

*Peter C. Blain on*

## Considering Service on a Creditors' Committee? The Ninth Circuit Provides Barton Protection to Committee Members

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One of the facts of commercial life today is the sudden failure of a large customer and a resulting petition for relief under Chapter 11 of the United States Bankruptcy Code (“Code”).<sup>1</sup> Within days of the bankruptcy filing, creditors whose claims are among the seven largest in the case are often asked to serve on the official unsecured creditors’ committee.<sup>2</sup> Because committees have the right to be heard on any matter in the case,<sup>3</sup> participate in the formulation of a plan of reorganization and are often authorized to commence litigation on behalf the estate, they often are among the most significant actors in the Chapter 11 proceeding.

Committee service may provide a unique opportunity to directly influence the fate of a significant customer, which may indirectly impact the success of the creditor client. Committees play a vital role in many Chapter 11 cases, particularly large complex cases with numerous, complicated and often hotly contested issues involving substantial dollar amounts. As noted, the committee often helps shape the contours to the plan of reorganization and pursues litigation to enhance the recovery of creditors.

The benefits of committee service do not come without burdens. A committee member must act as a fiduciary for all unsecured creditors. This requires the member to actively and conscientiously fulfill his or her duties.<sup>4</sup> In large complex cases, the time commitment may be significant. While the out-of-pocket expenses of a committee member are reimbursable,<sup>5</sup> the time expended is not.

An important question often put to the creditor’s counsel by a client considering whether to accept appointment to a creditors’ committee is, “What is the risk I will be sued as a result of my service on the committee?” In *Blixeth v. Brown (In re Yellowstone Mountain Club, LLC)*,<sup>6</sup> the U.S. Court of Appeals for the Ninth Circuit, the only circuit court to address this issue, recently concluded that a committee member acting in an official capacity is protected from being sued in a nonbankruptcy forum without permission from the bankruptcy court.

### IN RE YELLOWSTONE MOUNTAIN CLUB, LLC

The case involved the failure of the Yellowstone Mountain Club (“Yellowstone”), an exclusive ski and golf resort in Montana which catered to the ultra-wealthy, which was developed by Timothy

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<sup>1</sup> 11 U.S.C §§ 101–1532.

<sup>2</sup> [11 U.S.C. § 1102](#) (b)(1).

<sup>3</sup> 11 U.S.C. § 1103

<sup>4</sup> See Peter C. Blain & Diane Harrison O’Gawa, Creditors’ Committees Under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers and Duties, 73 Marq. L. Rev. 581, 612–15 (1990).

<sup>5</sup> [11 U.S.C. § 530](#)(b)(3)(f).

<sup>6</sup> *Blixeth v. Brown (In re Yellowstone Mountain Club, LLC)*, [841 F.3d 1090](#) (9th Cir. 2016).

Blixeth and his wife, Edra. Blixeth, acting on advice of his personal attorney, Stephen Brown, used proceeds of a loan to Yellowstone to pay off certain personal debts.

After the Yellowstone shareholders learned of this, they brought suit in Montana state court, and acting on Brown's advice, Blixeth settled. Shortly thereafter, Blixeth and his wife divorced. Brown represented Blixeth in the divorce proceeding, in which Edna received Yellowstone and its affiliated companies as part of a marital settlement agreement.

In November 2008, Edna filed Chapter 11 proceedings for the Yellowstone entities, and the United States Trustee formed an Unsecured Creditors Committee including Brown, who became the committee's chair.

Blixeth alleged that Brown used confidential information to his detriment in the Chapter 11 proceedings, and sued Brown in federal district court.

The district court dismissed the complaint because Blixeth had not first obtained permission of the bankruptcy court to bring the action. In reaching its decision, the district court relied upon *Barton v. Barbour*,<sup>7</sup> an 1881 U.S. Supreme Court case holding that the bankruptcy court must consent to suits against bankruptcy trustees and receivers relating to actions taken in their official capacities.

The district court extended the *Barton* protections to members of a creditors' committee, concluding that the objective of *Barton* was to centralize bankruptcy litigation.

Blixeth subsequently asked the bankruptcy court for permission to sue Brown in district court, asserting a number of his claims arose from prebankruptcy conduct that was unrelated to Brown's service on the creditors' committee.

The bankruptcy court found that it was impossible to isolate Brown's so-called prepetition malpractice from his post-petition malfeasance as a member of the creditors' committee, and denied Blixeth's request to sue Brown in district court. It also dismissed the claims against Brown on the merits.

Blixeth appealed to the Ninth Circuit.

## THE COURT'S DECISION

The Ninth Circuit began its decision by noting that the U.S. Court of Appeals for the Sixth Circuit had extended *Barton* protections to counsel for a trustee,<sup>8</sup> and the U.S. Court of Appeals for the Eleventh Circuit<sup>9</sup> had done the same with respect to individuals approved to conduct sales of estate assets. Both circuit courts had concluded that the parties protected were the "functional equivalent

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7 *Barton v. Barbour*, 104 U.S. 126 (1881).

8 *In re DeLorean Motor Co.*, [991 F.2d 1236](#) (6th Cir. 1993).

9 *Carter v. Rodgers*, [220 F.3d 1249](#) (11th Cir. 2000).

of a trustee” for the purposes of administering the estate. However, no court of appeals had extended Barton protections to members of a creditors’ committee.<sup>10</sup>

Blixeth tried to distinguish these cases, arguing that the defendants in the Sixth and Eleventh Circuit cases were aiding the trustee in maximizing the value of the estate. As a member of a creditors’ committee, Brown owed no duty to the estate. Instead, as a committee member, Brown represented parties seeking payment from the estate.<sup>11</sup>

The court concluded this was too narrow a view.

A committee can only maximize the recovery for creditors by increasing the size of the estate. The duties of the committee and the trustee are aligned, as evidenced by Bankruptcy Code Section 1103(c) (3), which authorizes a committee to initiate the appointment of a trustee. Because creditors<sup>12</sup> have interests closely aligned with trustees, the court concluded that there was good reason to treat the two as the same for the purposes of the Barton doctrine.<sup>13</sup>

The court observed that committee members are statutorily obliged to perform duties relating to the administration of the estate, including investigating acts, conduct, assets, liabilities of the debtor, and the financial condition of and desirability of continuing the debtor’s business;<sup>14</sup> participating in the formulation of a plan;<sup>15</sup> and examining the debtor.<sup>16</sup> A lawsuit challenging actions taken by committee members would seriously interfere with already complicated bankruptcy cases. Indeed, the mere fear of a lawsuit requiring committee members to defend their actions in a nonbankruptcy forum may make committee members timid about fulfilling their duties.<sup>17</sup>

The court noted that this was undoubtedly why the American Bankruptcy Institute Commission to Study the Reform of Chapter 11 recommended that the Barton doctrine be extended to statutory committees and their members.<sup>18</sup> The court concluded that the Barton doctrine applied to unsecured creditors’ committee members who are sued for actions taken in their official capacities. Any such suit must be brought in the bankruptcy court or in another court only with the express permission of the bankruptcy court.<sup>19</sup>

The court then turned to Blixeth’s specific claims.

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<sup>10</sup> Blixeth, [841 F.3d at 1094](#).

<sup>11</sup> [Id. at 1095](#).

<sup>12</sup> [Id.](#) Note that the court uses the term “creditors” instead of “creditors’ committee.” However, it is unlikely that the court intended to refer to all creditors. The reference is probably to creditors’ committees.

<sup>13</sup> [Id.](#)

<sup>14</sup> [11 U.S.C. § 1103\(c\)\(2\)](#).

<sup>15</sup> [11 U.S.C. § 1103\(c\)\(3\)](#).

<sup>16</sup> [11 U.S.C. § 343](#).

<sup>17</sup> Blixeth, [841 F.3d at 1095](#).

<sup>18</sup> See American Bankruptcy Institute, Commission to Study the Reform of Chapter 11, at 43–44 (Dec. 2014), <http://commission.abi.org/full-report>.

<sup>19</sup> Blixeth, [841 F.3d at 3](#).

It noted that although the bankruptcy court concluded that it was impossible to separate the prepetition claims from claims against Brown for his position on the committee, Blixeth alleged misconduct on the part of Brown relating to legal advice given in connection with the use of the Yellowstone loan proceeds resulting in the shareholder lawsuit, and the sub-par representation in connection with the shareholder litigation and the divorce settlement. These claims were based upon prepetition conduct and had nothing to do with Brown's actions on the committee. They were "untethered to Brown's position as [committee] chair."<sup>20</sup> The court concluded that the bankruptcy court erred in finding its permission was necessary for Blixeth to litigate these claims in district court.

However, bankruptcy court permission was needed to commence an action in district court with respect to Blixeth's claims relating to Brown's conduct after he was appointed to the committee.

Those claims challenged "acts done . . . within [Brown's] authority as an officer of the Court."<sup>21</sup> The court found that bankruptcy courts apply a five-factor test to decide whether to grant leave to sue in another forum under Barton:

- 1) whether the acts complained of "relate to the carrying on of the business connected with property of the bankruptcy estate";
- 2) whether the claims concern the actions of the officer while administering the estate;
- 3) whether the officer is entitled to quasi-judicial or derived judicial immunity;
- 4) whether the plaintiff seeks a personal judgment against the officer; and
- 5) whether the claims seek relief for breach of fiduciary duty, through either negligent or willful conduct.<sup>22</sup>

The court found that the fourth factor was met and that the bankruptcy court did not abuse its discretion in denying Blixeth's Barton motion to sue Brown in district court for Brown's post-petition conduct.<sup>23</sup>

## CONCLUSION

The case is welcome news for parties considering whether to serve on a creditors' committee. Accepting appointment to the committee should not entail the risk of having to defend potentially costly and time-consuming litigation in a nonbankruptcy forum. Instead, committee members should be free to vigorously fulfill their fiduciary duties to the unsecured creditor constituents without looking over their shoulders.

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20 Id. at 1096.

21 Id. (citing *Leonard v. Vrooman*, [383 F.2d 556, 560](#) (9th Cir. 1967)).

22 Blixeth, [841 F.3d at 1096](#) (citing *In re Kashani*, 190 B.R. 875, 886–87 (B.A.P. 9th Cir. 1995)).

23 Blixeth, [841 F.3d at 4](#).

However, the case also makes clear that the Barton protections only extend to actions taken in a member's capacity as a committee member; claims arising from actions taken outside of committee service are not, and should not be, protected.

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