Israel Securities Authority

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The plenum of the Authority approved a proposal to amend the liability sections of the Securities Law, 5728-1968

Background

The matter before us is an amendment of the civil liability sections of the Securities Law, 5728-1968 (hereinafter - the "**law**") in two of the aspects thereof, following a request by the Courts that dealt with these sections in the past years.

The civil liability arrangements in accordance with this law contain several tiers:

1. Sections 31 - 35 of the Law which deal with the responsibility for the prospectus. These sections provide the investors with the ability of suing on the grounds of damages caused to them in respect of a misleading detail in a prospectus.
2. Section 38C of the law which deals with responsibility for ongoing reporting. This section applies to the permanent arrangement for Sections 31 - 34 of the Law '*mutatis mutandis*', and provides the investors with the possibility of suing on the grounds of damages caused to them in respect of a misleading detail in reports.
3. Sections 52 (11) – 52 (14) of the Law deal with responsibility in respect of violation of the provisions of the various sections of the Law as well as the liability of a Trustee towards holders of 'Certificates of Indebtedness'.

Each of the civil liability arrangements determines the circumstances in which liability will arise towards the investors, the circle of responsible individuals, and the circumstances which negate liability. It should be specified that in Chapter E3 of the law - which includes the dual listing arrangement - no provision is included for liability.

In January 2021 a proposal for amendment of the Law was published for public comment, and in May 2021 the plenum of the Authority approved the advancement of the legislative process, as well as the final phrasing of the proposal.

Proposed corrections:

A. Clarifiying the relationship between the liability sections in respect of a misleading detail in the prospectus, and the general liability sections

The liability arrangements which are determined in the sections dealing with a misleading detail are, in effect, similar to those which are determined in Sections 52 (11) – 52 (14); however they differ in several

important respects. Thus, for example, there is no absolute overlap between the entities to whom the liability applies with regard to the two sections – whereas, according to section 52 (11) the presumption of responsibility applies to the issuer, the Directors of the issuer, its CEO and the controlling shareholder; the presumption of responsibility for publishing misleading information applies to other entities, such as a signatory who supported the offering and who provided an expert opinion, a report, review or approval that was either included or mentioned in the prospectus or in any other report, with his prior consent. Another significant difference concerns the various statutes of limitation between the sections - while the liability for publishing a misleading detail is restricted to two years from the date of the transaction, or seven years from the date of the prospectus - whichever is earlier - liability pursuant to Section 52 (11) is governed by the ordinary rules of limitation, which normally stipulates a statute of limitations of seven years.

These differences in the rules of liability often led to claims being filed by virtue of the two sections together, in which - notwithstanding the fact that the matter in question has an identical factual tract and alleges the publication of a misleading detail - the group of plaintiffs for each of these sections was different (due to the differing statutes of limitations), and therefore the group of defendants was different – a result which is difficult to justify. Moreover, when the Courts were required to consider the two sections, different interpretive approaches evolved: In one instance it was ruled that these two arrangements coexist and therefore there is no prevention from suing based on both sections for the same factual tract; and in another instance an explanation was brought forth that the arrangement relating to a misleading detail is a specific arrangement that overrides the general arrangement provided for in Section 52 (11) (see: P.C (C.C.) 49602-11-11 **Shlomo Peugeot v. Michael Hirschberg** (28.7.2016) para. 176-177; P.C (C.C.) 28811-02-16 **Gabriel Damati v. MannKind Corporation et al**.) (9.1.2018), para. 39). This lack of clarity in respect of the law inflicts on both companies and investors. It should further be stated that a decisive interpretation that the two arrangements apply simultaneously diminished the relevance of the statute of limitations in Section 31(B) with respect to the entities specified in section 31(A); since, in accordance with Section 52 (11), these entities in any event will be subject to the statute of limitations pursuant to Section 52 (11). For additional decisions in which the question of the relationship between the sections has arisen, see also: C.A. 345/03 **Dan Reichert v. Heirs of the late Moshe Shemesh**, of blessed memory, verdict SB(2) 437(2007); P.A. (Economic) 35879-05-14 **Azriel Zolti v. Delek Group Ltd**. (20.02.2017); P.A. (Economic) 38731-08-15 **Uzi Levin v. D - Pharm Ltd.** (31.12.2017).

In light of the aforementioned, it is proposed to amend Section 31 of the law so that it will stipulate that Section 52 (11) of the law will not apply to liability caused by a misleading detail in the prospectus, and the statute of limitation will apply in accordance with Section 31 (B) two years from the date of the transaction, or seven years from the date of the prospectus, the earlier of the two. In addition, since the responsibility for current reports which is determined in Section 38 (C) applies to the arrangement in Section 31 of the Law, Section 52 (11) of the law will also not apply to these reports, but rather only the specific arrangement which is set forth in Section 31 of the law. This determination will clarify the law, will prevent conflicting interpretations by the Courts and will increase assurance in the market with regard to the liability applied to reporting companies.

B. <u>Clarification of liability that applies on the matter of dual registration companies</u>

As stated, at the present time Chapter E (3) of the dual listing arrangement does not include a provision for liability. The absence of a specific arrangement has raised question with regard to a number of legal proceedings in which dual listed companies have been sued. The Israel Securities Authority (hereinafter:

the "ISA") has submitted a position to the Courts and this was, in effect, accepted in their rulings. In the most recent of the proceedings, the Supreme Court remarked that it would be appropriate to clarify the matter in law.

The plaintiffs in these legal proceedings have claimed that responsibility for disclosure should be in accordance with Israeli law, similar to the liability which is applicable to companies that are traded on the Tel Aviv Stock Exchange only. The dual listed companies, on the other hand, asserted that they are liable for disclosure pursuant to foreign law in accordance with the concept of the dual listing arrangement, since the disclosure provisions themselves are in accordance with foreign law.

The position submitted to the Courts by the ISA maintains that the rules of liability which are applicable to the disclosure provided by dual listed companies follow the rules of disclosure. That is to say, in civil lawsuits for breach of the duty of disclosure of a dual listed company, when the disclosure is given under the provisions of foreign law, the liability will be in accordance with the foreign law. However, in civil lawsuits for breach of a specific duty of disclosure which is applicable to a dual listed company pursuant to Israeli law, the rules of liability of the Israeli Securities Law will apply. Thus, for example, if a dual listed company that issued debentures in Israel was required to disclose the debentures and their collateral in accordance with the Israeli law, then in respect thereof the rules of liability pursuant to Israeli law will apply; whereas with respect to the rest of the company's disclosure which is given in accordance with foreign law, the rules of liability of foreign law will apply.

The proposed amendment is, therefore, intended to cement in the law the position of the ISA as this was submitted to the Supreme Court within the context of C.A.A. 7/8737 **Damati v. MannKind Corporation** and C.A. 2889/18 **Cohen v. Tower Semiconductor Ltd**. (together, herein below: the "matter of Damati ") which dealt with the rules of liability that are applicable to dual listed companies. In the Supreme Court ruling in the matter of Damati, the Court adopted the rulings handed down by the Tel Aviv District Court in two cases which were before it, and which had been consolidated in a manner that was consistent with the position of the ISA. The judges furthermore commented that "it would be appropriate to consider a legislative amendment that will clarify the state of matters on the issue that is being explicitly discussed" (para. 5 of the judgment). The proposed amendment addresses this recommendation made by the Court.

The proposed amendment clarifies the law which is applicable in the context of claims made by investors in Israeli Courts against dual listed companies. It retains the right to sue, but at the same time it prevents a situation where the rules of liability would impair the fundamental concept of the dual listing arrangement, which is based on disclosure in accordance with the provisions of foreign law. Moreover, the adaptation of the rules of liability to the rules of disclosure is intended to prevent a situation in which rules of liability of two different legal methods will be simultaneously applicable, in a manner that will impose on dual listed companies a double burden, or conflicting rules.

In accordance, the rules of liability will not impair the fundamental concept of the dual listing arrangement, which is based on disclosure in accordance with the provisions of foreign law. The rules of liability must be in compliance with the rules of disclosure, and not enlarge the exposure of dual registration companies to the Israeli law.

It should be noted that in addition to the rules of liability which relate to disclosure, general liability for violation of the provisions of the law pursuant to Sections 52 (11) through 52 (14) will continue to be applicable to dual listed companies. Thus, for example, a dual listed company which has not appointed a Trustee for holders of promissory notes issued in Israel could find itself liable for breach of the aforementioned obligation in accordance with the general liability sections. As has been explained above

with respect to the amendment of Section 31 of the law, this general liability shall not be applicable in connection with the aspects of disclosure.

A table of public comments and the Authority's reference to them is published on the website of the Authority.

Hereunder the wording of the proposed amendment:

Proposal for Securities Law (Civil Liability Sections) (Amendment No. ___) 5781 - 2021

Liability for damages due to a detail in the prospectus which is misleading

31. (A) (1) The individual who signed on a prospectus pursuant to Section 22 shall be responsible towards the individual who purchased securities within the context of the sale in accordance with the prospectus - and towards whomever sold or purchased securities for trading on the Stock Exchange, or not on the Stock Exchange – in respect of damages caused to them as a result of a misleading detail in the prospectus.

(2) The liability pursuant to para. (1) shall also apply to any individual who was - at the time when the Board of Directors approved the final version of the prospectus - a Director of the issuer, the CEO or its controlling shareholder.

(B) The statute of limitations of a claim pursuant to subsection (A) in respect of which no claim was filed against it for two years from the date of the transaction or seven years from the date of the prospectus, whichever is earlier.

(C) (Canceled).

(D) (Canceled).

(E) Section 52 (11) shall not apply to liability for damages due to a misleading detail in the prospectus.

Chapter E 3: Securities listed for trading on a Stock Exchange overseas

Responsibility for disclosure

35(31)1 (A) A corporation to which the provisions of this chapter apply shall not be liable for damage caused due to a misleading detail which was contained in a registration document, prospectus, reports or notifications, but rather in accordance with foreign law.

(B) Notwithstanding the aforementioned, in the event that a corporation has a duty of disclosure which is not in accordance with foreign law, including by virtue of sections 35 (29) through 35 (31), responsibility for damage resulting from a misleading detail in accordance with the provisions of sections 31 through 34, 38B and 38C shall apply in respect thereof, as the case may be, and *mutatis mutandis*.