AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
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Claims Chat

By Andrew A. DePeau

Permission to Sue: Applying the *Barton* Doctrine to Unsecured Creditors' Committee Members

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Is the bankruptcy court's permission required as a condition precedent to commence suit against a member of an official committee of unsecured creditors (the "committee")? This was the question facing the Ninth Circuit Court of Appeals in *Blixseth v. Brown (In re Yellowstone Mt. Club)*.[1] The *Blixseth* court held that under the *Barton* doctrine, leave of the bankruptcy court is required prior to filing a lawsuit against a committee member in a nonbankruptcy forum.

While the *Barton* doctrine has historically only applied to bankruptcy trustees, receivers or their functional equivalents, the Ninth Circuit extended the doctrine to committee members. The court recognized that although a committee member does not represent the estate, the member's interests are significantly aligned with that of the estate. Further, the court noted that the other policy reasons for *Barton* remained equally applicable to claims against committee members. The *Barton* doctrine's application in bankruptcy court has gained significant attention by various circuit courts in the past few years and is likely to continue to be a heavily litigated issue going forward.

Origins of the *Barton* Doctrine

The *Barton* doctrine originated from an 1881 decision by the U.S. Supreme Court in *Barton v. Barbour*,[2] which involved a personal-injury claim filed by a plaintiff who was alleged to have been injured in a railroad accident.[3] At the time of the accident, the defendant was operating the railroad company as a receiver appointed by a Virginia state court.[4] The plaintiff filed suit against the receiver in a court in the District of Columbia. In response, the receiver filed a "plea to the jurisdiction," claiming that the plaintiff could not maintain suit against him for actions taken as receiver without first seeking the permission of the appointing Virginia court.[5]

The Supreme Court agreed with the receiver and affirmed the dismissal of the plaintiff's case in the District of Columbia. In concluding that leave of the court was necessary, the Court held:

> When the court of one State has ... property in its possession for administration as trust assets, and has appointed a receiver to aid it in the performance of its duty by carrying on the business to which the property is adapted ... *a court of another State has not jurisdiction, without leave of the court by which the receiver was appointed*, to entertain a suit against him for a cause of action arising in the State in which he was appointed and in which the property in his possession is situated, based on his negligence or that of his servants in the performance of their duty in respect of such property.[6]

However, the Supreme Court's holding was not merely jurisdictional. The Court also recognized that permitting a lawsuit against the receiver would allow the plaintiff to gain an unfair advantage over other parties who also had claims against the assets controlled by the receiver.[7] If a plaintiff were permitted to file suit without first seeking leave, it would not only frustrate the rights of other creditors, but also the "orders of the court which is adminis-

1 841 F.3d 1090, 1095 (9th Cir. 2016).
2 104 U.S. 126 (1881).
3 *Id.* at 127.
4 *Id.*
5 *Id.*
6 *Id.* at 136-37 (emphasis added).
7 *Id.* at 128.

tering the trust property."[8] From this decision, the *Barton* doctrine was born.

Application to Bankruptcy Cases

Federal courts have uniformly applied the *Barton* doctrine to claims made against bankruptcy trustees. In doing so, courts have recognized three policy grounds. First, similar to the state court-appointed receiver in *Barton*, trustees must be free to execute their court-appointed duties without fear of litigation.[9] Second, the bankruptcy court holds an "overriding interest" in the administration of the estate, and other courts should avoid interference with this role.[10] Third, the *Barton* doctrine encourages bankruptcy courts to "centralize bankruptcy litigation" and permits bankruptcy courts to "keep a watchful eye" on its own appointed officers.[11]

While it is clear that the *Barton* doctrine applies to bankruptcy trustees, courts have wrestled with the extent to which it applies to other court-appointed officers. In 1993, the Sixth Circuit Court of Appeals applied the *Barton* doctrine to claims made against a bankruptcy trustee's counsel on the grounds that he was the "functional equivalent of a trustee."[12] The Eleventh Circuit Court of Appeals, utilizing the "functional equivalent" test, held that the doctrine applied to claims made against officers appointed by the trustee and approved by the bankruptcy court to sell estate property.[13]

Federal law also provides a limited statutory exception to the *Barton* doctrine. Section 959(a) of title 28 of the U.S. Code provides that "[t]rustees, receivers, or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions *in carrying on business* connected with such property."[14] Accordingly under § 959(a), leave of the bankruptcy court is not required when the acts alleged in the lawsuit involve the trustee's operation of a business.[15]

Notably, the *Barton* doctrine was also the subject of the ABI Commission to Study the Reform of Chapter 11's Final Report and Recommendations. Within the report, the Commission recommended codifying the *Barton* doctrine so that it would apply to all "estate neutrals, and statutory committees and their members."[16] The ABI Commission believed that codification of the doctrine in chapter 11 would "(i) allow any trustee, estate neutral, and statutory committee and its members to perform their fiduciary duties with confidence and focus, and (ii) eliminate unnecessary litigation concerning the application of the *Barton* doctrine."[17]

In re Yellowstone Mt. Club

The Yellowstone Mountain Club was a Montana-based ski and golf resort catering to the "ultra-wealthy" that was founded by Timothy Blixseth and his wife.[18] The couple later divorced, and Blixseth lost control of the company in the resulting marital settlement agreement.[19] Blixseth's ex-wife later filed bankruptcy petitions for the various entities that comprised the Yellowstone Mountain Club.[20] The dispute before the Ninth Circuit involved litigation between Timothy Blixseth and his former counsel, Stephen Brown, which the court referred to as "the latest chapter in the long-running saga of the Yellowstone Mountain Club bankruptcy litigation."[21]

Blixseth and his lawyer had a long-standing relationship. While operating Yellowstone, Blixseth allegedly used proceeds from a Yellowstone business loan to pay off his own personal debts.[22] When he was sued by Yellowstone shareholders, Blixseth sought relief based on the advice of his defense counsel,[23] and the lawsuit eventually settled. Blixseth's attorney also represented him during the divorce proceedings, including negotiating the marital settlement agreement that ultimately transferred Blixseth's interest in the Yellowstone entities to his ex-wife.[24]

Shortly after the bankruptcy petitions were filed against the Yellowstone entities in 2008, the Office of the U.S. Trustee appointed the committee.[25] Among those appointed was none other than Blixseth's attorney, who was appointed as the committee chair.[26]

Believing that Brown had improperly used confidential information to his detriment in the bankruptcy proceedings, Blixseth filed suit in federal district court against Brown.[27] The district court, citing the *Barton* doctrine, dismissed the lawsuit without prejudice, holding that it lacked jurisdiction over the claim because the bankruptcy court never previously authorized the lawsuit.[28] Blixseth then raised the claims in bankruptcy court, asking the court for permission to bring the claims in district court.[29] The bankruptcy court denied the request, and Blixseth appealed.[30]

The Ninth Circuit's Decision

While acknowledging that no other circuit court had previously reached this conclusion, the Ninth Circuit held that the *Barton* doctrine applied to committee members. Hon. Alex Kozinski, writing on behalf of the court, noted that committee members "have interests that are closely aligned with those of a bankruptcy trustee."[31] Specifically, committee members (1) are obligated to investigate the debtor and the debtor's business, (2) participate in the formulation of a reorganization plan and (3) can only maximize recovery for creditors by increasing the value of the estate.[32] While the Ninth Circuit's "alignment-of-interest" standard is distinct from the "functional-equivalent" standard adopted by the Fifth and Eleventh Circuits, the analysis remains the same:

8 *Id.* at 128-29.
9 *Blixseth v. Brown (In re Yellowstone Mt. Club)*, 841 F.3d 1090, 1095 (9th Cir. 2016).
10 *McIntire v. China MediaExpress Holdings Inc.*, 113 F. Supp. 3d 769, 773 (S.D.N.Y. 2015); *see also Allard v. Weitzman (In re DeLorean Motor Co.)*, 991 F.2d 1236, 1240-41 (6th Cir. 1993).
11 *Blixseth v. Brown (In re Yellowstone Mt. Club)*, 841 F.3d 1090, 1094 (9th Cir. 2016).
12 *Allard v. Weitzman (In re DeLorean Motor Co.)*, 991 F.2d 1236, 1241 (6th Cir. 1993).
13 *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000).
14 Emphasis added.
15 *Muratore v. Darr*, 375 F.3d 140, 144 (1st Cir. 2004).
16 ABI Commission to Study the Reform of Chapter 11, 2012-2014 Final Report and Recommendations 43 (2014), *available at* commission.abi.org/full-report (hereinafter "ABI Commission Final Report").
17 *Id.* The ABI Commission's recommendation was specifically cited by the Ninth Circuit in its decision in *In re Yellowstone Mt. Club.*
18 *Blixseth v. Brown (In re Yellowstone Mt. Club)*, 841 F.3d 1090, 1093 (9th Cir. 2016).
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.*
23 *Id.*
24 *Id.*
25 *Id.*
26 *Id.* at 1094.
27 *Id.*
28 *Id.*
29 *Id.*
30 *In re Yellowstone Mt. Club LLC*, 2013 Bankr. LEXIS 1131, at *17-18 (U.S. Bankr. D. Mont. March 15, 2013); 841 F.3d at 1094.
31 *Id.* at 1094-95.
32 *Id.* at 1095.

Barton is likely to apply when a court-appointed officer's role is to oversee and administer the estate.

The *Blixseth* court also concluded that public policy supported expanding the *Barton* doctrine to claims against committee members. He noted that requiring leave of the bankruptcy court is necessary to preserve the orderly administration of the estate.[33] Recognizing that bankruptcy proceedings are often complicated, the court stated, "Even the fear that such a lawsuit could be filed — and committee members could be called to answer for their actions in a court unfamiliar with bankruptcy proceedings — may cause committee members to be timid in discharging their duties."[34] Accordingly, the court held that if the doctrine did not apply, the result would cause substantial interference with the administration of the bankruptcy proceedings.

Analysis and Lessons for Practitioners

The decision in *Blixseth* holds that the *Barton* doctrine is a flexible doctrine that can be expanded to apply to a variety of claims against various court-appointed officers. In evaluating whether leave of the bankruptcy court is required, it is important to consider three factors: (1) *who* is the party being sued, (2) *what* is the nature of the claim and (3) *when* do the relevant facts supporting the claim arise?

First, the doctrine is likely to apply if you are suing an individual in their capacity as an estate representative. This clearly applies to a bankruptcy trustee and likely applies to his/her functional equivalent, such as the estate's professionals. As seen in *Blixseth*, that person could also be someone who has interests aligned with the trustee, such as a committee member. In fact, the ABI Commission's Final Report recommended codifying *Barton* for any trustee, estate neutral, and statutory committee and its members.[35]

Second, the *Barton* doctrine is likely to apply whenever the claim involves actions made in the performance of one's official duties. Courts have consistently recognized the need to protect officials who are acting within the scope of their court-appointed duties. In addition, courts have acknowledged the importance of allowing the bankruptcy court to monitor and review its own appointed officers. Thus, even if a lawsuit alleges that the fiduciary acted *beyond* the scope of his/her duties, the doctrine is likely to apply. At this juncture, it is also important to recall the limited statutory exception in § 959(a) of title 28, which provides that leave of the court is not required in order to file suit against a trustee for claims arising from the trustee's operation of a business.[36]

Finally, in evaluating whether the *Barton* doctrine applies to a particular claim, it is important to evaluate when the particular facts occurred in relation to the bankruptcy case. The Ninth Circuit specifically held that the *Barton* doctrine was inapplicable to claims that arose pre-petition. Thus, if all of the relevant facts of a claim arose prior to the petition date — or prior to the representative's appointment — then leave of the bankruptcy court would not be necessary prior to filing a claim in state or federal court.

There are a few lessons that can be gleaned from the Ninth Circuit's decision. First, unless the claim obviously arose pre-petition, it is necessary to seek leave from the bankruptcy court before asserting the claim in federal or state court. While this procedural misstep did not prevent Blixseth from seeking permission retroactively from the bankruptcy court, other litigants have not fared as well.

Notably, the *Barton* doctrine was also the subject of the ABI Commission to Study the Reform of Chapter 11's Final Report and Recommendations. Within the report, the Commission recommended codifying the *Barton* doctrine so that it would apply to all "estate neutrals, and statutory committees and their members."

For example, in *In re Summit Metals Inc.*, the bankruptcy court concluded that the failure to first seek leave of the court prior to filing state law claims in New York barred the plaintiff from refiling those same claims in the bankruptcy court.[37] The court reasoned that when a party violates *Barton*, the trustee is required to expend significant resources in asserting the *Barton* doctrine in the nonbankruptcy forum and to seek removal of the action. Thus, removal to the bankruptcy court could not cure the improper initial filing.[38] Accordingly, the court concluded that a leave of the court could not be retroactively issued and that the claims must be dismissed with prejudice.[39]

Another lesson from these cases is that disputes over the *Barton* doctrine often result in protracted litigation. Litigants spend significant time and resources fighting over whether their claims can be raised outside of the bankruptcy court. Practitioners can help clients avoid these expensive legal battles by carefully evaluating the claims and properly raising those claims in the proper forum.

It will be interesting to see if other circuit courts follow the Ninth Circuit's holding in *Blixseth*, which has already been approvingly cited by Hon. **Martin Glenn** in a recent bankruptcy decision in the Southern District of New York.[40] That decision has already been appealed to the district court and may eventually reach the Second Circuit. abi

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33 *Id.*
34 *Id.*
35 ABI Commission Final Report at 43-44.
36 28 U.S.C. § 959.
37 *Richardson v. Monaco (In re Summit Metals Inc.)*, 477 B.R. 484, 497-98 (Bankr. D. Del. 2012).
38 *Id.* at 497.
39 *Id.* at 498.
40 *MF Global Holdings Ltd. v. Allied World Assur. Co. (In re MF Global Holdings)*, 2017 Bankr. LEXIS 251 at *17-18 (Bankr. S.D.N.Y. Jan. 31, 2017).