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## **Israeli Case Law Update: Fiduciary Duties of a General Partner and Limitations on a Partner's Right to Seek the Dissolution of a Limited Partnership**

### **Client Updates**

A recently published judgment issued by the Economic Department of the Tel Aviv District Court,<sup>i</sup> addresses two significant issues within Israeli partnership law. The first issue pertains to the breach of fiduciary duties and disclosure obligations by the general partner towards the limited partners, as well as the potential consequences arising from such a breach. The second issue concerns the extent to which partners may limit their right to petition the court for the dissolution of the partnership.

### **Background**

The judgment addresses a petition for the dissolution of an Israeli limited partnership (the "Partnership"), filed by certain limited partners (the "Petitioners") against the general partner, an Israeli private company (the "General Partner"). The Partnership was established for the purpose of investing in a non-Israeli company (the "Target Company"), with the investment being funded by the limited partners.

The Petitioners alleged that the General Partner intentionally concealed material information regarding the aforementioned investment and benefited from the Partnership's funds without their consent, in direct breach of the partnership agreement. Notably, the General Partner received funds as a brokerage fee in connection with the investment in the Target Company, contrary to the provisions of the partnership agreement, and failed to disclose this information to the limited partners. In addition, the General Partner received direct interest in the Target Company without paying for it, contrary to prior representations made to the limited partners. The Petitioners also presented evidence of discrepancies between their investment in the Partnership and the actual investment eventually made in the Target Company, with the General Partner taking the difference for itself, contrary to the provisions of the partnership agreement.

In light of these claims, the Petitioners argued that there were reasonable grounds for the court to dissolve the Partnership based on principles of justice and equity (Section 45(6) of the Partnership Ordinance [New Version], 5735-1975 (the "Ordinance")). They further contended that the General Partner's conduct had effectively rendered the continuation of the business relationship between the limited partners and the General Partner no longer reasonably practicable (Section 45(4) of the Ordinance).

In its defense, the General Partner asserted, *inter alia*, that all its actions were in accordance with the provisions of the partnership agreement; that information regarding brokerage fees it received from a third

party, success fees it unilaterally determined and retained at the expense of the Partnership,<sup>ii</sup> and holdings it received from a third party in the property in which the investment was made, were irrelevant to the limited partners; that the dispute was merely a financial dispute, not justifying the dissolution of the Partnership; and that the Petitioners are pursuing ulterior motives while collaborating with a third party engaged in a separate dispute with the Partnership over its investment.

### **Fiduciary Duties and Disclosure Obligations of a General Partner**

The court referred to the **disclosure obligations incumbent upon the General Partner** under Section 29 of the Ordinance, which provides that partners must manage the partnership's business affairs for their collective benefit, must maintain honesty and faithfulness to one another, and must **provide each partner or their representative with accurate accounts and complete information on any matter concerning the partnership**. The court further determined that the General Partner owes a **fiduciary duty** towards the limited partners due to the imbalance of power between them. While the limited partners contribute their capital to the partnership, the authority to manage the partnership's business affairs is vested solely in the General Partner. Therefore, as determined by the court, **the General Partner is required to uphold an enhanced standard of trust, loyalty, fairness and good faith towards the limited partners**. The fiduciary duty of the General Partner is comprised of two key aspects: a **prohibition against conflicts of interest**, aimed at preventing self-dealing by the General Partner, **and a comprehensive disclosure duty**, designed to bridge the informational asymmetry between the General Partner and the limited partners.

The court determined that the General Partner had failed to provide the limited partners with complete and reliable information regarding the use of their funds and that the General Partner had concealed details regarding the structure of the investments and its own holdings in the Target Company. The court also noted that the **General Partner is obliged to disclose all of its interests in the partnership's business to the limited partners**, even when the partnership's purpose of maximizing its profits are aligned with the General Partner's additional personal interests. In this case, the court accordingly determined that the General Partner had **breached its disclosure obligations**, both under the aforementioned requirements of Section 29 of the Ordinance and under the general fiduciary duties owed by the General Partner.

The court further concluded that the General Partner **acted in a conflicts of interest**. The partnership agreement did not stipulate the specific rate for success fees, but rather imposed upon the limited partners the obligation to pay them. As a result, the court held that the General Partner's unilateral determination of the success fee rate constituted an action taken in breach of its duty to avoid conflicts of interest.

Finally, the court ruled that the dissolution of the Partnership is not an extreme or disproportionate remedy, given the circumstances described above, but rather it is considered the default remedy under Israeli partnership law, particularly in cases where the Partnership was formed to carry out a single transaction and does not involve the management of an ongoing business.

## **Limiting the Partners' Power to Petition the Court for the Dissolution of a Limited Partnership**

The General Partner argued that the partnership agreement stipulates that the Partnership shall be dissolved "only" in the events specified therein, which included the following circumstances: a decision made by the General Partner to dissolve the Partnership, the issuance of an order to dissolve the General Partner, the appointment of a receiver over the General Partner's assets, or the declaration of the General Partner as insolvent. Therefore, the General Partner argued that the limited partners are estopped from petitioning the court for the dissolution of the Partnership.

The court analyzed the various dissolution grounds set forth in the Ordinance, distinguishing between two categories of such grounds. The first category encompasses grounds for dissolution that may be initiated by the partners, as specified in Sections 42-44 of the Ordinance. The court determined that partners are permitted to contractually waive their right to demand the dissolution of the partnership based on these grounds.

The second category includes dissolution grounds set forth in Section 45 of the Ordinance, which grants the court the authority to order the dissolution of the partnership under the circumstances detailed in such Section. The court ruled that partners cannot derogate from the court's authority as granted by law. The court further acknowledged that partners have the freedom to shape their internal relationship as they see fit, **which also includes to the ability to limit (but not entirely negate) a partner's right to petition the court for partnership dissolution** under Section 45 of the Ordinance. However, since any limitation as such represents a significant infringement of a partner's fundamental right of access to the courts, **parties seeking to limit the possibility of dissolution through the court must do so explicitly in the partnership agreement**, or point to clear circumstances establishing such intention.

The court further determined that the partnership agreement in this case did not explicitly limit the ability to file a petition for the dissolution of the Partnership, and that the use of the word "only" to describe the circumstances under which dissolution could occur was insufficient to indicate a clear intent on the parties' behalf to limit their right of access to the courts.

## **Implications of the Judgment**

This judgment emphasizes the importance of crafting clear and explicit partnership agreements, particularly with regard to limiting the partners' right to petition the court for partnership dissolution, and clarifies that while it is possible to restrict the right of access to courts for the purpose of partnership dissolution, it cannot be completely denied. Additionally, the judgment reinforces the fiduciary duties and disclosure obligations imposed on the general partner in a limited partnership by virtue of law (and not merely by virtue of the contractual arrangements applicable to the parties), including the general partner's duty to provide full and complete disclosure to the limited partners as well as the prohibition on the general partner to act in conflict of interest with them. Moreover, this judgement clarifies that any breach

of these duties may lead, among other remedies, to the dissolution of the partnership.

Our firm provides legal advice to private investment funds, venture capital funds, partnerships used for alternative investments, and institutional and private investors onboarding to such funds and partnerships, on all aspects and areas related to their activities.

We would be happy to assist you with any questions.

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<sup>1</sup>TA (Tel Aviv-Yafo) 2133-10-22 Orit Sharon Frangi et al. v. M.H.R 1 Investment Management Ltd. (District; Sigal Yaacobi; 051124).

<sup>2</sup>The General Partner referred in this matter to a clause in the partnership agreement titled "Expenses to be covered by the Partnership", which included, among other things, "success fees of the General Partner", in addition to and distinct from payments to which the General Partner is entitled for management fees and from the proceeds of realizing the investment.

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