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## Pyrrhic Victory in Palmaz: Creditors Entitled to D&O Insurance Claims, but not D&O Insurance Payouts

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**August 8, 2018** - A recent decision by the Bankruptcy Court for the Western District of Texas in *In re Palmaz Scientific*, 2018 WL 1036780, at \*5 (Bankr. W.D. Tex. Feb. 21, 2018) serves as a cautionary tale of the importance of monitoring the plan confirmation process. In *Palmaz*, the bankruptcy court held that a chapter 11 bankruptcy reorganization plan would not bar investors from pursuing direct claims against the directors and officers of debtor. However, this was a hollow victory for the plaintiffs as the bankruptcy court went on to hold that the terms of the confirmed plan of reorganization prevented the plaintiffs from satisfying their claims from the proceeds from director and officers' insurance.

On March 4, 2016, Palmaz Scientific Inc., a biomedical company that developed implantable devices used in treating diseases, filed a chapter 11 bankruptcy petition. The court approved the debtor's chapter 11 plan on July 15, 2016. Palmaz Scientific's plan transferred some of the debtors' assets, including D&O claims, to a litigation trust. The plan defined D&O claims to include claims against the debtor corporation, but not against former directors and officers.

Soon after the corporation filed for bankruptcy, one group of investors (Turnbull plaintiffs) filed a direct action against its founder, Dr. Julio Palmaz. Before the bankruptcy case, another group of investors (Ehrenberg plaintiffs) had filed suit against Palmaz Scientific, Dr. Palmaz, and the company's CEO, Steven Solomon. To block these lawsuits, Dr. Palmaz and the corporation's litigation trustee filed an injunction in the District Court for the Western District of Texas.

To determine if the injunction impacted the Turnbull and Ehrenberg plaintiffs, the bankruptcy court had to decide whether their suits included D&O claims. While the bankruptcy court found that the Turnbull plaintiffs could proceed with their direct claims, the Ehrenbergs' derivative claims could not. In response to this ruling, the

Ehrenberg plaintiffs amended their original demand and eliminated their derivative claims. This prompted Palmaz Scientific's insurer and litigation trustee to jointly move for a declaratory judgment of whether the Ehrenberg plaintiffs' amended complaint interfered with the trustee's right to control D&O recoveries.

After closely reviewing Palmaz Scientific's reorganization plan and the bankruptcy injunction, the court determined that the injunction only enjoined derivative claims, or those brought against the corporation. As the amended Ehrenberg demand only included direct claims against Dr. Palmaz and Mr. Solomon individually, the injunction did not apply. However, the court also found that the Ehrenberg demand violated the plan's terms by interfering with the litigation trustee's right to "control. . . all D&O Insurance Recoveries, including negotiations relating thereto and settlements" (ECF No. 356, Plan ¶ 6.6(d)). According to the court, this clause gave the trustee a superior right over other creditors to all D&O insurance proceeds. As a result, the court found that the Ehrenberg plaintiffs lacked the legal ability to satisfy their demand.

The outcome in *Palmaz* is an example of winning the battle but losing the war. While creditor plaintiffs may be entitled to pursue claims against directors and officers of a debtor corporation, the terms of a chapter 11 reorganization plan may prevent them from satisfying their claims from the proceeds of a D&O insurance policy. This case demonstrates the importance to potential D&O claimants of monitoring the plan confirmation process to ensure that potential claims are not compromised.

-Summer associate Maya Jacob assisted in drafting.

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