings.

Shareholder activism

How frequent are activist campaigns in your jurisdiction and what are the chances of success?

Over recent years, including last year, there has been a surge in the involvement of shareholders in the operation and management of Israeli public companies traded on the Tel Aviv Stock Exchange. Nowadays, the shareholders, including the institutional investors, have evolved and are more sophisticated and professional. Also, we now see a phenomenon of institutional investors having set up special and designated departments dealing with institutional involvement.

It is important to state that this involvement is not limited to extreme situations, such as a crisis or insolvency or default in payment or suspicious transactions, but also with reputable companies capable of generating a higher added value for investors.

The institutional market realises its ability to influence matters affecting the quality of investment management, and institutional investors are becoming more and more involved, including by joining other activist campaigns, such as hedge funds.

In addition, a sharp and exponential rise has been occurring in the volume of money infused to hedge funds and institutional investors, enabling them to acquire larger stakes and carry out significant activist moves in the target companies.

Some of the hedge funds prepare detailed presentations analysing target companies, including recommendations on possible actions that will assist in increasing the companies' value. Such hedge funds engage with material shareholders in order to gain their support for activist campaigns.

Moreover, there is a drop in the number of companies that have a controlling shareholder (mainly dual companies in the hi-tech and life sciences sector). This makes it easier to carry out an activist campaign. At the end of 2010, 96 per cent of the non-dual companies were controlled by controlling shareholders or groups of control, and only one of the companies included in the Tel Aviv 100 Index was under distributed ownership. The average control interest in 2010 was 65 per cent; today some 90 per cent of the non-dual companies are under control of a controlling shareholder holding on average 51 per cent of the equity. The Tel Aviv 125 Index now includes 10 companies under distributed ownership; if we add dual companies, the present situation is that about 81 per cent of the companies are under control of controlling shareholders holding an average of 51 per cent of the equity on average.

How is shareholder activism generally viewed in your jurisdiction by the legislature, regulators, institutional and retail shareholders and the general public? Are some industries more or less prone to shareholder activism? Why?

The Companies Law is considered a paradise for activist shareholders. Herein are some examples of the rights of shareholders under Israeli law, which allow them to influence the operation of a company:

• Minority shareholders have the right to veto key corporate decisions, including the appointment of external directors and approval of controlling shareholders transactions.

• Shareholders are given the option of demanding to assemble a general meeting in certain cases, adding issues to the agenda of a general meeting, including the appointment and dismissal of directors and presenting their position on matters on the agenda of a general meeting.

• The shareholders also have the right to provide the company with a position statement, which must be published by the company to the public on the distribution website of the Israeli Securities Authority and the Tel Aviv Stock Exchange.

• The shareholders are given the right to vote via an electronic voting system affording them easier access to shareholders meetings and increase their involvement.

• The legal environment provides minority shareholders with the opportunity to take steps against a controlling shareholder and/or the company's directors and officers, for example, by filing class actions or derivative actions.

Anat Guetta, chairperson of the Israeli Securities Authority, recently expressed her views at a conference held on 27 November 2018, stating that there is an increased trend of involvement on the part of Israeli institutional investors in becoming more active in the companies in which they invest, especially those without control interest. Guetta stated that this is an important and welcome trend. She said: 'I feel that the fact that institutional investors are finally assuming responsibility and becoming significantly more involved with their substantial holdings is a good sign for the market, which is what should be aimed for and how the capital market should appear in this process of structural change.'

Increased shareholder activism may be observed in dual companies and technological or life science companies, especially those lacking a control interest and having high cash balances or with a performance lower than comparable companies.

In view of the fact that this is a relatively new phenomenon, shareholders still have a somewhat suspicious attitude towards aggressive activist activities on the part of hedge funds, which sometimes may be regarded as opportunistic and thought to only make short-term considerations that may prejudice the benefit of the company. This is despite the

fact that there are cases where cooperation between hedge funds and institutional investors has been noted. Institutional activist activity is most often perceived as a legitimate strategy to influence a company's behaviour especially with respect to corporate governance issues.

Shareholders activism may be identified in a large number of industries and sectors and in companies of various sizes, including some of Israel's major public corporations.

A lower level of shareholder activism is seen in the banking sector. There are several reasons for this lower involvement, such as:

• It is difficult to hold means of control over banks in Israel since one should receive the Bank of Israel approval to hold such means of control and also there is a maximum holding limit with an upper limit to holdings.

• The banks are subject to stringent regulation and many regulators, such as the Israeli Securities Authority, the Supervisor of Banks, the Governor of the Bank of Israel and the Supervisor of the Capital Market, Insurance and Savings.

• Each bank also employs a compliance officer, who is a senior executive, responsible for the bank's compliance with the provisions of the law and regulatory requirements.

• Banks in Israel are also subject to additional regulatory restrictions on their ability to modify their articles of association, thus making it more difficult for activist movements in this sector than in other public companies.

In view of this, the corporate governance in banks is highly developed and the financial results of the large banks also seem quite satisfactory, thus there is little incentive for significant shareholder activism.

In addition, the Remuneration Law for Officers of Financial Corporations (special approval and the disallowance of expenses for tax purposes owing to exceptional remuneration), which was enacted in 2016, has significantly limited senior bank officials' salaries by determining that the highest compensation that may be paid to an executive of a financial corporation shall not exceed 35 times the lowest salary paid to any of the coorporation's employees, and that the portion of an executive's salary in excess of 2.5 million Israeli new shekel per annum will not count as an employer's recognised expense.

The above does not imply that banks in Israel are immune from activist campaigns, just that the process has yet to mature.

What are the typical characteristics of shareholder activists in your jurisdiction?

Activist shareholders may be divided into a number of groups:

- Certain hedge funds of varying sizes operate in Israel, and their number remaining almost constant in recent years.

• In recent years, we have seen involvement of giant American hedge funds that have been involved in activist moves with public corporations whose shares are traded on the Tel Aviv Stock Exchange or abroad (eg, Elliott with Bezeq and Starboard with Mellanox).

• There is an increasing trend of significant involvement on the part of institutional investors in public companies, which in some cases have been cooperating with hedge funds.

• A non-negligible part of activist activity is carried out by private investors who in the past were passive investors in the company and after being disappointed by the company's performance, or for other reasons, changed their approach. As opposed to hedge funds, which are considered highly sophisticated 'classic' activist entities that come to the company with prepared plans and potential directors, these private investors do not have the same resources and abilities and there are those who perceive them to be 'pseudo-activists' and occasionally, even 'extortionists'.

What are the main operational governance and sociopolitical areas that shareholder activism focuses on? Do any factors tend to attract shareholder activist attention?

The most common topic addressed in the field of institutional activism in Israel is the composition of the board of directors.

Institutional investors intervene in changes in the composition and size of the board of directors, usually by proposing to appoint external directors. Recently, we have even seen intervention in the identity of the person to be appointed as chairman of the board, as well as an attempt to dismiss external directors within their statutory period of tenure (three years).

Entropy, an advisory body for institutional investors, has a voting policy supporting institutional investors' intervention in matters of corporate governance, including putting up their own candidates to be appointed as external directors and supporting their candidacy.

Other areas with significant intervention on the part of institutional investors are the compensation policy for executives, approval of the executives' compensation packages and controlling shareholders transactions.

In 2018, Entropy emphasised the model of 'compensation fairness' with respect to executive compensation agreements. This model is based on industry- and company-size parameters including share performance over time. Entropy encourages the formulation of performance-based compensation agreements in order to provide an effective incentive for business result improvements and value to the shareholders. Entropy is usually reluctant with compensation agreements that could lead management to take extreme risks that improve short-term results but may be detrimental to shareholders in the long run.

In addition, in complex M&A transactions (such as Frutarom and IFF, the merger of Equital and Joel-Jerusalem Oil Exploration and the merger of Castro and Hoodies), Entropy requested that the companies appoint an independent expert on behalf of Entropy to analyse the transaction in order to establish a voting recommendation.

At the same time, there remain a number of areas of institutional operation in the capital market still characterised by low to non-existent shareholder activism. In this context, Israeli institutional investors rarely file class and derivative actions concerning events taking place in companies in which they hold shares. The chairperson of the Israeli Securities Authority has said in this respect: 'I would have expected a greater presence of institutional investors with a wider outlook and in a more significant fashion.'

The most common areas of hedge fund activism are with regard to strategy changes in corporation (focusing on core activities and divestiture of underperforming assets), M&A (for example, pressuring for the sale of the company) and also occasionally dividend payments.

Hedge funds are aware that institutional investors are focused on ensuring that boards become diverse, have the relevant skills and experience to the specific business of the company and proper balance of independent directors. Hedge funds know to focus in their activist moves on issues related to corporate governance and in particular to the board of directors, thereby attracting institutional investors in their campaigns.

The most common areas of hedge fund activism are with regard to strategy changes in corporations (focusing on core activities), M&A and also occasionally dividend payments.

The effectiveness of shareholder activist moves has become more mature and efficient given that:

• shareholders are more sophisticated nowadays, with a much higher level of professionalism and natural maturity in shareholders' activism;

• institutional investors have set up specialist departments dealing with institutional involvement;

• a large portion of corporate shares are held by institutional investors, which have substantially increased their holdings in recent years;

• advisory bodies to institutional investors are placing a strong emphasis on corporate governance aspects;

• legislative amendments in recent years, such as amendments 16 and 20 of the Israeli Companies Law, have placed material powers in the hands of shareholders; and

• the distributed market structure has started to establish itself while enabling the shareholders to pressure companies into making various changes.

SHAREHOLDER ACTIVIST STRATEGIES

Strategies

What common strategies do activist shareholders use to pursue their objectives?

The activist's toolbox is diversified and has many ways to increase pressure on the company to comply with the activist demand.

For example, an activist may act to publish a position statement on general meeting agenda items, or to request the company to call a special meeting, usually in order to change the composition of the board of directors or to ask the company to add an additional item on the agenda of a general meeting.

Under the Companies Law, shareholders are entitled to review various company documents, including general meeting minutes. Such documents assist activists in their campaigns. For further information regarding shareholders rights to receive information, see question 26.

Some activists use the media, which has shown interest in shareholders' activism - for example, headlines regarding the replacement of office holders in a public company or a letter to the board containing severe statements on the operation of the company's management. These publications create interesting media publications of struggle and drama, which are like music to the ears of the press. Such publication obviously influences the company and its directors and officers.

Some activists may also approach the Israeli Securities Authority with a detailed complaint against the company or its office holders to increase pressure on the company.

Additionally, some activists engage directly with the board or the management following a thorough analysis of the company and the market in which it operates. In such cases, the activists present either a comprehensive document or presentation, which includes inter alia vulnerabilities of the company's strategy and the advantages of the strategy proposed by the activist. Such a document may sometimes be sent in advance to the company's major shareholders and might persuade them to support the activist's position.

The specific choice of strategy is dependent on the identity of the activist, his or her objectives, the identity of the leaders of the company, its corporate governance quality and the company's maturity to handle shareholder activism.

Processes and guidelines

What are the general processes and guidelines for shareholders' proposals?

One or more shareholders holding at least 5 per cent of the issued capital and at least 1 per cent of the voting rights in the company, or one or more shareholders holding at least 5 per cent of the voting rights in the company, is/are authorised to require the board to assemble a special meeting whose agenda will be determined by him or her/them.

The board is obliged to schedule the meeting within 21 days of the demand being submitted to it. Insofar as the board fails to call the meeting, the shareholders are authorised to call the meeting by themselves and the company is required to reimburse them the reasonable expenses incurred in connection with this.

One or more shareholders holding at least 1 per cent of the voting rights at the general meeting is/are authorised to request the board to include an item in the agenda of a general meeting to be held in the future, provided that the board determines that the item is appropriate for discussion at the general meeting. Such a shareholder's request as stated should be conveyed to the company between three to seven days after the summon for the meeting has been sent, depending on the type of meeting. A shareholder's request to include in a general meeting agenda nomination of a candidate as a director should include various particulars of the candidate as well as a declaration of the candidate's competence to serve as director, in accordance with the provisions of the Companies Law.

Any shareholder is authorised to submit a position statement to the company up to 10 days before the meeting is held, expressing his or her opinion in connection with the meeting agenda items. The position statement must be drafted in a clear and simple language and contain up to 500 words on each agenda item. A shareholder submitting a position statement, acting in concert with others for the purpose of voting at the general meeting on all or one of the items on the agenda, shall indicate this in the position statement, specifying the cooperation understandings and the identity of the shareholders party to the collaboration. In the event that the shareholder or some other person collaborating with him or her has a personal interest in the outcome of the vote at the general meeting, the nature of this personal interest shall be indicated.

The company must publish this position statement on the Tel Aviv Stock Exchange and the Israeli Securities Authority distribution websites.

The party submitting the position statement will bear sole legal responsibility for its content.

May shareholders nominate directors for election to the board and use the company's proxy or shareholder circular infrastructure, at the company's expense, to do so?

Shareholders are authorised to recommend directors for election to the board of a company in the general meeting by submitting a request for scheduling a meeting or adding an item to the agenda, as specified in question 7.

May shareholders call a special shareholders' meeting? What are the requirements? May shareholders act by written consent in lieu of a meeting?

Shareholders may call a special meeting following the process set out in question 7. There is no legal procedure in public companies, as opposed to private company, in reaching all resolutions in a written manner in lieu of holding a general meeting.

Litigation

What are the main types of litigation shareholders in your jurisdiction may initiate against corporations and directors? May shareholders bring derivative actions on behalf of the corporation or class actions on behalf of all shareholders? Are there methods of obtaining access to company information?

There are three main types of common shareholders' litigation:

- A derivative action, which is filed on behalf of the company;
- A class action, which is filed on behalf of a certain class, such as a class of shareholders; and
- An appraisal claim, which is filed following a full tender offer that includes a compulsory acquisition.

A derivative action can be filed by a shareholder or a director or a debtor pursuant to the conditions detailed in the Companies Law, including initial application having been made to the company (except, among other situations, under particular circumstances where the board is affected by a personal interest) requesting the company to file such claim. Insofar as the company rejects to file such claim, then plaintiff is allowed to submit a derivative action application on behalf of the company. The court will tend to certify the derivative action application if it determines mainly that there is prima facie evidence that there are merits to such claim and that the claim is to the benefit of the company and that the plaintiff is not acting in bad faith.

A derivative action may be filed in respect of any matter or issue, including a claim for compensation or disgorgement against directors and officers, third parties, other shareholders who has harmed the company, including the controlling shareholders and so on.

The Companies Law allows the Israeli Securities Authority to fund a derivative action, if requested by the plaintiff. If the Israeli Securities Authority is satisfied that the derivative action has a public interest and that there is a reasonable chance that the court will certify it as a derivative action, it may bear the costs of the plaintiff.

Whoever is authorised to file a derivative action is entitled to request the court, prior to or following submission of the application for approval of the claim, to instruct the company to disclose documents relating to certain issues of the company where there is a suspicion of wrongdoing by others that resulted in a loss to the company. This legal procedure is for the purpose of examining the merits of a potential derivative action. The court is authorised to approve this motion for disclosure if it is convinced that the applicant has provided an initial prima facie evidence for this preliminary stage and that the applicant is acting bona fide with respect to the motion.

Another litigious course of action is a class action. An application for approval to file a class action may be submitted in accordance with the Class Action Law, 2006. The Class Action Law specifies in its endorsement on what cause of action and against whom a class action can be filed.

According to the endorsement, a class action can be filed by a party having 'an interest in certain security', that is, allegations relating to securities must be involved. There are four preconditions, which the court must examine in order to certify a claim as a class action:

• the claim gives rise to substantial questions of fact or law common to the entire class and they are reasonably likely to be settled in favour of the class;

• the class action is the most efficient and equitable way of resolving the dispute other than by means of a regular claim;

- the court is persuaded that all members of the class are adequately represented; and
- the court is persuaded that the affairs of the members of the class will be managed in good faith.

Courts will tend to certify a class action where a wrongdoing has been demonstrated prima facie.

The Securities Law allows the Israeli Securities Authority to fund a class action, if requested by the plaintiff. If the Israeli Securities Authority is satisfied that the class action has a public interest and that there is a reasonable chance that the court will certify it as a class action, it may bear the costs of the plaintiff.

A person wishing to acquire shares of a public Israeli company and who would as a result of such acquisition hold over 90 per cent of the target company's voting rights or the target company's issued and outstanding share capital (or of a

class thereof) is required by the Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the issued and outstanding shares of the company (or the applicable class). If:

• the shareholders who do not accept the offer hold less than 5 per cent of the issued and outstanding share capital of the company (or the applicable class) and a majority of the offerees that do not have a personal interest in the acceptance of the tender offer accepted the tender offer; or

• the shareholders who did not accept the tender offer hold less than 2 per cent of the issued and outstanding share capital of the company (or of the applicable class), all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law.

A shareholder who had his or her shares so transferred may petition the court within six months from the date of acceptance of the full tender offer, regardless of whether such shareholder agreed to the offer, to determine whether the tender offer was for less than fair value and whether the fair value should be paid as determined by the court. A petition of this sort may also be filed as a class action. However, an offeror may provide in the offer that a shareholder who accepted the offer will not be entitled to appraisal rights as described in the preceding sentence, as long as the offeror and the company disclosed the information required by law in connection with the tender offer. If the full tender offer was not accepted in accordance with any of the above alternatives, the acquirer may not acquire shares of the company that will increase its holdings to more than 90 per cent of the company's issued and outstanding share capital (or of the applicable class) from shareholders who accepted the tender offer.

The Supreme Court ruled in the case of Atzmon v Bank Hapoalim Ltd that the value of the target company in an appraisal claim followed by a full tender offer will be determined in accordance with the discounted cash-flow method.

SHAREHOLDERS' DUTIES

Fiduciary duties

Do shareholder activists owe fiduciary duties to the company?

There is no legal provision or case law in Israel that discuss this question. We believe that activist shareholders have no fiduciary duties or duty of care towards the company, as opposed to directors.

Having said that, under Israeli law, a shareholder who votes at a general meeting on amendments to the articles of association, increase of the share capital, merger and the approval of controlling shareholders transactions, must act in good faith towards the company and the other shareholders, and refrain from taking unfair advantage of his or her power in the company.

Furthermore, a shareholder who is aware that his or her voting decision will have a decisive effect on the resolution of a certain decision, will have a duty to act in an equitable fashion towards the company. Such obligation of equitability was discussed in an Israeli precedential case law in the Bezeq ruling (Vardenikov v Elovitz) handed down by the Supreme Court, establishing that this duty is placed between fiduciary duty and the duty to act in good faith.

Compensation

May directors accept compensation from shareholders who appoint them?

In principle, directors may accept compensation from shareholder who recommends their appointment. There are cases where directors are employed by shareholders in other capacities in the other shareholders' organisations and receive compensation for their employment. In 2015, the Israeli Securities Authority expressed its opinion in the case of Oded Sarig, determining that payment of compensation to a director by a controlling shareholder is not considered a

transaction of the public company and therefore not subject to the approvals mechanism determined by the Companies Law.

The court case of De Lange v Israel Corporation gave rise to doubts over its legality but has left this matter for further consideration.

Amendment 20 of the Companies Law, passed a number of years ago, enacted the duty to determine that a compensation policy for directors and officers must be approved by a compensation committee, the board and a general meeting by special majority.

Thus, direct compensation of a director by a shareholder, who recommended him or her as a candidate, may create conflict of interests and breach the balance the legislator sought to achieve in Amendment 20 of the Companies Law. In any case, it seems that there is a duty to disclose such payments by the director.

Mandatory bids

Are shareholders acting in concert subject to any mandatory bid requirements in your jurisdiction? When are shareholders deemed to be acting in concert?

In public companies, in order to purchase a control stake, one should do so by a special tender offer. A special tender offer should be carried out when:

• the purchase would result in a single person holding a controlling stake (shares providing 25 per cent or more of the voting rights in the general meeting), if there is no controlling stake in the company beforehand; and

• the purchase would result in the purchaser's share of the holdings rights above 45 per cent of the voting rights in the company, if there is no other person holding over 45 per cent of the voting rights in the company.

Such purchases, as stated above, by means of a special tender offer, shall not apply to:

• purchase of shares by a private placement, provided that the purchase has been approved by the general meeting as a private placementintended to bestow on the offeree a controlling stake if there is no controlling stake in the company beforehand, or as a private placement intended to bestow 45 per cent of the voting rights in the company if the company has no person holding over 45 per cent of the voting rights in the company;

• purchase from a controlling stake holder that would result in a person becoming a controlling stake holder; and

• purchase from a holder of more than 45 per cent of the voting rights in the company that would result in the level of the purchaser's holdings rising above 45 per cent of the voting rights in the company.

As a general rule, shareholders will be deemed to be acting in concert when a written or oral cooperation agreement exists between them on the application of the means of control incorporated in the shares, such as voting rights at general meetings or the right to appoint directors.

In addition, the definition of a 'holding' under the Securities Law provides that when referring to a holding by a company, a subsidiary's holding shall be considered as the holdings of the company; and when referring to a holding by an individual, the individual and members of his or her family, or his or her dependants, are regarded as a single person.

Disclosure rules

Must shareholders disclose significant shareholdings? If so, when? Must such disclosure include the shareholder's intentions?

Shareholders are required to disclose their names and holdings in the event of their becoming material holders in the company and thereafter following any changes of their holdings.

A material holder is deemed to be one of the following: a holder of 5 per cent or more of the company's issued share capital or of its voting power, or one who is entitled to appoint one or more of the company's directors or the CEO, or one who serves as a director or CEO of the company, or a corporation that is held by a person holding 25 per cent or more of the issued share capital or of its voting power, or that is authorised to appoint 25 per cent or more of the directors.

Shareholders of banks have additional disclosure requirements.

Do the disclosure requirements apply to derivative instruments, acting in concert or short positions?

In general, there is no duty of disclosure on holdings in derivatives or positions that may make a person a substantial holder in the company, unless he or she is already considered a material holder.

A concert holding of shares constituting 5 per cent or more of the company's issued share capital or of its voting power must be disclosed.

Insider trading

Do insider trading rules apply to activist activity?

The legal provisions concerning the use of insider information apply to shareholder activism.

COMPANY RESPONSE STRATEGIES

Preparation

What are the fiduciary duties of directors in the context of an activist proposal? Is there a different standard for considering an activist proposal compared to other board decisions?

The directors are bound by their duty of care and fiduciary duty towards the company and there is no difference in the context of an activist's proposal. Any steps taken by directors in the course of and in relation to shareholder activism, shall not derogate from their duty to act for the benefit of the company.

The director's response to shareholder activism will usually be scrutinised by the business judgement rule (BJR). Judge Ruth Ronen, in the Altman v Gazit case, made the BJR applicable to a standstill agreement with an activist, ruling that: 'The desire for a truce among the company shareholders may in some cases be consistent with the benefit of the company and that of its shareholders.'

What do we mean when speaking of 'the company's benefit' that directors and office holders must uphold? Section 11

of the Companies Law provides that

A long line of scholars has attempted to get to the bottom of this broad definition, and there are several different views and constructions of how it should be interpreted. The accepted conception in the Israeli legal arena has for many years been that the essence of the company is first and foremost to act in the pursuit of profits, especially for the shareholders. This traditional conception fails to deal with the difficulty in those cases where the interests of the company and its shareholders do not coincide. Israeli case law expressed each one of these interpretations - the one enabling the benefit of the company to be jeopardised for the sake of the shareholders, and the other indentifying the right of the company as a distinct right from the shareholders.

What advice do you give companies to prepare for shareholder activism? Is shareholder activism and engagement a matter of heightened concern in the boardroom?

A company may take a variety of measures to prevent or mitigate potential confrontations with activists.

One of the methods is open communications. A key issue is to maintain an ongoing communication with the company's key investors. Open communication can create a strong trusting relationship with the company management, and can result in support of such investors in case an activist raises allegations against the leaders of the company. Although this may be difficult to maintain and may be inconvenient at times, in the long run, it can be beneficial and minimise crises.

It may be beneficial to be aware of the investors' positions and concerns, including the company's key shareholders (usually the institutional investors) for example, on issues such as the dividend distribution policy, capital investments and executive compensation, and not be first familiarised with them in times of crisis with an activist.

Another method is self diagnosis - identification of vulnerabilities of the company in advance regarding corporate governance and operative aspects. Following its identification, the company should act to mitigate the vulnerabilities. Many companies have updated their corporate governance practices to be in line with market standards. Thus, awareness may keep potential activists away from the company.

Additional method is 'activist thinking'. Here too, similar to self diagnosis, it is important that directors would try to adopt 'activist thinking' and as such would identify and handle existing weaknesses, such as constant evaluation of the company's business strategy and its alternatives. These actions are likely to keep activists away and turn to other companies.

Defences

What defences are available to companies to avoid being the target of shareholder activism or respond to shareholder activism?

The Israeli Securities Authority objects to extreme controlling entrenchment mechanisms in Israeli public companies, such as staggered board of directors for many years and poison pills of various types, in view of the Israeli Securities Authority's position regarding the importance of maintaining a market of efficient corporate control. The Israeli Securities Authority is not opposed to mechanisms for staggered boards as long as the period set between director replacements does not exceed three years.

It is doubtful that instruments provided in the articles of association - in particular, defence mechanisms against hostile takeover (such as staggered boards, special majority for amending the terms of the articles of association, etc) are appropriate when dealing with activism - since the aim of the activist is usually not to take over the control of the

company. Institutional investors as well as their advisory firms also object in principle to controlling entrenchment mechanisms in the articles of association.

There remain less drastic mechanisms to be considered - for instance, amending the articles to hold that a director may only be elected at the annual general meeting and not at a special meeting. This mechanism presents stability to the company and prevents frequent changes in the composition of the board at every whim of the shareholders.

The board of directors is also able to publish a position statement or a response to a position statement of an activist.

In addition, a company can turn to the court to classify the vote of an activist as having a negative personal interest (ie, the shareholder has a personal interest in the failure of the transaction).

Also, some of the companies turn to institutional investors before they convene a meeting to appoint an external director for the purpose of examining whether the candidate proposed by the company will receive the institutional investor support, or that they wish to suggest another candidate.

There are also certain anti-takeover defences determined in the Companies Law - see questions 10 and 13.

Reports on proxy votes

Do companies receive daily or periodic reports of proxy votes during the voting period?

During the period preceding the general meeting, companies receive proxy votes from shareholders not physically attending the meeting. Shareholders may also vote electronically and the company is accessible to these votes six hours prior to convening the meeting. In addition, advisory bodies to institutional investors, such as Entropy, provide their position on items on the agenda at a reasonable period in advance, which indicates the manner in which institutional investors receiving the services of the advisory body intend to vote.

Private settlements

Is it common for companies in your jurisdiction to enter into a private settlement with activists? If so, what types of arrangements are typically agreed?

Settlement agreements with activists are becoming more and more common, usually including: a stand still provision for a specified period of time; support of the company's nominees for board membership and support of one or more of the activist's nominees for membership of the company board of directors as long as the activist holds certain minimal ownership position in the company. Settlement agreements between the public company and an activist may be required to be disclosed in accordance with the reporting requirements under the Securities Law and regulations.

A question arises as to the enforcability of settlement agreements in view of the fact that, in such agreements, the company grants significant rights to specific minority shareholders and not to other shareholders. This preference may be found in court to be unlawful or not enforceable.

SHAREHOLDER COMMUNICATION AND ENGAGEMENT

Rules on communication

Is it common to have organised shareholder engagement efforts as a matter of course? What do outreach efforts typically entail?

Some companies hold regular meetings with investors every few months, either one-on-one meetings or non-deal road shows or conferences or conference calls. Continuous dialogue with investors has become more common in recent years with major investors. For example, there are companies that prior to scheduling a general meeting whose agenda includes the appointment of directors, hold discussions with some of the institutional investors on the identity of the board nominees and their competence to act in the company's interests.

The meetings with the investors vary and include discussions on the company's strategy, and steps for gaining profits as well as corporate governance issues with emphasis on the composition of the board and executive compensation.

Are directors commonly involved in shareholder engagement efforts?

Communications with investors are usually conducted by the senior management (eg, CEOs, CFOs) and occasionally the chairman of the board. Usually, independent directors are not involved in the communications with shareholders, unless this has some particular advantage under any specific circumstance.

Must companies disclose shareholder engagement efforts or how shareholders may communicate directly with the board? Must companies avoid selective or unequal disclosure? When companies disclose shareholder engagement efforts, what form does the disclosure take?

Companies usually have no disclosure duties regarding their communications with investors and they do not normally report this. Regarding disclosure of a position statement sent by a shareholder to the company - see question 7. Also, it is prohibited to discriminate in the provision of information between different investors, and the practice is to publish investors' presentation on the Stock Exchange and the Israeli Securities Authority reporting website prior to its presentation at an investor's conference.

What are the primary rules relating to communications to obtain support from other shareholders? How do companies solicit votes from shareholders? Are there systems enabling the company to identify or facilitating direct communication with its shareholders?

There is a prohibition on carrying out transactions with a company's securities based on information not publicly available, which is deemed to be insider information. Companies tend to initiate telephonic conversations or meetings with institutional entity advisory bodies in order to persuade them to provide a professional opinion in support of the items on the agenda of the general meeting. The board is entitled to publish a position statement to investors setting out its position on the agenda items and thus to seek support from the investors. It is not customary for the company to use social media in order to obtain support at the shareholders' meeting.

Must companies, generally or at a shareholder's request, provide a list of registered shareholders or a list of beneficial ownership, or submit to their shareholders information prepared by a requesting shareholder? How may this request be resisted?

Under the Companies Law, a public company must keep a shareholders register and also a register of substantial shareholders. The shareholders register and the register of substantial shareholders shall be open for inspection by any person. It is not clear under the Companies Law whether a company must provide a list of the beneficial owners of its shares.

In addition, one or more shareholders holding 5 per cent or more of the total voting rights in the company, as well as the holder of the said quantity out of the voting rights not part of the holding of the controlling interest in the company, is entitled himself or herself or by an agent on his or her behalf, following the convening of the general meeting, to review at the company's registered office, during normal working hours, the voting cards, the votes via the electronic voting records and the results of the votes.

In addition, shareholders are entitled to review various company documents, including general meeting minutes.

Shareholders also have the right to demand, while indicating the purpose of the demand, to review of any document in the company's possession relating to an operation or transaction requiring the general meeting's approval pursuant to the provision of the Companies Law. The company is entitled to refuse the shareholder's request to review a document in its possession if in its opinion the request was made in bad faith, or if the required documents contain some confidential information, such as trade secret or patent, or if disclosure of the document is not for the benefit of the company.

UPDATE AND TRENDS

Recent developments

What are the current hot topics in shareholder activism and engagement?

Until recently, institutional investors were concerned about cooperating between themselves regarding activist movements because such cooperation might constitute a restrictive arrangement.

In February 2019, the Competition Authority (formerly the Restrictive Trade Practices Authority) published a draft position statement regarding cooperation by institutional investors. According to the Competition Authority' position, cooperation between institutional investors should not be regarded as a restrictive arrangement if the following conditions are satisfied:

- The cooperation is focused on a particular corporation and on a specific matter under discussion.
- There is no competitive relationship between the activities of the corporation in question and those of the institutional investor.
- Involvement in the cooperation is barred from those whose participation is not essential for appraising the matters over which there is to be cooperation, or in order to attain agreement between the institutional investors; the parties shall only exchange information connected with the cooperation under consideration.

Only relevant information should be forwarded in a manner that minimises any concern of restricting competition between institutional bodies. Following approval of this opinion, it appears that cooperation between institutional investors is about to strengthen significantly, providing them with substantial extra power in activist moves in Israeli public corporations, especially in corporation without a controlling shareholder.

Recently, an interesting activist struggle has been going on in Paz Oil Company. A company with a distributed holdings structure following the sale two years ago by Zadik Bino, formerly the holder of the controlling interest in the company for many years. Paz's financial results were quite good; however, a number of shareholders believed they were insufficient and the company had a problematic balance sheet structure and unsatisfactory corporate governance, which led to a well-publicised activist move by Noked Capital, an Israeli hedge fund managed by Roy Vermus, together

with a number of institutional investors. Some of the institutional investors succeeded in appointing Avraham Bigger as a director in Paz on their behalf, to ensure that he will be a dominant chairman who will be able to monitor the dominant CEO of Paz, Yona Fogel. Paz's board met on 20 March 2019 and chose Bigger to become the chairman of Paz following the support of most of the institutional investors who de facto control Paz (without being considered controlling shareholders). Yair Lapidot, co-CEO at Yelin Lapidot - Mutual Funds Management, criticised the chairman election process:

During the past year, a fascinating struggle has been going on at Mellanox, a semi-conductor firm. In October 2017, the American activist fund Starboard purchased about 11 per cent of Mellanox share capital. The fund conducted a well-publicised campaign against the management and board of Mellanox, asserting that the company was underpriced because of its low operating profitability, and demanding members of the board be replaced. Following a few months of mutual moves by the company and the activist fund, the parties reached a settlement regarding appointment and replacement of some of the members of the Mellanox board and setting profitability targets. This activist campaign led to a more profitable and efficient operation, increasing significantly the share price of Mellanox. In March 2019, Mellanox was acquired by Nvidia for US$ 6.9 billion in cash. Starboard bought Mellanox shares for approximately US $250 million in late 2017 and sold them for approximately US$525 million.

Another American fund operating in the Israeli capital market in the past year is Elliott, belonging to Paul Singer. The fund held about 5 per cent of the share capital of Israel leading telecommunications service provider Bezeq and demanded changes to the Bezeq board, including the immediate resignation of all directors that had been under investigations of the Israeli Securities Authority or had connections with Eurocom - the controlling shareholder of Bezeq in the days of Shaul Elovitch. Resulting from the funds moves, and moves of institutional investors and their advisory bodies, none of these directors now serve on the board of Bezeq. The fund also tried to influence Bezeq to execute a repurchase of Bezeq shares; however, this attempt failed.