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Hard Drives

Growth in the Israeli tech sector has helped shape the legal sector here, with leading firms leveraging off the work this industry has to offer. How is the global situation affecting law firm business in Israel, and does the technology industry have the power to underpin momentum here?

Anastasia Hancock reports

THE trajectory of the technology sector has led to demand for high quality legal services in Israel. The leading firms here have advised on everything from start-ups, to representing angel investors, venture capital funds and private equity funds, as well as advising on offerings on NASDAQ and the Tel Aviv Stock Exchange.

The sector still provides a significant thrust to the Israeli legal market, and its growth served to open it up to financial and strategic international investors. 'The sector is certainly still among the most significant driving forces of the Israeli legal environment' says Meitar partner Michael Rimon. 'The practice of law in Israel in the tech sector has transformed over the last 20 years and is now more similar to US law in terms of forms, terminology and approach. The movement of lawyers from the US to Israel has contributed to this trend'.

The importance of the technology sector to the legal market and economy that developed alongside it is significant.

It is now considered one of its main growth engines and has helped win Israel its reputation as a successful 'start-up nation'. 'As a small country surrounded with non-friendly neighbours, the Israeli economy had tough starting conditions. On this background, the importance of the high-tech sector to the Israeli economy should be understood' points out legal marketing and consulting services firm Robus' founder, Zohar Fisher. 'Its contribution to the local economy has been creating a significant volume of legal work, which has been an important player in the growth and the development of the local legal market in the last decades'.

Given the hike in activity by technology companies during recent years, it is no surprise that leading Israeli firms have become increasingly involved in all relating issues, from investment transactions, both equity and debt, intellectual property, establishment of funds, tax, litigation, right to employment law. But, as Chaim Friedland, head of the international

capital markets practice at Gornitzky points out, the statutory landscape in Israel has also adapted itself to the growth of these new industries as well. 'The well-known amendment to the Israel Securities Law, which allowed dual-listed companies – companies listed on both the New York Stock Exchange or NASDAQ and on the Tel Aviv Stock Exchange – to enjoy exemptions from customary reporting requirements existing under Israeli securities laws and rely solely upon their reporting requirements in the US. Another well known statutory arrangement is the establishment of the Office of the Chief Scientist which serves as the government's own VC investor, providing companies with much needed funding to support their R&D activities in exchange for future royalties'. The domestic market here has shaped itself alongside the growth in the technology sector to be as attractive as possible to investors.

However, as the Eurozone debt crisis continues along with global economic uncertainty, how far has activity here been affected? Israel has remained one

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of the few economies worldwide that has protected itself largely against the ongoing downturn, but growing tensions on a global and Middle-Eastern level stand to put pressure on the ongoing development of both the technology industry and its legal market. While Israel's economy did expand last year, it was at a rate slower than initially expected.

'Israeli high tech looks out to world markets, primarily the US and Europe, but also the Far East. In fact, even though Israel has had ups and downs over the last 20 years in its security situation, its hi-tech sector has continued in a positive trajectory which has followed world capital markets and not Israel's geopolitical situation' explains Yigal Arnon's Barry Levenfeld. The pace of the technology industry in Israel has not slowed down in the face of the downturn, the result of which law firms have enjoyed a solid pipeline of activity as growth continues. And with leading global technology companies such as IBM, Oracle, Apple, Google, and EMC seeking out Israeli companies, it looks set to continue.

Israel's unique history and its legal framework have left it in an optimistic position. 'It has a culture of innovation and entrepreneurship which is undimmed even during the downturn' explains Keith Lassman, partner at HowardKennedyFsi. 'Remember that Israel was less exposed to the toxic debt than many other developed countries due to regulatory restrictions'.

The UN Conference on Trade and



David Schapiro,
partner at Yigal Arnon

Development's world investment report at the end of last year noted that global foreign direct investment saw an increase of 16% from \$1.3 trillion in 2010 to \$1.5 trillion in 2011. So despite ongoing economic turmoil globally, it was higher in

2011 than the annual average before the crisis hit in earnest.

'Global economic concerns certainly still exist, but the State of Israel has somehow miraculously continued to witness impressive growth despite the global crisis. There are those who would argue that this global economic crisis – particularly in Europe – has played a role in Israel's growth – this is due to the belief that the investment community, such as private equity funds, and strategic and financial investors, who suffered from a lack of targets investments in Europe began to look at Israel as an attractive destination for investments' notes Friedland. 'We definitely see more players in Israel, who previously were not here, and not only in the modern technology industry, but also in traditional technology industry such as food and manufacturing'.

According to research by PricewaterhouseCoopers, last year Israeli tech start ups were bought out for a high of \$5.5 bn. Although the past year did

see fewer deals, those that did complete were of a larger scale than in the past with 50 deals at an average deal size of \$111 m. The good news has continued into 2013 with the \$475m acquisition by network equipment company Cisco of Intucell.

'The global situation has had minimum effect on law firms in Israel, in part because Israel was less affected by the global slowdown' explains Yigal Arnon partner David Schapiro. 'Israel is probably the only OECD [Organisation for Economic Co-operation and Development] country in which no bank or insurance company has failed or defaulted and our economy has continued to grow. Add to that the constant growth engine of high tech, and you will find that Israeli law firms have continued to be very active'.

The relatively quick development of the legal market alongside the technology sector here and the recent loosening of regulations allowing foreign firms to practice home jurisdiction law on the ground rather than simply opening representative offices for business development here means that foreign firms are for the first time entering Israel. 'This is a sure sign that the legal business in Israel is healthy' adds Schapiro.

Traditional technology advice has certainly had enough impetus to underpin the development of the legal market in the past, and while the global downturn has not necessarily put a dent in this, the nature of the work being handled has changed in nature

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somewhat. Ashok Chandrasekhar, partner at Goldfarb Seligman says that the growth of the technology sector has led to a 'demand for high quality legal services, delivered very efficiently, to enable Israeli tech companies to run their legal affairs in a fashion which reflects international expectations'.

And the sophistication of the current market is obvious here, with enviable international investors flooding in. 'Both local and international funds, as well as a strong local cadre of angel investors, support these efforts. Meanwhile, the more mature tech companies are either ripe for interesting private or public exits, or are even making acquisitions of their own' Chandrasekhar adds. As such, the profile of investors has been gradually shifting here, reflecting the development of the market, and law firm client bases feature investors, companies, acquirers, and underwriters. Notably, the volume of exits has created an increase in investor capital, which has been reinvested back into the market.

Firms report a shift the way investment is distributed in the tech sector. Herzog Fox & Neeman's head of Hi-Tech Alon Sahar, says this has happened in as little as five years. Sahar, who acted for Facebook in its acquisition of Snaptu, and recently represented Intucell in its acquisition by Cisco Technology companies, says there has been a change in the mix and profile of the companies represented here. 'There has been a significant shift with regard to where the money is going and the type of companies active in Israel. The leading

innovators are thinking about building larger companies rather than selling them off early in the game'. However, Sahar says that this is less due to difficult global circumstances, and more to do with the nature of the market. 'One reason is that the Israeli market is relatively young. 20 years ago there was no VC environment in Israel –that only really began in the 90s. To build a company takes a skill set – this is more to do with the skills being acquired by the market'.

While the biggest transactions previously would have been M&A deals, the market is increasingly gearing itself towards NASDAQ IPOs. 'In the UK, AIM is showing early signs of interest in the Israeli market again', points out Lassman. While VC and private equity funds, fund formation and portfolio investments still form a good pipeline of work for firms, along with, of course, the well-established start-up advice and all the issues that stem from growth, NASDAQ and TASE offerings are increasingly forming a key component of the kind of work leading Israeli firms are handling.

Rimon explains that his firm has also witnessed this move towards capital markets, which compares favourably to global trends. 'Since 2007, we have advised primarily VCs, PEs and start ups. Recently, it seems that the US capital markets are opening up to Israeli companies, and we are already involved in a few IPOs of Israeli companies in the US.'

Israel's technology sector has almost



Adv. Zohar Fisher,
CEO, Robus – Legal
Marketing and
Consulting Services

always been highly international in nature, and cross border advice has historically featured largely in work handled by the leading players here. While this has a lot to do with Israel's relatively small size, the technology sector and its

innovations are also geared towards a global marketplace. 'Virtually all tech work is cross-border work' points out Levenfeld, and this is right from the grass roots of a deal. 'An Israeli VC invests in an Israeli company with sophisticated English language documents since we all hope the next round will include a global player. Cross-border has always been, and continues to be, a substantial part of our practice.'

While in the past there is little doubt that the work handled by firms advising on the technology sector has always been very international in focus, the level of domestic activity here has seen an increase too. As Friedland explains, 'in general, we have seen an increase in the volume of international transactions. That being said and as a result of the increase in the breadth and quantity of these opportunities, we have witnessed a growing number of financial institutions – funds and investment banks- that have

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established a physical presence on the ground in Israel in order to gain physical and cultural proximity to these investment opportunities'. The market has proved very attractive to these kinds of institutions, as well as to players in the tech sector, and as bureaucratic hurdles dwindle, tax laws improve and IP protection established, the rise of the 'tech-friendly' environment here is far from finished. With 'educational institutions churning out trained engineers and other professionals, it's no wonder Israel is dubbed the Start Up Nation' says Schapiro.

'Recently we have seen growth in the number of US VCs' says Sahar. 'It's an evolution – better companies, better quality VCs, capital is more efficient'. While Israeli firms have by necessity built up relationships with law firms in the US, for example, Sahar says he is not

concerned about the competition that will tighten with the entry of foreign firms into the market. 'There are lots of differences between us and especially in the tech sector. Rates are lower, of course, and also we are more involved with strategy. We are advising CEOs and they ask our advice not just on contracts but on strategy and relationships. It's a role that we're constantly building. Everyone knows everybody else, there's quite a lot of intimacy in the market'.

The internationalism of the sector has not necessarily increased steadily, however. There were a number of endeavours by Israeli companies to register at European stock markets, but this trend ended with the bubble years. Amir Zolty, the managing partner of Khayat, Zolty, Neiger & Co, a domestic high tech boutique, says that from the outset, European companies were not

key investors in the Israeli high tech scene. 'However, local start up companies' fundraising efforts in the US have faced more difficulties since 2008. This is especially true regarding venture capital funds, which their volume of investments in Israeli start up companies had significantly decreased. Most of these companies now raise funds through angel investors, some of them had to implement cutbacks'. Nonetheless, the British Embassy in Israel has established the High Tech Forum, which aims to support Israeli tech companies looking to establish a base in Western Europe to set up in the UK.

Although it has weathered the downturn especially well, Israel has seen a similar trend as in the Eurozone – an increasing visibility of investors from the East. Zolty adds that he has particularly noted 'a growing interest between the



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Israeli and the Asian- pacific technology markets in these areas. This is demonstrated by more cross- border transactions between Israeli, Chinese and Indian technology companies’.

One of the strongest links between Israel and other international markets remains its connections to the US, and in particular Silicone Valley. This is particularly, and increasingly, true of biotechnology and life sciences companies. However, given the economic turbulence the US continues to experience, how healthy are these links today?

‘Cross border activity between Israeli tech companies and the American market definitely decreased between 2009 and 2011, although the volume of commerce in this area between the countries has gradually grown from that point onwards’ says Tedd Lustig, a partner at Seyfarth Shaw. ‘The Israeli technology market functions as a hotbed of technology innovation. A large amount of knowledge is being transferred from Israeli companies that sell various advanced technology products in the US to their American counterparts. The Israeli tech sector actually exports technology to foreign markets as a commodity’.

The connections with Silicone Valley in particular are long and established, and the Israeli market has dedicated a lot of resources to advising on Silicon Valley giants acquiring Israeli companies, Israeli start-ups establishing subsidiaries in Silicon Valley and technology entrepreneurs splitting their

There is little doubt that Israel as a high tech hub is as sophisticated and developed as any other global technology centre, and the result is a legal market which has sprung up to match it and to equal leading global firms in this area.

time between the two. ‘Israel and Silicon Valley are connected at the umbilical cord’ says Levenfeld. ‘Lawyers from our firm are in the Valley several times a year, catching up with clients. The two-way traffic just keeps growing’. Leading players in the Israeli tech sector regard Silicone Valley as a key market not only from a technological standpoint, but also as a vital marketing environment where a presence here is an important business tool. While many Israeli companies have opened there doors here, increasingly New York has become a hub for Israeli tech players.

While no market has been completely immune to the struggles prompted by the downturn in the global financial world, Israel has fared remarkably well. This is in large part due to the strength of the

tech sector which had enough momentum in Israel to underpin business and support the legal market.

Nevertheless, recent announcements by the ministry of finance that the 2012 budget deficit had reached about \$10.5 bn, making up 4.2% of gross domestic product and double the government target, came as a surprise. The newly elected minister of finance announced budget cuts to address the deficit, and in the last quarter of last year the economy only expanded 2.4% – a much better performance than many Eurozone economies, but not as much as first predicted. This is not positive news for the Israeli tech sector in general as young start up companies in particular receives governmental financial support. ‘Therefore, some high tech companies are concerned that the expected budget cuts may take effect, especially among the start up companies and the R&D departments in larger companies’ says Lustig.

However, with governmental support in the technology sector administered primarily by the chief scientist of Israel, a statutory authority and in other various regulations, Fisher assumes that ‘the model of the governmental support in the tech sector is here to stay, although its magnitude may decrease in the short term’.

While, as Friedland points out, ‘It’s hard to say that the technology sector, in its traditional sense, is booming with the same intensity as it was during the bubble years’, any stress it has felt has been ‘revived’ by a ‘widening’ of the sector. ‘The parameters of the traditional



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“technology” sector have widened over the years to include new areas, such as cleantech, medical devices, agricultural technologies as well companies that have introduced innovative technologies in traditional industrial sectors. All these have contributed to this revival’.

In fact, the global economic downturn has affected the legal market to a lesser extent than when the dot.com bubble burst over a decade ago and the Second Intifada occurred around the same time. ‘Those of us practicing then saw a dramatic decline in our business, and asked ourselves: is this caused by Nasdaq, the world markets, or Nablus, the regional political/military situation. In retrospect, it was 98% Nasdaq and 2% Nablus’ says Levenfeld. In this respect, history shows that the strong technology sector in Israel has protected the legal market from the worst of the economic decline globally. ‘In

other words, as long as tech business remains strong, the Israeli tech and legal markets remain strong’ he adds.

And while Israel has little natural resources to support it, with the exception of the recently-discovered natural gas, many believe that this is one of the keys to its success. ‘The lack of natural resources has forced Israelis to adopt a culture of innovation problem solving in real time – characteristics that are embedded in the Israeli human capital’ explains Friedland. In this respect, it has been forced to develop new technologies to bolster itself. ‘I believe that Israel has taken, and will continue to take, concrete measures to allow technology-based companies to grow their businesses and research and development efforts, in order to enable them to succeed in the global marketplace’ he adds.

There is little doubt that Israel as a high tech hub is as sophisticated and developed as any other global technology centre, and the result is a legal market which has sprung up to match it and to equal leading global firms in this area. With such a large percentage of the deal pipeline featuring an international element, leading Israeli firms have gained significant cross border expertise.

And despite concerns over governmental support for the industry in the short-term in the face of budget cuts, Israel’s economy is still conducive to further activity in the technology sector. ‘We think and hope it is’ affirms Rimon. ‘The tech sector has been growing over the last 20 years and is likely to continue being a driving force in the Israeli economy, creating jobs, attracting foreign capital and contributing to Israel as a whole’. ■

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