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# The Ninth Circuit's Yellowstone Decision Increases Protection for Creditors' Committee Members

An unsecured creditors' committee plays a major role in Chapter 11 cases. The committee actively participates in many matters that could significantly influence the case's direction and the recovery to general unsecured creditors. That is why trade creditors with large unsecured claims often want to join a creditors' committee. Recently, the benefits of committee membership were stepped up a notch to protect committee members from certain lawsuits.

The U.S. Court of Appeals for the Ninth Circuit, in the *Yellowstone Mountain Club* Chapter 11 case, recently held that members of a creditors' committee enjoy the same protection as bankruptcy trustees in any litigation arising out of claims based on the performance of their duties. The Ninth Circuit's *Yellowstone* decision requires a plaintiff to obtain bankruptcy court approval prior to suing committee members in another court for actions taken in their official capacities. This affords committee members the additional comfort of the bankruptcy court acting as a gatekeeper in deciding which court should hear and decide claims arising out of their committee service: the more-likely sympathetic bankruptcy court where the case is pending or another less-knowledgeable and possibly less-sympathetic court.

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## The Role of an Official Unsecured Creditors' Committee

According to Section 1102 of the Bankruptcy Code, the U.S. trustee has the authority to appoint an official unsecured creditor's committee in a Chapter 11 case. A creditors' committee usually consists of the debtor's largest unsecured creditors. Committee members might be from different creditor constituencies, such as trade creditors, bondholders, unions, the Pension Benefit Guaranty Corporation, landlords, and tort or personal injury claimants.

The U.S. trustee selects a creditors' committee either at an organizational meeting of the debtor's largest credi-



tors that the United States trustee convenes, or based on responses by the debtor's largest creditors to the United States trustee's questionnaire sent to solicit their interest to join the committee. The committee's duties include: overseeing the debtor's business; investigating the debtor's assets, liabilities and business operations; investigating and, if grounds exist, prosecuting claims against third parties; negotiating the terms of a Chapter 11 plan that governs the treatment of creditors' claims; and otherwise advocating for its unsecured creditor constituents. Debtors frequently provide creditors' committees with confidential nonpublic information about their business to facilitate the committee's performance of its duties, and often require that a committee and its members sign confidentiality agreements.

A creditors' committee represents the interests of all of the debtor's general unsecured creditors. As a result, committee members owe a fiduciary duty to all of the debtor's unsecured creditors. That means acting in the best interests of all unsecured creditors and not using their committee membership to further their own self-interest at the expense of the unsecured creditor body. Any member that breaches its fiduciary duty is at risk of being sued.

Fortunately, committee members enjoy a limited immunity for their actions within the scope of the committee's authority and any not constituting willful misconduct. Which court, the bankruptcy court where the case is pending or another court, ultimately tries and decides any litigation against a committee member that might greatly impact the outcome of that litigation.

## The Barton Doctrine

Back in 1881, the U.S. Supreme Court adopted the *Barton* doctrine that requires a plaintiff asserting claims

against a receiver or other fiduciary, based on the fiduciary's actions during a proceeding, to first obtain the approval of the court appointing the fiduciary as a prerequisite for suing the fiduciary in another court. The *Barton* doctrine had previously been expanded to include bankruptcy trustees and other persons appointed in bankruptcy cases, such as a trustee's counsel. A plaintiff is, therefore, required to obtain bankruptcy court approval prior to suing a trustee and/or his or her professionals in any other court for their actions during the bankruptcy case. These courts relied on the bankruptcy court's strong interest, in the first instance, to decide whether a lawsuit against a trustee and his or her court-approved professionals, based on their actions in their official capacities, should proceed in a court other than the bankruptcy court. Anything short of the bankruptcy court acting as a gatekeeper could adversely affect the administration of a bankruptcy case if a trustee and his or her professionals face the threat of lawsuits in other courts.

## Background

In the late 1990s, Timothy Blixseth and his wife Edra developed the Yellowstone Mountain Club (together with its subsidiaries and affiliates "Yellowstone"). Yellowstone was an exclusive ski and golf resort, located in Montana, which had catered to the ultrawealthy. Blixseth, acting on behalf of Yellowstone, borrowed \$375 million from Credit Suisse to obtain funding for the development. Blixseth had used some of the loan proceeds to pay off his personal obligations. Blixseth later claimed he had relied on the advice of his counsel, Stephen Brown, who allegedly said Blixseth's actions were lawful.

## A creditors' committee represents the interests of all of the debtor's general unsecured creditors.

Shareholders of Yellowstone sued Blixseth, alleging improper use of loan proceeds to pay his personal debt. Blixseth, again, allegedly on Brown's advice, eventually settled the lawsuit. At around the same time, Blixseth and Edra divorced. Brown had also represented Blixseth in his divorce. Blixseth, again allegedly on Brown's advice, conveyed his interest in Yellowstone to Edra pursuant to a marital settlement agreement.

In November 2008, the Yellowstone entities filed Chapter 11 petitions. The U.S. trustee appointed a nine-member unsecured creditors' committee. Brown, who was a creditor of Yellowstone and no longer representing Blixseth, was appointed to the committee and elected as its chair.

Blixseth sued Brown in the U.S. District Court for the District of Montana (the "District Court"), alleging that Brown had acted improperly as committee chair by using confidential information he had gained representing Blixseth to assist the committee. Blixseth also raised claims based on Brown's allegedly inappropriate pre-petition legal advice to Blixseth with respect to Blixseth's use of loan proceeds intended for Yellowstone, Blixseth's divorce from and settlement with Edra, and

Blixseth's failure to allege defenses in the shareholder litigation and divorce proceeding.

The District Court dismissed Blixseth's complaint, extending the *Barton* doctrine to lawsuits against the members of a creditors' committee, like Brown. The court concluded that Blixseth had violated the *Barton* doctrine by, in the first instance, commencing litigation against Brown in the District Court, based upon Brown's alleged misconduct as creditors' committee chair, without first obtaining the bankruptcy court's prior approval.

## A plaintiff is required to obtain bankruptcy court approval prior to suing a trustee in any other court for their actions during the bankruptcy case.

Blixseth then commenced a lawsuit in the bankruptcy court seeking permission to refile his lawsuit against Brown in the District Court. Blixseth argued that the *Barton* doctrine (requiring prior bankruptcy court approval of the commencement of any litigation against a committee member in any other court) did not apply to several of his pre-petition claims against Brown, based on Brown's allegedly inappropriate pre-petition legal advice to Blixseth, that had nothing to do with Brown's service on the creditors' committee. The bankruptcy court declined to permit Blixseth to pursue his claims in the District Court and held that all of Blixseth's claims against Brown should be heard by the bankruptcy court. The bankruptcy court also dismissed Blixseth's claims based on the immunity from liability Brown had enjoyed for his actions as chair of the creditors' committee. Blixseth then appealed back to the District Court, which upheld the bankruptcy court's holding. Blixseth then took an appeal to the Ninth Circuit.

## The Ninth Circuit's Decision

The Ninth Circuit upheld the lower court holdings extending the applicability of the *Barton* doctrine to protect creditors' committee members acting within the scope of their duties. Blixseth had to first obtain the bankruptcy court's approval prior to suing Brown in the District Court on Blixseth's claims related to Brown's conduct as committee chair.

The Ninth Circuit observed that a bankruptcy trustee and creditors' committee members have the same interests. Both seek to increase the size of a bankruptcy estate to maximize the recovery for creditors. The court also noted that committee members' duties include investigating the debtor's acts, conduct, assets, liabilities, and financial condition, and the operation of and desirability of continuing the debtor's business, examining the debtor, and participating in the negotiation of a Chapter 11 plan.

The Ninth Circuit also noted that a lawsuit in a court other than a bankruptcy court where the case is pending that is challenging a creditors' committee member's actions could

seriously interfere with an ongoing Chapter 11 case. Creditors might be reluctant to join a committee where they are concerned about the risk of litigation, outside of the bankruptcy court, over their actions as committee members. Even the fear of such a lawsuit in a court that is totally unfamiliar with the proceedings in the Chapter 11 case and less likely to be sympathetic to the committee member's position might chill participation on a committee. Of note is the court's invocation of the Final Report and Recommendations of the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 that included a recommendation to extend the *Barton* doctrine to "estate neutrals and statutory committees and their members."

However, the Ninth Circuit held that Blixseth did not need prior bankruptcy court approval to commence a separate lawsuit in the District Court based on Brown's allegedly inappropriate pre-petition legal advice to Blixseth. The court concluded that the *Barton* doctrine did not apply to these claims because they had nothing to do with Brown's service on the creditors' committee.

The court noted that Brown was not automatically entitled to immunity for all of his actions as committee chair. Brown must have acted within the scope of his authority as committee chair and satisfied certain other requirements to enjoy such immunity.

The Ninth Circuit then addressed Blixseth's claim relating to Brown's conduct as committee chair. The court considered the following factors in determining whether Blixseth should have been granted leave to sue Brown in the District Court: (a) whether the claim related to Yellowstone's business; (b) whether the claim related to Brown's actions while serving on the committee; (c) whether Brown was entitled to immunity; (d) whether Blixseth sought a personal judgment against Brown; and (e) whether the claim was based on Brown's breach of fiduciary duty. The court concluded that the bankruptcy court had properly applied the *Barton* doctrine in refusing to permit Blixseth's claims against Brown, based on Brown's actions as committee chair, to proceed in the District Court.

However, the Ninth Circuit ended up refusing to uphold the bankruptcy court's dismissal of Blixseth's claims against Brown based on Brown's immunity from liability for his actions as chair of the creditors' committee. The court noted that Brown was not automatically entitled to immunity for all of his actions as committee chair. Brown must have acted within the scope of his authority as committee chair and satisfied certain other requirements to enjoy such immunity. Since the bankruptcy court did not address these issues, the Ninth Circuit sent the case back to the bankruptcy court to determine whether Brown was entitled to immunity.

## Conclusion

The Ninth Circuit's *Yellowstone* holding provides additional protection to creditors' committee members acting within the scope of their duties and should encourage creditors to

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join committees. They can now rely on the *Barton* doctrine to require a plaintiff to first seek the approval of the bankruptcy court prior to commencing a lawsuit in another court asserting claims against a committee member based on committee service. The bankruptcy court thereby becomes the gatekeeper in deciding whether to permit certain lawsuits against committee members to proceed in another court. ■

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