Special report

Israel

Tel Avision

Vibrant hi-tech and energy sectors along with a more liberal professional climate mean international law firms have high hopes of Israel

Christian Metcalfe

With an enviable position as a hi-tech innovator and hotbed for start-ups, recently discovered substantial offshore gas reserves and moves by the government to break up the power over the economy held by conglomerates, the liberalising legal market in Israel has much to attract foreign law firms.

Changes to Israel's Bar Association Act last year, allowing foreign lawyers to provide advice on international law and the law of their home jurisdiction as well as a provision allowing them to merge with local law offices, has opened the door for overseas lawyers.

Here to help

US firm Greenberg Traurig was the first to take the plunge, with the announcement of its office launch in Tel Aviv in late 2011 focused primarily on IP and life sciences.

"We've grown beyond our expectations for the first year and hope to see that rate of growth continue," says Greenberg Traurig Tel Aviv partner Scott Mortman.

While Mortman will not discuss revenue growth, he points to "a spike of activity in the venture capital area, in addition to growth in the hi-tech, green-tech, life sciences and agro-tech sectors" as evidence for his expectations.

Meanwhile, Berwin Leighton Paisner (BLP) launched a representative office in December 2012, adding former Allen & Overy finance specialist Simon Baum as a partner in the team in March.

Playing down suggestions they are trying to compete on domestic firms' home turf, Jonathan Morris, chair of BLP's Israel desk, says: "People seem comfortable and understand the philosophy of the office – we're not there to compete with, but to supplement Israeli law firms when they need assistance outside Israel. That has become clearer to them as the office has become more established."

In brief

The attractions of Israel's technology and energy sectors are beginning to draw foreign lawyers into the country. While M&A is slow, growth forecasts mean lawyers should remain busy for some time to come.

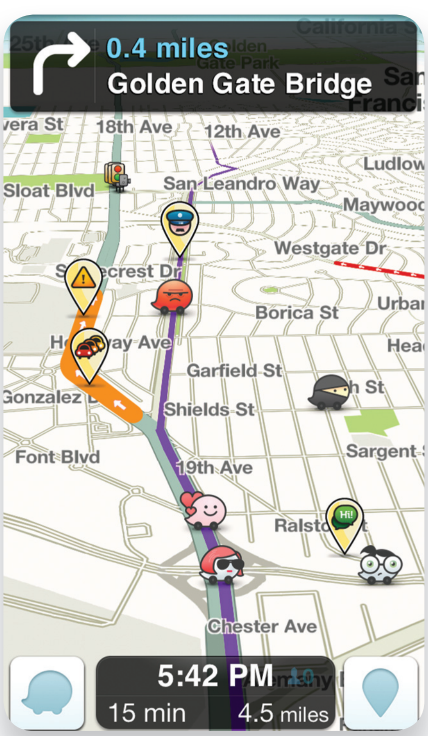
Seeking to quantify the early success of the office, Morris points to a growth in new clients.

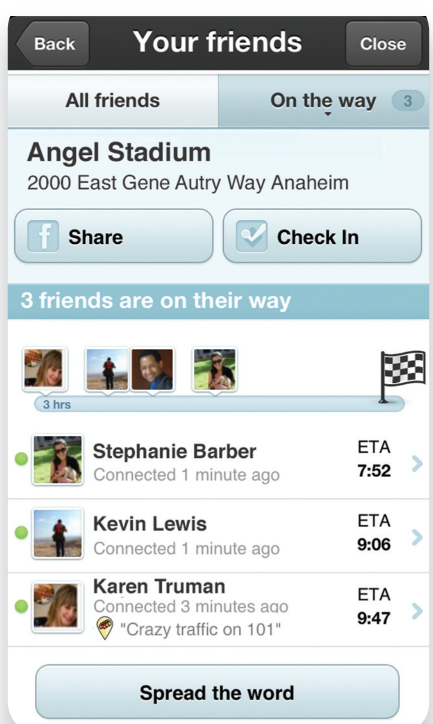
"When I look at the new clients won in the past six or seven months we've added at least 10. They're all different sizes, but the pot is growing."

"All the big firms understand that a) there is a massive amount of work coming out of Israel and b) the best chance of picking up work is not to sit in an office in London and wait for the next Israeli tycoon to walk in," observes Simon Jaffa, co-founder and partner at Barnea & Co. "It's to go to Israel and tell clients about opportunities – that is the strategy."

While Chinese firm Yingke is the only entrant so far to merge with a local outfit, targeting Israeli boutique Eyal Khayat Zolty Neiger & Co for its first step into the jurisdiction, many others including DLA Piper, Linklaters and Zelchner Ellman & Krause, have expressed an interest in moving into the market, whether through an office launch, a merger or the acquisition of a local law licence.

> **"We're not there to compete with but to supplement Israeli law firms"**
> **Jonathan Morris**





Techie dreams: crowd-sourcing app Waze is typical of the 'smart-up' trend, staying in Israel rather than relocating to the US

However, domestic consolidation is also important.

"There are now three firms of over 200 lawyers whereas seven or eight years ago there wasn't a single firm that had 100 lawyers," observes Clifford Felig, a corporate partner at Meitar Liquornik Geva & Leshem Brandwein, which recently merged with Kantor Elhanani Tal & Co. "No doubt there are talks going on among firms – no one sits back and watches other firms merge and have over 200 lawyers, and think of not doing anything."

Merger pressure will be felt most strongly by "firms with a strong international practice", warns Felig, "as it is a sign of credibility to international clients to be seen working with one of the largest firms. There's also the need to provide top-level services across the board – the one-stop-shop phenomenon."

While Epstein Rosenblum Maoz (ERM) partner Simon Marks recognises the phenomenon, he observes that mid-sized niche firms such as ERM see the growth of the large firms as providing opportunities to gain "clients that are unhappy with that move or are dropped by larger firms because they are not big enough".

Emphasising personal relationships rather than brands, Marks adds that even very large clients give out work "often based on the relationship between the person giving instructions and the lawyer within the firm providing the service.

That often means companies work with more than one firm, sometimes for the same type of work. There's no sign that approach is going to change any time soon."

"Every Israeli firm initially works on an extremely tight budget to attract tech companies in the development stage
Simon Jaffa

Electric dreams

The influence of the hi-tech sector remains crucial to the health of the Israeli economy and legal market. The buzz surrounding Google's $966m (£636m) acquisition of Israeli crowd-sourcing navigation app Waze in June is testament to this.

Described as a giant incubator, Israel is one of the most dynamic pockets of technology development in the world, but to support that firms have to be flexible.

"We understand that if we want to represent companies such as this we need to be flexible about how we charge start-up clients," says Jaffa. "Every Israeli firm initially works on an extremely tight budget to attract tech companies in the development stage."

Earlier talks between Waze and Facebook reportedly broke down over Waze's insistence that the company's managers and employees should remain in their Israeli headquarters rather than relocate to the US.

This, Mortman suggests, is part of a "shift from the 'start-up nation' to the 'smart-up nation' – Israeli companies are beginning to look beyond the quick exit. They're interested in building a lasting company here in Israel from which investors benefit, workers benefit and management benefits."

But the technology industry has been affected by the global downturn, with a shrinking venture capital industry pushing companies to look elsewhere for capital.

"A lot of gaps have been filled by smaller angel investors on one side and on the other by foreign investors," says Marks.

With the likes of Google, Facebook and Apple looking to invest to improve or broaden their offerings, Waze-type exits look likely to continue.

Resourcefulness

While Israel's human resources continue to be fought over, recently discovered natural resources in the form of huge gas reserves have the potential to further boost the economy for years to come, and transform the Middle East energy map.

Gas exports have the potential to bring the country a windfall of $60bn (£39bn) in profits over the next two decades. However, in June the government reached a long-awaited decision on gas exports, to reserve 60 per cent of the gas for domestic use, to the disappointment of the main investors in the sector, led by Noble Energy of the US and Israel's Delek.

The two companies began pumping gas from the offshore Tamar field earlier this year and wanted clarity on export guidelines before moving on to exploit the larger Leviathan field.

Apart from the infrastructure and projects work, there is a lot of regulatory work on the back of the government's decision but, warns Jaffa: "There are still big question marks hanging over the whole issue of gas, as to how gas will be commercialised and how financial models will be created if only 40 per cent of the gas can be exported."

Media reports out of Australia last month also suggest a huge deal in which Australian gas exploration company Woodside Petroleum would pay as much as $2.3bn for an interest in Leviathan is close to collapse.

Woodside, which plans to build an LNG plant at a cost of $10bn or

Gas stationed: 60 per cent of output must be kept for the domestic market

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more and to market the product to its customers in China and other Far Eastern countries, signed a memorandum of understanding with Noble, Delek and Ratio Oil Exploration in December 2012, but the signing of the deal was frozen until the government’s decision on gas export policy.

However, “like many things in Israel, everything is open for negotiation”, opines Jaffa. “There are some high-profile lobbyists pushing for a review of that decision. It could still change.”

In the realm of big-ticket finance work, says Baum, energy continues to dominate, and not just in terms of the traditional players in the market and the main gas fields.

“There are a number of new entrants starting to make progress with exploration and they need financing – there are a number of other fields being explored,” he reveals.

The renewables sector is also continuing to grow and evolve. Following a spate of projects being set up in the past two or three years, driven by government incentives, Marks says there is development.

“We’re beginning to see consolidation in that space on the M&A side, and we’re likely to see more in the next year or so,” he adds.

The debt pool

While the technology and energy sectors are faring well, the traditional corporate world is under pressure, causing a big growth in insolvency and restructuring work for lawyers, particularly on the back of January amendments to Israeli company law allowing the equivalent of the US Ch.11 process for “corporate rehabilitation”.

“The past 12 months have seen some of Israel’s biggest industrial concerns staggering under the weight of debt they can’t pay back,” observes Alan Sacks, a partner at Herzog Fox & Neenan. “What’s the buzz? Insolvency and corporate rehabilitation is the buzz.”

A perfect storm of popular protest over the high cost of living, government moves to attack economic concentration and foster competition in the economy, and pressure from the lenders the conglomerate tycoons used to build their empires means the front-page news around Israeli tycoon’s IDB conglomerate is indicative of the challenges in this sector.

IDB is one of 10 large business groups that control around 30 per cent of the market value of public companies in Israel. Such conglomerates make use of a ‘pyramid’ corporate structure, using tiers of holding companies to allow a powerful shareholder to hold sway over a business empire while owning only a fraction of equity in the companies it controls.

In the most recent development for IDB, following a Tel Aviv District Court order for it to sell half of its 55 per cent stake in Israel’s largest insurer Clal Insurance by August 22, the conglomerate is reportedly in advanced talks to sell to a group of Chinese investors.

While legislation to break the power of such conglomerates has yet to make its way through the Knesset, “market forces have done the work of the legislator”, remarks Sacks. “By the time the law comes into effect its impact will be limited because so many of these big borrowers have had to break up their conglomerates to pay off debt.”

“As much as the protests two years ago in Tel Aviv were a landmark event, the reality is they didn’t themselves bring change,” adds Jaffa.

However, whereas previously distressed companies under pressure from lenders may have found domestic buyers, this is being curtailed by the threat of anti-concentration legislation as the obvious buyers are being forced to shrink rather than get bigger.

This has created opportunities for foreign private equity firms such as York Capital, Carlyle or Oaktree Capital to buy up the debt of companies and use their position to try to take control of assets.

“There have been some deals done in the past 12 months,” notes Marks, adding that so far this is foreign private equity “dipping their toes into the market”.

While Sacks detects “the calm before the storm” in terms of traditional M&A activity on these assets, he also notes that if tycoons fail to hit legislative deadlines for the disposal of assets in any future anti-concentration laws, this could affect the largely dormant Israeli stock exchange.

“If they can’t sell they will have to offer the assets for sale on the stock exchange, but that may be something of a last resort,” says Sacks.

But with growth forecasts for the Israeli economy in 2014 of between 3 and 4 per cent, even this cloud will have a silver lining of legal work.

Key figures: Israel

GDP
$242.9bn

Annual inflation rate (2011)
2%

Population
8m

Life expectancy at birth
82

Unemployment (June 2013)
6.9%

Source: World Bank, Central Bureau of Statistics

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PRESS ASSOCIATION

Nochi Dankner: controlling shareholder of IDB