

Directors' and Officers' Liability

# Israeli Report

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DIRECTORS' AND OFFICERS' LIABILITY

## 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



DIRECTORS' AND OFFICERS' LIABILITY

## 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' LIABILITY

## 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



DIRECTORS' AND OFFICERS' LIABILITY

## 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**



DIRECTORS' AND OFFICERS' LIABILITY

## 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



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### 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

