CASE NO. 3:21-01295-X

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

HIGHLAND CAPITAL MANAGEMENT LP

(Debtor)

THE DUGABOY INVESTMENT TRUST AND
GET GOOD NONEXEMPT TRUST

(Appellants)

v.

HIGHLAND CAPITAL MANAGEMENT LP

(Appellee)

On appeal from the United States Bankruptcy Court for the Northern District of Texas, Dallas Division

ORIGINAL APPELLANT BRIEF FILED ON BEHALF OF THE DUGABOY INVESTMENT TRUST AND THE GET GOOD NONEXEMPT TRUST

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 8012 of the Federal Rules of Bankruptcy Procedure, and without waiver of any defenses/objections that it may have, Defendants Dugaboy Investment Trust and the Get Good Nonexempt Trust ("Appellants") state as follows:

> No publicly-held company owns 10% or more of the Dugaboy Investment Trust, nor does it have a parent corporation; and
>
> No publicly-held company owns 10% or more of the Get Good Nonexempt Trust, nor does it have a parent corporation.

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JURISDICTIONAL STATEMENT

Appellants, Get Good Nonexempt Trust ("Get Good") and Dugaboy Investment Trust ("Dugaboy" and together with Get Good, "Appellants") file this original Appellants' Brief regarding their appeal from a final order issued by the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (the "Bankruptcy Court"). This Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 158 & 1334 and Rules 8001 et. seq. of the Federal Rules of Bankruptcy Procedure.

I. STATEMENT OF ISSUES PRESENTED ON APPEAL

1. Whether the Bankruptcy Court erred in finding that it had jurisdiction to issue its *Order Approving Debtor's Settlement with UBS Securities LLC and UBS AG London Branch and Authorizing Actions Consistent Therewith* [ROA Vol. 1, p. 0004] (the "Settlement Order"), which approved a settlement between two non-debtor entities involving assets that do not constitute property of the estate. This issue goes to the jurisdiction granted to the Bankruptcy Court under the United States Code and to what constitutes "property of the estate," an issue of law. As such, it is subject to *de novo* review by this Court. *See Matter of Zale Corp.*, 62 F.3d 746, 751 (5th Cir. 1995); *Matter of Linn Energy, L.L.C.*, 936 F.3d 334, 340 (5th Cir. 2019).

2. If the Court does have jurisdiction whether the settlement between two non debtors should have been approved. Highland Multi Strategy Credit Fund L.P. (Multi Strat L.P.) was never represented by independent counsel (contrary to the statement) contained in the Settlement Agreement) no fairness opinion from a disinterested third party was ever obtained. Multi Strat under the proposed settlement is paying to UBS $18.5 Million in connection with a transaction where it received nothing and transferred assets worth $6,000,000.00. Whether the Bankruptcy Court erred in approving the settlement as being in the best interests of Multi-Strat? Aside from the questionable economics, the Court overlooked an actual conflict of interest between the Debtor and non-debtor Highland Multi Strategy Credit Fund, L.P. ("Multi-Strat LP). This issue is related to the Bankruptcy Court's approval of the 9019 Motion and is reviewable for the Bankruptcy Court's abuse of discretion. *In re Age Ref., Inc.*, 801 F.3d 530, 539 (5th Cir. 2015).

3. Whether the approved settlement between UBS and the Debtor constitutes an impermissible alteration of the already confirmed plan of reorganization. This issue is a legal conclusion and is subject to *de novo* review by this Court. *Linn Energy, L.L.C.*, 936 F.3d at 340.

II. STATEMENT OF FACTS AND PROCEEDINGS BELOW

On October 16, 2019 (the "Petition Date"), Highland Capital Management, L.P. (the "Debtor") filed a voluntary petition for relief under chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") in the U.S. Bankruptcy Court for the District of Delaware, Case No. 19-12239 (CSS). On December 4, 2019, the venue of this case was transferred to the Bankruptcy Court for this District.

On July 16, 2020, the Bankruptcy Court entered an order authorizing the Debtor to employ James P. Seery, Jr. as Chief Executive Officer and Chief Restructuring Officer of the Debtor. Mr. Seery continues to act in that capacity.

On April 15, 2021, the Debtor filed a *Debtor's Motion for Entry of an Order Approving Settlement With UBS Securities LLC and UBS AG London Branch and Authorizing Actions Consistent Therewith* [ROA Vol. 2, p. 0648] (the "Settlement Motion") seeking a settlement between itself and UBS (defined below) and Highland Multi Strategy Credit Fund, L.P. and UBS.

On May 4, 2021, The Dugaboy Investment Trust and Get Good Trust (the "Trusts") filed a *Limited Preliminary Objection to the Debtor's Motion for Entry of an Order Approving Settlement with UBS Securities LLC and UBS AG London Branch and Authorizing Actions Consistent Therewith* [ROA Vol. 3, p. 0752] (the "Preliminary Objection").

On May 12, 2021, the Trusts filed a *Supplemental Opposition to Debtor's Motion for Entry of an Order Approving Settlement With UBS Securities LLC and UBS AG London Branch*

and Authorizing Actions Consistent Therewith [ROA. Vol. 3, p. 0761] (the "Supplemental Objection" and together with the Preliminary Objection, the "Objection").

On May 14, 2021, the Debtor filed an *Omnibus Reply in Support of Debtor's Motion for Entry of an Order Approving Settlement with UBS Securities and UBS AG London Branch and Authorizing Actions Consistent Therewith* [ROA, Vol. 3, p. 0815].

On May 27, 2021, the Bankruptcy Court entered the Settlement Order [ROA Vol. 1, p. 0004].

One thing, above all else, is undisputed in this case. All entities involved are, in fact, separate entities with separate corporate identities and entitled to separate independent counsel to represent the interests of the company. The Pachulski firm served as general counsel to the Debtor and apparently evaluated the settlement and possibly helped negotiate the settlement on behalf of Multi Strat LP. This dual representation was hidden in the Settlement Agreement which the Pachulski firm presumably had a hand in drafting. This case represents a glaring example of the fact that the Debtor and its "Independent Board" which was appointed by the Bankruptcy Court wore multiple hats and at times owed a fiduciary duty to more than one master. No amount of semantic creativity can change this fact.

This point needs to be emphasized because a theme that ran throughout the entire settlement process was that the interests of Highland Multi Strategy Credit Fund, L.P. were never properly defended; whether it be through the Bankruptcy Court asserting jurisdiction over its interest in the dispute with UBS or through a failure for the Debtor to recognize its conflict of interest and provide independent counsel and obtaining a fairness opinion as to the settlement between Multi Strat LP and UBS.

A. The 2008 Note Purchase Agreement and Termination Agreement

On September 26, 2008, Highland Financial Partners, L.P. ("Highland Financial Partners") (an affiliate of the Debtor) issued a promissory note to Highland Credit Opportunities CDO, L.P., which is now known as Highland Multi Strategy Credit Fund, L.P. or Multi-Strat LP, in the amount of $6,616,429.00 (The "Multi-Strat Note").[1] [ROA, Vol. 21, p. 5025] The Multi-Strat Note was part of a collection of notes that were issued under a Note Purchase Agreement, also dated September 26, 2008 between Highland Financial Partners, Multi-Strat LP, and various other note holders who are referred to in the Note Purchase Agreement as "Purchasers." [ROA, Vol. 21, p. 4979] In exchange for the notes issued under the Note Purchase Agreement, Highland Financial Partners received various life settlements and collateralized debt obligations ("CDOs") from the various note holders, including Multi-Strat LP. See Note Purchase Agreement [ROA Vol. 21, pp. 4979–5047]. The assets (life settlements and CDOs) given by Multi-Strat LP were valued at $6,616,428.68. [ROA Vol. 21, p. 5046]

In conjunction with the Note Purchase Agreement, Sterling Valuation Group, Inc., an independent third party, issued a Certificate of Consent to Trade dated September 26, 2008 [ROA Vol. 20, p. 4737], wherein Sterling consented to the transaction on behalf of the "Asset Seller," who was the collection of the Purchasers as defined in the Note Purchase Agreement, including Multi-Strat LP.

Also in conjunction with the Asset Purchase Agreement, Watson Wyatt, through Jay Vadiveloo and on behalf of the Debtor, issued An Actuarial Valuation Analysis of a Life Settlement Portfolio as of October 1, 2008, dated September 24, 2008 [ROA Vol. 21, p. 4970] (the "Watson Wyatt Valuation"). The Watson Wyatt Valuation estimated the life settlements (excluding the CDOs) to be valued at $168,217,305. *See Id.* at 4977.

[1] Dugaboy is a limited partner in Multi-Strat and, thus, has a pecuniary interest in the settlement purportedly entered into by Multi-Strat.

Together, the Sterling Certificate of Consent to Trade and the Watson Wyatt Valuation show the Note Purchase Agreement was evaluated by independent third parties on behalf of both sides of the transaction and was deemed to be fair. To summarize the Note Purchase Agreement transaction, Multi-Strat LP gave up $6.6 Million in assets and in return received a promissory note for $6.6 Million.

Fast forward to March 20, 2009, when Highland Financial Partners, HFP Asset Funding II, Ltd. ("HAF II"), and HFP Asset Funding III, LTD. ("HAF III"), as the "Issuer Parties," and some of the Purchasers under the Note Purchase Agreement entered into a Termination, Settlement and Release Agreement (the "Termination Agreement"). [ROA Vol. 12, p. 2914, filed under seal as Debtor Exhibit 9] Significantly, Multi-Strat LP was ***not*** a party to the Termination Agreement. Rather, Highland Credit Opportunities CDO, LTD (n/k/a Highland Multi Strategy Credit Fund, Ltd. "Multi-Strat LTD"), who is a limited partner of Multi-Strat LP and was not a party to the Note Purchase Agreement, was a party to the Termination Agreement as the successor in interest to the Multi-Strat Note. The Multi-Strat Note was transferred from Multi-Strat LP to Multi-Strat LTD without any consideration going back to Multi-Strat LP. Under the Termination Agreement, the Issuer Parties returned the life settlements and CDOs to the note holders (excluding Multi-Strat LP) and the note holders returned the notes originally issued under the Note Purchase Agreement. No issue exists that the value of the Multi Strat LP life settlements transferred did not equal the note received by Multi Strat LP and the evidence is clear that Multi Strat LP never received anything pursuant to the Termination Agreement. In addition, no evidence exists for a Court to hold that other entities that have the name Multi Strat in them such as offshore entities are not separate and distinct legal entities from each other and the

liability of one Multi Strat entity is the liability of a different Multi Strat entity under some alter ego or single business enterprise theory.

To summarize, under the Note Purchase Agreement, Multi-Strat LP transferred $6.6 Million in life settlements and CDOs to Highland Financial Partners and initially received the Multi-Strat Note issued in the amount of $6.6 Million. At some point thereafter, Multi-Strat LP transferred the Multi-Strat Note to Multi-Strat LTD without receiving any consideration in return. Then, under the Termination Agreement, Highland Financial Partners transferred the $6.6 Million in life settlements and CDOs it originally received under the Note Purchase Agreement to Multi-Strat LTD (as opposed to Multi-Strat LP), leaving Multi-Strat LP $6.6 Million in the hole.

B. The UBS State Court Action

UBS Securities, LLC and UBS AG London Branch (together "UBS") filed claims 190 and 191, respectively, in this bankruptcy case, which are nearly identical and both based on the same underlying facts. On February 24, 2009, UBS filed a complaint in state court in New York alleging breach of contract claims against the Debtor, Highland Special Opportunities Holding Company ("SOHC"), and Highland CDO Opportunity Master Fund ("CDO Fund" and together with SOHC, the "Funds") arising out of a Warehouse Agreement, which was restructured in spring of 2008, and wherein UBS agreed to "warehouse" certain CDOs for the Debtor and the Funds (as amended, the "State Action"). UBS subsequently amended the State Action to add Multi-Strat LP and other entities as defendants. Significantly, Multi-Strat LTD was not named as a defendant and still has not been named as a defendant in any suit by UBS notwithstanding the fact that it is the party who received the Life Settlements pursuant to the Termination Agreement. As amended, the State Action further alleges that the Debtor and the Funds began to transfer assets out of the Funds to other affiliated entities in order to devalue the Funds and

reduce the Funds' exposure to UBS. For clarity, the asset transferred out of the Fund to Multi-Strat LP was a note that was never paid to Multi-Strat LP and the assets transferred to Multi-Strat LTD were $6.6 Million of Life Settlements in exchange for cancellation of the note. Sifting through the pure economics as far as Multi-Strat LP is concerned at the end of the two transactions, it has reduced the Life Settlements it owned by $6.6 Million and is now being asked to pay $18.5 Million to UBS.

This is where the Note Purchase Agreement and the Termination Agreement come in.

UBS alleges in the State Action that in September 2008, UBS made a first margin call pursuant to the restructured Warehouse Agreement and demanded additional collateral from the Funds and the Debtor to continue to warehouse the CDOs on behalf of the Debtor. UBS then alleges that when it became clear that the Funds would be unable to make the margin call, the Funds' parent, Highland Financial Partners, contributed to the payment to UBS. UBS alleges that the 2008 Note Purchase Agreement (including Highland Financial Partners' acquisition of $6.6 Million in Multi-Strat LP assets in return for the issuance of the Multi-Strat Note), despite the determination by independent analysists as being fair and equitable, was part of a wide-spread scheme by the Debtor, Highland Financial Partners, and other affiliates to transfer money around and comingle funds in an attempt to mislead UBS.

In January 2009, after two more margin calls, UBS decided to terminate the warehouse agreement and demanded $686,853,290.26 in damages from the Debtor and the Funds. Following the termination by UBS, UBS then alleges that the Debtor continued to defund and devalue Highland Financial Partners and the Funds through various transactions including the Termination Agreement. Again, Multi-Strat LP was not a party to the Termination Agreement and did not receive any funds from Highland Financial, the Funds, the Debtor or any other party

through the Termination Agreement. UBS is contending that both the transfer of the Life Settlements by Multi Strat LP is voidable under state law and the transfer of the Life Settlements to Multi Strat LTD is equally voidable. How a transaction that is in essence a wash can be in fraud of creditors is confounding.

Eventually, the State Action was bifurcated into two categories: the breach of contract claims against the Funds; and UBS's various other claims including a fraudulent transfer claim against Multi-Strat LP. In February of 2020, the State Court issued a judgment against the Funds and in favor of UBS in the amount of $1,039,957,799.44 on the breach of contract claim. The second phase (including UBS's claim against Multi-Strat LP) was stayed because of the instant bankruptcy case.

C. The May 2020 Settlement

On May 11, 2020, UBS along with Multi-Strat LP and other Debtor-affiliated entities entered into a Settlement Agreement (the "May 2020 Settlement"). Under the May 2020 Settlement, Multi-Strat LP agreed to sell certain life settlement policies that were held by its wholly-owned subsidiary, Highland Credit Opportunities CDO Asset Holdings, L.P. ("Asset Holdings"), with the proceeds (after payment of auction fees, premium payments, and other security interests in the policies) to be held in escrow. UBS expressly reserved all claims from the State Action and did not release them.

The May 2020 Settlement also contained a provision that stated:

> Each of the Parties represents that such Party has: (a) been adequately represented by independent legal counsel of its own choice, throughout all of the negotiations that preceded the execution of this Agreement; (b) executed this Agreement upon the advice of such counsel…[2]

[2] ROA Vol. 17, p. 4094.

This statement would later prove to be false.

The parties did not seek Bankruptcy Court approval for the May 2020 Settlement, presumably because it was between non-debtor entities. Mr. Seery signed as "authorized signatory" of Multi-Strat LP. No notice of the May 2020 Settlement was sent to any of the limited partners of Multi-Strat LP. *See* Transcript of Deposition of James P. Seery, Jr., May 14, 2021, ROA Vol. 21, p. 5068. The Debtor believed that Bankruptcy Court approval was not required for a transaction involving Multi-Strat LP that involved an amount far in excess of the Multi-Strat Note and involved the Debtor as a party; whereas for a severable transaction where the Debtor need not be a party, Court approval is requested. The justification by the Debtor and UBS for these two inconsistent positions is astonishing.

D. The March 2021 Settlement

This background brings us to the current issues before this Court: the Bankruptcy Court's Settlement Order. The Settlement Order granted the Debtor's Settlement Motion and authorized the Settlement Agreement between the Debtor, Multi-Strat LP, Strand Advisors, Inc. ("Strand"), and UBS, dated March 30, 2021 [ROA Vol. 1, P. 0009] (the "March 2021 Settlement").

Under the March 2021 Settlement:

1. UBS was granted an allowed Class 8 General Unsecured Claim in the amount of $65 million and a Class 9 Subordinated General Unsecured Claim in the amount of $60 million;[3]
2. Multi-Strat LP is to pay to UBS $18.5 Million;[4]
3. The Debtor obligated itself to "cooperate with UBS and ***participate*** (as applicable) in the investigation or prosecution of claims or requests for injunctive relief against the Funds, ***Multi-Strat***, Sentinel, James Dondero, …";[5]

[3] March 2021 Settlement at Section 1(a), ROA Vol. 1, p. 0012.

[4] March 2021 Settlement at Section 1(b), ROA Vol. 1, p. 0013.

[5] March 2021 Settlement at Section 1(c)(iii) ROA Vol. 1, p. 0013 (emphasis added).

4. UBS released all claims against the Debtor and Multi-Strat (excluding the obligation of the Debtor to participate in the prosecution of claims against Multi-Strat LP);[6]

5. The Debtor releases all claims against UBS, but does not release any claims against Multi-Strat LP;[7] and

6. Multi-Strat LP releases all claims against UBS.[8]

Significantly, the March 2021 Settlement, like the May 2020 Settlement, also contains a clause stating:

> Each of the Parties represents that such Party has: (a) been adequately represented by legal counsel of its own choice, throughout all of the negotiations that preceded the execution of this Agreement; [and] (b) executed this Agreement upon the advice of such counsel…"[9]

Just like its sibling in the May 2020 Settlement, this clause stating that Multi-Strat LP had independent counsel advise it in connection with the March 2021 Settlement is false. In fact, Pachulski Stang Ziehl & Jones, LLP advised both the Debtor and Multi-Strat LP in the May 2020 Settlement and the March 2021 Settlement, as testimony from James Seery shows.

> Q And so Multi-Strat never had separate independent legal counsel?
>
> A Not independent from counsel that HCMLP has, no.
>
> Q And that would be the same thing in connection with the May 20 – May 11, 2020 agreement?
>
> A That's correct.[10]

E. <u>The Plan of Reorganization</u>

[6] March 2021 Settlement at Section 3(a), ROA Vol. 1, p. 0015–16.

[7] March 2021 Settlement at Section 3(b), ROA Vol. 1, p. 0016–17

[8] March 2021 Settlement at Section 3(c), ROA Vol. 1, p. 0017.

[9] March 2021 Settlement at Section 11, ROA Vol. 1, p. 0020.

[10] Seery Testimony, ROA Vol. 22, p. 5282–83.

On February 22, 2021, prior to the March 2021 Settlement, the Bankruptcy Court entered an *Order (I) Confirming the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified) and (II) Granting Related Relief* [ROA Vol. 2, p. 0488], which confirmed the *Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified)* [ROA Vol. 2, p. 0579] (the "Plan"). The Plan created a Claimant Trust and a Litigation Sub-Trust within it.[11] Under the Plan, the Litigation Sub-Trust "shall be the exclusive trustee with respect to the Estate Claims…"[12] The Plan further states that "The Claimant Trust shall hold and distribute the Claimant Trust Assets (***including the proceeds from the Estate Claims***, if any) in accordance with the provisions of the Plan and the Claimant Trust Agreement."[13]

The purpose of the Litigation Sub-Trust is stated as follows:

> The Litigation Sub-Trust shall be established for the purpose of investigating, prosecuting, settling, or otherwise resolving the Estate Claims. Any proceeds therefrom shall be distributed by the Litigation Sub-Trust to the Claimant Trust for distribution to the Claimant Trust Beneficiaries pursuant to the terms of the Claimant Trust Agreement.[14]

Lastly, the Plan states:

> The Claimant Trust Agreement generally will provide for, among other things:
>
> …
>
> (vi) litigation of any Causes of Action, which may include the prosecution, settlement, abandonment, or dismissal of any such

[11] Plan, ROA Vol. 2, p. 0452.

[12] Plan at § IV(B)(1), ROA Vol. 2, p. 0453.

[13] Plan at § IV(B)(1), ROA Vol. 2, p. 0453 (emphasis added).

[14] Plan at § IV(B)(4), ROA, Vol. 2, p. 0455.

> Causes of Action, subject to reporting and oversight by the Claimant Trust Oversight Committee[15]

This plain language of the Plan, however, is in conflict with the language in the March 2021 Settlement that *requires* the Debtor to participate in and prosecute in its own name claims to recover assets that were stripped out of any of the defendants named in the State Action and hand those recovered assets over to UBS. In his testimony at the hearing on the March 2021 Settlement, Mr. Seery testified that he understood the language in the March 2021 Settlement to require just that:

> MR. DRAPER: So, so my question, Your Honor, is: Mr. Seery, if an asset was stripped out of [Highland Financial Partners] and transferred into the Debtor, the Debtor would be required under this agreement to transfer it back to UBS?
>
> THE WITNESS: We would be required to cooperate, if you have that language back up, exactly what – that it says.
>
> BY MR. DRAPER:
>
> Q And it's your view, based – and I asked you this question, that if that was the case, you would be required to transfer it to [UBS]?
>
> A Right.
>
> …
>
> A I think it's a fair – fair reading. We do, as I said, have a release. But if there is an asset that we determine was stripped out of one of these entities, that's our cooperation provision, yes.[16]

III. SUMMARY OF ARGUMENT

The March 2021 Settlement has two distinct settlements within it. One settlement is the resolution of all claims between the Debtor and UBS regarding the UBS Claims. The other settlement involves claims between Multi-Strat LP and UBS, two non-debtor entities and

[15] Plan at § IV(B)(5), ROA Vol. 2, p. 0455.

[16] ROA, Vol. 22, p. 5280.

involved claims and assets that are not property of the estate. Sections 157 and 1334 within Title 28 of the United States Code limits the jurisdiction of the Bankruptcy Court to claims that arise in or under a bankruptcy case and those that are "related to" a bankruptcy case. *See* 28 U.C.C. §§ 157(a) & 1334(b). Neither section can be read to confer jurisdiction to a Bankruptcy Court over claims between two non-debtors that involve property that is not property of the bankruptcy estate and claims asserted by a non debtor against another non debtor.

The Debtor and Multi-Strat LP have a clear conflict of interest in the March 2021 Settlement. The Debtor has many more claims asserted against it than Multi-Strat LP and it is common sense that the increase in payment from one would reduce the payment from the other. The March 2021 Settlement implicitly acknowledges this conflict when it states that all parties had independent counsel review the settlement terms and advise the parties regarding the same. Why would independent counsel be necessary if there was no conflict? As Mr. Seery conceded in his testimony in front of the Bankruptcy Court, however, this statement in both the May 2020 Settlement and the March 2021 Settlement was patently false. In fact, both entities were represented by the same law firm as admitted to by Mr. Seery. The dual representation is especially suspect given that Multi-Strat LP is paying $18.5 Million to UBS under the March 2021 Settlement when, again by Mr. Seery's own admission, it received a $6.6 Million note in exchange for $6.6 Million in assets, but in the Termination Agreement it received no consideration that can voided.

Lastly, the March 2021 Settlement conflicts with the confirmed Plan in that it requires the Debtor (or the Claimant Trust/Litigation Sub-Trust) to cooperate and participate in the prosecution of claims or prosecute in its own name claims for the benefit of UBS as opposed to the Claimant Trust Beneficiaries. As such, the March 2021 Settlement constitutes an

impermissible post-confirmation Plan modification. Any plan modification must go through the provisions required under 11 U.S.C. § 1127, which was not done. The Code sections that allow the Debtor to prosecute such claims are 11 USC 544, 547, 548, and 549. The claims all belong to the Debtor and under the plan are transferred to the Claimant Trust. The Plan as confirmed contains no carve out for recoveries from the claims that are covered by the Settlement Agreement.

The Bankruptcy Court (if it did have jurisdiction) erred: finding that the Settlement Agreement was fair to Multi-Strat LP when Multi-Strat LP was represented by the same law firm advocating the Settlement and the Settlement Agreement was negotiated on behalf of Multi-Strat LP by a party that owed a different fiduciary duty to the Debtor and Multi-Strat LP. To solve this problem all the Debtor needed to do was bring in separate legal counsel for Multi-Strat LP and obtain a fairness opinion and nobody could have complained.

A question also exists as to why Court authority was even requested. Was it to obtain judicial authority for a transaction where no jurisdiction existed on its face?

IV. ARGUMENT

A. The Bankruptcy Court Lacks Jurisdiction Over Non-Debtor Settlements

In *Matter of Zale Corp.*, 62 F.3d 746 (5th Cir. 1995), the Fifth Circuit made clear that settlements over non-debtor claims between non-debtor entities are outside of the Bankruptcy Court's jurisdiction. In *Zale*, the creditors' committee threatened suit against the debtor's former directors, which prompted settlement discussions. 62 F.3d at 749. Naturally, the settlement discussions included the debtor's primary D&O policy carrier, CIGNA. *Id.* However, the Debtor's excess D&O policy carrier, National Union Fire Insurance Company ("NUFIC") was not included in the settlement. *Id.* Eventually, a two-pronged settlement was reached between the debtor and its former directors and between the debtor and CIGNA. *Id.* At the hearing, a

modification to the settlement was made which enjoined NUFIC from bringing or pursuing claims against CIGNA (i.e. two non-debtor entities). *Id.* at 750.

NUFIC challenged the approval of the settlement (specifically the injunction affecting its rights against CIGNA). Because the appeal concerned actions between third parties, the Fifth Circuit stated that the only way for bankruptcy court jurisdiction to exist would be under the "related to" language of 11 U.S.C. § 1334. *Zale*, 62 F.3d at 751. "For the bankruptcy court to have subject matter jurisdiction, therefore, some nexus must exist between the related civil proceeding and the Title 11 case. Otherwise, 'an overbroad construction of § 1334(b) may bring into federal court matters that should be left for state courts to decide.'" *Zale*, 62 F.3d at 752 *quoting, In re Lemco Gypsum, Inc.*, 910 F.2d at 787–88 (citations omitted).

As the Fifth Circuit stated, such an analysis should begin "by noting that a large majority of cases reject the notion that bankruptcy courts have 'related to' jurisdiction over third-party actions." *Id.* at 753. Furthermore,

> a third-party action does not create "related to" jurisdiction when the asset in question is not property of the estate and the dispute has no effect on the estate. Shared facts between the third-party action and a debtor-creditor conflict do not in and of themselves suffice to make the third-party action "related to" the bankruptcy. Moreover, judicial economy alone cannot justify a court's finding jurisdiction over an otherwise unrelated suit.

Id. at 753–54. *See also, In re FoodServiceWarehouse.com, LLC*, 601 B.R. 396, 405 (E.D. La. 2019) ("Two crucial points have emerged from the controlling jurisprudence in this area. First, it is entirely possible for a bankruptcy estate and a creditor to own separate claims against a third party arising out of the same general series of events and broad course of conduct. Therefore, the existence of common parties and shared facts between the debtor's bankruptcy and the creditor's cause of action does not necessarily mean that the claims asserted by the creditor are property of the estate.") (citations omitted).

Thus, the mere fact that UBS's claims against the Debtor and Multi-Strat LP arose out of the same set of transactions and involve similar parties does not make the UBS claims against Multi-Strat LP "related to" the bankruptcy case. Here, as in *Zale*, UBS, in its claims against Multi-Strat LP, is seeking to recover from a non-debtor third party. Multi-Strat LP's defense (whether successful or not, settled or not) is not related to the bankruptcy case and Multi-Strat LP should be free to settle (or litigate) that claim outside of the bankruptcy case and the March 2021 Settlement, approved by the Bankruptcy Court, deprives Multi-Strat LP of that right without proper notice being given to the limited partners and without Multi-Strat LP receiving actually independent counsel and advice with respect to the March 2021 Settlement.

The *Zale* court also recognized the fairness element when it comes to settling claims of non-debtor third parties: "While it is true that the bankruptcy court has jurisdiction to determine whether a settlement between the debtor and other parties is fair and equitable, 'looking only to the fairness of the settlement as between the debtor and the settling claimant [and ignoring third-party rights] contravenes a basic notion of fairness.'" *Id.* at 754. In the present case, and as the facts stated above show, the settlement is not fair to Multi-Strat LP and (more importantly) its partners. Multi-Strat LP is paying $18.5 Million to UBS under the March 2021 Settlement. All Multi-Strat LP got was a $6.6 Million note, which it can no longer enforce. The Termination Agreement shows that the $6.6 Million in assets that were part of the original Note Purchase Agreement went back to Multi-Strat LTD, a completely separate entity, which is a limited partner of Multi-Strat LP and of which Multi-Strat LP has no ownership interest. The March 2021 Settlement, which requires a Multi-Strat LP payment of $18.5 Million without the advice from independent counsel is not fair to Multi-Strat LP or its partners, including the Dugaboy Investment Trust.

Further undermining the fairness of the settlement to Multi-Strat LP is the fact that none of Multi-Strat LP's limited partners were given notice of the May 2020 Settlement, which sold a significant portion of Multi-Strat LP's assets, or the March 2021 Settlement. See Seery Deposition at p. 12:

> Q. (BY MR. DRAPER) … I notice that there was no notice or analysis sent to MultiStrat's limited partners relative to the UBS claim, the May 2020 Settlement Agreement, and the settlement proposed in the settlement motion.
>
> Is that correct, Mr. Seery?
>
> A. I believe so.[17]

In its analysis, the Fifth Circuit bifurcated the enjoined claims that NUFIC would have against CIGNA into two categories, tort claims (including bad faith claims) and contract claims (stemming from the two D&O policies). Finding that the bad faith claims against CIGNA were the property of NUFIC (not the debtor), the only question was whether the debtor's consent to indemnify CIGNA should NUFIC assert those claims could somehow confer jurisdiction to the Bankruptcy Court over otherwise unrelated third-party claims. *Zale*, 62 F.3d at 756. The Fifth Circuit relied upon *In re Gallucci*, 931 F.2d 738, (11th Cir. 1991), out of the Eleventh Circuit, which involved similar circumstances involving a settlement that affected property of the debtor's mother (i.e. not property of the estate). The Eleventh Circuit held that "Because the property had no effect on the estate absent the compromise, . . . the compromise failed to establish a basis for jurisdiction." *Zale*, 62 F.3d at 756, citing *Gallucci*, 931 F.2d at 744. The Fifth Circuit concurred with this reasoning and held the same. "Because CIGNA, Feld, and NUFIC are not debtors and because the property at issue—the bad faith claims—is not property

[17] ROA Vol. 21, p. 5068.

of the estate, the bankruptcy court would have no jurisdiction over the tort claims absent the indemnification provision in the settlement." *Id.*

Similarly, the fraudulent transfer claims that UBS asserted against Multi-Strat LP are not property of the estate and the Bankruptcy Court would have no jurisdiction over those claims absent the March 2021 Settlement. If UBS believes that Multi-Strat LP fraudulently transferred its assets to another entity in order to avoid payment to UBS, that is a claim that UBS has against Multi-Strat LP outside of the bankruptcy.

Further, the mere fact that Multi-Strat LP and the Debtor are co-defendants in the State Action is insufficient to confer jurisdiction over Multi-Strat LP to the Bankruptcy Court. It is blackletter law that the automatic stay does not apply to co-defendants in a lawsuit. See *Wedgewoth v. Fibreboard*, 706 F.2d 541, 544 (5th Cir. 1983) and *In Re SI Acquisition*, 817 F.2d 1142, ns. 27 and 28 (5th Cir. 1987). At any point during this Chapter 11 case, UBS could have proceeded against Multi-Strat LP and the other non-debtor defendants in New York.

The Debtor's own motion seeking approval of the March 2021 Settlement admits the Bankruptcy Court's lack of jurisdiction.

> Here, Multi-Strat is not wholly owned by the Debtor and has meaningful third party investors. Thus, the payment to be made by Multi-Strat pursuant to the Settlement Agreement will not involve property of the Debtor's estate or implicate 11 U.S.C. § 363(b). Instead, it will involve the transfer of Multi-Strat's property in settlement of UBS's claim against Multi-Strat.[18]

B. Multi-Strat LP Had No Independent Counsel Despite the Conflict of Interest with the Debtor

As noted above, the March 2021 Settlement does not have the Debtor releasing any claims against Multi-Strat LP; falsely claims that all parties had independent counsel advising

[18] Debtor's Settlement Motion at ¶ 53, ROA Vol. 2, p. 674.

them; and presents a clear conflict of interest by having the Debtor, as the investment manager for Multi-Strat LP, obligate itself to investigate and participate in the prosecution and investigation of claims against Multi-Strat LP.

The Debtor serves as the investment manager of Multi-Strat LP. As such, it has certain fiduciary duties under the Investment Advisors Act, which duty cannot be waived. *See, e.g., SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *Transamerica Morg. Advisors (tama) v. Lewis*, 444 U.S. 11, 17 (1979) ("§206 establishes 'federal fiduciary standards' to govern the conduct of investment advisers."); *Santa Fe Indus. v. Green*, 430 U.S. 462, 471, n.11 (1977) (in discussing *SEC v. Capital Gains*, stating that the Supreme Court's reference to fraud in the "equitable" sense of the term was "premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers"). *See also* Investment Advisers Act Release No. 3060 (July 28, 2010 ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own") (*citing Proxy Voting by Investment Advisers*, Investment Advisers Act Release No. IA2106 (Jan. 31, 2003). Mr. Seery acknowledged that this role triggers certain fiduciary duties on the part of the Debtor to Multi-Strat LP.

> A. Highland, the Debtor, as an investment manager, is subject to the Advisers Act, yes.
>
> Q. And didn't you testify that, under the Advisers Act, you're required to put the interest of the entity you're the management advisor for over the interest of any other Highland entity where it's a fiduciary?
>
> A. I think where it's a fiduciary you owe a fiduciary duty to that entity. Then if you have two fiduciary duties, you balance those – those interests. So, while you have fiduciary duties to – Highland Capital Management has a fiduciary duty to Highland

> Multi-Strategy Credit Fund, LP, it may have fiduciary duties to other entities as well.
>
> Q. And just looking at this, it would have a fiduciary duty to Highland Multi-Strategy Credit Fund, Limited as investment manager as well as Highland Multi-Strategy Credit Fund, LP as investment manager?
>
> A. I believe that's the case, yes.[19]

By Mr. Seery's own admission, the Debtor served the interest of multiple parties in the March 2021 Settlement: itself; Multi-Strat LP; and Multi-Strat LTD. At the same time, it is in the interest of the Debtor to have Multi-Strat LP pay as much as possible to reduce the exposure of the Debtor to UBS. To the extent payment comes from Multi-Strat LP, the payment is coming out of the pocket of the third party investors. If in fact the Debtor owned one hundred percent (100%) of Multi-Strat LP, this would not be an issue. However, the Debtor's minimal interest in Multi-Strat LP places the burden of the UBS\Multi-Strat LP settlement on the various limited partners of Multi-Strat LP—directly contrary to its fiduciary duty as the investment manager.

At this point, it is important to note that the general partner of Multi-Strat LP is Highland Multi Strategy Credit Fund GP, LP ("Multi-Strat GP"), which is controlled by Highland Multi Strategy Credit CP, LLC, which is 100% owned and controlled by the Debtor. This means that the Debtor is in control of Multi-Strat LP's general Partner, Multi-Strat GP.

Mr. Seery acknowledged in his testimony that when the general partner faces a conflict of interest (like the one described above) that such a conflict would be grounds for the general partner to resign from one of the roles in conflict.

> Q All right. Now, in connection with the – you mentioned a subscription agreement. Isn't there a provision in the subscription agreement for LP that gives an example where, if in fact the general partner is a member of the Creditors' Committee – of a Creditors' Committee and also owns – owes a fiduciary duty to the

[19] Seery Testimony, ROA Vol. 22, p. 5250–51.

> partnership, that it will resign from one – one of those roles? It'll step down?
>
> A I don't recall the specific provisions. There's something to that effect. I'm not sure if it says it will resign or it may.
>
> Q Okay. It says it will. But the Court can read that in the subscription agreement.
>
> Mr. Seery, don't these partnership agreements, each one of them, have the ability for the general partner, where it faces a conflict or a potential conflict, to hire and – bring in an advisor and make its recommenda… [sic] and base its actions based upon the hiring of that advisor?
>
> A The GP has complete control over the partnership. It can do that if it thinks that's appropriate.
>
> Q And, in fact, in connection with the note transaction in September of 2008, Highland did that? They hired Sterling to obtain a valuation?
>
> A They did that, yes.[20]

That marks two roles (Investment Advisor and General Partner) where the Debtor had conflict with Multi-Strat LP and yet never brought in an independent advisor of any kind.

Turning next to the March 2021 Settlement itself. When questioned about the provision in the March 2021 Settlement that warrants that all parties had independent legal counsel, Mr. Seery again conceded that Multi-Strat LP was at all times controlled by entities with loyalty to the Debtor, not Multi-Strat LP. As indicated earlier, the economics of the transaction and the fact Multi-Strat LP is paying $18.5 Million to UBS when it received nothing cannot be justified by either the litigation cost to Multi-Strat LP—no evidence was put on focusing solely on the cost to Multi-Strat LP or any explanation as to fairness. Paying $18.5 Million when you received nothing and were not a party to the Termination Agreement where real assets were transferred out as opposed to future promises to pay seems to be a pretty compelling defense. Claims may

[20] Seery Testimony, ROA Vol. 22, p. 5281–52.

exists against Multi-Strat LTD, but they do not exist against Multi-Strat LP. This is another instance of the Debtor wearing too many fiduciary duty hats.

> Q And basically it uses the term, instead of legal counsel, it uses the term "independent legal counsel." In connection with this transaction, who represented Multi-Strat? Was it Pachulski?
>
> A Not -- not separately, no.
>
> Q Who – did – who else represented Multi-Strat?
>
> A WilmerHale and Pachulski represented HCMLP [the Debtor] in doing the transaction for Multi-Strat.
>
> Q And so Multi-Strat never had separate independent legal counsel?
>
> A Not independent from counsel that HCMLP has, no.
>
> Q And that would be the same thing in connection with the May 20 – May 11, 2020 agreement?
>
> A That's correct.[21]

The fact that the Debtor and Multi-Strat LP are both codefendants does not just present a potential conflict. There is an actual conflict present.

> Q All right. The Debtor has retained its claims against Multi-Strat, correct?
>
> . . .
>
> THE WITNESS: To the extent that the Debtor has claims against Multi-Strat.[22]
>
> …
>
> Q Mr. Seery, how many counts – in looking at the agreement, Multi-Strat, LP is not liable for the entire amount, but Highland may be. Correct?
>
> A Correct.[23]

[21] Seery Testimony, ROA Vol. 22, p. 5282–83.

[22] Seery Testimony, ROA Vol. 22, p. 5275.

[23] Seery Testimony, ROA Vol. 22, p. 5284.

Despite these clear and obvious conflicts of interest, Multi-Strat LP was never provided with independent counsel. Rather, the same attorneys retained by the Debtor represented Multi-Strat LP. This fact alone should raise questions with respect to the $18.5 Million being paid by Multi-Strat LP in the March 2021 Settlement when at no point has it been shown that it received anything more than a $6.6 Million note, which it cannot enforce. Add the fact that the Debtor also retains claims against Multi-Strat LP and it amounts to a clear abuse of discretion on the part of the Bankruptcy Court in approving a settlement that was negotiated without independent counsel (in clear contradiction of the plain terms of the settlement agreement itself).

C. The March 2021 Settlement Constitutes an Impermissible Plan Modification

As stated above, the Plan provides specifically that the Claimant Trust and the Litigation Sub-Trust were established for the recovery of estate assets and to pursue claims on behalf of the estate, to hold all proceeds from claims for the benefit of the Claimant Trust Beneficiaries, and to make distributions to the Claimant Trust Beneficiaries.[24] The Plan also places the sole responsibility over prosecution and resolution of all claims with the Litigation Trustee. "[T]he prosecution and resolution of any Estate Claims included in the Claimant Trust Assets shall be the responsibility of the Litigation Trustee."[25]

Compare that language in the Plan with the March 2021 Settlement that requires the Debtor to "cooperate with UBS and participate (as applicable in the investigation or prosecution of claims or requests for injunctive relief against the Funds, Multi-Strat, Sentinel, James Dondero, …"[26] Under the Plan, if the Debtor and UBS both have claims against the Funds for the transfer of property (as an example), the Litigation Trustee, on behalf of the Litigation Sub-

[24] Plan at Section IV(B)(5), ROA Vol. 2, p. 0456.

[25] Plan at Section IV(B)(5), ROA Vol. 2, p. 0456.

[26] March 2021 Settlement at Section 1(c)(iii), ROA Vol. 1, p. 0013.

Trust and for the sole benefit of the Claimant Trust Beneficiaries would be obligated to pursue that claim and distribute any proceeds obtained to the Claimant Trust Beneficiaries. However, under the March 2021 Settlement Agreement, the Debtor would be required to pursue (or at least cooperate with litigating) the claims against the Funds and, instead of distributing the proceeds for the benefit of the Claimant Trust Beneficiaries, would then be obligated to turn over the proceeds to UBS.

Section 1127 of the Bankruptcy Code requires that the plan proponent may modify a plan after the confirmation of the plan, but only if "circumstances warrant such modification and the court, *after notice and a hearing*, confirms such plan as modified, under section 1129 under this title." 11 U.S.C. § 1127(b). The March 2021 Settlement Agreement takes proceeds from litigation away from the creditors and distributes them, instead, to UBS. This raises questions as to whether the circumstances would warrant the modification. Regardless, no motion to modify the Plan was ever filed, much less a hearing held. It is improper to modify an already confirmed plan through a Rule 9019 motion.

V. CONCLUSION

The Bankruptcy Court erred in three significant ways. First, it improperly exercised jurisdiction over a third party settlement that did not involve property of the Debtor and which does not need to be resolved within the bankruptcy context. Doing so deprived Multi-Strat LP of its ability to resolve its separate disputes with UBS in state court and on its own terms and for its own benefit. Second, the Bankruptcy Court abused its discretion in approving the settlement where Multi Strat LP received nothing other than a future promise to pay in exchange for Life Settlements that had a real value when Multi-Strat LP was not properly represented by independent counsel despite the express provisions in the March 2021 Settlement stating that it

was and despite the clear conflict of interest between itself and the Debtor. In fact, the only representation that Multi-Strat LP had in the settlement negotiation was by counsel that is retained by and working in the best interest of the Debtor—not Multi-Strat LP. Third, the March 2021 Settlement constitutes an obvious modification of the Plan when the circumstances do not warrant such a modification and without a proper notice and hearing on the matter in direct violation of 11 U.S.C. § 1127(b).

This Court should reverse the Bankruptcy Court's *Order Approving Debtor's Settlement With UBS Securities LLC and UBS AG London Branch and Authorizing Actions Consistent Therewith* for legal error and abuse of discretion.

CERTIFICATE OF COMPLIANCE

In compliance with Rules 8014 and 8015, I hereby certify that:

1) This document complies with the type-volume limit of Fed. R. Bankr. P. 8015(a)(7)(B) because, excluding the parts of the document exempted by Fed. R. Bankr. P. 8015(g), this document contains 8127 words.

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Dated October 14, 2021:

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