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Ruth Plato-Shinar

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The Banking Contract as a Special Contract: The Israeli Approach

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THE BANKING CONTRACT AS A SPECIAL CONTRACT: THE ISRAELI APPROACH

*Ruth Plato-Shinar**

I. INTRODUCTION

The banker-customer relationship is a contractual relationship based on a contract between the parties.¹ As a contractual relationship, it is governed by contract law.² However, contract law does not provide the customer with the protection he or she requires against the bank.³ Therefore, the Israeli courts have adopted a unique approach in determining that the banking contract is a special contract—a fiduciary contract.⁴ Under a fiduciary contract, the bank, as a fiduciary, is subject to a fiduciary duty vis-à-vis the beneficiary, the customer.⁵ The fiduciary duty imposes a very high standard of behavior on the bank, much higher than the standard imposed on it under contract law. By adopting a fiduciary approach, the customer is granted very wide protection against the bank.

* Ruth Plato-Shinar is a law professor, founder, and director of the Center for Banking Law, Netanya Academic College, Israel. This Article was presented in a symposium entitled “Law of Contracts or Laws of Contracts?” that took place at Netanya Academic College, Israel, in December 2011.

¹ E.P. ELLINGER, E. LOMNICKA, C.V.M. HARE, ELLINGER’S MODERN BANKING LAW 119 (5th ed. 2011) [hereinafter ELLINGER ET AL., ELLINGER’S MODERN BANKING LAW]; RUTH PLATO-SHINAR, THE BANK’S FIDUCIARY DUTY: THE DUTY OF LOYALTY 38 (2010) [hereinafter PLATO-SHINAR, THE BANK’S FIDUCIARY DUTY].

² ELLINGER ET AL., ELLINGER’S MODERN BANKING LAW, *supra* note 1.

³ Ruth Plato-Shinar, *An Angel Named “The Bank”: The Bank’s Fiduciary Duty as the Basic Theory in Israeli Banking Law*, 36 COMMON L. WORLD REV. 27 (2007) [hereinafter Plato-Shinar, *An Angel Named “The Bank”*] (“The courts in Israel have stressed the tremendous power which the bank wields over its customers, the trust which the customer places in the bank and the almost blind reliance of the customer on the bank’s advice.”).

⁴ *Id.* at 27, 29.

⁵ *Id.*

This Article is structured as follows: Part II describes the stages of development of the Israeli legal approach to the bank-customer relationship from a general contractual approach to a fiduciary approach. Part III focuses on the banking contract as a fiduciary contract. It analyzes the justifications put forward by Israeli courts for the adoption of the fiduciary approach (i.e., the unique characteristics of the banking contract). It explains the nature of the fiduciary duty imposed on the bank and the scope thereof, and it describes the remedies granted to the customer in cases of a breach of the fiduciary contract. Part IV focuses on the bank's duty of disclosure. It compares the general contractual duty of disclosure to its counterpart under the fiduciary regime. Part V concludes that the recognition of the banking contract as a special fiduciary contract will lead to the creation of fair and proper banking practices.

II. FROM A GENERAL CONTRACTUAL APPROACH TO A FIDUCIARY APPROACH

A. The General Contractual Approach

The banker-customer relationship is a contractual relationship.⁶ It is created by engaging in a contract and continues to exist as long as the contract is in effect and comes to an end upon the termination of the contract.⁷ Because the relationship is contractual, it is governed by contract law.⁸

However, the implementation of contract law in the banking context creates a problem: contract law does not take into consideration situations of inequality of power between the parties.⁹ Contract law determines arrangements that seek to balance the interests of the contracting parties based on the presumption that they are equal in power.¹⁰ In situations of a serious power disparity

⁶ ELLINGER ET AL., ELLINGER'S MODERN BANKING LAW, *supra* note 1.

⁷ Plato-Shinar, *An Angel Named "The Bank," supra* note 3, at 36.

⁸ See Contracts (General Part) Law, 5733-1973, 27 LSI 117 (1972-1973) (Isr.) (defining a contract); see also Contract (Remedies for Breach of Contract) Law, 5731-1970, 25 LSI 11 (1970) (Isr.) (applying when a contract has been broken); Pledges Law, 5727-1967, 17 LSI 44 (1967) (Isr.) (applying to pledges and mortgages); Agency Law, 5725-1965, 19 LSI 231 (1965) (Isr.) (applying when the bank acts as a customer's agent); Bailees Law, 5727-1967, 21 LSI 49 (1967) (Isr.) (applying when the bank acts as a bailor for the customer).

⁹ Plato-Shinar, *An Angel Named "The Bank," supra* note 3, at 35.

¹⁰ DANIEL FRIEDMAN & NILI COHEN, CONTRACTS 59, 128 (1991) [hereinafter FRIEDMAN &

between the parties, these laws do not provide any particular protection for the weaker party. As will be explained later, the bank-customer relationship is characterized by a huge inequality of power, and therefore contract law is not an appropriate tool for the regulation of this contractual relationship.¹¹

Moreover, contract law is not *jus cogens* and therefore contractual derogation is permitted.¹² Hence, even if one of these laws contains a clause that aims to protect one of the parties to the contract, it can be assumed that in a situation of a disparity of power, the stronger party would contract out of such a clause. Indeed, this is the situation in the banking context; banks used to make stipulations regarding various statutory clauses in order to protect their interests and to minimize their liability.¹³

There are some exceptions to this rule. A few clauses in the Contracts (General Part) Law¹⁴ may provide the banking customer with adequate protection, such as the duty to act in good faith,¹⁵ the prohibition against misleading,¹⁶ or the prohibition against exploitation.¹⁷ These clauses seek to establish a proper and fair standard of behavior and therefore they are *jus cogens*. But however useful these clauses are, they are only isolated clauses and do not provide adequate protection for the banking customer.

Another contractual tool that may protect the banking customer is the Standard Contracts Law.¹⁸ This law applies to banking contracts, which are standard contracts.¹⁹ Sections 3 and 4 of this law authorize courts to “annul or change any condition of a standard contract which . . . involves an undue disadvantage to customers or an unfair advantage for the supplier, which is likely to

COHEN, CONTRACTS].

¹¹ *Id.*

¹² *Id.* at 125; GABRIELA SHALEV, THE LAW OF CONTRACT—GENERAL PART 50 (2005) [hereinafter SHALEV, THE LAW OF CONTRACT].

¹³ SHALEV, THE LAW OF CONTRACT, *supra* note 12.

¹⁴ *See generally* Contracts (General Part) Law, 5733-1973, 27 LSI 117 (1972-1973) (Isr.).

¹⁵ *Id.* at §§ 12, 39.

¹⁶ *Id.* at § 15.

¹⁷ *Id.* at § 18.

¹⁸ Standard Contracts Law, 5743-1982 37 LSI 6 (1982) (Isr.).

¹⁹ *Id.* at § 2 (defining the term “standard contract” as “the text of a contract, all or some of the conditions of which were determined in advance by one party, in order to serve as conditions of many contracts between him and persons unidentified as to number or identity”).

lead to the customers' deprivation."²⁰ But attempts to attack clauses of banking contracts on the ground that they are unfair usually fail.²¹ The courts have adopted a very conservative attitude in the implementation of the law.²² They usually prefer not to intervene in the content of the banking contract and avoid removing depriving contractual clauses from banking contracts.²³ The banks have taken advantage of the court's passive attitude and have continued using contracts that include unfair clauses.²⁴

In summary, from an empirical point of view, the use of contract law in banking disputes has neither created a proper balance between the banks and their customers, nor has it provided the customer with a suitable level of protection.²⁵

B. Banking (Service to Customer) Law, 5741-1981²⁶

The experience accumulated in the implementation of the contractual approach to the bank-customer relationship reveals that true protection for the customer requires a specific and cogent arrangement.²⁷ Indeed, this was the rationale behind the enactment of the Banking (Service to Customer) Law.²⁸ This law is the main law that regulates the contractual relationship between the bank and the customer.²⁹ It is intended to solve the problem of power disparity

²⁰ *Id.* at §§ 3-4.

²¹ Sinai Deutch, *Bank-Customer Relationship: Contractual and Consumer Aspects*, in A BOOK IN HONOUR OF GAD TADESKY 163, 183 (1996) [hereinafter Sinai Deutch, *Bank-Customer Relationship*].

²² *Id.*

²³ *Id.*

²⁴ The courts' attitude may change now as a result of several judgments that have been delivered recently by the Special Tribunal for Standard Contracts. *See, e.g.*, File No. 195/97, Att'y Gen. v. Bank Leumi (2004) Nevo Legal Database (by subscription) (Isr.) (holding that after examining the bank's checking account agreement, dozens of clauses deprived the customers and must be removed or altered); *see also* CA 6916/04 Bank Leumi Le-Israel Ltd. v. Att'y Gen. [2010] (Isr.); CA 8002/02 Supervisor of Banks v. First Int'l Bank Ltd. PD [2009] (Isr.) (holding that many of the clauses in a housing loan agreement deprive customers of their rights, pending an appeal in the Israeli Supreme Court).

²⁵ Sinai Deutch, *Bank-Customer Relationship*, *supra* note 21, at 164, 169, 170-71, 192, 194.

²⁶ Banking (Service to Customer) Law, 5741-1981, 35 LSI 312 (1981) (Isr.).

²⁷ PLATO-SHINAR, THE BANK'S FIDUCIARY DUTY, *supra* note 1, at 39.

²⁸ Ruth Plato-Shinar, *Banking (Service to Customer) Law 1981: On the Absence of a Fiduciary Duty*, HUKIM-J. ON LEGIS. (forthcoming 2013) [hereinafter Plato-Shinar, *Banking (Service to Customer) Law 1981*].

²⁹ *Id.*

between the parties and to ensure that the bank does not abuse it to the detriment of the customer.³⁰

The Banking (Service to Customer) Law includes a long line of protective clauses for the customer, such as the prohibition against misleading;³¹ the prohibition against injury in specific circumstances;³² the duty to disclose details of the banking transaction;³³ a duty to provide certain banking services;³⁴ a prohibition against making a service conditional on another service;³⁵ determining methods for calculating interest and the dates for entering debits and credits;³⁶ restrictions and responsibility regarding advertising;³⁷ etc. “The provisions of this Law” are cogent and applicable notwithstanding “any waiver or agreement to the contrary.”³⁸ It has furthermore been prescribed that any breach of the provisions confers the civil remedy of compensation on the aggrieved customer.³⁹ In addition, it may constitute a criminal offense on the part of the bank, its managers, and its senior officials.⁴⁰ Another important tool that has been prescribed by the law is the certification of the supervisor of banks to examine inquiries by the public concerning their transactions with the bank, and, in cases where the inquiry is deemed to be justified, to order the bank to rectify the defect.⁴¹

However, even the Banking (Service to Customer) Law does not afford the customer full protection. The law addresses specific issues and does not provide the customer with sweeping protection.⁴² It does not address common problems such as the provision of non-objective financial advice or the complex matter of conflicts of interest in banking activities.⁴³ Moreover, some of the sections

³⁰ *Id.*

³¹ Banking (Service to Customer) Law § 3.

³² *Id.* at § 4.

³³ *Id.* at § 5.

³⁴ *Id.* at § 2.

³⁵ *Id.* at § 7.

³⁶ Banking (Service to Customer) Law § 8.

³⁷ *Id.* at § 6.

³⁸ *Id.* at § 17.

³⁹ *Id.* at § 15.

⁴⁰ *Id.* at §§ 10, 11.

⁴¹ Banking (Service to Customer) Law § 16.

⁴² Plato-Shinar, *Banking (Service to Customer) Law 1981*, *supra* note 28.

⁴³ Ruth Plato-Shinar, *The Bank's Fiduciary Duty Under Israeli Law: Is There a Need to Transform it from an Equitable Principle Into a Statutory Duty?*, 41 COMMON L. WORLD

included in the law are drafted vaguely, resulting in their scope not being sufficiently defined; for example, section 3, which prohibits misleading.⁴⁴ It is disputed whether this section imposes an active duty of disclosure on the bank.⁴⁵ Another problem that arises with this law is that the only remedy it provides is compensation.⁴⁶ It does not include other basic remedies such as rescission of the contract.⁴⁷

The enactment of the Banking (Service to Customer) Law reflected the view of the legislator that the banking customer should be given special protection. The courts have continued in this direction and have implemented this concept by adopting the fiduciary approach.⁴⁸ As will be shown in Part III, the classification of the banking contract as a fiduciary contract can solve the aforementioned problems and provide the customer with the protection he or she needs.⁴⁹

C. The Doctrine of Consumer Protection

The two laws mentioned above, the Standard Contracts Law and the Banking (Services to Customer) Law, reflect an important trend that started to gain momentum in Israel in the 1980's: the trend towards consumer protection.

Underlying this trend is the disparity of power between the dealer and the consumer. The starting point is the consumer's inability to deal with the sophisticated markets of the modern world due to changes in market structure, technological innovations, and the variety of products and services. The inequality between the parties is due not only to the dealer's more substantial economic power, but also to factors such as the complexity of the transaction, the expertise of the dealer in the relevant field, and the lack of feasibility for the consumer to negotiate on the contract because of

REV. 219, 236-41 (2012) [hereinafter Plato-Shinar, *The Bank's Fiduciary Duty*] (discussing lack of consumer protection); see Plato-Shinar, *Banking (Service to Customer) Law 1981*, *supra* note 28.

⁴⁴ Banking (Service to Customer) Law § 3 (prohibiting misleading without defining it).

⁴⁵ PLATO-SHINAR, *THE BANK'S FIDUCIARY DUTY*, *supra* note 1, at 243; see also *infra* Part IV.

⁴⁶ Plato-Shinar, *Banking (Service to Customer) Law 1981*, *supra* note 28.

⁴⁷ *Id.*

⁴⁸ Ruth Plato-Shinar & Rolf H. Weber, *Three Models of the Bank's Fiduciary Duty*, 2 L. & FIN. MARKETS REV. 422, 428 (2008) [hereinafter Plato-Shinar & Weber, *Three Models*].

⁴⁹ *Id.* at 432.

the low chances of success in such negotiations.⁵⁰ The weakness of the consumer is reflected in various areas: both at the stage of the formation of the legal norm and at the stage of exercising it; on an individual level as well as on a group level; and in terms of bargaining power as well as in terms of informational gaps.⁵¹

Nevertheless, the inferiority of the consumer alone is not a good enough reason for the intervention of the law. The law should intervene only out of concern that the inferiority of the consumer could be abused by the dealer. The consumer protection law seeks to minimize the situations where the power of the dealer is abused by imposing limitations on the dealer's conduct.⁵² The traditional justification for the special protection of the consumer's interest is therefore protection against exploitation of the consumer's relative weakness.⁵³ The freedom of contract is undermined due to the need for intervention aimed at providing protection for the consumer, whose inferior position may be exploited by the dealer.

The Israeli courts have incorporated this rationale in various contexts, including in the banking field.⁵⁴ The recognition of the banking contract as a fiduciary contract is a reflection of this trend.

D. The Fiduciary Approach

In the 1980s, the perception of the banking contract as a fiduciary contract began to emerge in Israel.⁵⁵ The courts realized that the existing contractual tools did not provide the unique protection required by the banking customer.⁵⁶ The courts acknowledged that effective protection of the bank's customer required a different legal basis.⁵⁷ The solution to this was found in the form of the fiduciary contract.⁵⁸

⁵⁰ SINAI DEUTCH, CONSUMER PROTECTION LAW—FOUNDATIONS AND PRINCIPLES 52-53, 125-26 (2001) [hereinafter SINAI DEUTCH, CONSUMER PROTECTION LAW].

⁵¹ ORNA DEUTCH, CONSUMER LEGAL PROTECTION 87-118, 537 (2003) [hereinafter ORNA DEUTCH, CONSUMER LEGAL PROTECTION].

⁵² *Id.* at 129-32, 538; SINAI DEUTCH, CONSUMER PROTECTION LAW, *supra* note 50, at 120.

⁵³ ORNA DEUTCH, CONSUMER LEGAL PROTECTION, *supra* note 51, at 87-118, 537.

⁵⁴ Plato-Shinar & Weber, *Three Models*, *supra* note 48, at 424.

⁵⁵ *See id.* at 429 (citing CA 1/75 Israel Mortg. Bank Ltd. v. Hershko 29(2) PD 208 [1975] (Isr.) (showing the first case in Israel acknowledging the fiduciary duty of banks)).

⁵⁶ *Id.* at 432.

⁵⁷ *Id.*

⁵⁸ *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988

Israeli courts ruled that the banking contract is a unique contract: a fiduciary contract.⁵⁹ The fiduciary contract imposes on the bank, as a fiduciary, a very high standard of behavior: a fiduciary duty towards its customer.⁶⁰ The fiduciary duty is intended to curb the power of the bank and to make sure that the bank does not abuse it to the detriment of the customer. The fiduciary duty serves as a complementary and correcting standard where conventional contract law has failed. “Its draft as an obscure standard left the courts with an extensive area for discretion and casuistic application, and they applied it in a manner consistent with basic human and social attitudes.”⁶¹ The fiduciary duty has been “recognize[d] . . . as a justified and worthy instrument” for the protection of the bank’s customers, and courts have used it in an ever increasing number of cases.⁶² “Over the years, the fiduciary duty has been established as a basic theory in Israeli banking laws.”⁶³

III. THE BANKING CONTRACT AS A FIDUCIARY CONTRACT

A. The Nature of the Fiduciary Duty

The classification of the banking contract as a fiduciary contract imposes on the bank, as a fiduciary, a special duty towards its beneficiary—the customer—a fiduciary duty.

The bank’s fiduciary duty sets a very high standard of conduct for the bank, obligating it to act with integrity, fairness, professionalism, and skill. However, at the heart of the duty stands the duty to exercise the power vested in the bank without abuse. The key words are loyalty and fidelity. “The bank ‘as a fiduciary’ is required to perform its duties solely for the purpose for which the power was vested in it, without ulterior motives and while protecting

DUKE L.J. 879, 879 (1988); Scott FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 303 (1999); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1211 (1995); Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795 (1983) [hereinafter Frankel, *Fiduciary Law*] (regarding the relation between the general contract law and the fiduciary obligation in the general context).

⁵⁹ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 27.

⁶⁰ *Id.* at 29.

⁶¹ *Id.* at 28.

⁶² *Id.*

⁶³ *Id.*

the interest of the beneficiary—the customer.”⁶⁴ The bank must act for the best interest of the customer. “Moreover, the bank must prefer the interest of its customer to the interests of others, including its own self-interest.”⁶⁵

Requiring a person to act for the beneficiary’s interest and to prefer the beneficiary’s interest to his or her own personal interest is a particularly stringent one. Both private civil law and common law in Israel have no obligation that sets a conduct threshold higher than the fiduciary duty. . . . The fiduciary duty is a stringent obligation also when compared to the duty of care that lies at the base of the tort of negligence, because the duty of care requires the taking of reasonable precautions only, and nothing more. Thus, while the duty of care is intended to prevent damage, the fiduciary duty is intended to prevent a person from abusing his power. It is therefore possible for a breach of fiduciary duty to occur without any damage being caused.⁶⁶

“The fiduciary duty determines a standard of conduct higher than the duty of good faith,” which was adopted in Israel from German law.⁶⁷ “[W]hile the duty of good faith requires a person to act fairly in the course of pursuing his or her own personal interest, the fiduciary duty requires that person to prefer the interest of the other to his or her own personal interest.”⁶⁸ No wonder the fiduciary

⁶⁴ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 29 (quoting CA 6830/11 Baranovitz v. Teomim, 57(5) PD 691, 700-01 [2003] (Isr.)); see Frankel, *Fiduciary Law*, *supra* note 58 (discussing the nature of the fiduciary duty in general).

⁶⁵ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 29; see Klaus J. Hopt, *Trusteeship and Conflicts of Interest in Corporate, Banking and Agency Law Toward Common Legal Principles for Intermediaries in the Modern Service-Oriented Society*, in *REFORMING COMPANY AND TAKEOVER LAW IN EUROPE* 51, 77 (Guido Ferrarini et al. eds., 2004); Aharon Barak, *Conflicts of Interest in the Performance of Duties*, 10 MISHPATIM 11 (1980).

⁶⁶ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 30 (citing CA 610/94 Buchbinder v. Official Receiver 57(4) PD 289, 33 [2003] (Isr.)).

⁶⁷ *Id.*; Ricardo Ben-Oliel, *Foreign Influences in Israeli Banking Law*, 23 TUL. EUR. & CIV. L.F. 167, 167-68 (2008).

⁶⁸ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 30 (citing *Buchbinder*, 57(4) PD at 332; M. Rubinstein & B. Okon, *The Bank as a Social Agency*, in *SHAMGAR BOOK—ARTICLES* Part C 819, 821 (2003)).

duty was recognized as an altruistic duty, and was described by the metaphor of “an angel’s behavior.”⁶⁹

B. Justifications for the Classification of the Banking Contract as a Fiduciary Contract

Israeli courts have based the classification of the banking contract as a fiduciary contract on a variety of justifications and legal theories.⁷⁰ They emphasize the trust that the customer has in the bank and the reliance (sometimes blind) on the bank’s advice—the “theory of trust and reliance.”⁷¹ They mention the control that the bank has over the customer’s financial assets and economic interests (“the theory of control”).⁷² Israeli courts see the banks as quasi-public bodies and, as a result, they impose a particularly high standard of conduct on them.⁷³ However, it appears as if the main reason for the court’s special approach to the banking contract is the great inequality of power between the parties to the contract.⁷⁴

A huge disparity of power exists between the banks and most of their customers.⁷⁵ There are huge differences in the level of

⁶⁹ *Id.* (citing AHARON BARAK, JUDICIAL DISCRETION 497 (1987)).

⁷⁰ *See id.* at 35 (exploring the justifications given by Israeli courts); Ruth Plato-Shinar, *The Bank’s Duty of Disclosure Towards a New Model*, 27 BANKING & FIN. L. REV. 427 (2012) [hereinafter Plato-Shinar, *The Bank’s Duty*]; Ariel Porath, *The Responsibility of the Banks in Respect of Negligence: Recent Developments*, in HAMISHPAT YEAR BOOK 1992-1993, 324 (1994) [hereinafter Porath, *The Responsibility of the Banks*].

⁷¹ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 33-34; CA 1570/92 United Mizrahi Bank Ltd. v. Ziegler 49(1) PD 369, 384 [1995] (Isr.); 195/97, *Att’y Gen.* at ¶ 4.

⁷² Compare Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 34, with CA 817/79 Kosoi v. Y.L. Feuchtwanger Bank Ltd. 38(3) PD 253, 278 [1984] (Isr.), and HCJ 531/79 Likud Faction v. Petach Tikva City Council 34(2) PD 566, 570 [1980] (Isr.).

⁷³ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 35; CA 5379/95 Sahar Ins. Co. v. Isr. Disc. Bank 51(4) PD 464, 476-77 [1997] (Isr.); CA 8068/01 Ayalon Ins. Co. Ltd. v. Ex’r of the Estate of the Late Oppelgar 59(2) PD 349, 369 [2004] (Isr.).

⁷⁴ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 35; *see* Lloyds Bank v. Bundy, [1975] Q.B. 326 (Eng.) (rejecting this argument explicitly in England’s House of Lords as a basis for imposing a fiduciary duty on the banks); *overruled by* Nat’l Westminster Bank Plc. v. Morgan, (1983) 3 All E.R. 85 (Eng.), *rev’d* (1985) 1 A.C. 686 (Eng.) (preferring the doctrine of unequal bargaining power to that of the fiduciary duty); CA 5893/91 Tefahot Isr. Mortg. Bank Ltd. v. Tzabach 48(2) PD 573, 591-92 [1994] (Isr.); 195/97, *Att’y Gen.* at ¶ 4; Opening Motion CrimC (TA) 431/01 Isr. Ass’n of Banks v. Isr. Sec. Auth., PM 2002(2) 529, 548 (2002) (Isr.); CA 6234/00 Sh.A.P. Ltd. v. Bank Leumi Le-Israel Ltd. 57(6) PD 769, 788 [2003] (Isr.); *see also* CA 1304/91 Tefahot Isr. Mortg. Bank Ltd. v. Liepart 47(3) PD 309, 322 [1993] (Isr.) (regarding a guarantor).

⁷⁵ Plato-Shinar, *An Angel Named “The Bank,”* *supra* note 3, at 35. We should not ignore the existence of customers who possess financial and economic power that compares with

professional knowledge, technical methods of managing and monitoring financial activities, financial power, bargaining power, and so on. The customer's inferiority in his dealings with the bank characterizes every stage of their relationship from the negotiation stage through to the signing of the banking contract, the execution period of the contract, and up until the termination of the relationship. The customer's inferiority is also reflected in instances of legal disputes with the bank given the existence of a great inequality in the financial ability to conduct legal proceedings and the difficulties of proof that stem from the lack of full information; this is due to the inferiority in the bargaining position in the negotiation stage and the lack of previous experience in legal conflicts.⁷⁶

We have, therefore, seen the great inequality that exists between the bank and the typical customer. However, inequality of power alone is not a sufficient reason for the intervention of the law. The intervention of the law is justified only where the inequality of power is accompanied by a genuine concern that the party holding the power may unfairly take advantage of the weaker party.⁷⁷

Moreover, the power inequality becomes problematic when it creates a dependency of the inferior party on the stronger party.

the strength of the banks, such as the large corporations or wealthy families. These are sophisticated customers who have the power to purchase professional counselling services and inspection services, and who have bargaining power in their dealings with those banks that wish to acquire them as customers. A comparison of the relative power of the bank and the customer in such cases should, apparently, lead to the conclusion of denying a fiduciary duty in relation to these customers. However, this is not so. Israeli courts have used the justification of the inequality of power between the banks and the customer as a typical justification that does not require examination of every case on the merits. The courts view the inferiority of the customer as "sector based inferiority" and they apply the justification of the inequality of power as an assumption that cannot be contradicted with respect to each and every customer. See CA 7424/96 Mizrahi United Bank Ltd. v. Eliahu Garziani (1988) Co. Ltd. 54(2) PD 145, 161-62 [2000] (Isr.); 195/97, *The Att'y Gen.* at ¶ 4 (recognizing the inequality of power with respect to all of the bank's customers, and particularly with respect to retail customers). Compare CC (Jer) 2452/00 Bank Leumi Le Israel Ltd. v. Stukman Takdin District, 2006(4), 2822, ¶ 12 (2006) (Isr.) (acknowledging the inequality of power with respect to a business customer who was assisted by financial professionals), with ORNA DEUTCH, CONSUMERISM 536-37 (2001) [hereinafter ORNA DEUTCH, CONSUMERISM] (discussing the "typical inferiority" of the consumer vis-à-vis the dealer).

⁷⁶ ORNA DEUTCH, CONSUMERISM, *supra* note 75, at 537; see also Plato-Shinar, *An Angel Named "The Bank," supra* note 3, at 33, 36.

⁷⁷ ORNA DEUTCH, CONSUMERISM, *supra* note 75, at 129-32, 538; Sinai Deutch, *Bank-Customer Relationship, supra* note 21, at 120; see also Plato-Shinar, *An Angel Named "The Bank," supra* note 3, at 35; Plato-Shinar, *The Bank's Fiduciary Duty, supra* note 43, at 225-26 (stating that, unfortunately, there are more than a few examples for such a behavior that was executed by Israeli banks).

Indeed, the tremendous power given to the bank creates a real dependency of the customer. The customer is dependent on the bank in the provision of the service, the manner in which it is performed, the determination of the price, as well as in the determination of the legal arrangement that applies to it, as set forth hereunder.⁷⁸

1. *The Provision of the Service*

A discretion is conferred upon the bank to agree or refuse to carry out the banking transaction that the customer requests. Indeed, section 2 of the Banking (Customer Service) Law requires the bank to provide the customer with certain services, but this section is quite limited and applies only to three types of services: receiving a monetary deposit in Israeli currency or in foreign currency; selling bank checks; and opening and managing current accounts.⁷⁹ With respect to opening a current account, the obligation to provide the service is very limited and does not include providing credit, issuing checkbooks for the account, or providing a debit card.⁸⁰ Hence, in most of the transactions, the customer is dependent on the bank's willingness to provide the service requested. A customer's dependence on the service provider is not exclusive to the banking sector and therefore it is insufficient *per se* to justify the imposition of a fiduciary duty.⁸¹ However, what distinguishes it in the banking context is the fact that this is a dependency that relates to the provision of services essential to the public.⁸² There is not a person

⁷⁸ Sinai Deutch, *Protection of the Bank Customer: By Statute or by Ethical Codes—Which is Preferable? An Israeli Perspective*, 2 DEPAUL BUS. & COM. L.J. 419, 424 (2004) [hereinafter Sinai Deutch, *Protection of the Bank Customer*]; Tzabach, 48(2) PD at 591; CA 122/84 Mantzur v. Israel 38(4) PD 94, 101 [1984] (Isr.); RICARDO BEN-OLIEL, BANKING LAW—GENERAL PART 84 (1996) [hereinafter BEN-OLIEL, BANKING LAW]. This is true also with respect to business customers such as companies. See Committee for Establishing PARAMETERS FOR INST'L BODIES' INVS. IN NONGOVERNMENTAL BONDS, *Final Report* at 73 (2010), available at <http://www.mof.gov.il/Insurance%20savings/Pages/HodakCommitteeReport.aspx>.

⁷⁹ Banking (Service to Customer) Law § 2(a).

⁸⁰ See *id.* (noting that a banking corporation does not have to provide credit).

⁸¹ Plato-Shinar, *The Bank's Fiduciary Duty*, *supra* note 43, at 227.

⁸² See Plato-Shinar & Weber, *Three Models*, *supra* note 48, at 429 (explaining that many duties are provided banks to the general public); Banking (Service to Customers) (Amendment No. 12) (Enhancement of Competition) 2007, Official Bills 76, 77 (Isr.); A. WEINROT & B. MEDINA, LENDING LAWS—THE BORROWER'S PROTECTION IN ISRAELI LAW 98 (1990); see also *Commercial Cotton Co. v. United Cal. Bank*, 209 Cal. Rptr. 551, 554 (Cal. Ct. App. 1985) (showing the American approach). Compare Cecil J. Hunt, II, *The Price of Trust: An Examination of Fiduciary Duty and the Lender-Borrower Relationship*, 29 WAKE

or an entity today that does not require banking services in one way or another. Even a person who does not require business finance or complicated transactions needs a mortgage, a bank guarantee, investment counseling for small savings, or the possibility of making payments by means of direct debit orders. Even those customers whose financial activities are limited to receiving a salary as an employee or receiving an allowance from the National Insurance Institute need bank accounts if they cannot receive the payment in cash. This essentiality of the banking services increases the customers' dependence on the bank.

2. *The Manner of the Performance of the Service*

The customer is unable to effectively supervise the bank's activities either because the customer lacks the professional know-how and technical means required or because the customer usually receives information about what is happening in his account only retrospectively. Thus, even hiring professional inspection services, which involve a high financial cost, will not solve the problem of supervision.⁸³ The customer is left with no alternative but to rely on the professionalism and integrity of the bank in performing its duties.

3. *The Prices of the Banking Services*

The prices of banking services available to the client are prescribed by the bank.⁸⁴ For years the banks have used their influence as the mainstay of the Israeli economy to increase their profits, mostly at the expense of the retail sector, which is perceived as the weaker party in terms of bargaining power in dealings with the bank.⁸⁵ From the conclusions of the Parliamentary Investigative

FOREST L. REV. 719, 775-76 (1994) (showing the American approach), with Kenneth W. Curtis, *The Fiduciary Controversy: Injection of Fiduciary Principles into the Bank-Depositor and Bank-Borrower Relationships*, 20 LOY. L.A. L. REV. 795, 816-18 (1987).

⁸³ Frankel, *Fiduciary Law*, *supra* note 58, at 812-14 (suggesting that one possible way of controlling a fiduciary may be by contract, but noting that there are deficiencies with this arrangement); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1049 (1991) (recognizing the difficulty with monitoring an agent).

⁸⁴ Banking (Service to Customer) Law § 9(i).

⁸⁵ See THE REPORT OF THE PARLIAMENTARY INTERROGATORY COMMITTEE REGARDING THE

Commission, it emerges that the banks used their market power to charge households and small businesses high fees and interest rates.⁸⁶ As a result, the Commission determined that “Israeli households pay ‘a lack-of-competition fee’ when purchasing bank services.”⁸⁷ In the absence of competition between the banks, there was almost no difference between the fees charged by the various banks.⁸⁸ The multiplicity of fees charged by each bank for financial and operational services, as well as the billing of duplicate charges for the same service, added to the damage caused to the customer.⁸⁹ In 2007, the Banking (Customer Service) Law was amended and authority was thereby conferred on the Bank of Israel to oversee the fees charged to households and small businesses (the “bank-fees reform”).⁹⁰ By virtue of this authority, the Governor of the Bank of Israel published the Banking (Service to Customer) (Bank Fees) Rules,⁹¹ which include details of the schedule of fees that can be charged, while allowing the banks discretion to determine the amount of the fees and the rate thereof.⁹² However, it transpired that some banks took advantage of the bank fees reform by increasing their fees.⁹³ In addition, with regard to various charges, there remains no real significant difference among the prices of the different banks.⁹⁴ This phenomenon of the great similarity between the bank charges was the subject of an investigation by the Antitrust Authority.⁹⁵ As a result of a lengthy investigation that lasted several years, the

BANKING FEES at 9, 18-20, *available at* http://www.knesset.gov.il/committees/heb/docs/bank_inq.pdf [hereinafter THE REPORT OF THE PARLIAMENTARY INTERROGATORY COMMITTEE]; *see also* Yael T. Ben-Zion, *The Political Dynamics of Corporate Legislation: Lessons From Israel*, 11 FORDHAM J. CORP. & FIN. L. 185, 212, 213-214 (2006) (showing how banks dominated).

⁸⁶ THE REPORT OF THE PARLIAMENTARY INTERROGATORY COMMITTEE, *supra* note 85, at 9.

⁸⁷ *Id.* at 8.

⁸⁸ *Id.*

⁸⁹ *Id.* at 32.

⁹⁰ Banking (Service to Customer) Law, 5741-1981, 35 LSI 312 (Isr.) (amended 2007).

⁹¹ *Id.* at § 2(c).

⁹² *Id.*

⁹³ BANK OF ISRAEL, PUBLIC ANNOUNCEMENT: DATA ON THE FIRST QUARTER OF THE FEES REFORM, Dec. 31, 2008, *available at* <http://www.bankisrael.gov.il/he/NewsAndPublications/PressReleases/Pages/081230h.aspx>.

⁹⁴ *Id.*

⁹⁵ THE ISRAEL ANTITRUST AUTHORITY, A RULING REGARDING RESTRICTIVE ARRANGEMENTS BETWEEN THE ISRAELI BANKS RELATING TO THE TRANSFER OF INFORMATION ABOUT THE BANKING FEES, Apr. 26, 2009, *available at* <http://archive.antitrust.gov.il/ANTIItem.aspx?ID=9880&FromSubject=100047&FromYear=2009&FromPage=0>.

Antitrust Commissioner published a ruling, in April 2009, that the banks were accustomed to exchanging information regarding bank charges, which constitutes an illegal, restrictive arrangement.⁹⁶ Alleged price coordination by the banks was used as a cause of action in a class action against the banks, which has yet to be decided on the merits.⁹⁷

4. *Determining the Legal Rule that Applies to the Relationship*

In determining the legal rule that applies to the relationship, here too the customer is dependent on the bank. As mentioned above, the banking contract is a standard agreement that is drafted in advance by the bank.⁹⁸ Even if the bank agrees to conduct negotiations with a certain customer regarding the wording of the documents, the basis of the negotiations is the original draft that was prepared by the bank and clearly protects its interests.⁹⁹ The banking contract usually includes a long list of obligations that are imposed on the customer.¹⁰⁰ If a reference appears therein to the bank, this usually deals with the rights of the bank vis-à-vis the customer. Many of these clauses were recognized as depriving clauses.¹⁰¹

In summary, given the great power inequality between the bank and the customer, as well as the customer's dependency on the bank as a provider of vital services, the courts in Israel imposed a fiduciary duty on the bank vis-à-vis the customer. The fiduciary duty

⁹⁶ *Id.*

⁹⁷ See, e.g., File No. 2133/06 District Court (TA), Sharnoa Computerized Machs. Tel Aviv Ltd. v. Bank Hapoalim Ltd. (2008), Nevo Legal Database (by subscription) (Isr.) (approving the submission of a class action involving the coordination of interest rates). For cases filed pursuant to the Antitrust Authority ruling see DC (TA) 6472/08 Levy v. Mizrahi Tefahot Bank Ltd. (Isr.); DC (TA) 8700/09 Kosterinski v. Bank Leumi Le-Isr. Ltd (Isr.).

⁹⁸ Standard Contracts Law § 2.

⁹⁹ *Sh.A.P. Ltd.*, 57(6) PD at 788 (ruling that the bank, as the party that had the power to formulate the contractual terms as it wished, was under a duty to provide appropriate protection for the legitimate interests of the weaker party).

¹⁰⁰ *Id.*

¹⁰¹ See 195/97, *The Att'y Gen.* (ordering clause removal or alteration after a Tribunal examination of a standard checking account agreement found these clauses deprived customers); CA 6916/04 *Bank Leumi*; see also *Standard Contracts 8002/02 Standard Contracts Tribunal, Supervisor of Banks* (finding that many of the clauses in a housing loan agreement deprived customers of their rights); File No. CA 232/10 *First Int'l Bank Ltd. v. Supervisor of Banks* (2012), Nevo Legal Database (by subscription) (Isr.).

serves as a means to curb the bank's power and to prevent it from being abused to the detriment of the customer.

C. The Scope of the Duty

During the last two decades, Israeli courts have broadly implemented the bank's fiduciary duty.¹⁰² The fiduciary duty applies to each and every customer: whether he is an individual or a corporation; whether he is a business customer or a private customer; whether he is an ordinary customer without financial experience; or a sophisticated customer who is familiar with the banking and financial world. The fiduciary duty will apply even to customers who have financial power that can be likened to the strength of the bank.¹⁰³ Every customer, by virtue of his very status as a customer, is entitled to a fiduciary duty.

The bank's fiduciary duty is broad from an additional aspect: the type of activities to which it applies. The duty applies to the types of banking services, activities, and transactions that the bank performs on behalf of the customer.¹⁰⁴ The duty arises from the existence of a bank-customer relationship. The relationship between the parties, by its very definition, is what imposes the fiduciary duty, and not a specific action that the bank wishes to perform.

D. Remedies for Breach of the Fiduciary Contract

The breach of the fiduciary duty by the bank grants the aggrieved customer a broad range of remedies. Thus, the Israeli Supreme Court has ruled:

This relationship between the bank and its customer is perceived in law as a special fiduciary relationship which imposes more onerous duties on the bank [A]ny breach of these duties, by the bank, could provide the customer with a wide range of remedies, beginning with a declaration that the activities

¹⁰² See *Mizrahi United Bank*, 54(2) PD at 161-62; *Tefahot*, 48(2) PD 573, 594-95; Plato-Shinar & Weber, *Three Models*, *supra* note 48, at 429.

¹⁰³ Plato-Shinar & Weber, *Three Models*, *supra* note 48, at 429.

¹⁰⁴ *Tefahot*, 48(2) PD 573, 594-95; BEN-OLIEL, *BANKING LAW*, *supra* note 78, at 102-05; Plato-Shinar & Weber, *Three Models*, *supra* note 48, at 429 (describing the scope of the bank's fiduciary duty).

performed in his accounts are null and void, through operative financial remedies according to which the bank will be required to pay the customer in respect of damages caused to him, and culminating in declarations of the right of setoff, which is available to a customer in certain circumstances, in terms of which the debt owed by him to the bank is reduced.¹⁰⁵

Similarly, it has been ruled that the results in respect to the breach of the bank's fiduciary duty

varies according to the context in which the issue arises. Sometimes nonfulfillment of the duty results in the payment of compensation or ordering enforcement, sometimes in the denying of compensation or enforcement from the party in breach, or negating the power given to the party in breach pursuant to the contract, and sometimes the outcome is that the activity performed in breach of the duty is not perfected and is not applicable.¹⁰⁶

From the foregoing, it is evident that in cases of breach of the bank's fiduciary duty, a wide variety of remedies are available to the customer. The existence of such a basket of remedies ensures effective protection of the customer and is suitable for the special contract that exists between the parties. Not only does it enable the customer to sue for the relief appropriate to his needs according to the circumstances of the case, but it also allows the court flexibility in its rulings, which is important in order to grant the appropriate relief.¹⁰⁷

¹⁰⁵ File No. CA 8409/04 Yaacovi v. Isr. Disc. Bank Ltd. (2007), Nevo Legal Database (by subscription) (Isr.).

¹⁰⁶ DC (TA) 5295/88 Israel Disc. Bank Ltd. v. Himi, PM 1991(2) 421, 440 (1991) (Isr.).

¹⁰⁷ Plato-Shinar, *An Angel Named "The Bank," supra* note 3, at 37-38 (discussing the remedies available to a customer for a bank's breach of its fiduciary duty). Two additional remedies for breach of a fiduciary duty should be mentioned: disgorgement of profits and equitable compensation. *Id.* But these remedies are granted only in exceptional cases where a serious breach of a fiduciary duty has been committed deliberately. *Id.* These remedies have not yet been applied against a bank in Israel.

IV. THE DUTY OF DISCLOSURE: GENERAL CONTRACTUAL APPROACH VERSUS FIDUCIARY APPROACH

In order to understand the differences between the general contractual approach and the fiduciary approach, this Part examines the duty of disclosure in a test case.

A. The Duty of Disclosure Under the General Contractual Approach

Various legal systems are divided on the question of whether a duty of disclosure arises between parties who are about to enter into an agreement. In the United States, the answer is usually negative.¹⁰⁸ However, in Israel, a contractual duty of disclosure does exist.¹⁰⁹ Section 12 of the Contracts (General Part) Law 1973, which adopted the principle of good faith (*bona fides*) from the Continental Law, states: “In negotiating a contract, a person shall act in customary manner and in good faith.”¹¹⁰ The courts have interpreted this section as requiring the disclosure of facts that are material to the transaction.¹¹¹

¹⁰⁸ Compare SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS 567 (4th ed. 2003) [hereinafter WILLISTON & LORD, A TREATISE] (recognizing that there is not a duty of full disclosure); and JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS 302 (6th ed. 2009) [hereinafter PERILLO, CALAMARI AND PERILLO ON CONTRACTS] (comparing the duty to disclose to a game of poker and noting that no such duty exists); JOSEPH M. PERILLO, CORBIN ON CONTRACTS § 28.20 (2012) [hereinafter PERILLO, CORBIN ON CONTRACTS]; and E. ALLAN FARNSWORTH, CONTRACTS (4th ed. 2004) [hereinafter FARNSWORTH, CONTRACTS], with JACK BEATSON, ANDREW S. BURROWS & JOHN CARTWRIGHT, ANSON’S LAW OF CONTRACTS 332, 345, 347 (29th ed. 2010) [hereinafter BEATSON ET AL., ANSON’S LAW]; and HUGH BEALE ET AL., 2 CHITTY ON CONTRACTS 511 (30th ed. 2008); and G.C. CHESIRE & C.H.S. FIFOOT, THE LAW OF CONTRACTS 336, 372 (15th ed. 2007) (showing an approach that suggests widening the contractual duty of disclosure in different contexts, including the banking context).

¹⁰⁹ Contracts (General Part) Law § 12 (requiring good faith).

¹¹⁰ *Id.* “An obligation or right arising out of a contract shall be fulfilled or exercised in customary manner and in good faith.” *Id.* at 123, § 39; see also PERILLO, CORBIN ON CONTRACTS, *supra* note 108, at § 11.38 (discussing development of good faith in American contract law).

¹¹¹ See Supreme Court Tefahot Mortgage Bank Ltd. v. Netzer, 43(3) PD 828, 835 [1989] (Isr.) (“One of the main purposes of Section 12 is to prevent cases in which one of the parties to a negotiation permits the other party to be trapped by his own erroneous assumptions. Section 12 demands that the party, who is in possession of the information, eliminate any error made by the other party.”); see also FRIEDMAN & COHEN, CONTRACTS, *supra* note 10; SHALEV, THE LAW OF CONTRACT, *supra* note 12, at 149-51; Sinai Deutch, *Protection of the Bank Customer*, *supra* note 78.

In addition, section 15 of the Contracts (General Part) Law which has the heading “deceit,” states:

A person who has entered into a contract in consequence of a mistake resulting from deceit practised upon him by the other party . . . may rescind the contract. For this purpose, “deceit” includes the non-disclosure of facts which according to law, custom or the circumstances the other party should have disclosed.¹¹²

However, the scope of the duty of disclosure under these sections is not clear. The principle of good faith is rather amorphous, and despite attempts of the courts to define it in concrete terms, its scope remains vague.¹¹³ Section 15, which is apparently drafted in a more concrete manner, still does not make it totally clear when a proactive duty of disclosure would arise.

A similar problem exists under the Banking (Services to Customer) Law. Section 3 prohibits misleading by stating: “A banking corporation shall do nothing—by any act or omission, in writing, orally or in any other manner—that is likely to mislead a customer as to anything material to the performance of a service to him.”¹¹⁴ The section continues by providing a list of examples of matters that are regarded as material, including the nature of the service, its price, the yield and benefit that can be derived therefrom, the conditions of responsibility for the service, etc.¹¹⁵

However, it is not clear from the wording of section 3 of the Banking (Service to Customer) Law as to whether it imposes a positive duty of disclosure on the bank.¹¹⁶ The question becomes even more acute due to another section in the same law. Section 5 of the Banking (Service to Customer) Law authorizes the Governor of the Bank of Israel to publish rules of “proper disclosure” for the

¹¹² Contracts (General Part) Law § 15; *see also* FRIEDMAN & COHEN, CONTRACTS, *supra* note 10, at 810 (analyzing this section); SHALEV, THE LAW OF CONTRACT, *supra* note 12, at 317-21.

¹¹³ SHALEV, THE LAW OF CONTRACT, *supra* note 12, at 103.

¹¹⁴ Banking (Service to Customer) Law § 3.

¹¹⁵ *See id.*; *see also* Contracts (General Part) Law § 15 (listing examples); Plato-Shinar, *The Bank's Fiduciary Duty*, *supra* note 43.

¹¹⁶ Plato-Shinar, *The Bank's Fiduciary Duty*, *supra* note 43.

banks.¹¹⁷ By virtue of this power, the Governor published the Banking (Service to Customer) (Full Disclosure and Provision of Documents) Regulations.¹¹⁸ These regulations relate to various types of banking services (i.e., deposits, current accounts, provision of credit, lease finance, and future transactions) and set forth a long list of information the bank must include in a contract relating to each of these services.¹¹⁹ Nevertheless, these rules are merely technical; they cover only certain services and do not impose a sweeping duty of disclosure on the banks.¹²⁰ This is also the case with other rules and regulations that impose a duty of disclosure on the bank.¹²¹

The result is that even under Israeli legislation, which contains a relatively broad duty of disclosure between parties to a contract—and more specifically between the parties to the banking contract—the situation is still not satisfactory from the customer's perspective. The solution can be found in the form of a fiduciary duty. As will be shown below, the fiduciary approach imposes a very wide duty of disclosure on the bank.¹²²

¹¹⁷ Banking (Service to Customer) Law § 5.

¹¹⁸ Banking (Service to Customer) (Full Disclosure and Provision of Documents) Regulations, 5752-1992 (1992) (Isr.).

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *E.g.*, Banking (Early Repayment Fees), 5762-2002 (2002) (Isr.); Supervisor of Banks: Proper Conduct of Banking Business Regulations, Regulation 451 on "Procedures for Extending Housing Loans" (2006) (Isr.), available at http://www.boi.org.il/en/BankingSupervision/SupervisorsDirectives/ProperConductOfBankingBusinessRegulations/451_et.pdf (creating duty to provide information regarding housing loans); Banking (Service to Customer) Law § 5A (imposing a duty of disclosure regarding bank fees); Banking (Service to Customer) (Bank Fees) Rules 5768-2008 (2008) (Isr.); Credit Card Regulations, 5746-1986 (1986) (Isr.) (creating duty to provide data pertaining to fees that are charged to customers). For comparison, the Truth in Lending Act, 15 U.S.C. § 1601 (2006), obligates American banks to provide consumers with meaningful information about credit transactions and requires uniform disclosure of credit terms, including an annual percentage rate as defined in the act. Truth in Lending Regulation (Regulation Z), 12 C.F.R. Part 1026; Truth in Savings Act, 12 U.S.C. § 4301 (2006) (requiring depository institutions to disclose fees, interest rates, and other terms concerning deposit accounts to consumers before they open accounts; depository institutions must also provide periodic statements to consumers that include information about fees imposed, interest earned and the annual percentage yield); Truth in Savings Regulation (Regulation DD), 12 C.F.R. Part 1030.

¹²² Various legal systems concur that when a fiduciary relationship exists between the parties, a duty of disclosure will arise. *See, e.g.*, WILLISTON & LORD, A TREATISE, *supra* note 108, at 572-73, 590-96 (adding that a duty of disclosure may arise not only when a definite fiduciary duty existed between the parties, but also when a party to a contract expressly reposed trust and confidence in the other party or where the contract or transaction was intrinsically fiduciary and, therefore, required perfect good faith); *see also* PERILLO,

B. The Duty of Disclosure According to the Fiduciary Approach

The fiduciary approach imposes a duty on the bank to disclose any information to the customer that would be essential to the customer when making a decision about performing a banking transaction.¹²³ The duty is not limited to the details included in the various statutory and regulatory provisions regarding disclosure but is much wider. The fiduciary approach imposes a positive obligation on the bank to deliver all of the essential information regarding the transaction, in order to prevent a situation where the customer takes an obligation upon his or herself without knowing all the relevant facts.¹²⁴

According to the fiduciary approach, the duty of disclosure is broad in several aspects. Firstly, logic demands that the duty of disclosure relate only to information that is external to the contract. The assumption is that the matter that should be disclosed is hidden from the customer's knowledge while the stipulations of the contract are disclosed to the customer.¹²⁵ But, under the fiduciary approach, the duty of disclosure includes an obligation not only to disclose information that is external to the contract, but also various provisions of the contract.¹²⁶ The duty of providing information that is imposed on the bank must include providing—or “detailing”—the contents of the contract and the bank must be meticulous about pointing out essential information, even though such information is included in the banking agreement.¹²⁷

CALAMARI AND PERILLO ON CONTRACTS, *supra* note 108, at 305 (adding that the duty of disclosure “extends somewhat beyond such relationships. Whenever one party to a transaction justifiably believes the other is looking out for his or her interests, a duty of disclosure arises”); PERILLO, CORBIN ON CONTRACTS, *supra* note 108, at 93; FARNSWORTH, CONTRACTS, *supra* note 108; BEATSON ET AL., ANSON’S LAW, *supra* note 108, at 334, 340-41, 512; FRIEDMAN & COHEN, CONTRACTS, *supra* note 10, at 577-80, 824-25.

¹²³ Plato-Shinar, *The Bank’s Duty*, *supra* note 70, at 433.

¹²⁴ *Id.* The scope of the duty of disclosure under the fiduciary approach is dynamic and varies according to the particular circumstances of the case.

¹²⁵ ORNA DEUTCH, CONSUMERISM, *supra* note 75, at 355; FRIEDMAN & COHEN, CONTRACTS, *supra* note 10, at 582.

¹²⁶ FRIEDMAN & COHEN, CONTRACTS, *supra* note 10, at 586. The authors note that in a fiduciary relationship, when one party trusts the other party regarding the drafting of the contract, and the latter, while taking advantage of this trust, includes a clause in the contract that works to the detriment of the other party, this amounts to a breach of the duty of good faith. *Id.*

¹²⁷ *Id.*

Secondly, not only factual information should be disclosed. Sometimes, a duty is imposed on the bank to provide the customer with legal information as well.¹²⁸

Thirdly, the duty to provide information should not be limited to the pre-contractual stage in which the customer considers whether to enter into the banking agreement. In several instances, the bank should be required to provide the customer with information and reports during the term of the contract. Various banking services, such as managing a current account, managing financial deposits, and establishing a loan, are by their very nature ongoing services that will likely continue for many years. The duty of providing information will apply to the bank over the lengthy period of this relationship as well.

Fourthly, the initiative for the disclosure process must come from the bank itself. Even if the customer never approaches the bank for information, this does not exempt the bank from its duty, nor does it limit the extent of the bank's responsibility. A bank that does not provide the full information required, of its own initiative, bears the responsibility for its omissions.

The Israeli courts, though recognizing the banking contract as a fiduciary contract, have indeed imposed a wide duty of disclosure on the banks.¹²⁹ Nevertheless, the Israeli Supreme Court recently adopted a different approach in *Mercantile Discount Bank Ltd. v. Meonot Ezrat Israel Bnei Brak*.¹³⁰ In this case, a business customer of the bank, a non-governmental organization, had deposited a large number of post-dated checks in its account in the past.¹³¹ Each check that was deposited in the account was recorded on a separate line.¹³² The bank, having always charged its customers a "line entry fee," charged the customer a separate fee for each line, and, accordingly,

¹²⁸ *Id.* The legal information may include information pertaining to early repayment of the loan and information pertaining to the ability to "break" a deposit and withdraw the money before maturity. *Id.* In Israel, this includes information relating to special protection that is granted by law to a mortgagor of a residential property, information about special protection that the law grants to guarantors, etc. FRIEDMAN & COHEN, CONTRACTS, *supra* note 10, at 586.

¹²⁹ The leading case is *Tefahot*, 48(2) PD 573, 596-98.

¹³⁰ File No. ACA 4619/08 *Mercantile Disc. Bank Ltd. v. Meonot Ezrat Isr. Bnei Brak* (2012), Nevo Legal Database (by subscription) (Isr.).

¹³¹ *Id.*

¹³² *Id.*

for each check.¹³³ At some point, the customer learned that the bank allowed its customers to record all post-dated checks bearing the same date together in the same line—a method that reduced the fee.¹³⁴ However, this was only done if the customer specifically requested it.¹³⁵ The customer argued that the bank's failure to inform it of such a possibility amounted to misleading under section 3 of the Banking (Service to Customer) Law and since the bank had acted in this way, not only with respect to that customer but also with respect to many other customers, the customer filed a class action against the bank.¹³⁶ The Supreme Court rejected the action, holding that no misleading had taken place because there was no duty on the bank to inform the customer that a different method of performing bank transactions could save the customer fees.¹³⁷

This ruling reflects a narrow approach of the Court to the notion of misleading and is unusual in relation to the prevailing case law. The explanation for such a result might be the filing of the action as a class action. Israeli courts are conservative regarding class actions and tend to reject them even when class actions are justified.¹³⁸ Perhaps this is one of the reasons why the claim in this case was rejected.¹³⁹

C. The Duty to Provide an Explanation

The purpose of the abovementioned duty of disclosure is to give the customer all the information necessary for him or her to make a wise decision regarding the banking transaction. Nevertheless, even if the bank fulfills the aforesaid duty, there will be some customers who fail to understand the essence of the transaction or to grasp the financial and legal implications that stem therefrom.

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ ACA 4619/08 *Mercantile Disc. Bank*.

¹³⁶ *Id.*

¹³⁷ Ruth Plato-Shinar, *Israel: The New Law on Class Actions*, J. BUS. L. 527, 528 (2007).

¹³⁸ *Id.*

¹³⁹ Another example of a class action that was based on the cause of action of misleading and that was dismissed by the Supreme Court due to its narrow approach is ACA 8851/02 *Isracard v. Shlomovitz* 59(3) P.D. 422 [2004] (Isr.). This case dealt with inaccurate information in the standard credit card application form. *Id.* Since the plaintiff did not actually read the form before signing it, it was ruled that he did not rely on any misstatement and therefore was not misled by the company. *Id.*

Such customers require an additional explanation in a language and on a level that is suitable to them.

According to Israeli contract law, there is no duty on one party to a contract to explain the contents of the contract to the other party.¹⁴⁰ Negligence of a party to a contract stemming from their lack of understanding of the contents of the transaction is that party's responsibility alone.¹⁴¹ A person is deemed to be one who knows and understands the contents of a document that he or she signs and any claims by the person that this is not so will not be accepted.¹⁴² It was even held that a person who signs a document without understanding any of the terms and conditions thereof, and without seeking any explanation from the other party, acts in *prima facie* bad faith because they represent that they agree to and accept all the terms and conditions of the document.¹⁴³

However, a different rule should be established with respect to banking contracts as fiduciary contracts. A special duty is imposed on the bank to provide an explanation to the customer. Even if it is possible to deduce from the banking document itself the nature and essence thereof, a duty should be imposed on the bank to give the customer a detailed explanation regarding the content of the contract and the essence of the transaction. Furthermore, there will be instances where an obligation is imposed on the bank to advise a customer and to explain the transaction to him or her, even if the customer does not request such an explanation because he or she is unaware of how essential the explanation is.¹⁴⁴ According to the fiduciary approach, the bank is under the obligation to clarify the essence of the transaction and to provide explanations regarding the full significance, consequences, and implications thereof.

The duty to provide explanations, which is imposed on the

¹⁴⁰ ORNA DEUTCH, CONSUMERISM, *supra* note 75, at 355.

¹⁴¹ *Id.*

¹⁴² CA 1548/96 Supreme Court Lupo v. Union Bank of Israel Ltd. 54(2) P.D. 559, 570 (2000) (Isr.); CA 1513 Supreme Court Datiashvili v. Bank Leumi Le-Israel Ltd. 54(3) P.D. 591, 594 (2000) (Isr.). This is also the situation under American law, in the absence of special circumstances. *See* PERILLO, CALAMARI AND PERILLO ON CONTRACTS, *supra* note 108, at 342, 346, 347, 355. However this author notes that fiduciary relationship creates exception to the general rule. In such a case, the contract can be generally avoided by its signer on a showing merely that the fiduciary failed to make him aware of the legal significance of the signing of the contract. *See id.* at 348.

¹⁴³ FRIEDMAN & COHEN, CONTRACTS, *supra* note 10, at 172.

¹⁴⁴ Porath, *The Responsibility of the Banks*, *supra* note 70, at 324, 326.

bank, should be a broad obligation in various aspects.¹⁴⁵ Firstly, the obligation should apply to information that falls outside the scope of the contract, as well as to the content of the contract itself. Although in most cases we can infer from the wording of the document the nature and essence thereof, in banking contracts it is necessary to broaden the obligation. The bank is required to explain to the customer, properly and clearly, the significance of the document which he or she is about to sign, the scope of its application, and the possible implications thereof. The bank does not fulfill its obligation by simply relying on the wording of the documents.

Secondly, the obligation to provide an explanation should not be limited to the factual details that are provided by virtue of the duty of disclosure in the narrow sense. The obligation to provide an explanation should also include an obligation to provide legal explanations. The bank should also be obligated to give the customer an explanation regarding the main legal issues connected to the transaction, even though there may be many.¹⁴⁶

Thirdly, the duty to provide an explanation is especially important where the bank is aware that the contract contains a provision that is unusual or differs substantially from those that the customer could rightfully expect. In such a case, the recognition of the obligation to provide an explanation also arises because of the gap in the parties' expectations.¹⁴⁷ The obligation to provide an explanation should also be recognized where the bank is aware that the customer is not capable of reading the document, for example, due to language difficulties.

The Israeli Supreme Court has already acknowledged a duty of explanation in 1975 in the case of *Israel Mortgage Bank Ltd. v. Hershko*.¹⁴⁸ *Hershko* dealt with a customer who received a loan from the bank.¹⁴⁹ As a result of various limitations, the loan was established through a complex arrangement.¹⁵⁰ The customer was not given a satisfactory explanation as to the essence of the

¹⁴⁵ The extent of the duty to provide an explanation is dynamic and varies according to the particular circumstances of the case. See PLATO-SHINAR, *THE BANK'S FIDUCIARY DUTY*, *supra* note 1, at 29-30.

¹⁴⁶ Plato-Shinar, *The Bank's Fiduciary Duty*, *supra* note 43, at 237.

¹⁴⁷ FRIEDMAN & COHEN, *CONTRACTS*, *supra* note 10, at 582, 786-87.

¹⁴⁸ *Hershko*, 29(2) PD 208.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

transaction and therefore did not understand that the way the loan had been established would cause him huge losses.¹⁵¹ The Court found that the bank had breached its fiduciary duty by failing to provide the customer with the full explanation required, even though the customer had received personal advice from his attorney.¹⁵²

For many years *Hershko* was an isolated case. However, during the last decade the notion of a duty of explanation has gained momentum and has been applied in many cases and situations. It has been used more than once with regard to mortgage agreements in respect to the family home.¹⁵³ In one case, failure by the bank to explain to the debtor that the mortgage agreement contained a waiver of statutory protection and that non-payment of the loan would result in an eviction and sale by the bank resulted in a ruling that the bank was precluded from foreclosure of the property.¹⁵⁴

V. CONCLUSION

The banker-customer relationship is a contractual relationship. Nevertheless, general contract law does not provide the customer with adequate protection against the bank. For this reason, the banking contract should be viewed as a special contract—a fiduciary contract. According to this approach, the bank is subject to a fiduciary duty towards the customer. The fiduciary duty imposes a very high standard of behavior on the bank, much higher than the standard imposed on it by contract law.

The recognition of the banking contract as a fiduciary contract maintains the correct balance between the bank and the customer by imposing ethical norms of behavior upon the bank. The adoption of the fiduciary approach would create a better model of relationship between the bank and the customer and would lead to a fair and proper fulfillment of the banking contract.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *See, e.g.*, CA 9136/02 Mr. Money Israel Ltd. v. Reiz 58(3) PD 934 [2004] (Isr.); File No. CA 8611/06 Bank Hapoalim v. Martin (2011), Nevo Legal Database (by subscription) (Isr).

¹⁵⁴ *See* cases cited *supra* note 153.