Israel

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1. Directors' duties

1.1 Nature of the duties

(a) Duty of trust

Under the Companies Law 1999, an officer:

- has a duty of trust towards the company;
- has an obligation of good faith in carrying out his responsibilities to the company; and
- must act for the benefit of the company.

The officer's duty of trust requires him to:

- avoid any action that involves a conflict of interest between his role in the company and other roles in his business or personal affairs;
- avoid any action which involves competition with the company's business;
- avoid exploiting a business opportunity of the company in an attempt to benefit himself or others; and
- disclose to the company any information and provide it with any documents regarding its affairs which are brought to his attention within the framework of his position in the company.

The Companies Law defines an 'officer' as including a director, general manager, chief executive officer, deputy manager and any other such executive in a company, regardless of title, including any manager who is directly subordinate to the general manager.

At the core of the duty of trust is the concept that officers in general, and directors in particular, make a commitment to the company that they will be guided in their actions by the company's welfare, and not their personal interests. To avoid abuse, the Companies Law establishes rules for corporate transactions involving officers with personal interests in company transactions – for example, decisions regarding officers' employment conditions or officers' insurance, indemnity or exemption from liability. Under these rules:

- the officer must disclose his personal issue to the company a reasonable time in advance of the anticipated meeting at which the proposed transaction will be voted on;

- an independent organ of the company - that is, an organ which has nothing to gain from the authorisation of the proposed transaction - must confirm the interested-party transaction; and
- the independent organ is limited to authorising only those transactions which it believes in good faith will benefit the company.

Under the legislation, for the prospective action to be authorised, it is sufficient that the action will not harm the company. However, the Supreme Court has heightened this standard and applies an 'entire fairness' test. Under this test, it is not sufficient that the transaction is duly approved and that the conditions of the transaction are reasonable from the perspectives of the company and its shareholders; rather, the transaction's entire fairness, including the long-term benefit to the company, is required.

(b) Duty of care

Under the Companies Law, an officer also has a duty of care towards the company. In contrast to the duty of trust, which aims to prevent officers from exploiting their corporate powers for their own benefit, the duty of care aims to force officers to act reasonably and so prevent damage to the company. The duty of care should comply with certain sections of the Torts Ordinance (New Version) addressing the general prohibition on acting negligently toward any person. Additionally, the Companies Law provides that an officer should act with the level of proficiency that a reasonable officer in the same position would act with under the same circumstances. This includes taking reasonable measures to obtain information regarding the commercial sense of an action brought for authorisation, or of an action taken in the capacity as officer, and any other information pertinent to these actions. The Companies Law refers to the 'reasonable officer' as opposed to the 'reasonable person', thus heightening the duty typical under tort law.

The duty of care is personal and therefore, for example, it is imposed not merely on the entire board of directors as a whole, but rather on each director personally due to his activity on the board. As a general matter, all company officers must be able to show that they gathered the relevant information regarding the commercial sense of the action and acted upon it to enhance the company's value. Israeli case law teaches that a director's role in a company is pivotal and includes:

- being involved in the company's activities;
- knowing its business, its key players, the senior management, the internal monitoring system and its board of directors; and
- participating in board meetings.

1.2 Standards of care

An officer should act with the same level of proficiency as a reasonable officer in the same position under the same circumstances (see section 1.1(b)).

1.3 To whom duties are owed

(a) Duty of trust

The officer owes his duty of trust first and foremost to the company, since he controls the company and manages its affairs. It is logical that, in parallel with his power over the company, an officer should also have responsibilities towards it. However, the Companies Law explicitly notes that the duty towards the company does not preclude the existence of the same duty towards another person, such as a shareholder, employee, creditor or contract party. Case law shows that while an officer does have a duty of trust to the company, under certain circumstances he may also have a duty of trust towards a shareholder – this may occur if a special relationship has been cultivated between them or if principles of justice and good faith require this responsibility. Notwithstanding the foregoing, duties towards parties other than the company are secondary to those in respect of the company.

(b) Duty of care

As with the duty of trust, the officer owes his duty of care primarily to the company. By the same token, the fact that this duty is also aimed first and foremost towards the company does not preclude the existence of a duty of care in respect of other parties, such as shareholders, employees, creditors or contractual parties.

1.4 Common defences to and exemptions from liability

A company is not permitted to exempt an officer from liability stemming from breach of his duty of trust, but may exempt an officer from liability stemming from breach of his duty of care. As to the duty of care, a company is permitted to exempt an officer from all or part of his responsibility for damage caused as a result of breach of his duty of care, if this is provided for in the company's articles of association. Additionally, since the decision to exempt an officer from liability is considered a transaction with an interested party, the decision requires special authorisation pursuant to the Companies Law. For the company to grant an exemption to an officer who is not a director, this requires confirmation by the inspection committee and then the board of directors. For the company to grant an exemption to an officer who is a director, confirmation by the board of directors and then the general assembly is required. Further, in the case of a public company, confirmation by the inspection committee is also required.

Notwithstanding the above, a company is prohibited from exempting a director at the outset from responsibility stemming from negligence with respect to a distribution of dividends. This exception to the general rule that directors can be exempted from damage caused as a result of their acts of negligence aims to prevent situations in which the shareholders exempt directors from responsibility for unlawful distributions in order to promote their personal interest (eg, to increase their dividends at the expense of others, such as creditors).

Additionally, there are possibilities for indemnification and/or insurance, which are discussed in sections 4 and 5.

Officers may allege in their defence that they relied on external experts and advisers. Case law shows that for a court to accept this defence, at least the following cumulative conditions must be met:

- The officer addressed an expert who had professional knowledge and appropriate experience;
- The expert was privy to most of the facts relevant to the opinion;
- The officer acted in good faith; and
- The opinion was reasonable given the officer's skills.

Additionally, all general defences under law apply, including:

- statute of limitations;
- lack of privity between the parties; and
- the absence of a causal connection among the elements of the relevant cause of action.

2. Who can bring claims

2.1 The company (and its liquidators)

Given that it is an independent legal entity, a company has a right to bring claims against others in its own name. More specifically, this right is granted to the company's organs, including its directors.

In addition to the directors' general right to bring claims against company officers in the name of the company for breaches which have already taken place, under the Companies Law, if a director has a reasonable basis to suppose that an officer of the company is poised to breach a duty owed to the company, the director is first required promptly to convene a meeting of the board of directors to address the matter, provided that such meeting is possible under the circumstances. Next, the director may petition the district court to enforce the officer's duty or prevent the prospective act of breach. The court may issue an order preventing the action or any other remedy it deems fit under the circumstances. Notably, unless the court decides otherwise, the company will bear the expenses of a director who petitions the court in this regard. Such expenses include court and attorneys' fees.

Further, the Companies Law provides that where an officer breaches his duty of trust towards the company, the officer will be viewed as having breached his 'contract' with the company. Accordingly, general contract law will apply, including the remedies available for breach of contract, in addition to the law of tort. By reason of the fact that any person representing the company has the authority to bring claims against its officers, a successor board of directors may bring claims against its predecessor board or particular members thereof; more commonly, a company's liquidator is also entitled to bring claims. The liquidator's role, aside from managing the liquidation process, is to realise company assets and distribute the profits first between the creditors and then, if there is a surplus, between the shareholders. The liquidator essentially replaces the authorised company organs and is granted all authorities necessary to liquidate the company in the most efficient way possible. Among these authorities, the liquidator has the authority:

- held by the company directors to bring claims against the company officers, as described above; and
- to bring claims on behalf of the company against its creditors, provided that the court or company's inspection committee gives its prior consent.

2.2 Minority shareholders on behalf of the company

Despite directors' general right to bring claims against company officers, in practice, directors will frequently abstain from doing so since the claims would often need to be addressed against themselves. Due to this obvious concern, the Companies Law provides an alternative mechanism for suing officers: the derivative action brought by shareholders on behalf of the company.

Where the company organs authorised to bring claims in the name of the company due to a cause of action of the company refrain from doing so (eg, because of a conflict of interest, inability or unwillingness), a shareholder or director may do so instead in a derivative action, provided that the court gives its prior consent. A derivative action is materially different from a personal action. It is brought by a single individual or a number of persons (there is no minimum number of formal plaintiffs) on behalf of the company due to an offence against the company, whereas a personal action is brought by the direct party to the claim (ie, the injured party against the injurer). This notwithstanding, the company is the *de facto* plaintiff in the action and if the court rules in its favour, the remedy will be awarded to the company and not to the formal plaintiff.

Under the Companies Law, a prerequisite for filing a derivative action is that the prospective plaintiff first petition the company in writing and demand that the company file the action itself. The company, after receipt of the demand letter, may choose from three courses of action:

- take action to negate the cause of action or reach a decision which otherwise negates the cause of action;
- dismiss the plaintiff's demand, with an explanation; or
- file a claim.

After receipt of the company's response, the court may allow the plaintiff to file the derivative action if it is convinced that:

- *prima facie*, the action is for the benefit of the company and the plaintiff is acting in good faith;
- the action taken or the decision reached by the company to negate the cause of action failed;
- the company dismissed the plaintiff's demand to file the action; or
- the company did not respond to the plaintiff's demand or responded after the legal deadline.

Further, relevant case law indicates that a party wishing to sue on behalf of the company in a derivative action must demonstrate to the court that:

- the company's right was breached; and
- conditions exist to justify his request to wage the company's battle on its

behalf, including that his main consideration is the company's benefit and not his own.

Another prerequisite for filing a derivative action is that the plaintiff pay part of the court fees. Once the court has authorised the derivative action, the company must reimburse the plaintiff for expenses he has incurred and must pay the remaining court fees.

Notably, derivative actions cannot be brought on behalf of a company for which a liquidator has been appointed by the court.

2.3 Shareholders on their own account

In cases of minority oppression – namely, unfair distribution of resources between the company's controlling shareholders and the minority shareholders - the minority shareholders have standing to sue in order to relieve the oppression. The minority shareholders must demonstrate before the court that damage was caused to them. Recent case law shows that there is no need to demonstrate continuous oppression and even a single unlawful distribution is sufficient to raise the oppression argument. As to the damage itself to the minority shareholders, case law has developed two approaches:

- the consequential approach - damage to the shareholder is necessary and injury to a shareholder's legitimate expectations constitutes damage; and
- the intentional approach – in addition to the damage, the oppressive action was tainted with bad faith or fraud on the part of the company officer and was taken for a reason other than to benefit the company.

Additionally, a minority shareholder is entitled to file a claim when the company incurs damage and the unfairness also indirectly affects minority shareholders. Since the courts have recognised the difficulty involved in minority shareholders proving the existence of damage, the courts can apply the 'entire fairness' test in this regard, meaning that once the minority shareholder demonstrates *prima facie* evidence of oppression, the courts transfer the burden of proof to the defendants to prove the entire fairness of their actions. Likewise, there may be situations in which the shareholders, rather than the company, suffer losses, such as in case of unjust dilution of shareholders' shares. In such cases, shareholders may bring claims against directors.

Furthermore, in the event that a liquidation order is issued against the company, a shareholder, creditor, liquidator or receiver may file an action against a company officer, provided that the officer knowingly participated in fraudulent management of the company.

2.4 Third parties

A company, being a separate legal entity, can bear liability for negligence; however, the fact that a company bears liability for an action taken by a company officer does not negate the liability of the officer himself. Accordingly, the company officer is personally responsible for his actions and the company is responsible for the company officer's actions. In this regard, it is insufficient that a third-party plaintiff, such as a creditor, proves that the action was taken for the company and the company officer is a manager of the company. In contrast, to impose liability on an officer, it is necessary to show that the officer himself was the one who committed the tort, or at least participated in it, and that all elements of the tort were fulfilled with respect to him personally.

Another possible third-party plaintiff is a company employee who, for instance, is involved in a workplace accident and subsequently brings a claim against the foreman. In such case the employee would have to show that the elements of the tort of negligence were met by the foreman's acts or omissions.

Additionally, claims can be brought against directors by creditors or contracting parties in case of misrepresentation or fraud. In such cases the corporate veil may be lifted and the directors exposed to personal liability.

3. Claims culture

3.1 Litigation

Israel is a common law jurisdiction in which civil trials are conducted before a single, professional, nominated judge. There is no jury trial system. Generally, there are three levels of courts:

- at the first level are magistrates' courts;
- at the next level up are district courts; and
- at the third and highest level is the Supreme Court.

Specialised courts do exist, including family courts, labour courts, antitrust courts and small claims courts. Magistrates' courts have jurisdiction over monetary claims not exceeding NIS2.5 million (approximately $600,000) and district courts have jurisdiction over all other monetary claims. Plaintiffs who file claims in the magistrates' court have an automatic right to appeal to the district court and plaintiffs who file claims in the district court have an automatic right to appeal to the Supreme Court, which is the court of last instance. Rulings of the Supreme Court cannot be appealed.

Aside from the derivative action and the class action, actions on behalf of and against the company are filed in the same procedural manner as civil claims generally.

Claims against directors were rare in the past, but today there is a noticeable trend towards making claims against professionals in general (malpractice claims against doctors, lawyers, accountants and so on).

Often, claims against officers are brought by creditors in connection with insolvency and liquidation proceedings, and by shareholders in connection with interested-party transactions.

3.2 Ability to bring class actions

A class action is defined under the recently enacted Class Actions Law, 2006 as an action managed in the name of a group of people which did not give the representing plaintiff power of attorney to do so, and which raises substantive questions of fact or law common to all members of the group. A condition for filing a class action is that the court first gives its authorisation for the claim to be filed in the form of a class action.

For the court to authorise the filing of a class action, the plaintiff must show the existence of the following cumulative criteria:

- The action raises substantive questions of fact or law common to all members of the group;
- Based on *prima facie* evidence, there is a reasonable probability that the questions will be resolved in favour of the group;
- The class action is the most efficient and fairest way to resolve the dispute under the circumstances;
- There is a reasonable probability that the interests of the members of the group will be properly represented and managed; and
- There is a reasonable probability that the members of the group will be represented in good faith.

When class actions are brought against companies, plaintiffs commonly name the directors of the relevant company among the defendants.

3.3 Funding of claims and whether loser pays

(a) General

The court has discretion to decide whether to charge a party with payment of the attorneys' and court fees of the counterparty. Case law shows that in the absence of special circumstances that justify depriving the winning party of its expenses, it will be awarded costs. Nevertheless, the court is allowed to impose costs on a party, in favour of the counterparty or the Israeli Treasury or both, which unnecessarily prolongs the hearing by way of empty claims or otherwise, regardless of the outcome.

The costs awarded by the court are usually less than the actual legal expenses incurred. Accordingly, the risk of an adverse costs award does not materially deter claimants from bringing unmeritorious claims.

Generally, conditional and contingency fee agreements between attorneys and their clients can be made; however, payments to experts may not be made on a contingency basis.

(b) Derivative actions

As described in section 2.2, plaintiffs in derivative actions must pay an initial part of the court fees; if the action is subsequently authorised by the court, the company must reimburse the plaintiff for his expenses on behalf of the company and pay any outstanding court fees. Regarding reimbursement, the court can order the company to pay the plaintiff a certain sum for costs or to deposit a guarantee for their payment. Additionally, the court can order the company to guarantee the defendant's expected costs with a deposit.

If the defendant is awarded costs, the company must generally pay them. In exceptional cases, the court may order that the plaintiff pay the defendant's costs. Additionally, the court can order the company to pay the plaintiff's costs or order the plaintiff to pay the company's costs, depending on the circumstances.

As to attorneys' fees, the court will determine the amount of the fees to be awarded to the attorney who represented the plaintiff and such fees should generally be paid by the company. In exceptional cases, the court may determine that the plaintiff should pay the attorneys' fees.

If the court rules in favour of the company, the company will enjoy the fruit of the plaintiff's efforts. However, the court is entitled to order that the plaintiff be compensated for his efforts in filing and proving the derivative action.

(c) Class actions

A representative plaintiff seeking to file a class action based on a cause of action stemming from a connection to securities issued by the Israeli government, an option, a futures contract or securities issued to the public by a company may petition the Israeli Securities Authority (ISA) to bear his costs. If the ISA is convinced that the class action involves a public interest and there is a reasonable probability that the court will authorise it as a class action, it may take on the plaintiff's costs. If the court ultimately rules in favour of the plaintiff, it is permitted to order indemnification of the ISA for costs.

3.4 Plaintiffs' bar

There are several designated public authorities and organisations that are entitled to file class actions on behalf of large groups of people. Nonetheless, the claims are usually brought by individual lawyers.

3.5 Procedural barriers

(a) Statute of limitations

Under the Statute of Limitations Law, 1958, which deals with periods of limitations in civil actions, the limitations defence is purely an affirmative defence. If the defendant successfully raises the period of limitations defence, the court will be barred from hearing the claim, although the plaintiff's substantive right will be left unaffected. Accordingly, if the defendant does not raise a period of limitations defence within the requisite timeframe, the plaintiff can proceed with the action even if the period has lapsed. The defence should be raised at the first opportunity after the claim is filed; if later, the limitations defence will be disregarded.

The period of limitations of a civil claim that is not derived from a right to landed property is seven years. There are exceptions to this seven-year period; however, none apply to claims brought against directors and officers under the Companies Law. This seven-year period generally starts to run on the day on which the cause of action "was born". Exceptions exist - for example, in relation to the plaintiff's inability to know of the facts that gave rise to the cause of action or instances of fraud, damage etc which were revealed only later. In such cases the seven-year period will begin to run as from the plaintiff's actual or constructive discovery of the relevant facts.

(b) Statement of claim fails to demonstrate a cause of action

Normally, a statement of claim must demonstrate a cause of action to proceed. If the court is of the opinion that the claim is baseless or vexing, it can 'erase' the claim – the equivalent to dismissing the claim without prejudice. Accordingly, the dismissal does not establish *res judicata* and the plaintiff can bring the claim again in the future on the same grounds.

(c) Failure to pay court fees

If the plaintiff fails to pay all or part of the court fees he was required to pay, the court may erase his claim, without prejudice.

(d) Res judicata

If a claim was previously filed and addressed by the court, and a judgment was issued, the same claim brought a second time will be dismissed with prejudice on the grounds of *res judicata*.

(e) Requisite approvals not obtained

As mentioned in section 2.2, a shareholder or director who wishes to bring claims in the form of a derivative action must first obtain the court's consent. Similarly, a condition for filing a class action is that the court first gives its authorisation for the claim to be filed in the form of a class action.

4. Indemnification rights

4.1 When the company can indemnify

Provided that its articles of association allow it to do so, a company is permitted to indemnify an officer for money he spends or for his expenses that result from certain actions he takes in his capacity as officer. Indemnifiable costs include:

- a monetary obligation towards a third party imposed on him pursuant to a court judgment (including an arbitral award confirmed by the court and a settlement judgment handed down by the court);
- reasonable litigation costs, including attorneys' fees, which the officer expends as a result of a proceeding conducted against him which ends without filing an indictment and without charging him with monetary liability in lieu of a criminal proceeding, or a proceeding which ends without filing an indictment but with charging him with monetary liability in lieu of a criminal proceeding regarding a crime which did not require *mens rea*; and
- reasonable litigation costs, including attorneys' fees, which the officer expends or is required to pay pursuant to a court decree, in regard to a claim filed against him by the company, its representative or a third party, or with regard to a criminal charge from which he is acquitted or a criminal charge resulting in conviction for a crime which did not require *mens rea*.

In order to allow indemnification, the articles of association can include:

- a provision allowing the company *a priori* to commit to indemnify its officer, with restrictions (described below); or
- a provision allowing the company to indemnify its officers retroactively.

An *a priori* commitment to indemnify for a monetary obligation imposed on an officer pursuant to a court judgment is limited to:

- certain types of event that the board of directors thinks are foreseeable at the time the commitment to indemnify is given in light of the company's activity; and
- a certain amount of money which the board decides was reasonable under the circumstances.

In contrast, there are no predetermined limitations as to foreseeable types of event for which officers can be indemnified regarding reasonable litigation expenses.

4.2 Formalities for indemnification

As described above in section 4.1, a prerequisite for a company to be able to indemnify its officers is that its articles of association include a provision which explicitly permits it to indemnify its officers. Additionally, a decision to indemnify an officer is considered a transaction with an interested party and thus requires special authorisation pursuant to the Companies Law. For the company to commit *a priori* to indemnify an officer who is not a director, or to indemnify based on a retroactive commitment to indemnify, such decision requires confirmation by the inspection committee and then the board of directors. For the company to commit *a priori* to indemnify an officer who is a director, or to indemnify based on a retroactive commitment to indemnify, confirmation by the board of directors and then the general assembly is required. In a public company, confirmation by the inspection committee is also required.

Once the above conditions are met, the company may issue a written commitment, typically in the form of a writ of indemnification, addressed to the officer. Such commitment should specify, among other things, that the necessary company authorisations were obtained and that, within the parameters of the restrictions mentioned in section 4.1, the company *a priori* exempts such officer from potential future liability as a result of him breaching his duty of care towards the company.

4.3 How indemnification works

As mentioned in section 4.1, there are restrictions as to the types of event and the maximum sum, with regard to *a priori* commitments to indemnify for monetary obligations imposed on officers pursuant to court judgments. Additionally, all payments of indemnification moneys are subject to the particular provisions of the indemnification agreement.

4.4 What cannot be indemnified

A provision in the articles of association which permits a company to indemnify (or insure/exempt) an officer from liability will be deemed null and void if it supports any of the following:

- breach of duty of trust towards the company, unless the officer has acted in good faith and had reasonable grounds to assume that the action would not harm the welfare of the company;
- wilful or reckless breach of duty of care, as a result of negligence alone;
- action taken with an intent to produce unlawful personal gain; or
- imposition of a fine on the officer.

Additionally, a commitment to indemnify (or insure) an officer as a result of his breach of his duty of trust towards the company is deemed null and void, unless the officer acted in good faith and had reasonable grounds to assume that the action would not harm the welfare of the company. Moreover, officers themselves are explicitly prohibited from accepting such commitments and any such acceptance shall be deemed a breach of the duty of trust.

5. D&O insurance

5.1 Availability of D&O insurance

Under the Companies Law, and provided that the articles of association permit it to do so, a company can obtain insurance for an officer's liability incurred as a result of an action he takes in his capacity as an officer, with regard to each of the following:

- breach of duty of care towards the company or another person;
- breach of duty of trust towards the company, provided that he acted in good faith and had reasonable grounds to assume that the action would not harm the welfare of the company; and
- monetary liability imposed on the officer for the benefit of another person.

A company can insure its own officials, but cannot insure officials of another company; therefore, generally, a parent company cannot insure officials of subsidiaries or affiliated companies.

Additionally, the decision to obtain insurance for an officer is considered a transaction with an interested party and thus requires special authorisation pursuant to the Companies Law. For the company to obtain insurance for an officer who is not a director, confirmation by the inspection committee and then the board of directors is required. For the company to obtain insurance for an officer who is a director, confirmation by the board of directors and then the general assembly is required. In a public company, confirmation by the inspection committee is also required.

5.2 Local rules on cover provided under a non-domestic D&O policy

Under the Supervision of Financial Services (Insurance) Law, 1981, in order to engage in insurance in Israel, including the provision of D&O insurance, it is necessary to obtain an insurer's licence from the insurance supervisor. Only Israeli companies and foreign companies which are registered in Israel and engage in insurance abroad under the supervision of their home authorities are allowed to obtain such a licence. Accordingly, foreign insurers which are not licensed in Israel are not permitted to operate in Israel. That said, the Supervision of Financial Services (Insurance) Law provides an exemption for reinsurance, according to which an entity which engages primarily in insurance activity outside of Israel and does not operate in Israel, except in the field of reinsurance, will not be considered an entity that "engages in insurance" and therefore will not require a licence, unless it is a company which was incorporated in Israel.

Pursuant to the above, and as a practical matter, Israeli subsidiaries of foreign parent companies generally obtain D&O insurance from Israeli insurance companies.