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Case No. 22-10189

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: Highland Capital Management, L.P.,

Debtor.

Highland Capital Management Fund Advisors, L.P.; NexPoint Advisors, L.P.; The Dugaboy Investment Trust,

Appellants,

v.

Highland Capital Management, L.P.,

Appellee.

OPENING BRIEF OF APPELLANTS NEXPOINT ADVISORS, L.P. AND HIGHLAND CAPITAL MANAGEMENT FUND ADVISORS, L.P.

Appeal from the United States District Court for
the Northern District of Texas, the Honorable Sidney A. Fitzwater

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Appellee.

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities, as described in the fourth sentence of Rule 28.2.1, have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal:

1. **Appellants filing this brief:**

NexPoint Advisors, L.P.
Owned by:
The Dugaboy Investment Trust
NexPoint Advisors GP, LLC
Owned by:
James Dondero

Highland Capital Management Fund Advisors, L.P.
Owned by:
Highland Capital Management Services, Inc.
Strand Advisors XVI, Inc.
Okada Family Revocable Trust

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2. **Other Appellants:**

The Dugaboy Investment Trust

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3. **Appellee:**

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4. Other Interested Parties:

Official Committee of Unsecured Creditors (dissolved)

Members:

Redeemer Committee of Highland Crusader Fund
Meta-e Discovery
UBS Securities LLC
UBS AG London Branch
Acis Capital Management, L.P.
Acis Capital Management GP, LLC
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All creditors in Highland Capital Management, L.P. bankruptcy

By: /s/ Davor Rukavina
Davor Rukavina, Esq.

STATEMENT REGARDING ORAL ARGUMENT

The Appellants believe oral argument would benefit the Court. The issues this appeal will resolve are particularly important to bankruptcy jurisprudence. Chapter 11 contemplates a democratic process based on informed suffrage. But the Bankruptcy Court permitted the Debtor to create a post-confirmation trust funded with $25 million of creditor recoveries without putting it to the creditors for a vote, as required by the Bankruptcy Code. Affirming this subversion would have devastating, far-reaching consequences. Accordingly, the Appellants respectfully request oral argument.

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OPENING BRIEF OF APPELLANTS NEXPOINT ADVISORS, L.P. AND HIGHLAND CAPITAL MANAGEMENT FUND ADVISORS, L.P.

NexPoint Advisors, L.P. ("NexPoint") and Highland Capital Management Fund Advisors, L.P. ("HCMFA"), two of the appellants in this bankruptcy appeal (collectively, the "Appellants"), hereby submit this *Opening Brief of Appellants NexPoint Advisors, L.P. and Highland Capital Management Fund Advisors, L.P.*, in support of which they would respectfully state as follows:

I. STATEMENT OF JURISDICTION

On July 21, 2021, the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (the "Bankruptcy Court") entered its *Order Approving Debtor's Motion for Entry of an Order (I) Authorizing the (a) Creation of an Indemnity Subtrust and (b) Entry Into an Indemnity Trust Agreement and (II) Granting Related Relief* (the "Indemnity Trust Order"). ROA.18-20. The Appellants timely filed their notice of appeal of the Indemnity Trust Order on August 4, 2021. ROA.13-17. Accordingly, the District Court had appellate jurisdiction under 28 U.S.C. § 158(a)(1).

On January 28, 2022, the District Court entered its *Judgment* (the "Judgment") along with a memorandum opinion (the "Opinion"), fully resolving the appeal before it. ROA.4645-54. The Appellants timely filed their notice of appeal on February 24, 2022. ROA.4661-65. This Court therefore has appellate jurisdiction under 28 U.S.C. § 158(d)(1).

II. STATEMENT OF THE ISSUES

1. Whether the District Court erred by affirming the Indemnity Trust Order, entered by the Bankruptcy Court on July 21, 2021, including, without limitation, by (a) holding that the Indemnity Trust Order did not effectuate a plan modification; and (b) holding that HCMFA lacked standing to appeal.

2. Whether the relief requested and granted in the *Debtor's Motion for Entry of an Order (I) Authorizing the (A) Creation of an Indemnity Subtrust and (B) Entry into an Indemnity Trust Agreement and (II)Granting Related Relief* (the "Indemnity Trust Motion") constituted a plan modification.

3. Whether the relief requested and granted in the Indemnity Trust Motion satisfied the requirements of 11 U.S.C. §§ 1122, 1123, 1125 and 1127.

4. Whether the Bankruptcy Court otherwise erred by granting the Indemnity Trust Motion.

III. STATEMENT OF THE CASE

While the parties' relationship involves other litigation, including another appeal before this Court, this appeal revolves around discrete, simple, and undisputed facts.

A. THE PARTIES

The appellee, Highland Capital Management, L.P. (the "Debtor"), filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code

on October 16, 2019. ROA.549. The Debtor's business consists primarily of advising investors and managing investments totaling billions of dollars. *Id.* The Appellants hold claims as creditors in the Debtor's bankruptcy case. *See* ROA.4647. The Debtor has also named the Appellants as defendants in numerous lawsuits. *See* Bankr. Adv. Nos. 21-03000-sgj; 21-03004-sgj; 21-03005-sgj; 21-03010-sgj; and 21-03082-sgj.

B. THE PLAN

On February 22, 2021, the Bankruptcy Court entered its *Order (i) Confirming the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (As Modified) and (ii) Granting Related Relief* (the "Confirmation Order"), ROA.543, pursuant to which it confirmed the *Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (As Modified)* (the "Plan"). ROA.634. This Court currently has a direct appeal from the Confirmation Order under advisement. *See* 5th Cir. No. 21-10449.

Because Class 8 (general unsecured creditors) voted to reject the Plan, the Bankruptcy Court confirmed the Plan over their objections under Bankruptcy Code section 1129(b), commonly known as "cramdown," whereby a plan is confirmed over the dissenting votes of one or more classes of creditors. ROA.584, 587. Two classes of partnership interests (equity holders) likewise rejected the Plan, and the Bankruptcy Court crammed them down as well. *See id*.

The Plan "reorganizes" the Debtor in name only. It actually effectuates a liquidation. After confirmation, the Debtor continues to manage various funds and investments temporarily while it winds down its operations. ROA.547. Among other things, the Plan creates the "Claimant Trust," "established for the benefit of the Claimant Trust Beneficiaries." ROA.644. The Plan transfers considerable property from the Debtor to the Claimant Trust, for liquidation to benefit the Debtor's creditors. ROA.573.

The Plan also creates the "Litigation Sub-Trust," a subsidiary to the Claimant Trust, and vests in the Litigation Sub-Trust most of the Debtor's unliquidated causes of action. *See id*. As the Bankruptcy Court summarized:

> The parties have repeatedly referred to the Plan as an "asset monetization plan" because it involves the orderly wind-down of the Debtor's estate, including the sale of assets and certain of its funds over time, with the Reorganized Debtor continuing to manage certain other funds, subject to the oversight of the Claimant Trust Oversight Board. The Plan provides for a Claimant Trust to, among other things, manage and monetize the Claimant Trust Assets for the benefit of the Debtor's economic stakeholders. The Claimant Trustee is responsible for this process, among other duties specified in the Plan's Claimant Trust Agreement. There is also anticipated to be a Litigation Sub-trust established for the purpose of pursuing certain avoidance or other causes of action for the benefit of the Debtor's economic constituents.

ROA.547-48.

Among the assets the Plan transfers to the Claimant Trust is "Available Cash." R.576. The Plan defines "Available Cash" as "any Cash in excess of the amount needed for the Claimant Trust and Reorganized Debtor to maintain business

operations as determined in the sole discretion of the Claimant Trustee." ROA.642. The Plan does not saddle the Claimant Trust with any debt *per se*, but it makes the Claimant Trust responsible for its own expenses and ultimately to provide returns to its beneficiaries—*i.e.* the Debtor's creditors and, if they are paid in full, the Debtor's equity interest holders.

With respect to indemnification—the focus of this appeal—the Plan contains merely the following two paragraphs:

> Except as otherwise ordered by the Bankruptcy Court, the Claimant Trust Expenses shall be paid from the Claimant Trust Assets in accordance with the Plan and Claimant Trust Agreement. The Claimant Trustee may establish a reserve for the payment of Claimant Trust Expense (including, without limitation, any reserve for potential indemnification claims as authorized and provided under the Claimant Trust Agreement), and shall periodically replenish such reserve, as necessary.
>
> * * *
>
> The Claimant Trust Agreement and Litigation Sub-Trust Agreement may include reasonable and customary provisions that allow for indemnification by the Claimant Trust in favor of the Claimant Trustee, Litigation Trustee, and the Claimant Trust Oversight Committee. Any such indemnification shall be the sole responsibility of the Claimant Trust and payable solely from the Claimant Trust Assets.

ROA.667-68. It bears emphasis that the only parties the Plan allows the Claimant Trust to indemnify are "the Claimant Trustee, Litigation Trustee, and the Claimant Trust Oversight Committee." *Id.*

Consistent with the Plan, the Claimant Trust Agreement indemnifies "[t]he Claimant Trustee (including each former Claimant Trustee), Delaware Trustee,

Oversight Board, and all past and present Members ….” ROA.1029. Likewise, the Litigation Sub-Trust Agreement indemnifies “[t]he Litigation Trustee (including each former Litigation Trustee), Oversight Board, and all past and present Members ….” The Claimant Trustee and the Delaware Trustee are the same person, ROA.998, and “Members” refers to members of the Oversight Board. *See*, *e.g.*, ROA.1018 (¶ 4.1, referring to “Members of the Oversight Board”).

As additional protection for the indemnified parties, and as a condition precedent to the Plan’s effectiveness, “[t]he Debtor shall have obtained applicable directors’ and officers’ insurance coverage that is acceptable to each of the Debtor, the Committee, the Claimant Trust Oversight Committee, the Claimant Trustee and the Litigation Trustee.” ROA.685. However, the Plan permitted the Debtor, with the creditors committee’s consent, to waive this condition precedent, ROA.684, which is ultimately what happened.

C. THE INDEMNITY TRUST ORDER

After the Bankruptcy Court confirmed the Plan, but before the Plan went effective, the Debtor abandoned its efforts to procure D&O insurance, citing cost. ROA.705. On June 25, 2021, the Debtor filed the Indemnity Trust Motion. R.637. In lieu of purchasing D&O insurance, the Debtor sought authority to create yet another, third trust (the “Indemnity Trust), with three key features and concomitant problems.

First, the Claimant Trust *irrevocably* contributes $2.5 million in cash to the Indemnity Trust corpus. ROA.722 (defining Grantor as Claimant Trust); 723 (describing Indemnity Trust corpus). These funds otherwise would have been available for distribution to the Debtor's creditors.

Second, the Claimant Trust *irrevocably* issues an "Indemnification Funding Note" in the amount of $22.5 million (for $25 million total irrevocable funding) to the Indemnity Trust, which "will represent and document the Claimant Trustee's obligation to make additional cash deposits into the Indemnity Trust Account to satisfy the obligations of the Claimant Trust, the Litigation Sub-Trust, *and the Reorganized Debtor*, each of which will be jointly and severally liable under the Indemnification Funding Note …." ROA.723 (emphasis added). However, the Plan does not authorize the Claimant Trust to indemnify Reorganized Debtor. *See* ROA.668 ("The Claimant Trust Agreement and Litigation Sub-Trust Agreement may include reasonable and customary provisions that allow for indemnification by the Claimant Trust in favor of the Claimant Trustee, Litigation Trustee, and the Claimant Trust Oversight Committee.").

Third, the Beneficiaries of the Indemnity Trust include the Indemnified Parties under the Claimant Trust Agreement and the Litigation Sub-Trust Agreement. ROA.722. So far so good. The Plan authorizes the Claimant Trust to indemnify these parties. *See* ROA.668. But the Beneficiaries also include (a) "the

General Partner [of the Reorganized Debtor], and each member, partner, director, officer, and agent thereof," (b) "each person who is or becomes an Officer of the Partnership …," and (c) "each person who is or becomes an employee or agent of the Partnership …." ROA.722 (including Covered Persons in the definition of Beneficiaries); 1066 (definition of Covered Person). The Plan does not permit the Claimant Trust to indemnify these parties. *See* ROA.668.

The Appellants objected to the Indemnity Trust Motion, arguing it represented a request to modify the confirmed Plan. ROA.730. Plan modification requires solicitation, voting, and confirmation under section 1127(b) of the Bankruptcy Code, as opposed to simple motion practice, precisely because the creditors and equity interest holders who voted on the original Plan must receive sufficient disclosure and solicitation with respect to any Plan modification, and they must have the ability to vote on any modification to a plan that they already voted on:

> The proponent of a plan or the reorganized debtor may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified, under section 1129 of this title.

11 U.S.C. § 1127(b).

The Bankruptcy Court held the Indemnity Trust Motion did not seek to modify the Plan, so the court did not evaluate the Indemnity Trust Motion under the rigorous

§ 1127 standard. *See* ROA.3836 (Tr. 55:18-20) ("First, I overrule the objection notion that 1127 apples here, that this is a proposed plan modification post-confirmation."). Instead, the Bankruptcy Court evaluated the Indemnity Trust Motion under the undeniably lower business-judgment standard:

> So I find 363(b)(1) is actually the statute that applies here, and I find the evidence demonstrated this is a valid exercise of business judgment. Certainly, sound business justification, there's a sound business justification supporting it.

ROA.3838 (Tr. 57:10-14).

Ultimately the Bankruptcy Court overruled the Appellants' objection and granted the Indemnity Trust Motion. On July 21, 2021, the Bankruptcy Court entered the Indemnity Trust Order.

IV. SUMMARY OF THE ARGUMENT

The fundamental issue before the Court is whether the Indemnity Trust Order represents a "modification" to a confirmed plan under the Bankruptcy Code. If it does, then the Bankruptcy Court erred as a matter of law by entering the order and failing to follow the rigorous requirements of section 1127(b) of the Bankruptcy Code. On the other hand, if the Indemnity Trust Order is not a plan "modification," then the Bankruptcy Court was within its discretion to enter the order.

This presents a deceptively simple question: how can creating a wholly new trust, creating new liabilities, and transferring creditor property—none of which the Plan provides nor any of which is consistent with the Plan—amount to anything

other than a plan "modification?" Indeed, the fact that the Debtor filed the Indemnity Trust Motion in the first place necessarily admits that it sought to modify the Plan; otherwise, if the Debtor really could do what it wanted under the Plan as confirmed, then there would have been no need to file a motion in the first place.

This is not mere logical argument, for it is one of the reasons why this Court's binding precedent, directly on point, concluded another order before it constituted an improper plan modification. *See U.S. Brass Corp. v. Travelers Ins. Grp., Inc. (In re U.S. Brass Corp.)*, 301 F.3d 296, 307 (5th Cir. 2002) (asking why it was necessary to file the underlying motion if the plan already contemplated the relief). Not only should the Court ask the Debtor that question; the Court should answer it the same way it did in *U.S. Brass*. *See id.* ("the bankruptcy court correctly concluded, from its mere involvement in this post-confirmation dispute, that the true issue is whether the proposed agreement constitutes and impermissible attempt to modify the plan, despite the Appellants' characterization of the agreement as a settlement.").

The Plan permitted the Claimant Trust to reserve funds to indemnify "the Claimant Trustee, Litigation Trustee, and the Claimant Trust Oversight Committee"—no one else. *See* ROA.668. That limited authority does not fairly contemplate creating an undisclosed trust, with its own costly bureaucracy, funded with $25 million, to indemnify (a) "the General Partner [of the Reorganized Debtor], and each member, partner, director, officer, and agent thereof," (b) "each person who

is or becomes an Officer of the Partnership … " and (c) "each person who is or becomes an employee or agent of the Partnership …." ROA.722 (including Covered Persons in the definition of Beneficiaries); 1066 (definition of Covered Person).

When the Debtor filed the Indemnity Trust Motion, it necessarily sought to modify the Plan. Calling the request by another name does not change what it really sought. Courts routinely find so-called "settlements," for example, to constitute *sub rosa* plan modifications. *E.g. U.S. Brass*, 301 F.3d 296. This is no different. Instead of purchasing insurance to cover indemnification costs, as the Plan contemplates, the Debtor now seeks to saddle creditors with that burden. Those creditors deserve to vote on that modification, a fundamental right the Bankruptcy Court denied them. This Court should therefore reverse the Indemnity Trust Order and render judgment that the Bankruptcy Court could not have granted the Indemnity Trust Motion as a matter of law.

V. ARGUMENT

A. THE COURT SHOULD REVIEW THE INDEMNITY ORDER *DE NOVO*

This Court reviews the Bankruptcy Court's findings of fact for "clear error," while conclusions of law are reviewed *de novo*. *See Electric Reliability Council of Tex. Inc. v. May (In the Matter of Texas Comm. Energy)*, 607 F.3d 153, 158 (5th Cir. 2010). "A finding is clearly erroneous if a review of the record leaves a definite and firm conviction that a mistake has been committed." *Boudreaux v. U.S.*, 280 F.3d

461, 466 (5th Cir. 2002) (internal quotation omitted). This Appeal raises an issue of law only—*i.e.* whether the Indemnity Trust Order represents an impermissible plan modification. As the District Court appropriately observed, "[t]his court applies a *de novo* standard of review when deciding whether the bankruptcy court's order is a plan modification." ROA.4649 (citing *In re ASARCO, L.L.C.*, 650 F.3d 593, 601 (5th Cir. 2011)).

Put differently, this Court must determine what standard the Bankruptcy Court should have applied to the Indemnity Trust Motion. Should it have applied the lax business-judgment standard it applied? *See In re MF Global Ltd.*, 535 B.R. 596, 605 (Bankr. S.D.N.Y. 2015) (business judgment "entitled to great deference" if debtor acted in good faith on an informed basis). Or should the Bankruptcy Court have applied the more exacting and rigorous plan modification standard? *See* 11 U.S.C. § 1127(b) (requiring modification to satisfy, *inter alia*, all of 11 U.S.C. § 1129's numerous elements). The Court reviews this question *de novo*. *See Wells Fargo Bank of Tex. N.A. v. Sommers (In re Amco Ins.)*, 444 F.3d 690, 694 (5th Cir. 2006) ("The determination of which standard to apply … is a question of law reviewed de novo.").

B. A PLAN MODIFICATION CALLED BY ANOTHER NAME IS STILL AS PLAN MODIFICATION

This appeal ultimately turns on whether the Indemnity Trust Order effectuated a plan modification. The Bankruptcy Code does not define what constitutes a plan

modification. *E.g. SCH Corp. v. CFI Class Action Claimants*, 597 Fed. Appx. 143, 148 (3d Cir. 2015). Nor does the case law reveal any settled, explicit definition. But courts have found a wide variety of creative maneuvers to constitute impermissible, *sub rosa* plan modifications.

Most important is this Court's opinion in *U.S. Brass*. In that case, the confirmed plan contemplated liquidating certain claims "by institution of litigation in a court of competent jurisdiction." *U.S. Brass*, 301 F.3d at 300. After confirmation, various parties asked the bankruptcy court to approve a so-called "settlement" which required the same claims to go to binding arbitration. *Id.* at 302. They also asked the bankruptcy court to toll a limitations period in the plan. *Id.* at 308. This Court held that both of those requests violated § 1127(b) of the Bankruptcy Code: "[b]ecause the Appellants' proposed agreement would alter the parties' rights, obligations, and expectations under the plan, the bankruptcy court's denial of the motion was correct as a matter of law." *Id.* at 309.

U.S. Brass therefore sets forth the governing standard for whether proposed relief constitutes a request to "modify" a confirmed plan: if it "alter[s] the parties' rights, obligations, and expectations under the plan," then it modifies the plan. *U.S. Brass* also demonstrates how slight this standard is, meaning how even a slight change to a confirmed plan qualifies as a "modification." Adjudicating disputed claims by judicial determination versus arbitration does not appear on the surface

much of a material change. Both processes are lawful and designed to adjudicate disputed claims. But that is the point. If the parties (the debtor and its voting constituents) *agreed* on certain treatment, then the debtor cannot unilaterally change that agreement without seeking the voting constituents' consent, no more than one party to a contract may unilaterally modify the contract without the counterparty's consent. *See, e.g., In re Paige*, 118 B.R. 456, 460 (Bankr. N.D. Tex. 1990) (holding that confirmed plan is a "binding contract between the debtor and the creditors and controls their rights and obligations").

Similarly, in *In re Joint Eastern & Southern Dist. Asbestos Litig.*, 982 F.2d 721 (2d Cir. 1992), the plan created a trust for the benefit of asbestos claimants. The trust generally processed claims "on a first-in-first-out basis …." *Id.* at 726. But soon the trust became "deeply insolvent" *Id.* at 727. Numerous parties then proposed to revise the trust distribution process, which they "accomplished by means of the filing and rapid settlement of a class action." *Id.* at 728. Like this Court in *U.S. Brass*, the Second Circuit found the settlement constituted an impermissible plan modification. *Id.* at 747-49.

In *Doral Ctr. v. Ionosphere Clubs (In re Ionosphere Clubs)*, 208 B.R. 812 (S.D.N.Y. 1997), the plan set a deadline for the debtor to assume or reject a lease, and it modified the lease to delete a right of first refusal. *Id.* at 813. Meanwhile, an individual named Berger purchased an option from the landlord to buy the property.

Id. The debtor later "claimed it 'had been fraudulently induced by Berger to relinquish its right of first refusal' and that this fraud should be attributed to [the landlord]." *Id.* at 814. The debtor and landlord then entered into a settlement that purported to bind Berger and reinstate the right of first refusal, which the bankruptcy court approved. *Id.* The District Court held the order constituted a plan modification. *Id.* at 816.

Numerous other cases provide additional examples of *sub rosa* plan modifications. *See SCH Corp. v. CFI Class Action Claimants*, 597 Fed. App. at 148 (extension of repayment period constituted modification even if it "allegedly provides greater economic benefits for the estate and its creditors"); *Enters. Fin. Grp. v. Curtis Mathes Corp.*, 197 B.R. 40 (E.D. Tex. 1996) (motion seeking to allow debtor to pursue causes of action reserved to liquidating trust constituted modification "[e]ven if the proposed change does more accurately reflect the intent of the Plan …."); *Cohen v. Tic Fin. Sys. (In re Ampace Corp.)*, 279 B.R. 145 (Bankr. D. Del. 2002) (extending claim objection deadline constituted plan modification when the plan did not contemplate extensions).

This Court asked a critical question in *U.S. Brass* which perfectly sums up these cases' sentiment: "if the agreement is indeed consistent with the plan, the question becomes why did the Appellants file the motion for approval." *U.S. Brass*, 301 F.3d at 307. Not only should the Court ask the same question here; the Court

should answer it the same way: the very fact that the Debtor sought permission proves its motion fell outside the Plan's contemplation. *See id.* ("the bankruptcy court correctly concluded, from its mere involvement in this post-confirmation dispute, that the true issue is whether the proposed agreement constitutes and impermissible attempt to modify the plan, despite the Appellants' characterization of the agreement as a settlement.").

C. THE INDEMNITY TRUST ORDER EFFECTUATED AN IMPERMISSIBLE PLAN MODIFICATION

As noted, a plan modification changes "the parties' rights, obligations, and expectations under the plan." *U.S. Brass*, 301 F.3d at 309. Here, too, the Indemnity Trust Order alters the parties' rights, obligations, and expectations under the Plan, in at least two significant ways. First, it requires the Claimant Trust to indemnify numerous additional parties the Plan does not authorize it to indemnify. Second, it creates an entirely new trust, with all the attendant expense and bureaucracy, solely to benefit insiders.

i. The Indemnity Trust Order Requires the Claimant Trust to Indemnify Numerous People the Plan Does Not Authorize

The Plan authorizes the Claimant Trust to indemnify "the Claimant Trustee, Litigation Trustee, and the Claimant Trust Oversight Committee". ROA.668. But the Indemnity Trust Order requires the Claimant Trust to *additionally* indemnify: (a) "the General Partner [of the Reorganized Debtor], and each member, partner, director, officer, and agent thereof," (b) "each person who is or becomes an Officer

of the Partnership …," and (c) "each person who is or becomes an employee or agent of the Partnership …." ROA.722 (including Covered Persons in the definition of Beneficiaries); 1066 (definition of Covered Person). In other words, whereas previously the Claimant Trust only indemnified its own professionals and fiduciaries, now it must also indemnify the Reorganized Debtor's professionals, officers, and employees. And, unlike the Claimant Trust, which is liquidating its assets, the Reorganized Debtor continues to operate its business while it slowly liquidates. Given that the Reorganized Debtor manages billions of dollars in assets for the benefit of investors and third parties, as a fiduciary subject to various federal statutes, this new indemnity obligation may be huge indeed.

Thus, the Indemnity Trust Order expands, potentially greatly, the universe of persons indemnified by the Claimant Trust from those persons identified in the Plan. By itself, this is a plan modification because the Claimant Trust—the vehicle that exists to provide recoveries to creditors—is now saddled with greatly expanded and expensive indemnification obligations compared to those approved by the voting constituents under the Plan, potentially reducing creditor recoveries by $25 million or more.

The District Court found this broad expansion of liability unproblematic because the Reorganized Debtor is jointly and severally liable under the

Indemnification Funding Note. ROA.4651. But there are at least four problems with this argument.

First, it completely misses the point. With joint liability, the Claimant Trust still must indemnify people the Plan does not authorize it to indemnify. The Indemnity Trust Order creates liability beyond what the Plan contemplates. The fact that the Indemnity Trust arguably has a contribution claim against the Reorganized Debtor provides little comfort. The Plan's purpose is to liquidate the Debtor. *See* ROA.547-48. So there is no reason to believe it will always have the means to satisfy its indemnification obligations. And, the District Court placed the 'cart before the horse': the Indemnification Funding Note arises only as a result of the Indemnity Trust Order, which should not have been entered in the first place.

Second, the argument does not account for the $2.5 million in cash the Claimant Trust irrevocably contributes. *See* ROA.723. There is no mechanism for the Claimant Trust to recover those funds if the Indemnity Trust pays such funds to any of the new indemnitees. At a minimum, the Indemnity Trust Order immediately removes $2.5 million from creditors' already thinly lined pockets. *See* ROA.583 (projecting less than 100% return to unsecured creditors). This also violates the Plan's provision concerning "Available Cash" because the Plan required all "Available Cash" (as otherwise defined in the Plan and discussed above) to go to the

Claimant Trust for the benefit of creditors, as opposed to the new Indemnity Trust. *See* ROA. 655 (defining Claimant Trust Assets to include Available Cash).

Third, this is not a minor issue. The Indemnity Trust must maintain a *minimum* balance of $25 million. ROA.723-24 (describing and implementing "Indemnity Trust Account Minimum Balance"). The Claimant Trust is obligated to the Indemnity Trust under the new $22.5 million note, which is nowhere provided for in the Plan at all, thus representing a new, senior obligation of the Claimant Trust of at least $22.5 million that would otherwise go to the Claimant Trust's constituents. *See* part III.C, *supra*, ROA.723-25 (describing Indemnification Funding Note). Indemnification payments "will be senior to any distribution to beneficiaries under the Claimant Trust." ROA.724. And if cash runs short, "the Claimant Trustee must take all reasonable action to satisfy such obligations under the Indemnification Funding Note, including accessing any available credit lines or third-party leverage, and no current payments to Claimant Trust beneficiaries will be made until all current amounts due under the Indemnification Funding Note have been made." *Id.* Thus, up to $25 million of creditor and potentially equity holder recoveries will be sidelined in favor of new indemnification obligations.

Fourth, creditors reasonably expected the Reorganized Debtor to purchase D&O insurance to cover indemnification expenses, even if the Debtor could technically waive that protection. *See* ROA.685 (as a condition precedent to the

Plan's effectiveness, "[t]he Debtor shall have obtained applicable directors' and officers' insurance coverage that is acceptable to each of the Debtor, the Committee, the Claimant Trust Oversight Committee, the Claimant Trustee and the Litigation Trustee"). But nothing in the Plan alerted creditors *they* would have to pick up the bill following a waiver with respect to the new potential $25 million indemnification liabilities.

Under the Indemnity Trust Order, the Claimant Trust has undertaken vast indemnification obligations the Plan does not authorize. This altered the parties' rights, obligations, and expectations under the Plan—*i.e.*, it effectuated a Plan modification that could only be approved under the dictates of section 1127(b) of the Bankruptcy Code and the stringent confirmation requirements of section 1129, together with all of the disclosure, solicitation, and confirmation elements that these sections require. The Debtor's desire to short circuit these provisions by proceeding with a simple motion tacitly acknowledges not only that the Debtor was seeking to modify the Plan, but also that the modification would fail under these much stricter elements and standards. After all, why would creditors agree to devote their recoveries to indemnifying entities and persons who do not benefit them or work for them, and how could such an obligation be confirmed under cramdown over their objection as "fair and equitable"?

The Bankruptcy Court therefore erred by applying the wrong standard to the Indemnity Trust Motion, and the District Court erred by affirming. Since the Indemnity Trust Order effectuated a plan modification as a matter of law, there is nothing for this Court to remand to the lower courts, and this Court should therefore render judgment that the Indemnity Trust Motion must be denied as a matter of law.

ii. Creating an Entirely New Trust is not the Same Thing as Establishing a Reserve

The District Court also downplayed the Indemnity Trust merely as "an economic mechanism [which] functions as a reserve for payment of indemnity claims …." ROA.4650. Given that the Plan allows the Claimant Trust to establish a reserve, ROA.667, the District Court concluded the Indemnity Trust "is likely at least 'specifically contemplated' by the plan." ROA.4650 (citing *U.S. Brass*, 301 F.3d at 308).

Creating a reserve merely requires an accounting entry. The reserve need not be funded, and the reserve need not be used. The Claimant Trust would not even need to open a separate bank account. *See In re Acis Capital Mgmt.*, 18-30264-sgj11, 2019 Bankr. LEXIS 294, *125 (Bankr. N.D. Tex. Jan. 31, 2019) ("the Reorganized Debtor shall not be required to create separate accounts for such Reserves which may be created and memorialized by entries or other accounting methodologies").

Here, the Bankruptcy Court authorized the Debtor to create a whole new trust, and the Claimant Trust has obligated itself to fund that trust to the tune of at least $25 million. But trusts are not created in bankruptcy cases by motion. The Appellants are not aware of any reported opinion whereby a bankruptcy court permitted a debtor to *create* a new trust. Rather, trusts are created in Chapter 11 cases under Chapter 11 plans. *See* 11 U.S.C. § 1123(a)(5)(B) (providing that a plan may transfer property to a newly created entity).

What the Bankruptcy Court authorized the Debtor to do goes far beyond a mere accounting entry for a reserve—the Debtor cannot credibly contend the Plan "specifically contemplated" it, especially when the Plan specifically and explicitly contemplated D&O insurance. Creating the Indemnity Trust involves appointing a corporate trustee, ROA.722, who also receives indemnification. ROA.728. It eliminates the Claimant Trust Oversight Board's authority over investments for millions of dollars. ROA.729. The Indemnity Trust Administrator may hire his own financial and legal professionals, and the Claimant Trust must pay their fees. ROA.728. "Beneficiaries will not be involved in or have any rights with respect to the administration of the Indemnity Trust …." ROA.728. The Debtor's authority to set aside a reserve does not fairly encapsulate any of this extraneous relief.

And all of this is aside from the main point: if the Plan specifically contemplated a reserve set up by the Claimant Trust to satisfy its original

indemnification obligations under the Plan, then why go through with this new, cumbersome, expensive, and binding process and obligation? Why not just set up a reserve? And, if the Plan specifically contemplated anything of the sort, then why file a motion and seek the Bankruptcy Court's approval? The only logical and credible answer is because the Debtor was changing what was otherwise provided for in the Plan or, at a minimum, if not changing the Plan then adding to what was actually in the Plan. But then that is precisely what a plan modification is.

D. INFORMED SUFFRAGE IS THE HEART OF CHAPTER 11, AND THE BANKRUPTCY COURT DENIED CREDITORS THAT RIGHT

One gets the sense from the proceedings below that the lower courts failed to appreciate this Appeal's fundamental significance, essentially concluding (wrongly) that this was a matter of "no harm, no foul." But informed suffrage is the heart and soul of Chapter 11. *See DDJ Capital Mgmt., LLC v. Fruit of the Loom, Inc. (In re Fruit of the Loom, Inc.)*, 274 B.R. 631, 633 (D. Del. 2002) (citing *In re Lionel Corp.*, 722 F.2d 1063, 1066 (2d Cir. 1983), for the proposition that "The 'Code's requirement for informed suffrage which is at the heat of Chapter 11,' therefore, is clearly satisfied."); *In re Oxford Homes*, 204 B.R. 264, 270 (Bankr. D. Maine 1997) ("The result I reach is based on the need to honor the trust creditors are entitled to repose in the disclosure, solicitation, and confirmation process that are at the heart of Chapter 11.").

In other words, this is not a trivial matter, and the Appellants are not placing procedure over substance. This Appeal goes to the substance of the Chapter 11 confirmation process. This process requires extensive disclosures and solicitation (and potentially counter-solicitation), voting, and stringent requirements for confirmation—especially where the debtor seeks confirmation on "cramdown" over the votes of dissenting classes, as happened here with the Plan (and which is probably why the Debtor proceeded by simple motion, concerned that its Indemnity Trust would not be confirmed under the proper procedure). If a debtor can confirm a seemingly positive or innocuous plan, yet unilaterally change the plan later without creditor participation and voting, then that is an invitation for manipulating the Bankruptcy Code and debtor mischief.

It is true that creditors can object to motions filed in the Bankruptcy Court and that more creditors could have objected to the Indemnity Trust Motion, and that this is one form of creditor participation. But objecting to a motion does not change the standard under which the motion is considered, which here was the Debtor's "business judgment." Bankruptcy courts frequently approve such motions over creditor objections. Indeed, it is possible (and it occasionally happens) that a bankruptcy court approves a "business judgment" motion over the objection of every creditor, since creditor objections, while important, do not necessarily determine the underlying "business judgment" issues. Chapter 11 confirmation, however,

including with respect to plan modifications, requires the *affirmative* vote of at least one class of impaired, non-insider creditors. *See* 11 U.S.C. § 1129(a)(10). And, for every rejecting class, the test is not a simple "business judgment" test, but rather the far more stringent "fair and equitable" cramdown requirement (amongst other cramdown elements).[1] *See* 11 U.S.C. § 1129(b)(1).

For the Debtor to suggest it adequately disclosed the possibility of the Indemnity Trust and everything that comes with it to creditors before Plan confirmation has no basis in objective reality. Nor does the Debtor's suggestion that the Indemnity Trust is the functional equivalent of D&O insurance. With the latter, the Claimant Trust pays premiums and the insurer pays damages. But with the former, the Claimant Trust pays the underlying claims, at the expense of its stakeholders. Creditors, particularly those who voted to confirm the Plan, deserve the chance to cast their votes in light of this new paradigm shift. The Bankruptcy Court and the District Court deprived them of that right. That is the true substance and importance of this Appeal.

[1] "Fair and equitable" is in many respects a term of art, and case law provides substantial guidance on what this requirement entails. A thorough study of these cases is not necessary to this Appeal. Suffice it to say that the standard is far more exacting, and most plans are denied confirmation on cramdown largely because creditors have rejected them. Thus, while the "business judgment" test looks at a proposed course from a debtor's perspective; *i.e.* does the proposal make business sense to a debtor, the "fair and equitable" standard looks at the proposed course from the creditor's perspective and what the creditor wants and is reasonably entitled to receive, even if that is not to the debtor's liking.

E. HCMFA HAS STANDING TO PURSUE THIS APPEAL

Given that the District Court found NexPoint has standing to pursue this appeal, the question whether HCMFA also has standing presents a somewhat academic inquiry. But it matters, unfortunately, because of the Debtor's needless, unjustified acrimony toward the Appellants. HCMFA simply cannot trust the Debtor to restrain itself from attempting to graft the District Court's limited ruling onto situations where it does not apply, such as Appellants' other appeal before this Court.

The Bankruptcy Court expressly found HCMFA had standing to contest the Plan. ROA.852 (¶ 17); ROA.2824 (Tr. 20:15-16). It logically follows that HCMFA would have standing to object to a Plan modification. In fact, at the hearing on the Indemnity Trust Motion, the Debtor argued the Appellants lacked standing, but acknowledged the Bankruptcy Court would likely conclude otherwise. ROA.3799 (Tr. 18:2-7). Given that the Bankruptcy Court proceeded with the hearing and with a substantive ruling, one must conclude that the Bankruptcy Court rejected the Debtor's standing argument, as it had done before.

The District Court acknowledged HCMFA holds an administrative claim. ROA.4647. But the District Court somewhat misconceived the Appellants' statement that, "under the Plan, administrative claims are paid in full." ROA.4647, 4538. Sure, the Plan *proposes* to pay administrative claims in full. ROA.655. But there is no evidence it will actually happen, particularly when the Claimant Trust

and the Reorganized Debtor are pledging *at least* $25 million to satisfy insider indemnity claims.[2]

To the best of the Appellants' knowledge, the only administrative claimants the Debtor has paid are its professionals, just one of whose fees totaled almost $24 million for less than two years of work. *See Order Granting Fifth and Final Application for Compensation and Reimbursement of Expenses of Pachulski Stang Ziehl & Jones LLP as Counsel for the Debtor and Debtor in Possession, for the Period from October 19, 2019 through August 10, 2021*, 19-34054-sgj11, ECF No. 2047 (Bankr. N.D. Tex. Nov. 22, 2021). HCMFA has no reason to believe the Indemnity Trustee's professionals will exercise any greater billing restraint.

None of this bothered the District Court, however, because the Debtor's plan projections predict that the Debtor's liquidation will produce $181,879,000 for distribution to creditors. *See* ROA.4647 n.3 But the District Court erred by relying so heavily on the Debtor's superficial plan projections. The Debtor manages billions of dollars of other peoples' investments. ROA.548 (describing the Debtor as "a multibillion-dollar global investment advisor"). Mismanagement could therefore lead to billions of dollars in indemnity liability and related expenses.

[2] The Debtor even objected to HCMFA's administrative expense claim, which after a multi-day trial the Bankruptcy Court currently has under advisement. And having sued the Appellants no less than five times in a single year, *see* Bankr. Adv. Nos. 21-03000-sgj; 21-03004-sgj; 21-03005-sgj; 21-03010-sgj; and 21-03082-sgj, the Debtor will stop a nothing to steamroll the Appellants' rights. The Debtor's forthcoming (and baseless) allegations of vexatiousness notwithstanding, the Appellants have standing to resist those efforts.

Indeed, the Appellants firmly believe the Debtor has mismanaged certain investments, which is why they also appealed the Plan's third-party releases and injunctions. *See NexPoint Advisors, L.P. et al. v. Highland Capital Management, L.P. (In re Highland Capital Management, L.P.)*, No. 21-10449 (5th Cir.). The whole purpose of the Plan, all the way through to the Indemnity Trust Order, appears to be to shield the Debtor's management from liability.

No one disputes that the Plan, including its injunctions and releases, never would have gone effective but for the Indemnity Trust Order. The Reorganized Debtor's chief executive admitted it in a declaration:

> Although D&O Insurance was a condition to the Effective Date, the Independent Directors determined they would waive that condition *only* if the Indemnity Trust were approved as it would fill the gap and provide management the assurance they needed to implement and consummate the Plan.

ROA.4178. He also admitted it during direct examination at the hearing on the Indemnity Trust Motion:

> Q And did, as a matter of fact, the Debtor and the UCC agree to waive that condition?
>
> A Yes. Very specifically, so long as we could ensure that we could reserve for, protect, and indemnify the indemnification obligations that each of the trusts and the Reorganized Debtor have to those running it.
>
> Q So, stated another way, is it fair to say that the agreement on the waiver is conditioned on the approval of this motion?
>
> A Yes.

ROA.3823 (Tr. 42:10-19). Therefore, the Plan, with its injunctions, releases, and exculpations, never would have become effective, and would not now prejudice the Appellants' legal rights, but for the Indemnity Trust Order. The Indemnity Trust Order is simply the last link in a chain that severely prejudiced the Appellants' rights with respect to the Plan's provisions, which are now only effective because of the Indemnity Trust Order.

Under these facts, HCMFA is a "person aggrieved" within the meaning of the prudential standing doctrine upon which the District Court relied. ROA.4647 (citing *In re Coho Energy, Inc.*, 395 F.3d 198, 203 (5th Cir. 2004), and *In re Technicool Sys., Inc.*, 896 F.3d 382, 386 (5th Cir. 2018)). Holding otherwise elevates form over substance and places too much faith in the Debtor's ability to repay legitimate claims it continues to fight not to pay.

The foregoing notwithstanding, the Appellants hereby incorporate the brief of their co-appellant, The Dugaboy Investment Trust with respect to standing issues, including with respect to challenges to the application or constitutionality of *Coho Energy*.

VI. CONCLUSION

The Bankruptcy Court allowed the Debtor to modify the confirmed Plan simply because the Debtor called the modification something else. But this Court

should pull back the curtain and refuse to permit such subversion of fundamental bankruptcy principles and protections.

The Indemnity Trust Order requires the Claimant Trust to indemnify numerous parties the Plan does not allow it to indemnify. The Indemnity Trust Order creates a wholly new trust, with its own bureaucracy, professionals, and expenses. The Indemnity Trust Order removes $2.5 million from creditor recoveries and saddles the Claimant Trust with a new liability of $22.5 million in priority over the recoveries of creditors and equity interest holders. This undeniably altered the parties' rights, obligations, and expectations under the Plan.

If these changes or additions to the Plan do not represent a modification of the Plan, then it is hard to conceive of what would, especially in light of the low standard set by *U.S. Brass* (holding that merely changing the mechanism of claim adjudication from a judicial proceeding to an arbitration proceeding was a plan modification). And if the Debtor really believed the Plan already allowed for all this, then why did the Debtor ask for permission? The answer is obvious.

This Court should reverse the Indemnity Trust Order and render judgment that the Indemnity Trust Order must be denied as a matter of law because the Debtor failed to comply with the requirements of section 1127(b) of the Bankruptcy Code.

RESPECTFULLY SUBMITTED this 9th day of May, 2022.

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CERTIFICATE OF SERVICE

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Dated: May 9, 2022.

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