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

In Re: HIGHLAND CAPITAL MANAGEMENT, L.P., Debtor.	**Case No. 19-34054-sgj-11** Chapter 11 Dallas, Texas Tuesday, April 12, 2022 9:30 a.m. Docket
HIGHLAND CAPITAL MANAGEMENT, L.P., Plaintiff, v. HIGHLAND CAPITAL MANAGEMENT FUND ADVISORS, L.P., et al., Defendants.	**Adversary Proceeding 21-3010-sgj** TRIAL ADVISORS' ADMINISTRATIVE CLAIM *Excerpt: 9:38 a.m. to 2:19 p.m.*

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE STACEY G.C. JERNIGAN,
UNITED STATES BANKRUPTCY JUDGE.

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Proceedings recorded by electronic sound recording; transcript produced by transcription service.

DALLAS, TEXAS - APRIL 12, 2022 - 9:38 A.M.

THE CLERK: All rise. The United States Bankruptcy Court for the Northern District of Texas, Dallas Division, is now in session, The Honorable Stacey Jernigan presiding.

THE COURT: Good morning. Please be seated. All right. We have a two-day setting in Highland. It's both Adversary 21-3010 as well as the Funds' request for administrative claim. Let's get appearances from the lawyers first.

MR. MORRIS: Good morning, Your Honor. John Morris from Pachulski Stang Ziehl & Jones for Highland Capital Management, LP. I'm here this morning with my colleagues Greg Demo, Hayley Winograd, and Zachery Annable.

THE COURT: Okay. Good morning.

MR. RUKAVINA: Your Honor, good morning. Davor Rukavina and Thomas Berghman here for the Advisors: NexPoint Advisors, LP and Highland Capital Management Fund Advisors, LP.

THE COURT: Good morning. All right. Do we have any other appearances? These are, of course, the only parties, but ...

(No response.)

THE COURT: All right. Well, you all have given me a lot of paper to prepare me. Before we ask for opening statements, I'm going to ask for housekeeping matters. I see we have exhibit lists that have been filed and some written objections, and I think your scheduling order said that if there were no written objections then they were waived except for relevance and privilege, I guess. So do we have stipulations on exhibits?

MR. MORRIS: We do, in fact, Your Honor. I apologize for the late notice. Mr. Rukavina and I just reached an agreement about an hour ago that resolves all objections to documents, --

THE COURT: Okay.

MR. MORRIS: -- as well as the objection to the subpoenas that Highland had served upon the Advisors, --

THE COURT: Okay.

MR. MORRIS: -- which were the subject of the objection that was filed at Docket No. 98 and the response that was filed at Docket No. 101. So, if I may, I'd just like to read the stipulation into the record --

THE COURT: All right.

MR. MORRIS: -- and tell you where we go from there.

THE COURT: That's fine.

MR. MORRIS: So, the parties stipulate to the admissibility of a single document, which will be marked as Highland's Exhibit 161. That document, Your Honor -- this is not part of the stipulation -- but that document sets forth amounts that were paid to certain former Highland employees postpetition. And so that document is going to be marked as 161, and the parties stipulate that the Advisors acknowledge that they have no basis to challenge the facts that are recited and reflected in the document.

THE COURT: Okay.

MR. MORRIS: Based on the foregoing, the parties agree and stipulate that the objection to the trial subpoenas that was filed at Docket No. 98 shall be deemed resolved. I don't know if Your Honor would like us to file some kind of order or stipulation to that effect, or if this is sufficient.

THE COURT: I think this is sufficient on the record.

MR. MORRIS: Okay.

THE COURT: Thank you.

MR. MORRIS: The parties also agree that the Advisors shall withdraw all of their objections to Highland's exhibits, which were also filed on the docket. And forgive me, but I don't have that docket number.

THE COURT: Let's see. Docket 82 --

MR. MORRIS: Okay.

THE COURT: -- is where the Advisors' objection to the Debtor's exhibits is.

MR. MORRIS: Right. And then, finally, Highland stipulates that it does not contest the accuracy of the mathematical calculations in the Advisors' Exhibits G and H and that the charts are based on compensation information that was maintained by Highland and that is accurate only as to the compensation numbers paid to the listed employees.

MR. RUKAVINA: And Your Honor, that is correct, and you'll see as the trial progresses Exhibit G is a PDF of Exhibit H, which is an Excel spreadsheet which is our damages calculation. So I think, with that, with that stipulation -- I understand that Highland has other objections -- but I think that that stipulation will go some way. And then there's a couple more of my exhibits that are objected to. We'll just take those in due course.

THE COURT: Okay. All right. So, are you asking me, then, to pre-admit all of the exhibits that are not objected to at this point?

MR. MORRIS: Highland does move for the admission of Exhibits 1 through 161, and at this point I understand there are no objections.

THE COURT: Okay. And you confirm, Mr. Rukavina?

MR. RUKAVINA: I do.

THE COURT: All right. So Highland Exhibits 1 through 161 are now admitted.

(Plaintiff's Exhibits 1 through 161 are received into evidence.)

THE COURT: And then turning to the Advisors' -- I think I called them the Funds earlier. Sorry. I get my nicknames mixed up at times. The Advisors' Exhibits, it looks like --

MR. RUKAVINA: Your Honor, it's Exhibit A through DD. I'd move for the admission of all of those, except G, H, L, Z, CC.

THE COURT: Okay. So you aren't actually moving for admission of G and H, which you just talked about?

MR. RUKAVINA: Correct.

THE COURT: There's just a stipulation about --

MR. RUKAVINA: Correct. Yeah.

THE COURT: -- the correctness?

MR. RUKAVINA: We'll address -- yeah. We'll address that admissibility tomorrow when Mr. Norris testifies.

THE COURT: Okay.

MR. RUKAVINA: But with respect to all other exhibits other than G, H, L, Z, and CC, I'd move to admit them now.

THE COURT: Okay. So except for, you said, L, Z, CC?

MR. RUKAVINA: Correct.

THE COURT: Okay. And you agree?

MR. MORRIS: No objection to those exhibits.

THE COURT: Okay. So those are admitted by stipulation as well.

(Defendants' Exhibit A through DD, exclusive of G, H, L, Z, and CC, are received into evidence.)

THE COURT: All right. Is that all of our housekeeping matters?

MR. MORRIS: It is. I do have a copy of Exhibit 161, if I can approach --

THE COURT: You may.

MR. MORRIS: -- and give that to the Court.

THE COURT: And hopefully you have --

MR. MORRIS: And I have a couple of copies.

THE COURT: -- two copies. One for Nate over here.

MR. MORRIS: Yeah.

THE COURT: Thank you. All right. You may proceed when you're ready.

MR. MORRIS: Okay. Before I begin, I just do want to give the Court some sense of what we expect to do today and tomorrow.

THE COURT: Okay.

MR. MORRIS: We'll have our openings this morning. Highland intends to call as its first witness David Klos. Mr. Klos will be followed by Mr. Waterhouse. If time permits, we'll examine Mr. Seery. And then, regardless of what time we complete, if we complete a little bit early, we'd like to stop for the day. We're trying to manage a lot of schedules --

THE COURT: Uh-huh.

MR. MORRIS: -- and witnesses and third-party people who have said, I can do it Tuesday but not Wednesday, I can do it Wednesday but not Tuesday.

THE COURT: Uh-huh.

MR. MORRIS: So that's the plan, and I hope, I really do hope that we're able to get through those three witnesses today.

THE COURT: All right. Well, you've answered one question I had: Who goes first? Because we, you know, could go either way because we have the breach of contract claim in the adversary and the request for administrative expense. There's an agreement that you go first?

MR. MORRIS: We do have an agreement --

THE COURT: Okay.

MR. MORRIS: -- that Highland will call the witnesses that are on its witness list, to the extent that it decides to do so, first. And Mr. Rukavina will then cross without restriction to my direct.

MR. RUKAVINA: Exactly. Rather than me recalling them, we'll just handle it all at one time, get the subpoenaed witnesses out of here.

MR. MORRIS: Because it's really the flip side of the same coin.

THE COURT: Okay. All right. Well, I have flexibility as far as when and how long we stop for lunch, as well as when we stop tonight.

MR. MORRIS: Right.

THE COURT: So it sounds like you're wanting maybe a definite stopping point tonight, or no?

MR. MORRIS: No, not really.

THE COURT: Okay.

MR. MORRIS: The only -- the most important thing for me is to get Mr. Waterhouse off the stand.

THE COURT: Okay.

MR. MORRIS: Because he's not available tomorrow.

THE COURT: Gotcha. I've got you.

MR. RUKAVINA: Yeah. I think that the -- that's exactly right. Really, the concern that I have is that we actually finish early today. So we're just informing the Court that, if we finish early, we ask the Court's permission to just resume tomorrow morning, because, again, we subpoenaed certain witnesses tomorrow that are not available today.

THE COURT: Okay.

MR. RUKAVINA: So we may finish early. We may finish late. Either way, we only have three witnesses for today, and the other ones are going to appear tomorrow.

THE COURT: Okay. Gotcha. All right.

MR. MORRIS: So, with that, I'd like to just proceed to my opening.

THE COURT: Uh-huh.

MR. MORRIS: And I do have -- I do have a slide deck for use, if I can approach.

THE COURT: Okay. You may. Thank you.

OPENING STATEMENT ON BEHALF OF THE PLAINTIFF

MR. MORRIS: All right. I don't -- I don't know if Ms. Canty is putting this on the screen. Maybe it's blank because we're in the courtroom.

THE COURT: Ms. Canty?

MR. MORRIS: Ah, there we go. Yeah.

THE COURT: Ah.

MR. MORRIS: All right. So the expectation was that Ms. Canty would help me out in going through the slide deck.

This is going to be, you know, a somewhat lengthier opening than I'm used to, but this is a pretty fact-intensive case.

THE COURT: Uh-huh.

MR. MORRIS: We submitted what we thought was a fulsome description of the evidence in our proposed findings of fact and conclusions of law. You know, the Court either has or will read that. There is other evidence, obviously, that's going to be in the record that we didn't include there. And what I would do is I would describe what I'm about to say for the next hour or so --

THE COURT: Okay.

MR. MORRIS: -- is the greatest hits. It's kind of a summary of what we think the evidence is going to show.

THE COURT: Okay.

MR. MORRIS: So if we can go to the next slide, Your Honor. This is just a quick overview of the parties' competing positions. Highland is here to recover for breach of contract damages under an assortment of contracts. There's five different contracts at issue. It believes that it's entitled to unpaid fees and that it was -- that it will be entitled to recover attorneys' fees.

Highland believes that the Advisors' claims, such as they are, are without merit, and we take that position for the following reasons.

We believe that the contracts are clear and unambiguous on their face and they entitle Highland to a judgment. But the overwhelming evidence, Your Honor, we believe that even if the Court found an ambiguity, that the parol evidence -- really, the contemporaneous evidence at the time these contracts were entered into, the parties' unequivocal, uninterrupted course of dealing, and all of the surrounding circumstances, will lead the Court to conclude that only Highland's interpretation is reasonable.

Highland is going to prove that it fully performed, and it's going to prove that performance not just through its own witnesses but through the documentary evidence and through the Advisors' witnesses, the Retail Board minutes. Mr. Waterhouse is going to acknowledge that.

Your Honor is going to have to deal with the fact that the allegations of breach are particularly vague when it comes to what it is that Highland supposedly did or didn't do and when and how it didn't do it.

There's lawyers' letters that are part of the evidence of performance, because from October 16th until December 31st the Advisors sent five different letters by lawyers asserting all kinds of things except breach of contract, which is kind of telling.

The evidence is going to show that the Advisors had all of the information that they claim Highland used to hide the ball. The evidence is going to show that they knew what payments were projected. They knew what payments were made. They -- it's in their books, their own books and records, the evidence is going to show. They knew exactly when every dual employee was terminated. Right? They told the Retail Board time, time, time, time, and probably five more times again that they knew exactly -- that they were monitoring the services.

So we don't think -- we don't think the evidence is going to show anything other than full performance. But even if they -- even if they had some basis for a claim, they've either waived that claim or it's barred by the voluntary payment rule.

If we can move to the next slide, please.

This is just the contractual language of the payroll reimbursement agreements, Your Honor, and we believe that this is clear and unambiguous on its face. Paragraph -- Section

2.01 specifically states that NexPoint shall reimburse Highland for the actual cost to HCMLP. But note, Your Honor, actual cost is not lower case, it's upper case. It's a defined term. They could have used hamburger. They could have used tofu, if that's really to your liking. Actual cost has a meaning, a very specific meaning under this contract, and that's in the box below.

Originally, the Advisors wanted to read out that second sentence. You know, Mr. Norris, I think, is going to testify that he just assumed that Highland was adjusting the amounts paid as each dual employee left. There's no basis for that assumption, and that assumption is completely undermined by the second sentence of the definition of actual cost, which says specifically that, absent changes pursuant to 2.02, this is the fee. Such costs and expenses are equal to $252,000 per month. Clear and unambiguous.

If we can go to the next slide, please.

Let's look at 2.02. Right? The argument is made, well, Highland had a unilateral obligation to make adjustments. Highland had a unilateral obligation to adjust the payments. Highland had a unilateral obligation to do this, that, and the other thing. Where does the word Highland even appear in 2.02? It refers to the parties. It refers to the parties reaching an agreement. Highland can't act uni... not only is it not required to, it can't. It just can't. The parties may agree. That's what 2.02 says.

If we can go to the next slide, please.

As Your Honor may have seen from the evidence from the pretrial findings, proposed findings of fact, the parties actually amended their agreement just seven months after they signed it. And I'm talking specifically about the payroll reimbursement agreements. And that payroll reimbursement amendment specifically refers to what? I mean, it does refer to Section 2.02, which is stated in the paragraph above, I believe. But they're going to pay a flat fee of $168,000.

The evidence is going to show that this payment was not based on any calculation of actual cost with an upper A and an upper C or a lower A and a lower C. There's no analysis whatsoever.

You're going to hear an assertion that it was based on a true up. I think Dustin Norris is going to say that David Klos conducted some true up in December of 2018. No true up exists. Mr. Norris has absolutely no personal knowledge about what happened in December of 2018.

Mr. Waterhouse, who signed the amendment, is going to testify that he has no idea where the number came from.

So, so I actually think I'm a little bit confused. The $168,000, and I'm going to clear this up right now, the $168,000 is the monthly charge in the original document. So we actually confused that. This is the -- this is Paragraph

3.01 from the original payroll reimbursement agreement, and that's the flat fee from that particular document. I think that's the -- the HCMFA document.

So, here's the story, Your Honor. The story is pretty simple. Late 2017, Highland had a horrible year. They had to get more cash to Highland. Mr. Dondero knew that he had personal tax exposure at the Advisors. And so he just wanted to push money from the Advisors to Highland. It knocked off two birds with one stone, right? It got him a tax deduction at the Advisors level. It got more cash into the Highland bank accounts.

And the way they originally did that was to say, let's just do a subservice agreement. The evidence is going to be undisputed that prior to 2018 Highland provided subadvisory front office services to both Advisors and never got paid a nickel. Okay? But now they needed to get some more money to Highland, so they came up with the concept of a subadvisory agreement.

And what's on the screen, if we can go to Slide 5, is a page from a deck that was presented to Mr. Dondero in January of 2018 that showed -- the next slide, please, 5 -- that showed that NexPoint and subs and subsidiaries would be -- would be paying $6 million for subadvisory and shared services. That was an increase from less than $2 million. It was a number that Mr. Dondero personally dictated. Mr. Klos is going to testify that Mr. Dondero came up with that number and that they had to use these various agreements to come up with a $6 million fee. It's reflected in the document. It's reflected in the contracts. $6 million doesn't change from December 2017 until termination. It's exactly what NexPoint paid.

Interestingly, Your Honor, below it there's a reference to Acis. Acis, I know you're familiar with. This is January 2018. Highland is in control of Acis. Acis has its own subadvisory and shared services agreements with Highland. It's not based on actual costs. Nobody cares what the actual cost. It's based on basis points.

So they've got all of these -- you're going to hear testimony that they've got a myriad of ways of compensating: flat fees, percentage of assets under management, these basis points. There's no rhyme or reason to it. But the evidence is going to show and there'll be no dispute that in December 2017 the number was fixed at $6 million and never changed.

If we can go to the next slide.

So, Mr. Klos is going to testify that each January, maybe early February, there was a meeting. And the meeting was with Mr. Klos, Mr. Waterhouse, Mr. Dondero, and Mr. Okada. The purpose of the meeting was to look back at the prior year and to talk about the future year. And the meeting would take place at that particular moment in time because February 28th was bonus day and they used this information to decide how much, you know, how the pie was going to be divided and what bonuses were going to be paid.

So the documents that we're looking at right now come from the deck that was prepared by Mr. Klos, under Mr. Waterhouse's review, and was gone over with Mr. Dondero and Mr. Okada in this meeting.

And this is -- this slide here shows Highland's projected continued losses. You see that they were projected to lose $12 million on an operating basis in 2018. Mr. Klos will testify that they weren't projected to change that much at all, but that -- you see the flip to a positive $46 million? That $56 million, between a negative 12 and a positive 46 -- is I guess $58 million -- is really answered up above in 2019 by those incentive fees.

Those incentive fees were projected to occur. That was supposed to be the incentive fee for MGM. If you remember, Your Honor, that was going to be MGM. It didn't happen. And Your Honor knows, if it had happened, Highland would have gotten that $55 million, but according to Mr. Dondero and Nancy Dondero, Highland would have had to cancel the $70 million of notes that they had signed. But neither one of those things ever happened. Right?

The fact of the matter is if you reduce, if you eliminate that $55 million, and you should, they still would have been losing more than $12 million on an annualized basis.

If we can go to the next slide, please. Because this is another critical piece of evidence here. You've got the subadvisor fees and the shared services expenses. You'll recall, Your Honor, I said that they reached an agreement on the $6 million number in December. Well, here's the January annual review. It's presented to Mr. Dondero. And we've highlighted for you the projected subadvisor and shared services expenses. And if you add those two numbers up, it's not a coincidence that they add up to $6 million. And the $3,024,000 number, divide it by 12, you come up with the $252,000 that was in the subadvisory agreement and that ultimately became the payroll reimbursement agreement. $3,024,000 divided by 252 -- divided by 12 equals $252,000.

And the shared services expenses, there are actually two pieces there. And one of the things that I think is very important for the Court to know is that, prior to 2018, NexPoint's shared service agreement with Highland had a complicated mechanism for calculating the fee for the shared services. One option was actually actual cost. But Mr. Klos is going to tell the Court, he's going to testify that they didn't use that option, they used a different option, and they wound up paying based on a percentage of AUM, A-U-M, Assets Under Management.

But here's the important point. At this moment in time, to get to Mr. Dondero's $6 million number, they amend the shared services agreement for NexPoint to provide for a flat fee. And when you combine the flat in the NexPoint shared services agreement with the $80,000 flat fee in the NexPoint Real Estate Advisors' shared services agreement, which is a subsidiary of NexPoint, that's how you get to the $2,976,000. Not a coincidence here. It's three agreements. It's the subadvisory agreement. It's the newly-amended and restated shared services agreement with NexPoint. It's the new shared -- the newly-amended shared services agreement with NexPoint Real Estate Advisors. Add them up. $6 million. Right?

So, they're telling -- picture it. They're in a meeting room at Highland's offices. Everybody's sitting in Mr. Dondero's office. They're walking through this. And Mr. Klos is going to testify that here's where we told Jim this is how we're going to execute your plan. You've given us an instruction to get to $6 million. Here's the plan. Okay? No dispute.

So, a funny thing happens. Right? No so funny, actually. The deck is dated January 26th. I think Mr. Klos says the meeting happened at or around that time. But as Your Honor knows, just a couple of days later, Josh Terry filed Acis for bankruptcy. And what you're going to see in the deck, which I don't have the slide for, is that Highland had projected that it was going to receive almost $10 million in revenue through the Acis shared services and subadvisory agreement and that the Acis revenue represented Highland's second-largest projected source of revenue for 2018. And days after they have this meeting and go through this, Josh Terry files Acis for bankruptcy and all of a sudden all of that revenue is threatened.

So the very first thing they do in March, not in this deck but it's in the proposed findings, the very first thing they do when they realize all of this revenue is at risk is they say, let's duplicate that subadvisory agreement that we just prepared for NexPoint for HCMFA. The projections that we just looked at, you'll never find a projection showing that there was any expectation in January 2018 that HCMFA was going to pay subadvisory agreements. They were supposed to just continue getting them for free. But after the Acis bankruptcy was filed and there was a loss, a potential loss of up to $10 million in revenue, they needed to get more money to Highland, because that revenue was going to be -- was threatened and could be frozen. So that this was the plan they came up with. Just duplicate that agreement for HCMFA. And that's what they did, and that's what the evidence shows.

And the interesting thing, Your Honor, because I don't remember what the exhibit number is, but you'll look -- we'll look at the subadvisory agreement that was prepared. There's nothing about actual cost. It is flat fee agreements. And for NexPoint it was $252,000. Right? This was the first way they were going to address the crisis that was presented by Acis.

Days later, after coming to that solution, a new problem emerged. Lauren Thedford, an attorney at Highland who also served as the secretary of the Advisors -- she was a lawyer, she was an officer of the Advisors -- she was told by outside counsel, you can't use the subadvisory agreement. Why? Because (a) it can't be retroactive to January 1st; and (b) it can only be used if it's approved at an in-person meeting of the Retail Board. And they realized that that meeting wouldn't take place until June.

And so that meant Highland was going to be without all of this revenue that it desperately needed at the time that they intended to make retroactive to January 1st, they were going to go six months without any of the subadvisory revenue that they were hoping to place in Highland's lap through NexPoint and HCMFA.

Needed a solution. They came up with the payroll reimbursement agreement. It's the only reason it exists. Had they -- had Lauren Thedford not gotten the advice, and Mr. Klos will testify to this, had Lauren Thedford not gotten the advice that the subadvisory agreements couldn't be retroactive and couldn't be adopted without Retail Board approval in an in-person meeting, payroll reimbursement agreements would never exist. And so she said the only way around it is to use this payroll reimbursement agreement, because that can be retroactive and it doesn't need Retail Board approval.

And so if you go to Slide 8, please. This is -- this is the most classic parol evidence I have ever seen. Because, remember, the payroll reimbursement agreements aren't signed until May. And this is an email exchange between Mr. Klos and Ms. Thedford, a lawyer, an officer of the Advisors. And I'm not going to read it here, Your Honor, but it shows Mr. Klos saying, actual -- let's just start at the top. He's protesting. He says, What do you mean, actual costs? It would be creating a ton of internal work that isn't adding any value to the overall complex. It would involve subjective assumptions. He doesn't want to do this.

And Lauren says, look, I'm open to changing the definition, but we have to treat it as reimbursement.

And Dave's response at 10:56 the same day is, Could we say Actual Cost? Now he's using uppercase letters. Can we say Actual Cost is determined at the outset of the agreement? Have a schedule as of January 1, 2018 and say the actual cost will be set out in the schedule and paid in monthly installments for the term of the agreement? That way, the exercise is performed only once.

And then he says, and if the parties don't like it, they can terminate or renegotiate.

And that's exactly what the payroll reimbursement agreement says. She says -- Lauren's response is, I think that's workable. Do you have a methodology for the outset determination?

And you'll see the rest of the email during Mr. Klos's testimony. He actually does create a list of dual employees with allocations of how much time they're going to work with these entities, but he's going to explain to you very clearly it's just his own subjective numbers in his head. And what he -- the point of the exercise was to back into the $252,000 that was necessary so that we could get to the $6 million that Mr. Dondero determined.

It's not a coincidence that you have a list of two dozen or more employees, with allocations as random as nine percent, that you wind up with a $252,000 number. It's not a coincidence. It was, Mr. Klos is going to tell you, that was the point of the exercise. Okay? This is parol evidence like I've never seen before.

So they signed the agreement in May. And you have to understand -- this will be more evidence, Your Honor -- everybody -- nobody's going to contest this evidence. The dual employees on Exhibits A to the payroll reimbursement agreements, they're being terminated before the document was even signed. Four of the dual employees had been terminated before the document was even signed. So they created a document based on employees who weren't even there when Mr. Waterhouse signed this agreement on behalf of the Advisors.

But wait. There's more. During the course of 2018, more dual employees left. So that by the time you get to December, nine of the 26 dual employees have been terminated. More than a third of the people on the list have been terminated. And what do they do? They amend the agreement. This is the amendment that I was mistakenly referring to earlier. This is the amendment, Your Honor, on Slide 9. They amend the agreement, because Highland was still needing cash, the Advisors still had taxable income, so Mr. Dondero realized, I can kill two birds with one stone again. Let me shelter more of the income, let me get some more cash to Highland because they need some more cash. And so he decides, send $2.5 million from Highland -- from the Advisors to Highland. And they do that with two amendments to the payroll reimbursement agreements, one for $1.3 million, one for $1.2 million.

Mr. Klos is going to testify no true up -- this is the point of the true up. I think Mr. Norris is going to say that Dave told him that there was a true up in December 2018. These are random numbers that are designed just to keep Highland chugging along and giving Mr. Dondero a tax break. There's no analysis.

And it makes no sense. The concept that there was a true up is just categorically ridiculous. Why? Mr. Waterhouse is going to tell you that NexPoint was paying on an annualized basis an additional 40 percent over the annual cost based on the $252,000 and that HCMFA was paying almost 25 percent more. So they're paying 40 percent more, 25 percent more, at a time when more than one-third of the dual employees have been terminated. How could that possibly be a true up? How could that possibly reflect actual costs? It doesn't. And it didn't.

Dual employees continue to be terminated. The calendar turns to 2019. By the time Highland files for bankruptcy, I believe the number is 14. Fourteen of the 26 dual employees have been terminated. And here is undisputed fact. Not one time -- you know what, I want to take a step back for a second, Your Honor. I'm talking quickly.

These agreements were in effect for three years. They're signed as of January 1, 2018, and they're in effect basically until the end of 2020. It's a three-year period. It's 36 months. There's no dispute that Mr. Dondero controlled the Advisors and Highland for two of those three years. For 2018, even after the bankruptcy was filed, through the end of 2019, Mr. Dondero was in sole control of everything.

Why is that important? That's the course of dealing, Your Honor. The unequivocal, uninterrupted course of dealing. In those first two years, the Advisors paid a flat fee under the payroll reimbursement agreement. Nobody cared that dual employees were leaving. There will be no evidence that anybody said, how come we're not paying actual costs? They just did it, and they did it because that was the plan. And they have a document and an agreement that effectuated that plan, and everybody stuck to the plan. For two years. And the undisputed evidence is going to show that nothing changed after the bankruptcy, that the Advisors were charged and paid the exact same amounts in the 12 months in 2020 that they paid in the 24 months in 2018 and 2019. Nothing changed.

Nobody asked for a change in 2018. Nobody suggested that -- because everybody knew -- here's another piece of evidence. It's enormous. Your binders have dozens of what are called monthly headcount reports. Right? And we may look at one of them, but I'm going to tell you what they are right now in case we don't. Those monthly headcount reports identify -- name every single employee who ever worked for Highland since like 2007. It tells you when they were hired. It tells you when they were fired. It tells you what position they had. And it was distributed to a whole host of people, including D.C. Sauter, Dennis Norris, Lauren Thedford, Frank Waterhouse -- *i.e.*, every single officer of the Advisors. Every single officer of the Advisors got a report every single month that told them exactly who was terminated. And the reports would actually highlight the terminations in yellow in case somebody didn't know. So that everybody, every one of the officers knew, Frank Waterhouse knew, had the information in his lap when he signed the agreements, that four of the 26 dual employees had already been terminated.

There's going to be so much more evidence about what they knew.

But fast forward to 2020. So, Highland files for bankruptcy. Most of the dual employees are already gone. Nobody is saying a word about it. Nobody cares. Why? Because this is a pay-for-service agreement. It has nothing to do with who provides the services. It's important that the services be provided. And Highland continued to perform.

There will be no evidence, there's been no allegation, they filed an administrative claim, they have filed two different -- a response, they filed their pretrial brief. They don't make any allegation that Highland failed to perform front office investment advisory services. As their pleading says, their position is simple. Dual employees left. We shouldn't have to pay for dual employees that left.

The Advisors are not in the business of consuming dual employees. They're in the business of providing investment advisory services to the Retail Funds and to other investment vehicles. That's the point of the exercise. They are going to testify that is the reason they exist, is to serve their clients.

And so does it matter to the Advisors if one person or six people or 24 people provide the services? It shouldn't. The important thing is that they're getting the services that allow them to satisfy their contractual obligations to their clients.

This is all -- it's just -- it's just all so simple. It's a lot of facts, but it's all just so simple. They continued to pay not because they didn't know dual employees had left. They knew that. They continued to pay because they were getting uninterrupted service, as they told the Retail Board time and time and time again.

If we can go to Slide 10, I'm going to try and pick it up just a bit here.

The calendar turns to 2020, Your Honor. This is more, you know, particularly relevant evidence because it's another back-and-forth between Ms. Thedford and Mr. Klos. It's January 2020. And I note the timeline, Your Honor, because, you know, this is the moment that Mr. Dondero is about to surrender control to the Independent Board. But there's no disputes. There's no disputes. And that's the beauty of this particular email exchange. Nobody is questioning, how much am I paying? Nobody is questioning, what services are you providing? But Lauren does have some questions about -- because the Retail Board. That's what prompts this. This has nothing to do with the Advisors or anything. The Retail Board. And you'll see it in the full email. The Retail Board has asked some questions about, you know, how does the Advisors pay for expenses?

And Lauren said to Dave, and you'll see it in the email, wasn't there something about those Exhibit As? And Dave's response is, Those were a point-in-time estimate as of the beginning of 2018. Half the people are gone now. And if you were to reallocate them now, all the percentages would be different.

And Mr. Klos is going to testify that the reason that the percentages would be different is exactly what I just said, and that is this is a pay-for-service agreement. When the dual employees were terminated, Highland didn't just stop providing the services that those people were performing. They reallocated them. That's exactly what he's telling her. It's exactly what everybody knew to be true.

So if in January 2018 one of the dual employees was terminated and his job, let's say, was to give investment advice on Asset A, Highland didn't just suddenly stop providing investment advice on Asset A. Somebody was given the responsibility to do that. And that's exactly -- Mr. Klos is going to tell you that's exactly what that means there, that all the percentages would be different if you did it again today because you had the departure of all of these dual employees and somebody picked up the slack. Makes total sense. It's a pay-for-service contract. That's what it is.

It's a flat fee contract.

Later the same month -- if we can go to the next slide -- Mr. Waterhouse, who is the CFO, asks Mr. Klos, how much -- remind me again, how much is paid under those agreements? Without equivocation, without ambiguity, flat, flat, flat. Except for the one HCMFA shared services agreement that had a very, very narrow band, and Mr. Klos will testify as to why that band existed.

But there's that $6 million number again, if you look at NPA. That's NexPoint. $252,000 plus $248,000 equals $500,000 times 12. Six million. The $248,000 is for shared services. It's broken out, as I mentioned earlier, between NexPoint and NexPoint Real Estate Advisors. Here we are, January 2020, Mr. Klos again confirming for Mr. Waterhouse, flat fee, flat fee, flat fee, $6 million.

If we can go to the next slide.

I've alluded to some of this, Your Honor. The Advisors contemporaneously had all of the relevant facts. This is just, again, the highlights here.

If you look at Exhibit 14, it's the Advisors' responses to the Debtor's interrogatories. And if you look at Interrogatory 3 and 4, it's going to provide a list of each of the dual employees that were attached as the Exhibit As to the payroll reimbursement agreements and it's going to give you the date of termination for each person. And then

Interrogatory -- the response to Interrogatory No. 4 simply says, we knew contemporaneously when these people left. They've admitted it.

The monthly headcount reports, as I said, there's 12 plus 27, there's at least 39 of them. Thirty-nine monthly. Because I took it back to October 2017. I think it goes back much earlier, but that's what we produced, just to make sure the Court had the evidence, that this was a process of disclosure of hires and terminations that was provided before these contracts even existed. And it's a practice that continued right up until January 2021, when these contracts ended. Every single month. The same analysis. Went to every single officer of the Advisors.

And they're -- and Mr. Norris is going to sit in that box tomorrow and he's going to say he was shocked, shocked, that Highland was charging this money for these employees who were terminated. We'll see how that goes.

Annual reviews. Exhibits 86 and 142. These are portions of the annual reviews where Mr. Dondero is just given a wealth of information about hires, termination, compensation budgets, everything one would need to know from the human resources department. If Mr. Collins comes in and testifies, he's going to testify -- and I didn't depose him -- but he had no choice. He's the human resources officer reporting to the owner of the company. If he says anything other than I kept him fully informed about staffing issues, I'll be shocked.

Representations to the Retail Board. They represented to the Retail Board a couple of times that there has been no material attrition in employees. How can they make that representation if it's uninformed? They didn't. It was completely informed. The Advisors knew exactly what was going to be paid.

We looked at the projections in the annual review that was given to Mr. Dondero. Mr. Waterhouse is going to testify that there were 13-week forecasts that were prepared. The forecasts showed every single payment that was going to be made by the Advisors under these intercompany agreements. He's going to testify that before the Independent Board was appointed he would go through those forecasts with Mr. Dondero every week, and then after the Independent Board was appointed he would still do it with Mr. Dondero, although with less frequency. And Mr. Waterhouse started going through those forecasts with the Independent Board, and sometimes Mr. Dondero would participate. Right? In the early -- in the first six months of this case, everybody was looking to cooperate. Right? Before the board said, we need to get this done.

They knew what was going to be paid. Mr. Waterhouse, the unequivocal evidence will be that Mr. Waterhouse approved all payments. You may hear some argument about the shared services agreement, and Highland was supposed to do this or supposed to do that. You're going to have the evidence in front of you. Mr. Waterhouse is going to admit he had to approve all of the payments. He is not just the CFO of Highland. He is the treasurer of the Advisors, charged with the responsibility of finance and accounting. He's the approval person.

You're going to see emails from Kristen Hendrix that say, Frank, here's the payments I'm going to make today. Is it okay? And he would say, go ahead. And you're going to see, and we just have a couple of examples, but he's going to testify that was the practice. And you'll see in the examples it says $252,000, payroll reimbursement. Or subadvisory. Right? Mr. Waterhouse -- how do we know the Advisors knew what would be paid? From the projections. How do we know that they knew what would be paid? Mr. Waterhouse approved it.

But wait, there's more. Mr. Waterhouse is also going to admit that every single payment that was made by the Advisors under these intercompany agreements is reflected in the Advisors' books and records. Right? Their own books and records.

They represented to the Retail Board on October 23rd that all amounts due and payable under these agreements were paid in full. How do you make that representation if you don't do the due diligence to know what was paid and whether -- whether it should have been paid. Right?

So they -- they've either got to -- Your Honor is going to have to decide, did they lie to the Retail Board or are they lying in this courtroom? Because they can't be true. You can't reconcile what they told the Retail Board with what they may tell you today and tomorrow. It can't be reconciled. You can't tell the Retail Board Highland is fully performing, we've paid everything we're supposed to pay Highland, and then come into this courtroom with a contrived administrative claim to say, oh, gee, they didn't provide services and we overpaid. You can't reconcile the two.

I ask the Court to listen carefully to the testimony and see if there's a credible witness for the Advisors who can explain how they told the Retail Board fifty times that Highland was performing and that they paid everything, and yet somehow something fell through the cracks.

Again, think about the whole purpose of this. The purpose is for Highland to provide services to enable the Advisors to fulfill their obligations to the Retail Board, to the Retail Funds, and the other investment vehicles who were their clients. That's the purpose. And that's exactly what happened.

They knew what services were provided. We're just going to do a quick greatest hits here of some of the retail representations by the Advisors. You know, there had been an objection that some of the statements were made by people other than Advisors' representatives, so I took -- I took a little timeline here and focused really solely on the representations that were made by the Advisors and their officers.

In June, Mr. Post told the Retail Board, the level and quality of services are being monitored. I mean, think about that. Being monitored. It's a very active word. He is not aware of any disruptions in the service levels provided to the Funds.

A couple of months later, Mr. Norris -- we'll hear from him tomorrow -- he noted that there have been no issues or disruptions, no issues or disruptions in the services as a result of the bankruptcy.

The next month, the Advisors state in a memo -- I believe it's in a memo -- the Advisors and HCMLP believe the current shared services being provided are generally consistent with the level of service that has historically been received. How do they come into this Court and tell you we breached the agreement by failing to perform when they have told their clients exactly the opposite?

On October 13th, Mr. Sauter, a lawyer, the general counsel of the Advisors, noted that there has been no material attrition to date with respect to employees.

Somebody's going to come in here and say, oh, because of the bankruptcy, Highland was firing people? That's not true, as a practical matter. Maybe a couple people on a net basis. Didn't have a material impact.

Ten days later, the Advisors told their Retail Board, all amounts owed by each of the Advisors pursuant to the shared services arrangement -- that's not a mistake there, it's a lower case S, a lower case S, a lower case A, because it encompasses both shared services and front office investment advisory services -- all amounts owed pursuant to the shared services arrangement with HCMLP have been paid as of the date of this letter. That's October 23rd.

Go to the next slide. It continues. Five days later, the Advisors represent that the quality and level of services provided to the Funds by the Advisors and pursuant to the shared services arrangements have not been negatively impacted to date. No negative impact. October 28th. No negative impact.

November 5. Mr. Norris noted that there had not been any disruption to the services provided to the Funds by HCMLP pursuant to the shared services agreement and that he expects, his expectation, is that such services will continue to be provided in the normal course.

Your Honor may remember that on November 30th Highland gave notice of termination. We had just gotten our disclosure statement approved and time to execute. Right? The world is going to change. So we give notice of termination on November 30th. And the next day, the Advisors do what they're supposed to and they tell the Retail Board, we finally got that notice of termination that we were planning for. And they say, we're going to -- Mr. Post states that the Advisors expect to be able to continue to receive the services through a transfer of personnel.

You can't expect to continue to receive services that you're not receiving. Right? This is the morning after. This is what they report to the Retail Board. Don't worry. They've terminated. Don't worry. We're going to continue to receive these services.

As late as December 10th and 11th, Mr. Sauter noted that there had been no material attrition to date with respect to the employees. And they're here suing on a breach of contract theory for failure to provide services?

Mr. Waterhouse, the Advisors' treasurer, is going to testify that he knows of no services that Highland failed to perform postpetition.

These are excerpts from his deposition, but you can imagine that I might turn that into leading questions that'll go something like this: You were unaware of any specific service under the shared service agreements that Highland failed to perform at any time from the petition date until they were terminated in early 2021; isn't that correct? And he's going to have to say, I'm not aware of any.

Mr. Waterhouse is going to have to answer the question this afternoon: You never had any discussion with anybody at any time about Highland's failure or alleged failure to provide services under the shared services agreement at any time from the petition date until they were terminated in early 2021; isn't that correct, sir? He's going to have to say, I have no recollection of that.

This is their officer.

Last slide, 16. It's really important that the Court appreciate the complete change of position that the Advisors have undertaken here, because until they filed their pretrial brief their whole theory of the case was that, you know, the -- Highland failed to perform some services under -- some unidentified, vague services under the shared services agreement and that Highland overcharged them and they overpaid under the payroll reimbursement agreement because all these -- all these dual employees were gone. That was their theory of the case.

Their theory of the case was that we had the obligation, right, Mr. Norris testified on March 5th and he's going to testify tomorrow that he believed that Highland had the obligation to charge the right fees based on the dual employees.

In their pretrial brief, they've now completely changed their position, and they're -- I think they're basically agreeing with our interpretation of the contract, that it was a fixed fee unless changed by the parties. Because on March 28th or March 29th, I took Mr. Waterhouse's deposition and he told -- he told -- you know, he testified. I don't want to be pejorative. He testified that he recalled that in December 2019 Dave Klos did an analysis that showed that Highland was making millions of dollars off these agreements and that -- and that Mr. Waterhouse took that information and went to Isaac Leventon and Scott Ellington and Fred Caruso -- Mr. Caruso was an employee of DSI, the Debtor's then-financial advisor -- and he spoke to the three of them and he said, guys, we're overpaying, the Advisors are overpaying. And all three uniformly told him: Can't do anything about it because of the automatic stay. You can't do anything about it because of the automatic stay. That's what he's going to testify to. That's what he said took place.

Now, complete about-face, and so now they're saying that they should be relieved of any obligation to pay and they should get all their money back because Highland breached its duty under Section 2.02 of the payroll reimbursement agreement that says the parties shall negotiate in good faith. So they're saying Highland didn't negotiate in good faith because Frank spoke to Fred Caruso and Fred Caruso said there's nothing we can do about it because of the automatic stay. That's the story. That's their -- that's their theory today.

There's no excuse for them being surprised by Mr. Waterhouse's testimony. None. You may hear somebody say we couldn't speak to Mr. Waterhouse. And I know that his counsel has done the right thing, because he has an obligation under his agreement with Highland not to cooperate in claims against them, so he's done the right thing. But that, that advice, Mr. -- I don't know when the advice was given, obviously, but I know from the representations that have been made by counsel to the Advisors, that wall came down between them and Mr. Waterhouse last summer.

And we know it didn't come down before that because Your Honor already has a litany of evidence showing that D.C. Sauter had multiple conversations with Mr. Waterhouse in the spring of 2021. Remember, he submitted not one but two declarations in support of HCMFA's notes defense. And remember that? We'll talk about this more next week. Mr. Sauter conducted an internal investigation in the spring of 2021 to try to figure out where did these HCMFA notes come from. And remember, Frank Waterhouse told him those notes exist because we needed to document it for the auditors. Mr. Waterhouse knew exactly why those notes existed.

And so how do the Advisors do an investigation, interview Mr. Waterhouse three times in the spring of 2021 about the notes, and never ask him a question about this? And Mr. Waterhouse is going to testify he's never seen the administrative claim and he's never spoken to anybody in the world about the administrative claim until I deposed him, other than his counsel.

How do they do that? Frank Waterhouse is in their offices. There's investigations being conducted about HCMFA's notes. They're trying to figure out the origin of the notes. D.C. Sauter. And nobody asks him, what about this administrative claim? Do you know why we kept paying that money? Never happened. Maybe they would have learned at that time that Mr. Waterhouse thought that something happened in December of 2019 that was relevant.

The story that they've now adopted completely contradicts their early version, earlier theory of the case. Their earlier of the case, Your Honor, if you look at their response, which was filed in December, it's filed as Exhibit 13, at Paragraph 6, their response to our waiver argument was we could not have waived, we could not have waived because the issue didn't crystallize until November 2020. That's when they said they first learned about all these problems. And now they've done a complete about-face and they say no, wait, Frank knew about it, Frank -- Dave Klos told him about the overpayments, Dave Klos told Frank, and Frank went to Caruso, and Caruso said nothing we can do about it, and that's a violation of 2.02. And that's their theory. Really. Completely contradicts.

So all they've actually done now, if the Court actually buys that argument, is strengthen our waiver argument even more. Because now Frank knew in December 2019 -- I don't think the Court's ever going to credit his testimony, but if the Court did so, okay, fine, heads I win, tails they lose. It's just waiver. He knew -- he knew at the outset of the overpayments.

And here's the really interesting thing. He never told Mr. Dondero. And he never told Mr. Norris and he never told Mr. Sauter and he never told Ms. Thedford and he never told the Independent Board. He never told anybody. But if you buy the story, you have to buy the whole story. You can't just buy the fact that Mr. Waterhouse didn't tell anybody. You also have to buy the fact that apparently Mr. Leventon never told Mr. Dondero. Mr. Ellington never told Mr. Dondero. Because if they had told Mr. Dondero, we would have had this story -- we would have heard about this story in the administrative claim or we would have heard about the story in the response. Instead, we're told the issue didn't crystallize until November 2020.

So not only did Mr. Waterhouse simply accept the advice of two in-house counsel and a financial restructuring professional, he didn't tell anybody, and nobody who he told

told anybody. Kind of funny. Kind of interesting. I'll use interesting.

There will not be a document or a witness who will corroborate Mr. Waterhouse's assertions. The contemporaneous documents will actually completely contradict Mr. Waterhouse's assertion.

Which documents am I referring to? There actually was an analysis that Mr. Klos prepared in December 2019. He's going to share with the Court what that analysis was. And what that analysis shows is that, after making adjustments to present the analysis in the most positive light for the UCC, Highland was still losing a million and a half dollars a year under these intercompany agreements.

I can't explain Mr. Waterhouse's testimony. I thought originally when I was asking him about it that he was confused with a later analysis that was prepared in December 2020 that we'll talk about. He insists it was in December 2019. I don't know what to say. But there will be nothing that corroborates it. There won't be a witness in this courtroom who corroborates it. There's going to be -- it's going to be challenged by Mr. Klos. We're going to have documentary evidence that shows he's mistaken.

I don't need to ascribe bad motive. This guy's just mistaken. And given his lack of recollection about so many things, it's not terribly surprising.

Subsequent communications are inconsistent. There's another couple of exhibits. And we just looked at one, the one with Ms. Thedford from January. Like a couple of weeks after Dave supposedly told Frank that there's millions and millions of dollars of profit being made under these contracts, he's turning around and saying to Ms. Thedford, we're not doing actual cost, it's a flat fee agreement. He's just ratifying everything that the parties have been doing for the 24 months under Mr. Dondero's control.

I'm about done, Your Honor. I just want to talk for a moment about a couple of the witnesses. You are going to hear from Mr. Klos, and I'm delighted that you're going to do so. Nobody is going to take Mr. Klos on. He's a man of integrity. And I know, I know the Court will find him very credible. You'll find him credible for three reasons.

Number one, his story makes sense. Every single thing that he says, he's going to say, that makes sense on a timeline, that makes sense from an economic perspective, that makes sense based on what I know of this institution and these individuals.

You're going to find him credible for the second reason. His story is consistent. There's no equivocation. There's no change of story. I'm not worried about him being cross-examined with his deposition transcript. His story is going to be consistent. It's going to make sense. It's going to be consistent.

And the third reason is that it's all going to be corroborated by the contemporaneous documentation.

So I look forward to presenting Mr. Klos. I think that he has more knowledge about these issues than anybody. He was involved in structuring the entire economic relationship between the parties. He was involved in the drafting of the agreements. And he was the person primarily responsible for the administration of the agreements.

So that's one witness I hope the Court will pay particular attention to.

Mr. Waterhouse, obviously. He wore dual hats. He's going to say he wore dual hats. He's going to tell you that Mr. Dondero gave him all of those hats. But the Advisors can't get away from the fact that two of those hats were as the treasurer of HCMFA and as the treasurer of NexPoint. There's nothing that's in his head that can be attributable to Highland that cannot also be attributable to him as an officer and the treasurer of the Advisors. Right? So anything he knows, anything they want to put in his head, he knew not just for Highland but he knew for the Advisors.

And then there's Mr. Norris. I mean no ill will to Mr. Norris, but he has very little to offer here. And why is that? Because he's the executive vice president of the Advisors, and his responsibility was marketing.

You're going to hear Mr. Klos and I believe you will hear Mr. Waterhouse testify that Mr. Norris had absolutely no responsibility or involvement in the structuring of the economic relationship between the parties. They are going to testify that Mr. Norris had no involvement or personal knowledge about how these contracts were executed.

Mr. Norris comes on the scene at the very last second. And like Mr. Sauter did in the spring of 2021 when he insisted that Mr. Waterhouse, the officer whose name appears on the HCMFA's notes, made a mistake, even though Mr. Waterhouse had absolutely no personal knowledge of anything, you're going to hear Mr. Norris testify that he came onto the scene in October or November and December 2020 and he was shocked, shocked, at how much was being charged. Where have you been? Where have you been? Did you look? Did you look in 2018 when Mr. Dondero was in control and all of the dual employees were leaving? Did you say, hey, hey, what are we doing here? No. Did you do it in 2019? No. He did in Month 35 of a 36-month relationship, without having had any involvement or responsibility for the negotiation or administration of these contracts.

I will be objecting as appropriate on foundation grounds, because a witness can only testify based on personal knowledge. And he can testify to whatever he did, but he should not be permitted to testify about the parties' intent.

I have nothing further, Your Honor.

THE COURT: All right. Thank you. Mr. Rukavina?

OPENING STATEMENT ON BEHALF OF THE DEFENDANTS

MR. RUKAVINA: Respectfully, Your Honor, what you just heard was misdirection, irrelevancy, things that are not going to be in the record, things that are not in the record, and parol evidence.

What Highland is trying to do here today is to ignore the fact that there are four contracts. Two of them are payroll reimbursement agreements; two of them are shared services. They are different contracts that provide for different things. And what you just heard was confusing the two, and I think you even heard Mr. Morris say that the PRAs were actually pay-for-services agreements.

They're trying to read these contracts into something that they're not, using parol evidence. And I find it particularly ironic given that in all those promissory note cases Highland is here hitting this table saying, follow those notes to the letter, ignore everything else, and now they're trying to shoehorn what is a very clear, unambiguous payroll reimbursement agreement into some kind of parol evidence, it was meant to be a flat payment every month for services.

What I first want you to focus on, because I really believe that it's unbelievable misdirection, are all of these references to representations that my clients made to the board. And if you have Slide 13 of the deck, Your Honor -- did Mr. Morris give you Slide 13 -- you see -- you see, for example -- are you there, Your Honor?

THE COURT: Uh-huh.

MR. RUKAVINA: You see the first one, June 18th to 19th, level and quality of services are being monitored.

August 13th. No disruptions in the services.

September 17th. Current shared services are being provided.

October 23rd. Pursuant to the shared services agreements.

Yes, Highland performed under the shared services agreements, except for two minor things that we've put in our trial brief and that we'll talk about that total about $1.3 million in damages.

What we're talking about here today, the bulk of our claim is under the payroll reimbursement agreement. So as we proceed with the evidence, the Court needs to be careful to have that separation. Because the fact that we told the board the truth, that under shared services we were being provided shared services, does not mean that we told the board that, oh, wait, there's a problem under payroll reimbursement. The two are separate.

And I really want to point out two exhibits to Your Honor, if Ms. Canty would do me the favor, or if Your Honor wants to look at them in her binder. It's Highland Exhibit 58. Ms.

Canty, is it possible -- Mr. Morris, are you willing to share Ms. Canty?

Yes. Ms. Canty, if you have your own Exhibit 58.

She might not even be listening.

(Pause.)

MR. RUKAVINA: Is it just easier, Your Honor, if Your Honor gets a binder?

THE COURT: I can do that.

MR. RUKAVINA: Your Honor, it's -- I believe it's -- it's Volume 2. Volume 2 of the Highland exhibits.

That's okay, Ms. Canty. Thank you. I think this will be faster if we just use binders.

Your Honor, it's Exhibit 58, when you're ready.

THE COURT: Minutes?

MR. RUKAVINA: Yes, Your Honor. On the bottom, it's Page 20. Just it's a few pages in. The bottom, it says Page 20.

THE COURT: Okay.

MR. RUKAVINA: So, it says Mr. Post also discussed the quality and continuity of services provided to the Funds by HCMLP pursuant to shared services agreements with the Advisors. And then you'll see that he says that there's no material disruptions in services.

What about that is not true? What about that has anything to do with a multimillion-dollar overpayment under payroll reimbursement? But that's what you're being told. Again, they're trying to confuse the issues.

And if Your Honor will quickly flip to Exhibit 61.

THE COURT: Okay.

MR. RUKAVINA: And it's the bottom of Page 3. And in the very middle you'll see it says, Mr. Sauter also discussed the status of the shared services agreements.

THE COURT: Okay. The one I have is redacted.

MR. RUKAVINA: Page -- the bottom of Page 3, Your Honor?

THE COURT: Yes.

MR. RUKAVINA: Of this? The top should not be redacted.

THE COURT: It's not. Oh, okay. Yes. Mr. Morris discussed.

MR. RUKAVINA: And then, yeah, in the middle it says, Mr. Sauter also discussed the status of the shared services.

THE COURT: Okay. Gotcha.

MR. RUKAVINA: But look at what they say on Slide 13. They say Sauter noted that there has been no material attrition to date with respect to employees. Where is that in this document? We'll talk about that later. That's nowhere in this document.

Again, they're intentionally conflating shared services, that we're not saying we didn't get shared services, with payroll reimbursement.

The facts here matter, Your Honor. And I caution the Court to be careful because, again, these are separate contracts that have separate provisions and they work separately.

You're also going to be told about, oh, well, a lot of these employees weren't even there when the payroll reimbursement agreements were made. I think Mr. Morris said four. Yeah, except that they were signed in May to be effective as of January 1. And if Mr. Klos really is this impeccable, unbribable character of pristine morals, well, did he create a fake agreement? Did he lie? Of course not.

Again, misdirection. Misdirection.

You are told, well, a lot of these employees left. What you're going to hear is that a lot of those payroll reimbursement employees, those dual employees, left because the Advisors changed their business model to a real estate-heavy business model, whereas before they had a lot of credit, they had debt, equities. They changed to real estate. So that's why 20 out of 25 employees that were dual employees left, because they saw the writing on the wall, not for these other reasons. Because the argument that you're hearing is, well, don't look at these two contracts, Judge, the payroll contracts. Consider it a services agreement. And even though those 20 employees were no longer there, Highland made it up with other employees that were there. Therefore, the spirit and intent of the agreement is honored.

No. No, Your Honor. No. Highland did not make up those services. Highland was providing those services pursuant to the shared services agreements, and those dual employees left and they were not replaced, their services were not replaced, because they were no longer needed. Except guess what? Highland never told us that. The one we contracted with to review our contracts, to review our bills, to review our invoicing, to make sure that we're paying only appropriate amounts. You're going to hear from everyone that that was one of the services that we were paying pursuant to shared services. Highland never bothered telling anyone, oh, we're still going to bill you for these 20 employees that are gone.

You've been told that everyone in the world knew those employees were gone. Of course. But not that we were still being billed for it. Because it was only Highland people that billed us for that and paid themselves from our bank accounts which they have control over.

Mr. Dondero didn't know. No officer of the Advisors knew. Mr. Waterhouse knew. And yes, Mr. Waterhouse was an officer of the Advisors and an officer of the Debtor. And you're going to hear from Mr. Waterhouse what he tried to do about that.

But, again, don't allow that misdirection to color the true record here. Our contractual counterparty, the one providing services to us, a debtor in bankruptcy, every month was billing us and paying itself from our funds for 20 employees who weren't there.

And Mr. Klos -- again, the man that we've all be told is the most credible man in this court -- will confirm that. And he calculated our damages for us. You're going to see all that.

So let's, again, stick to the facts. The payroll reimbursement agreements are reimbursement agreements. Everyone in the world knows what the word reimburse means. There was not to be any profit margin on there. We are to reimburse for actual cost. Actual cost means the actual cost to Highland of a dual employee.

Yes, there are some issues with notices and when did we know, when did we act? You're going to hear all about that. But at the end of the day, if the Court is looking for the intent and purpose of the contract, it is a reimbursement. And each of those have a schedule of 25 employees that was accurate and current -- Mr. Klos himself performed those percentages -- that was accurate and current when those contracts were done.

You are then going to hear that Highland, pursuant to its general practices, did a true up or a reconciliation of all of its contracts on an annual basis.

There is language in these contracts that talks about, well, why don't the parties look at the actual costs every month. There is that language. We will discuss that. But the course of conduct at Highland, both generally and in this case, was to do it once a year at the end, because to do it monthly was burdensome.

In the first year of that contract, the parties did a true up, and my clients ended up paying $2.5 million more in because we underpaid. You're going to hear some fiction that this was some means of getting a tax deduction for Mr. Dondero. Well, the contracts, again, say what they say, and they say we did a true up -- they don't say that. We did an analysis and the Advisors underpaid, so now the Advisors are going to pay $2.5 million.

So, again, is that a fraudulent document? Is that Highland document a fraudulent document? Were people lying on these documents?

Then the bankruptcy happens, and it's time for the next true up in late 2019. Coincidentally, at the same time that the Committee, appropriately so, is asking DSI and asking the Debtor, what are these intercompany agreements? This -- these are insider agreements. Explain to us. Is Highland losing money? Is Highland making money?

So what happens next? Mr. Klos -- again, the most credible man in this room, we're told -- does an analysis, and he says that at that point in time Highland is making a $3 million annualized profit on the payroll reimbursement agreements. Okay. He also says that Highland is losing money on the shared services agreements. That's true. But, again, don't allow that misdirection. On the payroll agreements, Highland is at that point in time making a $3 million profit.

He tells Mr. Waterhouse, his boss, did you know about these overpayments? You should do something about that. And Mr. Waterhouse, a professional man, does what he should do. He talks to the general counsel at Highland and he talks to the CRO and DSI and says, it's time that we revise these numbers, because we're overpaying, the Advisors are overpaying by $3 million a year, and that's not fair, it's not right. That's extra-contractual. The general counsel, the associate general counsel, and the man who's been in bankruptcy for 30 years tell him there's nothing we can do because of the automatic stay. We will address it and deal with it in due course.

What more was Mr. Waterhouse supposed to do at that time? Call Mr. Dondero? His own general counsel and his own CRO just told him what the law is, and he relied on that and believed them and said, okay, there's nothing to be done at this time, we'll address it in due course.

Months go by. Months go by. The overpayments become greater and greater and greater as there's fewer and fewer employees. Mr. Waterhouse is still acting in reliance on this. You know that there were negotiations on a global plan. Well, at some point in September or October 2020, the situation was no longer tenable. That's when Mr. Norris comes in, my client's officer. Yes, he's a marketing guy, but he's a very sophisticated businessman with a lot of education, and he's tasked with this.

He starts talking to Mr. Kos. He starts talking to Mr. Waterhouse. He starts talking again to the lawyers. Hey, we are overpaying. And Mr. Klos, you'll hear, repeatedly acknowledged the fact of overpaying. But he's again told the automatic stay applies, you can't do nothing. If you send a letter, if you do anything, it's going to be a stay violation.

You'll recall we had a preliminary injunction hearing at which the Court was none too happy about a letter sent from K&L Gates to the Pachulski firm threatening action subject to the -- subject to the automatic stay. They hauled us in front of Your Honor on an emergency hearing on that. Imagine if we sent them a letter saying, we're going to revise this contract, or we're going to terminate this contract. That would have been a stay violation.

But all along, the contract says that once the issue is raised, once a change is requested, the parties shall negotiate in good faith. Shall negotiate in good faith. That's not meaningless language. And there was no negotiation. Repeated admissions of overpayments, no negotiations, but hiding behind the automatic stay, perhaps appropriately, perhaps not.

And then finally in December 2020 I think the key evidence here will come out, because it happened before litigation. It happened by a professional, honorable man of integrity that you've heard, Mr. Klos. It happened when we were not contemplating being here today. Mr. Klos was asked by Mr. Waterhouse to calculate the profitability or the loss of Highland on these four contracts. He was told, or he assumed, or he may -- well, the evidence differs. Mr. Klos will say Mr. Waterhouse told him to make assumptions. Mr. Waterhouse will say it was Mr. Klos's assumptions. It doesn't matter. There were two assumptions in the work product that Mr. Klos, this professional accountant, prepared. Use actual headcount today. Not the original 25, but the actual headcount today, which was five. And do not include bonuses. Highland didn't pay insider bonuses, which were a huge amount. There were other bonuses paid, so the numbers need to be adjusted a little bit. Mr. Klos didn't include any bonuses.

And he said at that point in time, in December 2020, Highland was making an annualized $6.6 million profit on the payroll reimbursement agreements and a $1 million annualized profit on the shared services agreements, even though you heard in this Court repeatedly from Highland employees and witnesses that, oh, we're losing money on all these contracts.

So, is Mr. Klos a liar? Is he -- is he a nincompoop who can't do his job? Is he changing his story now? How could there have been a $6.6 million profit on one and a $1 million profit on the others when the contracts (inaudible) profits then? Did he create a fictitious document then? No. He did his job as he should have, and that is the key evidence here. That is the key evidence.

What this trial will come down to, Your Honor, is the contract. Whether my clients had an obligation under the contract -- because, again, the fact of overpayment cannot and will not be disputed. Twenty of twenty-five employees weren't there. We can quibble about damages, but the fact of overpayment will not be disputed. Cannot be disputed. The question is, again, did my clients waive their rights because they did not more frequently or more formally trigger the process of revisiting the actual cost formula?

Those contracts are very clear. There's no need for parol evidence. There's no ambiguity. The fixed monthly amount stays unless changed at the request of either party, upon which time the parties shall negotiate such change in good faith.

We requested it repeatedly. They stood behind the automatic stay. And the Court will have to construe that contract as a matter of law and decide whether that is a waiver or not.

There's no other waiver. There's no voluntary payment rule. The voluntary payment rule doesn't apply to contracts. And we weren't paying these bills. Highland was paying itself.

And that's the thought I want to leave you with, Your Honor. That's the thought I want to leave you with, that your Debtor, who has gotten immense protections from this Court, fiduciaries to the estate, every single month billed my client for almost a million dollars more than they were entitled to under these contracts because there was no reimbursement by this Debtor of its own employees. Month after month, with knowledge that these employees weren't there, with knowledge that Highland was making a profit on these contracts when it was not allowed to, they billed my clients and paid themselves for employees who were not there. Whether it's contract or equity or just good business ethics or just being a good debtor-in-position, that ought to bother the Court. That ought to bother the Court, and that's why we have an administrative claim.

Thank you.

THE COURT: All right. Thank you. It's 11:01. We'll take a ten-minute break and come back and hear the evidence.

THE CLERK: All rise.

(A recess ensued from 11:01 a.m. until 11:15 a.m.)

THE CLERK: All rise.

THE COURT: All right. Please be seated. We're back on the record in the Highland matter.

Mr. Morris, are you ready to call your witness?

MR. MORRIS: Good morning. Yes, Your Honor. Highland calls as its first witness David Klos.

THE COURT: All right. Mr. Klos? Okay. If you could approach the witness box, I'll swear you in. Please raise your right hand.

(The witness is sworn.)

THE COURT: All right. Thank you. You may be seated.

DAVID KLOS, DEBTOR'S WITNESS, SWORN

DIRECT EXAMINATION

BY MR. MORRIS:

Q Good morning, Mr. Klos.

A Good morning.

Q So, I'm going to ask you some questions this morning. And I would ask you to listen carefully to my questions and do the best you can to answer them. Okay?

A Absolutely.

Q I've put before you, or Mr. Rukavina and I have put before you some binders. There is two binders that have Highland's exhibits and there is one binder that has the Advisors'

exhibits. And from time to time I may ask you to pull documents out. But that's what those -- that's what those big binders are in front of you.
A Okay.
Q Are you comfortable? Are you prepared to proceed?
A Yes.
Q Okay. Mr. Klos, you're familiar with Mr. Waterhouse, obviously, right?
A Yes.
Q Okay. And did you understand that Mr. Waterhouse served as Highland's chief financial officer at least for the five-year period through 2021?
A Yes. He -- he elevated to that role in the 2011-2012 time frame.
Q Okay. And are you aware that at the same time he served as Highland's CFO he also served as the treasurer of each of the Advisors?
A Yes.
Q And are you aware that Mr. Waterhouse, in his dual capacity as the CFO of Highland and as the treasurer of the Advisors, he's the one who signed the payroll reimbursement agreements?
A Yes. That's correct.
Q And the payroll -- do you recall that the payroll reimbursement agreements had the list of dual employees?

A Yes.
Q And from the time the -- for the three-year period from December -- from January 1, 2018 until the end of 2020, was it Mr. Waterhouse's practice to approve each and every payment that was made on behalf of the Advisors pursuant to not just the payroll reimbursement agreements but all of the intercompany agreements?
A Yes. That was the general practice.
Q Can you just describe for the judge your understanding of how that practice operated?
A For making the payments?
Q Yes.
A Yes.
Q Approval. Approval of the payments.
A Yes. Yeah, I mean, generally speaking, our assistant controller, usually Kristin Hendrix, would -- would prep wires on an ongoing basis, whether first of the month or just weekly type wires. She'd send an approval email to Frank saying, here are the wires for today. Okay to release? Or something like that. And Frank would respond with yes, or if he had questions then he might -- he might chime in. But usually just an approval.
Q Okay. Can you just -- are you currently employed, sir?
A Yes.
Q And who's your employer?

A Highland Capital.
Q And what's your title today?
A CFO and COO.
Q And when did you first join Highland?
A End of March 2009.
Q And during the period -- let's -- I'm going to use the phrase "the relevant period" to mean from January 1, 2018 until the end of 2020, that three-year period. Is that okay?
A That's fine.
Q Okay. During the relevant period, what titles did you hold at Highland?
A I was controller through April of '20, and then I was chief accounting officer from April '20 forward.
Q Okay. And you reported to Mr. Waterhouse, correct?
A Yes. Throughout.
Q Okay. Now, can you describe generally for Judge Jernigan what your duties and responsibilities were as the controller and the chief accounting officers during the relevant time?
A Sure. And I'll qualify that I had responsibilities over different departments. But as it pertains to this matter, I was the department head for corporate accounting group, so the group that does the Advisor accounting both for HCMLP as well as other call it non-fund advisor or proprietary-type entities, and oversaw a team of -- that encompassed the A/P and the general accounting function for those entities.

Q I'm going to use another term, I'll just call it "the intercompany agreements," to refer to the payroll service agreements and the shared services agreements between Highland and the Advisors. Is that okay?
A Yes, that's fine.
Q Okay. Did you personally play any role in the preparation, creation, and administration of the intercompany agreements during the relevant period?
A Yes. And even outside the relevant period, because one of the shared services agreements is long in the tooth and goes back to the 2012 time frame, and I was -- I was involved in that one as well.
Q Okay. And can you just describe generally -- well, we'll talk about the details of it. Let's take you back to December 2017, the month before the beginning of the relevant period. Do you have a recollection as to how Highland was performing on an operating basis in 2017?
A Yes. It was performing poorly. Assets were being shed. A lot of our business had been CLOs, which had been steadily declining over the years. They were past their reinvestment period, so assets declined, cash flow declined, and by that time we were cash flow negative. At HCMLP proper.
Q Okay. And did you participate in any discussions within Highland in December 2017 as to how Highland might address these operating losses?

A Yes. So we had standing weekly cash -- cash meetings between myself, the CFO, and usually Kristin would participate in those, and then we would also meet with Mr. Dondero from time to time on those cash meetings. And we did have such a meeting in December of 2017.
Q Can you describe for Judge Jernigan your recollection of the meeting that was had in December of 2017 where the issue of -- how the losses were going to be addressed?
A Absolutely. And I caution, I don't remember the specifics, the specifics in terrible detail of that meeting, but I'm certain that it was me, Frank, and Jim Dondero. And that the substance of that meeting -- again, I don't know if this was coming from Jim or from Frank and I -- was we're really bleeding cash quickly. We need more cash at Highland to operate, to pay bills, to do what we need to do, because we always operated very lean across the entire structure. And, you know, Jim, can you -- can you help with that? Help us solve this problem. And the solution that was given to us, my recollection, I think that the -- the idea was that you would just increase the shared services agreement that was already in place with NexPoint, and Mr. Dondero had this idea of bifurcating it, create a new agreement, such that NexPoint is paying Highland six in the aggregate on a prospective basis.
Q And six meaning $6 million?
A $6 million. I apologize.

Q And is your recollection that Mr. Dondero gave the instruction to increase the amount that NexPoint was paying to Highland for the services rendered, should be -- should be increased to $6 million?
A Yes. Because at the time, NexPoint was paying Highland about, annualized, $1.2 [million] per year. So this was a significant step up.
Q Okay. And did you personally do any work to try to figure out how to execute on Mr. Dondero's instruction?
A Just in the sense of -- I think I passed that off to one of the employees that worked under me to work with Legal to work through drafting of agreements to update to reflect that, that desire.
Q Okay. I'm going to ask you to turn to Exhibit 130. 1-3-0.
A Okay. I'm there.
Q And I'll just ask generally -- take a moment to look at it.
A Yep. I'm there.
Q Do you recall that in late December, early January of the relevant period, you were engaged in discussions with some of your colleagues about how to document the $6 million direction?
A Yes.
Q Okay. Directing your attention to the email that you sent

on January 4th at 3:16 p.m., which can be found on the document ending in Bates No. 47, --

A I'm there.

Q -- I see there's a chart. Can you explain to the judge what you're conveying in that chart?

A Sure. There are -- there are four agreements that are going to be put in place to get to the -- to the $6 million number in the aggregate. You see one of them, the one that's, at least on my thing, is highlighted, there's one that's an intercompany between parent and sub, NexPoint/NREA. For our purposes today, that's kind of irrelevant.

But for the other three, you have Highland HCMLP as the service provider, and you see the breakdown of those -- those three agreements between $252,000 per month for subadvisory -- sorry. $168,000 to NexPoint Advisors for shared services. And then $80,000 for -- from NexPoint to NREA for shared services.

And so the sum of those of three amounts to HCMLP, $252,000 plus $168,000 plus $80,000, equals $500,000 a month, times 12 is the $6 million number that we had talked to Jim about, you know, within a month.

Q Okay. So, as of January 4, 2018, this was the idea that you and your colleagues came up with on how to execute the $6 million directive; is that fair?

A That's -- that's -- generally. That's right.

Q Okay. I just want a stop for a second. You know, you refer in this to subadvisory, SubADV. Can you just explain to Court what your understanding is of what subadvisory services are and -- I'll just stop there.

A In the most general sense, investment advice to client funds. So, in the context of this, you have the Retail Advisors that are the named advisor, but you also have Highland people, HCMLP employees that are providing services. So this is a mechanic for those employees to give that service to the Funds, give investment advice, which is a little bit different than the shared service, which tends to be back and middle-office operational-type services.

Q Okay. Do you know if Highland provided subadvisory services to the Advisors prior to January 1, 2018?

A Yes. Not pursuant to an agreement, but the services were provided going back to -- to when those contracts were moved from Highland back in the twenty -- I want to say 2012 time frame.

Q So, for approximately six years, Highland had provided subadvisory services to the Advisors for no compensation? Do I have that right?

A That's correct.

Q Okay. Did anybody during that six-year period from Highland say, oh, gee, we should be getting paid for subadvisory services?

A No. No one said that.
Q At this time, Mr. Dondero controlled the Advisors and Highland, correct?
A That's right.
Q Why the change at this time, then? Why go, after six years of not paying for subadvisory services, to all of a sudden creating an agreement pursuant to which subadvisory services -- fees would be paid?

MR. RUKAVINA: Your Honor, object. There's a lack of foundation. He didn't sign those contracts and there's no predicate been laid as to why.

THE COURT: Response?

MR. MORRIS: The witness has already testified that he's the person -- I mean, look at his email. He's the one who's responsible for allocating money under these various agreements. I can -- I'll ask -- I'll ask a foundational question.

THE COURT: Okay. He'll ask --

BY MR. MORRIS:
Q As part of the discussions, did anybody talk about why the subadvisory agreement was going to be adopted at that moment in time?
A In a general sense, yes. It was going to be providing for the services that had already been provided, but to have Highland be able to start earning a fee for that service.

Q And was there discussion at that time that the fee that would be paid to Highland would not only give Highland access to needed capital but it would also provide a shield to the taxable income of the Advisors?

MR. RUKAVINA: Your Honor, that's leading.

THE COURT: Sus...

MR. RUKAVINA: And again, what is the -- I'm sorry. I'm sorry, Your Honor.

THE COURT: I'm going to sustain on leading.

MR. MORRIS: Okay. Fine.

BY MR. MORRIS:

Q Can you tell me what the reasons were for entering into these agreements? What were the -- what were all of the reasons that were discussed at that time?

A Yeah. The reasons I remember specifically were need for cash flow at Highland, because Highland was negative on cash flow, and need for a deduction at NexPoint, because NexPoint was generating taxable income that indirectly flowed -- flowed up to Mr. Dondero.

Q And when you wrote your email and you said that the subadvisory fee should be $252,000 a month, had you done an analysis of the actual cost to Highland of providing those services?

A No.

Q Did anybody ask you to make sure that the $252,000 was

tied to the actual cost of services being delivered?
A Not at all.
Q Was the $252,000 number that was allocated to the subadvisory agreement related in any way to the cost of providing services?
A No, just in the sense that it was a -- you know, that there was service being provided for value. But in terms of the actual number, no.
Q Did the Advisors -- do you know whether Highland went out and tried to determine what the value of their services were to make sure that they were getting fair value for the services?
A Absolutely not. It would have been a preposterous proposition to do that.
Q Was there any discussion at any time as to whether or not the Advisors should go out into the marketplace to see whether they could obtain these subadvisory services at a price less than $252,000?
A No discussion. And you have to keep it in context, because this all was a single complex. So you had people that were being used across different Advisors to support the complex's goals. And they were being used that way. And, you know, I think -- I think Mr. Dondero was generally happy with the people and the team. And so this is all behind the scenes, just transferring money between, you know, pockets

that he -- that he has.
Q Was there any discussion at that time as to whether or not Highland would make a profit off of a $252,000 subadvisory contract?
A No.
Q Was there any discussion at that time as to whether Highland should or shouldn't make a profit under the subadvisory agreement?
A No.
Q You mentioned that -- in your email that the sub -- the shared services would be at $168,000. Do I have that right?
A Correct. With respect to the NexPoint Advisors, LP agreement, --
Q Okay.
A -- yes.
Q And do you have an understanding as to whether or not that --

MR. RUKAVINA: Your Honor, again, objection. Leading. The question should be, What is your understanding, not, Do you have an understanding that--?

THE COURT: Well, I'll let him ask the whole question.

MR. RUKAVINA: But that's the problem, because then the witness will hear the question, and then my objection will be irrelevant.

MR. MORRIS: Okay.

THE COURT: I'll sustain. I'll let you rephrase the question.

MR. MORRIS: Okay.

BY MR. MORRIS:

Q Was the hundred and -- so, were these -- were these numbers -- did you intend, when you wrote these numbers, --

MR. RUKAVINA: Objection, Your Honor. Again, leading. Did you intend? It's -- the question should be, What did you intend?

MR. MORRIS: I don't --

MR. RUKAVINA: It's a leading question. Did you intend that--? The question, the question has the answer within it, Your Honor.

THE COURT: Okay.

MR. MORRIS: Mr. Klos, --

THE COURT: Sustained.

BY MR. MORRIS:

Q -- were these numbers intended to be variable?

A No.

Q And when you say that, what do you mean?

A What I mean by that is we already had the direction, $6 million was going to be the number from NexPoint Advisors, including subsidiaries, to HCMLP. So the numbers were already known. And just as I was explaining before, there's three components to it, but $252,000, $168,000, and $80,000 gets you to the $500,000 per month or $6 million per year.

Q And was the $168,000 for shared services by NexPoint, was that a change in the methodology by which the fee would be calculated?

A Yes. Yeah. Yeah, it was a change.

Q Can you get -- please turn to Exhibit 29?

A Okay. I'm there.

MR. MORRIS: All right. Let me know when you have that, Your Honor.

THE COURT: Uh-huh.

BY MR. MORRIS:

Q Okay. Do you know what that document is, Mr. Klos?

A I do. This appears to be the original shared services agreement between Highland Capital Management, LP and NexPoint Advisors that went all the way back to 2013. So this was the predecessor for the 2018 amendment.

Q And can you turn to Page 4, Section 4.01?

A Okay. I'm there.

Q Do you have an understanding as to how NexPoint paid Highland for shared services prior to January 1, 2018 under this provision?

A Yes. It was all -- it was all pursuant to 4.01(c) that has a little bit of a long, convoluted discussion, but at the end of the day, just boiling it down, what this -- what this section means is that Highland was going to be charging NexPoint Advisors 10 basis points on assets managed by the -- I think it was NHF at the time, NexPoint Strategies Fund, and it was going to be charging 15 basis points on basically all other assets of that fund, and that that was going to be -- that was, I think it's a defined term, that was actual cost, notwithstanding that that concept is completely divorced from cost.

Q And how is the issue of actual cost completely divorced from cost?

A Because the charge itself was being generated off of the assets managed by a single fund, and that -- I don't know how else to say it other than that has -- that has nothing to do with cost.

Q Okay.

A What it does have to do with was that that was a charge -- that was a fund that charged 120 basis points, so NexPoint was earning 120 basis points and it was paying some blend of 10 to 15, so it was pocketing 90 percent of the revenue.

Q And can you explain to the judge why the change was made from a formula depending on asset values to a fixed fee of $168,000 a month?

A Yeah.

MR. RUKAVINA: Your Honor, objection, based on foundation.

MR. MORRIS: Your Honor, he has testified to everything already.

MR. RUKAVINA: No, he hasn't, Your Honor. He hasn't testified that he knows why this change was made or that anyone told him why this change was made or that he made this change. He's speculating.

THE COURT: I overrule the objection.

THE WITNESS: So, the reason to switch it to fixed is, again, you already know the answer, so the answer is $6 million, the answer -- the split is going to be roughly 50/50. It's a little bit -- it's a little bit weighted to the -- to the subadvisory. Why are you introducing any variability when you already know the answer?

BY MR. MORRIS:

Q Okay. And the answer here was what?

A The answer here was $168,00 with respect to NexPoint Advisors, $80,000 with respect to NexPoint Real Estate Advisors. And then, like I said, on the subadvisory, $252,000.

Q Okay. Can you turn to Exhibit 3, please? And can you describe for the Court your understanding of what that document is?

A Exhibit 3, you said?

Q Yes.

A Ah. So this, this is the amended and restated agreement

for NexPoint Advisors.
Q Okay.
A So this, this is the agreement that updates to the fixed $168,000.
Q Okay. And if you can turn to last page, the one ending at Bates No. 647. Are you familiar with those signatures?
A Yes, I am.
Q And what's your understanding of who signed this contract?
A So, this contract was by Frank Waterhouse.
Q Okay. And when was this contract effective?
A This was effective January 1st of 2018. I believe it was executed in the early part, around -- on or around January 11th, my recollection.
Q Okay. Can you turn to Page 9, please?
A I'm there.
Q In Section 3.01, is that the section that sets forth the provision for compensating Highland for shared services by NexPoint?
A I'm sorry. What's the exhibit again?
Q It's Exhibit 3, Page 9.
A Oh. I'm sorry. I went to Exhibit 9.
Q I may have -- I may have misspoken.
A Exhibit 3, Page 9?
Q Right.
A Okay. Okay. I'm there.

Q And can you describe for the Court your understanding of what Section 3.01 provides?

A Yes. It's providing for what I was -- what I was just explaining, which is the flat fee of $168,000 per month.

Q So, did this agreement put into practice what was in your email?

A Yes.

Q Okay. Did you personally, as the controller of Highland at the time, did you have any view as to whether or not $6 million was the right number of compensation for subadvisory and shared services by NexPoint?

A I don't know that I had a view on that that was the right number, but it was certainly a number in the right direction, because the previous charges, like -- as you mentioned earlier, there were no previous charges for any of the front office services, and the back office services were locking in a 90 percent profitability. So it was -- it was a step in the right direction. Hard to say if that was the perfect number, but a stopped clock tells the right time twice a day, so at some point maybe.

Q Did you personally do any analysis in late 2017 or early 2018 to determine whether $6 million was fair value for the subadvisory services and shared services that Highland was providing?

A No.

Q Are you aware of anybody doing any such analysis?
A No.
Q Did you do any analysis to assess on a holistic basis whether Highland was going to make a profit off of the $6 million for shared and subadvisory services?
A In a way. Maybe not directly, but, you know, around that same time we were preparing our annual presentation for Jim, so we had a sense of what the Advisors were -- where they were shaking out in the future.
Q Okay. We'll look at that in a moment. On your email, there was the $80,000 for NREA. Do I have that right?
A Yes.
Q Can you just explain to the Court what that referred to and why that was part of your email?
A Yes. So, NREA, NexPoint Real Estate Advisors, LP, is a wholly-owned subsidiary of NexPoint Advisors. At the time, I believe it just had a single entity that it provided services for, which was a public REIT with a ticker NXRT. And so there were services being provided by Highland people to that advisor to basically keep that REIT functioning.
Q Okay. You just mentioned an annual review. Did you participate in an annual review?
A Yes.
Q And can you describe for the Court the process of the annual review?

A Yes. So, going back to I want to say 2013, myself and Frank would generally meet with Mr. Dondero and Mr. Okada at the end of the -- at the beginning of the year. And, really, the purpose of that agreement, or that meeting, was to sit down, review the year that we just had, what happened, who came, who went, what were our wins, what were our losses, and then -- and then talk about the year to come, how we're projecting what's on the horizon, and then also, you know, we had -- our bonus process culminated at the end of February, so this was a good opportunity to start getting initial feedback from Jim on where he saw the compensation pool for that coming year. And this was a good way to wrap that all together, try to be objective, and give him the data to kind of do his own evaluation of what kind of a year we just had.

Q Okay. In connection with the annual review, did you prepare written information?

A Yes.

Q Can you describe for Judge Jernigan what information you prepared and how you went about preparing it?

A Yes. So, the information, my recollection, it was usually like a 40 to -- 40- to 60-page type presentation, a slide deck. And it would include financials from the previous year, a section on HR, a section on forward-looking projections, a section on fund performance across the platform, and probably a few other things that I'm forgetting up here.

Q And did you obtain information from other areas of the enterprise?
A Yes. So that was a -- it was a collaborative process. I would work on it, I would delegate some parts of it to my team, and then also go to other departments for some of the information as well.
Q Would Mr. Waterhouse have an opportunity to review the deck before it was presented to Mr. Okada and Mr. Dondero?
A Yes. Absolutely. We would meet on it ahead of time, he would provide comments, and we would -- I would work through incorporating those comments.
Q So do you recall preparing a deck for the review of 2017 and for the outlook of 2018?
A Yes.
Q Okay. Let's take a look at Exhibit 86, please.
A Okay.
Q Do you know what this is?
A Yes. This is -- these are materials I was just referring to.
Q And do you recall meeting -- having the annual review meeting on or around January 26, 2018?
A Yes. Right around that time.
Q And can you describe for the Court just the setting that you recall about this meeting?
A Yes. This was always an in-person meeting, so this would

have been in Jim's adjacent conference room, with, again, me, Frank, Jim, Mark. I can't remember, it's possible that Sean Fox might have sat in, but I don't remember specifically.

Q Okay. Let's just take a look at some of the information in here. If we can turn to the second page, the executive summary.

A Okay. I'm there.

Q Do you see there's a bullet point that begins, The platform will continue experiencing operating cash shortfalls?

A Yes. I see that.

Q Can you just tell the judge what that and the bullet point underneath were intended to convey?

A Yes. So, by cash shortfalls, hopefully self-explanatory. On an operating basis, we're burning cash. And what the sub-bullet is saying is that overall operating income -- and by that I mean operating income across all of the affiliate Advisors -- is projected at, you know, positive $.9 million. But on a standalone basis for HCMLP, it's negative 12.

Q Uh, --

A And I -- if I can add one more thing. The clause at the end there is just -- is -- this is -- this is kind of a tickler for Jim to remind him you have substantial other investment commitments. You're invested in private equity funds that call capital. So Highland is losing 12, but then you're also going to need to generate more cash to fund those

commitments as well.
Q Can you turn to Slide 6 in this deck, the one with Bates No. 308?
A I'm there.
Q Can you describe for the Court what this shows? Just generally?
A Yes. So this is a balance sheet, so it's a point-in-time look at the assets and liabilities of -- we're saying consolidated, meaning Highland -- it's in the -- it's contained in the Footnote 1. Highland, Highland Capital Management Fund Advisors, NexPoint, including its subsidiaries, Acis Capital Management, and then three other kind of rounding error-type Advisors: Falcon, Granite Bay, and Highland Healthcare Advisors.
Q And was it the practice in Highland at this time to look at the enterprise from a holistic point of view?
A Absolutely.
Q Okay. And if we could just flip some of the pages here, would the same holistic enterprise view be reflected on Slide 11 and being in Bates No. 313?
A Let me just make sure I'm on the right slide. The -- it has Consolidated P&L --
Q Yes.
A -- with a footnote? Yes. That's correct. Same -- same view. Same entities incorporated.

Q Meaning -- does that mean that the view on this slide was looking at the profits and loss for the Highland enterprise at a whole -- as a whole, without regard to its component pieces?
A Correct. And along those same lines, all -- it's part of the reason we refer to them as intercompany. They're all intercompany, so they all just eliminate. So that activity isn't even shown on here because it all cancels each other out.
Q All right. We'll talk about that more in a moment. And the same would be true of Slides -- tell me if it's different or if you can confirm that the following slides are also presented on a consolidated basis: Slide 13, 14, 15, 16, 17, 18?
A Um, yes, yes to all, although I'm not sure on 18, if you'd just bear with me for a moment.
Q Uh-huh.
(Pause.)
A It -- it appears 18 is consolidated, but I'm not a hundred percent sure. I'm 90 percent sure.
Q Okay. Can you go to Slide 29, please? Can you describe for the Court what Slides 29 to 30 -- through 33 convey, what type of information?
A Yes. So this was what I was referring to in terms of some of the -- a refresh on what happened over the course of the year. So, hey, Jim, here's -- here's what happened over the

course of the year from an HR perspective. Here are people that transferred roles. Here are people that were promoted during the year. Here's a view on headcount. I'm flipping from Slide 29 to Slide 30.

31, here's a summary of all the people we hired over the year. And, again, this is agnostic as to Highland Capital Management versus the other Advisors. This is looking at it all holistically. Although it is subdividing between our broker-dealer and everybody else, so I should -- I should point that out.

And then Slide 32, 2017 Terminations. Here's a summary of all the people that terminated over the course of the year.

Q Did Brian Collins participate in these meetings at all?

A He didn't participate in the meetings, but he would help on some of the document-gathering and helping me validate the accuracy.

Q Okay. Let's go to Slide 34, please. The first bullet point is about CLOs. Can you explain to the Court what you were conveying in the first bullet point about Acis CLOs?

A Yes. So what's being conveyed here was the current thinking at the time, which was that the likely outcome for the Acis CLOs -- and just for additional background, the Acis CLOs were CLOs managed by Acis Capital Management that were subadvised and shared services provided by HCMLP. And so what this bullet is saying is we expect that 3 through 6 are going

to reset, they're going to reset under Highland, and -- directly or indirectly, and the reinvestment period and maturity is going to shift out by two and a quarter years.
Q Do you know if the expected reset was intended to have any implications for the shared services and subadvisory arrangement?
A Up until the reset, the assumption was that Highland would continue earning subadvisory and shared services, then post-reset it would be -- I don't frankly recall if it was direct or if it was indirect, but effectively Highland was going to retain the management fees on a go forward basis.
And I should point out, there is a second bullet here that's talking about new issuance. So it's assuming that CLOs continue to be churned out over the next several years and that -- and that all that AUM goes to HCMLP.
Q Okay. Can you go to the next slide, please? Can you describe generally what Slide 34 depicts? 35 depicts?
A Yes. I can. One moment. Yeah. So, 35 is depicting the revenue that's coming in from all the various funds. Again, this is Highland as well as the affiliate Advisors. And it's just breaking it out by either fund or it's lumping the 2.0 and the 1.0 CLOs together to give you a picture of where's all the revenue coming in from the complex from all these different sources.
Q And what is the second rank, the Highland 2.0 CLOs? Do

you know what that's referring to?
A Yes. That's referring to the Acis deals that were assumed to be up for reset, 2.0 meaning the post -- post prices.
Q So am I reading this correctly that the Acis CLOs were expected to generate fees for Highland in 2018 of approximately $9.7 million?
A Yeah, in that ballpark.
Q Okay.
A That's the projection.
Q And was that projected to be approximately 12 percent of Highland's entire revenue in 2018?
A The royal Highland. Not HCMLP, but the overall complex, yes.
Q Okay. As part of this presentation, did you and your team present forecasts?
A We did.
Q Okay. And are those forecasts in this deck?
A They are.
Q Okay. Let's go to Slide 36. That's entitled Assumptions in the Forecast. Can you just describe for the Court what assumptions are listed in the first piece concerning material intercompany arrangements?
A Yes. So, the first piece on intercompany is describing the HCMFA, NexPoint, and Acis relationships, and it's saying that at this time we're projecting -- or, we're assuming for

purposes of the forecast that HCMFA will pay 2.7 to Highland. NexPoint and subsidiaries will pay 6. That's the same 6 that we've already spent some time on. And then the third bullet point being Acis, saying that it'll continue to pay the then-rates in effect of 20 basis points subadvisory, 15 shared services. And then the Up to Reset is an allusion to the fact that once they reset it'll just -- it'll be to Highland and that mechanism goes away.

Q Okay. Let's go to Slide 44, please. Can you describe for the Court what Slide 44 is?

A Slide 44, it's looking at a three-year forward forecast for HCMLP. This is just HCMLP. Excuse me. So this is a single -- a single entity view. And so, as a result, you do have -- you have the intercompany agreements that are picked up in this agreement. And the total operating income number of 12 is -- is the very same that we were looking at on the executive summary.

Q And I see in 2019 the operating income is supposed to go -- projected to go from negative 12 to positive 46. Do I have that right?

A Yes.

Q And do you have an understanding as to what the cause of that $58 million flip is?

A Yes. So it's primarily driven by the lines, the second line called Incentive Fees.

Q Uh-huh.
A And what we were using in this forecast -- again, it's just a forecast, you know, it's -- it's never going to be exactly right -- but this was assuming a monetization of MGM that would trigger a large fee in 2019. Obviously, that didn't happen, but that was what was assumed in the projections.
Q And if you remove that assumption, where does that -- where does that leave Highland on a projected operating income basis for 2019?
A It would be -- it would be a dollar-for-dollar reduction, so you'd just take the 45,919 of operating less the 55,298.
Q Okay.
A So, call it -- call it 10 negative. I'm not going to do the math.
Q And these -- withdrawn. Does the 2018 projection of $12 million loss, does that take into account the $6 million, --
A It -- it does.
Q -- or it does not?
A It does. It takes into account the $6 million from NexPoint. It -- those -- that amount is a component part of the line that says Shared Services & Subadvisory Fee. So it's 6 of the 10.
Q So is my math right that if the amount hadn't been increased from, let's say, 1.5 to 6, then the $12 million loss

would have been increased --
A Be close to 17.
Q -- by 4-1/2?
A Yeah. Yes. Call it 16, 17.
Q Okay. Let's go to the next slide, please, which is Slide 45. What's being depicted there?
A So, again, this is a -- going to a standalone view, so Highland Capital Management Fund Advisors standalone. And it -- it looks like this is also consolidating the broker-dealer that sits under it. But that's somewhat irrelevant. But it's depicting a three-year forecast for HCMFA. Again, '18, '19, '20. And it's got a line item for shared services expenses, which I believe is a reference to HCMLP, at least 2.7 of it, if not the full 2.8.
Q And there's a reference there to subadvisor fees, do you see that, for several hundred thousand dollars?
A I do.
Q Does that relates the Highland or to somebody else?
A No, no, that relates to -- there was a subgroup of -- I think there was around three at the time -- of funds that were subadvised by an actual -- an actual outside subadvisor. And so those are -- those are fees to that outside subadvisor, not fees to Highland.
Q As of the date of this deck, January 26, 2018, was HCMFA projected to pay any subadvisory fees to Highland?

A No.
Q Let's go to Slide 46, please.
A Okay. I'm there.
Q Is this just the same three-year P&L for, this time, NexPoint?
A Yeah.
Q Okay. And focusing your attention to the lines Subadvisor Fees and Shared Service Expenses, can you describe for the Court what those line items reflect?
A Yes. Those are reflecting amounts to HCMLP for subadvisory and shared services. And we've spent a lot of time talking about $6 million, but this is the $6 million. $3,024,000 plus $2,976,000. There's the six. So that's what's being assumed as far as the intercompany.
Q And do you recall that the subadvisory agreement was already in place at the time of this meeting?
A Yes. Yeah, it was.
Q Okay. And let's just -- let's just take a look at Exhibit 130 quickly.
A Okay. I'm there.
Q Do you know what that is?
A 130. This looks to be a continuation of the chain that we were discussing earlier, going back and forth with the internal attorneys on having these agreements executed in the very early part of January and then culminating with the

actual execution of those agreements, it looks like, on January 11th of '18.
Q And are you specifically referring to Mr. Fox's email as of January 11th, the very last email in the chain, looking in reverse order?
A Yes.
Q Okay.
A That's right.
Q Okay. So let's talk about the subadvisory agreement for just a moment, if you can turn to Exhibit 5.
A Okay. I'm there.
Q And if you can -- if you can, just tell the Court what your -- do you have an understanding of what that document is?
A Yes. This is the subadvisory agreement between NexPoint Advisors, LP and Highland Capital Management, LP.
Q And can you turn to the page that ends in Bates No. 580?
A I'm there.
Q And do you -- are you familiar with the signatures on that page?
A Yes. It's Frank's. Frank Waterhouse.
Q Okay. And can you go back to the first page of the document and let the Court know if you have an understanding as to when this subadvisory agreement became effective?
A It became effective January 1st of 2018. But, as discussed, it was -- it was executed, you know, a little -- a

little less than two weeks later, but to be effective January 1st of '18.
Q Okay. And if you can turn, please, to Section 2 on the page ending in Bates No. 570.
A I'm there.
Q And can you explain to the Court what Section 2 provides?
A So, Section 2(a) provides for a monthly fee in the amount of $252,000.
Q And is that fee variable or fixed?
A No, it's fixed. It's just $252,000 a month.
Q And is that -- do you recall if that's consistent with the number that was in your earlier email at Exhibit 130?
A I don't remember the exhibit number, but yes, it's consistent with the email.
Q Okay. Is it fair to say that this agreement is another agreement intended to execute on the direction that you received from Mr. Dondero?
A Absolutely.
Q Is there anything in the subadvisory agreement that's before you that concerns or relates to Highland's actual cost of providing subadvisory services?
A No.
Q Do you recall anyone ever suggesting in late 2017 or early 2018 that NexPoint should only pay its allocable share of actual costs for subadvisory services?

A No. Nobody said that.
Q Okay. So the meeting takes place on or around January 26th. Does anything happen to upset the projections or any of the information that you had just conveyed to Mr. Dondero and Mr. Okada?
A Yes. So, contemporaneous, within days of that, of that presentation, Acis is put into an involuntary by Mr. Terry. And so this is -- at best case, we understood that a critical fee stream was going to be tied up a while. And worst case, it might be -- it might be gone forever. And so definitely an important moment, and a big change relative to the projections, because, as you pointed out, there was a $10 million assumption in there that, like I said, at least temporarily is going poof, if not forever going poof.
Q And did you personally participate in discussions about how to address that development?
A Yes. So, you know, this wasn't a mystery to anybody, that Acis had just been put into involuntary, so by the beginning part of March we met again with Jim. Kind of a similar conversation to the December 2017 conversation of we're not going to get any Acis fees for a while, if not forever. We need help to operate. What do you want, you know, what -- what do you want to do?

And the response was, well, just do the same thing that you guys just did for NexPoint. Put in place a subadvisory agreement and -- and that's the -- it's not the solution because it doesn't -- it doesn't completely cushion the fall, but it at least mitigates the -- some of the loss that we would be experiencing.

Q And did you personally participate in the conversation and the follow-up to that meeting?

A Yes.

Q Okay. And do you recall whether a subadvisory agreement was created for HCMFA?

A It wasn't ultimately, no.

Q Okay. Let's turn to Exhibit 87. And I apologize. Before you look at that, when you say it wasn't, do you mean it wasn't drafted, or it was never executed?

A It --

Q If you recall.

A It was -- I don't remember if it was drafted. What I recall was that there was communication with in-house counsel to draft it and there were -- there were concerns expressed about whether that agreement would -- would work, for lack of a better term.

Q Okay. Do you recall how much was initially discussed that HCMFA would pay for subadvisory services?

A It was around $5 million. I have a recollection of exactly $5 million, but I have seen other emails that refer to $450,000 a month, which annualizes to a little bit more than

5, around 5.4. But the number that I remember was 5, which was the -- $5 million, which was the number that was ultimately landed on.

Q Okay. Did there come a time after this discussion with Mr. Dondero about duplicating that NexPoint subadvisory agreement for HCMFA, did there come a time when you learned that that wasn't a viable option?

A Yes. It was -- it was sometime in the late March, early April time frame. And the thinking going into that was this shouldn't be a very difficult exercise, you've already got a template, it's going to look exactly the same save for the number on the page. So the expectation was that that would be a pretty quick and easy process to get documented through Legal. But, you know, when concerns were raised, obviously, we had to pivot.

Q And do you recall what those concerns were?

A Yeah. So the concerns as I understood them were that our internal legal team, mainly Lauren Thedford, who is a -- she's an HCMLP employee and an officer of the Advisors, and the Funds, I believe. But she, she highlighted a potential issue that because it's -- it's subadvisory, that it would -- the only way to have an agreement like that ratified was going to be to go to the board in an in-person meeting. The next such meeting was going to be in June, later that year. And that -- and that it couldn't be made retroactive. It had to only be prospective.

Q And just take a look at Exhibit 87 now. Does that -- does that comport with the recollection you just described for the Court?

A I'm sorry. 87?

Q Yes.

A Okay. Ah, yes. Yes, it does. I was looking at the older part of the chain. But, yes, this is the email from Lauren saying that it's in person, it can't be made retroactive. So that's, you know, that's the problem.

And another problem is that it also means that the NexPoint agreement that was already in place doesn't work and that needs to be -- that needs to be fixed as well.

Q And what's the implications of being unable to use the subadvisory agreements under those circumstances?

A So, without being able to go back, you're talking about $5 million with respect to HCMFA and $3 million with respect to NexPoint. And the earliest you're going to be able to implement that is the middle part of the year. So, call it $8 million times 50 percent is the -- is the implication there.

Q And you're getting those numbers by -- how are you getting those?

A Yeah. Sorry.

Q Yeah. It's a little shorthand.

A The $252,000 annualizes to $3,024,000. The $416,000 for

HCMFA annualizes to $4,994,000. So the sum of those two is approximately $8 million per year. Fifty percent of the year is $4 million.

Q Had -- was there any discussion prior to Ms. Thedford sending her mail on March 15th, had there been any discussion of using a model for the payment of subadvisory fees other than the subadvisory agreements that had been drafted?

A No, not that I can remember.

Q Had anybody expressed any concern prior to March 15th that the Advisors should be paying fees based on actual costs?

A No.

Q Had anybody done an analysis before March 15th about what the cost was to Highland for providing subadvisory services to the Advisors?

A No.

Q Okay. After getting this news from Ms. Thedford, what happened?

A Um, definitely a reaction. This is -- this is a problem. That as we just looked at, we're already operating quite negatively. We're no longer getting a fee stream from Acis. We're being told that we're not going to be able to start getting a fee stream from these other Advisors for several months, at the cost of millions more dollars. So this needs to be addressed.

Again, this is all in the spirit of one big happy family, one complex, so the whole exercise itself seems somewhat silly, for someone who just wants to move money from his right pocket to his left pocket, to have to go through all this brain damage, but we need to go through the brain damage to get this done.

Q And did you see a draft of a payroll reimbursement agreement after March 15th?

A Yes. I think towards the end of April, to the best of my recollection.

Q And did you participate in discussions with Ms. Thedford about the terms and provisions of the draft agreement that you saw?

A Yes, I did.

Q And did you communicate with Ms. Thedford in writing about -- about that draft agreement that you saw?

A I did.

Q Okay. Can we turn to Exhibit 129, please? And I'm going to start at the beginning, which is at the page with Bates No. 425. Did -- do you recall in mid-April that Mr. Fox sent you a draft of the payroll reimbursement agreement?

A Yes.

Q And can you review and then describe for the Court what you told Ms. Thedford after you obtained a copy of the initial draft of the payroll reimbursement agreement?

A Yes. So I think, similar to NexPoint, I had tasked Sean with running it down through Legal. It looks like Sean was on vacation, so he passed it along to me to review as well. And my -- from email and from my recollection, recall the way that the agreement was stated being very clunky, because we don't have a way to actually track actual costs in any sort of scientific way.

And so I make the suggestion to Lauren that -- and it's kind of a parenthetical; it's not necessarily apparent in the email -- but can we just do this once? Can we do an estimate of cost as of some point in time, done in good faith, you know, with a reasonable estimate, and not have to do it ever again?

Because, again, there's not a way to really validate any of the assumptions in such an analysis, and all it's going to be doing is churning up a lot of work for people to do internally to track amounts that ultimately benefit Jim. It's just not a -- it's not a useful -- it's not a good use of time.

Q And is that essentially what you're -- is that a fair description of what you're saying to Ms. Thedford at 10:48 a.m. on April 17th?

A Yeah. That's exactly right. Too much subject -- too much subjectivity. Too much time involved. We already know what the number is going to be. So this is creating a lot of unnecessary scrambling around.

Q And what did -- do you recall or can you read what Ms. Thedford said in response?
A So, she responds, she says she's open to changing the definition. There needs to be some method of determining amounts. To which I say, can we -- can we set it out as of the beginning of the agreement, have a schedule, never update that schedule unless -- with the only update ever being if the -- if the parties come to a consensus and want to change it at some point in the future.
Q And is it your understanding that that's what became the actual agreement that was signed?
A Yes.
Q And did you subsequently perform the -- create the numbers that are reflected in the email above on Pages 423 and the top of 424?
A I did.
Q Okay. Why did you create that?
A Well, you know, per the -- per the email chain, that was going to check the box for what we needed to check the box. So we were -- we were going to have a schedule that had percentages set out. And, you know, I was able to, you know, work through a spreadsheet and put percentages in that ended up resulting in the $252,000 a month number for NexPoint and the $416,000 a month number for FA.
Q Okay.

A HCMFA.
Q And when you are having these -- did you speak with Ms. Thedford beyond the emails, or does the emails --
MR. MORRIS: God bless you, Your Honor.
BY MR. MORRIS:
Q Or do the emails reflect the entirety of your communications?
A I think they reflect the substance of it. There may have been some -- some additional -- some minor additional discussion. I don't remember specifically.
Q And are these, are these allocations -- can I call these allocations? Is that fair?
A That's okay.
Q Okay. Are the allocations on this email the allocations that were ultimately adopted in what became Exhibit As to the two --
A Yes.
Q -- payroll reimbursement agreements?
A Yes.
Q Did anybody change it?
A No.
Q Did anybody ask you how you calculated the numbers?
A No.
Q Did anybody ask to see your work?
A No.

Q Did anybody suggest that maybe these allocations weren't right?
A No.
Q Did anybody -- did you have any discussion with anybody at any time as to how you came to these numbers?
A Not that I remember.
Q In this time period?
A No, not that I can remember.
Q Okay. At the top of Page 423, which is really the beginning of your email that contains the allocations, there's -- can you just read out loud what that sentence says or what those two sentences say?
A I'm sorry. It's this that starts, Here are the listings?
Q Yes.
A Yes. It says, Here are the listings for the reimbursement agreements. Monthly amounts should be $416,000 for HCMFA and $252,000 for NPA.
Q And how did you come up with those numbers?
A So, these were already-known numbers. The $252,000 in respect of NPA, consistent with what we had talked about for the past several months and what was already in effect via the subadvisory agreement, and then the $416,000 based on further conversation in the March time period where he was comfortable to do a $5 million a year run rate payment from FA.
Q So the $252,000 is the same $252,000 that was in your

December email, in the January deck, in the subadvisory agreement, --
A Yes.
Q -- and now it's still there?
A Yes. Of course.
Q The allocations there, what information did you rely on to create those allocations?
A So, I relied on compensation information for the -- for the list of employees. And then the, in terms of the percentages, it was at the time, I believe, based in part for some people on AUM across the platform, and then for some other people it was just -- basically, just subjective percentages based on my general understanding of what those people tended to work on.
Q Did you -- did you speak to any of the dual employees to see if those allocations were accurate from their perspective?
A No.
Q Did you have any records that you could rely upon to confirm your subjective assessments?
A No. There were no such records.
Q If we wanted to know today how much time each dual employee spent working on matters for the Advisors, how would we create such an analysis?
A There's not a -- there's not a good way to do it.
Q Is there -- is there any way to do it?

A No. Not -- not any -- not any good way. The reason I'm hedging a little bit is, if it was important enough, you could talk to every single employee, ask them how they think they spend their time. And then even that's flawed, because people's compensation isn't necessarily tied to how they were -- to how much time they spend on something. They could have spent a little time on something, had a great return, got paid a huge bonus, and it has nothing to do with time.

So no matter how you do it, it's going to be incredibly subjective and really fatally flawed.

Q Is this fatally flawed?

A It's -- it's maybe flawed -- it's flawed from the standpoint that it has all those subjective assumptions baked into it. It's not fatally flawed from the standpoint that there's a -- there was a general effort to assess where people were likely spending their time.

Q Were investment professionals ever asked to keep time entries so that actual costs could be accurately calculated?

A No.

Q Did you ever update Exhibit -- withdrawn. So I think you've testified, these -- this analysis became the Exhibit As. Do I have that right?

A Yes, that's right.

Q Okay. Did you ever update Exhibit A at any time from the date of this email until today?

A No.
Q Did anyone ever ask you or instruct you to update Exhibit A from the time you sent this email to today?
A No.
Q Are you aware of anybody at Highland or the Advisors ever making any effort --
A If I could take a step back, there was -- there was a request from Lauren in the early 2020 time range. So I should be fair, she did ask the question, and I basically pushed back and said that's a ridiculous exercise, we should do it a different way.
Q Okay.
A I didn't really take that as a request to update it, but she was -- she was implicitly asking for that information, --
Q All right.
A -- so I should qualify that.
Q We'll take a look at that. You're aware that a number of investment professionals, these dual employees, were terminated even at the time you wrote this email, right?
A Yes. Yes.
Q Why would you include dual employees in this analysis if they'd already been terminated?
A So, I'm not sure if it's in this email chain, but as I mentioned in one of the email chains, we were going to be doing a roster as of a specific point in time, that time being

the effective date of the agreement, or January 1st.
Q And I think, just to be clear, if you can look back at your April 17 email sent at 10:56 a.m., is that the one you're referring to?
A 10:56? Yes. That's -- that's exactly right. That's the one.
Q And can you just explain to the judge what you're telling Ms. Thedford in that email?
A Yes. So I'm really laying out what would ultimately be the agreement, which is that we're going to have a schedule, it's going to be as of January 1st, it's going to have the roster that was in place at that time, and that's -- that's where the schedule's going to originate, and we'll -- we're -- we're not planning to update. We're only going to perform this exercise once.
Q Okay. Did anyone express any concern to you that you were using a -- you were setting the costs of subadvisory services based on employees that were known to have already been terminated?
A No. No concern.
Q Did that ever come up before December 2020?
A I don't know if I would go so far as December. Certainly, by summer of 2020, no one had ever brought it up.
Q Okay. During the two-year period that Mr. Dondero was in control of Highland and the Advisors, did anybody ever ask you

if that number should be adjusted to take into account terminated dual employees?
A No.
Q Okay. Do you recall that, after the payroll reimbursement agreements are entered into, that dual employees continue to be terminated throughout 2018?
A Yes.
Q And do you have a recollection to the magnitude of the dual employees on the Exhibit As that were terminated as of December 2018?
A Yes. It was -- it was around ten, nine or ten.
Q Okay. Can we just take a quick look at Exhibit 14, please?
A 14?
Q And I'll represent to you that these are the Advisors' responses to interrogatories. If you could turn to Page 12 of 18.
A Okay. I'm there.
Q Okay. Do you recall that this list of people here that continues to the top of the next page, that's the list of -- is that the list of dual employees?
A It appears to be. I can't quickly reconcile it, but it looks to be the same list.
Q Okay. And do you have any reason to doubt the dates of termination set forth in the Advisors' response to

Interrogatory No. 3?
A No, no reason to doubt any of those.
Q Okay. And if you can turn the page to Interrogatory No. 4, do you see the Advisors stated that they were, quote, generally aware of the employees' terminations and departures as they occurred?
A Yes.
Q And is that consistent with your understanding of how information was shared and conveyed within Highland?
A Yes. Absolutely. Both informally and formally. Informally, you had everyone sharing the same office space, sitting next to each other. More formally, there were -- there were things like monthly reports that would go out, again, agnostic as to HCMLP versus NexPoint or others, just looking at it all as a complex, that would be distributed pretty broadly to -- to, you know, among others, officers of HCMFA and NexPoint, but also including a pretty wide swath of the rest of the overall complex for multiple different entities.
Q Okay. So do you recall that in December 2018 the payroll reimbursement agreements that had just been signed the prior May were amended?
A Yes.
Q Okay. Did you participate in discussions concerning those amendments?

A Yes.

Q Can you describe for the Court what you recall about the discussions that led to the execution of the December 2018 amendments?

A Yes. I remember a meeting early December of 2018, early/mid-December, I can't remember the specific date, with -- with Jim and Frank. I don't believe anyone else was in that meeting. And part of the concern expressed in that meeting was that NexPoint in particular, but both Advisors, but particularly NexPoint, taxable income was -- was looking like it was running a little too hot for 2018. Too hot as in too high, so too much tax liability. And, you know, should there be -- what can be -- what can be done over the course of the next several weeks to generate taxable deductions for those Advisors?

Q And what was the solution?

A So, the solution was to amend the two payroll reimbursement agreements. I don't think we got into that level of detail in the meeting with Jim, but when we -- we took that away and worked with internal Legal, the amendment that was ultimately produced was just an amendment to add an additional amount for both of the Advisors in the sum of 2.5 in the aggregate. And the split amount was 1.3 and 1.2 to the two respective Advisors. I can't remember which one was 1.3 and which one was 1.2.

Q Okay. Let's take a look at Exhibit 7, please. Can you tell the Court what that is?

A Yes, it's the amendment itself. And I can clarify that the 1.3 was for NexPoint Advisors, the 1.3 of additional annual costs as it's defined in the amendment. And that tells me that the identical agreement for Fund Advisors was also put in place except with the amount being 1.2 even.

Q Okay. Did you update Exhibit A before executing -- before Mr. Waterhouse executed this document?

A No.

Q Do you know if anyone took any steps to try to determine HCMLP's actual costs of providing front office services before signing this?

A No.

Q Did you do a true up?

A No.

Q Did you ever do a true up in your life?

A I suppose I've done true ups, but not as it pertains to this agreement. This was -- this was a mechanism to send another $2-1/2 million of cash --

Q Did you --

A -- from these Advisors.

Q Did you tell Dustin Norris at any time that the amounts set forth in the amendments were the result of a true up?

A Not that I remember. I'm sure I told him that there was an end-of-the-year amendment, so it's possible that he mistook me or misunderstood. But no, never a true up. This was an end-of-the-year amendment.

Q Do you know whether the $2.5 million, or the amount that each of the Advisors paid, was that in any way based on any assessment of actual costs?

A No. (Pause.) If I can -- the answer is no, but if I can expand on that. There wasn't an analysis done. However, we had a current view of who's making money and who's not making money. And the reality is that, at this point in time, much of the revenue at Highland Capital Management, LP is coming from these intercompany agreements. Highland Capital Management, LP is losing money hand over fist. The other Advisors are making money.

So that's not an analysis, obviously, that 2.5 is the right number, but it tells you that it's directionally right, because these are effectively the same people doing the same type of business for the same types of client, earning a fee. In what -- on what planet does one of those operate at a massive operating loss while the other two operate really strongly?

Q Did anybody suggest that it was terribly unfair that Highland was performing these services at an operating loss?

A I don't -- no. I don't remember anyone saying that.

Q Was there any guarantee in any agreement that you're aware

of that prevented Highland from incurring operating losses through the performance of these intercompany agreements?
A No.
Q By the time Highland filed for bankruptcy in October of 2019, more investment professionals or dual employees had been terminated, correct?
A Yes. A handful. Maybe four or five.
Q And do you --
A In that area.
Q Do you have a recollection as to how many of the dual employees, roughly how many of the dual employees had been terminated in the 21-month period between January of 2018 and the end of September 2019, just prior to the petition date?
A It was -- it was on the magnitude of half.
Q So roughly half of the dual employees were already gone? During that period, did anyone request an analysis of actual costs?
A This is around the time of the petition date?
Q Yep.
A Um, --
Q Up to the petition date.
A Up to the petition date? No.
Q Okay. Up to the petition date, did anyone request that Exhibit A be updated?
A No.

Q Up to the petition date, did anybody ever suggest that the Advisors should only be paying the actual costs under the payroll reimbursement agreement?

A No, other than the amounts were fixed per the agreement, so that what's had been paid all along.

Q In fact, do you recall if, during this two-year period when Mr. Dondero was in control, the Advisors made monthly payments under the PRAs that differed in any way from the initial amounts set forth in those agreements?

A No. They paid exactly the amounts, those amounts each month.

The one caveat on that is, because it was executed a few months in arrears, I think there was some sort of a catch-up. But notwithstanding that initial catch-up, it was exactly the same amount per the agreements every single month.

Q And did that practice continue after the bankruptcy as well?

A Yes. It continued until November of 2020.

Q And what happened in November?

A So, on November 30th, there were notices of termination of the shared services agreement, and shortly thereafter there was a directive that I understood to have come through Mr. Dondero to stop all payments.

Q Do you have an understanding as to who that directive was given to?

A Yes. To Frank.

Q And did Mr. Waterhouse follow that directive?

A Yes. He conveyed that to the accounting team, and -- in uncertain terms, that that's the -- that's the directive from Mr. Dondero.

Q So when Mr. Dondero wanted the payments stopped, was he able to effectuate that desire?

A Yes.

Q Okay. So, Highland files for bankruptcy in October 2019. Were you given any instructions by anybody concerning the continued administration of these agreements post-bankruptcy?

A I don't remember specific to these agreements, but more generally there was a business as usual, keep -- Team, keep doing what you're -- what you've been doing. That was the -- that was the go-forward direction.

Q Do you recall the intercompany agreements being the topic -- a topic of discussion with the UCC and FTI after the bankruptcy filing?

A Yes. It was a -- it was a very -- it was immediately a point of issue. I had conversations with Fred Caruso as well as Jack Donoghue from the DSI team. And it was my understanding that this was a -- this was an issue that was very hot on the minds of both the UCC as well as their financial advisors, FTI, and that there was -- there was going to be -- there was going to need to be some work done to get, you know, help them get comfortable with where we stood on those agreements.

Q When you say the issue was hot, can you just explain for Judge Jernigan specifically what the hot issue was, as you understood it?

A Yes. So, I mean, the hot issue was really just that these were all agreements with affiliates. These are -- these are creditors who have been fighting with Jim for years. And the fear on their part would have been these are wildly unprofitable contracts for Highland, value is siphoning out to these other advisors that he owns and controls and that are separate and apart from the bankruptcy, so if that is in fact happening, we, the UCC, need to intervene quickly.

Q Did you undertake any analysis of these contracts in response to the issues and concerns raised by the UCC?

A Yes.

Q And who did you work with on that analysis?

A I worked with a number of people. That included the two gentlemen from DSI that I just mentioned, Fred and -- Fred and Jack, as I recall. Frank, internally, as well as Isaac. And then it was my understanding -- I don't know that I had direct conversations with Scott Ellington, but it was my understanding that he had at least -- kind of was aware of the analysis. Put it that way.

Q Okay. Can you turn to Exhibit 144, please? And can you tell the Court what's depicted on that analysis there?

A So, this is -- sorry. This is a -- this is an early iteration of that analysis sent to Isaac with the overall summary of the output of that analysis. And I'd be happy to walk through it.

Q Yes, please.

A Okay.

Q Well, let me try and speed this up a little bit. Can you just explain for the judge the portion of the analysis that deals with the intercompany agreements?

A Yes. So, the portion that deals with the intercompany agreements is, if you have it in front of you, it's the top -- it's the top box. And that box is summarizing what was being paid and charged under those agreements. It's the four agreements -- there's technically five here because the NexPoint and NREA are both being included as a single number. But this box is showing you the 6 that's being charged to NexPoint and then the 8.6 that's being charged to Fund Advisors, broken out between five of -- we're calling it investment support fee here, but that's a reference to the PRA. And then 3.6 of shared services. So a total of 14.6 being charged.

And then the other number that I suppose indirectly pertains to the agreements is the number directly below that of estimated cost to provide services of 16.9.

Q Okay. So, under this analysis, how does the cost of providing services under the intercompany agreements compare with the revenue?
A So, the cost is higher by approximately $2.3 million, which is just the 16.9 less the 14.6.
Q Okay. And why is that 16.9, why is there a, you know, really a reduction of $900,000 to the 1.4?
A Yes. So this is -- you know, with this being a hot issue for the UCC, projecting this in the best possible light, there were -- Highland had a few other small shared services agreements with other parties that it was generating it looks like less than a million dollars a year of shared services revenue.
So, for presentation purposes, the takeaway is, notwithstanding that Highland might be -- might, again, very subjective, might be losing $2.3 million on these contracts collectively, well, we're getting some fees from other places, too, so it's not really 2.3, it's really 1.4, which -- which is a little bit of a stretch.
Q Until the time that you prepared this analysis for the UCC, had you ever undertaken any attempt to try to look at how the costs of providing services compared to the revenue under the intercompany agreements?
A No. No, this was the -- this was the first.
Q Until the UCC made this request, had anybody in the world

ever asked you at any time whether you could analyze the costs under the intercompany agreements as compared to the revenues?
A No.
Q Okay. Did you give this document to the UCC?
A Not this document, no.
Q How come?
A So, like I said, this was an iteration. We're within a few weeks of having filed. So this analysis continued to get refined over the next couple weeks. And ultimately an updated version was presented to FTI in the offices in December of '19.
Q Okay. Can you tell me how you calculated, how you -- it says estimated costs to provide services. What's -- how do you get to that $16.9 million number?
A Yeah. So, the methodology that was used, and I don't think I'm underestimating when I said I mentioned this to FTI probably 50 times in the thee-hour call -- was goalposts. Subjective ranges of how people might have been spending their time around the time of the bankruptcy.
So we took a September -- sorry. We took an October 15th roster at the time and we put -- we put big ranges on people. This, you know, Person A, they might be spending between 30 and 70 percent of their time on NexPoint-related matters. And so we had a low end of the goalpost and a high end of the goalpost. And the sausage that's being made to have the 16.9

spit out is the midpoint of those huge goalposts.
Q Did you do this analysis only for the dual employees, or did you do it for all employees?
A Everybody. And also including the people that were brought in to replace the dual employees that had left between 2018 and 2019.
Q Does this have anything to do with an analysis of the actual costs of any particular contract?
A Only in the sense that all the contracts are spelled out. It's not necessarily apparent on this page.
Q Uh-huh.
A But they are, they are spelled out within the body of the analysis.
Q And when you did the analysis for the payroll reimbursement agreements, did that include -- did that exclude all of the terminated employees?
A It excluded anybody that would have terminated up until the petition date.
Q Okay. And did you have a conversation with the UCC about what was being paid under the agreements at that time?
A Not with -- not with the UCC. But we -- but we met with FTI, their financial advisor, in December and discussed, you know, what was being paid at the time.
Q Okay. Did you modify this analysis in the future?
A The updated analysis that was done was from -- I just want

to make sure I'm on the same page -- but from this November iteration to Isaac for the actual version that was presented to the -- to the -- to FTI.

Q Okay.

A In December. Mid-December of 2019.

Q Okay. Let's go to --

THE COURT: Mr. Morris, I had hoped to --

MR. MORRIS: Yes?

THE COURT: -- break for lunch when the direct is over. How much more, do you think?

MR. MORRIS: I've got a bit. I would suggest that we break for lunch now. I would respectfully request that we try to limit that to maybe a half hour or 45 minutes, if we could.

THE COURT: Well, it's easier for us to take a short lunch break than it is for you all.

MR. MORRIS: Yeah.

MR. RUKAVINA: Your Honor?

THE COURT: Mr. Rukavina?

MR. RUKAVINA: Your Honor, I think the cafeteria downstairs -- the cafeteria downstairs is closed, so we're going to -- we didn't bring a box lunch, not knowing that, so --

THE COURT: Okay.

MR. RUKAVINA: We'll go to the nearest place, though.

THE COURT: Okay.

MR. RUKAVINA: Post-pandemic, I'm not even sure what's here anymore.

THE COURT: Well, let's take a 45-minute break. We'll come back at 1:30.

MR. MORRIS: Okay.

THE COURT: Okay.

MR. MORRIS: Thank you, Your Honor.

THE COURT: Thank you.

THE CLERK: All rise.

(A luncheon recess ensued from 12:45 p.m. to 1:35 p.m.)

THE CLERK: All rise.

THE COURT: All right. Please be seated. We're going back on the record in the Highland matter. Let's see. Are we ready to proceed?

MR. MORRIS: Yes, Your Honor.

THE COURT: Okay. Mr. Klos, you're still under oath.

THE WITNESS: Yes.

THE COURT: Thank you.

MR. MORRIS: Okay. May I go ahead, Your Honor?

THE COURT: You may.

MR. MORRIS: Okay.

DIRECT EXAMINATION, RESUMED

BY MR. MORRIS:

Q Mr. Klos, just to kind of reset after the lunch break, before we left we had looked at a November 2019 analysis that you had prepared and had shared with Isaac Leventon. Do you remember that?

A Yes.

Q And did you revise that analysis in December of 2019?

A Yes.

Q Can you turn to Exhibit 145 in your binder? Oh, you know what, hmm, I think we need Ms. -- oh, no.

THE COURT: Mine says, Document provided in native format.

MR. MORRIS: Yes. Okay. So we're just going to have to wait a moment for Ms. Canty, because that's an Excel spreadsheet.

THE COURT: Okay.

MR. MORRIS: So I'm going to cross my fingers and hope --

MS. CANTY: Which document, John? I'm sorry.

MR. MORRIS: 145.

(Pause.)

MS. CANTY: I'm sorry, John. I'll need a minute for that one. It's not in my -- yeah, I'll need a minute on that one.

MR. MORRIS: Okay.

MR. RUKAVINA: John, we have it ready right now, if you want.

MR. MORRIS: If you can -- in hard copy, or you can put it on the screen?

MR. BERGHMAN: Well, I have to be able to share my screen on WebEx.

MR. MORRIS: Yeah.

MR. RUKAVINA: We just printed it out and just brought it to court.

(Pause.)

MR. RUKAVINA: I mean, yeah, John, if you want Thomas to screen-share, we can put it up.

MR. MORRIS: You know, I'm just going to wait for Ms. La Asia, and I'm going to -- I'm going to detour for a second --

THE COURT: Okay.

MR. MORRIS: -- while we wait for her.

THE COURT: Okay.

BY MR. MORRIS:

Q Mr. Klos, do you remember having a conversa... or, communicating with -- with Ms. Thedford in approximately January of 2020 concerning the payroll reimbursement agreements?

A Yes.

Q And do you recall generally -- so we're going to just jump a little bit in time, we're going to come back to your revised analysis in December of 2019. But after you prepared that, do you recall talking to Ms. Thedford about the payroll reimbursement agreements?

A Yes, I do.

Q And what do you recall about that?

A I recall, generally speaking, around that January time frame, the Retail Board that's the trustees over the Retail Funds understandably was asking questions about who's providing services and digging in maybe more than they had previously.

And one of the questions and where I got pulled into it with Lauren was asking about the schedule, the Schedule A, if we're able to provide an update to the Retail Board on that, on that schedule, to which I basically responded to say it doesn't exist. You know, again, as a refresher from when we put this agreement in in the first place, this was a -- this was a one-and-done deal. This was something that we were going to do as of January. We can be more general and say, you know, these are the amounts that are being paid for these services, but not get to the granularity of employee by employee.

Q So your recollection is that this was an exchange that was intended to provide information to the Retail Board; is that right?

A That's my recollection.

Q All right. Can you go to Exhibit 151 in your binder? Okay. And do you see Lauren's email at the bottom of the

first page? She's got some boxes there.
A Uh-huh. Yes.
Q And do you recall what -- what it is she was asking to be done here?
A Yes, although just give me one moment to --
Q Yeah. Take your time.
A -- to refresh myself on this one.
Q Sure.
(Pause.)
A Yeah. So, this is the -- oh, this is actually -- this is an interesting example. So this is -- just starting at the back of the chain, this is that monthly process that we were describing earlier with the effective headcount report that's -- that's pushing out to a number of people within the organization anybody who is termed hired during that period. And so, responding to that email that would have gone out every month, Lauren is saying to Brian and Kelly, who are the HR department at Highland, we have a request from the Retail Board. You know, they want to understand the contractual employer, the ultimate payor, and their starting point is going to be -- is going to be headcount. So, you know, I explained that the payment is accomplished through the shared services and the expense reimbursement. That's a reference to the PRAs, as we've been describing them.
Q Uh-huh.

A And then Lauren asked me to fill out a chart that says -- although actually I'm not sure if this was directed at me or HR -- but saying, can we have a list of employees, show their contractual employer? And then she's asking for, can we do the percentages like you did for Schedule A? And I'm sorry, this is a lot of background, but it's helpful for me to see it. Where I say, basically, it doesn't exist. It was a point-in-time estimate.

And that's the email that's at 11:45 a.m., where I say, this was a point-in-time estimate. January 1. Estimate is -- is definitely the word.

Q Can you just read the email?

A Sure. Sure.

Q I'm sorry to interrupt, but --

A Sure. Sure. Sure.

Q -- let's make sure the record is clear.

A Yeah.

Q Go slowly, because --

A Yeah. Yeah.

Q -- I know that you know this stuff, but Judge Jernigan didn't live it like you did.

A Yes. Yeah.

Q So can you just read your 11:45 a.m. email to Ms. Thedford?

A Yes. So, in response to Lauren asking, wouldn't this just be the Exhibit A percentages, I say, Those were a point-in-time estimate as of beginning of 2018. Half the people are gone now. If you were to reallocate them, all their percentages, all the percentages would be different. On top of that, we don't have anything comprehensive that is comparable for back office people. So the only thing we can really provide is a stale percentage on a small subset of the overall population. It would be much more logical to do Yes/No and then have a -- and then as a blanket statement say that NPA/HCMFA pay *x* and *y* dollars annually to HCMLP for these employees' services and overhead.

Q And from your perspective, is that consistent with the email communication and exchange you had with Ms. Thedford in April of 2018 before the payroll reimbursement agreements were signed?

A Yes, it's consistent.

Q And did -- did Ms. Thedford accept your response?

A Yes. She said, Got it. Thanks. And I don't remember ever having any follow-up beyond that.

Q Okay. So did -- do you know, to the best of your knowledge, did Highland or the Advisors ever provide to the Retail Board any updated analysis of the allocation of costs?

A No.

Q To the best of your recollection, did Highland or the Advisors ever provide to the Retail Board any assessment of the costs that the Advisors were bearing under the payroll reimbursement agreements?

A No, not specifically. No. No. The answer is no.

Q And why is it not specifically?

A Because, as part of the 15(c) process that happens every year, there is some disclosure to the board about the profitability of the Retail Advisors. And so kind of implicit in that is some of the underlying information from what they're paying under these -- the PRAs and the SSAs.

Q And --

A So, that's why I was a little hesitant there.

Q And so I really appreciate the specificity. Within the analysis that you're thinking of, would the flat monthly fees that were paid under the payroll reimbursement agreements, would that be one component of the profitability of the Advisors?

A Yes.

Q And that's what you were referring to, --

A That's right.

Q -- right?

A That's right.

Q Okay. Let's go back. Now we've got the document up on the screen. This is Exhibit 145. Can you just describe for the Court what's happened here? And, again, just to level set, this is an update of the analysis that we looked at

before lunch that you did in November, right?
A Yes.
Q What's -- what's changed? What is this?
A Yes. So this is the same summary output in terms of the overall presentation. I'm looking at these side by side, so I'll try to -- try to walk through.
Q Uh-huh.
A But you have the same top box with the same number, 14.6. This is what's being charged, $14.6 million, across the -- the several contracts.
Q Uh-huh.
A You have the same line just below it of estimated cost to provide services. This number has come in between iterations, so what was 16.9 on the previous analysis is now 16.1.

And then the other difference that's rolling through here is that there is another offset that doesn't really have, really, relation to these agreements, which is an offset of nondebtor employees that are -- were providing services. So that's the -- that's the .9. And it looks like we did a sign flip on the -- on the shared services agreement.

So, net-net, our loss went from -- estimated loss went from 2.3 on the original analysis to 1.5. And then when you start to take in these factors that are outside of the agreements, we picked up another $900,000 of offsets.

And this was the version that was ultimately presented to

FTI, showing that -- what, net, net, net, with all the -- with all the disclaimers about subjectivity, these shared services agreements -- and when I say shared services, I'm lumping in the lot of them -- all of the intercompany are kind of a net, it's kind of a net neutral. It's basically a breakeven, understanding that there's tremendous subjectivity.

Q And did you have a goal? Like, were you trying to accomplish anything other than running numbers when you prepared this analysis for the UCC?

A Yeah. Absolutely. The goal here was to be able to, in good faith, be able to come up with an analysis that we could share with the UCC that would effectively buy time in the bankruptcy process. We were still very early. We understand Jim Dondero was working really hard to come to some sort of a resolution. And we really wanted space before something drastic would happen. So there was definitely a bias in this exercise to put the profitability of these contracts in the best possible light that we could and still -- and still have our credibility.

Q Okay. I appreciate that. So, in the span of the one month, the difference between the -- the deficit or the loss under the intercompany agreements was reduced by $800,000, right? 6.9 to -- $800,000, right?

A $800,000. Yeah. 16.9 to 16.1.

Q And you got there solely by adjusting the expense side,

right?
A Correct. Correct. The fee side stayed exactly the same.
Q Right? Because the fee side is fixed and that can't change, right?
A Correct. That's the 15.6 --
Q Okay.
A -- in the box in both analyses.
Q And so did anything actually happen between November and December to change the expenses?
A No. I think we had one employee who left right at the end of December who was a -- not a highly-compensated employee.
Q So that -- so that the difference is the result solely of the change in assumptions that you were making; is that fair?
A Right. More tweaking and -- yeah, that's right.
Q Okay. And can -- okay. Fine. So you prepared this analysis. You give it to the UCC. You speak with Ms. Thedford. We looked at that. And I'm just trying to finish this up. Do you recall that at the end of November Highland had given notice of termination of the shared services agreements?
A Yes.
Q Okay. Do you recall the very next day you exchanged some emails with Dustin Norris?
A Yes.
Q You knew Dustin, right?

A Yes.
Q Okay. And how did you know him?
A We -- we've worked together for a long time. Never particularly closely, but he was hired at Highland in the 2010-2011 time frame, and then a few years in moved to Highland Capital Management Fund Advisors. And then in 2019 transferred again from Highland Capital Management Fund Advisors to NexPoint Advisors, LP. And so we've interfaced from time to time on a variety of issues.
Q Do you have an understanding of what his role is at the Advisors?
A Yes. You know, generally speaking, marketing and distribution and investor and wirehouse interface for the (inaudible) funds, as well as for some of the private offerings done through NexPoint.
Q To the best of your recollection, did Mr. Norris participate in any way in the discussions in late 2017 through May 2018 about the creation of these agreements and the economic relationship between the Advisors and Highland?
A No.
Q To the best of your recollection as you sit here today, did Mr. Norris play any role at all in formulating, drafting, or administering the subadvisory agreements that were originally prepared for NexPoint and HCMFA in early 2018?
A No.

Q To the best of your recollection, did Mr. Norris play any role at all in the formulation, drafting, or administration of the payroll reimbursement agreements?
A No.
Q To the best of your recollection, did Mr. Norris play any role in formulating, drafting, or executing the amendments to the payroll reimbursement agreements in December 2018?
A No.
Q To the best of your recollection, did Mr. Norris play any role at all in the formulation, drafting, or administration of the NexPoint or HCMFA shared services agreements?
A No.
Q Prior to December 2020, had you ever discussed with Mr. Norris how the amounts paid under the payroll reimbursement agreements were calculated?
A Not that I can remember, no.
Q Prior to December 2020, had Mr. Norris ever asked you any questions about the actual costs of services rendered under the shared services or payroll reimbursement agreements?
A Maybe -- maybe in the November time frame, but it really became acute in December and January.
Q Okay. If Mr. Norris testifies that the December 2018 amendments to the PRAs was the result of a true up that you prepared, what would you say?
A I would say there was -- there was no true up. There was

no analysis done. And I'm sorry to put it so bluntly, but you weren't there, and so it just didn't happen.

Q And did you ever tell him that?

A Not -- certainly not in those -- in those words, no.

Q Okay. Let's go -- let's grab the Advisors' binder and go to Exhibit P, please. P as in Peter. I think -- I think you testified that you recall the notice of termination of the shared services agreement was November 30th. Do I have that right?

A Yes.

Q Okay.

A Yes, you do.

Q Let's take a look at this. If you could just -- are you familiar with this email exchange?

A Yes. Yes.

Q Okay. And can you describe generally for Judge Jernigan what's happening on December 1, 2020, the morning after notice of termination is given?

A Yes. So, I think there's a lot of running around, hair on fire going on around that time, particularly for the Retail Advisors. So the notice was I think the evening of November 30th. And it's my understanding that that notice was quickly provided to the -- to the Retail Board, who certainly, understandably, wanted assurance that there would be no disruption in services and that there would be a smooth transition.

So I think there was a flurry of activity right after that point to help, you know, answer those types of questions that the Retail Board had. And then also really get serious about an actual transition plan.

Q And if you look on the page ending in Bates No. 107, you'll see an email from Mr. Norris at 8:53 a.m. Do you see that?

A Yes.

Q Okay. And is -- are the emails that followed a discussion about kind of amounts that were paid under the payroll reimbursement agreements?

A Yes. As well as the shared services agreements.

Q Okay. And do you see Mr. Norris included a chart there of fees?

A I do.

Q And did you give him that information?

A I don't believe so. Based on the date being 6/30 of 2020, I assume he -- he likely pulled it himself from the 15(c) materials that I was discussing earlier, because those materials were presented each year through 6/30. So that would have been -- that's my guess, is that that's where he pulled those, those numbers.

Q Any idea why NexPoint paid $5,040,000, why it's shown as -- for the 12-month period, and not the $6 million?

A Yes. And actually, that's contained in my response at 9:00 o'clock a.m.

Q Uh-huh.

A So, yeah, so he sent this at 8:53. And it looks like, from his -- from his email, he's wanting to, first and foremost, make sure the numbers are right, but -- but is starting to think about these termination notices. So the reason it's -- to answer your question, the reason it's $5,040,000 is because the numbers that he pulled were NexPoint standalone, and so it's missing the $80,000 a month from NexPoint Real Estate Advisors. And that's what I clarify in the email that I sent back to him seven minutes later, is just saying that, you know, note that while these, you know, these amounts are what they are, there is an additional $960,000 per year in shared services through NREA.

Q So, if we went back and looked at your -- not that I'm going to do this -- but if we went back and looked at your December 2017 email that we started a couple of hours ago with, it would show the exact same numbers that are on this, but for the addition of that $80,000 a month from the NexPoint Real Estate Advisors shared services agreement. Do I have that right?

A Yes. And that was -- and that was there, too. It's just that it's not included in this specific chart.

Q Okay. Now, do you see Mr. Norris's email at the top?

A Yes.

Q Okay. And can you just describe for the judge what your recollection and understanding is of what the back-and-forth here, what's going on?

A Yeah. So he's -- he's highlighting the fact that some of the people that were originally part of schedules aren't there anymore. Mark, which that's a reference to Mark Okada. Jim. That's a reference to Jim Dondero. Pogs. That's a reference to Jon Poglish, who -- who term'd in, I think, September of 2020.

Q Uh-huh.

A Trey is a reference to Trey Parker, who term'd in February of 2020. Parm is a reference to Andrew Parmentier, who term'd in May -- May-ish 2019. And many others. So he's -- he's asking me about, are we still paying the same amounts because of the BK?

Q Okay. And what's your response? What do you tell Mr. Norris at this point?

A So, I say the amounts have not changed since BK. And then I go on to point out that -- that given the changes in headcount, profitability would have increased from HCMLP's perspective.

Q And why did you -- why did you tell Dustin that?

A I think mainly it's -- it's a statement that's somewhat obvious, which is that if revenue stays exactly the same and

expensive people leave, then profitability is going to increase for the -- for the party that's receiving the revenue and bearing the burden of the expense. So it's -- I think it's a pretty straightforward statement. And recognizing that, you know, we have been paying -- sorry, we had been receiving those flat amounts throughout the period.
Q And is it your understanding, after your negotiations -- withdrawn. I'll just leave it.
After you had this exchange with Mr. Norris, do you recall being asked by Mr. Waterhouse to update the analysis that you had prepared in December 2019?
A Yes. So, about a week later, December -- I think it was December 8th, --
Q Uh-huh.
A -- I got a call from Frank with a request to update the analysis that we had done for the UCC the previous year.
Q And do you recall discussing that with Frank?
A Yes. I'll say, this -- the agreements had just been terminated the week before. It was, I guess, my -- my Spidey senses were up a little bit. It was -- it seemed like an odd request. We hadn't -- we hadn't looked at this in a long time. And so I did, I asked him in that moment what are -- can you -- can you confirm for me that this is not for any sort of adverse purpose? And he told me that -- that it wasn't.

And then in terms of the actual analysis, the analysis that was requested was, you know, roll forward that schedule from last year that you shared with the UCC, update it for the current headcount -- so remove people who terminated; add people who were hired -- and delete everyone's bonus, and don't touch any of the percentages.

Q And do you understand that that became the foundation of the administrative claim that was filed the following a month?

A I believe it probably was.

Q And the assumptions that you were just asked to make, were those assumptions that you on your own decided to make, or were those assumptions that Mr. Waterhouse asked you to make?

A They were -- they were given.

Q Did you believe -- let's see. Let's take a look. We're at Exhibit Q. That's your email to Mr. Waterhouse. Do I have that right?

A Yes.

Q Okay. And let's look at the attachment for a second. So, the attachment -- tell -- explain to Judge Jernigan what's happening in this attachment to Exhibit Q.

A Yes. So this attachment, it actually -- it looks different from some of the other analyses that we were looking at before. In reality, it's just another tab on the same analysis in the Excel spreadsheet.

And so what it is, what it is doing is it's doing a -- the

-- I'll point out the individual numbers. The front office current charge is a reference to the -- to the PRAs of $8 million a year. So, $3 million for NexPoint, $5 million for HMCFA. And then the shared services, again, current charge is the $3 million of shared services to NexPoint plus NREA and the $3.6 million for HCMFA that was running around -- it was 300 a month-ish, but it would vary slightly from month to month.

And then all the other numbers that are -- that are -- for example, the investment support, directly below current charge, is -- is the build up from the assumptions that I had layered in: namely, updating the headcount, not touching the percentages, and deleting everyone's bonuses.

Q Did you ever discuss this document with anybody prior to confirmation of the Debtor's plan on February 2, 2021?

A I don't believe so, other than Frank.

Q Do you know what Frank did with the document?

A No, I don't.

Q Did you believe at that time that this document accurately and fairly reflected Highland's profitability under the payroll reimbursement agreements or the shared services agreements?

A Absolutely not.

Q And why is that?

A Well, bonuses are a big component of compensation for asset managers. So there are some -- there are some definite flaws here in terms of leaving that out, both the bonuses as well as the deferred bonuses, which were material for some people.

Another factor that would have skewed this result is not touching any of the allocations, because the reality is, after the petition date, investment activity of Highland, at HCMLP-managed funds, dropped tremendously, because you had investor redemptions, you had funds getting closed. So those same employees were -- would have been spending more time and working more on Retail Advisor issues. And you also did have people whose roles changed in the interim time period.

For example, Trey Parker left, who was an investment professional, and his roles and responsibilities were transferred to the legal team which took over the distressed PE management, which was pretty active for the -- for the Retail Funds.

Q So, on that topic, can you go to -- let's flip through these real quick -- Exhibit 36?

A Bear with me.

MR. MORRIS: Your Honor, this is a good time to tie one other tiny loose end. I think on Friday the Reorganized Debtor filed an emergency motion to I think redact or file under seal certain documents. The documents we're about to look at are those documents.

THE COURT: Okay.

MR. MORRIS: And they have been redacted to take out addresses, home addresses of certain people. I just want you to know that what you have in your binder is not going to be the official exhibit, --

THE COURT: Okay.

MR. MORRIS: -- the only difference being that if that motion is granted -- I don't think Your Honor has tended to it yet -- but we're just going to redact addresses. That's the only purpose of the motion.

THE COURT: Okay. I have not tended to it, --

MR. MORRIS: Yet.

THE COURT: -- but I presume it's not opposed.

MR. MORRIS: I just -- correct.

THE COURT: Okay.

MR. MORRIS: He certainly is familiar with all these people.

THE COURT: Okay. Mr. Rukavina, you're --

MR. RUKAVINA: No, Your Honor, of course --

THE COURT: The motion to redact is not opposed? It's just addresses?

MR. RUKAVINA: No, of course not.

THE COURT: All right.

MR. RUKAVINA: Yeah.

THE COURT: All right. I'll be signing an order on that.

MR. MORRIS: Okay.

BY MR. MORRIS:

Q So, starting with -- we're just going to look at these very quickly. In February 2020, do you recall that the titles of certain employees at Highland were changed?

A Yes. For a number of people.

Q And were the -- were the title changes related in any way to the changing responsibilities that these employees undertook?

A Yes. And specifically for the ones that I think we're about to look at, it's -- it was in relation to Trey Parker leaving, who he was the head of private equity at Highland, and so his responsibilities were carved up amongst a number of people.

Q So, did Ms. Irving take on responsibility as a managing director of distressed, as reflected in Exhibit 36?

A Yes.

Q And let's go to Exhibit 37. As of February 28th, was Ms. Vitiello given responsibility in the area of distressed?

A Yes.

Q Exhibit 38. Was Mr. DiOrio made a managing director of private equity?

A Yes.

Q The next exhibit is 39. Was Mr. Leventon, in February

2020, given the new title, the new additional title of managing director, distressed?

A Yes.

Q Exhibit 40, Mr. Cournoyer. Was he also given a new title, co-head of private equity?

A Yes.

Q And were all of these changes related to changes in responsibilities?

A Yes. Expansion of responsibilities and, you know, coinciding with the termination of Mr. Parker, which was on the same date as all these letters, February 28th of 2020.

Q And did those individuals we just looked at, do you know if those individuals kind of filled the void of Mr. Parker's departure?

A Yes. Again, group effort, so it's not -- it's one person's big responsibilities getting carved up amongst a number of different people.

Q So when you talked about with Ms. Thedford, really, in the exact -- I guess the month before all of this happened, you mentioned that there would be reallocations if somebody was actually to go back and look and review the exhibit, the exhibits. Do I have that right?

A Yeah. That's -- that's correct. Everyone's role -- and this was true prepetition and postpetition -- people's roles evolved and changed. And so any sort of a point-in-time

estimate, however flawed, is just that. It's a point in time.
Q Are you aware of any -- the changes that you just described for the individuals that you just described, would it be fair to describe those new responsibilities as investment advisory services?
A I believe so.
Q And they were within Trey Parker's bailiwick; is that right?
A Yeah, within his bailiwick. You know, managing and monitoring those PE investments.
Q Okay. Are you aware of anybody ever saying at any time prior to November 2020 that Highland was failing to provide investment advisory services of the type that they provided for a decade before?
A No, with the only small exception was that there was a -- there was a conflict identified on a single private equity asset in the summer, call it August-ish time frame.
Q What's the name of that asset?
A That one was OmniMax.
Q So, other than with respect to OmniMax, did -- are you aware of any statement, suggestion, allegation prior to November 2020 where somebody alleged that Highland was failing to provide investment advisory services?
A Never.
Q Okay. Two very short topics. Let's turn to Exhibit 159.

Can you tell Judge Jernigan what that is?
A Sorry. Bear with me. 1-5-9?
Q Yes.
A Okay. I'm there.
Q Can you just describe for the Court what that document is?
A Yes. This is the September monthly invoice from Highland Capital Management, LP to Highland Capital Management Fund Advisors under the shared services agreement. We haven't spent too much time on it, but most of the agreements were fixed. This was the one that did have a little bit of variability because we would -- we would charge these invoices each month.
Q Okay. And that was the practice going back to about 2013; is that right?
A Might have even been 2012, but a long way back.
Q Okay. And when we talk about the five intercompany agreements today, is this the only one that was variable?
A Yes.
Q Okay. And did you have any responsibility for the -- would Highland prepare four HCMFA monthly invoices for shared services?
A Yes.
Q And did you have any responsibility for the preparation of those invoices?
A Like I said, this was a practice for many years, so early

on I did, maybe the first year or two. And then that became a task that was passed among the team. And so for years that process rolled up through me as the -- as the head of the department.

Q Okay. And did -- did the invoiced amount stay fairly consistent within a small band over time? During the relevant period?

A Yeah. During the relevant period, during the relevant period it would have crept up a little bit as compensation went up, and I believe there was a small net increase in headcount. Postpetition, it barely moved. It was always between call it $290,000 and maybe just over $300,000 per month.

Q Okay. I just want to ask about one particular entry on here. There's an entry in the middle for legal. Do you see that?

A Yes.

Q And it's $10,000?

A Yes.

Q Does that mean that for legal services rendered by Highland under the shared service agreement HCMFA paid $10,000 per month?

A Yes. At this time, that's right.

Q That's the total of what they paid?

A Yes.

Q So, $120,000 for a whole year?
A Yes. There's a five percent markup on it, so it's $10,500 per month times 12.
Q How did that -- did anybody do an analysis to see if HCMFA was actually responsible for $10,000 a month --
A No.
Q -- in legal fees?
A No.
Q Anybody ever say at Highland, gee, we should be charging HCMFA more money because the actual cost of their services is much greater?
A No. Nobody said that.
Q Finally, let's just talk about damages. Have you done an analysis of the damages that Highland alleges that it has sustained from the Advisors' breach of contract?
A Yes, in part.
Q Okay. Let's talk about the part that you prepared. Can you describe for the Court your damage analysis?

MR. RUKAVINA: And Your Honor, I do have to object here. This witness has not been qualified as an expert, designated as an expert. There's no expert report.

Now, if the damages are just they didn't pay per month and they owe us for that month, that's not an expert deal. But I hear damages analysis and I hear that this person did an analysis, so --

MR. MORRIS: He's going to -- he's going to add the amounts in the contracts, multiply them by the number of months that weren't paid, and come up with a number.

MR. RUKAVINA: That's -- that's easy.

THE COURT: Okay.

MR. RUKAVINA: We know what that number is. That's easy.

THE COURT: Okay.

MR. MORRIS: So will you stipulate?

MR. RUKAVINA: Huh?

THE COURT: Okay. I overrule the objection if there's still one pending.

MR. MORRIS: Okay. All right.

BY MR. MORRIS:

Q Mr. Klos, can you describe for the Court how we arrive at our breach of contract damages?

A So, to summarize, NexPoint was paying $500,000 per month. It didn't pay for two months. So that's a million from NexPoint.

HCMFA had the payroll reimbursement, the $416,000 per month. It didn't pay for two months. So that's $832,000.

And then on the shared services agreement, HCMFA actually didn't pay for three months, because the -- the November of twenty -- let get my year right -- November of 2020, HCMFA invoice hadn't been created at the Mr. Dondero said to stop payments.

So three months of HCMFA shared services, two months of PRA, and then two months of NexPoint for everything.

Q And if we could just quickly look at Exhibit I in the Advisors' exhibits so we can get a number for the HCMFA shared services three-month piece.

A I?

Q Yes.

A Do you have a page, by any chance? Is it in the back?

Q It's the last page.

A In the last --

Q It's Exhibit A. And I'll just represent to you that this is the Debtor's responses to the Advisors' discovery requests.

A This -- this, to me, looks like payments made as opposed to amounts outstanding.

Q I understand that.

A Okay.

Q Okay. So, so the Advisors -- did the Advisors pay for shared services in November, December of 2020, or January of 2021?

A Oh, I understand. Not as it pertained to Highland Capital Management Fund Advisors shared services.

Q Okay. And if you look at the middle of the page, the amount that was paid each month for the preceding six months is approximately two hundred and -- $308,000 or $305,000? Is

that right?
A I'm sorry. One -- can you ask that again, please?
Q The amount -- do you know what Exhibit A is?
A Yes. Exhibit A is a listing of all the payments that were made postpetition by the Retail Advisors.
Q Okay. So in the middle of the page, there are payments that were made each month by HCMFA under the shared services agreements. Am I reading that correctly?
A Yes. Yes, you are.
Q And how much were they paying in 2020?
A Got it. Yes. So they were paying, just looking at it quickly, it looks like the lowest was about $294,000 and the highest was around $308,000.
Q Okay. And how would you calculate the damages for the three months that they didn't pay, looking at this?
A It would be approximately -- the best proxy for it would be the November payment, so it would be approximately three -- three more of the November 30th payment of about $308,000.
Q Okay. So 308 times three?
A Yes.
Q Plus the million dollars from NexPoint?
A Yes. Plus the 832 of PRAs.
Q Ah. Correct. Okay. And is it your understanding that Highland also seeks to recover its attorneys' fees, costs, and expenses under the contracts?

A That's my understanding.
Q Okay.
MR. MORRIS: Your Honor, I have no further questions.
THE COURT: All right. Pass the witness. Mr. Rukavina?

(Transcript excerpt concluded at 2:19 p.m. Proceedings concluded at 6:19 p.m.)

--oOo--

CERTIFICATE

I certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter.

/s/ Kathy Rehling **04/14/2022**

_______________________________________ _________________
Kathy Rehling, CETD-444 Date
Certified Electronic Court Transcriber

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Excerpt: 9:38 a.m. to 2:19 p.m.