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.

REPLY 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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REPLY 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", and with NexPoint, the "Appellants") hereby submit this their *Reply 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. SUMMARY OF REPLY

The Debtor's primary arguments continue to avoid the actual issue. Yes, the Plan permitted the Claimant Trust to create reserves for its indemnification obligations. Yes, the Plan entitled all of the indemnified parties to indemnification from their respective post-confirmation entities. But that is different from the creation of a wholly new Indemnity Trust with its own trustee. Reserves are different from a transfer of millions of dollars of cash to a third party and the incurrence of tens of millions of dollars in priority liabilities to that third party. And, most importantly, whereas under the Plan the Claimant Trust indemnified only its own agents, now it indemnifies the Debtor, its general partner, and all of their officers, agents, and professionals. All of this is new. The assets, liabilities, obligations, and freedom of movement of the Claimant Trust changed from what those creditors voted on at confirmation.

That amounts to a *prima facie* plan modification. Again, if the Plan already enabled the Debtor and the Claimant Trust to do what they did, then why the need for a motion and order from the Bankruptcy Court? The only credible and logical answer demonstrates why this Court should reverse the Indemnity Trust Order: because the Plan did not permit the creation of the new Indemnity Trust and the various other transfers and obligations that came with it.[1]

The Plan represents a new, binding contract between the Debtor and its creditors and equity holders. That contract has now been changed without the counterparties' consent. That change amounts to a modification, not an "implementation." That modification has not been subjected to the Bankruptcy Code's rigorous requirements of disclosure, voting, and confirmation.

This Appeal does not represent a procedural nit such that "no harm, no foul" may carry the day. The very core of Chapter 11—creditor democracy, disclosure, transparency, and voting—has been case aside. That is the real danger of this case. If the Court affirms the Bankruptcy Court, one of the biggest protections for creditors and the process itself will be diluted, which is something that crafty debtors and their professionals will surely use in future cases to avoid their obligations. It would be nice indeed if material changes to obligations could be made under the simple

[1] The Debtor criticizes the Appellants' characterization of the Indemnification Sub-Trust as the Indemnity Trust, as being somehow misleading. The difference between the "sub-trust" and a "trust" is meaningless: the new trust is a separate legal entity with its own trustee, its own governance, and its own obligations.

business judgment rule of section 363(b) of the Bankruptcy Code. As in *U.S. Brass Corp.*, this Court should firmly clamp down on such machinations.

II. REPLY

A. NEXPOINT HAS STANDING AND THIS APPEAL IS JUSTICIABLE

For reasons not fully understood, the Debtor argues that HCMFA and Dugaboy lack standing in this Appeal while acknowledging that NexPoint has standing and that this Court therefore need not address standing issues. Appellee Brief at p. 1. The Appellants agree. The District Court held that NexPoint had standing and the Debtor did not cross-appeal this conclusion. As NexPoint clearly has standing, there is no need to consider the standing of other appellants. *See Carey v. Population Servs. Int'l*, 431 U.S. 678, 682 (1977) ("We conclude that appellee Population Planning Associates, Inc. (PPA) has the requisite standing and therefore have no occasion to decide the standing of the other appellees").

B. THE DEBTOR'S FAILURE TO CITE TO THE RECORD

Throughout its brief, the Debtor makes various statements of fact without giving the Court citations to where in the record they are evidenced—which should alert the Court to the *absence* of any evidence to substantiate the Debtor's *ipse dixit*. This includes the following:

- "The Plan, which garnered the nearly unanimous support of all Appellee's creditors . . ." Appellee Brief at p. 5. In fact, twenty-seven general unsecured

creditors voted against the Plan and only seventeen voted to accept the Plan, meaning that the Bankruptcy Court confirmed the Plan on "cramdown" over the rejection of the Plan by unsecured creditors.[2] ROA.21-10449.4202; ROA.584, ROA.587.

- "As each entity would have its own obligations and operating expenses—including the indemnification of its management and agents—the Claimant Trust would provide a back-stop if the Reorganized Debtor or the Litigation Sub-Trust were unable to satisfy those obligations and expenses." Appellee Brief at p. 5. As discussed below, there is no "back-stop," thus explaining why there is also no citation to any such "back-stop."
- "The Plan explicitly provided that the Claimant Trust's obligation to provide that backup funding was senior to the interests of the Claimant Trust's beneficiaries and that the Claimant Trustee was specifically authorized to establish sufficient cash reserves to meet backup funding requirements." Appellee Brief at p. 6. Again, as discussed below, there is no "backup funding" in the Plan.
- "All parties at Plan confirmation understood and expected that the lynchpin of all the bankruptcy estate's post-Effective Date operations was the

[2] The Debtor is correct to state that the unsecured creditors who accepted the Plan held the vast majority of the amount of unsecured claims, but that does not matter any more in this country and under the Bankruptcy Code than does a rich man's vote over a poor man's vote.

willingness of qualified individuals to run the Post-Effective Date Entities, protected by the indemnification rights clearly established in the Plan, and that their willingness to serve depended directly on the securing of those indemnification rights—especially under circumstances where Mr. Dondero was almost certain to sue everyone for everything they did or didn't do." Appellee Brief at p. 10. Not only is there no citation for this statement, but given that unsecured creditors overwhelmingly rejected the Plan by number, there is no reason to believe it.

C. THE INDEMNITY TRUST ORDER *EXPANDED* THE CLAIMANT TRUST'S INDEMNIFICATION OBLIGATIONS

A key issue in this Appeal is whether the Indemnification Subtrust Order expanded the Claimant Trust's indemnification obligations under the Plan—if it did, then it is much harder for the Debtor to argue there was no plan modification. Thus, the Debtor employs alchemy and misleading quotations to convince the Court that there was no such expansion. Basically, the Debtor uses the multitude and complexity of the underlying documents to confuse the issue in an attempt to distract the Court from the simple truth and unmistakable language actually at issue. The Court should see through this, and the Appellants will demonstrate on an argument-by-argument basis why the Debtor is not only wrong, but is intentionally manipulating the language of the governing documents, as it did (successfully) below.

First, the Debtor states that the "argument that the Indemnified Parties include people under the Indemnity Sub-Trust not already listed in the Plan Implementation Documents is plainly wrong." Appellee Brief at p. 18. But that is not the Appellants' argument. Yes, all of the persons entitled to indemnification under the Indemnity Trust are entitled to indemnification under the Plan, but from *three separate* post-confirmation entities and not all from the Claimant Trust.

As the Appellants briefed and the Debtor concedes, the Plan created three post-confirmation entities: the Claimant Trust, the Litigation Subtrust, and the Reorganized Debtor. Each of these indemnified its own agents under the Plan. Now, however, the Claimant Trust also indemnifies the Debtor, its general partner, and all of their officers, agents, professionals, and so on. That is the point: not whether all were entitled to indemnification under the Plan, but from which entity they were entitled to receive such indemnification. This is important because the Debtor is engaged in ongoing business managing billions of dollars in assets and funds, which can give rise to huge indemnification claims that can swamp the Claimant Trust and therefore all creditor recoveries.

The Plan requires the Claimant Trust to indemnify "the Claimant Trustee, Litigation Trustee, and the Claimant Trust Oversight Committee." ROA.668. Just those three. The Indemnity Trust Order, however, includes as "Beneficiaries" of the Indemnity Trust "'Covered Persons' under Section 10 of the Reorganized Limited

Partnership Agreement." ROA.722. This means the reorganized Debtor, its general partner, and their officers, agents, professionals, and the like. *See* Appellee Brief at p. 18 and n. 32.

The Debtor's motion leading to the entry of the Indemnity Trust Order expressly states that the "Beneficiaries" of the trust are "The Indemnified Parties," which is defined as including "New GP LLC (as the Reorganized Debtor's general partner) and each member, partner, director, officer, and agent thereof, (ii) each person who is or becomes an officer of the Reorganized Debtor, and (iii) each person who is or becomes an employee or agent of the Reorganized Debtor if New GP LLC determines in its sole discretion that such employee or agent should be indemnified." ROA.711; ROA.710 (at n. 8). Therefore, there is no question that the Claimant Trust, through its funding of the Indemnity Trust and its $22.5 million liability to the Claimant Trust, is paying for the indemnification obligations of the Debtor under the Plan and not just for its own separate indemnification obligations.

At the same time that the Debtor denies this simple and incontrovertible fact, the Debtor tacitly admits this to be the case. On page 12 of its brief, the Debtor discusses the Claimant Trust Agreement and confirms that under this agreement the:

> The Claimant Trustee (including each former Claimant Trustee), Delaware Trustee, Oversight Board, and all past and present Members (collectively, in their capacities as such, the "Indemnified Parties") shall be indemnified by the Claimant Trust against and held harmless by the Claimant Trust from . . .

Appellee Brief at p. 12. There is no mention of the Claimant Trust indemnifying the Debtor or its general partner or their agents, officers, and professionals.

The Debtor continues on page 13 of its brief where it discusses the indemnification obligations of the Debtor as providing "for the Reorganized Debtor's broad indemnification of, among others, the Reorganized Debtor's general partner and its members, partners, directors, officers, and agents, as well as any officers of the partnership." Appellee Brief at p. 13. That is precisely the point. Under the Plan and its implementation instruments, the Claimant Trust did not indemnify these persons. The Debtor did.

And that is logically what everyone expected: the Debtor continues to be involved in risky financial management and advice, which may subject it to serious potential liability. The Claimant Trust exists to provide a recovery for creditors. Why would the creditors subject their recoveries to the risk of having to indemnify the Debtor with respect to its post-confirmation business affairs? True, the creditors have an interest in the Debtor succeeding, since the Claimant Trust now owns the Debtor. But much like owners form corporations to shield themselves from personal liability, there is a difference. The Claimant Trust has other assets separate from the Debtor. If the Debtor fails due to post-confirmation mismanagement and lawsuits, then it can fail without threatening the other assets of the Claimant Trust under the

Plan. Yet under the Indemnity Trust Order, the Claimant Trust has now exposed itself precisely to that potential liability, to the tune of at least $25 million.

As noted above, the Debtor did not cite to any provision of the Plan or its implementation documents where the Claimant Trust allegedly agreed to "backstop" the separate and independent indemnification obligations of the Debtor. The Debtor's discussion of this issue on page 13 of its brief proves that this is in fact not the case; hence probably the reason for the lack of any citation. The Debtor notes that the Claimant Trust's indemnification obligations are senior in priority to creditors, which is true, and the Debtor then quotes that Plan obligation as follows:

> The Claimant Trust shall pay, advance or otherwise reimburse on demand of an Indemnified Party the Indemnified Party's reasonable legal and other defense expenses (including, without limitation, the cost of any investigation and preparation and attorney fees, disbursements, and other expenses related to any claim that has been brought or threatened to be brought) incurred in connection therewith or in connection with enforcing his or her rights under this Section 8.2 as a Claimant Trust Expense . . .

Appellee Brief at pp. 13-14.

But this is intentional slight-of-hand. The Debtor's citation for this provision is to page 1029 of the Record and therefore to section 8.2 of the Plan. But that section begins with the following language, which the Debtor omits: "the Claimant Trustee (including each former Claimant Trustee), Delaware Trustee, Oversight Board, and all past and present Members (collectively, in their capacities as such, the "Indemnified Parties") shall be indemnified . . ." ROA.1029. In other words,

that same section limits the definition of "Indemnified Parties" to a few named person or entities, which list does not include the Debtor, its general partner, or their agents, officers, professionals, etc.

The Debtor finally cites to section 6.1 of the Plan on page 14 of its brief, where it quotes at length and bolds certain provisions which it argues provide for expanded indemnification obligations, in particular that the Claimant Trust shall distribute funds to its beneficiaries net of, among other things, any amounts that:

> **are necessary to satisfy or *reserve* for other liabilities incurred or anticipated by the Claimant Trustee in accordance with the Plan and this Agreement (including, but not limited to, indemnification obligations . . .**

Appellee Brief at p. 14 (emphasis in original).

But what "liabilities?" The Claimant Trust may well reserve for its incurred or anticipated liabilities, but nowhere does the Plan or any implementation document provide that it is the Claimant Trust's liability to indemnify the Debtor, its general partner, or their officers, agents, professional, etc. There is nothing to reserve for. That is the point—any such liability is newly created by the Indemnity Trust Order. This Court should not be fooled by the Debtor's alchemy and its intentional misdirection—the Plan and implementation documents nowhere provide for any direct indemnification or any indemnification "backstop" by the Claimant Trust of the reorganized Debtor's or its general partner's agents, officers, professionals, etc.

Finally, the Debtor argues that "[i]n fact, the Indemnity Sub-Trust did not create any obligation to indemnify anyone." That may be technically true. However, as has been shown above, it is the Claimant Trust who is solely funding the Indemnity Trust with at least $25 million in cash and debt instruments, and the beneficiaries of the Claimant Trust include persons who the Plan does not provide for the Claimant Trust to indemnify, including the Debtor, its general partner, and their officers, agents, professionals, etc. Or, to use the Debtor's terminology, the Claimant Trust is using $25 million of creditor recoveries to "collateralize" not only its own indemnification obligations, but also those of the Debtor. Yes, if the Claimant Trust had any obligation under the Plan to indemnify the Debtor's agents, that would be a different matter. But it does not. Yet it now must pay for that non-existing obligation. That is indemnification, in substance even if not technically in form. And that is $25 million of creditor recoveries used to pay the obligations of a separate entity.

The truth is very simple. Mr. Seery controls the Claimant Trust as its trustee. Mr. Seery also controls the Debtor as it continues to engage in business and manage third party assets. Mr. Seery was not able to obtain insurance to protect himself with respect to his control of the Debtor and its business operations. Mr. Seery does not want to get sued or face personal liability for that control and for those business operations. So Mr. Seery saddled the Claimant Trust—of which he is the trustee and

fiduciary—with tens of millions of dollars of potential new liability to protect himself, simply because the Claimant Trust has the assets to do so and because he believed he could get away with it. Creditors should have been provided with detailed disclosures regarding these facts and issues, they should have been able to vote on such an important an issue, and the Bankruptcy Court should have considered the Indemnity Trust under the strict requirements of plan confirmation.

As in *U.S. Brass Corp.*, "if the agreement is indeed consistent with the plan, the question becomes why did the Appell[ees] file the motion for approval." *U.S. Brass Corp. v. Travelers Ins. Group, Inc. (In re U.S. Brass Corp.)*, 301 F.3d 296, 307 (5th Cir. 2002). Likewise here, if the Indemnity Trust is already contemplated by, or is consistent with, or merely constitutes the implementation of, the Plan, then why did the Debtor file its motion for approval? Precisely because the Debtor needed the judicial protection afforded by a court order because the Debtor *was* modifying the terms of its confirmed Plan.

III. 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 indefinitely 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 29th day of July, 2022.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that, on this the 29th day of July, 2022, a true and a correct copy of the foregoing document was served on the counsel of record listed below via electronic service.

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)'s TYPE-VOLUME LIMITATION, TYPEFACE LIMITATION, AND TYPE-STYLE REQUIREMENTS

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 3,912 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word in Times New Roman, 14 pt. font.

Dated: July 29, 2022.

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