Directors' and Officers' (D&O) Liability

Vienna, 28 March 2017

Directors' and Officers' Liability

Israeli Report

Israel Gilead, Hebrew University, Israel

Topics – 1

• Directors and Officers (‘Position Holders’) Compared
• Parties Protected by D&O Liability
• Bases of D&O Liability with Regard to Each of the Protected Parties: Tort? Contract? Other?
• The Essence of Each Base of Liability to Each Protected Party

Topics – 2

• Is Tort Liability of D&O a Special Kind of Tort Liability?
• Insurance, Waiver and Indemnity
• Special Procedures: Representative and Derivative Claims

Directors and Officers (‘Position Holders’) Compared

• Different organs
• Different tasks
• Yet, same kinds of duties to protected parties
• But different content of the same duties

Parties Protected by D&O Liability

• The company
• Shareholders
• Third parties
• Note: company and shareholders are also protected by duties of fairness and good faith imposed on shareholders

D&O’s Duties to the Company – An Overview

• Duty of loyalty (equated to contractual duty)
• Duty of care under negligence law and other duties imposed by tort law
• Specific statutory duties
• Contractual duties of officers as employees
Directors’ and Officers’ (D&O) Liability

Vienna, 28 March 2017

D&O’s Duties to Shareholders

▪ Duty of care under negligence law and other duties imposed by tort law
▪ Emphasis on the duty to refrain from deprivation of shareholders by unfair allocation of the company’s assets.

D&O’s Duties to Third Parties – An Overview

▪ Duty of care under negligence law and other duties imposed by tort law
▪ Judicial duty of good faith in dealing with third parties
▪ Pre-contractual duty to negotiate a contract, as the company’s agent, in good faith

Duty of Loyalty to the Company

Avoiding:
▪ Conflict of interests
▪ Competition with the company’s business
▪ Taking advantage of the company’s business opportunity
▪ Concealing information received in office
▪ Voting agreements and any submission of independent discretion

Duty of Care to the Company

▪ A branch of the general duty of care in negligence law
▪ Objective duty to act like a reasonable director
▪ Emphasis on the need to be well informed
▪ Stricter subjective test for above reasonable skills

Duty of Care to Third Parties

▪ Tort law applies to D&O. Company’s service provides no shield
▪ General tort of negligence is the major source of liability
▪ Liability is individual – neither collective nor vicarious

Other Duties to Third Parties

▪ Pre-contractual duty of good faith negotiation
▪ Judicial duty of good faith in dealing with third parties
▪ Specific statutory duties like duty to avoid a misleading details in a prospectus
### General Restrictions on the Scope of Negligence Liability – Denying Duty of Care

As with the general law of negligence, ‘no duty’ findings are used to avoid undesirable liability:
- **To the company:** example – BJR
- **To shareholders:** example – no liability for indirect (secondary, derivative) loss
- **To third parties:** example – no liability unless ‘assumption of responsibility’

### Insurance, Waiver and Indemnity

- **Aim:** to quite concerns of risk-averse Ds&Os that negatively affect their performance
- **Principle:** allowed only with regard to conduct in good faith. Forbidden for intentional and reckless conduct
- Being a part of D&O’s remuneration, these arrangements require special proceedings

### Derivative Action

- **Aim:** sue D&O who breach their duties to the company where the organs fail to do so due to conflict of interests
- **Means:** authorise shareholder to sue on the company’s behalf
- **Procedure:** court has to approve such claims in advance
- **Approval:** if the action serves the company’s interest and the shareholder is qualified and acts in good faith

### Representative Action

- **Aim:** incentivise shareholders to sue for minor economic loss
- **Means:** authorise a shareholder to sue on the behalf of shareholders
- **Procedure:** court has to approve such claims in advance
- **Approval:** the actions involve common questions of fact and law and the representative is fit

### External Directors

- **At least two required in any public company**
- ‘External’ means lack of any ‘linkage’ to the controlling shareholder
- **Special qualifications required**
- **Special procedures of appointment and removal**

### Creditors Suing D&O

- **When company solvent** – for unlawful reduction of capital
- **When insolvency excepted** – duties to shareholders are shifted to creditors
- **After insolvency** – direct claim for fraudulent acts
- **After insolvency** – claims on the company’s behalf for restitution of assets unfairly misused