

The Tel Aviv District Court: A Bankruptcy Trustee cannot limit the rights of Directors and Officers under a D&O Liability Insurance Policy

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On 30 September 2021, the honorable Judge H. Kabub of the Economic Division of the Tel Aviv District Court handed down a judgment which rejected an attempt of the bankruptcy trustee of Africa Israel Industries Ltd. ("**the Company**") to prevent the directors and officers from using the D&O Policy issued to the Company for the settlement of a motion to certify a class action which was filed against them.

Background:

During 2015 a motion to certify a class action was filed against two public companies in the Africa Israel Group and against their directors and officers, based on allegations regarding their breach of the Securities Laws, which led to the restatement of the Companies' financial reports.

The parties to the class action proceedings entered into a long and complex mediation proceeding, during which both companies became subject to insolvency proceedings. The mediation continued between the

plaintiffs, the D&Os and the D&O Insurers, and eventually the parties were able to reach a settlement agreement, which included a payment of ILS 5 million by the D&O Insurers of Africa Israel Industries. The Company, which was under insolvency proceedings, was not a party to the settlement.

On 7th December 2020 the parties filed to the court a motion to approve the settlement agreement concluded between them. In response, the bankruptcy trustee of Africa Israel Industries ("**the Trustee**") submitted a notification to Court, in which he claimed that the D&O Policy is an asset of the bankruptcy estate, and thus cannot be used for the settlement of a claim against the D&Os. The Trustee furthermore claimed, that the events described in the class action are investigated by him, and *prima facie* constitute a breach of the D&Os duties towards the Company. Therefore, he alleged that he is considering the filing of a claim against the D&Os, and that the D&Os are not entitled to reduce the

outstanding policy limit by settling the class action against them.

The Court's decision:

In its ruling, the court rejected the Trustee's allegations and ruled that under the circumstances the Trustee cannot limit the ability of the D&Os to use the policy for the settlement of the class action proceedings.

The Court analyzed the Policy and distinguished between the various coverages available thereunder: Side A coverage to the D&Os; Side B coverage to the Company in cases where it indemnified its D&Os; and Side C coverage providing entity coverage to the Company for securities claims.

According to the court, the Trustee's allegations regarding the Company's rights under the Policy do not arise from the Company's position as a potential insured under the Policy (under Side B or C coverage) but rather as a potential claimant. As such, the Trustee is competing over the insurance benefits against the class action plaintiffs, and the priority rights should be determined according to the principle of "first come, first served". Considering the fact that the class action proceedings were initiated six years ago while the Trustee's potential claim has not yet been filed, the Trustee cannot prevent the parties from using the D&O policy for the settlement of the class action proceedings.

The court emphasized, that the Trustee's rights in this case, are not different than

the rights of any third-party potential claimant, and the fact that the Company is a beneficiary under the Side B and C coverages, does not provide it with any priority rights when seeking coverage to the Trustees' potential claim against the D&Os.

Nevertheless, the Court ruled that there may be extraordinary circumstances, in which the Court would be convinced that a class action settlement agreement was reached in bad faith. In such case, the court may decide not to approve the settlement agreement concluded between the parties. However, the Court stated that under the circumstances, this is not the case, and far from that.

The court further ruled that the Trustee also has no right to object to the settlement agreement based on the Company's capacity as a potential insured under the Side B and C coverages. The court referred to the Order of Payment term according to which payment under the Policy should be first made for loss covered under Side A coverage, only afterwards under Side B and finally, if any amount remains, then payment should be made for loss covered under Side C coverage. Therefore, the Company's rights as a beneficiary under the Policy are secondary to the D&Os' rights under Side A coverage.

The court furthermore emphasized the fact that the settlement amount exhausts only a small share of the Policy limit, and this also reinforces the court's conclusion.

In addition, the court referred to public policy considerations, and ruled that the Company, or the Trustee standing in its shoes, should not be entitled to deprive the D&Os from their rights under the Policy. The court stated: **"the purpose of the Policy is not to assist the company to collect its debts, but rather to enable the directors to execute their job without fear. This is part of the employment and service terms of directors, and it is an essential term required to preserve this institution"**. The judge also noted that **"accepting the trustee's position, according to which during liquidations the D&Os rights under the policy are revoked, and they become dependent upon the Trustee's good will - contradicts the**

essence of the policy, and is not founded on any basis or on any legal provisions".

The Court noted that accepting the Trustee's objection to the agreement, may increase the exposure of the insurers and of the D&Os without any good reason, especially since the Trustee himself is unwilling to take upon himself the risk involved in the continuation of the proceedings.

In view of all the above, the court approved the settlement agreement and rejected all of the Trustee's allegations.

An appeal on this judgement may yet be submitted.

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