Case No. 3:20-cv-03390-X

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

In re: Highland Capital Management, L.P.,
Debtor.

James Dondero,
***Appellant*,**

v.

Highland Capital Management, L.P., *et al.*,
***Appellee*.**

On Appeal from the United States Bankruptcy Court for
the Northern District of Texas, Case No. 19-34054
Hon. Stacey G.C. Jernigan, Presiding

BRIEF OF JAMES DONDERO

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CORPORATE DISCLOSURE STATEMENT

Appellant, James Dondero ("Mr. Dondero"), is a natural person and need not make a corporate disclosure. The Debtor, Highland Capital Management L.P., is a party to the instant appeal.

LOCAL RULE 8012.1 CERTIFICATE OF INTERESTED PERSONS

Appellant, Mr. Dondero, certifies that the following list is, to the best of his knowledge, a complete list of all persons, associations of persons, firms, partnerships, corporations, guarantors, insurers, affiliates, parent corporations, and/or other legal entities who or which are financially interested in the outcome of this appeal.

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Mr. Dondero also states that certain other creditors and parties in interest from Highland Capital Management L.P.'s underlying bankruptcy case may have a financial interest in the outcome of this appeal. The consolidated creditors are listed in Highland Capital Management, L.P.'s bankruptcy schedules. (R. 003506-24).

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

BASIS FOR APPELLATE JURISDICTION

On October 28, 2020, the Bankruptcy Court entered its *Order Approving Debtor's Settlement with (A) Acis Capital Management GP LLC (Claim No. 23), (B) Joshua N. Terry and Jennifer G. Terry (Claim No. 156), and (C) Acis Capital Management, L.P. (Claim No. 159) and Authorizing Actions Consistent Therewith* (the "Settlement Order"). (R. 000029). The Settlement Order approved a settlement agreement between Highland Capital Management, L.P., on the one hand, and Acis Capital Management GP, LLC and Acis Capital Management, L.P, Joshua N. Terry, and Jennifer G. Terry on the other. *Id*. The Bankruptcy Court had jurisdiction to enter the Settlement Order pursuant to 28 U.S.C. § 157 and 28 U.S.C. § 1334, as well as Rule 9019 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

The Settlement Order is a final, appealable order. *See In re Gibraltar Res., Inc.*, 210 F.3d 573, 576 (5th Cir. 2000) (approval of a Fed. R. Bankr. P. 9019 compromise is a final order). As a result, this Court has jurisdiction over the instant appeal. 28 U.S.C. § 158(a)(1) ("[t]he district courts of the United States shall have jurisdiction to hear appeals … from final orders."). Mr. Dondero filed a timely notice of appeal on November 9, 2020. (R. 000001).

ISSUE PRESENTED

Whether the Bankruptcy Court erred in approving the settlement agreement and release entered into between Highland Capital Management, L.P. and Acis Capital Management, L.P., Acis Capital Management GP, LLC, and Joshua and Jennifer Terry pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure as being fair, equitable, and in the best interest of the estate.

STANDARD OF REVIEW

The Bankruptcy Court's approval of a settlement is reviewed for abuse of discretion. *In re Foster Mortg. Corp.*, 68 F.3d 914, 917 (5th Cir. 1995); *In re Senior Care Ctrs., LLC*, No. 3:19-CV-2722-B, 2021 U.S. Dist. LEXIS 29845, at *18 (N.D. Tex. 2021). The lack of a sufficient factual foundation to approve a settlement is an abuse of discretion. *In re AWECO, Inc.*, 725 F.2d 293, 299 (5th Cir. 1984). The Bankruptcy Court's factual findings are reviewed for clear error. *In re Cajun Elec. Power Coop.*, 119 F.3d 349, 355 (5th Cir. 1997). A clear error exists where there is a "definite and firm conviction that a mistake has been committed." *CFB-5, Inc. v. Cunningham*, 371 B.R. 175, 179–80 (N.D. Tex. 2007) (citation omitted).

STATEMENT OF THE CASE

Highland Capital Management, L.P. ("Highland" or "Debtor") has been at odds with Acis Capital Management, L.P. and Acis Capital Management GP, LLC (together "Acis") for several years. Part of the source of the friction arises from the individuals behind the entities, principally Joshua Terry ("Mr. Terry"). Mr. Terry's

falling out precipitated a series of events, litigation, and bankruptcies that bring the parties to where they are today.

The "short version" is that Mr. Terry obtained an arbitration award against Acis on October 20, 2017. (R. 002375). A final judgment confirming the arbitration award was entered on December 18, 2017. (R. 002377). Mr. Terry, as a creditor of Acis, then filed an involuntary chapter 7 petition for relief against Acis on January 30, 2018. (R. 000394). On April 13, 2018, the Bankruptcy Court entered the order for relief on the involuntary petition. (R.000395). The Bankruptcy Court later entered an order converting the case to Chapter 11 and a Chapter 11 Trustee was appointed shortly thereafter. (R.000395) On January 31, 2019, the Bankruptcy Court entered an order confirming the third amended plan of reorganization (the "Acis Plan") proposed by the Chapter 11 Trustee. (R.000392).

Under the confirmed Acis Plan, Mr. Terry acquired 100% of the equity interest in the reorganized Acis in exchange for a $1,000,000 reduction in the allowed amount of his claim against the Acis estate. *See* Acis Plan, Arts. 1.97, 4.02. (R. 000447, 000451). The Plan provided for "Estate Claims"—meaning causes of action held by Acis's bankruptcy estates— to vest in Acis, and gave Acis the exclusive authority to assert such claims "for the benefit of the Reorganized Debtor." *Id.*, Arts. 1.55, 6.01, 9.03. (R.000445, 000455, 000461) The Plan does not require Acis to distribute litigation proceeds to creditors. *See id.*, Arts. 4.03(c), 4.04(e),

4.04(i). (R.000452-453). The Acis bankruptcy has resolved[1], with Mr. Terry as the new equity holder and the Acis creditors paid. (R.001211, 002978, p. 188:11-20).

On October 16, 2019, Highland filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (R. 000053). On December 31, 2019, Acis filed a proof of claim (the "Acis Claim") asserting claims of at least $75 million levied predominately as claims for fraudulent transfers that occurred prior to the Acis bankruptcy. (R. 002350). The Acis Claim is based on and incorporates an adversary complaint filed against Highland in the Acis case. (R.002350-002463). Upon the filing of the Highland bankruptcy case, this litigation was stayed and Acis filed its proof of claim to preserve its right to receive a recovery from the Highland estate. (R.002350) Highland vehemently objected to the Acis Claim. (R. 001211–1276). In its objection, Highland stressed that the Acis Claim is based on a "fallacious premise" and subject to fatal legal flaws. (R. 001213–1214). Underlying Highland's claim objection is one overarching fact that undercuts and is potentially fatal to the Acis Claim: reorganized Acis cannot recover $75 million on behalf of itself when all of Acis's creditors have been paid and any recovery will only benefit Mr. Terry as Acis's sole owner. (R.001211-1214).

Shortly after a mediation between the main constituents in the case, Highland and Acis reached a settlement of the Acis Claim and Highland's claims against Acis

[1] *See* Final Decree entered at Docket No. 1210 in Case No. 18-30264.

in that were pending in Acis's bankruptcy case (the "Settlement"). On September 9, 2020, Highland, Acis, and Mr. and Mrs. Terry executed a written settlement agreement (the "Settlement Agreement"). (R.002208).

Among other things, the Settlement Agreement provided that the Acis Claim would be allowed as a general unsecured claim in the amount of $23 million. (R.002209) Under the Settlement Agreement, Highland also agreed to make several direct payments to Terry and Acis upon the effective date of a confirmed plan. (R.002210) Under the Settlement Agreement, in addition to granting Acis a $23 million unsecured claim, Highland would pay (i) Acis $97,000 on account of Proof of Claim No. 159 for purported attorney's fees incurred by Acis in litigation, despite the fact that Acis was not listed as a party in the complaint attached to the claim and the basis for the claim was listed as "contract, negligence" (R.006035-6039) (ii) Mr. & Mrs. Terry $425,000, plus interest, on account of Claim No. 156 for the Terrys' 401(k), providing for a 100% recovery on that claim (R.006014-6018); and (iii) Mr. Terry $355,000 for alleged attorney's fees incurred by Mr. Terry personally in litigation to which neither the Debtor nor Acis were parties and for which no proof of claim was filed against Highland. (R. 002210, 002068, 002209–16). In exchange, the Debtor also agreed to release and withdraw with prejudice two of its claims that were pending against Acis in the Acis bankruptcy case: (i) a proof of claim; and (ii)

an application for an administrative expense claim under 11 U.S.C. § 503(b). (R.002210)

On September 23, 2020, Highland filed a motion with the Bankruptcy Court to approve the Settlement under Bankruptcy Rule 9019 (the "9019 Motion"). (R. 0002186–2204). Mr. Dondero filed a response to the motion stressing the need for the Bankruptcy Court to independently evaluate the Settlement to ensure that the Settlement was fair, equitable, and in the best interest of the estate. (R.002340) Dondero believed this was particularly important given the Debtor's initial, aggressive litigation position and the fact that the Debtor's first offer to resolve the Acis Claim, $4 million (R.003010), was substantially less than the amount of consideration to be given to Acis and Terry under the proposed Settlement. (R. 002340–49). Other interested parties objected to the Settlement or sought to proceed under a reservation of rights. (R. 002758–90).

On October 20-21, 2020, the Bankruptcy Court conducted a hearing on the Debtor's motion to approve the Settlement. (R. 002791–3094). On October 21, 2020, at the conclusion of the hearing, the Bankruptcy Court issued an oral ruling from the bench approving of the Settlement. (R. 003078–3083). On October 27, 2020, the Bankruptcy Court entered its written order approving the Settlement pursuant to Bankruptcy Rule 9019. (R. 000029–52).

ARGUMENT SUMMARY

Under Bankruptcy Rule 9019, a settlement approved by a bankruptcy court must be fair, equitable, and in the best interest of the estate. In determining whether a settlement meets this standard, a bankruptcy court is to consider several factors, including the probabilities of ultimate success in litigating the claim and the complexity, expense, and likely duration of such litigation.[2] The bankruptcy court must not simply "rubber stamp" a debtor's proposal. Rather, the court must undertake an "intelligent, objective and educated evaluation" of the proposed settlement "to ensure that the settlement is fair, equitable, and in the best interest of the estate and creditors." *See In re Mirant Corp.*, 348 B.R. 725, 739 (Bankr. N.D. Tex. 2006) (quoting *Conn. Gen. Life Ins. Co. v. Foster Mortgage Corp. (In re Foster Mortgage Corp.)*, 68 F.3d 914, 917 (5th Cir. 1995)). "The words fair and equitable are terms of art -- they mean that senior interests are entitled to full priority over junior ones." *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984) (internal quotations omitted).

The Bankruptcy Court abused its discretion in approving the Settlement. The record reflects that the Bankruptcy Court—rather than make its own independent, objective evaluation of the proposed settlement—deferred largely to the Debtor's business judgment and supposed due diligence in making its determination to enter into the Settlement. In doing so, the Bankruptcy Court failed in its "quasi-

[2] *See Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968)

inquisitorial" duty and did not "apprise itself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the potential claims . . . be litigated." This failure is demonstrated by, among other things, the fact that the Bankruptcy Court did not consider (i) the merits, contentions, and value of the Debtor's two pending claims against Acis in the Acis case; and (ii) the basis for and the merits of three additional claims of Acis and Terry that were being compromised under the Settlement. The motivations of the Debtor, in turn, were not primarily centered on whether the Acis Claim had merit or whether the probability of success of the various settled claims would weigh in favor of the ultimate settlement. Rather, the record reflects that there were two, overriding factors that largely influenced the Debtor in deciding to settle the Acis Claim for $23 million and make certain additional payments to Mr. Terry: (i) empathy for Mr. Terry (as reorganized Acis's sole owner); and (ii) obtaining creditor support for its plan (and then tacit approval of this progress by the Bankruptcy Court).

The Bankruptcy Court further abused its discretion because the Settlement and the compromises of the various claims therein violated the absolute priority rule—a strict requirement to satisfy the "fair and equitable" standard in the Fifth Circuit.

Finally, the cost associated with Highland's pursuit of the litigation of the Acis Claim does not outweigh the potential benefit to the estate and its creditors if

Highland were successful. At the time of the settlement, the Acis Claim was ripe for summary adjudication and the parties were on the verge of being able to have a decision as to the threshold gating issue on whether Acis had standing to pursue its claims.

The Settlement Order should be reversed and the matter remanded to the Bankruptcy Court.

ARGUMENT & AUTHORITIES

I. MR. DONDERO HAS STANDING TO APPEAL.

Mr. Dondero is a creditor and indirect equity security holder of Highland. (R. 002344, ¶¶ 19–21). As a "party in interest," Mr. Dondero had standing to challenge the approval of the Settlement in the Bankruptcy Court. *See Kipp Flores Architects, L.L.C. v. Mid-Continent Cas. Co.*, 852 F.3d 405, 413 (5th Cir. 2017) (creditors and equity security holders are considered parties in interest). Mr. Dondero has standing to appeal as a "person aggrieved" as he is "directly and adversely affected pecuniarily" by the Settlement Order. *In re Coho Energy, Inc.*, 395 F.3d 198, 202–03 (5th Cir. 2004) (quotations omitted). Mr. Dondero is subject to suit by Highland's unsecured creditors for claims that cannot be satisfied by the estate. (R. 2066, 3765, 3775). Mr. Dondero, then, has a pecuniary interest in the assets of the estate as the greater the amount of allowed claims, the more financial risk Mr. Dondero faces. The Settlement grants Acis an unsecured claim for $23 million, where Highland has

previously argued the Acis Claim is worthless. The Settlement directly and adversely impacts Mr. Dondero pecuniarily, giving him standing to assert this appeal.

II. THE BANKRUPTCY COURT ABUSED ITS DISCRETION BY APPROVING THE SETTLEMENT.

The approval of a proposed settlement in bankruptcy is evaluated through the Supreme Court's criteria stated in *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*. 390 U.S. 414 (1968). The settlement must be "fair and equitable." *TMT Trailer*, 390 U.S. at 424; *In re Age Ref., Inc.*, 801 F.3d 530, 540 (5th Cir. 2015). "The words fair and equitable are terms of art -- they mean that senior interests are entitled to full priority over junior ones." *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984) (internal quotations omitted). To decide if a settlement is fair and equitable, a bankruptcy court "must make a well-informed decision, comparing the terms of the compromise with the likely rewards of litigation." *In re Cajun Elec. Power Coop.*, 119 F.3d at 356 *quoting In re Jackson Brewing Co.*, 624 F.2d 599, 602 (5th Cir. 1980). In reaching that well-informed decision, a bankruptcy court must evaluate:

> (1) the probability of success in litigating the claim subject to settlement, with due consideration for the uncertainty in fact and law;
>
> (2) the complexity and likely duration of litigation and any attendant expense, inconvenience, and delay; and
>
> (3) all other factors bearing on the wisdom of the compromise.

In re Age Ref., Inc., 801 F.3d at 540.

The third prong includes two additional factors: (a) the best interest of the creditors and (b) the extent settlement resulted from arms-length bargaining. *In re Cajun Elec. Power Coop.*, 119 F.3d at 356 (citing *In re Foster Mortg. Corp.*, 68 F.3d at 917-18).

In considering whether to approve a settlement under Rule 9019 a "court had a duty to apprise itself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the potential claims . . . be litigated. *In re Bos. & Providence R. Corp.*, 673 F.2d 11, 12 (1st Cir. 1982) (citing *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*. 390 U.S. 414 (1968)). A bankruptcy court also has an "obligation to form an independent judgment of the complexity, expense, and likely duration of litigation." *Id.*

The debtor does not have "unfettered freedom" to do as it wishes. *See In re Pilgrim's Pride Corp.*, 403 B.R. 413, 426 (Bankr. N. D. Tex. 2009) ("a debtor in possession must administer its case and conduct its business in a fashion amenable to the scrutiny to be expected from creditor and court oversight.").

a. The Bankruptcy Court did not independently consider Highland's probabilities of success in litigating the Acis Claim and form an independent judgment of the complexity, expense, and likely duration of litigating the Acis Claim

The Bankruptcy Court's sole reliance on Highland's assessment of the settlement and the related probabilities of success was an abuse of discretion. A bankruptcy court may not "rubber stamp" a debtor-in-possession's recommendation

regarding a settlement agreement. *In re Am. Res. Corp.*, 841 F.2d 159, 162 (7th Cir. 1987). The bankruptcy court must itself make a full and fair assessment of the wisdom of the proposed settlement and conduct an "intelligent, objective and educated evaluation." *In re Jackson Brewing Co.,* 624 F.2d at 602. "[T]he bankruptcy court must apprise itself of the relevant facts and law so that it can make an informed and intelligent decision." *In re Age Ref., Inc.*, 801 F.3d at 541 (internal quotation omitted).

In considering whether to approve a settlement under Rule 9019 a "court had a duty to apprise itself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the potential claims . . . be litigated. *In re Bos. & Providence R. Corp.*, 673 F.2d 11, 12 (1st Cir. 1982) (citing *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*. 390 U.S. 414 (1968)). A bankruptcy court also has an "obligation to form an independent judgment of the complexity, expense, and likely duration of litigation."

The evaluation undertaken by a bankruptcy court, then, is distinct from the debtor's decision to settle and the debtor's business judgment. *See id.* A debtor may believe and assert that a settlement is appropriate, but whether that settlement is fair and equitable is still subject to the Bankruptcy Court's independent and objective evaluation. *See id.*

In this case, the Bankruptcy Court's focus was nearly uniformly on whether the testimony of Highland's CEO, Mr. James Seery, regarding Highland's process for evaluating the settlement was credible and whether Highland thoroughly analyzed whether it was worth it to litigate the Acis Claim. (R. 003080–81, 34:1–35:8). The Bankruptcy Court noted that it believed Mr. Seery when he testified of his "deep understanding of the risks and rewards of further litigation and the uncertainty" in the legal and factual bases of Highland's defenses to the Acis Claim. (R. 003080, 34:7–34:8). It was Mr. Seery's due diligence in evaluating the settlement and Mr. Seery's personal testimony of his understanding of case law that largely influenced the Bankruptcy Court's decision to approve the settlement. (R. 003080–81, 34:1–35:8). Mr. Seery made the determination that the probabilities of success favored settlement, the Bankruptcy Court, on the other hand, did not independently do so. (R. 003078-3083)

The record here is similar to the record in *TMT Trailer* where the Supreme Court remanded the settlement for further investigation. In *TMT Trailer*, the bankruptcy court "accepted the bald conclusions of the trustee" that no better compromise could be obtained and that the chance at reduction of the asserted claim did not warrant extensive litigation. 390 U.S. 414, 432-33 (1968). The Supreme Court emphasized the contradiction of the trustee given that the trustee had "once concluded that the [basis of the claim] was null and void." *Id.* at 433. By not going

beyond the conclusory assertions of the trustee, the bankruptcy court failed to evaluate the merits of the settled claims and the settlement itself. *Id.* at 440.

The same flaws exist here. The Bankruptcy Court's ruling focused largely on the credibility of Mr. Seery's testimony as to the Debtor's reasoning for settlement and the probability of success in the litigation. (R. 003080–81, 34:1–35:8). This is similar to the conclusory assertions of the trustee in *TMT Trailer*, which is not the proper basis for weighing a settlement. The test is not whether a debtor can make a showing that it weighed the probabilities of success, it is whether the probabilities of success make the settlement reasonable after being independently weighed by the Court. Here, the Bankruptcy Court relied exclusively on—and deferred to—the Debtor's opinion as to the probability of success in the litigation without conducting its own independent and objective analysis as to the probability of success of the litigation. (R. 003078-3083) Nor did the Bankruptcy Court make any determination as to the probability of success in the litigation or issue any finding that the probability of success favored the settlement. (R. 003078-3083) This was an abuse of discretion.

A distinguishable record existed for the Fifth Circuit with *In re Age Ref., Inc.* 801 F.3d 530 (5th Cir. 2015). That record showed the bankruptcy court's explanation of its own consideration of the merits of a post-petition claim for interest based on values of collateral. *Id.* at 540–42. The bankruptcy court made implicit findings

regarding the values of the collateral related to the claim, which supported the trustee's conclusion of likely losing in litigation over the claim. *Id.* at 541–42. There is no such explanation here. There is only Mr. Seery's testimony that once he considered the equities regarding Mr. Terry and read the case law, he became less convinced of the success of litigating Highland's objection to the Acis Claim. (R. 003003–4, 213:15 – 214:3; R. 003005–6, 215:8–216:5).

It is not clear from the record if the Bankruptcy Court's assessment of Mr. Seery's credibility is to be understood as an implicit endorsement of the Debtor's opinion as to why it entered into the Settlement. Regardless, without having made its own finding, the Bankruptcy Court shirked its quasi-inquisitorial role to independently ensure the proposed settlement is fair and equitable. *See In re AWECO, Inc.*, 725 F.2d at 298 (noting the bankruptcy court's "quasi-inquisitorial role" in determining the value of the estate as it related to the approval of a settlement).

For the reasons set forth above, the Bankruptcy Court abused its discretion by not making an independent determination on Highland's probabilities of success against the Acis Claim. By only relying on Highland's "due diligence" in deciding to settle, the Bankruptcy Court shifted the determination of fairness and equity to the debtor and effectively rubber stamped the debtor's decision. This constitutes an abuse of discretion that should be reversed.

b. The Bankruptcy Court did not independently consider Highland's probabilities of success of its claims against Acis and form an independent judgment of the complexity, expense, and likely duration of litigating those claims

The Bankruptcy Court abused its discretion in approving the Settlement because it did not independently consider the Debtor's probability of success in litigating its two pending claims against *Acis* that were released under the Settlement. There were two claims held by the Debtor's estate that were compromised under the Settlement. The Bankruptcy Court was therefore required under Rule 9019 to independently consider the probabilities of success in litigating these claims and to form an independent judgment of the complexity, expense, and likely duration of litigating those claims. These claim documents were not in the record before the Bankruptcy Court and there was no evidence in the record as to the detailed legal and factual contentions underlying these claims or the merits of these claims. Accordingly, the Bankruptcy Court did not have sufficient factual findings upon which to analyze these claims and approve the settlement.

The Supreme Court has stated that, in analyzing whether a settlement is justified under Rule 9019, "a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390

U.S. 414, 434 (1968). There must be an "explanation of how the strengths and weaknesses of the debtor's causes of action were evaluated or upon what grounds it was concluded that a settlement which allowed the creditor's claims in major part was fair and equitable." *See id.*

Under the Debtor's Settlement with Acis, the Debtor agreed to release and withdraw with prejudice two claims that were pending against Acis in the Acis bankruptcy case: (i) a proof of claim; and (ii) an application for an administrative expense claim under 11 U.S.C. § 503(b). (R.002010). While these two claims were consolidated into the adversary proceeding where the Acis Claim was pending, these claims themselves, and their detailed legal and factual contentions, were not in the record. Moreover, Mr. Seery did not testify as to the merits of these claims, Highland's likelihood of success in litigating these claims, the complexity or the cost of litigating the claims, or why Highland agreed to withdraw the claims with prejudice. Nor did the Bankruptcy Court undertake an independent analysis of the merits of these claims, the Debtor's probability of success in pursuing the claims, or the potential value of the claims as an offset to the millions of dollars being awarded to Acis under the Settlement. Instead, in violation of standards promulgated by the Supreme Court in *TMT Trailer*, the Bankruptcy Court—shirking its "quasi-inquisitorial role"— effectively "rubber stamped" the Debtor's proposed settlement,

even though there was little if any evidence in the record as to the merits, value, and likelihood of success of the claims the Debtor was giving up under the Settlement.

Accordingly, like in *TMT Trailer*, the record before the Bankruptcy Court here "leaves us completely uninformed as to whether the trial court ever evaluated the merits of the causes of actions held by the debtor, the prospects and problems of litigating those claims, or the fairness of the terms of compromise." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 440 (1968). The record before the Bankruptcy Court here was "inadequate for assessing" the "merits of the Debtor's causes of action or as to the actual fairness of the proposed compromises." *Id.* at 441. There was no way for the Bankruptcy Court to determine that the Settlement was fair, equitable, and in the best interest of the estate when it had little or no evidence as to the claims the Debtor's estate was releasing and withdrawing under the Settlement. Accordingly, the Bankruptcy Court abused its discretion in approving the Settlement and the matter should be remanded to the Bankruptcy Court for further proceedings.

c. The Settlement is not in the best interests of the estate.

Even if the Bankruptcy Court had made a determination on the probabilities of success, those probabilities must still be weighed against the costs of settlement. *See In re Jackson Brewing Co.*, 624 F.2d at 602 (The Court must "compare the terms of the compromise with the likely rewards of litigation."). In effect, where the risk

of litigating is worth the reward, a settlement is unlikely to be fair and equitable. Here, Highland is giving up the opportunity at a $0 Acis Claim in exchange for removing the risk of the claim being $75 million. That risk aversion cost $23 million, plus the sunk cost of the expenses it took to get to settlement.

Such risk aversion is not in the best interest of the creditors where (1) the costs to take the risk are minimal in comparison and (2) the debtor asserts a strong probability of success. *See In re Cajun Elec. Power Coop.*, 119 F.3d at 357–58 (discussing the costs of litigation and interest of the creditors). The fact that a settlement may resolve protracted litigation quickly is not singularly dispositive. *In re AWECO, Inc.*, 725 F.2d at 298. "Litigation and delay are always the alternative to settlement," but when strong defenses can be asserted that reduce the value of a claim by more than the cost of defending the claim then it is in the best interest of creditors to assert those defenses. *TMT Trailer*, 390 U.S. at 434; *Cf. In re Cajun Elec. Power Coop.*, 119 F.3d at 357–58 (approving a settlement where costs are high and probabilities of success are low). Otherwise, bankruptcy courts would be obligated to approve all settlements absent fraud or collusion.

Based on Highland's original objection, Acis lacked standing post reorganization to pursue its claim. Under its plan, all of Acis's creditors were paid in full and any recoveries received by Acis on account of the Acis Claim would not benefit the Acis estate, but only Mr. Terry, as the sole owner of reorganized Acis.

(R. 000348, § 7.03). The Acis bankruptcy plan did not provide for litigation recoveries for the creditors. (R.000452-453) Therefore, Highland's position was that Mr. Terry's stepping-in as the new equity owner meant that post-reorganization claims, where the creditors had been fully paid, meant that neither the estate nor its creditors would receive any benefit from a recovery on account of the Acis Claim. The beneficiary would be solely Mr. Terry. Such a windfall would be tantamount to Highland giving away $23 million, especially where the fundamental issue of standing remained to be determined at the time of the settlement.

Mr. Seery also testified repeatedly that empathy towards Mr. Terry personally (rather than Acis) was a primary motivation driving the Debtor to settle with Acis. (R. 003005–7, 215:19–217:7). While this may be a noble position, it is not one that is in the best interest of the creditors where it results in giving a separate entity—Acis—a $23 million claim that may potentially be worth as little as $0.

For example, the record reflects that the Debtor was not liable for the fees in the Guernsey litigation but it nevertheless agreed to compromise those and pay Mr. Terry personally—even though he had no pending claim against the Highland estate for that litigation or those amounts and the Debtor did not control HCLOF. (R.002985, p. 195:16-17) The record reflects that this was included in the Settlement because "it was something that was really important to Mr. Terry." (R.002985, p. 195:22)

Mr. Seery testified that the Debtor did not have liability for this debt and that it did not control the subject entity, Highland CLO Funding, Ltd. ("HCLOF") (R.002985, p. 195:16-17)[3] HCLOF, with its own independent counsel, actually filed a response to the Debtor's 9019 Motion. (R.002777). Despite these facts, the Mr. Seery testified that the Debtor would settle a claim in which it was not involved: "Rather than have either two non-debtors, either "HCLOF or Acis" go and spend additional dollars to litigate in Guersney to determine fees . . . we compromised it." (R.002986, p. 197:2-6)

At a minimum, if Highland believed that the bulk of the Acis Claim could be dismissed after a ruling on standing, then it would be more prudent for the estate to pursue that ruling instead of allowing a $23 million claim. This is especially poignant here because Highland's defenses were on the verge of summary adjudication and the parties had already briefed the issues before the Bankruptcy Court.

d. The cost of summary adjudication of the Acis Claim is minimal compared to the potential benefit

The cost associated with Highland pursuing its defense against the Acis Claim is comparatively low. The record reflects both the actual legal costs Highland has spent getting to the precipice of summary judgment and an estimate of the costs to take the defense through appeal at the Fifth Circuit. Prior to settling, Highland

[3]

thoroughly researched and briefed the gating issues that could be dispositive of the Acis Claim. The evidence presented in connection with the Settlement Motion reveals the *de minimus* additional cost to fully litigate these preliminary issues.

In *Cajun Electric*, the Fifth Circuit analyzed the claims that Cajun was required to drop under the settlement agreement. 119 F.3d at 356. Cajun had effectively already lost on all of those claims. *Id.* It had lost a trial on one claim, been hit with a counterclaim judgment on another, and failed to establish any fiduciary duty in its equitable subordination claim. *Id.* at 356–57. The Court described the equitable subordination claim as "iffy at best." *Id.* at 357. The litigation had already cost Cajun $37 million and continuing it was to cost millions more. 119 F.3d at 357. The underlying fraud trial took four months. *Id.* It was estimated the breach of contract trial would take up to fourteen months. *Id.*

Cajun's probabilities of success were low and its anticipated costs (in time and money) were high; the perfect recipe for settlement. The distinction here is that Highland's probabilities have not been solidified the same as Cajun's. Cajun had already lost. Highland's defenses have not been tested. Highland still has a viable argument that the Acis Claim is worthless.

The record dictated that Cajun would need to spend millions and endure years of trial to litigate "iffy at best" claims. The Acis Claim, on the other hand, is set up for summary adjudication. As part of an agreed upon scheduling order, Highland

and Acis were to file motions for summary judgment on the Acis Claim by September 16, 2020. (R. 001966) and a hearing on those motions was initially set for October 20, 2020—the same day as the settlement hearing. (R.001967) This summary adjudication, by its nature, would be less costly and less time consuming than the dropped claims in *Cajun Electric*.

Any remaining issues were set to be determined via an "expeditious trial setting." (R. 005816, 113:19–113:120). Even if summary adjudication did not resolve the Acis Claim entirely, the mechanisms were already in place to avoid the same costs of extended litigation as in *Cajun Electric*. While the Bankruptcy Court stated it believed Professor Rapoport's fee estimate to litigate the proof of claim (between $350,000 and $1.1 million) was on the low end (R. 003082), it is unclear whether the Bankruptcy Court relied on evidence in the record to support this belief. The Bankruptcy Court instead appears to have relied on its knowledge of the fees incurred generally in the separate *Acis* case in coming to the conclusion that Professor Rapoport's estimate was "way, way low as far as future fees and expenses." (R.003082).

In another example, *CFB-5, Inc. v. Cunningham*, there was no abuse of discretion where the settled claims were determined to either (1) leave the estate with no assets if the claim prevailed or (2) be long and expensive with an uncertain outcome if the claim were litigated. 371 B.R. at 182-83 (N.D. Tex. 2007). Here, there

is no assertion that the Acis Claim would leave the estate with no assets. There is no such risk for Highland in testing the mettle of its arguments against what it originally called the "fallacious premise" of the Acis Claim. (R. 1213).

The legal costs will continue to grow for Highland regardless of the Settlement. The bankruptcy is not resolved; all the claims are not settled; and all the litigation is not complete. To link the cost of summary adjudication and expeditious trial of one set of claims to the costs of the entirety of the Highland bankruptcy/litigation ecosystem is unreasonable. While the Bankruptcy Court's position that it thought the fee estimate given by Nancy Rapoport was low should not be entirely disregarded, it remains that there is no indication in the record that Professor Rapoport's estimate was so low that it was unreasonable. (R. 003082, 36:1–36:4).

The record reflects that, from October 16, 2019 to August 31, 2020, Highland spent just north of $4.2 million in legal costs in litigation related to its bankruptcy, the claims made in that bankruptcy, and related litigation with Acis.[4] This time

[4] For the period of October 16, 2019 to March 31, 2020, Highland spent $10,787.00 on non-bankruptcy litigation, $1,228,954.50 on bankruptcy litigation, $1,182,888.50 on claim objections, and $51,250.50 on Acis related stay litigation. (R. 637, 640, 643, 645). For the period of April 1, 2020 to July 31, 2020, Highland spent $0 on non-bankruptcy litigation, $510,875.00 on bankruptcy litigation, $1,172,004.50 on claim objections, and $373,218.50 on Acis related stay litigation. (R. 1589, 1590). For the period of August 1, 2020 to August 31, 2020, Highland spent $0 on non-bankruptcy litigation, $54,947.00 on bankruptcy litigation, $216,854.00 on claim objections, and $0 on Acis-related stay litigation. (R. 2239, 2240).

period includes the briefing Highland had already done on the Acis Claim. (R. 1211–1272).

Professor Rapoport's opinion was that carrying Highland's objection through to the Fifth Circuit on appeal would cost the estate between $350,000.00 and $1.1 million. (R. 2685–2689). This estimate is consistent with the amounts Highland had already spent on all claims related to the bankruptcy. Based on the Debtor's prior fee statements, it would be inconsistent and not supported by the record for one to assert that the litigation of just the Acis Claim would far exceed Professor Rapoport's top-end estimate of $1.1 million. If Highland's defenses to the Acis Claim are as strong as it articulated in its Objection to the Acis Claim then the litigation costs would be money well spent.

e. The Settlement of the Acis Claim is not fair and equitable because it does not satisfy the Absolute Priority Rule.

The Settlement also does not satisfy the Fifth Circuit's "fair and equitable" standard because it violates the absolute priority rule. The Fifth Circuit requires that for a settlement to be fair and equitable, "senior interests are entitled to full priority over junior ones." *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984).

Here, the Settlement violates the absolute priority rule because it pays Acis and Mr. Terry ahead of senior claims and other general unsecured claims outside of the priority scheme of the Bankruptcy Code. Among other things, this is evidenced by several direct payments to Mr. and Mrs. Terry.

First, on account of Proof of Claim No. 156, the Terrys are to receive *payment* in the amount of $425,000 (plus interest) in "full and complete" satisfaction of proof of claim number 156. Proof of Claim 156 was filed as a general unsecured claim in the amount of $425,000, plus interest. (R.006014-6018) Rather than provide the Terrys with full *allowance* of their claim with payment to be made under the priority scheme of the Bankruptcy Code and under a plan of reorganization, the Terrys—jumping ahead of holders of senior claims and other general unsecured claims—are to receive full payment, including interest, on account of their general unsecured claim upon the effective date of a plan of reorganization. The Debtor's plan of reorganization, as filed at the time, provided general unsecured claims were impaired and that there were impaired classes of claims ahead of unsecured. (R.001970-002030) Accordingly, this payment to the Terrys on account of Proof of Claim 156 violates the Fifth Circuit's "fair and equitable" standard because it pays the Terrys ahead of senior claims and other general unsecured claims.

The treatment of Proof of Claim 159 under the Settlement is similar. Under the Settlement, the Debtor agreed to pay Acis $97,000 for "legal fees incurred by [Acis] with respect to *NWCC, LLC v. Highland CLO Management, LLC*, et al." Proof of Claim 159 was filed as an unliquidated, unsecured claim, with the only basis for the claim listed as "contract, negligence." (R.006035-6039) This proof of claim attached the original complaint filed in the referenced lawsuit. Neither Acis Capital

Management, L.P. nor Acis Capital Management GP, LLC were listed as a defendant in the complaint. (R.006039). The Debtor, on the other hand, was identified as a Defendant in that proceeding (R.006039). This payment on account of Proof of Claim 159 violates the absolute priority rule because there is nothing in the record to show that Acis is a party to the litigation referenced in the claim or is entitled to its legal fees from the Debtor. In addition, Proof of Claim 159 was filed not as a claim for attorney's fees, but as an unliquidated "contract, negligence" claim. The basis for the claim and the alleged amount of the claim as filed is unclear, and the record provides no evidence to support this payment of $97,000 from the Debtor to Acis for attorney's fees in a lawsuit that Acis is not a party to and was not commenced by the Debtor. And, like Claim 156, this claim violates the absolute priority rule in another way by providing a cash payment on the effective date rather than the allowance claim to be paid like other similarly-situated creditors under a plan of reorganization.

Third, the Settlement violates the absolute priority rule because it pays Terry $355,000 in cash for an alleged claim that was not filed against the Debtor's estate and for which the Debtor believed it did not have liability. Rather, the Debtor paid the claim because of misdirected empathy toward Mr. Terry. (R.002985, p. 195:15-

23)[5] Mr. Seery testified that the Debtor did not have liability for this debt and that it did not control the subject entity, Highland CLO Funding, Ltd. ("HCLOF") (R.002985, p. 195:16-17) HCLOF, with its own independent counsel, actually filed a response to the Debtor's 9019 Motion. (R.002777) Accordingly, this payment also violates the absolute priority rule because it is a cash payment to Mr. Terry that was not made on account of any liability of the Debtor or any proof of claim filed by Mr. Terry.

There was no evidence in the record to support a deviation from the absolute priority rule and the Bankruptcy Court made no finding to support deviating from the Fifth Circuit's strict requirement that the absolute priority rule be satisfied in considering whether a settlement is fair and equitable under Rule 9019. Accordingly, the Bankruptcy Court abused in discretion in approving the Settlement. *See In re AWECO, Inc.*, 725 F.2d 293, 299 (5th Cir. 1984) ("An approval of a compromise, absent a sufficient factual foundation, inherently constitutes an abuse of discretion.").

Finally, by giving Acis a $23 million claim, the Settlement violates the absolute priority rule by giving Acis more than which it is entitled, prejudicing senior claims, other unsecured claims, and equity holders in the process.

CONCLUSION

[5] "And Acis and Mr. Terry took the view that we had the ability to stop that litigation. We actually went out and had outside counsel tell us we did not have that ability. And after doing – doing work on it. . . . And this is one of those items that I suspect that, because of our case as a manager, it was something that was really important to Mr. Terry."

Mr. Dondero respectfully requests that the Settlement Order be reversed and the matter remanded to the Bankruptcy Court for summary adjudication of the Acis Claim based on the record currently before the Court and an expeditious trial setting for any part of the Acis Claim surviving summary adjudication.

Dated: April 5, 2021

Respectfully submitted,

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ATTORNEYS FOR APPELLANT JAMES DONDERO

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that, on April 5, 2021, a true and correct copy of the foregoing document was served via the Court's CM/ECF system on all parties requesting or consenting to such service in this case.

/s/ Bryan C. Assink
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CERTIFICATE OF COMPLIANCE WITH RULE 8015

This document complies with the type-volume limit of Fed. R. Bankr. P. 8015(a)(7)(B)(i) as it contains 7,049 words, excluding the portions of the document exempted by Fed. R. Bankr. P. 8015(g).

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