Foreign Influences in Israeli Banking Law

Ricardo Ben-Oliel*

A foreigner who sets out to read Israeli private law, mainly in the field of contracts,[1] might find him/herself deeply surprised. In fact, if s/he is a continental lawyer, s/he will likely feel instantly familiar with Israeli legislation, as its technique, basic concepts and manner of internal organization are very close to the legislation in continental countries.

This is the experience that I had when I immigrated to Israel more than thirty years ago from Lisbon, Portugal. When reading the major Israeli contract laws, I felt, to some extent, "at home". But it does not take long to realize that Israeli contract law, in practice, differs significantly from its continental counterparts, largely because the very laws that were originally enacted under continental influence have been discussed by academics, and applied by judges, who did not receive a European-continental legal education.

For instance, regulation of Israeli "banking business", which is a contractual arrangement by nature, is heavily influenced by continental law. However, the laws can be traced to various other sources, rendering it a most interesting field of research in the Israeli mixed jurisdiction.[2]

First, Israel's Banking Law (Licensing), 1981, concerning, among other things, the scope of transactions permitted to commercial banks, is

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* Professor of Private Law and Banking Law at the Law Faculty, Haifa University, Israel. This Article was delivered in Edinburgh in June 2007 and is one of the Papers of the Second World Congress on Mixed Jurisdictions. Six others from the World Congress are published in this volume of the *Tulane European and Civil Law Forum*, seven others are published in volumes 2007(3) and 2008(2) of the *Stellenbosch Law Review*, and ten others are published in the *Journal of Comparative Law* (2008). The entire set is also published online in the *Electronic Journal of Comparative Law* (2008), www.ejcl.org.

1. The most important contractual laws are the Contracts (General Part) Law, 1973, the Contracts (Remedies for Breach of Contract) Law, 1970, and the Standard Contracts Law, 1982. Individual laws cover each contract separately. Actually, there is no Civil Code in Israel, but a final draft was prepared by a special Committee appointed by the Minister of Justice, and awaits approval by the Knesset (Parliament).

2. On the mixed character of Israeli Law, in general, see mainly: D. Friedman, *Independent Development of Israeli Law*, 10 ISR. L. REV. 515 (1975); A.M. Rabello, *The Harmonization of Common Law and Civil Law in the Private Law of the State of Israel*, *in* ISRAELI REPORTS TO THE XIII INTERNATIONAL CONGRESS OF COMPARATIVE LAW 1 (Jerusalem: Sacher Inst. 1990); 1 A. BARAK, INTERPRETATION OF LAW 179 (Jerusalem, Nevo 1992) (in Hebrew); R. Ben-Oliel, *The Israeli Legal System and the Role of Doctrine*" 4 MISHPAT OUMIMSHAL 349 (1998) (in Hebrew).

notorious for being influenced by German law, namely the "Gesetz über das Kreditwesen (KWG)" in the version published on May 3, 1976.

In fact, in both Israel and Germany, the legislature adopted the "universal banking" model, under which the scope of transactions permitted to commercial banks is quite varied and extensive. This model is, in itself, a complex and important topic;[3] however, in this paper, I prefer to focus on foreign influences on the legal framework governing several specific banking transactions.

Banking transactions are contracts.[4] They are covered in Israel by general contract laws which, as previously stated, are the result of a manifest continental influence. The Israeli general rule on *good faith*, and its interpretation in an objective sense, is probably the best example of this influence.[5]

It should be noted that banking contracts are not exclusively covered by general Israeli contract law. For example, with respect to the making of certain banking contracts, frauds and extortion by banks, the Banking (Service to Customer) Law, 1981, introduced specific and original provisions, extending beyond basic contract law.[6] However, a discussion of this and similar laws exceeds the scope of this paper.

To start, I shall consider the most popular of all banking transactions: the current account. As is well known, the distinctive feature of a current account lies in the fact that customers may freely use their money by cheques, credit cards and other means of payment. Cheques are governed by two different laws: one is the Bills of Exchange Ordinance (New Version); the other is the Cheques without Cover Law, 1981. The Bills of Exchange Ordinance (New Version) is basically a direct translation of the English Bills of Exchange Act, 1882. Moreover, under section 2 of the Ordinance, as a general rule, it must be interpreted according to English Law on bills of exchange, cheques and promissory notes.

The purpose of the second law on cheques, the Cheques without Cover Law, 1981, is to punish customers who draw a certain number of

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3. *See* Ricardo Ben-Oliel, *Elements for a Legal Definition of Commercial Banking: A Comparative View*, 16 ISR. L. REV. 499 (1981).

4. For an analysis of the laws covering banking contracts in Israel, see R. Ben-Oliel, *Les Grandes Lignes des Contrats Bancaires en Israel*, 4 REVUE INTERNATIONALE DE DROIT COMPARÉ 1119 (2006).

5. On the matter, see in particular: A.M. RABELLO, THE LAW OF OBLIGATIONS—SELECTED TOPICS FROM ROMAN LAW TO THE NEW LAW OF CONTRACTS 169 et seq. (Jerusalem 1977); 1 D. FRIEDMANN, N. COHEN, CONTRACTS 556 et seq. (Jerusalem 1991); G. SHALEV, THE LAW OF CONTRACTS, GENERAL PART—TOWARDS CODIFICATION OF CIVIL LAW 100 et seq. (Jerusalem 2005).

6. *See* Ben-Oliel, *supra* note 4, at 1121 et seq.

dishonoured cheques. In essence, the punishment consists of "restricting" a customer who has drawn, during a period of twelve months, at least ten cheques which were dishonoured, *inter alia*, for lack of funds. The "restriction" entails preventing the customer from opening a new current account and from drawing cheques on the same account for a period of one year.[7] The Cheques Without Cover Law, 1981, was enacted based on French legislation dealing with a similar phenomenon.[8]

Credit cards are regulated by the Debit Cards Law, 1986. Typically, understanding the purposes of a law, and the "raison d'être" of its provisions, requires the study of its "travaux préparatoires". In the case of the Debit Cards Law, a very detailed report was presented to the Ministry of Justice, at its request, which recommended essential rules to be incorporated into the new legislation.[9] The report demonstrates the dominant influence that Anglo-American legislation had on the development of Israel's Debit Cards Law.

A significant example of this influence concerns the damage caused in cases of misuse of a credit card: Section 5 of the Law adopted a socio-economic test that considers the issuer as the "good risk bearer". Under this perspective, it was established that in a case in which a credit card is stolen or lost, and used by a non-authorized person, the holder of the card shall not be responsible for losses caused from the moment s/he informs the issuer of the loss of the card. With respect to losses caused by misuse of the card before informing the issuer, card holder liability is restricted. This system was directly influenced by American and English law, which established similar basic provisions.[10]

The Bills of Exchange Ordinance (New Version) shall be considered now. As was previously mentioned, generally speaking, the law derives directly from the English Bills of Exchange Act, 1882. As a result,

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7. This is the basic rule of the law. The law established a scheme of cooperation between a bank that restricts a customer after dishonouring his (her) cheques and the Central Bank. The information received by the Central Bank shall be transmitted to the other banks. In case of aggravating circumstances a "restricted customer" shall be prevented from opening a new current account in any other bank for a period of two years. In specific situations restrictions may be imposed by the Execution Officer and by courts. In such a case restrictions may be for a longer period not exceeding five years. For a critical review of the law, see R. Ben-Oliel, *New Banking Business Law in Israel—Critical Notes*, 17 ISR. L. REV. 334, 341 et seq. (1982).

8. Law No. 75-4 of Jan. 3, 1975, specially arts. 65-2, 73, 74.

9. *See* REPORT BY THE COMMITTEE IN CHARGE OF THE LEGAL PROBLEMS REGARDING CREDIT CARDS, STATE OF ISRAEL (Ministry of Justice 1982).

10. In the United States, see the Consumer Credit Protection Act (15 U.S.C. § 1643) and in England, the Consumer Credit Act (1974), § 83, 84. For a general discussion of the Debit Cards Law, 1986, and of section 5 in particular, see R. BEN-OLIEL, BANKING LAW—GENERAL PART 399 et seq. (Jerusalem 1996).

consideration was introduced into the Israeli legal system, in spite of the fact that it is not required in Israeli contract law.

Indeed, Israeli contract law exhibits some degree of autonomy by ignoring both the continental notion of *causa* and the English concept of *consideration*. However, as far as the law of bills is concerned, consideration has been incorporated. The practical result is that the donee of a bill may become unprotected through the rules of the Bills of Exchange Ordinance.[11]

Interestingly, the Bills of Exchange Ordinance was not only influenced by English law. French influence may also be observed. In particular, the French commercial law served as the basis for the provision in the Ordinance regarding guarantees given in promissory notes.[12] In fact, section 57(b) of the Ordinance actually refers to the French term, "bon pour aval", with respect to these guarantees. Additionally, on the promissory note forms currently used, there is a special place for the guarantors' signatures, labelled with the term "guaranty aval".

Of particular interest is the concept of "good faith" under the Bills of Exchange Ordinance and its recent developments. Naturally, acting in good faith is a basic requisite to become a holder in due course.[13] In dealing with cheques, banks are frequently protected when they cause damage to others, as long as they are acting in good faith.[14]

However, what does good faith actually mean? Section 91 of the same Ordinance establishes that the significance of acting in good faith is that a person has acted with honesty.[15] This means that the legislature adopted the *subjective* meaning of good faith, as is accepted in Common law. Consequently, good faith is subject to double interpretation in Israeli private law: it is given an *objective* definition in contract law, and a *subjective* meaning in the law of bills. However, the Israeli Supreme Court is gradually altering the situation. Assuming that a bill is a contract, the Court has decided that the law of contracts also covers the

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11. *See* BEN-OLIEL, *supra* note 10, at 263 et seq.

12. On the above fact and its influence in courts in interpreting the regime of guarantees given in promissory notes according to French law, see Y. SUSSMAN, THE LAW OF BILLS OF EXCHANGE 292 (6th ed. Jerusalem 1983).

13. Bills of Exchange Ordinance § 28(a)(2).

14. Section 23(c) grants protection in case of payment of a cheque with a forged or unauthorized endorser's signature. Sections 79 and 80 protect in case of payment of a crossed cheque and section 82 in collecting a crossed cheque.

15. *See* in particular: SUSSMAN, *supra* note 12, at 272 et seq.; A. BARAK, THE ESSENCE OF A BILL 125 (Jerusalem 1974); BEN-OLIEL, *supra* note 10, at 97 et seq., 274 et seq.; S. LERNER, THE LAW OF BILLS AND NOTES 472 (2d ed. Jerusalem 2007).

bill and, therefore, the concept of good faith may be considered in its *objective* sense.[16]

There are numerous other examples of the influence, whether direct or indirect, of foreign laws and legal theories on Israeli law. Rather than continue to focus on specific instances, however, this paper will now consider the same phenomenon in a more general sense.

The question of the fiduciary duties of banks is a basic theory that has recently developed in the field of banking. The concept derives from English law, but Israeli courts have changed it deeply. In fact, over the past several years, the courts have repeatedly established that in giving their services, banks must act under three different rules: they must act in good faith, with due care and also under fiduciary duties towards their customers.

The principle of good faith is contractual, and it was established in Israel by the general Contract Law. Due care proceeds directly from the Torts Ordinance (New Version).[17] However, regarding the fiduciary duty, some questions arise, including, what is its legal source and true meaning?

The fiduciary duties of banks were not generally recognized by Israeli law, with the exception of two particular laws: the Investment Advice Law, 1995,[18] and the Agency Law, 1965. According to section 11 of the former, a fiduciary duty exists in the provision of any investment consulting service. Section 8 of the Agency Law recognizes the fiduciary duties of agents, but it is obvious that in many situations bankers are not acting as agents.

The fiduciary duties of banks were established by the Supreme Court in the case of *Tefahot Mortgage Bank v. Tzabach & Others*.[19] This case represented the first time that an Israeli court deeply analysed the concept and decided that a banker-customer relationship is, by its very nature, a fiduciary relationship. The facts in the *Tefahot* case were simple: several young couples applied for bank credit in order to purchase houses that were being constructed by another customer of the same bank. The building contractor was in financial straits, and the

16. *See* Liberman v. Bank Discount LeIsrael, (2000) 54 (4) P.D. 804 at 811 et seq. In this case the Court discussed the nature of the obligation of the bank towards a guarantor who signed a bill in favour of a client. After establishing that a right incorporated in a bill is in its nature a contractual one, Chief Justice Barak decided that there is no reason not to apply in the contract of the law of bills the general concept of good faith in its contractual (objective) meaning.

17. Sections 35-36.

18. The full name of the law is Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management Law, 1995.

19. (1994) 48 (2) P.D. 573.

banker was helping him to avoid bankruptcy. Clearly, the bank was, in principle, under two conflicting obligations: one was the duty owed to the first group of customers to be forthright about the very risky transaction they intended to make; the other was the obligation of secrecy toward the building contractor.

In an unprecedented decision, Justice Shamgar established that in conflict of interest cases, banks must be very careful in resolving the question of preference of one or another obligation. However, in the *Tzabah* case, it was maintained that the bank had a duty to disclose the conflict to its customers.

Justice Shamgar took advantage of the opportunity to examine the fiduciary duty theory and established two basic rules: first, a fiduciary duty exists in every banker-customer relationship, and not only in specific situations, as is the case in English law;[20] and second, the definition and scope of the fiduciary duty owed will be specific to the kind of transaction and the concrete circumstances under which the transaction is made.[21] But what about the true meaning of a fiduciary duty? Banks must act in good faith and with due care. Then, the question frequently arises in Israel about the real need for the new concept.

The fact is that, following the *Tzabach* case, tens of other court decisions have maintained the same rule emphasizing the particularity of this duty, namely the very high standard of professionalism, due care and honesty required of banks. This means that banks are not under the general rules of good faith and diligence covering every contract, but rather their transactions fall under much higher standards of integrity and professionalism. This duty can only be seen as the price banks must pay for the rather beneficial treatment frequently given to them by Israeli law,

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20. *See, e.g.*, Lloyds Bank v. Bundy, 3 All E.R. (1974) 757; Woods v. Martins Bank, 1 Q.B. 55 (1959); Nat'l Westminster Bank v. Morgan, 3 All E.R. 85 (1983) A.C. 686 (1985).

Also in English law, see: J. WADSLEY & G.A. PENN, THE LAW RELATING TO DOMESTIC BANKING 107 (2d ed. London: Sweet & Maxwell 2000); R. CRANSTON, PRINCIPLES OF BANKING LAW 187 (2d ed. Oxford: Oxford University Press 2006); E.P. ELLINGER, E. LOMNICKA & R.J.A. HOOLEY, ELLINGER'S MODERN BANKING LAW 130 (4th ed. Oxford: Oxford University Press 2006).

In Canada, see, for example: M.H. OGILVIE, CANADIAN BANKING LAW 457 (2d ed. Toronto: Carswell 1998). *See also* Ruth Plato-Shinar, *The Bank's Fiduciary Duty: An Israeli-Canadian Comparison*, 22 B.F.L.R. 1 (2006).

21. In so deciding, the Supreme Court accepted an opinion that I had previously maintained in my article *Safety Boxes: A New Approach for the Definition of the Service and the Terms of Liability of the Banker Towards His Customer*, 37 HAPRAKLIT 76, 82 et seq. (1986).

and for the confidence placed in them by customers, who receive banking services under standard contracts.[22]

In short, the Supreme Court did not adopt a specific theory in recognizing the fiduciary duty of banks—such as those of trust and reliance, theory of control, or of inequality of bargaining power between the parties—but, rather integrated these principles.[23] The practical result is that banks are not limited to the duty of good faith, and the obligation to take reasonable precautions in their transactions, as imposed by the duty of care, in order to prevent the tort of negligence. Rather, under the fiduciary theory, banks must act—in every transaction and toward every kind of customer—with the highest standard of skill and professionalism, integrity and fairness. Whatever the transaction, banks are under a fiduciary duty.

Furthermore, since the *Tzabach* decision, the courts must define on a case-by-case basis, given the particular circumstances, the specific content of the fiduciary duty owed. One can accurately conclude that the Common Law theory on fiduciary duties was accepted in Israel. However, the original concept has been significantly altered, mainly by enlarging its scope: instead of the limited approach under which the duty was recognized only regarding specific transactions and in particular circumstances, a much more expansive view was adopted. Thus, under this different and broadened perspective, the bank's fiduciary duty has become a basic and valuable principle in Israeli banking law.

In sum, although Israeli banking business law is heavily influenced by continental and Anglo-American law, Israeli courts and jurists have noticeably altered the legal concepts on which these laws were originally based, creating a new set of laws particular to Israel.

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22. BEN-OLIEL, *supra* note 10, at 99 et seq.; Ben-Oliel, *supra* note 4, at 1138 et seq.; Ruth Plato-Shinar, *An Angel Named "The Bank": The Bank's Fiduciary Duty as the Basic Theory in Israeli Banking Law*, 36 COMMON LAW WORLD REV. 27 (2007).

23. Plato-Shinar, *supra* note 22, at 33 et seq.