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

CHARITABLE DAF FUND, L.P., AND CLO HOLDCO, LTD.	§	
	§	Adv. Proc. No. 21-03067-sgj
Plaintiffs,	§	
vs.	§	Case No. 3:22-cv-02802-S
HIGHLAND CAPITAL MANAGEMENT, L.P., HIGHLAND HCF ADVISOR, LTD., AND HIGHLAND CLO FUNDING, LTD.	§	
Defendants.	§	

APPENDIX IN SUPPORT OF RESPONSE TO OBJECTION TO THE BANKRUPTCY COURT REPORT AND RECOMMENDATION TO THE DISTRICT COURT ON "RENEWED" MOTION TO WITHDRAW THE REFERENCE [BANKR. DOC. NO. 128]

Ex.	**Description**	**Appx. #**
1.	Transcript of Hearing Held November 23, 2021, Adv. Proc. No. 21-03067-sgj (Bankr. N.D. Tex. Nov. 23, 2021)	1-105
2.	Transcript of Hearing Held January 25, 2023, Adv. Proc. No. 21-03067-sgj (Bankr. N.D. Tex. Jan. 25, 2023)	106-218
3.	Securities and Exchange Commission, C.F.R. Parts 275, *Prohibition on Fraud by Advisers to Certain Pooled Investment Vehicles*, Release No. IA-2628; File No. S7-25-06	219-238
4.	*Second Amended and Restated Investment Advisory Agreement*, dated to be effective January 1, 2017, by and between Charitable DAF Fund, L.P., Charitable DAF GP, LLC, and Highland Capital Management, L.P	239-261
5.	Members Agreement, November 15, 2017	262-290
6.	Securities and Exchange Commission, C.F.R. Parts 276, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248; File No. S7-07-18	291-333
7.	NexPoint Diversified Real Estate Trust Form 8-K dated July 1, 2022	334-345
8.	*In re Acis Capital Management, L.P., et al.*, Case No. 18-30264-sgj11, D.I. 497 (Bankr. N.D. Tex. Aug. 13, 2018)	346-377
9.	*In re Acis Capital Management, L.P., et al.*, Case No. 18-30264-sgj11, D.I. 549 (Bankr. N.D. Tex. Sept. 4, 2018)	378-385

Dated: March 21, 2023

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EXHIBIT 1

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS (DALLAS)

IN RE:	Case No. 19-34054-11(SGJ)
HIGHLAND CAPITAL MANAGEMENT, L.P.,	
Debtor.	
CHARITABLE DAF FUND, LP, et al.,	Adv. No. 21-03067(SGJ)
Plaintiffs,	Earle Cabell Federal Building 1100 Commerce Street
v.	Dallas, Texas 75242
HIGHLAND CAPITAL, MANAGEMENT, L.P., et al.,	
Defendants.	Tuesday, November 23, 2021 9:40 a.m.

TRANSCRIPT OF HEARING ON
PLAINTIFFS' MOTION TO STAY ALL PROCEEDINGS (55);
PLAINTIFFS' MOTION TO STRIKE REPLY APPENDIX (47); AND
DEFENDANTS' MOTION TO DISMISS COMPLAINT (26)

BEFORE HONORABLE STACEY G. JERNIGAN
UNITED STATES BANKRUPTCY COURT JUDGE

TELEPHONIC APPEARANCES CONTINUED ON NEXT PAGE.

Audio Operator: Hawaii S. Jeng

Proceedings recorded by electronic sound recording, transcript produced by a transcript service.

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INDEX

THE COURT: Good morning. Please be seated.

All right. We have a setting in the Charitable DAF Fund, et al., v. Highland, Adversary 21-3067. We have three motions that are set.

Let me get appearances from the Plaintiffs' counsel first. Go ahead.

MR. SBAITI: Good morning, Your Honor. This is Mazin Sbaiti for the Plaintiffs.

THE COURT: Okay. Thank you.

Now for the Defendants, who do we have appearing?

MR. POMERANTZ: Good morning, Your Honor. It's Jeff Pomerantz and John Morris from Pachulski Stang Ziehl & Jones. Your Honor, before -- I understand Your Honor is going to take up the motion to stay first.

Before Your Honor does so, I have a procedural issue relating to that motion that I would like to address the Court after appearances are made.

THE COURT: All right. I assume that's all the lawyer appearances for this adversary.

MR. JORDAN: Your Honor?

THE COURT: Oh, go ahead.

MR. JORDAN: Your Honor, we are a nominal defendant, but John Jordan on behalf of Highland CLO Funding, Ltd.

THE COURT: Okay. Thank you. Sorry about that.

MR. BESSETTE: And, Your Honor, Paul Bessette, Mr.

Jordan's colleague is on the phone, as well.

THE COURT: Okay. Thank you.

All right. Anyone else I missed?

(No audible response)

THE COURT: All right. Mr. Pomerantz, your procedural issue?

MR. POMERANTZ: Thank you, Your Honor.

Your Honor, I must once again bring to this Court's attention a violation of the Court Rules by the various counsel representing Mr. Dondero. This time it's by Mr. Sbaiti.

When the district court entered its order granting Highland's motion to enforce the reference and referring this matter to Your Honor, there were three matters on the Court's docket, district court's docket that got transferred. First was the motion to dismiss, second was the motion to stay, and third was the motion to strike, which essentially has been rendered moot.

The briefing was complete with respect to the first two matters, the motion to dismiss and the motion to stay. And all that remained for the Court to do was to set a hearing and have oral argument. Your Honor, on October 13th, Your Honor set a hearing for today for each of those two motions. Nevertheless, on November 10th, almost a month after the Court set the matters for hearing and after pleadings were closed, Plaintiffs filed what they called their amended motion to stay.

As an initial matter, Your Honor, the amended motion was not even filed in this adversary proceeding initially. It was filed in the main case, and there was an error that Mr. Sbaiti corrected on November 18th, five days before this hearing. Plaintiff did not ask for leave of court to file any further pleadings. They did not provide the time under the local rules for response. And, in fact, they raised additional arguments in their amended motion.

Well, Your Honor, we can certainly argue to the Court that the amended motion constitutes a new motion, is untimely, and the hearing should be continued to allow us to file a response. We're not going to do that, Your Honor. As I will discuss when it's my time to response substantively to the motion, the new arguments to stay the proceedings, the amended motion are equally as frivolous as the arguments contained in the original motion.

But I bring this to the Court's attention because, again, it's extremely frustrating to have the lawyers representing Mr. Dondero's related entities continue to act as if the rules do not apply to them. Your Honor will recall just a week or so ago, Your Honor made a -- we had a similar issue in connection with the motion to dismiss. Failure to follow the rules is unprofessional, and it's disrespectful not only to Highland's professionals but also to the Court and it interferes with Your Honor's ability to control your docket and sufficiently prepare for contested matters.

At some point, Your Honor, there should be real consequences for the continued violation of the rules. Having said that, Your Honor, we are prepared to go forward with the motion to stay today.

THE COURT: All right. Mr. Sbaiti, what say you? I'm looking at Docket Entry Number 69 in the adversary proceeding that was filed last Thursday. So, obviously, very, very late in the game, shall we say. What is your response to this?

MR. SBAITI: Your Honor, that was not filed in the adversary as an error. When we asked one of our paralegals to file it, we're not as familiar with the bankruptcy court system and it was an error. It was corrected once the lawyers realized it, which was last -- which was on November the 18th. It was filed in, I guess in the main case. But it was simply an inadvertent error, Your Honor.

MR. POMERANTZ: I would add, Your Honor, the original motion filed inadvertently was November 10th. It still was not timely. I think Mr. Sbaiti needs to answer the question of why that was filed untimely, okay.

THE COURT: All right. Thank you, Mr. Sbaiti.

So, one of my pet peeves in life is people blaming paralegals, by the way. But be that as it may, as Mr. Pomerantz points out that it was still untimely the motion filed in the underlying bankruptcy case November 10th. So what is your --

MR. SBAITI: Your Honor, when we looked at the motion and looked at the progression of the case, we filed an amended motion simply to clarify our position. And really I don't think we've changed our arguments all that much. We simply clarified our position. We've seen amended motions filed in the bankruptcy in our prior dealings, and so at that point, we felt like there wasn't a rule explicitly saying we couldn't have an amended motion.

But if it's untimely, Your Honor, you know, we don't think it changes the underlying arguments. As Mr. Pomerantz said, we don't think there's any prejudice to Highland either.

THE COURT: All right. Well, just to be clear, you know, it's one thing in an underlying bankruptcy case to file an amended motion after you've gotten a motion set for hearing that might slightly adjust, you know, facts or relief sought. And, of course, we independently look at it when it happens in an underlying case to see do we need more notice to affected parties.

But in an adversary proceeding, you know, you just don't do this. All right? If you have some sort of exceptional circumstances, you can file I guess a motion to amend because I got to include this new information that didn't exist. But you just don't do this, okay?

So I don't -- could you be clear what was the new information? What was the new information that had to be brought before the Court suddenly?

MR. SBAITI: Your Honor, there wasn't new information. We were simply giving notice of our understanding of where the legal arguments were going. The reason being is that after those motions were filed and recently, the debtor took the position in two other cases that they should be dismissed pursuant to the permanent injunction.

And so that clarified for us at least a couple of arguments that were unclear to us where the debtor stood on whether or not the permanent injunction would be a basis to dismiss or stay any of the claims that were pending. There are two other claims pending in district court. Since we had filed that motion, the debtor filed a motion to reconsider the stays that were granted in those two courts. And then they also moved to dismiss on the basis of the permanent injunction.

And so given that the debtor took the position that they were willing to dismiss those cases based upon the permanent injunction, it in many ways contravenes the position they took in response to our motion which is that the -- for example, they somewhat take the position in Paragraph 22, it wasn't as clear then but it's clear -- it seems clearer now that the permanent injunction is not relevant to whether or not the case can go forward in any capacity.

And so we simply wanted to incorporate that, but it's mainly legal argument about the choices that are before the Court. That was really it. I mean, theoretically, I would have made them for the first time during oral argument and we thought we were doing something good by giving -- apprising the Court in writing and giving notice of these arguments to the other side by filing an amended motion. We didn't add new evidence or anything like that.

MR. POMERANTZ: Your Honor, that argument is completely disingenuous because our motion to dismiss and motion for reconsideration that Mr. Sbaiti refers to is several weeks ago, okay. It wasn't November 10th. It was several weeks ago.

I will respond substantively why Mr. Sbaiti is wrong and there's no inconsistent positions when it's my time to speak. But for Mr. Sbaiti to say he was doing us a favor and he was reacting to recent new information is just wrong, Your Honor. And they should just not be continued to allowed to get away with flouting the rules.

THE COURT: All right. Well, let me just say I'm confused, maybe I should say baffled, about this amended motion. You know, the motion to dismiss that is before the Court for oral argument today isn't about the injunction, isn't about the plan injunction. It's about res judicata and other 12(b)(6) arguments.

So I'm confused and I think, you know, it's been clear for many months in this adversary proceeding, in particular, the debtor's position on the plan injunction, particularly, you know, in the whole argument on the motion to leave to add Mr. Seery as a defendant.

So I'm confused, but we're going to go forward on the argument today, whatever argument you want to make. And you've been, I guess, forewarned. I will say that these last-minute amended motions are not going to be tolerated, are not going to be considered. And so, you know, I hope you won't do it again. Your firm has already been sanctioned once in this adversary proceeding. I'm sure we all remember.

So, you know, I'm just kind of baffled why you would take a chance filing an amended motion without leave or somehow getting it to the attention of the Court or running it by the other parties for their consent to you doing it. But we're going to go forward and just hear the arguments, okay. And so --

MR. SBAITI: Thank you.

THE COURT: -- I'll hear your argument.

I'm letting people know I don't know where this time estimate came on the calendar today, three hours. I don't know if someone specifically expressed that. But I'm letting you know at noon I have a swearing-in ceremony that I'm doing back in my chambers. So I will stop at noon Central time.

And so does anyone think that's going to be a problem?

MR. SBAITI: It should not be, Your Honor, from our perspective.

THE COURT: Mr. Pomerantz?

MR. POMERANTZ: I don't believe so. Mr. Morris is going to handle the motion to dismiss which is going to be the bulk. My presentation on the motion to stay is only going to be around ten minutes or so.

THE COURT: Okay. Thank you.

Mr. Sbaiti, your argument on the motion for stay.

MR. SBAITI: Thank you, Your Honor.

Your Honor, may I share my screen?

THE COURT: You may.

MR. SBAITI: I have a PowerPoint that can kind of --

THE COURT: Okay. You may.

MR. SBAITI: -- walk us through. Thank you.

Is Your Honor able to see my screen?

THE COURT: I can, yes.

MR. SBAITI: Thank you, Your Honor.

Your Honor, what I would point you to is, first, the injunction language. This is what Your Honor's permanent injunction says, and this is really what animates our motion to stay. Out motion to stay is derived specifically because my clients and I feel like our case has been enjoined by this injunction, if not completely disposed of.

The language says that we're an enjoined:

"An enjoined party is permanently enjoined from commencing, conducting, or continuing in any manner any suit, action, or other proceeding of any kind including any proceeding in a judicial, arbitral, administrative, or other forum against or affecting the debtor or the property of the debtor."

And then (v) of that injunction says:

"or acting or proceeding in any manner in any place whatsoever that does not conform to or comply with the provisions of the plan."

One of the things that was suggested in Paragraph 22 of their response was that the DAF and Holdco are not enjoined parties. But the final plan defines an enjoined party in Article 1(b)(56) as any entity who has or -- all entities who have held, hold, or may hold claims against the debtor; any entity that has appeared and/or filed any motion, objection, or other pleading in this Chapter 11 case regardless of the capacity in which such entity appeared and any other party in interest. And, five, the related persons of each of the foregoing.

Article 1(b)(22) defines a claim as any claim that's defined in Section 1015 of the Bankruptcy Code. And Section 1015 of the Bankruptcy Code defines a claim as a right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

So given this definition, when we've read this injunction, we believed that we were enjoined parties, the DAF and Holdco were both enjoined parties. They had appeared in the -- they have claims. Obviously, those are the claims being asserted here.

And so going back to the injunction language, we believe this lawsuit has been disposed of by this permanent injunction. We believe there's really only one or two things that should probably happen with this lawsuit. Either it could be dismissed based upon the permanent injunction or what we proposed in our motion to stay is that the Court exercise its inherent authority to simply stay the case pending the appeal of this language, which is up on appeal in the Fifth Circuit right now.

If that language, and if the injunction gets affirmed by the Fifth Circuit, then certainly the dismissal can happen once that affirmance happens and there's no harm, no foul, and no one's wasted any time.

If they're not, if it's overturned, then, obviously, the injunction would be vacated, presumably by the Fifth Circuit. And at some point, if the Court decides not to enter a similar injunction that would likewise dispose of this case, then the case could proceed on the merits.

The issue we've identified both in our original motion and as we fleshed out in our -- as a matter of law in our amended motion to simply put a finer point on it is that the merits are now -- have been disposed of. This injunction ends this case, at least as far as we read it. It ends this case irrespective of the underlying merits of the lawsuit, which means that the lawsuit merits themselves have become moot and any opinion or any attempt to resolve it is obviously an advisory opinion by the Court.

So we really only see two ways that this could go right now without either gutting the injunction or circumventing it completely, which is to say that either the case should be dismissed based upon the permanent injunction or the case should be stayed based upon the permanent injunction.

Mr. Pomerantz or the debtors' brief suggests that, well, the injunction doesn't prevent hearing pending motions. But I would respectfully disagree with that. If you look at the language, "commencing, conducting, or continuing in any manner in any suit, action, or other proceeding against or affecting the debtor."

As 12(b)(6) hearing, I would imagine, was intended to fall under the umbrella of a proceeding. And us arguing a 12(b)(6) motion would us be conducting and maybe even continuing the suit because we're trying to protect the merits of the suit, which as I said are at this juncture already moot.

And so it comes down to I think a very simple question, which is what do we do at this juncture. Do we just simply dismiss the lawsuit in light of this permanent injunction or stay the lawsuit in light of this permanent injunction?

The debtor makes a lot of hay out of the fact that, well, there are special rules that apply when you're trying to stay a case pending appeal. But if you look at all of their case law, it has to do with different circumstances where an appeal -- where there's a matter on appeal that could substantially affect the resolution of the case, which here we think it actually could. But in those cases, those appeals would affect the resolution of the case on the merits; whereas, here, the question goes to whether or not a permanent injunction that really has stopped us all in our tracks.

As soon as we understood this injunction and its scope, we're the ones who reached out to the debtor's counsel and asked them on a meet-and-confer whether or not they would just agree to stay the matter. And we were a little bit surprised by their reaction when they first didn't think that this applied to our case, and we didn't understand how. And then they changed their mind, said it did apply to our case but they didn't think that we should stay the case. And they didn't suggest let's just dismiss it based upon the permanent injunction.

So it kind of comes down to the same small -- same simple issue, Your Honor. There's this permanent injunction, and I don't think there's any way for us to get around it at this juncture.

THE COURT: Mr. Pomerantz:

MR. POMERANTZ: Yes, Your Honor.

I'm going to respond to several of the arguments Mr. Sbaiti made in his motion, which apparently he's abandoned because he only is focused on the injunction. And I'm also going to tell Your Honor, what our arguments are because despite Mr. Sbaiti's efforts, he's completely misquoted them.

So in the motion and the amended motion, the Plaintiffs make several arguments why this Court should stay the matter. First, they argue they're entitled to a stay because the exculpation provision in the plan prohibits them from proceeding against the Defendants in the action. And there are several problems with that argument.

First, Mr. Sbaiti and the Plaintiffs don't even attempt to meet the Fifth Circuit's standards for a stay pending appeal because, of course, they can't. Mr. Sbaiti's trying to sidestep the grounds for a stay pending appeal by arguing it doesn't apply just is incorrect.

They would have to show that there is a likelihood of success on the merits, they would suffer irreparable harm, the debtor wouldn't suffer irreparable harm, and there is -- public interest supports a stay. They can't do any of them.

In fact, as Your Honor is well aware, Your Honor denied the actual appellants in that suit, in that order, the confirmation order, a stay pending appeal and that was denied by the district court and also denied by the Fifth Circuit Court of Appeals.

The Plaintiffs didn't object to the plan, they are not parties to the appeal, and they never sought a stay pending appeal. So they really can't explain why they as really strangers to the appeal are entitled to a stay of the effectiveness of the plan when the actual appellants to that order were denied a stay pending appeal up through the appellate ladder.

Second, notwithstanding Mr. Sbaiti's arguments in the motion, the exculpation provision is neither as broad nor does it affect all the parties that are subject to this litigation. There are three Defendants in the complaint. The only Defendant that is covered by the exculpation provision is the debtor. The exculpation provision does not apply HCF Advisors, and it does not apply to Highland CLO Funding.

Also, while the exculpation provision does apply to the debtor, it only exculpates the debtor from claims of negligence. The complaint raises a variety of causes of action that have nothing to do with negligence and would not be covered by the exculpation provision.

But, Your Honor, the biggest problem with their argument that the exculpation provision supports a stay is that the exculpation -- the appeal of the exculpation provision has nothing to do with this case. Why? Because the Fifth Circuit appeal concerns whether the exculpation provision is appropriate for parties other than the debtor. The debtor is the only Defendant in this case that obtains the benefit of the exculpation.

And there is no dispute, there was no dispute at confirmation, there's no dispute in the case law, there's no dispute in <u>Pacific Lumber</u>, there's no dispute in the appeal that a plan can exculpate the debtor. So the Fifth Circuit appeal doesn't implicate the exculpation provision and cannot support a basis for a stay.

The next argument Mr. Sbaiti makes is the injunction provision, and the injunction provision is on appeal to the Fifth Circuit. But the aspect of the appeal of the injunction is not the provision that Mr. Sbaiti points to.

And, again, as with the exculpation provision, the same arguments about failure to obtain a stay, failure to be party to the appeals, and failure to object to the plan apply, as well. But as is the case with the exculpation provision, the resolution of the appeal of the injunction provision will not affect this case in any way.

They point to the portion of the injunction that prohibits enjoined parties from directly or indirectly continuing, commencing, or conducting in any manner any suit or action proceeding against the debtor. They argue that they cannot proceed without violating the injunction because the injunction was intended to put all litigation against the debtor to an end.

But, of course, Your Honor, that is not true. That is not what the injunction is. The issue on appeal before the Fifth Circuit as it relates to the injunction is whether the injunction impermissibly enjoins parties from enforcing their rights with respect to post-effective date commercial relationships with the reorganized debtor. And, of course, we argue that it's appropriate, but it has nothing to do with the provision Mr. Sbaiti identified.

The appeal does not impact in any way whether a plan can enjoin prosecution of claims that arose prior to the effective date. And, of course, such a plan provision is completely appropriate and is customary. The plan provided the debtor as the plan provides all debtors with a fresh start and enjoins litigation against the debtor.

But importantly, Your Honor, that does not mean as Plaintiffs argue that any liability for pre-effective date conduct just goes away and that creditors are left without a remedy to pursue claims against the debtor for pre-effective date conduct.

Rather, if they have a pre-petition claim in lieu of their litigation that's pending, they file a pre-petition claim against the estate and that matter is resolved in the claims objection procedure. Or, as in the case here, when they make an allegation that there is a post-petition claim, what do they do? They file a request for payment of an administrative claim, and this Court addresses the validity of the administration claim. The lawsuit pending in another jurisdiction stops, but the claim has to be resolved in the bankruptcy court.

The only conduct that the injunction really prohibits is them from proceeding with actions in other courts. It does not deny them a remedy. Accordingly, their argument that they cannot proceed with claims against the debtor because of the injunction provision just lacks any merit and can't form the basis for a stay.

Plaintiffs' next argument in their briefing is that if the Court refuses to stay the complaint, they will file a motion to withdraw the reference of this matter to the district court. Your Honor, this is the biggest head-scratcher of them all given how this complaint ended up before Your Honor. This exact issue and Plaintiffs' arguments as to why the reference should be withdrawn have already been fully briefed and decided by the district court.

As Your Honor may recall, the Plaintiff filed this action in the district court, conveniently failing to include the bankruptcy case as a related case or mentioning that the bankruptcy courts have related jurisdiction in the filings. Your Honor may have had occasion to review the underlying complaint when the debtor brought a motion for contempt against counsel for Plaintiffs for pursuing a claim against Mr. Seery in violation of Your Honor's January 9th, 2020 and July 16th, 2020 orders.

Your Honor issued an order finding counsel and various parties in contempt which order is, of course, subject to appeal. At the time we were litigating the contempt motion, we filed two motions in district court. The first was a motion to enforce the reference and have the district court send that complaint to Your Honor. And that motion to enforce the reference is now on Your Honor's docket at Number 22 and 23.

The second was the motion to dismiss which is before Your Honor today. Plaintiffs oppose the motion to enforce the reference arguing that mandatory withdrawal was required because the matter involved consideration of non-bankruptcy federal law, specifically federal securities laws and the Investment Advisors' Act.

Plaintiffs further argue to the district court why would you refer the case to the bankruptcy court if it's only going to end up back in the district court upon mandatory withdrawal of the reference. They argue to the district court that would be a complete waste of time.

We filed our reply at Docket Number 42 explaining to the district court why mandatory withdrawal of the reference did not apply and why this case should be referred to Your Honor. And what did the district court subsequently do? It entered an order referring this action to Your Honor which is why we are here today.

Plaintiffs now flout the district court's order of reference by telling the Court that if the Court does not stay the matter, they will file a motion to withdraw the reference before Your Honor, and they attach virtually identical pleading that they filed in opposition to our motion to enforce the reference.

Plaintiffs did not disclose in their amended motion that there was a fully-briefed motion to enforce the reference before the district court. Plaintiffs' argument is disingenuous and designed to mislead the Court.

The district court has only agreed that mandatary withdrawal of the reference does not apply and this case belongs in Your Honor. And while we cannot stop the Plaintiffs from filing any motion before this Court, we want to put them on notice that if they do file a motion for withdrawal of the reference in light of the facts as I just stated them, we will seek sanctions.

In any event, Your Honor, the fact that they may file a motion for withdrawal of the reference at some point in the future is not grounds to stay the matter.

Lastly, Your Honor, Plaintiffs argued in the opening that Highland's position today in opposing the motion to stay is inconsistent with positions Highland has taken in two other lawsuits commenced by the Sbaiti firm. Like all of their other arguments, they misrepresent the facts and are frivolous.

The Sbaiti firm filed a complaint on behalf of the DAF in the district court arguing that Highland mismanaged (audio drop). That complaint followed in the heels of an almost identical complaint filed by Dugaboy asserting the same claims.

And Your Honor may recall questioning Mr. Sbaiti at a hearing in June how Dugaboy could pursue such a claim in the district court if Dugaboy had a pending proof of administrative claim on file in the bankruptcy case. Well, soon after that hearing, Your Honor, the Dugaboy complaint was dismissed, and a few days later the DAF complaint was filed. That complaint has never been served on Highland.

The second lawsuit is also a lawsuit filed by the Sbaiti firm on behalf of an entity called PCMG in the district court. And PCMG previously held less than five one-hundredths of a percent interest in a certain fund managed by highland.

The lawsuit alleges that Highland acted improperly to sell certain assets of the fund, thereby damaging PCMG. That complaint has also never been served on Highland.

The Plaintiffs sought a stay of those matters before Highland could file a response, and the court -- the district court's entered stays in those matters. And Highland has filed motions for reconsideration and the motions to dismiss because they violate the injunction.

But, importantly, Your Honor, if you read the motions, Highland does not argue that Plaintiffs do not have a remedy for the alleged wrongs they say they suffer. Rather, Highland's argument is that any claims alleged in those lawsuits, just like any claims alleged in the lawsuit before Your Honor today, must proceed in bankruptcy court as part of the claims objection process. That's where they will have their day in court. The lawsuits don't go away. The injunction prevents them from continuing on in district court.

Accordingly, Highland is being totally consistent in all matters, and the litigations may not proceed there but must proceed before Your Honor. And, of course, none of these three matters are implicated by the Fifth Circuit appeal.

Your Honor, the amended motion was procedurally improper and is substantively without merit. And for all these reasons, we request that the Court deny the stay motion and proceed with the hearing on the motion to dismiss.

Thank you, Your Honor.

THE COURT: All right.

Mr. Sbaiti, you get the last word.

MR. SBAITI: Thank you, Your Honor.

Your Honor, the administrative claim process that was described as being the way that these claims were supposed to proceed, by the language of the order that we read, does not allow for these claims. Those claims are limited to a specific category of claims that don't include the claims that are alleged in this lawsuit.

And in any event, this lawsuit wasn't filed as an administrative claim. So if that's the case and it needs to be refiled or reasserted as an administrative claim, then I think that's a subject for another day. All I know is that we have this injunction right now that either should stay this case pending the appeal, which I'll address the issue on appeal in a moment, or it should be dismissed, perhaps without prejudice so that it can be refiled properly as an administrative claim if that's what's supposed to happen, because I guess this converts the matter.

The appeal, the subject of the appeal as to the injunction, Your Honor, the appeal actually encompasses many of the issues that we're talking about in this case. Now Mr. Pomerantz tries to narrow the scope of what's up on appeal, and that may indeed be the argument that they're going to present to the Fifth Circuit or that they've presented to the Fifth Circuit.

But the actual issue up on appeal is the enforceability and validity of the order for a variety of reasons which includes the provision that we're talking about and the enforceability of the provision that we're talking about because it gets rid of particular claims. And I guess the argument back is, no, it doesn't because there's now an alternative means of going there.

Mr. Pomerantz says that we shouldn't have proffered a motion to enforce the reference. That proffer, however, was because Judge Boyle's reference to this Court didn't deal with our motion to -- our cross-motion to withdraw the reference. All it dealt with was their motion to enforce the reference as a -- to enforce the standing order in the district court. And that's all she ordered was she cited the standing order and the statutes, I think it's 157(a), and that's really all it did.

So it left open the question of whether she wanted Your Honor to deal with the withdrawal of the reference specifically as to the 12(b)(6) issue in the first instance. It didn't resolve the question. It doesn't purport to resolve that question. And it's not unheard of for the district court then to send the matter to the bankruptcy court and then to piecemeal which proceedings the withdrawal of the reference is applicable to and then all the other proceedings would stay with Your Honor or with the bankruptcy court.

So we weren't flouting the district court's order, and we certainly weren't flouting any of the previous orders. And the threat of a sanction for simply exercising our rights in due course is not well taken.

Now Mr. Pomerantz says, well, the DAF and CLO Holdco are not parties to the appeal. I don't think that's relevant because if the provision is struck by the Fifth Circuit, it's not only struck for the appellants, it's struck as to all. It's either valid or it's invalid. And even if it's declared to be invalid only as to the appellants, it's not suddenly valid as to everyone else who didn't appeal. That's not generally how these appeals have worked.

If the Court doesn't stay this matter, Your Honor, and doesn't dismiss it, we still maintain, Your Honor, that as it stands today, the question on the merits have been mooted and we cannot proceed. I think what Mr. Pomerantz is hoping for or the debtor is hoping for is a provision where our hands are potentially tied to argue the motion.

And if the Court tells us they're not, then we'll certainly argue the 12(b)(6). But what I don't want to do is argue a 12(b)(6) motion that on its face appears to violate the permanent injunction and then be held in contempt for violating that injunction.

And so that's why we've asked for the Court to either stay the matter under its inherent jurisdiction or to -- if you're going to -- if it's not going to be stayed, then we believe it has to be dismissed according to the permanent injunction as it stands right now.

THE COURT: All right.

The motion to stay is denied. The amended motion to stay is likewise denied. This is an odd argument. I guess one might say the traditional four-factor test for a stay of a proceeding has really not been the subject of the argument here for a stay.

So suffice it to say the four-prong test for a stay, you know, hasn't been met here. There hasn't been a showing of substantial likelihood of success on the merits or irreparable injury if the stay's not granted or a stay will not substantially harm others or the stay would serve a public interest.

But going on to the arguments that were focused on by movant, I just don't think that you have shown that, you know, either the exculpation clause or the injunction provisions of the plan somehow tie your hands in arguing the 12(b)(6) motion, defending against the 12(b)(6) motion today or I just think that your arguments reflect, frankly, a misunderstanding of how the injunction language and exculpation language applies here.

So the motion for stay is denied, and I will ask Mr. Pomerantz to submit an order reflecting the Court's ruling.

So it looks like we have another procedural matter, Mr. Sbaiti. You filed a motion to strike reply appendix of the Plaintiffs quite a while back. So did you want to present that?

MR. SBAITI: Yes, Your Honor. I think it's a very simple procedural issue.

Generally, a party that files a 12(b)(6) is limited to the four corners of the complaint. And if there's a contract incorporated or a document incorporated as an intrinsic part of the complaint, you know, that's usually considered under the 12(b)(6) motion.

What the Defendants did, what the debtor here did is they filed a bunch of evidence in their 12(b)(6), essentially attempting to argue it as a summary judgment. We raised that in our response. So as part of our response, we objected to all the evidence. But then on the reply, they filed a bunch more evidence both without leave and improperly, basically sandbagged us.

And so we raised two points for striking that evidence. One was akin to the first argument, which is it's not an evidentiary hearing. It's not an evidentiary process in the first instance. A 12(b)(6) motion has to assume that the facts pled are true, and then the question is whether they state a claim.

And, secondly, adding them to the reply is especially egregious because the reply is the last word. And we didn't have an opportunity to respond, and we also don't think it's relevant nor should we have to respond to a whole bunch of extra evidence that was attached.

That's essentially the basis of our motion, Your Honor.

MR. POMERANTZ: Your Honor, the simple answer to the issue is we filed the reply of the appendix in connection with the motion to enforce the reference. We didn't file it in connection with the motion to dismiss. The motion to enforce the reference is moot. So what Mr. Sbaiti, his whole argument doesn't make any sense.

As a substantive matter, just there wasn't any evidence. It was pointing to court pleadings, orders, and stuff. So it's irrelevant. I don't know why it's still on the docket. It shouldn't be on the docket since it related to the motion to enforce the reference.

THE COURT: All right. Mr. Sbaiti, did you just simply --

MR. SBAITI: Your Honor, much of that evidence was --

THE COURT: -- misunderstand or what?

MR. SBAITI: I think we might have because it was filed as a separate item, and it may have been miscalendared or misapplied on our system. But the way it was presented to us when we got it was it appeared to be evidence in support of, well, I guess both, but certainly evidence that was averted to in the reply.

But if they're saying that the Court's not going to consider it, then that moots the motion and I think we can move on.

MR. POMERANTZ: Yes, Your Honor. I had nothing to do with his motion. I guess there was another mistake on their end. I guess that stuff happens occasionally.

THE COURT: Okay. All right. So I'll deny it as based on a mistake that's been acknowledged here. And so with that, let's have an order cleaning that up, as well, Mr. Pomerantz, please.

With that, we'll move on to the Defendants' motion to dismiss complaint. I think, Mr. Pomerantz, you said Mr. Morris will be making this argument?

MR. POMERANTZ: That is correct, Your Honor.

THE COURT: All right.

Mr. Morris, I'll hear your argument.

MR. MORRIS: Good morning, Your Honor. John Morris for Pachulski Stang Ziehl & Jones for the reorganized debtor. Can you hear me okay?

THE COURT: I can. Thank you.

MR. MORRIS: Okay.

Your Honor, this is a bit like Groundhog's Day. I believe that we're going to spend the next half hour or an hour discussing the very issues that were before the Court earlier this year on the HarbourVest 9019 motion.

As the Court will recall from the June 8 hearing, there is a complaint that's been filed ostensibly by the DAF and CLO Holdco. As Your Honor will recall, the testimony established that Mark Patrick had just been installed as the trustee, had no knowledge of the prior events, and Mr. Dondero and Mr. Sbaiti spent quite some time together formulating this particular complaint that is nothing less than a collateral attack on the Court's prior order.

I'd like to, if I can, just walk through a PowerPoint presentation to try to make the debtor's position quite clear, if I may.

THE COURT: You may.

MR. MORRIS: And I would ask my assistant, Ms. Canty (phonetic), to put up the first slide.

Your Honor, you'll recall that last December, the debtor filed its motion under Rule 9019 for court approval of a settlement. The debtor was completely and utterly transparent in what the terms of the settlement were.

Very briefly, as set forth in Appendix 2 or Exhibit 2 which was the motion itself, in Paragraph 32, Your Honor, the debtor set forth the terms of the transaction for which it was seeking approval. Those terms included in the very first bullet point a statement that HarbourVest shall transfer its entire interest in CLOF to an entity to be designated by the debtor.

And that's an important point that we'll talk about in a number of different contexts, Your Honor. The debtor made it very clear at the very first moment of this matter that it was not going to acquire the asset but the asset was going to be transferred to an entity to be designated by the debtor. The debtor's motion filed last December clearly stated the value of the interest that it would be acquiring in return. That was also set forth in Paragraph 32 in a footnote.

It didn't say that it was the fair market value. It said the method of valuation was the net asset value and gave a valuation date of December 1st so that all parties in interest who received the motion understood the economics of the deal. And the deal that the debtor was asking the Court to approve was one whereby HarbourVest would receive certain claims and in exchange for those claims, they were going to transfer their interest in CLO -- HCLOF.

The debtor also filed on the docket for all to see a copy of the settlement agreement. The settlement agreement sets forth the terms of the deal, including again the statement that HarbourVest "will transfer all of its rights, title, and interest in HCLOF." It actually says to an affiliate or an entity to be designated by the debtor. And the transfer agreement itself was also put on the docket.

So that's where things stood just before Christmas. I know that there's some due process and other type arguments that are in the Plaintiffs' opposition to the motion. But, of course, the undisputed facts are that the debtor timely filed the motion. The time period was consistent with all applicable rules. Nobody ever asked the debtor for an extension of time. Nobody ever filed a motion for an extension of time. And so those due process arguments I think carry no weight at all.

So the debtor filed the motion. And if we can go to the next slide, we see what the responses were, and there were several. All of the responses, the only responses were objections to the motion filed by Mr. Dondero and his certain of his affiliated entities.

Mr. Dondero's objection can be summarized as follows. He made the following observations and asserted the following objections to the proposed settlement. The first thing he said is that the settlement far exceeds the bounds of reasonableness. Now, of course, one cannot make a determination of reasonableness without having an understanding of value. The debtor was giving something and it was getting something.

And so Mr. Dondero understood that the issue of value was front and center. If there was any mistake about it, he also noted that he understood that as part of the settlement and, again, I've written this incorrectly, HarbourVest will transfer its entire interest in HCLOF to the debtor. That is not what Mr. Dondero understood. In fact, Mr. Dondero understood that it would transfer its entire interest in HCLOF "to an entity to be designated by the debtor," again, making it clear that he knew exactly what the debtor was doing here. And that can be found at Appendix 4 in Footnote 3 on Page 1 if you want the exact quote from Mr. Dondero's pleading.

In the same footnote, he also specifically acknowledges that he understood the valuation. He understood the method valuation. He understood the valuation date of December 1st. And he urged the Court in his pleading to scrutinize the settlement to make clear that the available value of the investment should be realized by the debtor's estate.

And this is such a critical point, Your Honor. His concern was that by placing the value in an entity other than the debtor itself, that the Court wouldn't have jurisdiction over that asset. That was his concern. So not only did he understand that the asset was going to be transferred to an affiliate, he wanted to make sure that this Court had jurisdiction over the asset.

And, of course, Mr. Seery in his testimony and otherwise, we provided the Court with all the comfort it needed to know that even though it was being assigned to a special-purpose vehicle wholly-owned by the debtor, it would nevertheless be subject to the Court's jurisdiction.

Mr. Dondero's trusts also filed an objection if we can go to the next slide.

Dugaboy and Get Good represented by Douglas Draper made the following observations and asserted the following objections to the HarbourVest Settlement. They, too, made clear that they understood that the asset was going to be transferred to an entity designated by the debtor. They, too, acknowledge that they understood that the debtor was valuing the asset at approximately $22 million as of December 1st. And their objection was that the Court couldn't evaluate the settlement without knowing how the asset was valued, without knowing whether the debtor could acquire the asset, very critical point.

These are the points that are made in the complaint. These are the exact same points that are made in the complaint. And also the Court couldn't evaluate the settlement unless they understood that the value would be inure to the benefit of the debtor's estate, again, mimicking Mr. Dondero's concern that by placing the asset in an affiliate of the debtor, that it might not be subject to the Court's jurisdiction.

Finally, and most importantly, if we can go to the next slide. The Plaintiff, CLO Holdco, filed an objection to the 9019 motion. And this is just so critical. And this is the Groundhog Day aspect that I specifically speak of. CLO

Holdco's objection was based solely on its assertion that it had a superior right to the opportunity to acquire the asset that was being transferred by HarbourVest. It only made one argument in support of its contention that it had a superior right, but that argument was specifically premised on the membership agreement, Section 6.1 and 6.2 of the membership agreement.

CLO Holdco, the Plaintiff in the underlying action, argued to this Court that HarbourVest had no authority to transfer the asset without complying with the right of first refusal that would give CLO Holdco the opportunity to take the asset for itself. That's what this Court was told. CLO Holdco didn't make this argument fleetingly. They provided an extraordinarily detailed analysis of Sections 6.1 and 6.2 of the membership agreement and concluded "that HarbourVest must effectuate the right of first refusal before it can transfer its interest in HCLOF. That was the objection. Objections have consequences, as Your Honor knows.

If we can go to the next slide.

By filing an objection, CLO Holdco and the trusts and Mr. Dondero became participants in the litigation. Notwithstanding the Plaintiffs' arguments to the contrary, when they file the objections, they participate in what's called a contested matter. And in a contested matter, they had every right to take all discovery on any issue that was related to the 9019 motion, including the transfer, the disposition of the asset to an affiliate of the debtor, the valuation of the asset that's being received, the merits of the settlement itself, the causes of action, whether, you know, what communications that were, the negotiations, what did Mr. Seery and Mr. Pugatch discuss? Right?

They could have taken any discovery they wanted. And they did avail themselves of discovery, in fact. They did -- I don't know why they did what they did, but they chose to take one deposition, and that was Mr. Pugatch, okay.

His deposition transcript, I think is at Exhibit 7, or Appendix Number 7, and it was a long deposition. It really was. And they asked Mr. Pugatch at the deposition if he knew what the value of the asset that was being transferred was. And he said $22.5 million. So it wasn't just Mr. Seery or the debtor who was subscribing to this valuation. The party on the other side of an arm's length negotiation was subscribing to the exact same valuation.

The Plaintiffs could have taken whatever discovery they wanted. This is a full and fair opportunity to participate in the litigation. We proceeded to trial. Before we got there, actually, the debtor filed its response to CLO Holdco's objection and proffered its own very detailed and apparently very persuasive analysis that CLO Holdco's objection was without merit, that CLO Holdco had no right of first refusal under the facts and circumstances as they existed, and with Grant Scott, Mr. Dondero's childhood friend at the helm, we got to Court for the contested hearing on the debtor's 9019 motion, and CLO Holdco withdrew their objection.

And I've put up on the screen just an excerpt of the transcript because, you know, when we talk about whether or *res judicata* should apply, because was there a hearing on the merits? Was there a decision on the merits? Just look at the words of CLO Holdco's lawyer. "CLO Holdco has had an opportunity to review the reply briefing and after doing so has gone back and scrubbed the HCLOF corporate documents based on our analysis of Guernsey law."

And some of the arguments of counsel in those pleadings and our review of the appropriate documents, counsel obtained the authority from Mr. Scott to withdraw the CLO Holdco objection based on the interpretation of the member agreement. We were grateful for that and the Court specifically said in response, "That eliminates one of the major arguments that we had anticipated this morning."

Apparently, the Plaintiffs believe that those events have no meaning and that this Court's reliance on CLO Holdco's substantive withdrawal of its objection has no meaning. I think they're wrong, and we'll get to that in a moment.

We proceeded with the hearing. Mr. Seery and Mr. Pugatch testified at length. If you look at Footnote 3, you'll see Mr. Seery testified for almost 70 pages of testimony. Mr. Pugatch testified for almost 45 pages of testimony. His testimony was exhaustive. And, again, any of the objecting parties had the right to ask whatever questions they want.

But I do want to just note a few things that aren't up on the screen right now. If you go to Appendix 9, Your Honor, which is the transcript of the hearing, at Page 13, you will see that the very first thing I discussed in my opening statement was the economics and how with a valuation of $22.5 million this deal made sense for the debtor.

You will see from Pages 30 to 42 there is extensive testimony from Mr. Seery about the amount and the value of the asset. But the most important part of Mr. Seery's testimony is that he explains how it came to be that HarbourVest agreed to transfer its interest in HCLOF to an affiliate of the debtor. And that came about, not because Mr. Seery or the debtor was initially at all interested in doing this. The whole idea originated with HarbourVest.

They wanted to extract themselves from the Highland platform. They wanted to give this piece up. So there's no conspiracy going on here. The unrebutted testimony that all of the objecting parties had an opportunity to challenge was that the whole idea originated with Mr. Pugatch and with HarbourVest. I think that's an important point to take into account.

And finally, again, from the hearing, if you look at at Appendix 9, you'd also find that Mr. Pugatch, again, testified, as he had in his deposition, as to the value of the interest being transferred. So we completed the testimony. We rested our case having had a full and fair opportunity to contest the motion. The objecting parties rested as well. And we got to the point where we had to prepare the notice, and we were discussing that at the hearing, if we can go to the next slide.

And it's very important, because again, this was all done transparently, and it was all done on the record. And after the close of evidence, I addressed the order that was going to be prepared. I specifically said that I wanted to make clear that we were going to include a provision, "that specifically authorizes the debtor to engage in, to receive HarbourVest the asset, you know, the HCLOF interest," right. I wanted everybody to know that was what was going to happen, and then I said, "The objection has been withdrawn." I think the evidence is what it is and we want to make sure that nobody thinks they're going to go to a different court somehow to challenge the transfer. But yet, that is exactly what the complaint seeks to do.

Having put everybody on notice as to where we were going, as to what the evidence showed, the debtor drafted and the Court adopted an order, and the order says, among other things, that HarbourVest was authorized to transfer its interest to the debtor. Actually, it says, "to a wholly owned and controlled subsidiary of the debtor," pursuant to the transfer agreement, "without the need to obtain the consent of any party or to offer such interest first to any other investor in HCLOF." So the Court heard the 9019 motion pursuant to a Bankruptcy Rule and entered and order that was unambiguous and that the Plaintiffs did not appeal from.

We can go to the next slide.

At a very high level, Your Honor, it is just crystal clear that the complaint is just inextricably intertwined with the 9019 proceedings and the order itself. I think Mr. Sbaiti would agree with me that but for the order that approved the transfer of the asset and the testimony about the value of that asset, they have no claims.

Every single claim is predicated on what happened in the 9019 hearing. Every single claim is predicated on the Court's order approving the transfer of the asset and the testimony and evidence that was adduced in relation to that asset.

There were really only two issues that the Court -- I mean, if you want to think about it at its most simplistic level, the Court was being asked to assess, is it fair, is it reasonable, is it legally permissible for the debtor to give something. In this case, allowed claims and releases, and to get something in return. In this case, HarbourVest's interest in HCLOF and releases in return. And that is really the gravamen of the complaint.

The complaint is based whether it's breach of fiduciary duty or RICO or breach of contract or tortious interference, whatever the claim is, none of them exist if the debtor doesn't get this. They just don't exist. And that is why the complaint and the proceeding are inextricably intertwined. And if you just take a look at just one paragraph of the pleading, it says at the core of this lawsuit is the fact that HCM, that's the then debtor, purchased the HarbourVest interests in HCLOF for $22.5 million knowing that they were worth far more than that. There's not a cause of action that exists in the complaint that isn't dependent on Paragraph 36.

So if we can go to the next slide with that background, I'd like to argue why under 12(b), the complaint should be dismissed because the claim should be barred under the doctrine of *res judicata*. Luckily, Your Honor, there is at least one area of agreement between the parties here, and that is the purpose of the doctrine and the elements that have to be satisfied in order to meet the burden of proof necessary to have the claims barred. And in Footnote 1, you can -- I've tried to just be helpful to the Court to show that we may not cite to the exact same cases, but the parties agree that the doctrine is intended to foreclose the re-litigation of claims that were or could have been raised in a prior action and that there's four elements that have to be satisfied for the doctrine to apply.

The parties have to be either identical or at least in privity, the judgment in the prior action had to have been rendered by a court of competent jurisdiction. Number three, the prior action had to have been concluded by a judgment on the merits. And the last one is that the same claim or cause of action was involved in both suits. So I just want to spend a few minutes now, Your Honor, going through those four elements to show the Court how easily the reorganized debtor meets this standard.

If we can go to the next slide, I can take care of the first two elements very quickly.

The first element, the debtor asserted that the Plaintiffs were parties or in privity with parties to the prior proceeding. That's at Paragraph 17 of the motion to dismiss. The debtor relies on the deposition testimony of Grant Scott, who was then the trustee of the DAF.

CLO Holdco is a wholly-owned subsidiary of the DAF, or wholly controlled, in any event, and Mr. Scott's testimony was that he was the only director and there were no employees of either entity. So we, in our motion, put forth evidence to establish the first element, and I don't believe, maybe I've missed it. I don't believe that the Plaintiffs have contested that element. If they have, I think Mr. Scott's testimony will carry the day, in any event.

The second element as to whether or not a court of competent jurisdiction is the entity or the court that rendered the ruling. Of course, that's been met, too. The Plaintiffs, in their opposition to the motion to dismiss, suggested that the bankruptcy court would have lacked jurisdiction if their cross motion to withdraw the reference was granted. They said if the district court decides that mandatory withdrawal applies, then it cannot find that the bankruptcy courts already entered final judgment was rendered on Plaintiffs' causes of action and had jurisdiction to do so. I think that's just a clear misstatement of the law.

But in any event, Your Honor, at this point, I believe it's irrelevant because the district court, in fact, sent the case back to Your Honor and back to this Court. And so, at the end of the day, Plaintiffs' argument doesn't hold water because of the district court's ruling, which can be found -- the order of reference can be found at Docket Number 64. And so I think that easily takes care of the second prong.

The third prong is whether -- if we can go to the next slide -- the prior proceeding resulted in a judgment on the merits. And this is really the critical point, Your Honor. As the Court knows, the whole doctrine of *res judicata* is designed to prevent, as the parties agree, the re-litigation of claims. Stated another way, it's to bring finale. It's to make sure that the Court doesn't hear the same claims and the same issues that either were brought or that could have been brought in a prior proceeding. And so, we believe that we easily meet the standards set forth in the third prong. The 9019 order necessarily determined that the *quid pro quo* that I described earlier was fair, reasonable, and legally permissible.

Notwithstanding their assertions to the contrary, the Plaintiffs are most definitely seeking to unwind at least one half of the Court's order by belatedly claiming that they are entitled to the benefit of the bargain while leaving Highland burdened, frankly, with the claims that HarbourVest got as part of the deal. I will tell you, Your Honor, and this is argument, the debtor would never have asked for, and I don't believe that the Court would ever have granted, the 9019 motion if they thought that there was a risk in the future that Highland wouldn't get the benefit of the bargain and it was incumbent upon CLO Holdco and the DAF, and frankly, any party in interest, to stand up and be counted and tell the Court and the debtor, why the debtor was not entitled to do this deal and CLO Holdco did that. They actually did.

They stood up and they filed an objection and they said we have a superior right to this asset in the form of a right of first refusal. They wound up folding in the face of persuasive argument, and I respect the lawyer who did that. I just do. But that was the time to speak up, and that's why it is on the merits because that is exactly what *res judicata* is intended to do. It's intended to have everybody put your cards on the table. You don't put one card on the table and say, I'm going to challenge this under 6.2 of the members agreement, but I'm not going to tell you that I also think you owe me a fiduciary duty under the Advisors Act or as the control party or under any other theory that they had. They can't do that. That's exactly what the problem is here.

If we can go to the next slide. Is it a judgment on the merits? The debtor and the Court relied on CLO Holdco's representation that it was withdrawing its argument, its claim, its contention, its assertion that it had a superior right to obtain the HarbourVest interest in HCLOF. Again, they did so not whimsically, not because Mr. Kane was going to be out of town and he couldn't make the hearing. He did it after, and I don't think this matters frankly, but I think it's worth noting that he did it after an extremely careful analysis. I would tell you, Your Honor, that -- well, I would argue, Your Honor, that even if Mr. Kane at CLO Holdco had never filed an objection, if they'd never filed -- if they'd gotten notice that this was happening and they sat silently, that would have been enough for *res judicata* because the issue before the Court was whether it was legally permissible for the debtor to acquire this asset.

And if they had an obligation, if they owed a duty to another party, it wouldn't have been legally permissible. And if somebody believed that it wasn't legally permissible because a duty was owed to them, they had an obligation to speak up. And so I think it's very important, particularly for the collateral estoppel argument that I'll make in a moment, that CLO Holdco did in fact file an objection. It was based on the breach of contract claim that's in their complaint. It's the exact same claim. And they withdrew it. I think it's very, very important. I think it highlights why *res judicata* applies. I think it is the linchpin of the collateral estoppel argument.

But at the end of the day, I think if they say nothing, they should be estopped or precluded under *res judicata* from now asserting -- it would be like -- I was thinking about this earlier, Your Honor. If you'll remember earlier this year, Mr. Dondero and his entities have kind of a habit of withdrawing objections at the last minute. We had a couple of sale hearings earlier this year. And the issue was valuation, you know, and the process, and could the debtor meet its burden of proving that the sale outside of the ordinary course of business was in the debtor's best interest. And they sold that restaurant. And Mr. Dondero objected. And at the last second, they withdrew the objection. Did they sue tomorrow? Does Your Honor really think that they could bring a lawsuit tomorrow and say they just found a document or theory on which the debtor had an obligation to give them a right of first refusal, even though we've already closed on the transaction, even though they were given notice of the transaction, even though they filed an objection to the transaction, even though they withdrew the objection? Would the Court tolerate for one second a new pleading tomorrow from Mr. Dondero that the debtor actually had a fiduciary duty to give him a right of first refusal to buy that asset under whatever theory, just because he pleads it and the Court has to accept as true the allegations in the complaint? I think not. And I think it's worth thinking about that to highlight just how -- just how wrong this is.

Continuing on. You know, the Plaintiffs in opposition say it can't be a trial on the merits because we weren't parties. Of course they were parties. Again, they filed an objection. They were the parties to the contested matter, full stop. They rely on a case called Applewood and they say, this is the very first point they make in their brief. Applewood, if it wasn't *res judicata* in Applewood, how could it possibly be *res judicata* here? But the facts are just so inapposite, right?

In Applewood, you had a garden variety plan and release where the debtor and the officers and directors got a discharge. No objection to it. And a secured lender later on sought to sue guarantors who happened to be officers and directors. And the court, not surprisingly, said that the confirmation order wouldn't prevent the secured lender from going after the officers and directors, not in their capacities, as such, but in their capacity as guarantors, which were never part of the confirmation order. That just doesn't apply here because here, we have the debtor making a motion before the Court in which it sought permission and authority to acquire a particular asset. Anybody who had a claim to that asset should have stepped forward and put their cards on the table.

And again, CLO Holdco put their cards on the table and they lost, and they folded. To use the poker analogy, they folded. And to hear them come into Court today and say we're going to sue you because I reshuffled the deck, it's not right and Applewood has no relevance.

Finally, Your Honor, you know, it's not on the merits, they say, because you know, Mr. Seery and the debtor hid the true value of the asset, and had we only known the true value of the asset, we would have made all of these other claims. The fact of the matter is, you either have a fiduciary duty or you don't. And if you had a fiduciary duty, they should have spoken up and they did only under 6.2, but they did.

But here's the important part, Your Honor. Take the allegations as true. You have to take all of the allegations as true, not just some of them. And if you look at Paragraph 127 of the complaint, and I would ask Ms. Canty to go to Appendix 11 and let's just put Paragraph 127 up on the board.

Here's the irony of the whole thing, right. The whole complaint is based on the fact that somehow Mr. Seery was engaged in insider trading. They accused him of insider trading, and they say he didn't disclose the full value of the asset. Just read Paragraph 127. James Dondero, who was on the board of MGM, is the tippee. You've got an insider trading case -- I mean, I don't represent MGM. I'm not with the SEC. I don't know why Mr. Dondero thought he should be telling Mr. Seery in December, 2020. It's not clear if it was before or after the 9019 motion was filed. But Mr. Dondero is the very source of information -- you can't make this up. He's the very source of the information that he now complains Mr. Seery didn't disclose.

Of course, Mr. Dondero, the trust, CLO Holdco could have asked Mr. Seery at any time, how did you come up with your valuation? Mr. Dondero, knowing that he had supplied to

Mr. Seery, according to Paragraph 27, please take it as true for purposes of this motion only. He's the source of the inside information. And now he has the audacity to come to this Court, notwithstanding the Court's approval, all of the time and money and effort spent in the 9019 process, and say, Mr. Seery was wrong because he didn't tell CLO Holdco and the DAF about the information that Mr. Dondero gave to Mr. Seery. It's not right.

It was a judgment on the merits. And if Mr. Dondero or the DAF or CLO Holdco or the trust wanted to challenge the valuation, they had every opportunity to do so. And based on Paragraph 127, if the Court accepts it as true, shame on them. Shame on them for not pursuing this issue before. The guy gave Mr. Seery, according to this allegation, and I'm just going to leave it there, inside information. And he sits there in silence, right? It says, look at the last sentence: "The news of the MGM purchase should have caused Seery to revalue HCLOF's investment." Seriously?

The third element is (indiscernible). The fourth element, if we can go to the next slide.

Are they the same claims? Did the claims arise from the same set of operative facts? I've addressed this pretty clearly already, so I don't want to belabor the point. But obviously, both the 9019 motion and the complaint arise solely from the debtor's settlement with HarbourVest. The debtor's acquisition of HarbourVest's interest in HCLOF and the debtor's valuation of that interest. Without those three facts, there is no complaint. It's just not credible to argue that the fourth element is not met.

The case law is clear. It's quoted in the Plaintiffs' opposition. It's not just the test of whether the claims are the same. It's whether the claim is the same as that which was brought or could have been brought.

In their opposition, the Plaintiffs contend that the claims "did not write them until after the settlement was consummated," and that the first time the plaintiffs heard about the valuation of HarbourVest's interests was at the January 14, 2021, hearing. I think I quoted that. If you look, I don't know if it's Page 10 or Paragraph 10; the way I wrote it, it's probably Page 10. I think that's a quote right out of there. But of course, as we saw the debtor disclosed the valuation in its very initial motion, CLO Holdco's counsel elicited valuation testimony directly from Mr. Pugatch, so that was before the hearing.

And of course, Mr. Dondero and the trusts both cited in their objections the valuation. The notion that this was not right, just -- it's contradicted by their own conduct, their objections, their questions in deposition, the information that was contained in the motion that they objected to.

I do want to go off-script for just a minute, if we could just take that down because I know that this is probably something that Mr. Sbaiti may argue. And that is, well, gee, but you have to take the allegation as true that Mr. Seery wasn't honest, that Mr. Seery lied to the court. I don't understand why there's not a fraud cause of action in there, but there's not. But that's their theory.

And gee, how does he get to skate away Scott free if he's allowed to do that with impunity, right? I will tell you, Your Honor, of course you've seen Mr. Seery many times. You've made your own assessments of his credibility. I'm not here to argue the merits, but I will just say that the Defendants, if ever forced to, will contest the allegation.

But here's the thing, and here's the important point about, you know, whether or not he could lie with impunity and say, I suspect that's where Mr. Sbaiti is going to want to go.

Mr. Seery said what he said. And he had a reason to speak, and he spoke, and he said what he said and he told everybody who would listen exactly what he was doing and how he was doing it. For whatever reason, the objectors put the valuation front and center. It's right in their objections. They noted the objections. But for whatever reason, they did nothing.

Whether they were negligent or whether they were lying in wait is kind of irrelevant. They had a full and fair opportunity to contest this issue. And if they had done so, and the evidence proved what they're now alleging, they can't tell you what would have happened. So, you know, HarbourVest may have taken a different position. The Court may have done something.

We're never going to know now because Mr. Seery and the debtor are getting away with something, but because they put in evidence that went unchallenged by Mr. Dondero and the Plaintiffs. It simply went unchallenged. And they say, oh, gee, that's because we didn't know. Well first of all, you didn't ask. And second of all, again, the source of the inside information, the reason that Mr. Seery should have known the asset was worth more. The reason that he should have refrained from trading and not engaged in insider information was Paragraph 127. It was Mr. Dondero.

Here's another thing. If -- if again Mr. Seery had not been honest with the Court and that was ever brought out, Maybe HarbourVest -- maybe HarbourVest would have had a right to complain. There's a lot in the complaint about oh, HarbourVest was misled. The actual evidence that's in the record, and this is part of res judicata, Mr. Seery testified very clearly to the arm's length negotiation that took place. He told the Court under oath that the negotiations were contentious.

He told the Court under oath that in order to try to resolve the case, he and Mr. Pugatch went off and had their own private conversation without lawyers. They could have taken discovery on any of that, right. What did you guys talk about? It's certainly not privileged. They had every opportunity. But what we do know is that Mr. Pugatch under oath, in deposition, and at trial, said the value is $22.5 million.

So I don't think Mr. Pugatch or HarbourVest is ever, ever, every going to complain about the transaction they did. Because of what the evidence simply shows. But again, you've got the Plaintiffs in their complaint saying that somehow the debtor and Mr. Seery in negotiating this transaction has now exposed the debtor to liability. It just makes no sense.

So there was a time and there was a place to challenge Mr. Seery. Somebody, you know, maybe HarbourVest could have done something, maybe they could still do something. I don't know. If they really think that there's a problem, maybe we'll hear from HarbourVest someday. But the Plaintiffs have no right to complain. They just don't. They knew everything. They were the source of the inside information. They sat on their hands, and they shouldn't be allowed to do what they're doing now.

If we can go to the next slide. I want to move to the next theory and try to finish this up. The next theory is that the Plaintiffs' claims are barred by judicial estoppel. The judicial estoppel argument is really, really very straight-forward. And it's important because if the Court thinks about this the way I do, it's that the whole issue of valuation is completely irrelevant to the Plaintiffs unless they can show that they were owed some kind of duty, that they had some superior right to acquire the asset. But that's exactly the issue that CLO Holdco relied upon and withdrew and should now be estopped from pursuing. Right.

The legal standard, again the parties agree on, that in order to be estopped, the party must take an inconsistent position. And the party must have convinced the Court to accept that position. Again, both prongs are easily met here in just a few sentences from the January 14 hearing. You have Mr. Kane saying that he understands and acknowledges and admits that they have no superior right to the investment. And the Court relying on that very representation in declining to conduct a hearing and render a ruling on the merits of the claim that was withdrawn. The objection that was withdrawn.

And for the avoidance of doubt, after Mr. Draper spoke on behalf of the Trust, the Court, at Page 22 engaged in the following colloquy. The Court asked Mr. Draper:

"THE COURT: Were you saying that the Court still needs to drill down on the issue of whether the debtor can acquire HarbourVest's interest in HCLOF.

"MR. DRAPER: No.

"THE COURT: Okay. I was confused whether you were saying I needed to take an independent look of that. Now that the objection has been withdrawn of CLO Holdco, you're not pressing the issue.

"MR. DRAPER: No. I am not."

Okay. You can call it res judicata, you can call it judicial estoppel, collateral estoppel, the two prongs are easily met. They're taking an inconsistent position today and through all kinds of different theories, including the one that they withdrew, the Plaintiffs assert that they had a superior right to acquire the interest from HarbourVest.

And they should have asserted those rights at the hearing. That was the time. And they should be estopped now from taking a completely inconsistent position from the one that was before the Court. And I just do want to point out, the statement from a case called <u>Hall vs. G.E. Plastic</u>. And it's interesting, Your Honor, because there's only a few cases that I focused on, because this is really more fact intensive. And there isn't a dispute as to the, you know, the elements of these matters.

But it is interesting that the Plaintiffs, you know, generally ignore all of the cases that we cite to. One which is <u>Hall vs. G.E. Plastic</u>, where the Court said that the focus on the prior success or judicial acceptance requirements is to minimize the degree of a party contradicting a Court's determination, based on a party's prior position. That's the whole point of the exercise. You can't do this. You can't do this.

Just quickly, that leaves the individual arguments as to each of the five causes of action and I just want to go through some highlights. There's a negligence claim, Your Honor. And we did not file a pleading, but the Court can certainly take judicial notice of the fact that the effective date has occurred. Under the effective date, the plan is now effective. That includes the exculpation clause, as Mr. Pomerantz, I think accurately and without contradiction pointed out earlier, the exculpation clause applies specifically to the debtor and to negligence claims. And that's not a matter that's at all subject to appeal.

So I think just to add to the arguments that we have in our papers, which I adopt and do not abandon for any purpose, I would add to the argument on negligence, that it's now precluded, as a result of the plan becoming effective.

The fiduciary duty count suffers from numerous defects. I just want to point out a couple of them. They don't respond to the argument under Corwin, that under the Advisor's Act, there is no private right of action to sue for damages arising from a breach of fiduciary duty. This claim rears its head in virtually every single complaint. They've never addressed Corwin. Corwin is binding on this Court, and it is unambiguous that there is no private right of action to sue for damages for breach of fiduciary duty under the Advisor's Act.

They ignore Goldstein. Goldstein is not from the Fifth Circuit, but it's very persuasive authority that advisors do not owe fiduciary duties to their individual investors. Instead, they owe fiduciary duty to their client. Their client is the entity with whom they're in contractual privity. And so in this case, there's no fiduciary duty there, either.

The breach of contract claim. Again I just -- I would just say quickly, Your Honor, it's barred under judicial estoppel. Even if it wasn't, it's clear based on Mr. James' analysis and admission that the debtor's, or the reorganized debtor's interpretation of 6.2 is accurate. And you know, I said this in the beginning. Now let me tie it in a bow because the breach of contract claim, and the tortuous interference claim are both tied to the same thing. And that is the assertion that the Plaintiffs had a right under the membership agreement, a right of first refusal.

And they basically say that the debtor was playing games. That they shouldn't be able to get through 6.2 by assigning it to an affiliate. And that's where I go back, Your Honor, and just remind the Court that the debtor told the whole world exactly what they were doing in their motion. And their objections, Mr. Dondero and the Trusts both acknowledge to the whole world that they understood exactly what was happening.

In fact, their concern was not that it was going to the debtor, but that it might be going to an affiliate outside of the bankruptcy court's jurisdiction. And for them to now say, having taken all of those positions -- talk about inconsistent positions. They should be barred from saying today, that the use of an affiliate to effectuate the transaction was wrongful, because they actually told the Court that they needed to -- that the Court needed to make sure that it had jurisdiction over the very entity they now say somehow shouldn't have been allowed to get the asset.

It's a bit much. So that takes care of the tortuous interference.

The RICO claim, Your Honor, again is a motion. There's so many different aspects to it. But I don't think the Court needs to get past the Supreme Court holdings in HJ, Inc. Again, just simply ignored by the Plaintiffs in their opposition to the motion to dismiss. In HJ, Inc., the Court -- the Supreme Court did an exhaustive analysis to try to determine and ultimately did determine, what a pattern of racketeering activity meant. And the Supreme Court came to the following formulation. That it had to have two or more predicate related offenses that amounted to a threat of continued criminal activities.

You know, the notion here is that the debtor and Mr. Seery engaged in insider trading. We've already -- I've already mentioned that according to the complaint, which the

Court can take as true. Mr. Dondero, himself, was the tippee. But be that as it may, they don't come close to meeting the very high standards set forth by the Supreme Court in HJ, Inc. to show that whatever conduct Mr. Seery and the debtor engaged in, and if you take the allegations as true, in not telling what the fair value of the asset was, that that doesn't amount to a hill of beans for purposes of RICO. That you don't have any, I think predicate acts. I think here's the Court, predicate acts extending over a few weeks or months, threatening no future criminal conduct, do not meet RICO pleading grounds. Right.

Security fraud claims cannot be predicate acts for purposes of RICO. That is also clear. And that is really, I mean they say mail, wire and fraud. But what's really at heart is the 10(b)(5). Okay, it's the 10(b)(5) claim. Again, Mr. Seery being -- I mean Mr. Dondero being the tippee. But those are just some of the reasons.

None of, you know, that the RICO claim fails. You know, I'll otherwise rely on the papers, unless the Court has specific questions as to any of the other pieces of the motion to dismiss the RICO claim, or any other aspect of the Defendants' motion. I think this is clear. I think we win, no matter how you slice it. It's just wrong. It's just wrong.

This Court will never, ever have a final order if Mr. Dondero is able to engineer complaints such as this, which seek to assert claims that absolutely positively could have and should have been brought at the time the debtor made its motion.

Unless the Court has any questions, I have nothing further.

THE COURT: I do not. All right.

Mr. Sbaiti, I'm going to let you have as much time as Mr. Morris. He took 55 minutes. As I mentioned, I have a hard stop at 12:00 to do a swearing in ceremony. So if you're not finished in 40 minutes, then I'm going to have to take a break and come back and let you finish. All right?

MR. SBAITI: Thank you, Your Honor. Although I don't think I'm going to be much longer than 35-ish minutes.

THE COURT: Okay.

MR. SBAITI: if not less.

THE COURT: Okay.

MR. SBAITI: I think you'll be able to be done by -- we'll be able to be done by noon.

THE COURT: All right. Thank you.

MR. SBAITI: Thank you, Your Honor. Your Honor, may I share my screen?

THE COURT: You may.

MR. SBAITI: Thank you, Your Honor. Do you see my Power Point, Your Honor?

THE COURT: I do.

MR. SBAITI: Thank you, Your Honor. I don't know what which one you see. Is it the --

THE COURT: I see presentation.

MR. SBAITI: With the full page?

THE COURT: Yes, uh-huh.

MR. SBAITI: Okay, yeah, great. I just want to make sure we're on the right page. Thank you, Your Honor. So Your Honor, the defendant debtor is a registered investment advisor. And it all begins with that. And this where the distinctions between what happened in the 9019 and I'll get to the elements of res judicata through argument.

But the first thing that has to be identified is that the Defendant is a registered investment advisor. The objection filed by Holdco back during the 9019 was an objection against HarbourVest selling its interest by filing the right of first refusal. It did not deal with the investment advisor feature of Highland's relationship. And I'll get to why the 9019 doesn't preclude these arguments today.

This is essentially the structure. Highland was the investment advisor of HCLOF, and Holdco is an investor in HCLOF. And so Highland would owe a fiduciary duty under the Advisor's Act against -- to CLO Holdco.

Highland also had a direct advisor relationship with the DAF. And so under the Investment Advisor's Act, it owed fiduciary duties to both of those entities. The law governing registered investment advisors is that it's a federally recognized and defined fiduciary duties. The fiduciary duty to there's a fiduciary duty to affirmatively keep the advisee informed and the fiduciary duty not to self-deal, i.e., not to trade ahead of an advisee and opportunity that an advisee would want or expect and without the advisee's expressed informed consent.

This is a federally recognized and defined fiduciary duty and it's actionable under state fiduciary duty laws. While Mr. Morris ended his argument by saying we didn't deal with their case law saying that there's no private right of action under the Advisor's Act, the fact of the matter is that Judge Boyle, about ten years ago, found that a state -- the breach of fiduciary duty claim can be predicated on breaches of federally imposed fiduciary duties under the Advisor's Act. And that's what Douglass v. Beakley held. And that's actually what we cited in our response. So I'm not sure why he would argue that we haven't addressed the issue of where does this private right of action come from.

Federal Law supplies the rules of the relationship and State Law provides the cause of action for those breaches. Now the scope of that has been expounded upon by many cases. The Fifth Circuit held in Laird, as a fiduciary, the standard of care to which an investment advisor must adhere imposes an affirmative duty of utmost good faith and full and fair disclosure to all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading his clients.

The word "affirmative" there is important because it means the investment advisor is not supposed to wait to be asked. The investment advisor as an affirmative duty to proactively provide the information to the client.

The next standard comes from the SEC. We call it the SEC interpretation letter. It's a release that came out in 2019. And to meet it's duty of loyalty, an advisor must make full and fair disclosure to its clients of all material facts relating to the advisor relationship. Material facts relating to the advisor relationship include the capacity at which the firm is acting with respect to the advice provided.

The SEC had another release in 2000 -- or excuse me, in that same release, the SEC said the duty of loyalty requires that an advisor not subordinate its clients interests to its own. In other word, an investment advisor must not place its own interest ahead of its clients' interests. An advisor has a duty to act in the client's best interest, not its own.

The SEC general instruction three to part 2 of Form ADV, that every investment advisor has to pull out. And this is cited in our papers. As a fiduciary, you must also seek to avoid conflicts of interest with your clients, and at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisor relationship. This obligation requires that you provide the client with sufficiently specific facts, so that the client is able to understand the conflicts of interest you have, and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them.

And, finally, the Third Circuit in Belmont said:

> "Under the best interest test, an advisor may benefit from a transaction recommended to a client if, and only if, that benefit, and all related details of the transaction are fully disclosed."

These fiduciary duties are unwaivable by the advisor. Any condition, stipulation or provision binding any person to waive compliance with any provision of this subchapter, or with any rule, regulation or order thereunder shall be void.

So the lawsuit does not allege that the HarbourVest settlement should be undone or unwound. I'd like to move to that point. Mr. Morris says well, you have to unwind half of the settlement. Maybe HarbourVest doesn't have to give back what it got, but Highland would still be saddled with the cost of the settlement, but not with the benefit of the settlement.

Well, actually that's not true. There's two points that we would make on that. Number one, our suit is a suit for damages. In other words, the suit would be a suit for money damages, based on the difference between the value of the asset and what HarbourVest or what the actual value of the asset that was represented, $22.5 million. So the second point, though, is that even under a situation where CLO or Holdco or the DAF, or even HCLOF were to purchase the HarbourVest suit, the expectation would obviously be that they'd pay the $22.5 million that Highland paid for it.

So Highland is -- so it's not unwinding, and there's no saddling Highland with a burden that they didn't otherwise have, I think that's a misrepresentation. But we're not seeking to unwind the lawsuit -- or excuse me, unwind the settlement.

Now Mr. Morris is correct, the representation of value by Mr. Seery is -- is one of the main points here. And the representation was that the value of the entire asset. Not just the shares of MGM, but the value of the entire asset was $22.5 million. So in other word, nearly half of HCLOF was represented to be worth $22.5 million. It was argued by counsel on Page 14 of the January 14th transcript, and then on Page 112 of that transcript, Mr. Seery specifically says the current value is right around $22.5 million.

Now that was also in some of the filing papers and Mr. Morris put up the evidence to Your Honor that Mr. Pugatch, on behalf of HarbourVest also parroted that number. But there's not any evidence today about where that number came from, or whether he was simply relying on Highland's representation of that value.

Now as a general rule, in these 12(B)(6) motions, as I said before, we don't look at the evidence because the whole point of discovery is to find out what's behind a lot of the evidence. That's been quoted. The amount of evidence that went into the 9019 motion as not necessarily full-blown discovery.

I understand Mr. Morris saying well, they could have asked the question. But as I just showed you, they shouldn't have to ask the question. There should be fair and full disclosure of all the material facts. And if it turns out, which we believe it is true, that by January, the value of HCLOF was twice what it was represented, or the HarbourVest portion of HCLOF was twice as to what it was represented, that's a material omission that Highland had an affirmative duty to not misrepresent. Irrespective of the questions being asked.

The DAF found out later on that the representation of the value wasn't true. Now Mr. Morris talked for a very long time about all the opportunities that somebody, Mr. Dondero, somebody other than CLO Holdco. In addition to CLO Holdco, could have asked the magic question to find out whether or not they were telling the truth. But that runs right in the face of the standards set forth by the SEC and by the Courts as to the affirmative obligation of an advisor to disclose all the material benefits that they're going to get as part of a trade. The idea being that when you're a registered investment advisor and you want to engage in a transaction, you make a full disclosure and say this is the transaction. It's worth 41, but I'm paying 22-1/2. But here's why I'd like to be able to do it. And then that's the discussion that happens.

That clearly didn't happen here. And when it turned out that there was this entirely huge upside that they were gaining the benefit of, and maybe HarbourVest didn't care, that that was a false statement. Now the reason we don't have a common law fraud claim, or that we don't necessarily hang our hat on a fraud claim is we don't have enough evidence as it stands today, to specifically say that Mr. Seery intentionally misrepresented that. Although we believe that it was grossly reckless of him to do so. But we don't really need a fraud claim with a gross recklessness standard. We have a breach of fiduciary duty, which basically gets us to the same place.

So the timeline we have is September 30th was the last valuation of HCLOF assets provided by HCMLP. And the value of HCLOF, at that time, or the HarbourVest of that value, would have been about 22.5 million. So what it appears to be is that in January or in late December, the valuation that was being done -- what was being reported, wasn't the current valuation. It was the valuation as of the end of the third quarter of 2020.

On December 22nd, the motion to approve the settlement with HarbourVest was filed. HCMLP should have had or would have had up-to-date valuations of the HCLOF assets, but didn't necessarily disclose them as being different than the 22.5 million. On January the 14th, Your Honor, held the 9019 hearing. And then that same day, Your Honor entered the approval order.

And finally, in March, the DAF learns the true value of HLOF assets as of January 2021 and starts to look into it. Now Mr. Morris makes much of the fact that well, Mr. Dondero at least knew that he had tipped them off, Mr. Seery. And if you actually read Paragraph 127, you'll see specifically what it's purported that he said. He said stop trading in the MGM assets, because MGM might be in play. So you can't trade because I'm an advisor, Mr. Dondero's an insider, he's the tipper, not the tippee. Mr. Seery becomes the tippee under that theory of the case, and he has to, and is required to, because of their affiliation at the time, he's required to cease trading. And that was the purpose of saying that.

The collateral issue that we point is that he at the very least knew about that, and that should have caused him to revalue, if he hadn't done so at the time. Not that, knowing that alone is sufficient to know what the value of HCLOF actually was on that date. That's a complete misrepresentation of the point and purpose of that allegation.

And as Your Honor knows, under 12(B)(6) jurisprudence, the way this is supposed to go is we get the benefit of every inference based upon the allegations, not the movant. So the first violation is that the debtor as an IRA failed to affirmatively disclose the true current valuation of HCLOF and failed to keep the DAF and CLO Holdco reasonably informed of the value of the assets.

And the debtor as an IRA, failed to obtain CLO Holdco's with the DAF's informed consent before it traded in the asset, because it didn't have all of the information. The typical remedy for breach of fiduciary duty is typically damages for any loss suffered by the Plaintiff as a result of the breach. I don't think there's a debate there.

So now we get to Mr. Morris' key argument. His key argument is that we should be talking about res judicata. The elements of res judicata and I think we agree is you have to have identical parties in the action; the prior judgment was rendered by a Court of competent jurisdiction; the final judgment was final on the merits, and the cases involved the same causes of action or the same transaction and nexus of facts.

Now I'm going to skip to three, because I think that's one of the key points that we disagree with them on. There is no case, Your Honor, that we could find, and no case that I read them citing that says an order on an 9019 has preclusive effect under res judicata under an objector to the settlement. We looked. We looked in the Fifth Circuit. We looked outside of the Fifth Circuit. No District Court, no Fifth Circuit Court of Appeals' opinion we could find held that a 9019 order has res judicata effect on an objector's objection. And I think the reason is pretty simple. Is it doesn't.

Because the Plaintiff's claims, here our claims hadn't even accrued. We have a four year statute of limitations, but I think more importantly is that, as the Fifth Circuit said, the 9019 motion grants the Court discretion. It's not supposed to be a mini trial. The Court can approve a settlement over even the valid objection of an objector. It's not a trial on the merits. It's not supposed to be a trial on the merits. It's not supposed to be a disposition on the merits.

So the fact that Your Honor could have approved the 9019 settlement with HarbourVest, even if we had a valid objection, means this isn't a disposition on the merits, as res judicata would envision. It wasn't a trial on the merits, even though it was withdrawn.

The other elements that we would point out to is that neither the DAV nor Holdco were parties to the dispute between HarbourVest and Highland. And this keys off of the issue that I just raised. The cases that are cited by the debtor to Your

Honor all have to do with where one of the settling parties is trying to undo the settlement for some collateral reason. And the Courts have held, no, that's res judicata, because you were a party to the action. HarbourVest brought the claims against Highland. Highland settled those claims.

CLO Holdco was collateral to that settlement, it's not a -- excuse me, collateral to that dispute. It's not a party to that dispute. Its claims weren’t being resolved by the settlement. And while you have a notice to all creditors and those objections can be raised, there was not inherently any manner for resolving those objections on their own merits. Only -- it was only resolved in so far as deciding whether or not the settlement was in the best interest of the debtor, which Your Honor decided, and we don’t challenge that. But we do argue that it caused damages and the debtor shouldn’t get off for those damages.

The fourth element is that the --

THE COURT: Just for the record, the standard in a 9019 context is not best interest of the debtor, right?

MR. SBAITI: Your Honor, I mean that’s what the rule says and Your Honor’s order --

THE COURT: That is not what the rule says. The rule is actually very sparsely worded and then we have Fifth Circuit case law and U.S. Supreme Court law that talk about what the standard is.

MR. SBAITI: Yes, Your Honor. And there are five --

THE COURT: And it's -- is it fair?

MR. SBAITI: There are five elements.

THE COURT: Is it fair and equitable and in the best interest of the estate given a long list --

MR. SBAITI: Correct, Your Honor. And I didn't mean to --

THE COURT: -- of considerations that the Court is supposed to consider that "bear on the wisdom of the settlement." Okay. So it's actually much more involved, is my point, than is it in the best interest of the estate. Is it in the best interest of the estate and fair and equitable given all factors bearing on the wisdom of the compromise? And then we have a long laundry list of things the Court should consider as part of that analysis.

MR. SBAITI: That's a --

THE COURT: I just bring that up because if I'm still -- my brain is still stuck five minutes ago on your comment that you can't find any case saying that an order approving a 9019 compromise has res judicata effect on creditors. And it's -- let me just say it's shocking to me that someone would argue otherwise. Bankruptcy is a collective proceeding --

MR. SBAITI: Your Honor --

THE COURT: -- where creditors can weigh in and object and raise whatever arguments they think the Court should consider that bear on the wisdom of the compromise. And the Fifth Circuit in Foster Mortgage has said the Court should give great deference to the views of the creditors, the paramount interest of creditors.

So it's a really sort of shocking proposition that the order approving a 9019 compromise wouldn't have res judicata effect on all parties and interests who got notice of that. So if you have any elaboration on that, I'd like to hear it.

MR. SBAITI: Your Honor, we looked at the Fifth Circuit cases that they cited, which I believe included that case. And even in that case, the point that we made in our papers and the point I was trying to arrive at is that among the factors, yes, the Court should give great deference to the creditors. But among the factors is not that the objections lack merit or are meritless or that they wouldn't be winnable if they were simply standalone claims.

And that was really the only point I was trying to make is that Your Honor has discretion. Granted it's -- as you mentioned, it's not unfettered discretion. It's bounded by standards and there are -- there is, I know, about five standards Your Honor has to consider or the Court has to consider. But among those, that laundry list of standards, is not that the Court finds that any objection lacks merit. And that was really the only point I was making.

And in terms of the case law, we looked at the Fifth Circuit. We looked, frankly, outside the Fifth Circuit as much as we could, and because this is actually not an easy one to research, as it turned out, despite the language. And we also looked for district court opinions in the Fifth Circuit to see did any district court or did any court of appeals give this type of approval to the standard that a 9019 order has res judicata effect on a claim raised in an objection by a creditor.

And we couldn’t find any and I read all the cases that Mr. Morris cited in his papers, and they didn’t cite one that explicitly said that. They tried to drive at it through insinuation that, well, if the Court has to give great deference or if the Court has to take into account the underlying facts and the fact that there is discovery, surely that must mean this is akin to the trial on the merits. And I think that’s where we simply disagree in good faith. I’m not ascribing any bad intention. But we disagree that that’s where the law goes.

Res judicata is not -- while it’s supposed to stop the relitigation of issues, it is predicated on there having been actual litigation of those issues. And when HarbourVest and Highland settle a case and my clients show up with an objection, even though they withdraw an objection, that, in our opinion -- and we’re asking the Court to see it our way -- is not trial on the merits. It’s not a disposition on the merits of the objection in and of itself. Some objections we can --

THE COURT: But the context matters. In the context of a 9019 compromise, the hearing is about look at the bonafide ease of the settlement. And it’s either fair and equitable and in the best interest of the estate or not. And an objector can say this is a terrible settlement and here’s why it’s a terrible settlement and let me cross-examine the movant and let me put on my own witness that will enlighten the Court as to why this is a terrible settlement, why I say terrible, why it’s not fair and equitable.

That’s your chance to convince the Court, don’t approve this settlement because there are, you know, 14 problems with it. And if you convince the Court, then you convince the Court and it’s not approved. If you don’t, you appeal, and we do have an appeal of the settlement order.

So, again, I’m not understanding the "res judicata doesn’t apply" argument.

MR. SBAITI: Your Honor, if I could riff on two points based upon what you just said, if I could address those.

The first is there are clearly two kinds of objections that get -- at least two kinds of objections that get raised in these 9019 approval hearings. The two that you heard recounted, some were this is bad for the estate. There’s reasons why we don’t think the estate will benefit from it and it will be harmed from it.

And those types of objections, which I believe mostly comprise the objections that Mr. Morris was talking about because they are concerns for the estate. And so creditors who want to get money from the estate are concerned that the settlement will not enter (phonetic) to the benefit of the estate, and therefore, not enter to their benefit as creditors. That's number one.

But those don't adhere in a lawsuit. Those aren't claims for damages that the settlement is going to create for the person objection or for the party objecting. There's a whole separate set of objections similar to the ones HCLO Holdco raised where that what inheres in the objection is this is actually going to cause us some kind of damage.

And so, the factors though, don't require the Court in those second set of instances to say, well, you know what? Not only do I think you're wrong, but I think that your lawsuit, the underlying causes of action that give rise to this objection, have no merit on their own face, that the discovery is not there to support them, that a jury is not going to find there. I am now the trier or the Court is now the trier of fact on the merits of the underlying causes of action that animate the objection.

And that's where I believe we're diverging with the debtor on the law. It goes too far to say that a 9019 hearing where the Court in the end has discretion to approve it, even over a meritorious objection by any party, regardless of what bucket of objections the objection falls into. It goes -- our argument today, Your Honor, and we're asking the Court to see it our way, is that that would go too far. That an actual cause of action shouldn't be eradicated simply because of the 9019 process because, as you pointed out, the Court does have to go through a litany of factors.

And if the Court determines that it's fair and it's more equitable to overrule the objection, the Court has that discretion. And we're not here to unwind that discretion.

But the settlement process did violate certain obligations and did cause my client damages. And that's what we're saying isn't precluded.

THE COURT: Okay.

MR. SBAITI: The fourth element, Your Honor, which I guess in many ways maps on to the argument I just made to Your Honor is that the cases, the underlying cases, do not involve the same claims. Plaintiffs' claims arise from the settlement process itself and not from the underlying issues being settled between HarbourVest and Highland. So that's why we think at least three of the four elements aren't met here. And we'll reserve on the papers, you know, whether jurisdiction was applicable because I think that's probably water under the bridge at this point in the oral argument.

Now, Mr. Morris attacks the case that we cite, Applewood Chair vs. Three Rivers Planning. And he argues that, well, this is not applicable. And the argument he made however was he put it in the context of, well, the parties there, the issue was you had guarantors who were not parties in their capacity as guarantors. But that's not actually what the Court held.

The Court didn't say that the release wasn't applicable to them because they didn't appear as parties in their guarantee capacities. They -- the Court held that, well, the specific discharge language doesn't enumerate those specific guarantees, and so therefore it's not released.

And where this dovetails, we believe, as closely as we can, this isn't a 9019 case. This is a final confirmed plan. But where it dovetails with what our argument is, is that the Court there as well was essentially saying the underlying causes of action weren't really presented to us, so we're not -- we -- and the confirmation of the plan didn't involve disposing of them, so we're not going to say that they are precluded. And we think that that's as close an analogy as we've found in the Fifth Circuit to the issues here today.

So I would say, Your Honor, that we believe that dispenses with the res judicata argument. The judicial estoppel argument, they conflate the language. I'll go back to this for a second. They conflate the language of judicial estoppel on the success of the claim. None of the cases they cite on judicial estoppel involved where a party took a position, withdrew their argument, and then the Court moved on.

Mr. Morris tries to convert a judicial estoppel claim into a judicial reliance claim, which is not the purpose of the doctrine and is not the doctrine at all. The doctrine is that if you take a successful position in one court, you can't take the opposite position in another court. CLO Holdco didn't take a successful position in one court and then change its position later on. In fact, its positions, as Mr. Morris stated, are remarkably similar. They're not inconsistent, which is the problem with their judicial estoppel argument. And we -- I think we fairly briefed that in our papers and we'll otherwise rest on the papers.

To deal -- to address the actual claims, again, I come back to the idea of a fiduciary duty claim, which is our lead claim. And to be clear, it's a state claim predicated on the violation of federally imposed fiduciary duties.

And I'm looking for a clock to make sure I'm not abusing Your Honor's time, and I don't have one right in front of me because my screen -- my screen is up.

Your Honor, the Douglass v. Beakley case is, like I said, is Judge Boyle's case. It specifically provides a cause of action based upon violations of the Advisers Act. We also cite about four or five other cases in footnote 8 of our response from other circuits, including the Third Circuit, the Belton case that I referred to earlier, all of which held that, yes, a state fiduciary duty claim can be predicated on breaches of a federal Advisers Act violation.

The other point that they make on the fiduciary duty claim is they argue HCMLP doesn't owe fiduciary duties to CLO Holdco. And the cases they cite, Your Honor, we dealt with in the papers why they were distinguishable, because in those cases they were dealing with the fact that there wasn't any harm or any direct relationship. But what they ignore is the actual language of the Advisers Act, which is important.

Well, first of all, Mr. Seery admitted in his own testimony during the approval hearing in July of 2019 that he says, "We owe." He says, "There are third party investors in the fund -- in these funds who have no relation whatsoever to Highland, and we owe them a fiduciary duty both to manage their assets prudently, but also to seek to maximize value." I think Mr. Seery was absolutely correct when he said that. Highland owes fiduciary duties to the investors in the funds that Highland manages. The core of our case is that Highland is using or abusing the assets of the funds it managed in HCLOF for its own enrichment, which is a classic breach of fiduciary duty case under the Advisers Act.

Now -- excuse me. The other point that I would say, Your Honor, is that there is a statutory basis for us to argue a breach of fiduciary duty. Excuse me. I didn't mean to stop sharing. I apologize.

Are you back with me, Your Honor, on my --

THE COURT: Yes.

MR. SBAITI: -- PowerPoint?

THE COURT: Yes.

MR. SBAITI: Sorry about that, Your Honor. I just hit the wrong thing. I'm not very technologically savvy. Here we go.

So Holdco is an investor in HCLOF, which is a pooled investment vehicle. A pooled investment vehicle under the case law we cite is simply defined as an investment vehicle that doesn't publicly solicit investors and has few than 100 investors. Highland advises it. That's the same holding in <u>TransAmerica Mortgage</u>, by the way, which we also cite.

15 U.S. C. Section 80(b)(6) establishes the federal fiduciary standards to govern the conduct of registered investment advisers. That's also the <u>TransAmerica</u> case. 15 U.S.C. Section 80(b)(6)(D) delegated to the SEC the power to decide the scope of those duties that are imposed under the statute. And so the SEC enacted 17 C.F.R. Section 275.206(4)-8.

And it expressly states, and we cite the statute or the regular in full in our papers, that the fiduciary duties are owed to investors in the pooled investment vehicles. It specifically says that. It talks about two different duties owed and they're owed to the investors in the vehicles, which means they're owed to Holdco as an investor in HCLOF, which is the vehicle that Highland manages.

It's black and white in the regulation. And we haven't seen any response. There was no response of that in the reply that was filed, Your Honor. And so the argument that there's not a fiduciary duty owed to Holdco because it's merely an investor in HCLOF simply doesn't comport with the law.

And finally, the petition lays out the basis for our claims including the applicable federal and state law. Plaintiffs' response lays out why the legal arguments aren't opposite at the 12(b)(6) stage and Rule 9(b) is met where necessary under the federal claim. And I'm trying to unshare so that I can get back to regular argument.

I'd like to briefly address Mr. Morris' argument, Your Honor. Your Honor, I re-raise my argument that I made before, which is that a 12(b)(6) motion and hearing is not the appropriate time for all the evidence that was poured in here. And I understand Mr. Morris' contention, well, it's really hard to ignore all the history of this case. But a lot of that history really boils down to things that were actually admitted in the complaint. The complaint recognized there was a 9019. But what Mr. Morris wants to do is go beyond that and to go to what people said and what they must have meant. What Mr.

Dondero must have meant in his objection, what Dugaboy must have meant by their objection, what Mr. Pugatch must have meant by his testimony.

All of that is highly improper at this stage of the proceeding, Your Honor. It's outside of the 12(b)(6) confines. It's outside the four corners of the complaint. And we object to all of that evidence being considered.

THE COURT: Let me --

MR. SBAITI: The question we --

THE COURT: Let me ask you about that procedural point.

MR. SBAITI: Yes, Your Honor.

THE COURT: As we know, 12(d) provides that if matters outside the pleadings are presented to and not excluded by the Court in a 12(b)(6) motion, the motion must be treated as one for a summary judgment under Rule 56 and all parties must be given a reasonable opportunity to present all the material that is pertinent to the motion.

Are you -- what are you arguing? That I should treat it as a motion for summary judgment and give you more time to present other materials? I mean, you both presented an appendix, okay. And I'm telling you we're seeing this more and more, I've noticed. People are going beyond the four corners of a motion to dismiss and attaching things. And there's some, you know, Fifth Circuit authority that says, well, if what is attached is integral to understanding, you know, an allegation or whatever in the pleading, you know, there is some discretion to go outside the four corners.

So I'm trying to understand the point you're making with this. Are you saying I should treat it as a motion for summary judgment or do these attachments really -- you know, do I have authority under the Fifth Circuit to consider them as part of the 12(b)(6) motion or not?

MR. SBAITI: Typically, in our experience, Your Honor, is when a summary or when a 12(b)(6) is going to be treated as summary judgment under 12(d), the Court says that and then the parties are given an opportunity, as you said, to go do some discovery in order to put together the evidence and materials to then come back and respond as a summary judgment. We responded to a 12(b)(6) and objected to the evidence. If the Court wants to treat it as a summary judgment, then we would ask for an opportunity for -- to conduct discovery in order to be able to respond as a summary judgment motion, but we didn't -- because we responded to a 12(b)(6) --

THE COURT: You did the same thing though. You did the same thing in your response. You submitted an appendix of evidence, if you want to call it evidence. As someone pointed out, it's stuff from the bankruptcy court record. I don't think it went beyond what was already in the bankruptcy court.

MR. MORRIS: And if I -- can I be heard on this, Your

Honor?

THE COURT: You can. You can.

MR. MORRIS: Just to respond. This is really quite simple. The motion to dismiss is based on res judicata. Res judicata necessarily requires a review of what happened in connection with the prior hearing. There's nothing that we have identified or put forth in the appendix or on our exhibit list except for the pleadings in the 9019, the transcripts, the one deposition transcript, the one trial transcript, the settlement agreement, the transfer agreement. I'd love to know what the Court couldn't or shouldn't take judicial notice of. There is no emails. There is no -- there is no -- there is no extrinsic evidence, if you will. All of this is either on the docket or was presented as part of the hearing.

THE COURT: Yeah. I'm just trying to ferret --

MR. MORRIS: And it's necessary. And it's necessary for the motion.

THE COURT: Yeah. I'm just trying to ferret out the procedural position that's being asserted here. And I don't have the case cites off the top of my brain, but there is authority from at least the Northern District judges, if not the Fifth Circuit, saying in a 12(b)(6) motion I can take judicial notice of items in the record. And then, you know, there -- I know there's Fifth Circuit authority saying I can go beyond the four corners in a 12(b) context if it's just basic, you know, explaining things that are in allegations. You know, such as --

MR. SBAITI: May I address that, Your Honor?

THE COURT: -- such as if a contract is in dispute, okay. Like there's no way you can have a cause of action under the contract and here's the contract. So I'm just trying to nail down your procedural position here.

MR. SBAITI: Your Honor, the distinction I was trying to make that I don't think I put as artfully as I might be able to put now is in a 12(b)(6) if there's a contract, as you said, if there's a legal document, a contract and order that's integral to the case, Your Honor can take judicial notice of that. Generally, a court can take judicial notice of filings in a bankruptcy, the fact that they were filed.

So the transcripts, which Your Honor can't take judicial notice of, is the truth of those. And that was what I was objecting to is it's one thing for him to say an objection was filed and therefore, because an objection was filed, that should be it. That was your only chance. I'm not saying Mr. Morris can't make that argument.

But when he goes beyond the fact of the filing or the fact that there was a transcript or the fact that there was a deposition and starts to read from the depositions or read from the filings and say this is what those mean, that goes against the 12(b)(6) parameters because, number one, now it's substantive evidence and not simply a judicial notice of something that's right there in front of the Court, i.e., something on its own docket. Because those statements and the interpretation of those statements are subject to credibility findings. They're subject to clarification. They're subject to rebuttal. That's the purpose of discovery.

And so if Your Honor -- and Mr. Morris is right. Usually, res judicata involves knowing what happened in the prior proceedings. So if all he wants to do is rest on the fact that an objection was filed by CLO Holdco and maybe even other people, and that should be it and he thinks that's enough for Your Honor to say res judicata applies, then I don't think we have a problem. It's when he goes beyond that and says, Your Honor, these people must have known and this is what they meant by their argument, that's what I'm asking Your Honor not to consider. And if Mr. Morris wants you to consider that, that's a summary judgment motion and we should have the opportunity to do discovery at the very least into the issues he has now raised as supporting his res judicata defense which he has the burden of proof on.

MR. MORRIS: Your Honor, this is one of the strangest arguments I have ever heard. I'm allowed to offer the Court and the Court is allowed to accept the documents, but I'm not allowed to read them. I'm not allowed to make arguments. I don't understand what that even means. If it were a contract, I would be allowed to put the contract in front of Your Honor, but I wouldn't be able to argue why the contract doesn't say what the Plaintiff says. I don't get it.

THE COURT: Okay.

MR. MORRIS: That's --

THE COURT: Just I've heard enough on this. I don't think we have moved into Rule 12(e), that realm of me needing to treat this as a motion for summary judgment. I think the so-called evidence, the appendix that was attached to the motion as well as the appendix that was attached to Plaintiffs' response, it's stuff that I can take judicial notice of that's in the record of this Court and I can look at it. You know, it is what it is, the record of this Court.

All right. So I have nine people waiting in chambers. I'm trying to figure out should I take a break now or are you fairly close to wrapping up. Either answer is fine, Mr. Sbaiti. I just need to figure out who I make wait here.

MR. SBAITI: I have -- oh, I'm sorry. I didn't mean to interrupt you, Your Honor. I was just going to say I have five minutes left, but I know Mr. Morris probably wants to come back. So if you want to break now and we can come back at whenever the Court wants us to, we can do so.

THE COURT: All right. Why don't you make your final five minutes and then we'll take a break?

MR. SBAITI: Okay. Thank you, Your Honor.

I just wanted to address some of the arguments that Mr. Morris raised in his argument. The first thing is -- and I addressed this in part -- but Mr. Morris makes a big deal about paragraph 127 of the complaint and essentially suggests that we're the -- or that Mr. Dondero is the perpetrator of a nefarious scheme. Whereas, what the pleading actually says, and I again encourage Your Honor to re-read -- to read it specifically, is that Mr. Dondero warned Mr. Seery not to trade in the stock and not to make any transactions because the stock was going to appreciate in value.

That has two implications for us, Your Honor. Number one, it means Mr. Seery was a tippee of insider information, and number two, it means that Mr. Seery, if he did trade on that information or if he did pass that information on to someone else, that is a problem from the Advisers Act standpoint, which is really the only purpose of saying that.

While paragraph 127 also says that that should have caused Mr. Seery to revalue the NAV of HCLOF, it does not state and we did not plead that the entire value of HCLOF is tied to the MGM stock. So the insinuation that that somehow gave us inside information about what the true value of HCLOF was and we should have known or that Mr. Dondero should have known is simply untrue.

The other argument Mr. -- that Mr. Morris likes to harp on is that CLO Holdco withdrew its argument, but he characterizes Mr. Kane's withdrawal testimony -- as he says, Mr. Kane admitted that CLO Holdco lacked the superior right to obtain the HarbourVest. If you read the very language that was highlighted on Mr. Morris' slide, that's not what Mr. Kane says. Mr. Kane says, "We've gone back to the drawing board. We've read your reply. And my client has given me permission to withdraw the argument or withdraw the objection." That's all he said. There was not an admission that he was wrong. There was not an admission that they had made a mistake. There was simply an admission that they decided to withdraw the objection for whatever reason.

Lastly, on the specific claims --

THE COURT: That's not an accurate description of the record. He said he looked at --

MR. SBAITI: Your Honor, I was reading it along with him.

THE COURT: -- Guernsey Law. And I don't know if his words were deep dive.

MR. SBAITI: Yeah.

THE COURT: But he had looked at the agreements extensively. That's just not what he said.

MR. SBAITI: And he said he was with -- Your Honor, he said he was withdrawing. He didn't say we were wrong. He didn't say we don't have a claim. What he said was, "We're withdrawing the objection."

THE COURT: After doing an extensive look at the agreements in Guernsey Law, okay, so.

MR. SBAITI: Sure. But, Your Honor, he might have -- he could just as easily thought we have a chance, but it's not a good one. And frankly, we'll be here for 20 days and we're withdrawing it for that reason because we'll live to fight another day. Your Honor, there's an innumerable number. To simply say that he admitted that they didn't have a correct claim, it's just he didn't say that. That's all. That's the only point I'm making.

Your Honor, I don't disagree with the debtor that the Court's exculpation clause gets rid of the negligence claim which was obviously filed before the effective date, so that claim is gone.

And I think the last argument that Mr. Morris makes on the RICO claim is the federal court, the Supreme Court standard for pleading a RICO claim, that acts that only continue for a few weeks are not -- don't set out a RICO claim. Your Honor, in our response to that, we actually submitted an amended complaint that shows that the type of acts we're talking about, the pattern of the debtor using its investor vehicles assets to liquidate is a long pattern and practice than simply the HarbourVest suit. And so, we move to amend on that basis to satisfy that pleading defect, which is the main one that they focused on.

That's all I have, Your Honor.

THE COURT: All right. Thank you.

We're going to take a 15 minute break and come back. I'll ask Mr. Jordan and Mr. Bessette did they have anything they wanted to say today. I know they joined in the debtor's motion. And then we'll let Mr. Morris have rebuttal.

All right. So we'll be back in 15 minutes.

THE CLERK: All rise.

MR. MORRIS: Thank you, Your Honor.

(Recess at 12:05 p.m./Reconvened at 12:23 p.m.)

THE CLERK: All rise.

THE COURT: All right. Please be seated.

We're back on the record in Charitable DAF v. Highland Capital. All right. So I promised I was going to go back to counsel for Highland CLO Funding, Ltd. So Mr. Jordan, Mr. Bessette, is there anything you wanted to say for oral argument?

MR. JORDAN: Thank you, Your Honor. John Jordan on behalf of HCLOF.

Our points are two procedural points. The first is as the Court anticipated, in our motion to dismiss filed back in August, we joined in the motion to dismiss of Highland. And so to the extent that the Court after deliberation is inclined to grant that motion, we would ask that as a joining party, HCLOF be pulled along with that.

The second procedural point is that back in our motion to dismiss, we pointed out that the complaint does not actually allege anything against HCLOF. In the story, we're essentially the football and neither Oklahoma nor UT. And we pointed that out as an additional argument to what you've heard today. That motion was never responded to. The deadline by agreement was extended to October 11th. And the lack of response was, we believe, not inadvertent but simply an acknowledgment that HCLOF is not a party that anything is being claimed against.

It particularly makes sense since effectively and in rough numbers, they're half owned by both sides. So for every dollar that HCLOF spends hanging around the case, the parties are paying essentially 100 cents collectively. So for that reason, we would ask, and subject to Mr. Sbaiti's input, whether the Court would ask us or direct us to upload an order granting our motion as unopposed. We just feel like we don't have any role in this case.

THE COURT: All right.

Mr. Sbaiti, what about that?

MR. SBAITI: Your Honor, they were originally added as a nominal party. And as a nominal party, because of the potential need to have a derivative action, I think that based upon Highland's arguments and the arguments that we had, I don't think the derivative action is necessary for us to maintain on a go-forward basis. And so we don't oppose them being dismissed.

THE COURT: All right. Then I assume, Mr. Morris, you don't have any problem with this, correct?

MR. MORRIS: No, Your Honor.

THE COURT: Okay. So I'll look for the parties to submit an agreed order of dismissal of HCLOF after the hearing. All right?

MR. JORDAN: Thank you, Your Honor.

THE COURT: All right. Mr. Morris, you get the last word.

MR. MORRIS: Thank you, Your Honor. I hope to be relatively brief. I really just want to focus on the arguments concerning whether or not the order that was entered by this Court was an order that was entered on the merits.

As the Court is well aware, a 9019 motion filed by a debtor is done so on notice. It is to give all parties in interest an opportunity to be heard, not just as to whether or not the debtor meets its burden of proof under Rule 9019 but whether or not the Court can find, as it must, that the proposed settlement is in the best interest of the estate.

The purpose of -- I mean that is the purpose of the giving notice so that everybody has a chance to be heard. The questions that the Court asked, the questions that every bankruptcy court asks in a 9019 is can the debtor do this deal, should the debtor do this deal, is it in the best interest of the estate to do this deal.

And, you know, the idea that a 9019 order is somehow res judicata only to the parties to a settlement is just something that doesn't make any sense to me because it abrogates so many rules that exist that allows and encourages and requires parties who have objections to be heard.

Mr. Sbaiti's clients filed an objection. They initiated a contested matter. They obtained rights. They were litigants. They are litigants in a contested matter where they're required to tell the Court what objections they have to the settlement, and they did that.

Mr. Sbaiti, you know, told me that I wasn't allowed to characterize the words that are used in the documents that have now been admitted by the Court. And, yet, I heard him say that maybe Mr. Kane (phonetic) really meant to tell Your Honor that he was withdrawing the claim because he was going to save it for another day.

I'd just ask the Court to look at the transcript. I don't have to interpret it at all. And I'd ask the Court to read the words. I can put them back up on the screen, but they're pretty short. It's at Pages 7 and 8 of the transcript of what Mr. Kane told you and what you said in response. It's on the page, not my interpretation, and what the import of that was.

Mr. Sbaiti believes, I guess, if one is allowed to engage in such conduct without consequence, that one is allowed to allow to file objections, cause the Court and the litigants to participate, to give discovery, to write briefs, to do analyses, withdraw it on the basis of their own good faith analysis of Guernsey law of the documents and somehow say it's irrelevant. Not what the law is, not what res judicata is intended to do.

He should have put all of his cards on the table. In fact, I think that Mr. Kane believed he was putting all of his cards on the table because that's what he did. He filed a very comprehensive objection. He asserted a right to the opportunity that the debtor was proposing to take in the 9019 motion. That's what he was doing. He was objecting on the basis that he claimed his client had a superior right to this asset.

And he didn't -- like I said earlier, Your Honor, I don't think he would be permitted, I don't think these claims would fly today if no objection was filed. But the fact that there was renders, I think, indisputable that there was a finding on the merits, right. And the only reason that the Court didn't rule on Mr. Kane's motion, the only reason the Court didn't rule on it is because Mr. Kane withdrew it.

Is that really the way this process is supposed to work, that one can tell the Court that after a review of the documents, I'm going to withdraw the objection and then file a claim for damages three months later with a different client, with a different control person, with a different lawyer? That's okay under doctrine of res judicata? I don't think so.

They had a full and fair opportunity. The fact that this was somehow -- you know, they're denigrating the fact that this was a 9019 motion. There's not supposed to be a mini-trial. Your Honor had discretion as to what to do. Every court in every bench trial has discretion as to what to do and whether or not to overrule objections and whether or not to substain [sic] objections. That's what judges to.

And there's nothing offensive about the fact that it happened in the context of a 9019 motion. They don't get to sit on their hands and wait to fight another day. If they believed that the debtor was exposing itself to liability, and that's what they actually say in the opposition, that's what I actually think they say in the complaint, accept it as true, they believe that the debtor created liability for itself by rendering -- by entering into this transaction.

Shouldn't they have raised their hand and said you can't do this deal, right? And the only response to that -- they have to that is they had no idea about value. Paragraph 127, Your Honor, Mr. Dondero, the architect of this complaint, as was proven on June 8th, knew very well about value. And it doesn't matter that it was only MGM. Your Honor commented on that at the June 8th hearing in a different context. But everybody knows, right, it is. He sits on the board of MGM.

And I'm sorry if I called him a tippee instead of a tipper. But if this complaint goes forward, we'll dig into that real deep. But there's no reason it ought to, Your Honor. This case ought to be dismissed on res judicata grounds. It should be dismissed on judicial estoppel grounds. And it should be dismissed for all the reasons that I said in my argument in my brief.

But I do just want to close with one point, and that is to read from a case called Goldstein, which I think I alluded to earlier on this issue of whether there's a fiduciary duty that's owed by an advisor to an investor and a fund:

> "At best, it is counterintuitive to characterize the investors in a hedge fund as the clients of the advisors. The advisor owes fiduciary duties only to the fund, not to the fund's investors."

There's a lot of discussion about fiduciary duties, Your Honor. But to the extent that they have any basis to defeat the motion to dismiss on res judicata or collateral estoppel grounds, we hope and we trust and we know the Court will review the case law vigorously to test some of the assertions to that.

I have nothing further, Your Honor.

THE COURT: All right. Well, thank you to all of you.

As a reminder, I don't think you need it, but as a reminder, I am essentially acting as a magistrate for Judge Boyle in this action. And whichever way I go on whichever theories, I think she would expect a thorough write-up. It would, of course, be in the form of a report and recommendation for her to either adopt or not if I dispose of some or all of the counts in the lawsuit.

Even to the extent I deny dismissal, even though the rule typically does not require a court to make detailed findings and conclusions in connection with a denial of a motion to dismiss, again, since I'm sitting as a magistrate, I think Judge Boyle would expect some thorough explanations and reasoning from me.

So that's my way of saying I'm taking this under advisement. I am going to drill down on some of the cases that have been argued. I think some important issues are raised here that need some thorough reasoning.

So I will do the best to get this out without too much delay. I think there's probably zero chance, zero chance I'm going to get it done by the end of the year. We're just too behind with some of our under-advisements. But I will try earnestly to get it out fairly soon after the first of the year. All right?

Thank you. You all have a good holiday.

THE CLERK: All rise.

(Proceedings concluded at 12:37 p.m.)

* * * * *

C E R T I F I C A T I O N

We, DIPTI PATEL, KAREN WATSON, CRYSTAL THOMAS, AND PATTIE MITCHELL, court approved transcribers, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of my ability.

/s/ Dipti Patel

DIPTI PATEL, CET-997

/s/ Karen Watson

KAREN WATSON, CET-1039

/s/ Crystal Thomas

CRYSTAL THOMAS, CET-

/s/ Pattie Mitchell

PATTIE MITCHELL

LIBERTY TRANSCRIPTS DATE: November 23, 2021

EXHIBIT 2

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

IN RE:	.	Case No. 19-34054-11(SGJ)
	.	
HIGHLAND CAPITAL MANAGEMENT, L.P.,	.	Earle Cabell Federal Building 1100 Commerce Street Dallas, Texas 75242
Debtor.	.	
. . . .	.	
	.	Adv. No. 21-03067-11(SGJ)
CHARITABLE DAF FUND, LP, *ET AL.*,	.	
Plaintiffs,	.	
v.	.	
HIGHLAND CAPITAL, MANAGEMENT, L.P., *ET AL.*,	.	
Defendants.	.	Wednesday, January 25, 2023
. . . .	.	1:38 p.m.

TRANSCRIPT OF HEARING ON DEFENDANT HIGHLAND CAPITAL MANAGEMENT L.P.'S RENEWED MOTION TO DISMISS COMPLAINT (122) AND STATUS CONFERENCE RE: MOTION FOR WITHDRAWAL OF REFERENCE FILED BY PLAINTIFF CLO HOLDCO, LTD., PLAINTIFF CHARITABLE DAF FUND, LP (128)

BEFORE THE HONORABLE STACEY G. JERNIGAN
UNITED STATES BANKRUPTCY COURT CHIEF JUDGE

APPEARANCES ON NEXT PAGE.

Audio Operator: Michael F. Edmond

Proceedings recorded by electronic sound recording, transcript produced by a transcript service.

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For the Defendants:	Pachulski Stang Ziehl & Jones LLP BY: JOHN A. MORRIS, ESQUIRE GREGORY V. DEMO, ESQUIRE 780 3rd Avenue, 34th Floor New York, New York 10017

INDEX

(Proceedings commenced at 1:38 p.m.)

THE COURT: All right. We have settings this afternoon in Highland Adversary 21-3067. We have a renewed motion to withdraw the reference set for status conference and a renewed Rule 12(b)(6) motion to dismiss.

So let's get all of our appearances from the lawyers before we get started. I'll start with our plaintiffs. Who do we have appearing for Charitable DAF and CLO Holdco?

MR. SBAITI: Your Honor, this is Mazin Sbaiti on behalf of the two plaintiffs.

THE COURT: Thank you.

Any other lawyer appearances for plaintiffs?

MR. PHILLIPS: Your Honor, Louis N. Phillips on -- I have been asked and agreed to argue the motion to withdraw reference. I did not file a special appearance. We've talked with opposing counsel, and they were aware that I was involved. I am not counsel of record in the lawsuit, but I've been asked to argue this, the bulk of the motion to withdraw reference.

THE COURT: All right.

Appearing for defendants, who will appear today?

MR. MORRIS: Good afternoon, Your Honor. This is John Morris from Pachulski Stang Ziehl & Jones. I'll be arguing if Your Honor chooses to hear the renewed motion to dismiss. I'm joined by my colleague Gregory Demo. Mr. Demo is going to argue on behalf of defendants and our position the motion to withdraw the reference.

I would note just procedurally while we have absolutely no objection to Mr. Phillips participating today, he really should be making an appearance on behalf of the entity making the motion. I don't see how he can bind the plaintiffs without serving as their counsel.

I've never heard that before. That wasn't my understanding of what was happening. But, you know, given some of the things that have happened in this case, I think it would be prudent to make sure that the person who's advocating on behalf of a party actually represents them.

THE COURT: Okay. We'll circle back to that. But have I missed any lawyer appearances?

(No audible response)

THE COURT: All right. Others --

MR. MORRIS: Not for the defendants, Your Honor.

THE COURT: Just observers.

All right. Well, Mr. Phillips, let's be crystal clear. I know that during the underlying bankruptcy case you have, if not this adversary, you have appeared for the Charitable DAF.

Exactly let's be clear, you know, you said your role, you've been asked to argue the motion to withdraw th reference. Are you retained by Charitable DAF and CLO Holdco in connection with this adversary?

MR. PHILLIPS: Your Honor, I have and I will -- we will file in today a notice of appearance. And I'm assuming that will be satisfactory, and we will provide any limitations on our representation. But we are authorized to represent the plaintiff CLO Holdco and the plaintiffs in this matter with respect to the motion to withdraw reference.

THE COURT: All right.

MR. PHILLIPS: And we will file a formal notice of appearance to that effect.

THE COURT: Okay. So we will look for that to happen.

All right. We're going to take up the motion to withdraw the reference now. Just as a reminder, my courtroom deputy was in communication with the lawyers and I think the lawyers agreed to 15 minutes each as far as your arguments on the motion to withdraw the reference.

Are we all on the same page on that?

MR. MORRIS: It's 25.

THE COURT: Twenty-five.

MR. MORRIS: Correct.

THE COURT: Okay. That as wishful thinking maybe on my part.

Okay, 25 minutes each. And so I will hear from you, Mr. Phillips.

MR. PHILLIPS: Okay. Thank you, Your Honor.

As an introductory matter, we discussed with Mr. Demo and Mr. Morris. We have a peculiar situation here where we have a motion to dismiss that calls into question the claims arising under federal law. And that argument dovetails almost completely with the argument about the consideration of federal law.

And we have agreed that I will defer -- I will grant, carve out some of the 25 minutes so that Mr. Sbaiti who is going to be arguing the motion to dismiss can argue the intricacies of the claim with respect to federal law.

THE COURT: Okay.

MR. PHILLIPS: Thank you, Your Honor.

Louis M. Phillips on behalf of the plaintiffs.

We're here on what's been deemed a re-urged motion for withdrawal of reference. We have a response that the withdrawal of reference on multiple grounds, pretty much all the grounds they could oppose. And we'll start with what I think would be kind of a clearing mechanism. We have arguments on both sides about various and sundry approaches to whether or not the reference should be withdrawn. And it seems to me like some of those arguments may not necessarily be relevant.

And what I'm talking about is there's an argument, both sides, about the nature of the jurisdiction core versus non-core, whether or not this is an administrative expense claim which is core, whether or not the Court has jurisdiction pointing out that courts have jurisdiction to decide securities law matters certainly, including 5.3(a)(19). We think the following with respect to all of this.

Number one, the structure of -- this is a mandatory withdrawal motion. The structure of 157(d) is that motions that the court shall -- the district court shall withdraw upon a timely motion a proceeding that requires for resolution consideration of both Title 11 and other laws of the United States for regulatory organization of activities affecting interstate commerce.

So what we have here is a question of authority. as I see it, and as we argue, the withdrawal of reference is compelled upon a timely motion, not with respect to -- not considering whether or not the proceeding is core because core proceedings can be withdrawn, not considering whether or not the proceeding is an administrative expense claim or proceeding because administrative expense claim proceedings if they meet the statutory definition of a proceeding subject to mandatory withdrawal can be withdrawn. In fact, we've got a citation later on in the argument where there's a proof of claim that is subject to mandatory withdrawal.

We've seen this -- the point is the question of whether -- there's no question about the Court having jurisdiction. If this was a matter of subject matter jurisdiction, then you couldn't waive subject matter jurisdiction by failing to file a timely motion. And clearly, the jurisdiction of the district court under 1334 is referred to the bankruptcy court in the event there is no motion to withdraw reference.

So our position here in argument and before the Court is that the question is not whether the Court has jurisdiction, what the nature of the proceeding is, is it an administrative expense proceeding, is it an adversary proceeding. It's not whether the Court is capable of deciding this type of issue because clearly the statute provides that, number one, the Court has authority to decide the proceeding if there's no motion to withdraw reference and if it's not related to. And if it is related to and there's consent, you have authority to decide the proceeding.

So the question is whether or not the Court, notwithstanding its authority, notwithstanding the fact that the proceeding might be a core proceeding, has to recommend to the district court or the district court has to withdraw the reference under mandatory withdrawal Section 157(d). So --

THE COURT: Okay. Let me --

MR. PHILLIPS: -- I think what we can do --

THE COURT: Let me call time out and my law clerk will stop the timer --

MR. PHILLIPS: Yes, ma'am.

THE COURT: -- when I interrupt with questions.

So we're on the same page, I think I hear you saying you don't dispute that this is a core in nature proceeding, that it's essentially a request for allowance of an administrative expense claim and even if those involve federal law or non-bankruptcy law, that's core.

What you're saying is sometimes even when you have a core matter, whether it's a proof of claim or a request for administrative expense claim, if it involves I guess a significant enough amount of federal law, 157(d) requires it to be yanked from the bankruptcy court?

MR. PHILLIPS: Well, it would be 157(d) would deal with a certain type of federal law, consideration of federal law or an organization and activity involving the regulation of interstate commerce. So it's not federal law --

THE COURT: Okay. But I want to make sure I have an answer from you because district courts like you to have certain bells and whistles in your reports and recommendations about is it core or non-core or stern.

You acknowledge this is a core matter?

MR. PHILLIPS: Your Honor, what I would rather do if tied to the stake, I might approach this in a different manner. And if you want to tie me to the stake, I might have to. But what I would rather do is tell the Court that I don't think -- I hear the Court with respect to what the district court might want as regards to whether it's core or non-core.

But what I would rather do at this point, I don't have authority to admit or acknowledge. What I would rather acknowledge is that I don't think it's relevant to the question of whether a proceeding gets withdrawn under mandatory abstention because --

THE COURT: Okay.

MR. PHILLIPS: -- the proceeding, the definition of a proceeding that's subject to mandatory abstention has no reference to core, non-core, or related to. It is just a proceeding. And it clearly is subject to 1334 jurisdiction but this is one provision of Section 157 that does not deal with whether or not a proceeding is core, non-core, arising in, arising under, related to.

It's just a proceeding with the assumption that you have jurisdiction under 1334, an assumption that it got referred to the bankruptcy court because of the order of reference and 157 that authorizes reference of matters arising in, arising under, or related to a bankruptcy case to the bankruptcy court.

My position is that it's not relevant to whether or not it is core, non-core --

THE COURT: Okay.

MR. PHILLIPS: -- related to because the statute simply refers to the type of proceeding and its involvement with a certain component of federal law.

THE COURT: Okay. We've started the timer again.

MR. PHILLIPS: So -- okay, thank you.

I've got my own little timer but, of course, my phone goes off and then I have to find it and if the Court could just tell me when I -- I'd like to reserve five minutes. If the Court could tell me when I'm at ten minutes, I'd appreciate it.

THE COURT: Okay.

MR. PHILLIPS: So where I think we --

THE COURT: When you are at ten minutes left. Okay, go ahead.

MR. PHILLIPS: Where I think we were, Your Honor, is that we have a motion to withdraw reference that was originally filed in the district court. I think there are two questions here. I think the questions are not -- the questions are whether or not this is a timely motion and, secondly, whether or not the requirements of 157(b) are met with respect to the nature of the proceeding and the involvement of federal law regulating activities or organizations under -- involving interstate commerce. That's what I think we're here to discuss.

And so with respect to timeliness, we have a motion filed in the district court. We have a motion to enforce the reference under the local order of reference. And we have a cross-motion that says to the district court don't do that because it's not efficient. You ought to go ahead and just keep it and, quote, withdraw the reference because this is a 157(d) type proceeding.

I think what happened and what we have in the district court's order of reference is no resolution of the motion to withdraw reference. It's simple an order enforcing local order of reference that applies to all proceedings.

So I guess the way I look at this, the way I approach -- I'm arguing to the Court that this should be approached is that you can't withdraw reference of a proceeding unless the order of reference is complied with. And I can see how the district court would say I am not -- we are not going to abide by litigants that file -- we are not going to grant relief because it's efficient in the face of a proceeding automatically referred to the bankruptcy court that should have been filed in the bankruptcy court but was not.

And if you look at the order of reference, the order of reference simply says that the matter is referred under the local -- under the order of reference and is to be treated as a proceeding related to the bankruptcy case below and given an adversary proceeding number. There's no ruling on the question of whether or not mandatory abstention applies because I think what we're dealing with here, in fact, I know what we're dealing with here.

We're dealing with a situation where the district court considered any withdrawal of reference to be premature because the order of reference in its mind needed to be enforced so that the proceeding was in the bankruptcy court prior to the ruling on, filing of, or consideration of a motion to withdraw the reference.

THE COURT: Okay. Let me stop you again there.

MR. PHILLIPS: So our position is --

THE COURT: Let me stop you again there because --

MR. PHILLIPS: Yes, ma'am.

THE COURT: -- before I started preparing for today's argument, I had wrongly had in my head that Judge Boyle, the district judge just sua sponte did a one-paragraph order sending this lawsuit to the bankruptcy court. But then as I started preparing, I either was reminded --

MR. PHILLIPS: Yes, ma'am.

THE COURT: -- or realized for the first time that the debtor, defendants, filed a motion to enforce the reference arguing, please send this to the bankruptcy court. And your clients opposed that and essentially made a cross-motion to keep the case.

And so the district judge's short little order was actually -- it wasn't sua sponte, it was after presumably reading everybody's pleadings, right?

MR. PHILLIPS: Agreed. I don't think I argued that it was a sua sponte order. I did not do that, no. It was --

THE COURT: Well, no. I point that out because I think the argument was essentially no motion to withdraw the reference even though this is called renewed was really fully made and considered by the district court. Was that not what you were arguing?

MR. PHILLIPS: I agreed that that's correct. I agreed that that's my argument. And the reason that's my argument is you don't have to rule and in fact the district court -- I'm not going to say the district court was wrong because if the district court made a decision that the order of reference, that the plaintiff did not comply with the order of reference, then trying to short-circuit the order of reference by filing in the district court.

The court didn't have to, and this is not something that had to be litigated to decide whether or not to refer in accordance with the order of reference because technically I'm not sure that the district court could have concluded that the order of reference could be withdrawn before it was complied with. So I don't -- I think what we're -- we're not talking about a collateral estoppel or res judicata on the motion to withdraw reference because it was not necessary even to address the motion to withdraw reference before ordering enforcement of the reference.

So I'm not saying it was sua sponte. I'm not saying that the plaintiff who I represent in connection with this argument didn't say keep it, but the plaintiffs' argument about keeping it was you might as well keep it because of efficiency. And the district court in our estimate made the determination that we don't care about efficiency. We have an order of reference that needs to be complied with as an initial gatekeeper issue. If you don't comply with the order of reference and file up here, we're going to make sure you start at a right place by ordering the enforcement of the reference.

I don't think you have to -- I know you don't. The district court didn't have to get to the issue of whether or not the reference would be withdrawn on a mandatory withdrawal under 157(d) to order compliance with the reference. In other words, you can't refer what's not -- you can't withdraw what's not heard. And I think that's what happened. We're arguing that that is what the district court did.

THE COURT: Well, let me stop you again. We're going to be here a long time today, I fear. Did you argue back at that stage you can't send it to the bankruptcy court, Judge Boyle, this involves material consideration of other federal laws affecting interstate commerce, you can't do it. And she, nevertheless, did it?

MR. PHILLIPS: No, I think the argument -- I mean I didn't write the brief. I didn't -- I don't think there was an argument, frankly. In the brief, as I read it, it was this matter is subject to mandatory withdrawal. And it makes no sense to order the reference just so we would then bring it and try to bring it back.

So I don't think that -- even if -- and I'll tell you that even if the plaintiff argued you can't do it, it's clear to me that the -- it's clear that under the order of reference, that the district court could absolutely have just said I'm not listening to any of this. I'm ordering the reference and that's what I'm doing.

But there was never in the order that was issued by the district court a ruling on mandatory withdrawal. Why? Because the district court's concern was that the reference had not been complied with. And so I don't think we're talking about something that had to be actually litigated to get to the district court decision that the order of reference needs to be complied with and this needs to be given an adversary number. Why? That's what our automatic reference requires.

What we don't want at the district court is litigants deciding we don't have to comply with the order of reference because it's going to be withdrawn anyway. And I think, Judge, if you look at what the district court did, it did not mention any type of withdrawal ruling. It did not mention any analysis of the nature of the proceeding. I'm not sure it even knew what the proceeding was.

I think what it did was exactly what the defendant asked it to do was enforce the reference, which it could do and did do without consideration of the premature request in its mind that the reference be withdrawn as a mandatory withdrawal under 157(d).

THE COURT: Okay.

MR. PHILLIPS: That's our position.

THE COURT: All right. Does that conclude your argument?

MR. PHILLIPS: No, ma'am. We have to address timeliness, and we have to address --

THE COURT: Okay.

MR. PHILLIPS: So the timeliness issue is that this Court, the reference was not enforced. The proceeding came to this Court, and the defendants raised dismissal and basically raised dismissal on the basis that everything raised in the complaint was actually litigated or determined either through the doctrine of res judicata or collateral estoppel and/or was precluded by judicial estoppel.

None of -- those issues were not issues of the type of federal law that is applicable to 157(d). Those issues are preclusion issues: res judicata, collateral estoppel. This Court ruled 100 percent on collateral estoppel and res judicata and judicial estoppel and dismissed the complaint with prejudice.

In the November hearing, this Court advised the parties that it was in essence sitting as the magistrate and would be writing up a recommendation.

"I'm essentially acting as a magistrate for Judge Boyle in this action and whichever way I go and whichever theories I think she would expect a thorough write-up. It would of course be in the form of a report and recommendation. for her to either adopt or, if not" --

THE COURT: Can I stop you?

MR. PHILLIPS: Yes.

THE COURT: Did I later correct myself at some point and go, oh wait, she referred this to me? I thought at one point I misspoke and then later in open court corrected myself? Did I -- am I wrong?

MR. PHILLIPS: Your Honor, I will look again.

THE COURT: Okay.

MR. PHILLIPS: We'll look again.

THE COURT: Okay. I --

MR. PHILLIPS: But --

THE COURT: Go ahead.

MR. PHILLIPS: But I will say this. I will say this, we are faced with and we have to argue about and we're dealing with a final order. The Court issued a final order, and the plaintiff appealed.

So there's no question that the Court, whether or not it advised the parties, it made the decision to issue a final order. And that order was appealed. So there's no question, we're not challenging the fact that the Court issued a final order. The Court did. And the final order went to the Court of Appeals, and it took time at the Court of Appeals to issue a ruling.

And the ruling was that collateral estoppel/res judicata did not apply because of the actual litigation requirement given the difference in burdens of proof and standards of proof; and, secondly, that there was one of the components of judicial estoppel that was not resolved by the Court with respect to the request to dismiss Counts 2 and 5 through judicial estoppel.

So the matter was sent back to Your Honor. And a motion to dismiss was filed that focuses, re-urges judicial estoppel on Counts 2 and 5 and focuses on the substantive nature of the complaint and kind of a pure failure to state a claim under Rule 12 which involves the substantive nature of the claim.

And so what in the answer, in the response to the motion to dismiss, there was a motion to re-urge or renew the motion to withdraw reference. Now that the substantiative nature of the claim is put at issue by a motion to dismiss, because there's no preclusion -- there is a preclusion argument on Counts 2 and 5, there's no preclusion argument on res judicata or collateral estoppel.

The motion to withdraw reference was re-urged, and we don't think that was a surprise to anybody. In fact, in November of '21, counsel for the defendants was suggesting that a motion to withdraw reference was coming and it would be sanctionable, et cetera, et cetera. We don't think it's sanctionable, clearly, or it wouldn't have been brought.

But we now have the substantive issues in the complaint being put to the test by a motion to dismiss. And at this point, we think it's ripe for motion to withdraw reference. And we also --

THE COURT: This is your ten-minute warning.

MR. PHILLIPS: -- would point out that --

THE COURT: This is your ten-minute warning --

MR. PHILLIPS: Okay, thank you.

THE COURT: -- you asked for.

MR. PHILLIPS: Yes, thank you very much, Judge.

We'd point out that there are -- you know, this court and other courts take the position that -- some courts take the position motions to withdraw reference are premature until and unless there's a jury trial or a trial that the matters are trial-ready. In fact, I think in the Curson (phonetic) litigation, you have recommended withdrawal of reference but not until it's trial-ready, although those were motions to withdraw reference up at front.

But we'd point out In re Reed. We cited -- we'd point out In re Reed, 2017 WL 1788295, which deals with a prematurity finding by the court pending jury trial readiness.

And we also look at National Gypsum, 145 B.R. 539,542, which is a Judge Fish case. And in that case, you had an objection to a proof of claim and a subject judgment on the proof of claim. I don't really understand that, but the respondent to the summary judgment waited until that was filed to bring a motion to withdraw reference because the summary judgment had raised the issue of antitrust law. And Judge Fish said that this was -- notwithstanding this was late into the case, that the motion to withdraw reference would have been premature prior to that.

We understand -- we think this is a very closely analogous case and that the question of the substantive nature of the cause of action and the causes of action are now squarely before the Court which generates a motion to withdraw reference where when we're talking basically about preclusion, that wasn't necessarily -- this is the better time to bring it than that time was.

Finally, I would say there's an allegation of prejudice. Everything's been briefed. The only question in our mind is whether the Court issues a final order or proposed findings and conclusions so no party is prejudiced. The Court will either do one or the other based on the briefing that's before the Court.

So I'll use the rest of my 20 minutes to defer to Mr.

Sbaiti about the applicability of federal law and the intricacy of federal law and necessity of dealing with federal law.

THE COURT: Okay. Mr. Sbaiti?

MR. SBAITI: Good afternoon, Your Honor.

I've prepared some remarks for the actual motion to dismiss, and so if it's okay, I'd like to just go through just the legal portions and then I'll save the actual motion to dismiss arguments for my time during the motion to dismiss. Is that okay?

THE COURT: Okay.

MR. SBAITI: Your Honor, so the main federal statute or the federal statute that we're dealing with here is the Advisers Act, as Your Honor knows. When we first filed this case, the core allegations or principal allegation was that Highland breached the Advisers Act by -- well, several sections of the Advisers Act by essentially cherry-picking a provision, an opportunity to buy the HarbourVest, the HarbourVest interest in HCLOF.

And it does so essentially by making a statement about the value of the HarbourVest, the interest, and then using its position as both a principal and as an adviser in the HarbourVest business in order to accomplish that. Section 206 of the Advisers Act establishes fiduciary duties. The Supreme Court in Transamerica Mortgage Advisers v. Lewis, 444 U.S. 11,17, held that Section 206 imposes federal fiduciary standards to govern the conduct of investment advisers. And the -- if you actually look at Mr. Seery's appointment hearing in July of 2020, he admitted that the Investment Advisers Act puts a fiduciary duty on Highland Capital to discharge its duty to the investors.

And that language that he used I think is going to be important later on when we talk about whether there is a direct fiduciary duty owed by Highland to Holdco, for example, as an investor in HCLOF.

I'd like to focus specifically, Your Honor, on Section 206(4) of the Advisers Act which says it's unlawful to directly or indirectly engage in any practice or act in the course of business which is fraudulent, deceptive, or manipulative. Some of the cases cited by the other side tend to argue that, no, there's only a direct fiduciary duty to a client. The language that they refer to or the cases they're referring to are usually citing the language in Section 206(1) or Section 206(2), indeed, do discuss the duties directly owed to a client. Section 206(4) has no such limitation.

The next point about that issue, Your Honor, is Section 206(4) also gave the SEC the power to explain the scope of what 206(4) means. And they cast a rule, 206(4)-8, which Your Honor can find at 17 CFR 275.206(4)-8. And it specifically says that an investment adviser shall not make any untrue statement of material fact or admit to state a material fact necessary to make the statements made not misleading to any investor or prospective investor in a pool investment fund, which HCLOF is.

And it also prohibits them from otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor in such a fund.

Our argument has been the premise of the complaint -- and this rule is cited in the breach of fiduciary duty claim in the complaint. The premise of the complaint is that these (indiscernible) fiduciary duties that Highland had to abide by, and those fiduciary duties can be broken down into a couple that are relevant for us here.

The first one is, is there's a fiduciary duty of care which ports, for example, SEC v. Tambone which we cite in our brief, 550 F.3d 106, says the Advisers Act imposes a fiduciary duty to act at all times in the best interest of the fund and its advisers. There's also a duty of care which we -- excuse me, a duty of loyalty, and we cite several cases on that.

And one example is SEC v. Word Tree Financial, which is a Fifth Circuit case, 43 F. 4th 448,460. And there, the Fifth Circuit held that because cherry-picking involves allocating more profitable trades to certain accounts, an adviser is stealing from one customer to enrich himself when they engage in cherry-picking.

And in that case, an advisor was cherry-picking between one customer and sending the opportunity to another customer. Here, it's worse. Here the --

THE COURT: Okay. I'm going to --

MR. SBAITI: -- adviser is sending the --

THE COURT: I'm going to interrupt again. You did --

MS. SBAITI: Yes, Your Honor.

THE COURT: -- foreshadow that your argument might overlap a little with the motion to dismiss argument.

MS. SBAITI: Yes.

THE COURT: I really want to hear why 28 U.S.C. 157(d) is triggered here. And I'm going to give you a "for example." This court --

MS. SBAITI: Okay.

THE COURT: -- other bankruptcy courts get proofs of claim, claims made against the estate that involve other federal law and certainly state law all the time.

The most readily -- the example that most readily comes to mind is employee WARN Act claims, okay. We see them sometimes in large Chapter 11s where employees were laid off, didn't get the 60 days' notice that the WARN Act contemplated, so under Fair Labor Standards Act, we think we're entitled to X amount of claim.

No one ever asks for those to be sent to the district court. Well, I mean maybe here have been before, but my point is we try things in this Court involving other federal law fairly often. What makes your situation different? What is so hard or beyond what bankruptcy courts should do about your claims if they go forward?

MS. SBAITI: Your Honor --

MR. PHILLIPS: Your Honor, if I --

MR. SBAITI: Yeah, I was going to ask Mr. -- the bankruptcy attorney to --

MR. PHILLIPS: Your Honor, I just want to -- we agreed --

THE COURT: Well, no, no, no.

MR. PHILLIPS: We agreed --

THE COURT: I had understood that Mr. Sbaiti was going to address the federal law --

MR. PHILLIPS: Okay.

THE COURT: -- in more in depth. And so I'm hearing some explanations of the claims, but I'm not really hearing him zero in on what is significant about these claims or so significant that 157(d) is triggered. So Mr --

MS. SBAITI: Your Honor, if I may, I would -- sorry, am I on mute?

MR. PHILLIPS: No. You're -- we can hear you.

MR. SBAITI: Can you hear me?

Okay. Your Honor, I would have two points to make, Your Honor. Number one, I don't know much about the WARN Act.

I do know that the Advisers Act is one of the statutes that is not as highly litigated as an employment statute. And so while there is case law to support the general proposition --

THE COURT: Well, and the argument is because it doesn't give a private right of action is what I hear the other side saying.

MS. SBAITI: And that was where I was going is they now are citing cases in their reply that says, well, there's no private right of action, at least their reply to the motion to dismiss. You know, and I'm assuming that's what they've argued in the motion to withdraw reference is that there's not private right of action under Section 215.

Well, that kind of -- obviously, we disagree with that because the Supreme Court in <u>Transamerica</u> specifically said there is a private right of action. It's a private right of action for rescission and there's a private right of action for what the Supreme Court called the incidence of voidness.

Section 215 does two things. It makes void any contract hat requires someone to waive any rights or obligations under the Advisers Act. And Section 215 also voids the rights of anybody who performed a contract in violation of the Advisers Act. Now the precise scope of that hasn't been heavily litigated and it's -- you know, these are broad principles.

And, in fact, in the reply to the motion to dismiss, they bring up a case pending in New York where a court there, although against the overwhelming weight of authority said, well, Section 215 only applies when you have a contract that facially requires someone to violate the Advisers Act or which was made in violation of the Advisers Act.

But we argue that the settlement was made in violation of the Advisers Act because it was made as part of a way -- a part of a self-dealing scheme. But the intricacies of that law and the background and the underlying rules and regulations that go into that that we claim violated I think are not -- I don't know that 157 is a sort of court-competency issue.

The way I've always understood it to be is, you know, when there's an Article III court deciding these types of things and there's going to be a jury, that's where this is supposed to go. I would defer to the bankruptcy experts to correct me on that. But that is how I've always understood the position that -- on the bankruptcy issue on mandatory withdrawal to be.

THE COURT: All right. Anything else?

MS. SBAITI: Your Honor, I'll just hit the actual causes of action issue and get them (indiscernible) on the motion to dismiss if that's okay with Your Honor. I hope we gave Your Honor a flavor of the federal law issues that are very much at play here.

THE COURT: Okay. Yeah, just to be clear, you have one more minute so.

MR. SBAITI: Oh, I'll kick it back to Mr. Phillips.

THE COURT: Okay.

MR. PHILLIPS: We just have one more minute out of the 25?

THE CLERK: Yes, Your Honor.

THE COURT: Yes.

MR. PHILLIPS: Okay. I'll reserve one minute, Your Honor, for rebuttal.

THE COURT: Okay.

Mr. Demo?

MR. DEMO: (Clears throat). Excuse me.

Yes, Your Honor. Greg Demo for the record, Pachulski Stang Ziehl & Jones, on behalf of Highland Capital Management.

That's a lot to unpack, Your Honor, mostly because most of it is factually inaccurate. And I'll go through why it's factually inaccurate in a minute. But as we go through this -- oh, I'm sorry, Your Honor. Before I start, can I do our exhibits?

THE COURT: All right. So you have exhibits on a motion to withdraw the reference?

MR. DEMO: We do, Your Honor. And they're at Docket Number 146. There are six exhibits. Five of them are just cases that are either on your docket in the Acis bankruptcy or on the docket. Two of them are SEC guidance. We think Your Honor can just take judicial notice of those.

The last which is Exhibit 3 is the investment management agreement between Highland Capital Management and the DAF. I did talk to Mr. Phillips before we started, and he said he had no objection to these being entered.

THE COURT: All right.

MR. PHILLIPS: Correct. Correct.

THE COURT: Then I'll admit them. I'll admit them.

(Defendant's Exhibits 1 through 6 admitted into evidence)

MR. DEMO: Okay. Thank you, Your Honor. And apologies for that aside.

But going back and, again, I'll unpack these facts, you know, as we go through. But the one thing that I'd ask Your Honor to keep in mind as we go through this is that Your Honor has actually already adjudicated this issue. In November of 2023 [sic], Highland filed a substantially similar motion to dismiss. All parties fully briefed that motion to dismiss. On November 23, 2021, all parties argued the merits of that motion to dismiss including the Investment Advisers Act in this court.

In March of 2022, Your Honor entered a final order on that motion to dismiss which again is substantially the same as what we're here on today. But we're still here today because plaintiffs are asking you to withdraw the reference on a motion to dismiss that Your Honor has already heard and entered a final order on.

I would ask Your Honor just keep that in your mind, keep the absurdity of that in your mind as I walk through the rest of this case because I am going to have a timeline as I normally do. But before we get to that timeline, Your Honor, you've heard plaintiffs' arguments, and their argument boils down to mandatory withdrawal is required because the Investment Advisers Act is somehow implicated.

And now plaintiffs also had an argument that mandatory withdrawal is somehow required because this was a non-core proceeding barely even related to this. Now they've backed off that second argument, Your Honor, and I thin they've done it tactically because they don't want to admit it. Mr. Phillips said he couldn't admit to Your Honor that this is a core proceeding.

And while we agree that in terms of Section or 28 U.S.C. 157(d) that that is not entirely relevant. Your Honor can withdraw or a core proceeding can be referenced and withdrawn in that case. But because it's a core proceeding, and I'll get to this at the end if Your Honor wants me to go once again in the Supreme Court's <u>Reading</u> (phonetic) case, and this is, claims allowance, equitable jurisdiction of an administrative expense claim, Your Honor can enter final orders, which you just heard Mr. Sbaiti said that, well, maybe you shouldn't do it, and there is no jury trial right.

And so while again we believe that there's limited relevance to the motion to withdraw the reference, it is an extremely important issue that plaintiffs put into relevance and now are (indiscernible). And now going -- and Ms. Canti (phonetic), can you please put up Slide 1 -- going to the text of 28 U.S.C. 157(d). And this is the text that we all know well. And when it comes up on the screen, you'll see it. It's really the second section of 157(d) that governs mandatory withdrawal of the reference.

And there are two elements to that. The first element is timeliness, if a movant -- not this court, but if a movant does not file a timely motion, there can be no mandatory withdrawal. The second element assumes that a timely motion has been filed and requires mandatory withdrawal only if there's substantial consideration, and that's the case law of a non-bankruptcy federal law.

Neither of those two elements are met here, Your Honor. And in terms of timeliness, we take fresh approaches in our case, our papers and we cite other case. And for the purpose of timeliness, a movant is supposed to file a motion to withdraw a reference as soon as it becomes apparent that there is going to be issues that must be adjudicated by the district court. Courts look at that dispositively. If that motion is not timely filed, there is no withdrawal of the reference under 157(d).

But there's more, Your Honor, and again, we cite these cases. If the motion to withdraw the reference seems to be forum-shopping, that goes into the timeliness requirement. If the motion to withdraw the reference is prejudicial to a non-movant -- in this case, Highland and its creditors -- that goes to timeliness.

All of those elements are present here, Your Honor. Not timely, forum shopping, and it's prejudicial. And this, Your Honor, is where, you know, I want to go through the timeline again because I think the timeline proves our case. And as we go through the timeline, I'll rebut some of the factual misstatements that Mr. Phillips and Mr. Sbaiti made.

And, Ms. Canti, if you can go to the next slide, please.

As Your Honor knows, this case was started not in this court, notwithstanding the fact that it sought an administrative expense claim, but it was began in district court on April 12th, 2021.

And, Ms. Canti, there should be dates up on the top of those slides if you can make sure that those show.

The next slide, I'll give you a second to adjust.

They're not there, but I can go through the dates, Your Honor. So this is April 12th, 2021. In the next slide is May 19th, 2021. On this date, Highland filed its motion to dismiss their complaint both for failure to state a claim on the merits and pursuant to res judicata. And this complaint -- I'm sorry, this motion to dismiss that we filed originally I believe is Docket Number 36 on the docket.

And if you just go to the table of contents of that pleading, Your Honor, Article 3, subsection (c) is failure to state a claim. And it's failure to state a claim under RICO. It's failure to state a claim for breach of fiduciary duty. It's failure to state a claim for negligence. It's failure to state a claim for tortious interference. And it's failure to state a claim for breach of contract.

And if you go to the back end of that motion to dismiss, Your Honor, you'll see that we argue Transamerica, no private right of action under 206. We argue Goldstein, no fiduciary duty to an investors in a fund. We argue all of the Investment Advisers Act claims that you are going to hear today. That was in our motion to dismiss filed in May of 2021.

Ms. Canti, next slide, please.

And this is May 27th, 2021, and it's plaintiffs file their response to the motion to enforce the reference. And you've heard a lot of talk about how plaintiffs filed a motion in district court for mandatory withdrawal, and that's the basis for their timeliness argument, Your Honor, is that there's a motion sitting out there somewhere that's never been ruled on.

But if you look at this response, and this is the only thing they filed in the district court, it's a response to our paper and in the title, it says "Cross motion to withdraw the reference." There is no stand-alone motion. It was procedurally improper the way they did it, and basically they only made an argument to the district court that mandatory withdrawal of the reference should apply. And that argument is verbatim, nearly verbatim the arguments that you're hearing today. They brought those two in district court.

And now you heard Mr. Phillips says things about how, you know, it's just -- there's no thought of judicial economy, right. It's just you enforce the reference and then Your Honor gets to decide whether it would have to bounce it up to the district court. That's just not true, Your Honor.

In this motion, plaintiffs cited a case, it's called In re Harrah's Entertainment. They actually cited it in this round of pleadings. And in that case, which was filed in the Eastern District of Louisiana, there was a case filed in the Eastern District of Louisiana, and the question there was whether or not that case should be referred to the bankruptcy court as a related case.

A party filed a motion for mandatory withdrawal of the reference in the district court and also a motion for permissive withdrawal again in the district court. The district court denied the motion to enforce and decided that it wouldn't make sense because you would end up having to withdraw the reference anyway. Judicial economy, Your Honor.

Plaintiffs cited that case. And they cited that case in this paper that we're talking about now to argue to the district court that it made absolutely no sense to enforce the reference and bring it down here because it would just get roundtrip back and how does that make sense in terms of judicial economy. The exact opposite of what you heard earlier.

And I'll also point you to another case they cite, and this is Continental Airlines, which was affirmed by the Fifth Circuit. Substantially similar facts, and in that case, the Southern District of Texas, the district court said, "This court strongly suspect that if it does not withdraw the reference, it will only see this exact same lawsuit again in the future on such a de novo review of a report and recommendation. That duplication of judicial effort would needlessly waste this court's limited resources."

The idea -- and again, we'll get to the order that the district court entered, but the ideas that Mr. Phillips put forth in this Court is not borne out by the case law nor are they borne out by what they actually pled.

And next slide, please, and I'll move this a little bit faster.

June 28th, 2021 -- I'm sorry, we are now in August, Your Honor. And this is plaintiffs' move to stay the complaint. You've hard this one before, arguing they can't be prosecuted because of the plan injunction.

Next slide.

September 20th, 2021, this is when the district court entered its order referring this case to Your Honor to be adjudicated as -- and there is a typo there -- it just said related to Highland's bankruptcy. Now you just heard me cite Harrah's, you heard me cite their papers. Now did the district court say that this cross-motion, this procedurally improper cross-motion was denied? No, but it enforced the reference notwithstanding plaintiff's arguments that it would aid judicial economy because the reference would have to be withdrawn. They made the exact same arguments that are being made here today.

The inference is not what Mr. Phillips said. The inference is that the district court read plaintiffs' papers and said, no, there's no basis for mandatory withdrawal, let's send it to the bankruptcy court where it should have been filed in the first instance.

Next slide, please.

This is November 8th, 2021. Now this is the first time that plaintiffs indicate in this Court that they think that the reference should be withdrawn, and they did it by attaching a proposed motion to withdraw the reference to a procedurally improper amended motion to stay pending adjudication of the confirmation order in the Fifth Circuit. Again, that motion that they attached was verbatim the arguments they made in the district court and verbatim the arguments that they're making here today.

Now it begs the question, Your Honor, why they thought they needed to file a motion to withdraw the reference in this Court in November of 2021 if they already had a motion to withdraw the reference pending when it was referred down to this Court. It makes not sense, Your Honor.

Now they've threatened to file that motion if you were to deny the stay. And now -- can we go to the next slide, please?

November 23, 2021, Your Honor denied the stay. What did plaintiffs do? I can tell you what they didn't do. They didn't file their motion to withdraw the reference. Again, they argued in the Court the merits of the motion to dismiss including that the Investment Advisers Act claims should be dismissed.

Now fast track because there's a fairly large gap between September '21 and November of '21. What happened in that gap? The answer to that, Your Honor, is not that a motion to withdraw the reference was filed. What happened in that gap is that the parties agreed on the November 23rd date to hear both the motion to dismiss and the motion to stay.

Next slide, please, Ms. Canti.

And this is March 11th, 2022. This is the date that Your Honor entered a final order. All the equivocation about whether you're acting as a magistrate, all of that stuff goes out the window. Your Honor did not enter a report and recommendation to the district court. Your Honor entered a final order, as Your Honor could do because this is a core proceeding.

Important to Mr. Phillips' argument is what did this order say. Primarily it dismissed on collateral and res -- and, sorry, and judicial estoppel grounds. That's correct. But if you look at the last paragraph of Your Honor's March 2022 order, it said that it reviewed all of Highland's other arguments which are the arguments as to why the Investment Advisers Act claims should be dismissed.

And Your Honor in March of 2022 in the last paragraph of that order said she was inclined to agree with our arguments on the Investment Advisers Act claims. Your Honor has done this before, yet we're here again today.

Next slide, please.

Now this is fast forwarding a year. Now we are in September, specifically September 2nd, 2022. This was when the district court remands this back to Your Honor for one finding. But, again, there's a fairly large gap between March of 2022 and September of 2022. And so what was happening during that time period? Again, no motion to withdraw the reference was filed.

But what was happening is that the parties were fully briefing the merits of your final order on the motion to dismiss to the district court. Plaintiffs at no point during that briefing made reference to a need to withdraw the reference or made reference to the Court's, your inability to enter a final order. September 2nd, 2022.

Next slide, please.

This is October 14th, 2022. Now this is when Highland filed its renewed motion to dismiss in this Court. Again, there's a month. September, October, no motion to withdraw the reference filed. The motion to dismiss that you'll hear today from Mr. Morris, again, substantially similar to the motion to dismiss that you heard in November of 2021, a year ago.

Next slide, please, Ms. Canti.

All right. Now we are at finally, finally November 18th, 2022. Plaintiffs respond to the renewed motion to dismiss and file what they call a renewed motion to withdraw the reference pursuant to 28 U.S.C. 157(d). That renewed motion, again, is the exact same as their supposedly cross-motion that was filed in the district court. It's the exact same as the motion they threatened to file a year ago in November of '21. And it's now being asked to be heard today when Your Honor has already adjudicated these exact same facts.

And, again, look at that gap, Your Honor. November -- I'm sorry, September to November, Highland takes the time and effort to file a renewed motion to dismiss. At no point in that three-month gap until November of 2022, a year after Your Honor already heard this issue, did they file their first motion to withdraw the reference. And, again, if they already had one on file, why did they file one again? It doesn't make sense, Your Honor.

And that's timeliness. And, Ms. Canti, if you can go to the next slide, please.

And all this is, Your Honor, is a summary of what I just went through, right. Like look at this, April 2021, November 2022. November 2022 after we've done all of this is the first time they asked this Court to withdraw the reference. Where is the timeliness? This is per-se untimely.

They could have filed a motion to withdraw the reference in September of 2021. They didn't. They could have filed their threatened motion to withdraw the reference in November of 2021. They didn't. They could have at any time between November '21 and March '22 before Your Honor entered her final order filed a motion to withdraw the reference. They didn't. Instead, they briefed their appeal, made no mention of it.

September 2nd, 2022 it's remanded back here for an adjudication on the merits of the motion to dismiss. They could have filed a motion to withdraw the reference. Didn't. Highland filed this motion to dismiss, no motion to withdraw the reference. Only a year after Your Honor has heard the merits of his exact motion to dismiss did they ask Your Honor to withdraw the reference.

That's untimely, Your Honor. That is absolutely at least in my estimation untimely, and I don't know how you get around it. But it's worse than that, Your Honor. It's forum shopping. Again, April 2021, they start this thing in the district court an administrative expense claim. They seek to prosecute outside of Your Honor. That's the first indication.

But going back to March of 2022 when Your Honor reviewed the argument that Mr. Morris is about to make and said that it was inclined to agree with Mr. Morris -- I'm sorry, inclined to agree with Highland. Only after Your Honor gave plaintiffs a preview of how you would rule on the motion to dismiss that you're to hear today did Highland -- I'm sorry, did plaintiffs file their motion to withdraw the reference. That's forum shopping.

And the prejudice to Highland should also be apparent from the timeline. Each of these little bullet represents a significant cost to the estate. And what do plaintiffs want? They want to go from November 2022 back to April of 2021. They don't want any of this, Your Honor. They want to restart the clock with significant cost to Highland and it creditors.

Impermissible.

28 U.S.C. 157(d) requires timeliness. If timeliness is not met, the motion must be denied. There is no timeliness, there is forum shopping, and there is prejudice. If that weren't enough, Your Honor, they still lose on the merits on the question of the (indiscernible) consideration of federal non-bankruptcy law. And I think the clearest indication of that is Mr. Sbaiti's argument. Supreme Court case, Supreme Court case, Supreme Court case. Here are the SEC guidance.

Where did he say that there's a circuit split? Where did he say that there's any unsettled law? Nowhere, Your Honor, and he did that because there is no unsettled law. These are very simple questions. Was there a fiduciary duty? Was there a breach of that duty? And what is the remedy? That's the exact same question that Your Honor and bankruptcy courts all over this country answer and adjudicate every day.

There is nothing complicated about this case, notwithstanding what plaintiffs want you to believe because let's look at the issues, right. Let's drill them down. The first issue is, is there a fiduciary duty under the Investment Advisers Act. Yes. How do we know that? The Supreme Court told us so. Non-issue.

The second issue is who does that fiduciary duty run to? Under Goldstein, which we cited in our papers, under the SEC guidance which we cited in our papers, it's very clear that

that fiduciary duty which is separate and apart from Rule 206(4) that Mr. Sbaiti cited, that fiduciary duty runs only to the fund, not to the investors in that fund. And that makes perfect sense, Your Honor. If an investment manager has a fiduciary duty to the hundreds of -- potentially hundreds of people who are invested in a fund individually, that's chaos. And the investment manager will be sued every day. Settled law, Your Honor.

And so what do you have to do? You have to look at two agreements, the HCLOF investment management agreement, Highland is indirectly the investment manager to HCLOF, fiduciary duty. CLO Holdco is an investor in HCLOF. No fiduciary duty between Highland to CLO Holdco because of HCLOF. Again, Goldstein clear precedent.

Highland had an investment management agreement with the DAF. Is there a fiduciary obligation to the DAF under that agreement? Yeah. That's it, Your Honor. Okay, question one's done.

Question two, assuming there's a fiduciary obligation, what's the scope of that obligation and what's the remedy for breach? Going to breach first, again, you heard Mr. Sbaiti argue 206, 206, 206. Supreme Court precedent is absolutely clear that 206 provides no private right of action. Cases have been dismissed because they've been brought by a private investor under Rule 206. That's the Corman case.

That's the Fifth Circuit we cite in our papers.

The Fifth Circuit doesn't stand alone on this, Your Honor. Supreme Court precedent. 206 which again is the only actual rule that they pled in their complaint does not provide a private right of action. That's it, Your Honor. That's all you have to do. Not complicated.

And I'll get to 215 in a second because even though it wasn't pled in the complaint, I still want to talk about it. Okay. So what is the scope of that allegation? Mr. Sbaiti talked about a duty of care. Okay, that's fine. That's clearly set out in the guidance, and a duty of loyalty. The duty of loyalty under clear, again, Supreme Court precedent, SEC guidance and, as Mr. Morris will talk about, a Northern District of Texas case entered in an appeal from Mr. Dondero, one of this Court's orders said the same thing. That duty of loyalty is satisfied by disclosure.

So all Your Honor has to do is look at the disclosures made to the DAF and say are those sufficient to satisfy a reasonable investor about the conflict of interest or the potential conflict of interest. That's it. Easy-peasy.

And so where do we go next? And, you know, I'm actually going to leave out 215. It wasn't pled. It can't be a motion.

THE COURT: This is your two-minute warning.

MR. DEMO: The case law is clear.

THE COURT: You have two more minutes.

MR. DEMO: Okay. Thank you.

Thank you, Your Honor. And I guess the last point, and it bears repeating, is that Your Honor has already adjudicated this in this Court and Your Honor actually adjudicated it in the Acis bankruptcy. And this is on our witness and exhibit list.

In the Acis bankruptcy, Highland then under the control of Jim Dondero filed an objection to the plan saying that it could not be confirmed because it violated applicable law. What was that applicable law? The Investment Advisers Act of 1940 for the exact same things that they're doing here.

(Indiscernible) examples of significant federal law, plan injunction prohibits it. That's already been addressed three times. Jury trial right, it's not up, but they don't have a jury trial right because this is an administrative expense claim, Your Honor.

The motion is untimely, it's prejudicial, it's forum shopping, and there is nothing that's not -- nothing that rises to the level of a material consideration of unsettled federal law. All you have to do is look at the federal law and apply it to a set of facts, the same thing you do every day in this courtroom. For that reason, Your Honor, we'd ask the motion to be denied and I can answer any questions.

THE COURT: All right. Mr. Phillips, you get one minute in rebuttal.

MR. PHILLIPS: Your Honor, a couple of thing very quickly.

Number one, whether or not what the district court did, we asked and frankly maybe don't know the answer to whether or not this Court can decide what the district court did in its order of reference. But I guess, number one, I guess we'll find out what the district court did.

We understand the case law, but we also understand there's another version of the approach to matters filed in the district court and that is we want the reference withdrawal order to be complied with before we deal with anything.

That is a long-term judicial economy because if you have people filing in the district court making their own determinations, what's the best way to stop that from happening? The order of reference will be enforced and if you have a motion to withdraw reference, file it then.

Secondly, one of the things about the scope of fiduciary duty that's before the Court in the lawsuit is that they say there's an investment adviser agreement with DAF Fund, the DAF Fund but not CLO Holdco.

But the investment advisory services subject to -- (indiscernible) the investment adviser shall act as an investment advisor to the fund -- that's the DAF -- the general partner with respect to the fund and its subsidiaries and shall provide investment advice with respect to the investment and reinvestment of the cash, financial instruments, and other properties comprising the assets and liabilities of the fund and the subsidiaries.

The subsidiary CLO Holdco is the one where the investments are. That's where the investment advice actually bore fruit. So the question -- there is a question about scope of fiduciary duty and you couldn't have the investment adviser agreement without the investment adviser being subject to the Investment Advisers Act.

THE COURT: Okay.

MR. PHILLIPS: My point is from my standpoint --

THE COURT: Time's up.

MR. PHILLIPS: -- is that there was a question about the scope of the duty. Thank you, Your Honor.

THE COURT: Thank you.

All right. Here's what I am going to do.

I am going to recommend that the district court deny this renewed motion to withdraw the reference. First, I had put together my own timeline before I saw Mr. Demo's and I think I have to find that this is not a timely motion to withdraw the reference.

The action as we all know was filed April 12th, 2021. We are now January 25th, 2023. So I don't think the timeliness requirement has been met here.

Second, this does feel like a second bite at the apple, to use that worn-out metaphor. I think substantially the same arguments were made, albeit in a differently-worded pleading maybe to Judge Boyle, again, back in 2021. I guess it was June 29th, 2021 when the plaintiffs first argued that the district court should keep this matter and, among other things, argued 28 U.S.C. 157(d). This involved consideration of both Title 11 and other laws of the United States.

So it's sort of a second reason on top of untimeliness that I think this has already been asked for once and denied.

But yet another reason I will recommend denial of this motion is I don't think this action ultimately involves material consideration or significant consideration of other laws of the U.S. regulating organizations or activities affecting interstate commerce.

Again, the Investment Advisers Act is implicated. RICO is implicated. But I don't think it's terribly complicated. As I alluded to, bankruptcy courts consider proofs of claim as well as requests for administrative expense claims all the time that involve significant other law including federal law, and I just don't think this triggers mandatory withdrawal under 28 U.S.C. 157(d).

So I am going to go ahead and do that written report and recommendation to the district court. Now normally, I guess my most often followed practice is I don't rule on motions to dismiss or any kind of dispositive motions while I'm waiting on the district court to either adopt or reject a report and recommendation.

But I'm going to go ahead and hear the arguments on the motion to dismiss today even with that risk that the district court may say, no, you're wrong, I'm yanking the case. I'm going to go ahead and hear the arguments because my best guess is the district court is going to adopt my report, okay.

My best guess is the district court is going to say untimely, is going to say second bite at the apple, and I think this is not materially enough other federal law to yank it from the bankruptcy court. I may be wrong, and this may all be a waste of time today. But I'm going to go ahead and hear the hearing, the arguments on the motion to dismiss.

I'll say a couple of additional things. It's still nagging at me the transcript that Mr. Phillips read from where I said in this adversary I'm going to do a report and recommendation to the district court on the previously-argued motion to dismiss. I'm not questioning that because I have this memory of me later going why did I say that.

This was referred to me. I had in my mind core matter because it was a request for an allowance of administrative expense claim against a debtor for conduct while it was still a debtor in possession. So I thought at some point I had come out and announced maybe in a different Highland hearing and maybe others, not everyone was on the call.

I thought I remembered correcting myself out loud to the parties. Maybe I didn't. Maybe that was just back in chambers to my law clerk, and I had every intention of coming out and telling y'all and I didn't. So that's just an explanation of that. I misspoke when I did that.

And then what was the other thing I wanted to say. Well, gosh, I've lost my train of thought on that. Oh, I know what it was. My law clerk noticed this week that when the renewed motion to withdraw the reference was transmitted to the district clerk's office from the bankruptcy clerk's office, guess what? A new district court civil action number was created, and it was assigned to a different district judge, Judge Karen Scholer.

I don't think anyone would think that is the most efficient thing to happen here, so we'll do our part on our end to get personnel talking to personnel and hopefully get that fixed to where it goes back to Judge Boyle. But no promises there. We will just point it out and point out that we think that was inefficient and a mistake and they'll do whatever they're going to do.

All right. So with that, do you all need a five-minute break before we launch into the motion to dismiss arguments?

MR. MORRIS: I would --

MR. PHILLIPS: Your Honor, this is Louis Phillips. I just wanted to tell Your Honor that we wanted to make sure that we hadn't overlooked anything in the transcript that we cited. And we read it again. I didn't. Ms. Heard read it again while we were arguing. And we did not find anything else.

I have to -- I will tell the Court on the record that we read a lot of pleadings, but we did not -- we did not come across anything that we left out that would contradict that. And we made sure again today there's nothing else in that transcript that would contravene what I read to Your Honor. So --

THE COURT: Okay.

MR. PHILLIPS: -- look, we understand that what happened after was -- there was a final order. And so we understand there was an appeal of the final order. And we have to admit that we didn't read the entire record, and we have not come across and ignored and not brought before Your Honor something that would contravene what we've mentioned today in argument.

THE COURT: Okay. Thank you for that. And, again, it may have been back in chambers that I said what did I say that for. I have the authority to issue a final order, and certainly someone could have raised that on appeal if they thought she made a mistake.

All right. So --

MR. PHILLIPS: Understood. Understood.

THE COURT: -- why don't we take a five-minute -- please, five minutes, not six -- five-minute break, and we'll hear the oral arguments on motion to dismiss.

THE CLERK: All rise.

MR. PHILLIPS: Thank you, Your Honor.

(Recess at 2:58 p.m./Reconvened at 3:05 p.m.)

THE CLERK: All rise.

THE COURT: Please be seated.

All right. We are going back on the record in the Adversary, CLO Holdco DAF versus Highland, the renewed motion to dismiss.

Mr. Morris, I think we agreed 45 minutes and 45 minutes, right?

MR. MORRIS: That's correct.

THE COURT: Okay. You may proceed.

MR. MORRIS: Okay. Before I begin, Your Honor, may I please just move for the admission into evidence of the Defendant's Exhibits that are lodged at Docket 145? It's Exhibits 1 through 14, and I understand there's no objection.

THE COURT: Confirm there's no objection.

MR. SBAITI: Your Honor, we agreed that we would reserve our rights to object to the relevance of those to certain arguments, but overall, we have no objection. And I guess while we're on it, we also were asking to admit our exhibits, which are on Docket 150.

THE COURT: Okay. And there's no objection to those, Mr. Morris?

MR. MORRIS: Yeah. It's a little vague to say that I have no objection to the exhibits, except potentially as to relevance. I didn't quite understand that part.

THE COURT: Well --

MR. MORRIS: Is there objection or isn't there?

MR. SBAITI: Well, I just, they might not be relevant to some arguments, is all I'm saying, but they can still be --

THE COURT: Well --

MR. MORRIS: So --

THE COURT: I'm going to say something. I've been saying this a lot lately. You probably haven't heard it. But I'm old enough to remember when a 12(b)(6) motion was, I look at the motion response reply and look at the four corners of the complaint, and there's either a plausible claim articulated or not.

And what I have been seeing is these motions to dismiss with appendices that are hundreds of pages long and then responses with appendices that are hundreds of pages long. So much so that one day, different case, I had a law clerk go do research for me. Am I an old fogey who has it wrong, who thinks I'm only supposed to look at the four corners of the complaint?

And to my surprise, there is a Fifth Circuit case, maybe everyone knew about it but me, that says if it's either something attached to the complaint or something that goes at the heart of the claims in the complaint, or words to that effect, yeah, you can go beyond the four corners of the complaint and have some evidence.

But I will tell you, I and every judge I know just we keep getting these longer and longer and longer appendices and then people just agree, as opposed to saying no, it doesn't go to something at the heart of the complaint. And then, we find ourselves with 4,000 pages of stuff to read before we can even rule on a 12(b)(6) motion.

So that was my rant. If each side thinks the appendices are within the spirit of that Fifth Circuit case that says these items go to the heart of the complaint, the claims articulated in the complaint, then I'll consider it all. So are you both --

MR. SBAITI: Your Honor, if I may --

THE COURT: -- conceding to that?

MR. SBAITI: If I may, Your Honor --

MR. MORRIS: No, Your Honor. The point I was making --

THE COURT: Okay. One at a time. One at a time. So

I'll let Mr. Sbaiti --

MR. MORRIS: -- with respect to the defendants' exhibits --

THE COURT: -- since he --

MR. MORRIS: -- Your Honor --

THE COURT: Okay. Mr. Sbaiti, do you agree or not agree that the Court can consider these exhibits of defendant?

MR. SBAITI: Yeah, Your Honor. Your point went to the heart of my reservation of rights to argue relevance. I think a lot of the exhibits they've attached and what we've attached are relevant to the judicial estoppel argument because I think that's something we do have to look outside the complaint to look to whether judicial estoppel was there.

I don't think those exhibits are relevant to the other issues. That's the heart of my reservation.

MR. MORRIS: And I would agree with that, Your Honor. I was going to actually make the exact same point. So --

THE COURT: Okay.

MR. MORRIS: -- there you've got (indiscernible) agreement on the admission of the exhibits, but on the scope.

MR. SBAITI: Yeah.

THE COURT: Okay. Got it. So you both agree to all of your exhibits with the understanding that these go to the judicial estoppel arguments. Yes?

MR. SBAITI: Not all of them. Exhibits 13 and 14 are two agreements that are at the heart of the case that --

MR. MORRIS: I agree with that.

MR. SBAITI: -- at the heart of the matter.

THE COURT: All right. So with that out of the way, we'll start the timer. I've admitted these exhibits.

You may proceed.

(Defendants' Exhibits 1 to 14 admitted into evidence)

MR. MORRIS: Okay. Thank you, Your Honor.

John Morris, Pachulski Stang Ziehl and Jones, for the defendants.

Your Honor, I want to begin with just a brief background. Although I know how familiar the Court is with these facts, this entire adversary proceeding arises from the debtor's settlement with HarbourVest. HarbourVest had a $300 million claim based, unfortunately, on misrepresentations and other causes of action.

And as the Court is aware, a settlement was a reach that was effectively a rescission of HarbourVest's investment whereby the debtor divided HarbourVest with allowed claims of $80 million, which was their investment amount, a portion of which was in Class 8 and a portion of which was a subordinated, unsecured claim in Class 9. And HarbourVest surrendered their interest in HCLOF to a wholly owned affiliate of Highland.

There's no dispute that CLO Holdco objected, contending that the transfer of HarbourVest's interest was not permitted under the members agreement because it violated supposedly its right of first refusal and there's no dispute that after the issue of the ROFR was fully briefed that CLO Holdco did further diligence and thereafter acknowledged that the ROFR did not apply to the circumstances at issue, and they withdrew their objection.

Following the withdrawal of CLO Holdco's objection, the Court heard argument, overruled the remaining objections, and approved the 9019 settlement and the settlement was effectuated. The settlement order expressly provided that the transfer of the HarbourVest interest to the debtor's affiliate could be effectuated "without the need to obtain the consent of any party or to offer such interest first to any other investor in HCLOF." And while that order is the subject of an appeal pending in the Fifth Circuit right now, it wasn't appealed for purposes of challenging that provision.

A couple of months later, the plaintiffs brought this action with new counsel and a new trustee. Your Honor may recall that shortly after the HarbourVest settlement, Grant Scott left the trustee, and John Kane, his lawyer, was terminated as well to be replaced by Mr. Patrick and Mr. Sbaiti.

And they commenced this action originally in the district court. And in substance, there's really two issues that underlie the entirety of the complaint. Number one, the plaintiffs allege that the debtor had a legal obligation to offer the HarbourVest interest to the plaintiffs before effectuating the transfer. We'll show in a few minutes that the plain and unambiguous terms of the two agreements I just pointed out, Exhibits 13 and 14, the very agreements that plaintiffs rely upon, prove that no such duty existed and no such duty exists under federal law or fiduciary duty for this particular transaction because of the nature of the parties' agreements.

The second issue that underlies the complaint is the allegation that Mr. Seery received inside information in December, 2020, and therefore, knew or should have known, the $22.5 million value be placed on HarbourVest's interest was, I think the words used in the complaint are, "off the mark."

Rest assured, Your Honor, if Highland is ever required to do so, Highland will prove that these insider trading allegations are absurd. But we understand the law. We understand that for purpose of a motion to dismiss, the Court must accept the allegations as true.

But at the end of the day, Your Honor, since Highland had no legal or contractual obligation to make this transaction available to the plaintiffs, the valuation is completely irrelevant. It really doesn't matter because there's nothing for the plaintiffs to rely upon at the end of the day if they had no ability to participate in the transaction.

Based on these two issues, Your Honor, plaintiffs have conjured up five separate causes of action, breach of fiduciary duty, breach of the members agreement for the ROFR, negligence in regards to Mr. Seery's testimony about the sales price, and the failure to give plaintiffs the opportunity to buy the asset. There is a RICO claim, of course, and there's tortious interfere.

Procedural history, very briefly, Your Honor. Highland, as Mr. Demo described, moved to dismiss on substantive grounds, as well as on grounds of collateral and judicial estoppel. Ultimately, this Court granted the motion on collateral and judicial estoppel and stated that while it was inclined to agree with the defendants on the substantive points, it simply refrained from addressing the motion to dismiss on 12(b)(6) grounds really for purposes of judicial economy.

The plaintiffs appealed that final order. After determining that collateral estoppel did not apply, the district court affirmed this Court's findings on the first two elements of judicial estoppel, but remanded on the sole issue of whether the plaintiffs' inconsistent positions was "inadvertent" and really the only issue that the Court sent down here, and here we are.

Let me begin with Counts 2 and 5 and the matter that the district court referred back to the bankruptcy court, judicial estoppel. The only issue is whether the inconsistent positions are inadvertent. CLO Holdco, as I mentioned and as the Court knows, withdrew its objection to the 9019 motion based on the ROFR with the advice of very sophisticated counsel, John Kane.

Mr. Kane's statements to the Court provide all the evidence that's needed to show that CLO Holdco's decision to withdraw the objection based on the ROFR was deliberate, intentional, and made on a fully informed basis.

Ms. Canty, if you can put up Slide 1.

I'm putting up on the screen, Your Honor, just an excerpt of Mr. Kane's presentation to the Court where he said, among other things, that CLO Holdco has had the opportunity to review the reply briefing. After doing so, has gone back and scrubbed the HCLOF corporate documents. They analyzed Guerensey law and some of the arguments of counsel in those pleadings and they reviewed appropriate documents.

And after doing all of that work, Mr. Kane informed the Court that he had obtained the authority from his client, Grant Scott as the trustee for CLO HoldCo, to withdraw the CLO Holdco objection based on "the interpretation of the member agreement."

You can take that down now.

Plaintiffs can't refute this, right? There's nothing to refute. Those words are clear as day. The decision to withdraw was informed. It was deliberate. It was purposeful. And it was consequential.

Instead, new counsel makes arguments concerning basically the state of mind of Mr. Scott and Mr. Kane that not only have no factual basis but really are not plausible at all, right? If they wanted this Court to know what Mr. Scott or Mr. Kane thought, perhaps they should have had them submit some evidence into this. They didn't do that. They didn't do that, and instead, they speculate as to what they would have done if they were in their shoes. That's not proper here.

They argue first that the claim now is that Highland breached the members agreement, a claim that Mr. Kane and Mr. Scott were apparently unaware of since they only waived the objection with respect to HarbourVest's obligations under the agreement. So this is their first argument that it was inadvertent because they didn't know.

There's no evidence that they didn't know, but that's their argument. Simply an argument that they made by new counsel on behalf of a new trustee with citation to nothing. More importantly, Your Honor, the district court has already held that CLO Holdco "made clear in the withdrawal of its objection that it no longer disputes the other party's interpretation of the right of first refusal, which now forms the basis of Charitable DAF's second and fifth causes of action. That's at Page 16 of the Court's order.

The district court's holding that CLO Holdco's position applied to all parties was correct. It's the law of the case and cannot be overcome by new counsel's speculative musings.

Second, plaintiffs speculate that quote, and this is I think on Page 9 of their opposition, "But for the misrepresentation, Holdco would not have withdrawn its objection. It would've made a more robust objection to the settlement or sought a different path." This argument fails for at least the following reasons.

Again, there's absolutely no evidence to support it. It's simply an argument made by new counsel on behalf of a new trustee with citation to nothing. But more troubling to me, Your Honor, is it suggests that Mr. Kane would have engaged in unethical conduct. We know what he told the Court. We know that he concluded that his clients couldn't rely on the ROFR to prevent the transfer. That's what he told you.

Even the plaintiffs don't contend that valuation is relevant to determining whether ROFR applies. It doesn't. The ROFR applies or it doesn't, and it has nothing to do with value. And yet, we're told today that counsel wants this Court to find that even though the legal analysis would not change at all, Mr. Kane would have pressed the objection or done something different, even though he concluded it was without merit based on a representation that has absolutely nothing to do with the ROFR. I don't think that's proper.

I don't think the Court should find that Mr. Kane, having concluded that the ROFR applied, would have told the Court that it did simply because you have to accept the misrepresentation claim as true. It's not a particularly credible argument. (Indiscernible), Your Honor, that the purpose of judicial estoppel is to protect the integrity of the judicial process by "preventing parties from playing fast and loose with the courts to suit the exigencies of self-interest."

The evidence conclusively establishes that based on Mr. Kane's thoughtful advice and analysis, after due deliberation, that CLO Holdco knowingly and intentionally acknowledge that the ROFR and the members agreement did not preclude the HarbourVest transaction to an affiliate of the debtor.

The Court should protect the integrity of the judicial process, reject plaintiffs' attempts to play fast and loose, and dismiss Counts 2 and 5 on the ground of judicial estoppel.

Having said all that, it's kind of easier on a certain level, although I think that's pretty black and white. If you just look at Mr. Kane's own words, it's really easy to dismiss both counts on the merits. Even if Count 2 wasn't barred by judicial estoppel, it must be dismissed for failure to state a claim upon which relief can be granted.

And if we can put up Slide 2, please.

Let's take a look at the members agreement, Your Honor. This is the members agreement. It's Defendant's Exhibit 13. We're looking at Sections 6.1, 6.2.

Section 6.1 of the members agreement expressly provides that members shall not transfer their shares other than to an affiliate of an initial member party hereto without getting consent.

So if a member wants to transfer their shares to an affiliate of an initial member to this agreement, they don't have to get consent. They can do it whenever they want. And there is no dispute that HarbourVest was a member. And there's no dispute that the transfer was to an affiliate of Highland who was an initial member and party to this agreement. So I don't think there's any argument at all that HarbourVest had the ability to transfer its interest in HCLOF to an affiliate of Highland.

6.2 is the ROFR, okay. So what we've done is we've highlighted the portion that I think applies here. Prior to the transfer, prior to making any transfer, and that's where the parenthetical really ends the whole discussion. Other than transfers to affiliates of an initial member, a member must first offer to the other members the right to purchase the shares.

So the obligation, the ROFR, by the plain unambiguous terms of the agreement simply does not apply to transfers to affiliates of an initial member. Again, this was a transfer in the settlement to an affiliate of an initial member. In this instance, Highland. This is the parties' agreement.

Highland and HarbourVest had every right under this agreement to do this transaction. They had no obligation to offer it to the plaintiffs or to anybody else. That's what the plain terms say. So while we think they should be estopped, judicially estopped, from making the arguments and pursuing these claims, they fail on the merits anyway. And these Counts 2 and 5 should be dismissed with prejudice because there's nothing they can do to rewrite this agreement. There's no way around it. The agreement says what it says. The parties are bound by it.

Let's turn to Count 5. We can take that down.

Count 5 fails to allege a plausible plan for tortious interference, and that's kind of simple because the tortious interference here is that Highland allegedly interfered with CLO Holdco's rights under Section 6.2 of the management agreement. As we just saw, it did not. It could not. It had no obligation. It simply had no obligation.

Let me state it differently. CLO Holdco had no right to participate in this transaction. They had no right of first refusal and there was no right in the contract otherwise because they cite exclusively to 6.2. There's no right otherwise that the plaintiffs rely upon as a right that Highland tortiously interfered with.

So since 6.2 did not provide CLO Holdco with a ROFR under these particular circumstances, Highland could not have tortiously interfered with it. Stated differently. There can't be a cause of action for tortious interference with a contractual right that never existed. No amendment changed that. Count 5 should be dismissed with prejudice.

Count 4 fails to state a cause of action for RICO. Plaintiffs allege that defendants are liable under RICO. The defendants move to dismiss this count because there is no plausible cause of action for at least the following reasons.

RICO claims can't be predicated on Securities Law violations. Allegations concerning mail and wire fraud were not stated with particularity and otherwise fail to meet the heightened pleading requirements under Rule 9(b).

Plaintiffs fail to plead a pattern of racketeering activity, nor could they since, based on the pleading, the entire complaint is based on a singular statement during the 9019 hearing concerning a singular transaction with no suggestion that there would or could be a continuing or future threat. So you don't have a pattern of racketeering activity.

They fail to state a cause of action because they fail to plead that the RICO association in fact enterprise. They fail to plead causation. And here's the thing, Your

Honor, this is really simple, they didn't contest any of this. Plaintiffs did not file a substantive response to the motion to dismiss on RICO.

Instead, at the end of their pleading, at Page 23, they purport to move to dismiss the RICO claim "at this time, pursuant to Rule 41, while purportedly reserving the right to bring the claim at some future time." Your Honor has heard this playbook before. We heard it in HCRE. We heard it with claims that have been withdrawn. You know, don't rule on this because we want to save it for another day. They can't do that. The Fifth Circuit has said you can't do that. That's not what Rule 41 is about.

Their so-called motion on Page 23 is improper for at least the following reasons.

It doesn't comply with Bankruptcy Rule 8013(a)(2)(A) because it fails to state with particularity the grounds for the motion and the legal argument necessary to support it.

Rule 41(a) is made applicable to this adversary pursuant to Bankruptcy Rule 7041. The title of that rule, Your Honor, is "Dismissal of Adversary Proceedings." Neither the title of the Rule nor the substance of the Rule concerns, addresses, or permits the dismissal of individual claims.

The same is true for Rule 41 itself. It is titled, "Dismissal of Actions." Section (a), which the plaintiffs rely upon, states "Plaintiff may dismiss an action without a court order under certain circumstances." That's not what they're trying to do here. They're trying to dismiss a singular claim.

Even if they had complied with 8013, and they didn't, they have no right to do that under Rule 41. You don't have to take my word for it, Your Honor, we cite it in our brief. The Fifth Circuit's decision in National Horsemen's. It's in Paragraph 1 of our reply.

The Fifth Circuit said very clearly that Rule 41(a) does not allow for the dismissal of individual claims, right. If they wanted to dismiss an individual claim, they had to amend their pleading and proceeded under Rule 15, and we would have had the opportunity to say they can't do this unless it's without prejudice -- you know, unless it's with prejudice, right.

We would have argued hard that all of these issues should be pled together, that there is no basis to with withdraw it to save it for another day. It would be, you know, it would wreck havoc on the judiciary. You'd be trying the same case in multiple forums at multiple times. They didn't do that. They went under Rule 41(a). The Fifth Circuit has said you can't do that.

So the dismissal of this claim, the RICO claim, should be with prejudice. There is no plausible claim that can be alleged under the circumstances. There is no defense to the motion to dismiss. There is no substantive defense. They'll never be able to plead a pattern of racketeering. We know what the factual predicates are here.

It's the HarbourVest settlement, a singular transaction that occurred over a matter of weeks with no continuing or future, you know, harm that could ever be done. That's the claim that they have. So this cause of action, too, should be dismissed with prejudice.

Negligence, Count 3, should also be dismissed with prejudice. Count 3 alleges that Mr. Seery negligently valued HarbourVest's interest in HCLOF. They fail to give plaintiff the opportunity to purchase the interest. This count should be dismissed with prejudice for the following reasons.

Number one, of course, Highland's plan of reorganization exculpates the debtor for claims of negligence arising from the administration of the estate. That part of the confirmation order has been specifically affirmed by the Fifth Circuit Court of Appeals. I can't think of a better example of a debtor administrating the estate and resolving claims.

If there's one thing that I know a debtor does, and I know a debtor does many things, but there's no dispute that one of the -- there's one thing debtors must do to administer the estate is to resolve claims. So the exculpation provision bars Count 3.

They suggest somehow that the defense should be stricken because it was raised previously and therefore waived. I'm not sure what that means, but there's no evidence. There will never be any evidence that Highland ever knowingly, intentionally, you know, relinquished their protection from negligence claims arising from the administration of the estate. The plan's exculpation clause really should end this inquiry.

But there is more if Your Honor needs it.

The plaintiffs also refer to the Advisers Act to contend that it imposes a duty of care and loyalty. You heard Mr. Sbaiti say that earlier under Section 206. This is their argument.

You know, he did refer to some case out there that said otherwise. And he's right and he should know that because it's his case. He brought the case on behalf of NexPoint from Mr. Dondero, the Southern District of New York, against Josh Terry and Acis. It's the case that we've cited in our brief.

And last summer, the Southern District of New York, who probably does have a lot of experience with Investment Adviser Act claims, said "No private right of action under 206." Plain and simple. They cited to <u>Transamerica</u>. They quoted <u>Transamerica</u>. They said the Supreme Court held there that there is no private right of action under Section 206. <u>Transamerica</u> made no distinction between investors or the fund. It unequivocally held that there is no private right of action under Rule 206.

But there's more because there's always more. In the advisory agreement, there's a very explicit separate exculpation clause that the DAF agreed to. And if we can put up to the screen Slide 3. And I will admit, Your Honor, this is not in our brief. But this is the document that the Plaintiffs are relying upon. This is the advisory agreement that they contend, you know, imposes duties on Highland.

I'll wait for Mr. Sbaiti to explain his views as to this agreement, but the Court has to consider the four corners of the agreement. It is the principal -- one of the principal basis for the whole lawsuit. And in Section 11, the DAF agreed that to the fullest extent permitted by law, no covered person shall be liable, general partner, or the Fund, or any of its subsidiaries including CLO Holdco.

I heard Mr. Phillips say that somehow CLO Holdco is a beneficiary under this agreement. Well, if they are, they've also exculpated Highland for any reason whatsoever, less the act or omission constituted willful misconduct or gross negligence. They can't bring their own agreement. And it's funny, Your Honor, because think about the context in which this agreement is drafted.

This agreement is drafted by Mr. Dondero's company, Highland, who's going to provide advisory services to his own Donor Adviser Fund, the DAF. This is his agreement. I want to hear why it doesn't apply. I want to hear why this exculpation provision doesn't preclude a negligence claim. It absolutely does.

Finally, the negligence claim could never be plausible in any event, because the Plaintiffs didn't have a right of first refusal. We saw that they reached an agreement with Highland that said they were not going to get a right of first refusal if there's a transaction between affiliates of initial members.

And so if you have agreed that that conduct is permitted, you cannot plausibly assert a cause of action that says you were negligent in executing that same contract. And by the same token, the whole concept of oh, they misstated the value. Also irrelevant, because the valuation has nothing to do with any rights that the Plaintiff has. There's nothing for them to rely on.

HarbourVest maybe. You know, HarbourVest would have a complaint. I haven't heard from them on that point, although I speak to from time to time. But Plaintiffs have no standing here. They have no interest. There's no reliance. Whatever Mr. Seery said about value, the Court can accept as true. All the allegations in the complaint, it is a big so what.

Finally, the fiduciary duty issue. That also must be dismissed. Count 1 is for breach of fiduciary duties. It's premise are the exact same facts; insider trading, misrepresentation, or the concealment of the true value of HarbourVest's interests and the diversion of the investment opportunity. This count must also be dismissed with prejudice. To be clear, as a matter of law, the Defendants never owed a fiduciary duty to CLOF -- CLO Holdco.

HCF as the adviser, is a wholly-owned affiliate of the debtor and it serves as the portfolio manager of HCLOF, but it is black-letter law -- and this is gold standard, you heard Mr. Demo refer to it earlier -- that there is no fiduciary relationship between a Fund adviser and the funds investors.

The relationship is between the Fund adviser and the Fund. That's who the agreement is with. That's who they serve. They all take direction from Fund investors. They have no obligation to listen to Fund investors. And as Mr. Demo cogently pointed out, think about the chaos that would result if Fund advisers owed fiduciary duties to each of the Fund's investors.

To the extent that the Plaintiffs allege that the fiduciary duties are owed by Highland to the DAF under the Investment Advisers Act, I'd again point out, Your Honor, there is no private right of action under the Investment Advisers Act to enforce violations of Rule 206, which is the only thing that the Plaintiffs have pled. There is no viable remedy. You can't bring a claim for damages as they're trying to do here. That's the holding of the Supreme Court in TransAmerica. And that's the holding in Mr. Sbaiti's NexPoint case from the Southern District of New York.

But here's the thing. Even if a fiduciary duty existed, they still can't plead a plausible cause of action. Why? Because Highland owes no duty to CLO Holdco as an investor in HCLOF. None. Even if it did, Highland complied with the members agreement governing HCLOF. They were permitted to do this transaction. How can you breach your fiduciary duty by complying with the very agreement that the Plaintiff is a party to? They can't.

Second, Highland had an investment advisory agreement with the DAF as Mr. Demo conceded. It does give rise to fiduciary duties. But what are the obligations? To make a full and fair disclosure of potential conflicts of interest. And what did Highland do under the direction of Mr. Dondero? He did exactly that. Right? Mr. Dondero is always looking out for Mr. Dondero. And he's got to live with the consequences of that now, even though he's not in control of Highland.

And here's the thing. Mr. Dondero knows that because Dugaboy made the exact same argument that Mr. Sbaiti is making here. He did it in connection with the UBS settlement. Your Honor, will recall that Dugaboy objected to that settlement. They appealed that settlement to Judge Starr. It wound up in front of Judge Starr in the District Court. And he heard the exact same argument that these folks are making here.

Dugaboy argued that Highland, that's Multi Strat's investment manager, had fiduciary duties that could not be waived, right? We hear Mr. Sbaiti say that. Unwaivable fiduciary duties could not be waived. But Judge Starr found that the applicable provision, and I'm going to quote from it here, this is the Dugaboy decision that we've cited in our brief.

He said, "It's true that the Act prohibits any provision binding any person to waive compliance with any provision of the Act, but that provision stands for the proposition that general waivers of the Investment Advisers Act protections will not be enforceable." It says nothing about whether a fiduciary duty beneficiary, such as the Plaintiffs here, gave informed consent to a specific scheme.

So the notion that the fiduciary duties somehow can never be waived, it's not true, right? Take Judge Starr's word for it. He's in the District Court, right. The same court that these guys think would be a more appropriate forum to hear these very sophisticated issues. Judge Starr said no. Dugaboy, you're absolutely wrong.

Judge Starr found specifically in the conflict of interest section in the Multi Strat private placement memo, evinced informed consent that Highland might resolve issues in a manner inconsistent with the interests of Multi Strat's investors. Highland was allowed -- Highland had complete authority to settle or compromise suits on behalf of Multi Strat without notice, without seeking anybody's prior approval.

He went through in detail and quoted some of the conflict of interest language. The same result hold here. Let's take a look at the advisory agreement and see the conflict of issues that were disclosed to the Plaintiffs here. If we can put Slide 4 on the screen.

So Slide 4, this is Exhibit A, again to the advisory agreement. It's Exhibit 14, and they've got a whole section. It goes on for a couple of pages, Your Honor, called potential conflicts of interests. And it says that the Highland Group can age in transactions whether or not such vendors are competitive with the Fund. The Fund here is the DAF.

"The Fund will be subject to a number of actual and potential conflicts of interest involving Highland, including among other things, that Highland may actively engage in transactions for the same securities saw by the Fund and may compete with the Fund for investment opportunities, or may hold positions opposite to positions maintained by the Fund." If we can go to the next slide, because it continues.

"Highland Group Trading as part of its regular business, the members of the Highland Group may hold, purchase, sell, trade, or take other related actions for their own account. The members of the Highland Group will not be restricted in their performance of any services or in the types of debt or equity investments, which they may make."

And this is the most important part here. In connection with those activities, "The members of the Highland Group may hold, purchase, sell, trade, or take related actions in securities or investments of a type that may be suitable to investments for the Fund.

"Members of the Highland Group will not be required to offer such securities or investments to the Fund or provide notice of such activities to the Fund." In other words, Highland could enter into this -- this is the party's agreement. This is exactly what Judge Starr said was permitted. Informed consent.

This is Mr. Dondero talking to Mr. Dondero. It's his company talking to his Donor Adviser Fund, and he's talking to himself, and he's saying, okay, look, I may -- I'm going to be able to do whatever I want. And don't worry. You know, it may conflict with you. But if I want to look out for this guy, I'll look out for this guy. I want to look out for that guy, I'll look out for that guy. I'm not going to tell you. I'm not going to give you the opportunity. This is the agreement that he struck with himself. He may not like it today. But that's the agreement that he struck with himself.

Through these provisions, Highland has made full disclosure about potential conflicts of interest. DAF, a fiduciary duty beneficiary, to use Judge Starr's term, gave its informed consent to a specific scheme. It was not a general waiver of the IAA's protections. That would be wrong. No general waiver. That's what Judge Starr said he couldn't do. And that's not what's happening here. Rather, a specific scheme was agreed upon between Mr. Dondero's company and his donor advised Fund.

Finally, let's just look at reality. There was no corporate opportunity to divest. Highland didn't buy anything. They settled a $300 million claim. They structured it at the request of HarbourVest in a manner of rescission. So they took the investment back, gave the $80 million back in the form of claims. And that's it. That's not an opportunity that ever existed for the Plaintiffs or for anybody else.

In short, no fiduciary duty to CLO Holdco. Highland made full and complete disclosure of its conflicts of interest, including expressly stating that Highland could acquire securities without offering them to the DAF or even giving the DAF notice. At the end of the day, Highland didn't take an opportunity that was ever available to the DAF that they had no right to. Rather it settled a $300 million claim and transferred its interest as part of the settlement.

No amendment can change these facts, Your Honor. There was no private cause of action under the Investment Advisers Act. Highland owed no duty to CLO Holdco. Highland fully disclosed the very scheme that purported to settle the

HarbourVest claim as it did. And there was no opportunity that the Plaintiffs could have taken advantage of. By my count, Your Honor, I'm at 38 minutes, so I'd like to reserve seven for rebuttal.

THE COURT: Okay. My law clerk confirms 38 minutes.

All right. Mr. Sbaiti?

MR. SBAITI: Thank you, Your Honor. Your Honor, the -- I'm going for the most part rest on our briefs because I think they deal with a lot of the issues that were discussed. And I'd like to focus on the Advisers Act and the fiduciary duty argument and I'll address Mr. Morris' arguments there.

The case does begin though with Mr. Seery's testimony at the settlement appeal hearing on January 14th, 2021. Mr. Morris has that correct. He testified specifically that the HarbourVest interest in HCLOF was worth 22 and a half million. He also testified that that was the value at the end of November of 2020. He also testified that that was a fair value for the HarbourVest interest that Highland actually had, and he testified that the value hasn't gone up explosively. And he said that we think that's good real value.

After Your Honor approved the settlement, the DAF discovered two months later that in January 2021, Highland's internal metrics did or should have valued HCLOF under an NAV, a net asset value basis, because these are not totally liquid securities. And when they went back and did the math internally, the net asset value as we pled of those securities at the end of November, would have been about 34 and a half million, not 22 and a half million. And it would have been closer to $42 million by the time that he was testifying in Your Honor's court. So we start with that misrepresentation and the case it arises from the outcroppings of the implications of that misrepresentation.

One of the things that we looked at is under the Advisers Act is that under Transamerica Mortgage, as I said earlier, it says that violations of Section 206 are actionable under Section 215. You've heard Mr. Demo and now Mr. Morris say that the Supreme Court has held that Section 206 does not have a private right of action for damages. And he's absolutely correct. But that doesn't mean that if there's a violation of Section 206, that you have nothing.

What Transamerica Mortgage held, was that there was a private right of action under Section 215 of the Advisers Act for breaches of Section 206. You do have a private right of action. And that's one of the ways we believe violations of Section 206 are actionable.

The other way we argued that violations of Section 206, which does impose fiduciary duties on an investment adviser, purely by virtue of its activities as an investment adviser is that Judge Boyle and other courts, as we cite in our brief, Judge Boyle had a case called Douglas v. Beekley (phonetic). Held that state fiduciary duty actions can be predicated upon breaches of the fiduciary duties owed under the Investment Advisers Act.

Judge Boyle found that, and then we've also cited cases in other jurisdictions that have similarly found. And I would note that although in the reply, Mr. Morris, or excuse me, Highland takes the position that, you know, we haven't pled a state cause of action. We actually pled a breach of fiduciary duty and then pled both damages, and discouragement/rescission, the full panoply which are available under both state and federal.

And in fact, as you've heard Highland's lawyers say multiple times today that they originally filed their motion to dismiss, and that this new motion to dismiss is substantially similar. In our response to their original motion to dismiss, we also cited the case law that says that violations of Section 206 of the Advisers Act are actionable through state law, fiduciary duty actions, and that's what we've pled. We didn't limit ourselves to only state or federally available remedies. So I'll concede --

THE COURT: Can I stop you? Because I'm really hung up on this issue. If it's actionable, what is the remedy? If it's not damages, what is the remedy you think is available?

MR. SBAITI: So I do believe damages are available under a fiduciary duty claim under Section -- under the Section

215. And this is where I was going earlier on. Section 215 essentially voids either a contract that waives or waives compliance with the Advisers Act or voids the provisions, but it also voids the rights of someone who performs a contract in violation or makes a contract in violation of one of the duties under the Advisers Act.

And what the Supreme Court said in Transamerica is, once you have a void right or a void provision, then the incidences of voidness, which they included to be restitution or disgorgement, and other courts have construed to mean other equitable remedies that would happen once you have voided a right, it could include things like disgorgement, of course, then you actually have those rights.

And in fact, Judge Boyle's case, Douglas v. Beekley also addresses the fact that those can be the remedies once the rights of a violator have been voided under Section 215 of the Advisers Act.

THE COURT: So let's take that from conceptual to these facts. How would that play out?

MR. SBAITI: Sure. So Your Honor, we would argue, because we're seeking damages for the lost opportunity, or disgorgement of the asset, and so one of two options could happen. Either Highland could transfer the interest in exchange for, you know, would have an offset, would have an unjust enrichment right. DAF I think would owe $22 and a half million to Highland to compensate for what it paid. Or we could just get damages under a state cause of action for whatever the potential value is. I'm not sure what the value of it is stands today. But that would be the idea.

THE COURT: Okay. Well, I have to say, and you can either move on or not, I'm very confused. Because --

MR. SBAITI: Okay.

THE COURT: -- no private right of action -- and you say that just applies to damages -- you know, no private right to damages. But you can get the remedy of voiding a contract or voiding provisions of the contract. But somehow at the end of it, you're saying damages or disgorgement? You want to --

MR. SBAITI: Sure. Let me be a little bit more specific, Your Honor.

If there's a violation of Section 206, the Supreme Court in Transamerica has held that you can seek to avoid the rights of the other party violating Section 206. And then you can seek the equitable remedies surrounding the voiding of those rights. That's what Transamerica held. It held that you can simply walk in and say you violated Section 206. We want damages. But you can seek to (indiscernible) the rights of the violator and then seek whatever equitable remedies arise out of that, whatever those may be.

The flip side of that, Your Honor, is that as Judge Boyle has held and as other courts have held, is that because the Advisers Act imposes fiduciary duties, those are formal fiduciary duties recognizable under Texas fiduciary duty law. So I can have a Texas fiduciary duty claim for breach. And then I get the full panoply of remedies, including damages that are available under Texas law for a breach of fiduciary duty.

So in other words, Section 206, and both of these regimes simply provides the duty, the basis of the duty. It's a federal law imposition of a fiduciary duty. The violation of that then is actionable through either Section 215, or it's bore by the state or adopted by the state fiduciary duty cause of action. That's what the case law says that we cite.

THE COURT: Okay. And again --

MR. SBAITI: I'm hoping I'm answering your question.

THE COURT: Sorry to interrupt. Maybe you're going to get to this, but --

MR. SBAITI: It's okay.

THE COURT: But the argument very strongly made -- vehemently made by Highland is there's no fiduciary relationship to investors, i.e. the DAF. If you're right, this could only be a tool of CLO Holdco. You disagree with that?

MR. SBAITI: I do, for a couple of reasons, Your Honor.

THE COURT: Okay.

MR. SBAITI: I can address that.

THE COURT: Okay, go ahead.

MR. SBAITI: And if Mr. Morris is correct, they didn't argue the implications of the contract as it would apply to the fiduciary duty. So I'll address that at the end of these comments, Your Honor.

THE COURT: Okay.

MR. SBAITI: Because I think they're obviously relevant and they've been brought up. But in terms of simply a matter of federal law, there is a fiduciary duty by Highland to the DAF and its subsidiaries and that's in the agreement that Mr. Morris was going through. So they can't escape the idea that there's not a fiduciary duty. Those fiduciary duties arise as a result of Highland performing services as an investment adviser to the DAF.

I think what Mr. Morris was arguing is that because that contract waives anything, what anything -- any liability for anything that was less than gross negligence or intentional misconduct. I think he was arguing that therefore that contract takes away the idea that the fiduciary duties imposed under the Advisers Act, to the extent that they're actionable is negligence. I think he was arguing that goes away, because that's where I understood his argument to come from.

I didn't understand his argument to say there is no fiduciary duty from Highland directly to the DAF. In fact, I believe Mr. Demo conceded that that fiduciary duty existed because he was trying to show Your Honor how simple of an issue it is and how not complicated it is in terms of for the purposes of the question of withdrawing reference.

So you have a direct fiduciary duty from Highland as the DAF's adviser. You also have a direct fiduciary duty by Highland to Holdco. Now you've heard them cite a case. They call it Goldstein. It's a DC Circuit case. And what Goldstein held is that you own -- is that an investment adviser only has a fiduciary duty to its client. And the client is the Fund. It's not the investors in the Fund.

And I mentioned this without mentioning the name of the case. But I mentioned that they had cited cases that deal with Section 206(1) or (2) of the Advisers Act, which Goldstein is a Section 206 -- I believe (2) case. And indeed, it specifically says Section 206(2) specifically only applies to the clients or the advisers due to its client.

So under 206(2), indeed, you have a fiduciary duty only for the Fund. The part that they miss is that Rule 206(4)-8, which I brought up earlier in regards to when I was going through the mechanisms. That rule was actually passed in response to Goldstein to actually clarify that, no, under 206(4), those same duties are going to exist directly to the Fund and its (indiscernible).

And that's what I read, Your Honor, the rule and it's -- I believe I read you the statutory -- the actual cite, which is -- get to it again, for Your Honor's record. And it's in the CFR. I believe it's 17 CFR 275.206(4)-8. And it is very clear. And if you look at the SEC -- and the SEC passed it, if you look at when they passed it. They passed it the year after Goldstein. So Goldstein isn't good law for the provision that there's no fiduciary duty to the investor in a Fund. It's just not good law at this point. Nor in any of the other cases that they cite, or that Goldstein backs with the same proposition, because it relies on the wrong part of the statute. The statute, I should say.

So now that we have an agreement that Highland and its subsidiary are the investment advisers to HCLOF, and this provision, this regulation passed by the SEC says there -- the duties under 206(4) actually do apply to the investors in the Fund, and not just Fund itself. That's the direct investment advisory relationship to Holdco. So you can get at it either way, Your Honor, under the statute. And that's kind of the point that we make.

And then you look at the other cases that we've cited, and the statutes that we've cited, and they're all basically get to the same provision. So the math is pretty simple for us on this. Section 206 of the Advisers Act says, those fiduciary duties, that's what Transamerica and its progeny held. And Rule 206 defines the scope of Section 206, which includes investors in the managed Funds, which means there's a direct fiduciary duty.

They hang their hat a lot on the lack of a direct fiduciary duty or the lack of a cause of action for actuating these duties when they've been breached, but they're just simply wrong as a matter of law. In their reply, Your Honor, they also bring up the argument which we talked about a little earlier, that there is -- they cite the Acis -- NexPoint v. Acis decision for a premise that, you know, therefore, there's no private right of action. That's actually not what that case held.

What that case held is that under Section 215, you could only void -- you can't void someone's performance of an otherwise lawful agreement. Which is not the issue here. Here, we're saying that an agreement was made in violation of the Advisers Act, because the settlement agreement was predicated on a misrepresentation of fact to the advisers and breached the adviser's duty to cherry-pick for itself the best investments.

And if you look at the contract that Mr. -- and which I'll get to now -- look at the contract that Mr. Morris was talking about, right after the provisions he read under the Attachment A specifically says, "It is the policy of the investment adviser to allocate investment opportunities fairly and equitably over time." And it goes on to say that the considerations -- that's its fiduciary duties -- owed to the accounts, the primary mandate of the accounts.

In other words, if there are some accounts that are specifically there for certain types of investments, those investments are going to be allocated there. The capital available to the accounts, restrictions on the accounts and the investment opportunity, the sourcing of the investment, the size, and so on. It goes through about 11 different considerations.

So as a matter of fact, we can argue later whether or not Highland went through those provisions when it decided to take it for itself. But the most important thing about everything that Mr. Morris read to you about Highland's ability to trade and to do these things, is that the allocation of the investments is amongst its other accounts. It doesn't get to (indiscernible) it somewhere for itself at the expense of its advisees, number one.

And number two, if it does, we would argue that that's void under Section 215(a) and (b), that the Advisers Act doesn't let it -- the Advisers Act imposes duties where it's not allowed to do that.

Now he cited anew Judge Starr's decision, which I actually haven't had a chance to read. I tried to pull it up while he was reading from it, but it just didn't come up and so I don't know what to say about that specifically, what he found or how he relates in any way.

I don't have the underlying documents to see whether or not it's the exact same language or different. But the upshot, I believe, of what he said was that by disclosing all of these things that Highland, the person who signed it basically made an agreement that they were going to let Highland do whatever it did.

And that was an informed -- that amounted to informed consent except for one thing, that the Advisers Act doesn't let you do it ahead of time. You have to go through specifically with the actual investment, talk about it just like the provisions in the agreement I was reading from which comes right after Mr. Morris's quotation.

And those provisions don't talk about it being ahead of time. Those considerations have to be done on an investment-by-investment basis. So it is a general waiver otherwise, if you're not talking about a particular investment and that's all I can really comment on that, Your Honor, because I don't have Judge Starr's opinion or the underlying facts in front of me, unfortunately.

Turning back to sort of the core argument, Your Honor, so the alleged breach we have is that Highland as an adviser is liable for cherry-picking and making it, bringing it over to itself.

In our brief, we actually cited a Fifth Circuit case that said that's a violation of the Advisers Act and it's not -- again, it's not a waiveable -- it's simply not waivable in the way that they've cited. And the second alleged breach that we have is that Highland failed to disclose the true violation of it, excuse me, the true valuation of the HarbourVest interest.

And so the fact that they didn't do those two things and keep the DAF apprised or keep Holdco apprised as the case may be, are two independent and actionable violations -- and I'm making these points in summary -- and that's really what it boils down to is it was an act of self-dealing.

The remedy for breach of fiduciary duty is, Your Honor, as is for any loss suffered by the plaintiff. And I would cite, I would refer Your Honor, for example, to the cases we cited, but also to <u>Hsin-chi-Su v. Vantage Drilling</u>, for example, 474 S.W.3d 284, which also says, under state law disgorgement of profits is an equitable remedy appropriate when a party has breached his fiduciary duty; its purpose is to protect relationships of trust by discouraging disloyalty. We've got both state and now federal remedies, including a panoply of possibilities for violations of breaches of fiduciary duty.

Turning to, Your Honor, to some of the arguments that were made by Mr. Morris regarding these, the argument that they make about, excuse me, about Section 215 not having a, having a viable cause of action -- and like I said, the argument's incorrect. It is a viable cause of action -- I admit it is a limited cause of action.

It's limited to declaring a provision or a right void and then, you know, crafting an appropriate remedy that arises out of that. But it doesn't mean that there's no cause of action.

And I've seen no case cited by them, and I've looked, and I haven't seen a case saying that a Texas or a state fiduciary duty action cannot be predicated on the breach of a federally imposed fiduciary duty, which is what (indiscernible) actually held.

Interestingly, Your Honor, twice, at the beginning and at the end of his colloquy, Mr. Morris said that the settlement was essentially a rescission of the HarbourVest investment in HCLOF, a rescission to Highland. The problem with that language and maybe it is a rescission, but I don't see how it could possibly be because we actually pled the background of that transaction.

And the background of that transaction is that HCLOF was a hundred percent owned by Holdco, by the DAF, not by Highland. So if it was a rescission then the shares should have gone back to the DAF or Holdco. They shouldn't have gone to Highland if that's how they were going to treat it.

And I believe he makes that argument because he wanted to show that it's just not a big deal that this is simply a way to settle the case, and I can see that. This lawsuit is not about unwinding the HarbourVest settlement to drag them back in here and undo and unscramble the egg.

But that doesn't mean that there aren't specific equitable remedies that Highland had, excuse me, that the DAF or Holdco had vis-a-vis Highland because of the breaches of fiduciary duty. The fact that he admits that it's a rescission action but it was rescinded to the wrong party, I think, is very telling.

I'll briefly touch upon the other arguments, Your Honor. I think, I don't think I need to use all 45 minutes. I think these arguments are pretty well laid out in our brief. I think the law is pretty well laid out in our brief as much as they want to argue that, you know, that we're just misstating it.

When he says Highland owes no duty to Holdco, I think I've addressed that. But he also says, well, how could there be a breach of fiduciary duty when Highland was complying with the agreement that Holdco agreed to, and I believe he's talking about the membership agreement. But we have two different readings of the membership agreement, which is why I don't think it's appropriate to dismiss at this stage.

The reading that Highland wants you to adopt is that when it says in 6.1, no member shall sell its shares other than to an affiliate of an initial member, thereto, without the prior written consent of the portfolio manager, and then it goes on in 6.2 to say you have to offer it to another member, highland wants you to read that as saying that well, then you can only sell, as long as you don't sell to your own affiliate, which is how we read it, then you're in the clear.

But if you actually look at the way it's constructed, it's the member selling to its own affiliate that was supposed to be carved out. So Holdco might be able to sell to its own affiliate. That was the purpose and intent, otherwise it really doesn't make any sense that a member has to offer it to another member unless it sells to another member's affiliate.

It's actually kind of an absurd reading that Highland wants you to adopt.

THE COURT: You're going to have to repeat that. I got very lost during that.

MR. SBAITI: Oh, sure. Would it help if I bring it up, Your Honor?

THE COURT: It would be helpful if it was on the screen again, but if you could --

MR. SBAITI: May I share my screen, Your Honor?

THE COURT: Absolutely.

MR. SBAITI: Do you see the contract, Your Honor?

THE COURT: I do.

MR. SBAITI: I just want to make sure I -- where it says "no member," so it's this language, Your Honor, that we're looking at, 6.1 and then down here, 6.2. And I'll just -- so

6.1 first says, "no member shall sell, pledge, charge, mortgage, assign, assign by way of security transfer." And it goes on "other than to an affiliate of an initial member party thereto without the prior written consent of the portfolio manager."

That exclusion which also exists in 6.2, prior to making any transfers of shares other than transfers to affiliates of an initial member, or in the case of CLO Holdco or Highland, to Highland, its affiliates or another Highland principal, "a member must first offer to the other members a right to purchase the shares."

Your Honor, setting aside the judicial estoppel argument, I'm simply talking about the read of this. What Highland wants you to adopt here is the idea that where it says, "other than transfers to affiliates of an initial member," it's talking about an affiliate of a member other than the one doing the transferring, and that's an absurd read.

What it means, they way they read it, it means that if I'm CLO Holdco, I can't transfer it to HarbourVest but I can transfer it to a HarbourVest affiliate. But if I transfer it to HarbourVest, then I have to offer it to the other members. That makes no sense. There's no reason for that.

The better reading, we believe, is that the exclusion is that if I'm Holdco, I could transfer it to my own affiliate without offering it to anybody else because it's basically the same person sitting in that membership seat. The same would go for HarbourVest. HarbourVest can offer it to its own affiliate, but shouldn't be able to offer it to somebody else or their affiliate without first offering it to the other membership pro rata.

So that's --

THE COURT: What about that word --

MR. SBAITI: -- the reading in the --

THE COURT: -- "initial member?" In your example, you said HarbourVest could only transfer it to an affiliate of HarbourVest, but HarbourVest wasn't an initial member.

MR. SBAITI: I actually believe HarbourVest is an initial member to this agreement, Your Honor, because they're actually named up here. Sorry to scroll. See, those are there. I believe all the signatories of this are initial members and I believe that definition is down here. Sorry to scroll fast. I'm just trying to find it. It may not be a defined term here, Your Honor.

THE COURT: Well, I saw HarbourVest. It's just what you would expect, all the HarbourVest entities, but it wasn't an initial member. It was not an initial member of HLO or whatever the --

MR. SBAITI: It's an initial member of this --

MR. MORRIS: Your Honor, I believe it is. I think if you just scroll to the top you'll see they are. This is the original document.

THE COURT: They were an initial member?

MR. MORRIS: Yes, they were.

MR. SBAITI: Yes.

THE COURT: Oh.

MR. MORRIS: They are right there. This is the original agreement.

MR. SBAITI: And they're an original member.

MR. MORRIS: I would agree with that. So.

THE COURT: Okay.

MR. SBAITI: So anyway, Your Honor, our position is it's -- this is at best an ambiguous contract that would require discovery to go into what that was really supposed to mean. I know there is a judicial estoppel. I think that argument's been beaten to death by both sides in the briefing so, you know, we'll rest on our briefing in that issue and, you know, I guess to the extent they are relevant in the exhibits.

But, Your Honor, the point of the matter is the agreement, you know, read the way Highland is suggesting just really doesn't make a whole heck of a lot of sense from a practical and common sense standpoint. I think it's ambiguous as to what that meant, "an affiliate of the initial member."

I think it was intend -- we believe it was intended to mean the member doing the transferring can transfer to its own subsidiary, its own affiliate without anybody objecting, which makes perfect sense because all of these investment company are, you know, they sometimes need to move investments around.

HarbourVest did it. That's why there's ten, you know, the half dozen of their affiliates that are there, Your Honor. So, you know, when it comes down to that, I don't really don't have an argument other than that because I think that's the only argument Mr. Morris made on the membership agreement.

And I believe the tortious interference argument, specifically, has, you know, has a little bit heightened relevance because of the testimony and because nobody knew what the actual value was until one of Highland's people left and there was a discussion which you have heard about.

I believe at one of the hearings there was a discussion where he actually told some of the advisers to the DAF that those values were actually much higher at the (indiscernible). I think discovery if bears true then there's been a misrepresentation and there should be consequences for those misrepresentations.

And nothing in Highland's agreement with the DAF or with HCLOF says that misrepresentations are somehow excused or that those misrepresentations don't rise above the negligence level, you know, to the extent where those are actionable.

I don't know if you have any more questions, Your

Honor, but that really is the argument, I think. We rest on our briefs and ultimately we have fulsome argument on a lot of these issues the last time. So unless Your Honor has additional questions, I'll rest.

THE COURT: I guess a couple of follow-up questions.

Okay, I'm zeroing in on the -- what exhibit is this? I think it's Exhibit 6 in your notebook, the amended and restated investment advisory agreement.

MR. SBAITI: Okay.

THE COURT: Paragraph 11, the exculpation, the indemnification, 11B. I think every single adviser agreement I've seen in my history of dealing with Acis and Highland has had a provision like this, substantially similar if not exactly like this.

Is your position that basically even though these provisions are always in investment advisory agreements, this is a meaningless provision? That you cannot contract around some federal fiduciary duty in the IAA, so any, you know, agreement between sophisticated people that says, you know, we're not going to hold you liable for negligence or any other misconduct, it's just wasted ink on paper.

It's not -- it's overridden by the IAA.

MR. SBAITI: Your Honor, I've seen this. Yes. I mean in a word, yes. I think a lot of times these are in boilerplate -- this is boilerplate -- not only in Highland's but in a lot of investment adviser agreements.

And one thing you're allowed to do under the IAA is define the scope of your services, what you're going to do and what you're not going to do in terms of the types of investments you're going to advise; whether you're going to be the one to buy them or make the investor go buy them (indiscernible). There's a whole way to discuss the scope.

But within that scope, the Advisers Act is fairly crystal clear in Section 215(a) and (b) that when there is a duty imposed -- and the duties are under Section 206 and elsewhere, by the way. Section 208(d) says you can't do indirectly what you can't do directly, you know, you can't waive those.

It specifically says anything that allows someone to not comply with the Advisers Act is void.

THE COURT: Okay.

MR. SBAITI: And I don't blame investment advisers for putting things, I mean they're not the only ones who put things like this in their contracts to give themselves a fighting chance, I suppose, or to make the arguments that Mr. Morris has made and maybe sometimes they're even successful.

But I think the statute is so plain and clear that I don't know how this --

THE COURT: Okay. My last question was the motion to dismiss the RICO claim that is --

MR. SBAITI: Yes.

THE COURT: -- on Page 23 of your response to the motion to dismiss. What about the argument that you dismiss actions not claims pursuant to Rule 41, this is not a proper procedural mechanism for what you're trying to do here.

MR. SBAITI: Here's how I was thinking about it, Your Honor, when we put that in. If Your Honor doesn't dismiss the Securities Act claim, essentially the Advisers Act claim, then I think the lead argument that they made because we've pled RICO in the alternative, the lead argument that they made is that if we have an Advisers Act claim we don't have a RICO claim, I think, is correct.

So in a world where you uphold the Advisers Act claim, then I think the RICO claim is dismissed with prejudice, without prejudice because we have an actionable Securities Act claim, so I think their lead argument on that was correct.

In a world where you dismiss based upon everything because you don't think we have a Securities Act claim, we are asking Your Honor to dismiss that claim without prejudice because we believe there would be other reasons to plead because we do think we can show a, you know, as we argued in response to the first motion to dismiss, there are other things that we think this adviser has done in similar fashion that show a pattern of activity of misleading the activity or violating their duties under state law, for example, but using the interstate wires to accomplish that.

We do believe we can plead that, but we agreed with their lead argument that if we succeed on Count 1 then we don't have a RICO.

THE COURT: Okay. But what is the efficiency in taking it out now without prejudice to reasserting it? Where's the judicial economy and efficiency there?

MR. SBAITI: I guess what we're asking for, Your Honor, is either a dismissal for, well, allowing us to re-plead to meet the other issues that they talked about, which is the further, you know, is there an actual (indiscernible).

Rather than brief that all the way, we saw the argument that they've cited which they didn't bring in their first motion, but we saw the argument that they were making, "Well, these two can't co-exist. You can't have a Securities Act claim and a RICO claim." We agree. So if we win our Advisers Act claim, RICO claim goes away. We agree with that.

If we don't though, we should be allowed to re-plead because we disagreed with everything else he said. I think we do have, we do meet 9(b), but we should have an opportunity to plead the other acts that we believe make this part of a (indiscernible).

THE COURT: Okay, thank you.

All right, Mr. Morris, you have seven minutes.

MR. MORRIS: Okay. To try to get to this as quickly as I can, first of all, Your Honor, to the extent that Mr. Sbaiti is suggesting that there is more claims to come, I'll just remind him in court that the administrative bar date passed a year and a half ago.

Going to Section 6.1, there is not two readings of this. There's nothing irrational about the plain words that are on this page. It says other than to an affiliate of an initial member. It doesn't say other than to an affiliate. It says other than to an affiliate of an initial member.

And it makes absolute perfect sense. Just look at the percentages of the interests that were held at the time this agreement was entered into. HarbourVest had almost but not quite 50 percent and every entity and person controlled by Mr. Dondero, the majority.

Mr. Dondero was in control. He didn't care if, you know, it was never going to happen under his watch that somehow somebody was going to transfer something to HarbourVest. He was always going to be in control, so it didn't matter to him.

It didn't matter to him how among the members it was transferred because the one thing he knew was not going to happen was that he was not going to lose control. I guess he just didn't foresee the bankruptcy two years later. But that's perfectly consistent with this.

What this provision does say is that we're keeping this in the family. We're keeping this among ourselves and we're not letting anybody in who's not already here. Because dealing with the people who are already here, he knew he would always be in control and that's perfectly consistent with the way this is drafted.

The language is unambiguous, "other than to an affiliate of an initial member." That is exactly what this transaction did. It transferred HarbourVest's interests. HarbourVest was a member. It transferred HarbourVest interest. They sold, they assigned, they transferred, actually, the word is "transfer."

HarbourVest is the member who transferred its interest to an affiliate of an initial member. Highland is the initial member. Actually, Your Honor had it right before because HarbourVest actually acquired its interest from CLO Holdco, so you were right. I don't know that HarbourVest was an initial member, but I know Highland was. I know HarbourVest was a member. But these provisions say --

THE COURT: Yeah. And again, I'm not counting -- I had thought it came along, you know, a couple years down the road but, you know, shortly --

MR. MORRIS: You may be right.

THE COURT: -- shortly before the whole Acis. But anyway, but I guess Mr. Sbaiti's wanting me to read this parenthetical in 6.2 as other than transfers from --

MR. MORRIS: To an affiliate.

THE COURT: -- an initial member to its own affiliate. And that's, it's not worded that way.

MR. MORRIS: It's not what it says.

THE COURT: Yeah.

MR. MORRIS: It's just not what it says. It may be what they wish it said today, but that doesn't -- you can't just change a contract to make it say what you wished it did. This is the contract that they drafted. This is Dondero's contract.

It says other than to an affiliate of an initial member. And it's kind of irrelevant as to whether HarbourVest was an initial member. The important point is that Highland was an initial member and HarbourVest was a member. So the member HarbourVest transferred its interest to an affiliate of an initial member. Period, full stop. It was permitted under 6.1 and the ROFR doesn't apply under 6.2.

Number two, next, the concept of rescission is a euphemistic term, okay. It's not like what Mr. -- because, you know, if Mr. Sbaiti was right and we were trying to undo it and put everybody back to where they were, his clients would have to take on $300 million of liability.

You don't just get to take the interest. The whole thing was part of a transaction. He forgot the 300 million dollar debt. Let's go to Section 215. 215 is not anywhere in the complaint, okay, but the important point here is what does

215 say?

If you go back to the Nexpoint case from the Southern District of New York, it says that every contract made in violation of a provision of the Investment Advisers Act shall be void. Period. Full stop. It doesn't have other remedies. It doesn't mean that the plaintiffs here get money.

In fact, I would argue that they don't even have standing to pursue this under 215. They are not party to the agreement. How do they even have the ability to come in? There's no case that Mr. Sbaiti can cite to. No court has ever said a nonparty to the agreement can come in and somehow try to void it.

No case in the history of the world has ever said that a third party who's not party to the agreement cannot only come in and void the agreement but somehow benefit from it. They're nobody. Like the plaintiffs are nobody here. The agreement that they signed said that Highland that they didn't have a right of first refusal.

The agreement that the court approved was an agreement between Highland and HarbourVest. If there's a misrepresentation as to the price, maybe HarbourVest has a complaint. I don't know what their remedies would be. I'm not saying they do, but they're not here.

Who are the plaintiffs? What on earth gives them the right to come in here and say they should have that contract, they should have that benefit without, of course, the liability? There's nothing. It's prohibited under the members' agreement.

It's permitted under the advisory agreement. No fiduciary duty at all. How can you breach a fiduciary duty when all you're doing is complying with the terms of the parties' agreement? There's no connection between 215 and 206, like he said.

There's no case that's ever said that. Just take a look at the Nexpoint case from the Seventh District of New York. It says a plaintiff may only pursue a remedy, may only pursue a claim to avoid the contract, right. That's all there is to it.

And so again, you can't just unwind the portion of the contract that they're really interested in. You can't just say Highland has to give back its interest. That means that Highland also has to pay back the 300 million-dollar liability. Where is HarbourVest here? How come HarbourVest doesn't have notice? How come -- think about how HarbourVest's rights would be impacted from what the plaintiffs are saying here.

They need to be at the table. They're the biggest party of interest of all. They thought this was in their rearview mirror. They wanted to get out of here. And now we're going to -- you can't just unwind part of a contract. You have to unwind the whole contract.

This is so much, this is so untenable, Your Honor, that it really needs to be dismissed with prejudice. I think that's all I have. I mean there's no -- you know, the remedies that are being suggested now, they're not in the pleading. But how, I just ask the Court to consider where's HarbourVest?

How do you unwind the piece of the transaction and not the only full transaction? Where does the plaintiff who agreed that it wouldn't have a right of first refusal, who agreed that Highland could pursue transactions on its own without notice of the other side, how do they come in here and try to undo a piece that they want? They can't.

Complaint should be dismissed with prejudice, Your Honor. Thank you very much.

THE COURT: All right. Thank you all.

Well, I'm obviously going to take this one under advisement and read all of your cases and pleadings. And I feel like I'm becoming a broken record on that sentence. Right now let's see where we are under Highland advisements.

We have the written ruling I need to do on the motion to conform plan to be consistent with the Fifth Circuit. We have the HCRE proof of claim trial. And then we have the motion, the renewed motion to recuse me, and then now we're going to have this, okay?

So that's going to be four Highland matters under advisement. All I can tell you is we've had a brutal December and January with things under advisements, trials, and different court commitments of all different kinds. So I hope we can have a very productive rest of January and February and March.

Inside baseball, judges, they tend to look at March 31st and September 30th as important catch-up days because we do these reports of how many things you have under advisement to our circuit courts. And I'm just giving you that inside baseball to let you know I really anticipate catching up on some of these things before that looming deadline. But hopefully, hopefully sooner.

And, of course, the report and recommendation I should have that out in a few days because I need to get that squared away, I feel like with the district court, especially since a different district judge is now in that loop because of what I think was a mess up between the clerk's offices.

So anyway --

MR. MORRIS: They've been pretty good about moving them when we've asked, Your Honor, as well. So maybe we can file something.

THE COURT: Okay. All right. But just circling back, the report and recommendation I should have out in a few days. But there may be a little bit of waiting on the ruling on the motion to dismiss.

All right. Is there anything else as far as housekeeping?

MR. MORRIS: Just thank you very much, Your Honor. I know this was a long day. We appreciate your diligence, as always, and for your time.

THE COURT: Okay. All right.

MR. SBAITI: Thank you for your time, Your Honor.

THE COURT: Okay. Thank you. We're adjourned.

THE CLERK: All rise.

(Proceedings concluded at 4:35 p.m.)

* * * * *

C E R T I F I C A T I O N

I, DIPTI PATEL, court approved transcriber, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of my ability.

/s/ Dipti Patel

DIPTI PATEL, CET-997

LIBERTY TRANSCRIPTS DATE: January 26, 2023

EXHIBIT 3

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275

[Release No. IA-2628; File No. S7-25-06]

RIN 3235-AJ67

Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting a new rule that prohibits advisers to pooled investment vehicles from making false or misleading statements to, or otherwise defrauding, investors or prospective investors in those pooled vehicles. This rule is designed to clarify, in light of a recent court opinion, the Commission's ability to bring enforcement actions under the Investment Advisers Act of 1940 against investment advisers who defraud investors or prospective investors in a hedge fund or other pooled investment vehicle.

EFFECTIVE DATE: September 10, 2007.

FOR FURTHER INFORMATION CONTACT: David W. Blass, Assistant Director, Daniel S. Kahl, Branch Chief, or Vivien Liu, Senior Counsel, at 202-551-6787, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5041.

SUPPLEMENTARY INFORMATION: The Commission is adopting new rule 206(4)-8 under the Investment Advisers Act of 1940 ("Advisers Act").[1]

1 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified.

I. INTRODUCTION

On December 13, 2006, we proposed a new rule under the Advisers Act that would prohibit advisers to pooled investment vehicles from defrauding investors or prospective investors in pooled investment vehicles they advise.[2] We proposed the rule in response to the opinion of the Court of Appeals for the District of Columbia Circuit in Goldstein v. SEC, which created some uncertainty regarding the application of sections 206(1) and 206(2) of the Advisers Act in certain cases where investors in a pool are defrauded by an investment adviser to that pool.[3] In addressing the scope of the exemption from registration in section 203(b)(3) of the Advisers Act and the meaning of "client" as used in that section, the Court of Appeals expressed the view that, for purposes of sections 206(1) and (2) of the Advisers Act, the "client" of an investment adviser managing a pool is the pool itself, not an investor in the pool. As a result, it was unclear whether the Commission could continue to rely on sections 206(1) and (2) of the Advisers Act to bring enforcement actions in certain cases where investors in a pool are defrauded by an investment adviser to that pool.[4]

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[2] Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, Investment Advisers Act Release No. 2576 (Dec. 27, 2006) [72 FR 400 (Jan. 4, 2007)] (the "Proposing Release"). In the Proposing Release, we also proposed two new rules that would define the term "accredited natural person" under Regulation D and section 4(6) of the Securities Act of 1933 [15 USC 77d(6)] ("Securities Act"). As proposed, these rules would add to the existing definition of "accredited investor" and apply to private offerings of certain unregistered investment pools. On May 23, 2007, we voted to propose more general amendments to the definition of accredited investor. Proposed Modernization of Smaller Company Capital-Raising and Disclosure Requirements, Securities Act Release No. (, 2007) [72 FR (, 2007)]. We plan to defer consideration of our proposal to define the term accredited natural person until we have had the opportunity to evaluate fully the comments we received on that proposal together with those we receive on our May 2007 proposal.

[3] 451 F.3d 873 (D.C. Cir. 2006) ("Goldstein").

[4] Prior to the issuance of the Goldstein decision, we brought enforcement actions against advisers alleging false and misleading statements to investors under sections 206(1) and (2) of the Advisers Act. See, e.g., SEC v. Kirk S. Wright, International Management Associates, LLC, Litigation Release No. 19581 (Feb. 28, 2006); SEC v. Wood River Capital Management, LLC,

In its opinion, the Court of Appeals distinguished sections 206(1) and (2) from section 206(4) of the Advisers Act, which is not limited to conduct aimed at clients or prospective clients of investment advisers.[5] Section 206(4) provides us with rulemaking authority to define, and prescribe means reasonably designed to prevent, fraud by advisers.[6] We proposed rule 206(4)-8 under this authority.

We received 45 comment letters in response to our proposal.[7] Most commenters generally supported the proposal. Eighteen endorsed the rule as proposed, noting that the rule would strengthen the antifraud provisions of the Advisers Act or that the rule would clarify the Commission's enforcement authority with respect to advisers.[8] Others, however, urged that we

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Litigation Release No. 19428 (Oct. 13, 2005); SEC v. Samuel Israel III; Daniel E. Marino; Bayou Management, LLC; Bayou Accredited Fund, LLC; Bayou Affiliates Fund, LLC; Bayou No Leverage Fund, LLC; and Bayou Superfund, LLC, Litigation Release No. 19406 (Sept. 29, 2005); SEC v. Beacon Hill Asset Management LLC, Litigation Release No. 18745A (June 16, 2004).

5 See Goldstein, supra note 3, at note 6. See also United States v. Elliott, 62 F.3d 1304, 1311 (11th Cir. 1995).

6 Section 206(4) of the Advisers Act makes it unlawful for an investment adviser to "engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative" and authorizes us "by rules and regulations [to] define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

7 We received over 600 comment letters that addressed the proposed amendments to the term "accredited natural person" under Regulation D and section 4(6) of the Securities Act. All of the public comments we received are available for inspection in our Public Reference Room at 100 F Street, NE, Washington DC, 20549 in File No. S7-25-06, or may be viewed at www.sec.gov/comments/s7-25-06/s72506.shtml.

8 E.g., Letter of the Alternative Investments Compliance Association (Mar. 5, 2007); Letter of the CFA Center for Financial Market Integrity (Mar. 9, 2007) ("CFA Center Letter"); Letter of the Coalition of Private Investment Companies (Mar. 9, 2007); Letter of the Commonwealth of Massachusetts (Mar. 9, 2007) ("Massachusetts Letter"); Letter of the Department of Banking of the State of Connecticut (Mar. 8, 2007); Letter of the North America Securities Administrators Association (Apr. 2, 2007) ("NASAA Letter"); and Letter of the U.S. Chamber of Commerce (Mar. 9, 2007). Another commenter observed that the proposed rules are broadly similar to current U.K. legislation and regulations. See Letter of Alternative Investment Management Association (Mar. 9, 2007) ("AIMA Letter").

make revisions that would restrict the scope of the rule to more narrowly define the conduct or acts it prohibits.[9]

Today, we are adopting new rule 206(4)-8 as proposed. The rule prohibits advisers from (i) making false or misleading statements to investors or prospective investors in hedge funds and other pooled investment vehicles they advise, or (ii) otherwise defrauding these investors. The rule clarifies that an adviser's duty to refrain from fraudulent conduct under the federal securities laws extends to the relationship with ultimate investors and that the Commission may bring enforcement actions under the Advisers Act against investment advisers who defraud investors or prospective investors in those pooled investment vehicles.

II. DISCUSSION

Rule 206(4)-8 prohibits advisers to pooled investment vehicles from (i) making false or misleading statements to investors or prospective investors in those pools or (ii) otherwise defrauding those investors or prospective investors. We will enforce the rule through civil and administrative enforcement actions against advisers who violate it.

Section 206(4) authorizes the Commission to adopt rules and regulations that "define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." In adopting rule 206(4)-8, we intend to employ all of the broad authority that Congress provided us in section 206(4) and direct it at adviser conduct affecting an investor or potential investor in a pooled investment vehicle.

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9 E.g., Letter of American Bar Association (Mar. 12, 2007) ("ABA Letter"); Letter of Davis Polk & Wardwell (Mar. 9, 2007) ("Davis Polk Letter"); Letter of Dechert LLP (Mar. 8, 2007) ("Dechert Letter"); Letter of New York City Bar (Mar. 8, 2007) ("NYCB Letter"); Letter of Schulte Roth & Zabel LLP (Mar. 9, 2007) ("Schulte Roth Letter"); and Letter of Sullivan & Cromwell LLP (Mar. 9, 2007) ("Sullivan & Cromwell Letter").

A. Scope of Rule 206(4)-8

Some commenters questioned the scope of the rule, arguing that the Commission should define fraud.[10] We believe that we have done so, only more broadly than some commenters would have us do. As the Proposing Release indicated, our intent is to prohibit all fraud on investors in pools managed by investment advisers. Congress expected that we would use the authority provided by section 206(4) to "promulgate general antifraud rules capable of flexibility."[11] The terms material false statements or omissions and "acts, practices, and courses of business as are fraudulent, deceptive, or manipulative" encompass the well-developed body of law under the antifraud provisions of the federal securities laws. The legal authorities identifying the types of acts, practices, and courses of business that are fraudulent, deceptive, or manipulative under the federal securities laws are numerous, and we believe that the conduct prohibited by rule 206(4)-8 is sufficiently clear and well understood.[12]

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10 E.g., ABA Letter, supra note 9; Letter of Debevoise & Plimpton LLP (Mar. 14, 2007); and NYCB Letter, supra note 9.

11 S.Rep. No. 1760, 86th Cong., 2d. Sess. (June 28, 1960) at 4. See rule 206(4)-1(a)(5) [17 CFR. 275.206(4)-1(a)(5)] under the Advisers Act; rule 17j-1(b) [17 CFR 270.17j-1(b)] under the Investment Company Act of 1940 [15 U.S.C. 80a-1] ("Investment Company Act"); and rule 13e-3(b)(1) [17 CFR 240.13e-3(b)(1)] under the Securities Exchange Act of 1934 [15 U.S.C. 77a] ("Exchange Act").

12 Loss, Seligman, & Paredes, Securities Regulation, Chap. 9 (Fraud) (Fourth Ed. 2006); Hazen, Treatise on The Law of Securities Regulation, Vol. 3, Ch. 12 (Manipulation and Fraud – Civil Liability; Implied Private Remedies; SEC Rule 10b-5; Fraud in Connection With the Purchase or Sale of Securities; Improper Trading on Nonpublic Material Information) (Fifth Ed. 2005). See, e.g., Superintendent of Insurance of New York v. Bankers Life & Casualty Co., 404 U.S. 6, 11 n. 7 (1971) ("'We believe that section 10(b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.'" (quoting A. T. Brod & Co. v. Perlow, 375 F.2d 393, 397 (CA2 1967))); Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 477 (1977) ("No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."). Moreover, the established legal principles are sufficiently flexible to encompass future novel factual scenarios. United States v. Brown, 555 F.2d 336, 339-40 (2d Cir. 1977) ("The fact that there is no litigated fact pattern precisely in point may constitute a tribute to the cupidity and ingenuity of the malefactors involved but hardly provides an escape from the penal sanctions of the securities fraud provisions here involved.").

1. Investors and Prospective Investors

Rule 206(4)-8 prohibits investment advisers from making false or misleading statements to, or engaging in other fraud on, investors or prospective investors in a pooled investment vehicle they manage. The scope of the rule is modeled on that of sections 206(1) and (2) of the Advisers Act, which make unlawful fraud by advisers against clients or prospective clients. Rule 206(4)-8 prohibits false or misleading statements made, for example, to existing investors in account statements as well as to prospective investors in private placement memoranda, offering circulars, or responses to "requests for proposals," electronic solicitations, and personal meetings arranged through capital introduction services.

Some commenters argued that the rule should not prohibit fraud against prospective investors in a pooled investment vehicle, asserting that such fraud does not actually harm investors until they, in fact, make an investment.[13] We disagree. False or misleading statements and other frauds by advisers are no less objectionable when made in an attempt to draw in new investors than when made to existing investors.[14] For similar policy reasons that we believe led Congress to apply the protections of sections 206(1) and (2) to prospective clients, we have decided to apply those of rule 206(4)-8 to prospective investors.[15] We believe that prohibiting false or misleading statements made to, or other fraud on, any prospective investors is a means reasonably designed to prevent fraud.

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13 Davis Polk Letter, supra note 9; Dechert Letter, supra note 9; NYCB Letter, supra note 9; Letter of the Securities Industry and Financial Markets Association (Mar. 9, 2007); Sullivan & Cromwell Letter, supra note 9.

14 See CFA Center Letter, supra note 8.

15 We have used the term "prospective investor" to give the term similar scope to the term "prospective client" in sections 206(1) and (2). See, e.g., In the Matter of Ralph Harold Seipel, 38 S.E.C. 256, 257-58 (1958) (the solicitation of clients is part of the activity of an investment adviser and it is immaterial for purposes of an enforcement action under sections 206(1) and (2) that an adviser engaging in fraudulent solicitations was not successful in his efforts to obtain clients).

2. Unregistered Investment Advisers

Rule 206(4)-8 applies to both registered and unregistered investment advisers.[16] As we noted in the Proposing Release, many of our enforcement cases against advisers to pooled investment vehicles have been brought against advisers that are not registered under the Advisers Act, and we believe it is critical that we continue to be in a position to bring actions against unregistered advisers that manage pools and that defraud investors in those pools.[17] The two commenters that expressed an explicit view on this aspect of the proposal supported our application of the rule to advisers that are not registered with the Commission.[18]

3. Pooled Investment Vehicles

The rule we are adopting today applies to investment advisers with respect to any "pooled investment vehicle" they advise. The rule defines a pooled investment vehicle[19] as any investment company defined in section 3(a) of the Investment Company Act[20] and any privately offered pooled investment vehicle that is excluded from the definition of investment company by reason of either section 3(c)(1) or 3(c)(7) of the Investment Company Act.[21] As a result, the rule

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16 A few commenters requested that we clarify how we intend to apply rule 206(4)-8 to offshore advisers' interaction with non-U.S. investors. See AIMA Letter, supra note 8; Letter of Jones Day (Mar. 9, 2007); Sullivan & Cromwell Letter, supra note 9. Our adoption of this rule will not alter our jurisdictional authority.

17 Proposing Release, supra note 2, at note 14.

18 Massachusetts Letter, supra note 8; NASAA Letter, supra note 8.

19 Rule 206(4)-8(b).

20 15 U.S.C. 80a-3(a). Unless otherwise noted, when we refer to the Investment Company Act, or any paragraph of the Investment Company Act, we are referring to 15 U.S.C. 80a of the United States Code, at which the Company Act is codified.

21 Section 3(c)(1) of the Investment Company Act excludes from the definition of investment company an issuer the securities (other than short-term paper) of which are beneficially owned by not more than 100 persons and that is not making or proposing to make a public offering of its securities. Section 3(c)(7) of the Investment Company Act excludes from the definition of investment company an issuer the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are "qualified purchasers" and that is not making or proposing to make a public offering of its securities. "Qualified purchaser" is

applies to advisers to hedge funds, private equity funds, venture capital funds, and other types of privately offered pools that invest in securities, as well as advisers to investment companies that are registered with us.[22]

Several commenters supported applying the protection of the new antifraud rule to investors in all these kinds of pooled investment vehicles, noting, for example, that every investor, not just the wealthy or sophisticated that typically invest in private pools, should be protected from fraud.[23] Some other commenters urged us not to apply the rule to advisers to registered investment companies, arguing that the rule is unnecessary because other provisions of the federal securities laws prohibiting fraud are available to the Commission to address these matters.[24] They expressed concern that application of another antifraud provision with different elements would be burdensome. These commenters claimed that the rule would, for example, make it necessary for advisers to conduct extensive reviews of all communications with clients. But the other antifraud provisions available to us contain different elements because they were not specifically designed to address frauds by investment advisers with respect to investors in pooled investment vehicles. In some cases, the other antifraud provisions may not permit us to

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defined in section 2(a)(51) of the Investment Company Act generally to include a natural person (or a company owned by two or more related natural persons) who owns not less than $5,000,000 in investments; a person, acting for its own account or accounts of other qualified purchasers, who owns and invests on a discretionary basis, not less than $25,000,000; and a trust whose trustee, and each of its settlors, is a qualified purchaser.

22 We have brought enforcement actions under the Advisers Act against advisers to these types of funds. See, e.g., In the Matter of Askin Capital Management, L.P and David J. Askin, Investment Advisers Act Release No. 1492 (May 23, 1995) (hedge fund); In the Matter of Thayer Capital Partners, Investment Advisers Act Release No. 2276 (Aug. 12, 2004) (private equity fund); SEC v. Michael A. Liberty, Litigation Release No. 19601 (Mar. 8, 2006) (venture capital fund).

23 E.g., NASAA Letter, supra note 8.

24 E.g., ABA Letter, supra note 9; Letter of Investment Adviser Association (Mar. 9, 2007); Letter of Investment Company Institute (Mar. 9, 2007) ("ICI Letter"); Sullivan & Cromwell Letter, supra note 9. Commenters noted in particular that section 34(b) of the Investment Company Act already prohibits an adviser from making fraudulent material statements or omissions in a fund's registration statement or in required records.

proceed against the adviser.[25] As a result, the existing antifraud provisions may not be available to us in all cases. As we discussed above, before the Goldstein decision we had brought actions against advisers to mutual funds under sections 206(1) and (2) for defrauding investors in mutual funds.[26] Because, before the Goldstein decision, advisers to pooled investment vehicles operated with the understanding that the Advisers Act prohibited the conduct that this rule prohibits, we believe that advisers that are attentive to their traditional compliance responsibilities will not need to alter their business practices or take additional steps and incur new costs as a result of this rule's adoption.

B. Prohibition on False or Misleading Statements

Rule 206(4)-8(a)(1) prohibits any investment adviser to a pooled investment vehicle from making an untrue statement of a material fact to any investor or prospective investor in the pooled investment vehicle, or omitting to state a material fact necessary in order to make the statements made to any investor or prospective investor in the pooled investment vehicle, in the light of the circumstances under which they were made, not misleading.[27]

The provision is very similar to those in many of our antifraud laws and rules that, depending upon the circumstances, may also be applicable to the same investor

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25 This may be the case with respect to section 34(b) of the Investment Company Act, for example, if the adviser's fraudulent statements are not made in a document described in that section, or with respect to rule 10b-5 under the Exchange Act, where the fraudulent conduct does not relate to a misstatement or omission in connection with the purchase or sale of any security.

26 See, e.g., In the Matter of Van Kampen Investment Advisory Corp., Investment Advisers Act Release No. 1819 (Sept. 8, 1999); In the Matter of The Dreyfus Corporation, Investment Advisers Act Release No. 1870 (May 10, 2000); In the Matter of Federated Investment Management Company, Investment Advisers Act Release No. 2448 (Nov. 28, 2005).

27 A fact is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information available. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). See also In the Matter of Van Kampen Investment Advisory Corp., supra note 26; In the Matter of the Dreyfus Corporation, supra note 26.

communications.[28] Sections 206(1) and (2) have imposed similar obligations on advisers since 1940 and, before Goldstein, were commonly accepted as imposing similar requirements on communications with investors in a fund. For these reasons, and because the nature of the duty to communicate without false statements is so well developed in current law, we believe that commenters' concerns about the breadth of the prohibition or any chilling effect the new rule might have on investor communications are misplaced.[29] Advisers to pooled investment vehicles attentive to their traditional compliance responsibilities will not need to alter their communications with investors.

Rule 206(4)-8(a)(1) prohibits advisers to pooled investment vehicles from making any materially false or misleading statements to investors in the pool regardless of whether the pool is offering, selling, or redeeming securities. While the new rule differs in this aspect from rule 10b-5 under the Exchange Act, the conduct prohibited is similar. The new rule prohibits, for example, materially false or misleading statements regarding investment strategies the pooled investment vehicle will pursue, the experience and credentials of the adviser (or its associated persons), the risks associated with an investment in the pool, the performance of the pool or other funds advised by the adviser, the valuation of the pool or investor accounts in it, and practices

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28 See, e.g., sections 12 and 17 of the Securities Act [15 U.S.C. 77l, 77q]; section 14 of the Exchange Act [15 U.S.C. 78n]; section 34 of the Investment Company Act; rules 156, 159, and 610 under the Securities Act [17 CFR 230.156, 230.159, 230.610]; rules 10b-5, 13e-3, 13e-4, and 15c1-2 under the Exchange Act [17 CFR 240.10b-5, 240.13e-3, 240.13e-4, 240.15c1-2]; and rule 17j-1 under the Investment Company Act [17 CFR 270.17j-1]).

29 Letter of Managed Funds Association (Mar. 9, 2007) ("MFA Letter"); NYCB Letter, supra note 9; Davis Polk Letter, supra note 9; Dechert Letter, supra note 9; Letter of Seward & Kissel LLP (Mar. 8, 2007) ("Seward & Kissel Letter").

the adviser follows in the operation of its advisory business such as how the adviser allocates investment opportunities.[30]

C. Prohibition of Other Frauds

Rule 206(4)-8(a)(2) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business for any investment adviser to a pooled investment vehicle to "otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle."[31] As we noted in the Proposing Release, the wording of this provision is drawn from the first sentence of section 206(4) and is designed to apply more broadly to deceptive conduct that may not involve statements.[32]

Some commenters asserted that section 206(4) provides us authority only to adopt prophylactic rules that explicitly identify conduct that would be fraudulent under the new rule.[33] We believe our authority is broader. We do not believe that the commenters' suggested approach would be consistent with the purposes of the Advisers Act or the protection of investors. That approach would have us adopt the rule prohibiting fraudulent communications but not fraudulent conduct.[34] But, section 206(4) itself specifically authorizes us to adopt rules defining and prescribing "acts, practices and courses of business," (*i.e.*, conduct), and does not explicitly refer to communications, which, nonetheless, represent a form of an act, practice, or

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30 We have previously brought enforcement actions alleging these or similar types of frauds. See Proposing Release, supra note 2, at note 29.

31 Rule 206(4)-8(a)(2).

32 See Section II.C of the Proposing Release, supra note 2.

33 ABA Letter, supra note 9; ICI Letter, supra note 24; Schulte Roth Letter, supra note 9; Sullivan & Cromwell Letter, supra note 9.

34 See, e.g., ABA Letter, supra note 9.

course of business. In addition, rule 206(4)-8 as adopted would provide greater protection to investors in pooled investment vehicles.

Alternatively, commenters would have us adopt a rule prohibiting identified known fraudulent conduct or would have us provide detailed commentary describing specific forms of fraudulent conduct that the rule would prohibit.[35] Either approach would fail to prohibit fraudulent conduct we did not identify, and could provide a roadmap for those wishing to engage in fraudulent conduct. This approach would be inconsistent with our historical application of the federal securities laws under which broad prohibitions have been applied against specific harmful activity.

D. Other Matters

We noted in the Proposing Release that, unlike violations of rule 10b-5 under the Exchange Act, the Commission would not need to demonstrate that an adviser violating rule 206(4)-8 acted with scienter.[36] Commenters questioned whether the rule should encompass negligent conduct, arguing that it would "expand the concept of fraud itself beyond its original meaning."[37] We read the language of section 206(4) as not by its terms limited to knowing or deliberate conduct. For example, section 206(4) encompasses "acts, practices, and courses of business as are . . . deceptive," thereby reaching conduct that is negligently deceptive as well as conduct that is recklessly or deliberately deceptive. In addition, the Court of Appeals for the District of Columbia Circuit concluded that "scienter is not required under section 206(4)."[38]

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35 Id.

36 Section II.B of the Proposing Release, supra note 2.

37 See ABA Letter, supra note 9 at page 3.

38 SEC v. Steadman, 967 F.2d 636, at 647 (D.C. Cir. 1992). The court in Steadman analogized section 206(4) of the Advisers Act to section 17(a)(3) of the Securities Act, which the Supreme Court had held did not require a finding of scienter, id. (citing Aaron v. SEC, 446 U.S. 680 (1980)). In discussing section 17(a)(3) and its lack of a scienter requirement, the Steadman court

We believe use of a negligence standard also is appropriate as a method reasonably designed to prevent fraud. As the Supreme Court noted in U.S. v. O'Hagan, "[a] prophylactic measure, because its mission is to prevent, typically encompasses more than the core activity prohibited."[39] In O'Hagan, the Court held that under section 14(e) "the Commission may prohibit acts, not themselves fraudulent under the common law or §10(b), if the prohibition is 'reasonably designed to prevent . . . acts and practices [that] are fraudulent.'"[40] Along these lines, the prohibitions in rule 206(4)-8 are reasonably designed to prevent fraud. We believe that, by taking sufficient care to avoid negligent conduct, advisers will be more likely to avoid reckless deception. Since the Commission clearly is authorized to prescribe conduct that goes beyond fraud as a means reasonably designed to prevent fraud, prohibiting deceptive conduct done negligently is a way to accomplish this objective.

Rule 206(4)-8 does not create under the Advisers Act a fiduciary duty to investors or prospective investors in a pooled investment vehicle not otherwise imposed by law. Nor does the rule alter any duty or obligation an adviser has under the Advisers Act, any other federal law or regulation, or any state law or regulation (including state securities laws) to investors in a pooled investment vehicle it advises.[41] The rule, for example, will permit us to bring an enforcement action against an investment adviser that violates a fiduciary duty imposed by other law if the violation of such law or obligation also constitutes an act, practice, or course of

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observed that, similarly, a violation of section 206(2) of the Advisers Act could rest on a finding of simple negligence. Id. at 643, note 5. But see Aaron at 690-91 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976)); cf. S. Rep. No. 1760, 86th Cong., 2d. Sess. (June 28, 1960) at 8 and H. R. Rep. 2179, 86th Cong., 2d Sess. (Aug. 26, 1960) at 8 (comparing section 206(4) to section 15(c)(2) of the Exchange Act).

39 U.S. v. O'Hagan, 521 U.S. 642, 672-73 (1997).

40 Id. at 673.

41 For example, under the Uniform Limited Partnership Act, advisers who serve as general partners owe fiduciary duties to the limited partners. UNIF. LIMITED PARTNERSHIP ACT § 408 (2001).

business that is fraudulent, deceptive, or manipulative within the meaning of the rule and section 206(4).[42]

Finally, the rule does not create a private right of action.[43]

III. PAPERWORK REDUCTION ACT

The Paperwork Reduction Act of 1995 does not apply because rule 206(4)-8 does not impose a new "collection of information" within the meaning of the Paperwork Reduction Act of 1995. The rule does not create any filing, reporting, recordkeeping, or disclosure requirements for investment advisers subject to the rule. Accordingly, there is no "collection of information" under the Paperwork Reduction Act that requires the approval of the Office of Management and Budget under 44 U.S.C. 3501.

IV. COST-BENEFIT ANALYSIS

The Commission is sensitive to costs imposed by our rules and the benefits that derive from them. In the Proposing Release, we encouraged commenters to discuss any potential costs and benefits that we did not consider in our discussion. Three commenters addressed the issue of cost. Two of them stated their belief that the rule would increase advisers' costs of compliance, by, for example, making it necessary for advisers to conduct extensive reviews of all communications with clients.[44] One stated that the rule would achieve a reasonable balance of

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[42] For example, if an adviser has a duty from a source other than the rule to make a material disclosure to an investor in a fund and negligently or deliberately fails to make the disclosure, the rule would apply to the failure.

[43] The Supreme Court has held that "there exists a limited private remedy under the Investment Advisers Act of 1940 to void an investment adviser's contract, but that the Act confers no other private causes of action, legal or equitable." Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 at 24 (1979) (footnote omitted).

[44] NYCB Letter, supra note 9; Seward & Kissel Letter, supra note 29.

providing important benefits to investors at an acceptable cost.[45] None of the three commenters, however, provided analysis or empirical data in connection with their statements.

The rule makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) for any investment adviser to a pooled investment vehicle to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle. The rule also makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) for any investment adviser to a pooled investment vehicle to otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. For the reasons discussed, we do not believe that the rule will require advisers to incur new or additional costs.

Investment advisers to pooled investment vehicles should not be making untrue statements or omitting material facts or otherwise be engaged in fraud with respect to investors or prospective investors in pooled investment vehicles today, because federal authorities, state authorities, and private litigants often can, and do, seek redress from the adviser for the untrue statements or omissions or other frauds. In most cases, the conduct that the rule prohibits is already prohibited by federal securities statutes,[46] other federal statutes (including federal wire fraud statutes),[47] as well as state law.[48]

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45 CFA Center Letter, supra note 8.

46 See, e.g., section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and section 17(a) of the Securities Act [15 U.S.C. 77q] which would apply when the false statements are made "in connection with the purchase or sale of a security" or involve the "offer or sale" of a security, and section 34(b) of the Investment Company Act which makes it unlawful "to make any untrue statement of a

We recognize that there are costs involved in assuring that communications to investors and prospective investors do not contain untrue or misleading statements and preventing other frauds. Advisers have incurred, and will continue to incur, these costs due to the prohibitions and deterrent effect of the law and rules that apply under these circumstances. While each of the provisions noted above may have different limitation periods, apply in different factual circumstances, or require the government (or a private litigant) to prove different states of mind than the rule, as discussed above we believe that the multiple prohibitions against fraud, and the consequences under both criminal and civil law for fraud, should currently cause an adviser to take the precautions it deems necessary to refrain from such conduct.

Furthermore, prior to Goldstein, advisers operated with the understanding that the Advisers Act prohibited the same conduct that would be prohibited by the rule. Accordingly, we do not believe that advisers to pooled investment vehicles attentive to their traditional compliance responsibilities will need to take steps or alter their business practices in such a way that will require them to incur new or additional costs as a result of the adoption of the rule.

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material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to [the Investment Company Act] . . . . ”

[47] See, e.g., 18 U.S.C. 1341 (Frauds and Swindles) and 18 U.S.C. 1343 (Fraud by wire, radio, or television) which make it a criminal offense to use the mails or to communicate by means of wire, having devised a scheme to defraud or for obtaining money or property by means of false or fraudulent pretenses, and 18 U.S.C. 1957 (Engaging in monetary transactions in property derived from specified unlawful activity) which makes it a criminal racketeering offense to engage or attempt to engage in a transaction in criminally derived property of a value greater than $10,000.

[48] See, e.g., Metro Communications Corp. BVI v. Advanced Mobilecomm Technologies, 854 A.2d 121, 156 (Del. Ch. 2004) (court held that plaintiff-former member of LLC had sufficiently alleged a common law fraud claim based on allegation that a series of reports by LLC’s managers contained misleading statements; court stated that “[i]n the usual fraud case, the speaking party who is subject to an accusation of fraud is on the opposite side of a commercial transaction from the plaintiff, who alleges that but for the material misstatements or omissions of the speaking party he would not have contracted with the speaking party”).

We also recognize that the rule may cause some advisers to pay more attention to the information they present to better guard against making an untrue or misleading statement to an investor or prospective investor and to reevaluate measures that are intended to prevent fraud. As a consequence, some advisers might seek guidance, legal or otherwise, and more closely review the information that they disseminate to investors and prospective investors and the antifraud related policies and procedures they have implemented. While increased concern about making false statements or committing fraud could be attributable to the new rule, advisers should already be incurring these costs to ensure truthfulness and prevent fraud, regardless of the rule, because of the myriad of laws or regulations that may already apply.

The principal benefit of the rule is that it clearly enables the Commission to bring enforcement actions under the Advisers Act, if an adviser to a pooled investment vehicle disseminates false or misleading information to investors or prospective investors or otherwise commits fraud with respect to any investor or prospective investor. As noted above, the existing antifraud provisions may not be available to us in all cases. Through our enforcement actions we are able to protect fund investor assets by stopping ongoing frauds,[49] barring persons that have committed certain specified violations or offenses from being associated with an investment adviser,[50] imposing penalties,[51] seeking court orders to protect fund assets,[52] and to order disgorgement of ill-gotten gains.[53] Moreover, we believe that rule 206(4)-8 will deter advisers to pooled investment vehicles from engaging in fraudulent conduct with respect to investors in

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49 See section 203(k) of the Advisers Act (Commission authority to issue cease and desist orders).

50 See section 203(f) of the Advisers Act (Commission authority to bar a person from being associated with an investment adviser).

51 See section 203(i) of the Advisers Act (Commission authority to impose civil penalties).

52 See section 209(d) of the Advisers Act (Commission authority to seek injunctions and restraining orders in federal court).

53 See section 203(j) of the Advisers Act (Commission authority to order disgorgement).

those pools and will provide investors with greater confidence when investing in pooled investment vehicles.

V. REGULATORY FLEXIBILITY ACT ANALYSIS

The Commission certified, pursuant to section 605(b) of the Regulatory Flexibility Act, that rule 206(4)-8 will not have a significant economic impact on a substantial number of small entities.[54] This certification was included in the Proposing Release.[55] While we encouraged written comment regarding this certification, none of the commenters responded to this request.

VI. STATUTORY AUTHORITY

We are adopting new rule 206(4)-8 pursuant to our authority set forth in sections 206(4) and 211(a) of the Advisers Act (15 U.S.C. 80b-6(4) and 80b-11(a)).

List of Subjects

17 CFR Part 275

Reporting and recordkeeping requirements, Securities.

VII. TEXT OF RULES

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

<u>Authority</u>: 15 U.S.C. 80b-2(a)(11)(F), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

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54 5 U.S.C. 605(b).

55 Section VII.A of the Proposing Release, <u>supra</u> note 2.

2. Section 275.206(4)-8 is added to read as follows:

§206(4)-8 Pooled investment vehicles.

(a) Prohibition. It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b-6(4)) for any investment adviser to a pooled investment vehicle to:

(1) Make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or

(2) Otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

(b) Definition. For purposes of this section "pooled investment vehicle" means any investment company as defined in section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(a)) or any company that would be an investment company under section 3(a) of that Act but for the exclusion provided from that definition by either section 3(c)(1) or section 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(1) or (7)).

By the Commission.

Nancy M. Morris
Secretary

August 3, 2007

EXHIBIT 4

SECOND AMENDED AND RESTATED INVESTMENT ADVISORY AGREEMENT

THIS SECOND AMENDED AND RESTATED INVESTMENT ADVISORY AGREEMENT (this "***Agreement***"), dated to be effective from January 1, 2017 (the "***Effective Date***") is entered into by and between **Charitable DAF Fund, L.P.**, a Cayman Islands exempted limited partnership (the "***Fund***"), **Charitable DAF GP, LLC**, a limited liability company organized under the laws of the State of Delaware (the "***General Partner***"), the general partner of the Fund, and **Highland Capital Management, L.P.**, a limited partnership organized under the laws of the State of Delaware (the "***Investment Advisor***"). Each of the signatories hereto is sometimes referred to herein individually as a "***Party***" and collectively as the "***Parties***."

RECITALS

WHEREAS, the Fund, the General Partner and the Investment Advisor entered into that certain Investment Advisory Agreement dated January 1, 2012 (the "***Original Agreement***");

WHEREAS, the Parties amended and restated the Original Agreement in its entirety on the terms set forth in that certain Amended and Restated Investment Advisory Agreement dated July 1, 2014 (the "***Existing Agreement***");

WHEREAS, the parties desire to amend and restate the Existing Agreement in its entirety with the terms as set forth in this Agreement effective as of the Effective Date;

NOW, THEREFORE, in consideration of the mutual covenants herein contained and for other good and valuable consideration, the receipt of which is hereby acknowledged, the Parties hereby agree, and the Existing Agreement is hereby amended and restated in its entirety, as follows:

1. Investment Advisory Services. Subject to Section 7, the Investment Advisor shall act as investment advisor to the Fund, the General Partner with respect to the Fund and its subsidiaries and shall provide investment advice with respect to the investment and reinvestment of the cash, Financial Instruments and other properties comprising the assets and liabilities of the Fund and its subsidiaries.

2. Custody. The Financial Instruments shall be held in the custody of Jefferies & Company, Inc. or one or more banks selected by the General Partner (each such bank, a "Custodian"). The General Partner will notify the Investment Advisor promptly of the proposed selection of any other Custodians. The Custodian shall at all times be responsible for the physical custody of the Financial Instruments; for the collection of interest, dividends, and other income attributable to the Financial Instruments; and for the exercise of rights and tenders on the Financial Instruments after consultation with and as then directed by the General Partner. At no time shall the Investment Advisor have possession of or maintain custody over any of the Financial Instruments. The Investment Advisor shall not be responsible for any loss incurred by reason of any act or omission of the Custodian.

3. Authority of the Investment Advisor. Subject to Section 7 of this Agreement, the Investment Advisor shall advise the General Partner on behalf of the Fund and/or its subsidiaries with respect to:

(a) investing, directly or indirectly, on margin or otherwise, in all types of securities and other financial instruments of United States and non-U.S. entities, including, without limitation, capital stock; all manner of equity securities (whether registered or unregistered, traded or privately offered, American Depository Receipts, common or preferred); physical commodities; shares of beneficial interest; partnership interests, limited liability company interests and similar financial instruments; secured and unsecured debt (both corporate and sovereign, bank debt, vendor claims and/or other contractual claims); bonds, notes and debentures (whether subordinated, convertible or otherwise); currencies; interest rate, currency, equity and other derivative products, including, without limitation, (i) future contracts (and options thereon) relating to stock indices, currencies, United States Government securities, securities of non-U.S. governments, other financial instruments and all other commodities, (ii) swaps and contracts for difference, options, swaptions, rights, warrants, when-issued securities, caps, collars, floors, forward rate agreements, and repurchase and reverse repurchase agreements and other cash equivalents, (iii) spot and forward currency transactions and (iv) agreements relating to or securing such transactions; leases, including, without limitation, equipment lease certificates; equipment trust certificates; mortgage-backed securities and other similar instruments (including, without limitation, fixed-rate, pass-throughs, adjustable rate mortgages, collateralized mortgage obligations, stripped mortgage-backed securities and REMICs); loans; credit paper; accounts and notes receivable and payable held by trade or other creditors; trade acceptances and claims; contract and other claims; executory contracts; participations; mutual funds, exchange traded funds and similar financial instruments; money market funds and instruments; obligations of the United States, any state thereof, non-U.S. governments and instrumentalities of any of them; commercial paper; certificates of deposit; bankers' acceptances; trust receipts; letters of credit; choses in action; puts; calls; other obligations and instruments or evidences of indebtedness of whatever kind or nature; and real estate and any kind of interests in real estate; in each case, of any person, corporation, government or other entity whatsoever, whether or not publicly traded or readily marketable (each of such items, "***Financial Instruments***"), and the sale of Financial Instruments short and covering such sales.

(b) engaging in such other lawful Financial Instruments transactions;

(c) research and analysis;

(d) purchasing Financial Instruments and holding them for investment;

(e) entering into contracts for or in connection with investments in Financial Instruments;

(f) investing in other pooled investment vehicles, which investments shall be subject in each case to the terms and conditions of the respective governing document for each such vehicle;

(g) possessing, transferring, mortgaging, pledging or otherwise dealing in, and exercising all rights, powers, privileges and other incidents of ownership or possession with respect to Financial Instruments and other property and funds held or owned by the Fund and/or its subsidiaries;

(h) lending, either with or without security, any Financial Instruments, funds or other properties of the Funds, including by entering into reverse repurchase agreements, and, from time to time, undertaking leverage on behalf of the Fund;

(i) opening, maintaining and closing accounts, including margin and custodial accounts, with brokers and dealers, including brokers and dealers located outside the United States;

(j) opening, maintaining and closing accounts, including custodial accounts, with banks, including banks located outside the United States, and drawing checks or other orders for the payment of monies;

(k) combining purchase or sale orders on behalf of the Fund with orders for other accounts to which the Investment Advisor or any of its affiliates provides investment services ("***Other Accounts***") and allocating the Financial Instruments or other assets so purchased or sold, on an average-price basis or in any other manner deemed fair and equitable to the Investment Advisor in its sole discretion, among such accounts;

(l) entering into arrangements with brokers to open "average price" accounts wherein orders placed during a trading day are placed on behalf of the Fund and Other Accounts and are allocated among such accounts using an average price;

(m) organizing one or more corporations and other entities formed to hold record title, as nominee for the Fund and/or its subsidiaries (whether alone or together with the Other Accounts), to Financial Instruments or funds of the Fund and/or its subsidiaries;

(n) causing the Fund and/or its subsidiaries to engage in (i) agency, agency cross, related party principal transactions with affiliates of the Investment Manager and (ii) cross transactions with Other Accounts, in each case, to the extent permitted by applicable laws;

(o) engaging personnel, whether part-time or full-time, and attorneys, independent accountants or such other persons (including, without limitation, finders, consultants and investment bankers); and

(p) voting of Financial Instruments, participation in arrangements with creditors, the institution and settlement or compromise of suits and administrative proceedings and other like or similar matters.

4. <u>Policies of the Fund</u>. The activities engaged in by the Investment Advisor on behalf of the Fund and/or its subsidiaries shall be subject to the policies and control of the General Partner.

The Investment Advisor shall submit such periodic reports to the General Partner regarding the Investment Advisor's activities hereunder as the General Partner may reasonably request and a representative of the Investment Advisor shall be available to meet with the General Partner and/or any other representative of the Fund or its subsidiaries as reasonably requested by the General Partner.

In furtherance of the foregoing, the General Partner hereby appoints the Investment Advisor as the Fund's attorney-in-fact, with full power of authority to act in the Fund's name and on its behalf with respect to the Fund, as follows:

(a) to purchase or otherwise trade in Financial Instruments that have been approved by the General Partner;

(b) to execute and combine purchase or sale orders on behalf of the Fund with orders for Other Accounts and allocate the Financial Instruments or other assets so purchased or sold, on an average-price basis or in any other manner deemed fair and equitable to the Investment Advisor in its sole discretion, among such accounts; *provided, however,* that such purchase or sale orders shall be market rates;

(c) to direct the Custodian to deliver funds or the Financial Instruments, but only in the course of effecting trading and investment transactions for the Fund and subject to such restrictions as may be contained in the custody agreement between the Custodian and the Fund;

(d) to enter into contracts, provide certifications or take any other actions necessary to effect any of the foregoing transactions; and

(e) to select brokers on the basis of best execution and in consideration of relevant factors, including, but not limited to, price quotes; the size of the transaction; the nature of the market for the security; the timing of the transaction; the difficulty of execution; the broker-dealer's expertise in the relevant market or sector; the extent to which the broker-dealer makes market in the security or has an access to such market; the broker-dealer's skill in positioning the relevant market; the broker-dealer's facilities, reliability, promptness and financial stability; the broker-dealer's reputation for diligence and integrity (including in correcting errors); confidentiality considerations; the quality and usefulness of research services and investment ideas presented by the broker-dealer; and other factors deemed appropriate by the Investment Advisor.

5. <u>Valuation of Financial Instruments</u>. Financial Instruments will be valued in accordance with the then current valuation policy of the Investment Advisor, a copy of which will be provided to the General Partner upon request.

6. <u>Status of the Investment Advisor</u>. The Investment Advisor shall, for all purposes, be an independent contractor and not an employee of the General Partner or the Fund or its subsidiaries, nor shall anything herein be construed as making the Fund or its subsidiaries or the General Partner, a partner, member or co-venturer with the Investment Advisor or any of its affiliates or clients. The Investment Advisor shall have no authority to act for, represent, bind or obligate the Fund or its subsidiaries or the General Partner except as specifically provided herein.

7. Investments. ALL ULTIMATE INVESTMENT DECISIONS WITH RESPECT TO THE FUND AND ITS SUBSIDIARIES SHALL AT ALL TIMES REST SOLELY WITH THE GENERAL PARTNER AND/OR THE OFFICERS/DIRECTORS OF THE APPLICABLE SUBSIDIARY, IT BEING EXPRESSLY UNDERSTOOD THAT THE GENERAL PARTNER AND/OR THE OFFICERS/DIRECTORS OF THE APPLICABLE SUBSIDIARY SHALL BE FREE TO ACCEPT AND OR REJECT ANY OF THE ADVICE RENDERED BY THE INVESTMENT MANAGER HEREUNDER FOR ANY REASON OR FOR NO REASON.

8. Reimbursement by the General Partner. The Investment Advisor may retain, in connection with its responsibilities hereunder, the services of others to assist in the investment advice to be given to the General Partner with respect to the Fund and/or its subsidiaries (any such appointee, a "***Sub-Advisor***"), including, but not limited to, any affiliate of the Investment Advisor, but payment for any such services shall be assumed by the Investment Advisor, and, therefore, neither the General Partner nor the Fund or any of its subsidiaries shall have any liability therefor; *provided, however*, that the Investment Advisor, in its sole discretion, may retain the services of independent third party professionals, including, without limitation, attorneys, accountants and consultants, to advise and assist it in connection with the performance of its activities on behalf of the General Partner with respect to the Fund and/or its subsidiaries hereunder, and the Fund shall bear full responsibility therefor and the expense of any fees and disbursements arising therefrom.

9. Expenses.

(a) The Fund shall pay or reimburse the Investment Advisor and its affiliates for all expenses related to the services hereunder, including, but not limited to, investment-related expenses, brokerage commissions and other transaction costs, expenses related to clearing and settlement charges, professional fees relating to legal, auditing or valuation services, any governmental, regulatory, licensing, filing or registration fees incurred in compliance with the rules of any self-regulatory organization or any federal, state or local laws, research-related expenses (including, without limitation, news and quotation equipment and services, investment and trading-related software, including, without limitation, trade order management software (i.e., software used to route trade orders)), accounting (including accounting software), tax preparation expenses, costs and expenses associated with reporting and providing information to the Fund, any taxes imposed upon the Fund (including, but not limited to, collateralized debt obligations managed by the Investment Advisor or its affiliates), fees relating to valuing the Financial Instruments, and extraordinary expenses. In no event shall any of the foregoing costs or expenses include any salaries, occupational expense or general overhead of the Investment Advisor. For the avoidance of doubt, (i) the cost of all third party expenses incurred in connection with this Agreement shall not exceed standard market rates (which may include standard soft dollar arrangements) and (ii) to the extent any of the foregoing expenses were incurred on behalf of, or benefit of a number of Investment Advisor's advised accounts, such expenses shall be allocated pro rata among such accounts.

(b) To the extent that expenses to be borne by the Fund are paid by the Investment Advisor or by any Sub-Advisor, the Fund shall reimburse the Investment Advisor (or Sub-Advisors, as applicable) for such expenses so long as such expenses are at market rates.

10. Fees.

(a) The Fund shall pay the Investment Advisor a quarterly fee (the "***Management Fee***") equal to 2.0% per annum (0.5% per quarter) of the Net Assets (as defined below) of the Fund, payable in advance at and calculated as of the first business day of each calendar quarter. For purposes of calculating the Management Fee, the Net Assets of the Fund will be determined before giving effect to any of the following amounts payable by the Fund generally or in respect of any Investment which are effective as of the date on which such determination is made: (i) any fee payable to the Investment Advisor as of the date on which such determination is made; (ii) any capital withdrawals or distributions payable by the Fund which are effective as of the date on which such determination is made; and (iii) withholding or other taxes, expenses of processing withdrawals and other items payable, any increases or decreases in any reserves, holdback or other amounts specially allocated ending as of the date on which such determination is made. The Management Fee shall be prorated for partial periods and any applicable excess fees should be returned to the Fund by the Investment Advisor. Capital contributions made to the Fund after the commencement of a calendar quarter shall be subject to a prorated Management Fee based on the number of days remaining during such quarter.

(b) Subject to clauses (c) and (d) below, at the end of each Calculation Period (as defined below), an amount equal to 20% of the net capital appreciation of the Fund's Investments (as defined below) after deducting the Management Fee shall be paid to the Investment Advisor (the "***Performance Fee***"); *provided, however*, that the net capital appreciation upon which the calculation of the Performance is based shall be reduced to the extent of any unrecovered balance remaining in the Loss Recovery Account (as defined below) maintained on the books and records of the Fund. The amount of the unrecovered balance remaining in the Loss Recovery Account at the time of calculating the Performance Fee shall be the amount existing immediately prior to its reduction pursuant to the second clause of the second sentence of clause (c) below.

(c) There shall be established on the books of the Fund a memorandum account (the "***Loss Recovery Account***"), the opening balance of which shall be zero. At the end of each Calculation Period, the balance in the Loss Recovery Account shall be adjusted as follows: first, if there has been, in the aggregate, net capital depreciation of the Fund's Investments (as adjusted pursuant to the last sentence of this paragraph) since the end of the immediately preceding Calculation Period (or with respect to the initial Calculation Period, since the Effective Date), an amount equal to such net capital depreciation shall be credited to the Loss Recovery Account, and, second, if there has been, in the aggregate, net capital appreciation of the Fund's investments (as adjusted pursuant to the last sentence of this paragraph) since the end of the immediately preceding Calculation Period, an amount equal to such net capital appreciation, before taking into account any Performance Fee to be paid to the Investment Advisor, shall be debited to and reduce any unrecovered balance in the Loss Recovery Account, but not below zero. Solely for purposes of this paragraph, in determining the Loss Recovery Account, net capital appreciation and net capital depreciation for any applicable Calculation Period shall be calculated by taking into account the amount of the Management Fee paid for such period.

(d) In the event that all or a portion of the Fund's capital is distributed or withdrawn while there exists an unrecovered balance in the Loss Recovery Account, the unrecovered balance in the Loss Recovery Account shall be reduced as of the beginning of the next Calculation Period by an amount equal to the product obtained by multiplying the balance in such Loss Recovery Account by a fraction, the numerator of which is the amount distributed or withdrawn with respect to the immediately preceding distribution or withdrawal date, and the denominator of which is the total fair value of the Fund's Investment immediately prior to such distribution or withdrawal.

(e) For purposes of this Section 10, the net capital appreciation and net capital depreciation of the Fund's Investments for any given period will be calculation in accordance with the then current valuation policy of the Investment Advisor, a copy of which will be provided upon the General Partner's request. As soon as reasonably practicable following the end of a Calculation Period, the Investment Advisor shall deliver, or cause to be delivered, to the General Partner a statement showing the calculation of the Performance Fee, if any, with respect to such Calculation Period. The Performance Fee, if any, shall be payable within three (3) business days of the General Partner's receipt of such statement.

(f) Payments due to the Investment Advisor shall be made by wire transfer to:

Bank Name:	Compass Bank
ABA#:	113010547
FBO:	Highland Capital Management, L.P. (Master Operating Account)
Acct#:	0025876342

(g) For purposes of this Section 10, the following terms have the definitions set forth below:

"***Calculation Period***" means the period commencing on the Effective Date (in the case of the initial Calculation Period) and thereafter each period commencing as of the day following the last day of the preceding Calculation Period, and ending as of the close of business on the first to occur of the following: (i) the last day of a calendar year; (ii) the distribution or withdrawal of capital of the Fund (but only with respect to such distributed or withdrawn amount); (iii) the permitted transfer of all or any portion of a partner's interest in the Fund; and (iv) the final capital distribution of the Fund following its dissolution;

"***Investments***" means all investments, securities, cash, receivables, financial instruments, contracts and other assets, whether tangible or intangible, owned by the Fund;

"***Net Assets***" means, with respect to the Fund as of any date, the excess of the total fair value of all Investments over the total liabilities, debts and obligations of the Fund, in each case, calculated on an accrual basis in accordance with accounting principles generally accepted in the United States and the then current valuation policy of the Service Provider, a copy of which will be provided to the General Partner upon request; and

"***Services Agreement***" means that certain Second Amended and Restated Service Agreement, dated effective as of the Effective Date, by and among the Parties, as amended, restated, modified and supplemented from time to time.

11. Exculpation; Indemnification.

(a) Whether or not herein expressly so provided, every provision of this Agreement relating to the conduct or affecting the liability of or affording protection to the Investment Advisor, its members or any of their respective affiliates and their respective partners, members, officers, directors, employees, shareholders and agents (including parties acting as agents for the execution of transactions) (each, a "***Covered Person***" and collectively, "***Covered Persons***") shall be subject to the provisions of this Section.

(b) To the fullest extent permitted by law, no Covered Person shall be liable to the General Partner or the Fund or any of its subsidiaries or anyone for any reason whatsoever (including but not limited to (i) any act or omission by any Covered Person in connection with the conduct of the business of the General Partner or the Fund, that is determined by such Covered Person in good faith to be in or not opposed to the best interests of the General Partner or the Fund, (ii) any act or omission by any Covered Person based on the suggestions of any professional advisor of the General Partner or the Fund or any of its subsidiaries whom such Covered Person believes is authorized to make such suggestions on behalf of the General Partner or the Fund or any of its subsidiaries, (iii) any act or omission by the General Partner or the Fund or any of its subsidiaries, or (iv) any mistake, negligence, misconduct or bad faith of any broker or other agent of the General Partner or the Fund or any of its subsidiaries selected by Covered Person with reasonable care), unless any act or omission by such Covered Person constitutes willful misconduct or gross negligence by such Covered Person (as determined by a non-appealable judgment of a court of competent jurisdiction).

(c) Covered Persons may consult with legal counsel or accountants selected by such Covered Person and any act or omission by such Covered Person on behalf of the General Partner or the Fund or any of its subsidiaries or in furtherance of the business of the General Partner or the Fund or any of its subsidiaries in good faith in reliance on and in accordance with the advice of such counsel or accountants shall be full justification for the act or omission, and such Covered Person shall be fully protected in so acting or omitting to act if the counsel or accountants were selected with reasonable care.

(d) To the fullest extent permitted by law, the General Partner and the Fund and its subsidiaries shall indemnify and hold harmless Covered Persons (the "***Indemnified***

Party"), from and against any and all claims, liabilities, damages, losses, costs and expenses, including amounts paid in satisfaction of judgments, in compromises and settlements, as fines and penalties and legal or other costs and expenses of investigating or defending against any claim or alleged claim, of any nature whatsoever, known or unknown, liquidated or unliquidated, that are incurred by any Indemnified Party and arise out of or in connection with the business of the General Partner or the Fund or any of its subsidiaries, any investment made under or in connection with this Agreement, or the performance by the Indemnified Party of Covered Person's responsibilities hereunder and against all taxes, charges, duties or levies incurred by such Covered Person or any Indemnified Party in connection with the General Partner or the Fund or any of its subsidiaries, provided that an Indemnified Party shall not be entitled to indemnification hereunder to the extent the Indemnified Party's conduct constitutes willful misconduct or gross negligence (as determined by a non-appealable judgment of a court of competent jurisdiction). The termination of any proceeding by settlement, judgment, order or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the Indemnified Party's conduct constituted willful misconduct or gross negligence.

(e) Expenses incurred by an Indemnified Party in defense or settlement of any claim that shall be subject to a right of indemnification hereunder, shall be advanced by the General Partner prior to the final disposition thereof upon receipt of an undertaking by or on behalf of the Indemnified Party to repay the amount advanced to the extent that it shall be determined ultimately that the Indemnified Party is not entitled to be indemnified hereunder.

(f) The right of any Indemnified Party to the indemnification provided herein shall be cumulative of, and in addition to, any and all rights to which the Indemnified Party may otherwise be entitled by contract or as a matter of law or equity and shall be extended to the Indemnified Party's successors, assigns and legal representatives.

(g) The provisions of this Section are expressly intended to confer benefits upon Covered Persons and such provisions shall remain operative and in full force and effect regardless of the expiration or any termination of this Agreement.

(h) In no event shall any Covered Person be liable for special, exemplary, punitive, indirect, or consequential loss, or damage of any kind whatsoever, including without limitation lost profits.

(i) No Covered Person shall be liable hereunder for any settlement of any action or claim effected without its written consent thereto.

(j) Pursuant to the exculpation and indemnification provisions described above, the Investment Advisor and each Indemnified Party will generally not be liable to the General Partner or the Fund for any act or omission (or alleged act or omission), absent bad faith, willful misconduct, fraud or gross negligence, and the General Partner and the Fund will generally be required to indemnify such persons against any Losses they may incur by reason of any act or omission (or alleged act or omission) related to the General Partner, the Fund or its subsidiaries, absent bad faith, willful misconduct, fraud or gross negligence. As a result of these provisions, the General Partner, the Fund and its subsidiaries, as applicable (not the Investment

Advisor or any other Indemnified Party) will be responsible for any Losses resulting from trading errors and similar human errors, absent bad faith, willful misconduct, fraud or gross negligence or the ability to waive or limit such Losses under applicable law. Trading errors might include, for example, keystroke errors that occur when entering trades into an electronic trading system or typographical or drafting errors related to derivatives contracts or similar agreements. Given the volume of transactions executed by the Investment Advisor and its affiliates on behalf of the Fund and/or its subsidiaries, the General Partner acknowledges that trading errors (and similar errors) will occur and that the General Partner will be responsible for any resulting Losses, even if such Losses result from the negligence (but not gross negligence) of the Investment Advisor or its affiliates.

12. Activities of the Investment Advisor and Others. The Investment Advisor, and its affiliates may engage, simultaneously with their investment management activities on behalf of the Fund, in other businesses, and may render services similar to those described in this Agreement to other individuals, companies, trusts or persons, and shall not by reason of such engaging in other businesses or rendering of services for others be deemed to be acting in conflict with the interests of the Fund. Notwithstanding the foregoing, the Investment Advisor and its affiliates shall devote as much time to provide advisory service to the General Partner with respect to the management of the Fund's assets as the Investment Advisor deems necessary and appropriate. In addition, the Investment Advisor or any of its affiliates, in their individual capacities, may engage in securities transactions which may be different than, and contrary to, the investment advice provided by the Investment Advisor to the General Partner with respect to the Fund. The Investment Advisor may give advice and recommend securities to, or buy securities for, accounts and other clients, which advice or securities may differ from advice given to, or securities recommended or bought for, the Fund, even though their investment objectives may be the same or similar. The Investment Advisor may recommend transactions in securities and other assets in which the Investment Advisor has an interest, including securities or other assets issued by affiliates of the Investment Manager. Each of the General Partner and the Fund acknowledges that it has received, reviewed and had an opportunity with respect to (a) a copy of Part 2 of the Investment Advisor's Form ADV, and (b) the supplemental disclosures attached hereto as Exhibit A, each of which further describes conflicts of interest relating to the Investment Advisor, its affiliates and their respective advised accounts.

13. Term. This Agreement shall remain in effect through an initial term concluding December 31, 2017 and shall be automatically extended for additional one-year terms thereafter, except that it may be terminated by the Investment Advisor, on the one hand, or by the General Partner and the Fund, on the other hand, upon at least 90 days' prior written notice to the General Partner or the Investment Advisor, as the case may be, prior to General Partner's fiscal year-end.

14. Miscellaneous.

(a) Notices. Any notice, consent or other communication made or given in connection with this Agreement shall be in writing and shall be deemed to have been duly given when delivered by hand or facsimile or five days after mailed by certified mail, return receipt requested, as follows:

If to the Investment Advisor, to:

Highland Capital Management, L.P.
300 Crescent Court, Suite 700
Dallas, Texas 75201
Telephone Number: (972) 628-4100
Facsimile Number: (972) 628-4147

If to the General Partner or the Fund, to:

Charitable DAF GP, LLC
4140 Park Lake Avenue, Suite 600
Raleigh, North Carolina 27612
Attention: Grant Scott
Telephone Number: (919) 854-1407
Facsimile Number: (919) 854-1401

(b) Entire Agreement. This Agreement contains all of the terms agreed upon or made by the parties relating to the subject matter of this Agreement, and supersedes all prior and contemporaneous agreements, negotiations, correspondence, undertakings and communications of the parties, oral or written, respecting such subject matter.

(c) Amendments and Waivers. No provision of this Agreement may be amended, modified, waived or discharged except as agreed to in writing by the parties. No amendment to this Agreement may be made without first obtaining the required approval from the Fund. The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion shall not be considered a waiver thereof or deprive that party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement.

(d) Binding Effect; Assignment. This Agreement shall be binding upon and inure to the benefit of the General Partner, the Fund, the Investment Advisor, each Indemnified Party and their respective successors and permitted assigns. Any person that is not a signatory to this Agreement but is nevertheless conferred any rights or benefits hereunder (*e.g.*, officers, partners and personnel of the Investment Advisor and others who are entitled to indemnification hereunder) shall be entitled to such rights and benefits as if such person were a signatory hereto, and the rights and benefits of such person hereunder may not be impaired without such person's express written consent. No party to this Agreement may assign (as such term is defined under the U.S. Investment Advisers Act of 1940, as amended) all or any portion of its rights, obligations or liabilities under this Agreement without the prior written consent of the other parties to this Agreement; provided; however, that the Investment Advisor may assign all or any portion of its rights, obligations and liabilities hereunder to any of its affiliates at its discretion.

(e) Governing Law. Notwithstanding the place where this Agreement may be executed by any of the parties thereto, the parties expressly agree that all terms and provisions hereof shall be governed by and construed in accordance with the laws of the State of Texas applicable to agreements made and to be performed in that State.

(f) Jurisdiction; Venue; Waiver of Jury Trial. The Parties hereby agree that any action, claim, litigation, or proceeding of any kind whatsoever against any other Party in any way arising from or relating to this Agreement and all contemplated transactions, including claims sounding in contract, equity, tort, fraud and statute ("***Dispute***") shall be submitted exclusively to the U.S. District Court for the Northern District of Texas or, if such court does not have subject matter jurisdiction, the courts of the State of Texas sitting in Dallas County, and any appellate court thereof ("***Enforcement Court***"). Each Party irrevocably and unconditionally submits to the exclusive personal and subject matter jurisdiction of the Enforcement Court for any Dispute and agrees to bring any Dispute only in the Enforcement Court. Each Party further agrees it shall not commence any Dispute in any forum, including administrative, arbitration, or litigation, other than the Enforcement Court. Each Party agrees that a final judgment in any such action, litigation, or proceeding is conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

EACH PARTY IRREVOCABLY AND UNCONDITIONALLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN ANY LEGAL ACTION, PROCEEDING, CAUSE OF ACTION OR COUNTERCLAIM ARISING OUT OF OR RELATING TO THIS AGREEMENT, INCLUDING ANY EXHIBITS, SCHEDULES, AND APPENDICES ATTACHED TO THIS AGREEMENT, OR THE TRANSACTIONS CONTEMPLATED HEREBY. EACH PARTY CERTIFIES AND ACKNOWLEDGES THAT (A) NO REPRESENTATIVE OF THE OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT THE OTHER PARTY WOULD NOT SEEK TO ENFORCE THE FOREGOING WAIVER IN THE EVENT OF A LEGAL ACTION, (B) IT HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (C) IT MAKES THIS WAIVER KNOWINGLY AND VOLUNTARILY, AND (D) IT HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION.

Nothing in this Section 14(f) shall be construed to limit either party's right to obtain equitable or injunctive relief in a court of competent jurisdiction in appropriate circumstances.

(g) Headings. The headings contained in this Agreement are intended solely for convenience and shall not affect the rights of the parties to this Agreement.

(h) Counterparts. This Agreement may be signed in any number of counterparts with the same effect as if the signatures to each counterpart were upon a single instrument, and all such counterparts together shall be deemed an original of this Agreement.

(i) Survival. The provisions of Sections 8, 9, 10, 11 and 14 hereof shall survive the termination of this Agreement.

(j) Pronouns. All pronouns shall be deemed to refer to the masculine, feminine, neuter, singular or plural as the identity of the person or persons' firm or company may require in the context thereof.

(k) Arm's-Length Agreement. The General Partner and the Fund have approved this Agreement and reviewed the activities described in Section 12 and in the Investment Advisor's Form ADV and the risks related thereto.

[Signature Page to Follow]

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be executed to be effective from the date first written above.

HIGHLAND CAPITAL MANAGEMENT, L.P.

By: Strand Advisors, Inc., its general partner

By:______________________________

Name: James Dondero
Title: President
Date: 6/21/17

CHARITABLE DAF GP, LLC

By:______________________________

Name: Grant J. Scott
Title: Managing Member
Date:

CHARITABLE DAF FUND, L.P.

By: Charitable DAF GP, LLC, its general partner

By:______________________________

Name: Grant J. Scott
Title: Managing Member
Date:

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be executed to be effective from the date first written above.

HIGHLAND CAPITAL MANAGEMENT, L.P.

By: Strand Advisors, Inc., its general partner

By:______________________________

Name: James Dondero
Title: President
Date:

CHARITABLE DAF GP, LLC

By:______________________________

Name: Grant J. Scott
Title: Managing Member
Date: 6/21/2017

CHARITABLE DAF FUND, L.P.

By: Charitable DAF GP, LLC, its general partner

By:______________________________

Name: Grant J. Scott
Title: Managing Member
Date: 6/21/2017

EXHIBIT A

Supplemental Disclosures

Potential Conflicts of Interest

The scope of the activities of Highland Capital Management, L.P. (the "***Investment Adviser***"), its affiliates, and the funds and clients managed or advised by the Investment Adviser or any of its affiliates may give rise to conflicts of interest or other restrictions and/or limitations imposed on Charitable DAF Fund, L.P. and its subsidiaries (collectively, the "***Fund***") in the future that cannot be foreseen or mitigated at this time. The following briefly summarizes some of these conflicts, but is not intended to be an exhaustive list of all such conflicts. Additional conflicts are described in the Investment Adviser's Form ADV. You are urged to review the Investment Adviser's Form ADV in its entirety prior to investing in the Fund.[1]

Highland Group & Highland Accounts. None of the Investment Adviser, its affiliates and their respective officers, directors, shareholders, members, partners, personnel and employees (collectively, the "***Highland Group***") is precluded from engaging in or owning an interest in other business ventures or investment activities of any kind, whether or not such ventures are competitive with the Fund. The Investment Adviser is permitted to manage other client accounts, and does manage other client accounts, some of which may have objectives similar or identical to those of the Fund, including other collective investment vehicles that may be managed by the Highland Group and in which the Investment Adviser or any of its affiliates may have an equity interest.

The Fund will be subject to a number of actual and potential conflicts of interest involving the Highland Group including, among other things, the fact that: (i) the Highland Group conducts substantial investment activities for accounts, funds, collateralized debt obligations and collateralized loan obligations that invest in leveraged loans (collectively, "***CDOs***") and other vehicles managed by members of the Highland Group (collectively, "***Highland Accounts***") in which the Fund has no interest; (ii) the Highland Group advises Highland Accounts, which utilize the same, similar or different methodologies as the Fund and may have financial incentives (including, without limitation, as it relates to the composition of investors in such funds and accounts or to the Highland Group's compensation arrangements) to favor certain Highland Accounts over the Fund; (iii) the Highland Group may use the strategy described herein in certain Highland Accounts; (iv) the Investment Adviser may give advice and recommend securities to, or buy or sell securities for, the Fund, which advice or securities may differ from advice given to, or securities recommended or bought or sold for, Highland Accounts; (v) the Investment Adviser has the discretion, to the extent permitted under applicable law, to use its affiliates as service providers to the Fund and its portfolio investments; (vi) certain investors affiliated with the Highland Group may choose to personally invest only in certain funds advised by the Highland Group and the amounts invested by them in such funds is expected to vary significantly; (vii) the Highland Group and Highland Accounts may actively engage in transactions in the same securities sought by the

[1] The Investment Adviser's latest Form ADV filed and Part 2 Brochures can be accessed here: https://adviserinfo.sec.gov/IAPD/IAPDFirmSummary.aspx?ORG_PK=110126

Fund and, therefore, may compete with the Fund for investment opportunities or may hold positions opposite to positions maintained by the Fund; (viii) the Fund may invest in CDOs and Highland Accounts managed by members of the Highland Group; and (ix) the Investment Adviser will devote to the Fund only as much time as the Investment Adviser deems necessary and appropriate to manage the Fund's business.

The Investment Adviser undertakes to resolve conflicts in a fair and equitable basis, which in some instances may mean a resolution that would not maximize the benefit to the Fund's investors.

Allocation of Trading Opportunities. It is the policy of the Investment Adviser to allocate investment opportunities fairly and equitably over time. This means that such opportunities will be allocated among those accounts for which participation in the respective opportunity is considered appropriate, taking into account, among other considerations: (i) fiduciary duties owed to the accounts; (ii) the primary mandate of the accounts; (iii) the capital available to the accounts; (iv) any restrictions on the accounts and the investment opportunity; (v) the sourcing of the investment, size of the investment and amount of follow-on available related to the investment; (vi) whether the risk-return profile of the proposed investment is consistent with the account's objectives and program, whether such objectives are considered in light of the specific investment under consideration or in the context of the portfolio's overall holdings; (vii) the potential for the proposed investment to create an imbalance in the account's portfolio (taking into account expected inflows and outflows of capital); (viii) liquidity requirements of the account; (ix) potentially adverse tax consequences; (x) regulatory and other restrictions that would or could limit an account's ability to participate in a proposed investment; and (xi) the need to re-size risk in the account's portfolio.

The Investment Adviser has the authority to allocate trades to multiple Highland Accounts on an average price basis or on another basis it deems fair and equitable. Similarly, if an order for any accounts cannot be fully allocated under prevailing market conditions, the Investment Adviser may allocate the trades among different accounts on a basis it considers fair and equitable over time. One or more of the foregoing considerations may (and are often expected to) result in allocations among the Fund and one or more Highland Accounts on other than a *pari passu* basis. The Investment Adviser will allocate investment opportunities across its accounts for which the opportunities are appropriate, consistent with (i) its internal conflict of interest and allocation policies and (ii) the requirements of the U.S. Investment Advisers Act of 1940, as amended. The Investment Adviser will seek to allocate investment opportunities among such entities in a manner that is fair and equitable over time and consistent with its allocation policy. However, there is no assurance that such investment opportunities will be allocated to the Fund fairly or equitably in the short-term or over time and there can be no assurance that the Fund will be able to participate in all investment opportunities that are suitable for it.

The Investment Adviser and/or its affiliates may open "average price" accounts with brokers. In an "average price" account, purchase and sale orders placed during a trading day for the Fund, the Highland Accounts or affiliates of the Investment Adviser are combined, and securities bought and sold pursuant to such orders are allocated among such accounts on an average price basis.

Highland Group Trading. As part of their regular business, the members of the Highland Group hold, purchase, sell, trade or take other related actions both for their respective accounts and for the accounts of their respective clients, on a principal or agency basis, with respect to loans, securities and other investments and financial instruments of all types. The members of the Highland Group also provide investment advisory services, among other services, and engage in private equity, real estate and capital markets oriented investment activities. The members of the Highland Group will not be restricted in their performance of any such services or in the types of debt or equity investments which they may make. The members of the Highland Group may have economic interests in or other relationships with obligors or issuers in whose obligations or securities or credit exposures the Fund may invest. In particular, such persons may make and/or hold an investment in an obligor's or issuer's securities that may be *pari passu*, senior or junior in ranking to an investment in such obligor's or issuer's securities made and/or held by the Fund or in which partners, security holders, members, officers, directors, agents, personnel or employees of such persons serve on boards of directors or otherwise have ongoing relationships. Each of such ownership and other relationships may result in securities laws restrictions on transactions in such securities by the Fund and otherwise create conflicts of interest for the Fund. In such instances, the members of the Highland Group may in their discretion make investment recommendations and decisions that may be the same as or different from those made with respect to the Fund's investments. In connection with any such activities described above, the members of the Highland Group may hold, purchase, sell, trade or take other related actions in securities or investments of a type that may be suitable to investments for the Fund. The members of the Highland Group will not be required to offer such securities or investments to the Fund or provide notice of such activities to the Fund. In addition, in managing the Fund's portfolio, the Investment Adviser may take into account its relationship or the relationships of its affiliates with obligors and their respective affiliates, which may create conflicts of interest. Furthermore, in connection with actions taken in the ordinary course of business of the Investment Adviser in accordance with its fiduciary duties to its other clients, the Investment Adviser may take, or be required to take, actions which adversely affect the interests of the Fund.

The Highland Group has invested and may continue to invest in investments that would also be appropriate for the Fund. Such investments may be different from those made by the Fund. The Highland Group does not have any duty, in making or maintaining such investments, to act in a way that is favorable to the Fund or to offer any such opportunity to the Fund, subject to the Investment Adviser's internal allocation policy. The investment policies, fee arrangements and other circumstances applicable to such other accounts and investments may vary from those applicable to the Fund and its investments. The Highland Group may also provide advisory or other services for a customary fee with respect to investments made or held by the Fund, and neither the Fund nor its investors shall have any right to such fees. The Highland Group may also have ongoing relationships with, render services to or engage in transactions with other clients who make investments of a similar nature to those of the Fund, and with companies whose securities or properties are acquired by the Fund.

As further described below, in connection with the foregoing activities the Highland Group may from time to time come into possession of material nonpublic information that limits the ability of the Investment Adviser to effect a transaction for the Fund, and the Fund's investments may be constrained as a consequence of the Investment Adviser's inability to use such information for advisory purposes or otherwise to effect transactions that otherwise may have been initiated on behalf of its clients, including the Fund.

Although the professional staff of the Investment Adviser will devote as much time to the Fund as the Investment Adviser deems appropriate to perform its duties in accordance with the Fund's advisory agreement and in accordance with reasonable commercial standards, the staff may have conflicts in allocating its time and services among the Fund and the Investment Adviser's other accounts.

Various Activities of the Investment Adviser and its Affiliates. The directors, officers, personnel, employees and agents of the Investment Adviser and its affiliates may, subject to applicable law, serve as directors (whether supervisory or managing), officers, personnel, employees, partners, agents, nominees or signatories or provide banking, agency, insurance and/or other services, and receive arm's length fees in connection with such services, for the Fund or its investments or other entities that operate in the same or a related line of business as the, for other clients managed by the Investment Adviser or its affiliates, or for any obligor or issuer in respect of the CDOs, and the Fund shall have no right to any such fees. In serving in these multiple capacities, they may have obligations to such other clients or investors in those entities, the fulfillment of which may not be in the best interests of the Fund. The Fund may compete with other Highland Accounts for capital and investment opportunities.

There is no limitation or restriction on the Investment Adviser or any of its affiliates with regard to acting as investment adviser or collateral manager (or in a similar role) to other parties or persons. This and other future activities of the Investment Adviser and/or its affiliates may give rise to additional conflicts of interest. Such conflicts may relate to obligations that the Investment Adviser's investment committee, the Investment Adviser or its affiliates have to other clients.

The Investment Adviser and its affiliates may participate in creditors or other committees with respect to the bankruptcy, restructuring or workout of an investment of the Fund or another account. In such circumstances, the Investment Adviser or its affiliates may take positions on behalf of themselves or another account that are adverse to the interests of the Fund.

The Investment Adviser and/or its affiliates may act as an underwriter, arranger or placement agent, or otherwise participate in the origination, structuring, negotiation, syndication or offering of CDOs, Highland Accounts and other investments purchased by the Fund. Such transactions shall be subject to fees that are intended to be no greater than arm's-length fees, and the Fund shall have no right to any such fees. There is no expectation for preferential access to transactions involving CDOs and Highland Accounts that are underwritten, originated, arranged or placed by the Investment Adviser and/or its affiliates and the Fund shall not have any right to any such fees.

Investments in Highland Accounts Managed by the Investment Manager or its Affiliates. The Fund may invest a significant portion of its capital in Highland Accounts. The Investment Adviser or its affiliates will receive senior and subordinated management fees and, in some cases, a performance-based allocation or fee with respect to its role as general partner and/or manager of the Highland Accounts. If the Fund invests in Highland Accounts in secondary transactions, the Fund will indirectly pay the fees (senior and subordinated) of such Highland Accounts and any carried interest. If the Fund provides all of the equity for a Highland Account, there may be no third party with whom the amount of such fees, expenses and carried interest can be negotiated on an arm's-length basis. The Investment Adviser or its affiliates will have conflicting division of loyalties and responsibilities regarding the Fund and a Highland Account, and certain other conflicts of interest would be inherent in the situation. There can be no assurance that the interests of the Fund would not be subordinated to those of a Highland Account or to other interests of the Investment Adviser.

Multiple Levels of Fees. The Investment Adviser and the Highland Accounts are expected to impose management fees, other administrative fees, carried interest and other performance allocations on realized and unrealized appreciation in the value of the assets managed and other income. This may result in greater expense than if investors in the Fund were able to invest directly in the Highland Accounts or their respective underlying investments. Investors in the Fund should take into account that the return on their investment will be reduced to the extent of both levels of fees. The general partner or manager of a Highland Account may receive the economic benefit of certain fees from its portfolio companies for services and in connection with unconsummated transactions (*e.g.*, break-up, placement, monitoring, directors', organizational and set-up fees and financial advisory fees).

Cross Transactions and Principal Transactions. The Investment Adviser may effect client cross-transactions where the Investment Adviser causes a transaction to be effected between the Fund and another client advised by it or any of its affiliates. The Investment Adviser may engage in a client cross-transaction involving the Fund any time that the Investment Adviser believes such transaction to be fair to the Fund and such other client.

The Investment Adviser may effect principal transactions where the Fund acquires securities from or sells securities to the Investment Adviser and/or its affiliates, in each case in accordance with applicable law, which will include the Investment Adviser obtaining independent consent on behalf of the Fund prior to engaging in any such principal transaction between the Fund and the Investment Adviser or its affiliates.

The Investment Adviser may advise the Fund to acquire or dispose of securities in cross trades between the Fund and other clients of the Investment Adviser or its affiliates in accordance with applicable legal and regulatory requirements. In addition, the Fund may invest in securities of obligors or issuers in which the Investment Adviser and/or its affiliates have a debt, equity or participation interest, and the holding and sale of such investments by the Fund may enhance the profitability of the Investment Adviser's own investments in such companies. Moreover, the Fund may invest in assets originated by the Investment Adviser or its affiliates. In each such case, the Investment Adviser and such affiliates may have a potentially conflicting division of loyalties and responsibilities regarding the Fund and the other parties to such trade. Under certain circumstances, the Investment Adviser and its affiliates may determine that it is appropriate to avoid such conflicts by selling a security at a fair value that has been calculated pursuant to the Investment Adviser's valuation procedures to another client managed or advised by the Investment Adviser or such affiliates. In addition, the Investment Adviser may enter into agency cross-transactions where it or any of its affiliates acts as broker for the Fund and for the other party to the transaction, to the extent permitted under applicable law. The Investment Adviser may obtain independent consent in writing on behalf of the Fund, which consent may be provided by the managing member of the General Partner or any other independent party on behalf of the Fund, if any such transaction requires the consent of the Fund under Section 206(3) of the U.S. Investment Advisers Act of 1940, as amended.

Material Non-Public Information. There are generally no ethical screens or information barriers among the Investment Adviser and certain of its affiliates of the type that many firms implement to separate persons who make investment decisions from others who might possess material, non-public information that could influence such decisions. If the Investment Adviser, any of its personnel or its affiliates were to receive material non-public information about a particular obligor or issuer, or have an interest in causing the Fund to acquire a particular security, the Investment Adviser may be prevented from advising the Fund to purchase or sell such asset due to internal restrictions imposed on the Investment Adviser. Notwithstanding the maintenance of certain internal controls relating to the management of material nonpublic information, it is possible that such controls could fail and result in the Investment Adviser, or one of its investment professionals, buying or selling an asset while, at least constructively, in possession of material non-public information. Inadvertent trading on material nonpublic information could have adverse effects on the Investment Adviser's reputation, result in the imposition of regulatory or financial sanctions, and as a consequence, negatively impact the Investment Adviser's ability to perform its portfolio management services to the Fund. In addition, while the Investment Adviser and certain of its affiliates currently operate without information barriers on an integrated basis, such entities could be required by certain regulations, or decide that it is advisable, to establish information barriers. In such event, the Investment Adviser's ability to operate as an integrated platform could also be impaired, which would limit the Investment Adviser's access to personnel of its affiliates and potentially impair its ability to manage the Fund's investments.

Conflicts Relating to Equity and Debt Ownership by the Fund and Affiliates. In certain circumstances, the Fund and other client accounts may invest in securities or other instruments of the same issuer (or affiliated group of issuers) having a different seniority in the issuer's capital structure. If the issuer becomes insolvent, restructures or suffers financial distress, there may be a conflict between the interests in the Fund and those other accounts insofar as the issuer may be unable (or in the case of a restructuring prior to bankruptcy may be expected to be unable) to satisfy the claims of all classes of its creditors and security holders and the Fund and such other accounts may have competing claims for the remaining assets of such issuers. Under these circumstances it may not be feasible for the Investment Adviser to reconcile the conflicting interests in the Fund and such other accounts in a way that protects the Fund's interests. Additionally, the Investment Adviser or its nominees may in the future hold board or creditors' committee memberships which may require them to vote or take other actions in such capacities that might be conflicting with respect to certain funds managed by the Investment Adviser in that such votes or actions may favor the interests of one account over another account. Furthermore, the Investment Adviser's fiduciary responsibilities in these capacities might conflict with the best interests of the investors.

Other Fees. The Investment Adviser and its affiliates are permitted to receive consulting fees, investment banking fees, advisory fees, breakup fees, director's fees, closing fees, transaction fees and similar fees in connection with actual or contemplated investments. Such fees will not reduce or offset the Management Fee. Conflicts of interest may also arise due to the allocation of such fees to or among co-investors.

Soft Dollars. The Investment Adviser's authority to use "soft dollar" credits generated by the Fund's securities transactions to pay for expenses that might otherwise have been borne by the Investment Adviser may give the Investment Adviser an incentive to select brokers or dealers for transactions, or to negotiate commission rates or other execution terms, in a manner that takes into account the soft dollar benefits received by the Investment Adviser rather than giving exclusive consideration to the interests of the Fund.

EXHIBIT 5

EXECUTION VERSION

Between

CLO HOLDCO, LTD.

And

HARBOURVEST DOVER STREET IX INVESTMENT L.P.

And

HARBOURVEST 2017 GLOBAL AIF L.P.

And

HARBOURVEST 2017 GLOBAL FUND L.P.

And

HV INTERNATIONAL VIII SECONDARY L.P.

And

HARBOURVEST SKEW BASE AIF L.P.

And

HIGHLAND CAPITAL MANAGEMENT, L.P.

And

LEE BLACKWELL PARKER, III

And

QUEST IRA, INC., FBO LEE B. PARKER III, ACCT. # 3058311

And

QUEST IRA, INC., FBO HUNTER COVITZ, ACCT. # 1469811

And

QUEST IRA, INC., FBO JON POGLITSCH, ACCT. # 1470612

And

QUEST IRA, INC., FBO NEIL DESAI, ACCT. # 3059211

And

HIGHLAND CLO FUNDING, LTD.

And

HIGHLAND HCF ADVISOR, LTD.

MEMBERS AGREEMENT RELATING TO THE COMPANY

TABLE OF CONTENTS

THIS AGREEMENT is made the 15th day of November 2017

BETWEEN

(1) CLO HOLDCO, LTD. whose registered office address is at Intertrust Corporate Services (Cayman) Limited, 190 Elgin Avenue, George Town, Grand Cayman KY1-9005, Cayman Islands;

(2) HARBOURVEST DOVER IX INVESTMENT L.P. of c/o HarbourVest Partners, LLC, One Financial Center, 44th Floor, Boston, MA 02111, USA

(3) HARBOURVEST 2017 GLOBAL AIF L.P. of c/o HarbourVest Partners, LLC, One Financial Center, 44th Floor, Boston, MA 02111, USA

(4) HARBOURVEST 2017 GLOBAL FUND L.P. of c/o HarbourVest Partners, LLC, One Financial Center, 44th Floor, Boston, MA 02111, USA

(5) HV INTERNATIONAL VIII SECONDARY L.P. of c/o HarbourVest Partners, LLC, One Financial Center, 44th Floor, Boston, MA 02111, USA

(6) HARBOURVEST SKEW BASE AIF L.P. of c/o HarbourVest Partners, LLC, One Financial Center, 44th Floor, Boston, MA 02111, USA

(7) HIGHLAND CAPITAL MANAGEMENT, L.P. of 300 Crescent Court, Suite 700, Dallas, Texas 75201, USA

(8) LEE BLACKWELL PARKER, III of 300 Crescent Court, Suite 700, Dallas, Texas 75201, USA

(9) QUEST IRA, INC., FBO LEE B. PARKER III, ACCT. # 3058311 of 17171 Park Row #100, Houston, Texas 77084, USA

(10) QUEST IRA, INC., FBO HUNTER COVITZ, ACCT. # 1469811 of 17171 Park Row #100, Houston, Texas 77084, USA

(11) QUEST IRA, INC., FBO JON POGLITSCH, ACCT. # 1470612 of 17171 Park Row #100, Houston, Texas 77084, USA

(12) QUEST IRA, INC., FBO NEIL DESAI, ACCT. # 3059211 of 17171 Park Row #100, Houston, Texas 77084, USA

(together the "**Members**") and

(13) HIGHLAND CLO FUNDING, LTD., with registration number 60120 whose registered office is at First Floor, Dorey Court, Admiral Park, St Peter Port, Guernsey GY1 6HJ, Channel Islands (the "**Company**") and

(14) HIGHLAND HCF ADVISOR, LTD., whose registered address is at Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands (the "**Portfolio Manager**").

WHEREAS:

(A) The Company is a limited company incorporated under the laws of the Island of Guernsey on 30 March 2015.

(B) The Company has been established to provide its investors with exposure to CLO Notes on both a direct basis and indirect basis and senior secured loans on an indirect basis, through the use of the investments described in its investment policy as set forth in the Offering Memorandum dated 15 November 2017, the (the "**Offering Memorandum**"), subject to the restrictions set forth therein.

(C) The Members are the owners of the entire issued capital of the Company.

(D) The Parties are entering into this Agreement to regulate the relationship between them and the operation and management of the Company.

OPERATIVE PROVISIONS

1. INTERPRETATION

In this Agreement, including the Schedule:

1.1 the following words and expressions shall have the following meanings, unless they are inconsistent with the context:

"Adherence Agreement" means the agreement under which a person agrees to be bound by the terms of this Agreement in the form substantially similar as set out in the Schedule;

"Advisers Act" shall mean the U.S. Investment Advisers Act of 1940, as amended from time to time, and the rules and regulations of the U.S. Securities and Exchange Commission promulgated thereunder;

"Affiliate" means, with respect to a person, (i) any other person who, directly or indirectly, is in control of, or controlled by, or is under common control with, such person or (ii) any other person who is a director, officer or employee (a) of such person, (b) of any subsidiary or parent company of such person or (c) of any person described in clause (i) above. For the purposes of this definition, control of a person shall mean the power, direct or indirect, (i) to vote more than 50% of the securities having ordinary voting power for the election of directors of such persons or (ii) to direct or cause the direction of the management and policies of such person whether by contract or otherwise. For purposes of this definition, the management of an account by one person for the benefit of any other person shall not constitute "control" of such other person and no entity shall be deemed an "Affiliate" of the Company solely because the administrator or its Affiliates serve as administrator or share trustee for such entity;

"Agreement" means this agreement together with the Schedule;

"Articles" means the articles of incorporation of the Company as amended from time to time;

"Business" means the business of the Company as described in Recital (B);

"Business Day" means a day (other than a Saturday or Sunday) on which banks are open for ordinary banking business in Guernsey;

"Directors" means the directors of the Company from time to time;

"CLO Holdco" means CLO Holdco, Ltd. (or any permitted successor to the business of CLO Holdco, Ltd. or interest in the Company);

"Code" shall mean the U.S. Internal Revenue Code of 1986, as amended from time to time.

"Directors" means the directors of the Company from time to time;

"Dover IX" means HarbourVest Dover Street IX Investment L.P. (or any permitted successor to the business of HarbourVest Dover Street IX Investment L.P. or any interest in the Company);

"DOL" shall mean the U.S. Department of Labor, or any governmental agency that succeeds to the powers and functions thereof.

"DOL Regulations" shall mean the regulations of the DOL included within 29 C.F.R. section 2510.3-101.

"Dover IX" shall mean HarbourVest Dover Street IX Investment L.P. (or any permitted successor to the business of HarbourVest Dover Street IX Investment L.P. or interest in the Company);

"ERISA" shall mean the U.S. Employee Retirement Income Security Act of 1974, as amended from time to time;

"ERISA Member" shall mean a Member that (a) is a "benefit plan investor" (as such term is defined in the DOL Regulations as modified by section 3(42) of ERISA) subject to the fiduciary responsibility provisions of part 4 of title I of ERISA or is a "plan" (as such term is defined in section 4975(e) of the Code) subject to section 4975 of the Code or (b) is designated as an ERISA Member by the General Partner in writing on or before the date at which such ERISA Member is admitted to the Company;

"HarbourVest Entities" means: Dover IX; HarbourVest 2017 Global AIF L.P.; HarbourVest 2017 Global Fund L.P.; HV International VIII Secondary L.P.; and HarbourVest Skew Base AIF L.P. (or any of their respective permitted successors to their businesses or interests in the Company);

"Highland Principals" means: Highland Capital Management, L.P.; Lee Blackwell Parker, III, Quest IRA, Inc., fbo Lee B. Parker III Acct. # 3058311; Quest IRA, Inc., fbo Hunter Covitz Acct. # 1469811; Quest IRA, Inc., fbo Jon Poglitsch Acct. # 1470612; Quest IRA, Inc., fbo Neil Desai Acct. # 3059211 (or any of their respective permitted successors to their businesses or interests in the Company);

"Law" means the Companies (Guernsey) Law, 2008, as amended;

"Member" means a person whose name is from time to time entered in the register of members of the Company as the holder of shares in the Company;

"Parties" means the parties to this Agreement and any other person who agrees to be bound by the terms of this Agreement under an Adherence Agreement;

"Shares" means ordinary shares in the Company;

"Subsidiary" shall have the meaning ascribed to it in the Law;

"Subscription and Transfer Agreement" means the Subscription and Transfer Agreement, dated as of 15 November 2017, entered into by and among CLO HoldCo, Ltd. and each of the Members and acknowledged and agreed by the Company and the Portfolio Manager.

Any capitalized terms used herein without definition have the meanings specified in the Offering Memorandum.

1.2 any reference to the Parties being obliged to procure shall so far as they are able includes, without limitation, procuring by the exercise of votes which they directly or indirectly control at meetings of the Directors or general meetings of the Company;

1.3 any reference to a person includes, where appropriate, that person's heirs, personal representatives and successors;

1.4 any reference to a person includes any individual, body corporate, corporation, firm, unincorporated association, organisation, trust or partnership;

1.5 any reference to time shall be to Guernsey time;

1.6 except where the context otherwise requires words denoting the singular include the plural and vice versa and words denoting any one gender include all genders;

1.7 unless otherwise stated, a reference to a Clause or a Schedule is a reference to a Clause or a Schedule to this Agreement; and

1.8 Clause headings are for ease of reference only and do not affect the construction of any provision.

2. THE BUSINESS OF THE COMPANY

2.1 The Parties hereby agree that the objects and purpose of the Company shall be to carry on the Business.

2.2 The Parties shall so far as they are able (including without limitation by the exercise of votes which they directly or indirectly control at meetings of the Directors or general meetings of the Company) procure that (i) the Company's principal activities shall be the pursuit of the objects and purposes described in Clause 2.1 conducted in accordance with the provisions hereof and with the Offering Memorandum, the Subscription and Transfer Agreement and Articles of the Company and (ii) the Parties shall not take any action inconsistent with the provisions of the Offering Memorandum, including, without limitation the investment strategy set forth in the "Summary" and the applicable restrictions during and after the Investment Period and the suspension or termination of the Investment Period following a Key Person Event.

2.3 The Members shall (so long as they hold shares in the capital of the Company) use all reasonable endeavours to promote and develop the Business of the Company.

3. VOTING RIGHTS

3.1 The Parties agree that the following provisions of this Clause 3 shall apply during such period or periods as the Members parties hereto are Members.

3.2 The Parties shall procure that the Company shall not take any action at any meeting requiring the sanction of an ordinary or special resolution or by written resolution, in each case of the Directors or of the Members, without the affirmative vote or prior written consent, as applicable, of the Members totalling in the aggregate more than seventy-five percent (75%) of the Company, including, but not limited to, the following actions:

3.2.1 any issuance of new shares of the Company or a new class of shares of the Company or payment of any dividend by issuance of new shares of the Company, other than issuances of Shares pursuant to the Offering Memorandum and the Subscription and Transfer Agreement;

3.2.2 any alteration or cancellation of any rights of any Shares or of the Share capital of the Company,

3.2.3 any conversion or redemption of Shares, except pursuant to Clause 5.5,

3.2.4 any payment of commission in consideration for subscribing or agreeing to subscribe for any shares in the Company,

3.2.5 the creation of any lien on any Shares, except pursuant to the remedies in Clause 5.3. or

3.2.6 the suspension of the calculation of the NAV; other than a temporary suspension of the calculation of the NAV and NAV per Share by the Board of Directors during any period if it determines in good faith that such a suspension is warranted by extraordinary circumstances, including: (i) during any period when any market on which the Company's investments are quoted, traded or dealt in is closed, other than for ordinary holidays and weekends, or during periods in which dealings are restricted or suspended; (ii) during the existence of any state of affairs, including as a result of political, economic, military or monetary events or any circumstances outside the control of the Portfolio Manager or the Company, as a result of which, in the reasonable opinion of the Portfolio Manager, the determination of the value of the assets of the Company, would not be reasonably practicable or would be seriously prejudicial to the Members taken as a whole; (iii) during any breakdown in the means of communication normally employed in determining the price or value of the Company's assets or liabilities, or of current prices in any market as aforesaid, or when for any other reason the prices or values of any assets or liabilities of the Company cannot reasonably be accurately ascertained within a reasonable time frame; (iv) during any period when the transfer of funds involved in the realization or acquisition of any investments cannot, in the reasonable opinion of the Portfolio Manager, be effected at normal rates of exchange; or (v) automatically upon liquidation of the Company.

4. ADVISORY BOARD.

4.1 Composition of Advisory Board. The Company shall establish an advisory board (the "Advisory Board") composed of two individuals, one of whom shall be a representative of CLO Holdco and one of whom shall be a representative of Dover IX (or, in each case, or any permitted successor to the interest in the Company of such Member). No voting member of the Advisory Board shall be a controlled Affiliate of the Portfolio Manager (including, for the avoidance of doubt, following a permitted transfer of CLO Holdco's interest to an Affiliate of the Portfolio Manager, if applicable), it being understood that for the purposes of this sentence none of CLO Holdco, its wholly-owned subsidiaries nor any of their respective directors or trustees shall be deemed to be a controlled Affiliate of the Portfolio Manager due to their pre-existing non-discretionary advisory relationship with the Portfolio Manager. None of the members of the Advisory Board shall receive any compensation (other than reimbursement for reasonable and documented out-of-pocket expenses) in connection with their position on the Advisory Board. The Company shall bear any fees, costs and expenses related to the Advisory Board.

4.2 Meetings of Advisory Board; Written Consents. The Advisory Board shall meet with the Portfolio Manager at such times as requested by the Portfolio Manager from time to time. The quorum for a meeting of the Advisory Board shall be all of its members entitled to vote. All actions taken by the Advisory Board shall be (i) by a unanimous vote of all of the members of the Advisory Board in attendance in a meeting at which a quorum is present and entitled to vote and not abstaining from voting or (ii) by a written consent in lieu of a meeting signed by all of the members of the Advisory Board entitled to consent and not abstaining from consenting. Meetings of the Advisory Board may be held in person, by telephone or by other electronic device.

4.3 Functions of Advisory Board. The Advisory Board shall provide (or determine not to provide) any consents or approvals expressly contemplated by this Agreement and the Offering Memorandum to be provided by the Advisory Board and, at the request of the Portfolio Manager in its sole discretion, provide general advice (which, for the avoidance of doubt, shall be non-binding) to the Portfolio Manager or the Company with regard to Company activities and operations and other matters. For the avoidance of doubt, no consent or approval of the Advisory Board shall be required for any action or determination expressly permitted or contemplated hereunder or in the Offering Memorandum and not conditioned on such a consent or approval. The Portfolio Manager shall not act contrary to the advice of the Advisory Board with respect to any action or determination expressly conditioned herein or in the Offering Memorandum on the consent or approval of the Advisory Board. Without limiting the foregoing, the Advisory Board shall be authorized to give any approval or consent required or deemed necessary or advisable under the Advisers Act on behalf of the Company and the Members, including under Section 206(3) of the Advisers Act. The Portfolio Manager may from time to time in its discretion request the Advisory Board to review and ratify certain Company matters. The consent of the Advisory Board shall be required to approve the following actions: (i) any extension of the Investment Period; (ii) any extension of the Term (other than an automatic extension following an extension of the Investment Period that has been approved by the Advisory Board); (iii) any allotment of additional equity securities by the Company; and (iv) any investment in a Related Obligation or any other transaction between the Company or any entity in which the Company holds a direct or indirect interest, on the one hand, and Highland or any of its Affiliates, on the other hand and (v) other matters as set forth in the Offering

Memorandum. Notwithstanding the foregoing or anything to the contrary set forth herein, no transaction that is specifically authorized in the governing documents of the Company shall require approval of the Advisory Board, including, without limitation, sales or securitizations of all or a portion of the Company's loan portfolio into new Qualifying CLOs (i.e. the transfer of warehoused assets into new Qualifying CLOs), investments in CLO Notes issued by CLOs managed by Highland Affiliates, and the NexBank Credit Facility and any Permitted NexBank Credit Facility Amendments, in each case as described in the Offering Memorandum. Any such approval, consent or ratification given by the Advisory Board shall be binding on the Company and the Members. Neither the Advisory Board nor any member thereof shall have the power to bind or act for or on behalf of the Company in any manner, and no shareholder who appoints a member of the Advisory Board shall be deemed to be an Affiliate of the Company or Highland solely by reason of such appointment.

4.4 Term of Members of Advisory Board. A member of the Advisory Board shall be deemed removed from the Advisory Board (i) if such member is no longer an officer, director, manager, trustee, employee, consultant or other representative of CLO Holdco or Dover IX, as applicable, or their respective Affiliates and shall be replaced as soon as practicable with a representative of CLO Holdco or Dover IX, or their respective Affiliates, as applicable, or (ii) if the Member represented by such member either becomes a Defaulting Member or such member ceases to be eligible to represent such Member pursuant to Clause 4.1.

4.5 No Duties to Other Members. No Advisory Board member who is the representative of any Member shall, to the extent permitted by law, owe a fiduciary duty to the Company or any other Member (other than the duty to act in good faith), and may, to the fullest extent permitted by law, in all instances act in such member's own interest and in the interest of the Member that appointed such member.

5. DEFAULTING MEMBERS

5.1 In the event any Member defaults in its obligation to pay the full amount of the purchase price of Shares called for settlement under the Subscription and Transfer Agreement on the applicable Settlement Date (such unpaid amount, an "Outstanding Settlement Amount"), the Portfolio Manager, on behalf of the Company, shall provide written or telephonic notice of such default to such Member. If such default is not cured within 5 business days after written (or if applicable telephonic or email) notice thereof given by the Portfolio Manager, on behalf of the Company, has been received by such Member, such Outstanding Settlement Amount shall automatically accrue interest on a retroactive basis from the date such Outstanding Settlement Amount was due at 12% (the "Default Interest Rate") (which interest, once paid, shall not be applied to the purchase of the unsettled Shares of such Member, but which will upon receipt be distributed pro rata to those Members who have funded any such Outstanding Settlement Amounts pursuant to this Clause 5). No such Shares which have failed to be settled will be issued to any Member until settlement of the full amount of the purchase price has been made. In addition, if such default is not cured within 10 business days after written or telephonic notice thereof given by the Portfolio Manager, on behalf of the Company, has been received by such Member (a "Defaulting Member"), the following provisions shall apply:

5.2 Whenever the vote or consent of the Defaulting Member would otherwise be required or permitted hereunder or under the Articles, the Defaulting Member shall not be entitled to participate in such vote or consent in respect of his existing shareholding and with respect to any representative of such Defaulting Member on the Advisory Board, and such vote or consent shall be calculated as if such Defaulting Member were not a Member and, as applicable, any representative of such Defaulting Member on the Advisory Board were not a member of the Advisory Board.

5.3 The Portfolio Manager, on behalf of the Company, may pursue and enforce all rights and remedies available, including the commencement of legal proceedings against the Defaulting Member to collect the Outstanding Settlement Amounts, together with interest thereon for the account of the Company from the date due at the Default Interest Rate, plus the costs and expenses of collection (including attorneys' fees and expenses).

5.4 The Portfolio Manager, on behalf of the Company, may (at the sole cost of the Defaulting Member) borrow funds from any person (other than the Defaulting Member or its Affiliates) to cover such shortfall and/or advance all or a portion of the Defaulting Member's Outstanding Settlement Amount to the Company on behalf of the Defaulting Member, and such advance shall be repaid by the Defaulting Member to the Portfolio Manager, on behalf of the Company, with interest for the account of the Portfolio Manager, on behalf of the Company, on the amount outstanding from time to time commencing on the date of the advance at the Default Interest Rate. To the extent the Portfolio Manager, on behalf of the Company, advances funds to the Company on behalf of a Defaulting Member, all distributions from the Company that would otherwise be made to the Defaulting Member shall be paid to the Portfolio Manager, on behalf of the Company, (with any such amounts being applied first against accrued but unpaid interest and then against principal), until all amounts payable by the Defaulting Member to the Portfolio Manager, on behalf of the Company, under this Clause 5.4 (including interest) have been paid in full.

5.5 The Portfolio Manager, on behalf of the Company, may elect, upon notice to the Defaulting Member, to redeem the Defaulting Member's shares in an amount equal to 50% of the outstanding amount existing as of the date of the default at a price of $0.0001 per Share. Thereupon, the commitment of the Defaulting Member under the Subscription and Transfer Agreement shall be zero, the Defaulting Member shall not be obligated to make any further settlements, the voting capital of such Defaulting Member and of each other Member shall be re-determined as of the date of such default to reflect the new commitment of the Defaulting Member, and the Portfolio Manager shall revise the books and records of the Company to reflect the reduction of the commitment of the Defaulting Member. The Members agree (x) that the damages suffered by the Company as the result of a failure by a Member to settle a commitment to purchase Shares that is required by this Agreement cannot be estimated with reasonable accuracy and (y) that the foregoing provisions of this Clause 5.5 shall act as liquidated damages for the default by the Defaulting Member (which each Member hereby agrees are reasonable).

5.6 The Board may offer to the non-Defaulting Members (pro rata in accordance with their respective Commitments) the option of purchasing the Defaulting Member's unsettled Shares on the terms set forth in the applicable Settlement Notice (as defined in the Subscription and Transfer Agreement).

5.7 At the election of the Board, distributions of dividends otherwise payable to the Defaulting Member under the Articles shall not be paid to the Defaulting Member, but instead shall be applied against the amount of the Outstanding Settlement Amount (plus interest at the Default Interest Rate and related costs); provided that any amounts so applied shall be deemed to have been distributed to the Defaulting Member under the Articles.

5.8 The Portfolio Manager may send an amended or new Settlement Notice to the Members other than the Defaulting Member in an amount equal to the Defaulting Member's Outstanding Settlement Amount and otherwise in accordance with the Subscription and Transfer Agreement.

5.9 Each Defaulting Member further appoints the Portfolio Manager as agent and attorney-in-fact for the Defaulting Member and hereby grants to the Portfolio Manager an irrevocable power of attorney to take all actions necessary on its behalf to sell, assign, or transfer the commitment to purchase unsettled Shares of such Defaulting Member pursuant to Clause 5.6 or as necessary on its behalf to effect the other remedies or rights set forth in this Clause 5; provided that the Portfolio Manager shall not bind any Defaulting Member to an indemnification or other similar obligation which guarantees the financial performance of the Company or which exceeds the ability of the Defaulting Member to provide indemnification under applicable law.

6. TRANSFERS OR DISPOSALS OF SHARES

6.1 No Member shall sell, pledge, charge, mortgage, assign, assign by way of security, transfer, convey, exchange or otherwise dispose of its Shares or its commitment to settle purchases of Shares under the Subscription and Transfer Agreement (each a "**Transfer**"), other than to an Affiliate of an initial Member party hereto, without the prior written consent of the Portfolio

Manager, which consent shall be in the sole discretion of the Portfolio Manager; provided that no such Transfer shall be made unless in the opinion of counsel reasonably satisfactory to the Portfolio Manager (who may be counsel for the Company, and which requirement for an opinion may be waived, in whole or in part, in the sole discretion of the Portfolio Manager) that:

6.1.1 such Transfer would not require registration under the Securities Act or any state securities or "Blue Sky" laws or other laws applicable to the Shares to be assigned or transferred and is conducted in conformance with the restrictions set forth in the Offering Memorandum;

6.1.2 such Transfer would not be reasonably likely to cause the Company to be subject to tax in any jurisdiction other than of its incorporation on a net income basis, not be reasonably likely to cause the Company to become subject to registration as an investment company under the Investment Company Act of 1940, as amended;

6.1.3 such Transfer would not cause the Company to considered to be an entity whose underlying assets are considered to include "plan assets" by reason of investment by an "employee benefit plan" or "plan" in such entity pursuant to the U.S. Plan Assets Regulations; and

6.1.4 such sale, assignment, disposition or transfer would not to cause all or any portion of the assets of the Company to constitute "plan assets" under ERISA or the Code.

6.2 Prior to making any Transfer of Shares (other than Transfers to Affiliates of an initial Member or, in the case of CLO Holdco or a Highland Principal, to Highland, its Affiliates or another Highland Principal) a Member must first offer to the other Members a right to purchase the Shares, on a pro rata basis with respect to their current Shares, at the same price (which must be cash) as such Shares are proposed to be purchased by the prospective third party purchaser pursuant to an irrevocable offer letter. The other Members will have 30 days following receipt of the letter to determine whether to purchase their entire pro rata portion of the Shares proposed to be Transferred. If the other Members do not accept the offer, the Member may (subject to complying with the other Transfer restrictions in this Agreement) Transfer the applicable Shares that such Members have not elected to purchase to a third party at a price equal to or greater than the price described in the offer letter, provided that if the Member has not (a) entered into a definitive agreement to effect such sale within 90 days after the expiration of the period that the other Members have to accept the offer in the offer letter or (b) consummated the sale within 120 day after the entry into the definitive agreement to consummate the sale, it must comply with these right of first refusal procedures again. Any Member (other than the Member proposing to Transfer its Shares) may assign its right to purchase its pro rata portion of the Shares to any other Member (subject to complying with the other Transfer restrictions in this Agreement), any initial Member (other than the Member proposing to Transfer its Shares) may assign its right to purchase its pro rata portion of the Shares to an Affiliate (subject to complying with the other Transfer restrictions in this Agreement), and CLO Holdco and the Highland Principals (unless such Member is the Member proposing the Transfer its Shares) may assign its right to purchase its pro rata portion of the Shares to Highland, an Affiliate of Highland or other Highland Principals (subject to complying with the other Transfer restrictions in this Agreement).

6.3 No Highland Principal may transfer his or its interests in the Company other than (i) to a trust or other tax or estate planning vehicle or (ii) to the Portfolio Manager, its Affiliates or another Highland Principal upon the termination of such Highland Principal's (or the beneficial owner of such Highland Principal, if applicable) employment by Highland Capital Management, L.P.

6.4 Any transferor of any Share shall remain bound by the terms of this Agreement applicable to it prior to such transfer and that nothing in this Agreement shall constitute a waiver of any rights a Party to this Agreement may have by reason of a breach of this Agreement by a transferor prior to transfer. The transferor and/or the transferee shall bear all costs of any Transfer.

6.5 The Parties agree not to Transfer their Shares to any person unless such transferee agrees to be bound by the terms of this Agreement.

6.6 All Adherence Agreements executed pursuant to this Clause shall be executed by the transferee or allottee and each Party.

7. CONFIDENTIALITY

7.1 Each Party agrees to keep any information received by it pursuant to this Agreement or relating to the Business as confidential and not (save with the relevant Party's consent or as may be required by Law or the rules of any regulatory authority or any stock exchange) disclose to any person such information.

7.2 Notwithstanding the foregoing, the Parties agree that the HarbourVest Entities may disclose to their limited partners and prospective limited partners (including any agents of such limited partners or prospective limited partners), clients and applicable governmental agencies (a) the name and address of the Company, (b) the capital commitment and the remaining capital commitment, (c) the net asset value of such HarbourVest Entity's interest in the Company, (d) the amount of distributions that have been made to such HarbourVest Entity by the Company and the amount of contributions that have been made by such HarbourVest Entity to the Company, (e) such ratios and performance information calculated by such HarbourVest Entity using the information in clauses (a) through (d) above, including the ratio of net asset value plus distributions to contributions (i.e., the "multiple") and such HarbourVest Entity's internal rate of return with respect to its investment in the Company, and (f) tax information with respect to the Company.

8. DIVIDENDS

8.1 The Company agrees that it shall not, and the Portfolio Manager agrees it shall not cause the Company to, make any dividends except pursuant to the section titled "Summary—Dividend Policy" of the Offering Memorandum.

9. TERM OF THE COMPANY

9.1 Each Party agrees to cause the winding up and dissolution of the Company after the ten year anniversary of the date hereof (the "Term"); provided that the Portfolio Manager, in its reasonable discretion, may postpone dissolution of the Company for up to 180 days in order to facilitate orderly liquidation of the investments; provided, further, that the Term shall be automatically extended for any amount of time for which the Investment Period may be extended.

9.2 Notwithstanding the foregoing, the Term may be extended with the consent of the Portfolio Manager and the Advisory Board for up to two successive periods of one year each.

10. ERISA MATTERS

10.1 The Portfolio Manager, the Company and each Member shall use their reasonable best efforts to conduct the affairs and operations of the Company so as to limit investment in the Company by "benefit plan investors" (within the meaning of the DOL Regulations as modified by section 3(42) of ERISA) to less than the U.S. Plan Threshold. In the event the U.S. Plan Threshold is met or exceeded, the Portfolio Manager, on behalf of the Company, may require any Non-Qualified Holder that is a U.S. Plan Investor to sell or transfer their Shares to a person qualified to own the same that is not a U.S. Plan Investor within 30 days and within such 30 days and to provide the Company with satisfactory evidence of such sale or transfer such that such sale or transfer, together with other sale or transfers pursuant to this Clause, would result in the investment in the Company by "benefit plan investors" (within the meaning of the DOL Regulations as modified by section 3(42) of ERISA) to be less than the U.S. Plan Threshold. Where the conditions above are not satisfied within 30 days after the serving of the notice to transfer, such Non-Qualified Holder will be deemed, upon the expiration of such 30 days, to have forfeited their Shares.

11. TAX MATTERS

11.1 <u>PFIC</u>. For each fiscal year of the Company, the Company will no later than 120 days after the end of such fiscal year, commencing with the first fiscal year for which the Company is determined to be a PFIC (a "passive foreign investment company"), furnish to each of the

HarbourVest Entities (x) all information necessary to permit such HarbourVest Entity or any of its partners to complete United States Internal Revenue Service Form 8621 with respect to their interests in the Company and (y) a PFIC Annual Information Statement under section 1295(b) of the Code with respect to the Company; provided that if the Company is unable to furnish such final information and Statement within such 120 days, then the Company shall use its reasonable best efforts to furnish estimates of such information and Statement on or before the 120^{th} day after the end of such fiscal year.

11.2 CFC. The Company shall furnish to each of the HarbourVest Entities within 120 days after the end of each fiscal year of the Company, a United States Internal Revenue Service Form 5471 for such fiscal year, completed for all information concerning the Company required to be filed by such HarbourVest Entity or any of its partners (i.e., all portions applicable to the relevant category of filer other than page 1 items A-D and page 2 Schedule B), to the extent such Form 5471 is required to be filed by such HarbourVest Entity or any of its partners; provided that if the Company is unable to furnish such final information within such 120 days, then the Company shall use its reasonable best efforts to furnish estimates of such information on or before the 120th day after the end of each fiscal year.

11.3 Other Tax Information. The Company shall furnish to each of the HarbourVest Entities (a) within 120 days after the end of each fiscal year of the Company such other information reasonably requested by the HarbourVest Entities that any HarbourVest Entity may require in order for it or any of its partners to comply with its U.S. federal income tax reporting obligations with respect to its interest in the Company; provided that if the Company is unable to furnish such final information within such 120 days, then the Company shall use its reasonable best efforts to furnish estimates of such information on or before the 120th day after the end of such fiscal year and (b) promptly upon request such other information reasonably requested by such HarbourVest Entity in order to withhold tax or to file tax returns and reports or to furnish tax information to any of its partners with respect to the Company.

11.4 Withholding and Other Taxes. The Company will use reasonable best efforts to acquire investments that will not result in withholding or other taxes being imposed directly or indirectly on the Company by any jurisdiction with respect to income or distributions from such investments.

12. AMENDMENTS TO CERTAIN AGREEMENTS

12.1 The Portfolio Manager and the Company shall not amend or terminate, or agree to amend or terminate, the Memorandum or Articles of Incorporation of the Company or that certain Portfolio Management Agreement between the Portfolio Manager and the Company dated as of the date hereof (the "Management Agreement") without the consent of the Parties.

12.2 The Portfolio Manager agrees that it shall not assign its rights, duties and obligations under the Management Agreement without the consent of the Members totalling in the aggregate more than seventy-five percent (75%) of the Company. Notwithstanding the foregoing, the Portfolio Manager may, without the consent of the Members, assign any of its rights or obligations under the Management Agreement to an Affiliate; provided that such Affiliate (A) has demonstrated ability, whether as an entity or by its personnel, to professionally and competently perform duties similar to those imposed upon the Portfolio Manager pursuant to the Management Agreement, (B) has the legal right and capacity to act as Portfolio Manager thereunder and (C) shall not cause the Company or the pool of collateral to become required to register under the provisions of the Investment Company Act and such action does not cause the company to be subject to tax in any jurisdiction outside of its jurisdiction of incorporation.

12.3 The Company agrees that it shall not hire any portfolio manager without the consent of the Parties and such new portfolio manager shall be required to join and abide by this Agreement.

13. FINANCIAL REPORTS

13.1 The books and records of account of the Company shall be audited as of the end of each fiscal year of the Company by a nationally recognized independent public accounting firm selected by the Portfolio Manager that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules. During the Term, the Portfolio Manager or the Company shall prepare and mail, deliver by fax, email or other electronic means or otherwise make available a financial report (audited in the case of a report sent as of the end of a fiscal year and unaudited in the case of a report sent as of the end of a quarter) to each Member on or before the 120th day after the end of each fiscal year and the 45th day after the end of each of the first three quarters of each fiscal year, setting forth for such fiscal year or quarter (a) the assets and liabilities of the Company as of the end of such fiscal year or quarter; (b) the net profit or net loss of the Company for such fiscal year or quarter; and (c) such Member's closing capital account balance as of the end of such fiscal year or quarter; provided that if the Portfolio Manager or the Company is unable to furnish final information with respect to any of the above, then the Portfolio Manager or the Company shall use its reasonable best efforts to furnish estimates of such information on or before the 120th day after the end of each fiscal year and the 45th day after the end of the first three quarters of each fiscal year. On or before the 60th day after the end of each fiscal year, the Portfolio Manager or the Company shall provide to each Member an unaudited draft of the financial report for such fiscal year.

13.2 After the end of each fiscal year or quarter, the Portfolio Manager or the Company shall cause to be delivered to the Advisory Board a reasonably detailed summary of the expenses incurred by the Company during such period.

14. TERMINATION AND LIQUIDATION

14.1 Save as provided for in Clause 13.2, this Agreement shall terminate:

14.1.1 when one Party holds all the Shares;

14.1.2 when a resolution is passed by the Company's Members or creditors, or an order made by a court or other competent body or person instituting a process that shall lead to the Company being wound up and its assets being distributed among the Company's creditors, Members or other contributors; or

14.1.3 with the written consent of all the Parties.

14.2 The following provisions of this Agreement remain in full force after termination: Clause 1 (Interpretation), Clause 7 (Confidentiality), this Clause, Clause 14 (Whole Agreement), Clause 16 (Assignments), Clause 17 (Variation and Waiver), Clause 18 (Service of Notice), Clause 19 (General) and Clause 21 (Governing Law and Jurisdiction).

14.3 Termination of this Agreement shall not affect any rights or liabilities that the Parties may have accrued under it.

14.4 Where the Company is to be wound up and its assets distributed, the Parties shall agree a suitable basis for dealing with the interests and assets of the Company and shall endeavour to ensure that:

14.4.1 all existing contracts of the Company are performed to the extent that there are sufficient resources;

14.4.2 the Company shall not enter into any new contractual obligations;

14.4.3 the Company is dissolved and its assets are distributed as soon as practical; and

14.4.4 any other proprietary information belonging to or originating from a Party shall be returned to it by the other Parties.

15. WHOLE AGREEMENT

15.1 This Agreement, and any documents referred to in it, constitute the whole agreement between the Parties and supersede any arrangements, understanding or previous agreement between them relating to the subject matter they cover.

15.2 Each Party acknowledges that in entering into this Agreement, and any documents referred to in it, it does not rely on, and shall have no remedy in respect of, any statement, representation, assurance or warranty of any person other than as expressly set out in this Agreement or those documents.

15.3 Nothing in this Clause 14 operates to limit or exclude any liability for fraud.

16. STATUS OF AGREEMENT

16.1 Each Party shall, to the extent that it is able to do so, exercise its voting rights and other powers in relation to the Company to procure that the provisions of this Agreement are properly and promptly observed and given full force and effect according to the spirit and intention of the Agreement.

16.2 If any provision in the memorandum of incorporation of the Company or the Articles conflicts with any provision of this Agreement, the provisions of this Agreement shall prevail as between the Parties. Each of the Parties shall, to the extent that it is able to do so, exercise its voting rights and other powers in relation to the Company to procure the modification of the memorandum of association of the Company or the Articles (as the case may be) in order to eliminate the conflict, but this Agreement shall not itself constitute a modification of the memorandum of association of the Company or the Articles.

17. ASSIGNMENTS

Save as expressly permitted by this Agreement, no person may assign, or grant any security interest over, any of its rights under this Agreement or any document referred to in it without the prior written consent of the Parties.

18. VARIATION AND WAIVER

18.1 A variation of this Agreement shall be in writing and signed by or on behalf of the Parties.

18.2 A waiver of any right under this Agreement is only effective if it is in writing and it applies only to the person to which the waiver is addressed and the circumstances for which it is given.

18.3 A person that waives a right in relation to one person, or takes or fails to take any action against that person, does not affect its rights against any other person.

19. SERVICE OF NOTICE

19.1 Any notice required to be given by any of the Parties may be sent by post or facsimile to the address and facsimile number of the addressee as set out in this Agreement, in either case marked for the attention of the relevant person named below, or to such other address and/or facsimile number and/or marked for the attention of such other person as the addressee may from time to time have notified for the purposes of this Clause.

19.1.1 to the Company:
Address:
First Floor, Dorey Court, Admiral Park
St Peter Port, Guernsey GY1 6HJ
Channel Islands

19.1.2 to CLO Holdco:

Address:
c/o Highland Capital Management, L.P.
300 Crescent Court, Suite 700
Dallas, TX 75201
Attn: General Counsel
Tel: +1 (972) 628-4100
Email: Notices@highlandcapital.com

19.1.3 to any HarbourVest Entity:
Address:
c/o HarbourVest Partners, LLC
One Financial Center, 44th Floor
Boston, MA 02111
USA
Attn: Michael Pugatch
Tel: +1 (617) 348-3712
F
Email: mpugatch@harbourvest.com

19.1.4 to any other Party: by post or hand delivery only to the address specified in the register of members of the Company.

19.2 Communications sent by post shall be deemed to have been received 24 hours after posting. Communications sent by facsimile transmission shall be deemed to have been received at the time the transmission has been received by the addressee PROVIDED THAT if the facsimile transmission, where permitted, is received after 5.00pm or on a day which is not a Business Day, it shall be deemed to have been received 11.00am the Business Day following thereafter.

19.3 In proving service by post it shall only be necessary to prove that the notice was contained in an envelope which was duly addressed and posted in accordance with this Clause and in the case of facsimile transmission it shall be necessary to prove that the facsimile was duly transmitted to the correct number.

20. GENERAL

20.1 Each of the Parties hereby agree not to enter into or abide by any agreement whether written or oral with any one or more of the other Parties in respect of the voting of Shares or the submission of Member resolutions to any Members for voting by them, or otherwise to direct or influence, or attempt to direct or influence, the day-to-day management of the Company, either directly or indirectly, other than in order to comply with the other terms of this Agreement or the Articles. In this regard, each of the Parties agrees to not to direct or influence or to attempt to direct or influence any of the Directors through any employment relationship that the Directors may have outside of the Company other than in order to comply with the other terms of this Agreement or the Articles. Each of the Parties hereby agree that this provision shall continue to apply to them whether or not they are or remain a Member.

20.2 Unless otherwise provided, all costs in connection with the negotiation, preparation, execution and performance of this Agreement, shall be borne by the Party that incurred the costs.

20.3 The Parties are not in partnership with each other and there is no relationship of principal and agent between them.

20.4 All transactions entered into between any Party and the Company shall be conducted in good faith and on the basis set out or referred to in this Agreement or, if not provided for in this Agreement, as may be agreed by the Parties and, in the absence of such agreement, on an arm's length basis.

20.5 Each Party shall at all times act in good faith towards the other Parties and shall use all reasonable endeavours to ensure that this Agreement is observed.

20.6 Each Party shall promptly execute and deliver all such documents, and do all such things, as the other Parties may from time to time reasonably require for the purpose of giving full effect to the provisions of this Agreement.

20.7 This Agreement may be executed in any number of counterparts, each of which is an original and which together have the same effect as if each Party had signed the same document. This Agreement may not be amended except with the consent of each Party.

21. STATUS OF AGREEMENT

21.1 The Parties shall, when necessary, exercise their powers of voting and any other rights and powers they have to amend, waive or suspend a conflicting provision in the Articles to the extent necessary to permit the Company and its Business to be administered as provided in this Agreement.

21.2 If there is an inconsistency between any of the provisions of this agreement and the provisions of the Articles, the provisions of this agreement shall prevail as between the Parties.

22. GOVERNING LAW AND JURISDICTION

This Agreement shall be governed by and construed in accordance with the laws of the Island of Guernsey and each of the Parties submits to the non-exclusive jurisdiction of the Royal Courts of the Island of Guernsey.

[Signature Page Follows.]

IN WITNESS WHEREOF the Parties hereto have caused this Agreement to be executed the day and year first before written.

SIGNED for and on behalf of **CLO HOLDCO, LTD.**

By:..
Name: Grant Scott
Title: Director

SIGNED for and on behalf of
HARBOURVEST DOVER STREET IX INVESTMENT L.P.

By: HarbourVest Partners (Europe) Limited,
its Alternative Investment Fund Manager

By:..
Name: Michael J. Pugatch
Title: Authorized Person

SIGNED for and on behalf of
HARBOURVEST 2017 GLOBAL AIF L.P.

By: HarbourVest Partners (Europe) Limited,
its Alternative Investment Fund Manager

By:..
Name: Michael J. Pugatch
Title: Authorized Person

SIGNED for and on behalf of
HARBOURVEST 2017 GLOBAL FUND L.P.

By: HarbourVest 2017 Global Associates L.P.,
its General Partner

By: HarbourVest GP LLC,
its General Partner

By: HarbourVest Partners, LLC,
its Managing Member

By:..
Name: Michael J. Pugatch
Title: Managing Director

SIGNED for and on behalf of
HV INTERNATIONAL VIII SECONDARY L.P.

By: HIPEP VIII Associates L.P.
Its General Partner
By: HarbourVest GP LLC
Its General Partner
By: HarbourVest Partners, LLC
Its Managing Member

By:..
Name: Michael J. Pugatch
Title: Managing Director

SIGNED for and on behalf of
HARBOURVEST SKEW BASE AIF L.P.

By: HarbourVest Partners (Europe) Limited,
its Alternative Investment Fund Manager

By:..
Name: Michael J. Pugatch
Title: Authorized Person

SIGNED

....
Lee Blackwell Parker, III

SIGNATURE PAGE TO MEMBERS' AGREEMENT

SIGNED for and on behalf of
QUEST IRA, INC.
FBO LEE B. PARKER III, ACCT. # 3058311

Read and approved

X

By:...
Name: Emmanuel Maaeel
Title: transaction supervisor

SIGNED for and on behalf of
QUEST IRA, INC.
FBO HUNTER COVITZ, ACCT. # 1469811

By:...
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO JON POGLITSCH, ACCT. # 1470612

By:...
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO NEIL DESAI, ACCT. # 3059211

By:...
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO LEE B. PARKER III, ACCT. # 3058311

By:..
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO HUNTER COVITZ, ACCT. # 1469811

By:..
Name: Emmanuel Macier
Title: Transaction Supervisor

Read & Approved

SIGNED for and on behalf of
QUEST IRA, INC.
FBO JON POGLITSCH, ACCT. # 1470612

By:..
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO NEIL DESAI, ACCT. # 3059211

By:..
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO LEE B. PARKER III, ACCT. # 3058311

By:...
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO HUNTER COVITZ, ACCT. # 1469811

By:...
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO JON POGLITSCH, ACCT. # 1470612

By:...
Name: Emmanuel Macias
Title: Transactions Supervisor

Read and Approved:
11/7/17

SIGNED for and on behalf of
QUEST IRA, INC.
FBO NEIL DESAI, ACCT. # 3059211

By:...
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO LEE B. PARKER III, ACCT. # 3058311

By:..
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO HUNTER COVITZ, ACCT. # 1469811

By:..
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO JON POGLITSCH, ACCT. # 1470612

By:..
Name:
Title:

SIGNED for and on behalf of
QUEST IRA, INC.
FBO NEIL DESAI, ACCT. # 3059211

By:..
Name: Emmanuel Madel
Title: Transaction Supervisor

Read and approved

SIGNED for and on behalf of
HIGHLAND CAPITAL MANAGEMENT, L.P.

By: Strand Advisors, Inc.,
its General Partner

By:...
Name: James Dondero
Title: President

SIGNED for and on behalf of
HIGHLAND HCF ADVISOR, LTD.

By:..
Name: James Dondero
Title: President

SIGNED for and on behalf of
HIGHLAND CLO FUNDING, LTD.

By:..

Name: William Scott
Title: Director

SCHEDULE

Adherence Agreement

THIS ADHERENCE AGREEMENT is made on [●] 200[●]

BETWEEN:

(1) [●] of [●] (the "Covenantor");

(2) CLO HOLDCO, LTD. of [ ] (a "Member");

(3) [●] of [ ] (a "Member");

(4) [●] of [ ] (a "Member");

(5) HIGHLAND CLO FUNDING, LTD., with registration number 60120 whose registered office is at First Floor, Dorey Court, Admiral Park, St Peter Port, Guernsey GY1 6HJ, Channel Islands (the "Company")

(6) HIGHLAND HCF ADVISOR, LTD., registered address is at Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands (the "Portfolio Manager").

RECITAL

This Agreement is supplemental to the members agreement made on November 15 2017 between the Members, the Portfolio Manager and the Company (the "Members Agreement").

IT IS HEREBY AGREED as follows:

1. The Covenantor hereby confirms that he has been supplied with a copy of the Members Agreement and hereby covenants with each of the parties thereto to observe, perform and be bound by all the terms of the Members Agreement as if it were a party thereto.

2. Each of the other parties to the Members Agreement hereby covenants with the Covenantor that the Covenantor shall be entitled to the benefit of the terms of the Members Agreement as if he were a party thereto.

3. This Agreement shall be governed by and construed in accordance with Guernsey law.

IN WITNESS of which this Agreement has been executed by the Covenantor and each of the parties to the Members Agreement on the date shown above.

EXHIBIT 6

Conformed to Federal Register version

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 276

[Release No. IA-5248; File No. S7-07-18]

RIN: 3235-AM36

Commission Interpretation Regarding Standard of Conduct for Investment Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Securities and Exchange Commission (the "SEC" or the "Commission") is publishing an interpretation of the standard of conduct for investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act" or the "Act").

DATES: Effective July 12, 2019.

FOR FURTHER INFORMATION CONTACT: Olawalé Oriola, Senior Counsel; Matthew Cook, Senior Counsel; or Jennifer Songer, Branch Chief, at (202) 551-6787 or *IArules@sec.gov*, Investment Adviser Regulation Office, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is publishing an interpretation of the standard of conduct for investment advisers under the Advisers Act [15 U.S.C. 80b].[1]

[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to rules under the Advisers Act, or any paragraph of these rules, we are referring to title 17, part 275 of the Code of Federal Regulations [17 CFR 275], in which these rules are published.

TABLE OF CONTENTS

I. INTRODUCTION

Under federal law, an investment adviser is a fiduciary.[2] The fiduciary duty an investment adviser owes to its client under the Advisers Act, which comprises a duty of care and a duty of loyalty, is important to the Commission's investor protection efforts. Also important to the Commission's investor protection efforts is the standard of conduct that a broker-dealer owes to a retail customer when it makes a recommendation of any securities transaction or investment strategy involving securities.[3] Both investment advisers and broker-dealers play an important

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[2] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963) ("SEC v. Capital Gains"); *see also infra* footnotes 34–44 and accompanying text; Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2256 (July 2, 2004); Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204 (Dec. 17, 2003); Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (Apr. 5, 2000). Investment advisers also have antifraud liability with respect to prospective clients under section 206 of the Advisers Act.

[3] *See* Regulation Best Interest, Exchange Act Release No. 34-86031 (June 5, 2019) ("Reg. BI Adoption"). This final interpretation regarding the standard of conduct for investment advisers under the Advisers Act ("Final Interpretation") interprets section 206 of the Advisers Act, which is applicable to both SEC- and

role in our capital markets and our economy more broadly. Investment advisers and broker-dealers have different types of relationships with investors, offer different services, and have different compensation models. This variety is important because it presents investors with choices regarding the types of relationships they can have, the services they can receive, and how they can pay for those services.

On April 18, 2018, the Commission proposed rules and forms intended to enhance the required standard of conduct for broker-dealers[4] and provide retail investors with clear and succinct information regarding the key aspects of their brokerage and advisory relationships.[5] In connection with the publication of these proposals, the Commission published for comment a separate proposed interpretation regarding the standard of conduct for investment advisers under the Advisers Act ("Proposed Interpretation").[6] We stated in the Proposed Interpretation, and we continue to believe, that it is appropriate and beneficial to address in one release and reaffirm—and in some cases clarify—certain aspects of the fiduciary duty that an investment adviser owes

state-registered investment advisers, as well as other investment advisers that are exempt from registration or subject to a prohibition on registration under the Advisers Act. This Final Interpretation is intended to highlight the principles relevant to an adviser's fiduciary duty. It is not, however, intended to be the exclusive resource for understanding these principles. Separately, in various circumstances, case law, statutes (such as the Employee Retirement Income Security Act of 1974 ("ERISA")), and state law impose obligations on investment advisers. In some cases, these standards may differ from the standard enforced by the Commission.

4 Regulation Best Interest, Exchange Act Release No. 83062 (Apr. 18, 2018) ("Reg. BI Proposal").

5 Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, Investment Advisers Act Release No. 4888 (Apr. 18, 2018) ("Relationship Summary Proposal").

6 Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, Investment Advisers Act Release No. 4889 (Apr. 18, 2018).

to its clients under section 206 of the Advisers Act.[7] After considering the comments received, we are publishing this Final Interpretation with some clarifications to address comments.[8]

A. Overview of Comments

We received over 150 comment letters on our Proposed Interpretation from individuals, investment advisers, trade or professional organizations, law firms, consumer advocacy groups, and bar associations.[9] Although many commenters generally agreed that the Proposed Interpretation was useful,[10] some noted the challenges inherent in a Commission interpretation covering the broad scope of the fiduciary duty that an investment adviser owes to its clients under the Advisers Act.[11] Some of these commenters suggested modifications to or withdrawal

[7] Further, the Commission recognizes that many advisers provide impersonal investment advice. *See, e.g.*, Advisers Act rule 203A-3 (defining "impersonal investment advice" in the context of defining "investment adviser representative" as "investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts"). This Final Interpretation does not address the extent to which the Advisers Act applies to different types of impersonal investment advice.

[8] In the Proposed Interpretation, the Commission also requested comment on: licensing and continuing education requirements for personnel of SEC-registered investment advisers; delivery of account statements to clients with investment advisory accounts; and financial responsibility requirements for SEC-registered investment advisers, including fidelity bonds. We are continuing to evaluate the comments received in response.

[9] Comment letters submitted in File No. S7-09-18 are available on the Commission's website at https://www.sec.gov/comments/s7-09-18/s70918.htm. We also considered those comments submitted in File No. S7-08-18 (Comments on Relationship Summary Proposal) and File No. S7-07-18 (Comments on Reg. BI Proposal). Those comments are available on the Commission's website at https://www.sec.gov/comments/s7-08-18/s70818.htm and https://www.sec.gov/comments/s7-07-18/s70718.htm.

[10] *See, e.g.*, Comment Letter of North American Securities Administrators Association (Aug. 23, 2018) ("NASAA Letter") (stating that the Proposed Interpretation is a "useful resource"); Comment Letter of Invesco (Aug. 7, 2018) ("Invesco Letter") (agreeing that "there are benefits to having a clear statement regarding the fiduciary duty that applies to an investment adviser").

[11] *See, e.g.*, Comment Letter of Pickard Djinis and Pisarri LLP (Aug. 7, 2018) ("Pickard Letter") (noting the Commission's "efforts to synthesize case law, legislative history, academic literature, prior Commission releases and other sources to produce a comprehensive explanation of the fiduciary standard of conduct"); Comment Letter of Dechert LLP (Aug. 7, 2018) ("Dechert Letter") ("It is crucial that any universal interpretation of an adviser's fiduciary duty be based on sound and time-tested principles. Given the difficulty of defining and encompassing all of an adviser's responsibilities to its clients, while also accommodating the diversity of advisory arrangements, interpretive issues will arise in the future."); Comment Letter of the Hedge Funds Subcommittee of the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association (Aug. 24, 2018) ("ABA Letter") ("We note at

of the Proposed Interpretation.[12] Although most commenters agreed that an investment adviser's fiduciary duty comprises a duty of care and a duty of loyalty, as described in the Proposed Interpretation, they had differing views on aspects of the fiduciary duty and in some cases sought clarification on its application.[13]

Some commenters requested that we adopt rule text instead.[14] The relationship between an investment adviser and its client has long been based on fiduciary principles not generally set forth in specific statute or rule text. We believe that this principles-based approach should continue as it expresses broadly the standard to which investment advisers are held while allowing them flexibility to meet that standard in the context of their specific services. In our view, adopting rule text is not necessary to achieve our goal in this Final Interpretation of reaffirming and in some cases clarifying certain aspects of the fiduciary duty.

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the outset that it is difficult to capture the nature of an investment adviser's fiduciary duty in a broad statement that has universal applicability.").

12 *See, e.g.*, Comment Letter of L.A. Schnase (Jul. 30, 2018) (urging the Commission not to issue the Proposed Interpretation in final form, or at least not without substantial rewriting or reshaping); Comment Letter of Money Management Institute (Aug. 7, 2018) ("MMI Letter") (urging the Commission to "revise the interpretation so that it reflects the common law principles in which an investment adviser's fiduciary duty is grounded"); Dechert Letter (recommending that we withdraw the Proposed Interpretation and instead rely on existing authority and sources of law, as well as existing Commission practices for providing interpretive guidance, in order to define the source and scope of an investment adviser's fiduciary duty).

13 *See, e.g.*, Comment Letter of Cambridge Investment Research Inc. (Aug. 7, 2018) ("Cambridge Letter") (stating that "greater clarity on all aspects of an investment adviser's fiduciary duty will improve the ability to craft such policies and procedures, as well as support the elimination of confusion for retail clients and investment professionals"); Comment Letter of Institutional Limited Partners Association (Aug. 6, 2018) ("ILPA Letter 1") ("Interpretation will provide more certainty regarding the fiduciary duties owed by private fund advisers to their clients."); Comment Letter of New York City Bar Association (Jun. 26, 2018) ("NY City Bar Letter") (stating that the uniform interpretation of an investment adviser's fiduciary duty is necessary).

14 Some commenters suggested that we codify the Proposed Interpretation. *See, e.g.,* Comment Letter of Roy Tanga (Apr. 25, 2018); Comment Letter of Financial Engines (Aug. 6, 2018) ("Financial Engines Letter"); ILPA Letter 1; Comment Letter of AARP (Aug. 7, 2018) ("AARP Letter"); Comment Letter of Gordon Donohue (Aug. 6, 2018); Comment Letter of Financial Planning Coalition (Aug. 7, 2018) ("FPC Letter").

II. INVESTMENT ADVISERS' FIDUCIARY DUTY

The Advisers Act establishes a federal fiduciary duty for investment advisers.[15] This fiduciary duty is based on equitable common law principles and is fundamental to advisers' relationships with their clients under the Advisers Act.[16] The investment adviser's fiduciary duty is broad and applies to the entire adviser-client relationship.[17] The fiduciary duty to which advisers are subject is not specifically defined in the Advisers Act or in Commission rules, but reflects a Congressional recognition "of the delicate fiduciary nature of an investment advisory relationship" as well as a Congressional intent to "eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."[18] An adviser's fiduciary duty is imposed under the

15 *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979) ("Transamerica Mortgage v. Lewis") ("§ 206 establishes federal fiduciary standards to govern the conduct of investment advisers.") (quotation marks omitted); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 471, n.11 (1977) (in discussing SEC v. Capital Gains, stating that the Supreme Court's reference to fraud in the "equitable" sense of the term was "premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers"); SEC v. Capital Gains, *supra* footnote 2; Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010) ("Investment Advisers Act Release 3060") ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own," citing Proxy Voting by Investment Advisers, Investment Advisers Act Release No. 2106 (Jan. 31, 2003) ("Investment Advisers Act Release 2106")).

16 *See* SEC v. Capital Gains, *supra* footnote 2 (discussing the history of the Advisers Act, and how equitable principles influenced the common law of fraud and changed the suits brought against a fiduciary, "which Congress recognized the investment adviser to be").

17 The Commission has previously recognized the broad scope of section 206 of the Advisers Act in a variety of contexts. *See, e.g.,* Investment Advisers Act Release 2106, *supra* footnote 15; Timbervest, LLC, et al., Advisers Act Release No. 4197 (Sept. 17, 2015) (Commission Opinion) (" [O]nce an investment advisory relationship is formed, the Advisers Act does not permit an adviser to exploit that fiduciary relationship by defrauding his client in any investment transaction connected to the advisory relationship."); *see also SEC v. Lauer*, 2008 WL 4372896, at 24 (S.D. Fla. Sept. 24, 2008) ("Unlike the antifraud provisions of the Securities Act and the Exchange Act, Section 206 of the Advisers Act does not require that the activity be 'in the offer or sale of any' security or 'in connection with the purchase or sale of any security.'"); Thomas P. Lemke & Gerald T. Lins, Regulation of Investment Advisers (2013 ed.), at § 2:30 ("[T]he SEC has … applied [sections 206(1) and 206(2)] where fraud arose from an investment advisory relationship, even though the wrongdoing did not specifically involve securities.").

18 *See* SEC v. Capital Gains, *supra* footnote 2; *see also* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948) ("Arleen Hughes") (Commission Opinion) (discussing the relationship of

Advisers Act in recognition of the nature of the relationship between an investment adviser and a client and the desire "so far as is presently practicable to eliminate the abuses" that led to the enactment of the Advisers Act.[19] It is made enforceable by the antifraud provisions of the Advisers Act.[20]

An investment adviser's fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty.[21] This fiduciary duty requires an adviser "to adopt the principal's goals,

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trust and confidence between the client and a dual registrant and stating that the registrant was a fiduciary and subject to liability under the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934).

19 *See* SEC v. Capital Gains, *supra* footnote 2 (noting that the "declaration of policy" in the original bill, which became the Advisers Act, declared that "the national public interest and the interest of investors are adversely affected … when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients. It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, *are to mitigate and, so far as is presently practicable to eliminate* the abuses enumerated in this section") (citing S. 3580, 76th Cong., 3d Sess., § 202 and Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 1, at 28) (emphasis added).

20 *Id.*; Transamerica Mortgage v. Lewis, *supra* footnote 15 ("[T]he Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations."). Some commenters questioned the standard to which the Advisers Act holds investment advisers. *See, e.g.,* Comment Letter of Stark & Stark, PC (undated) ("The duty of care at common law and under the Advisers Act only requires that advisers not be negligent in performing their duties.") (internal citation omitted); Comment Letter of Institutional Limited Partners Association (Nov. 21, 2018) ("ILPA Letter 2") ("The Advisers Act standard is a lower simple 'negligence' standard."). Claims arising under Advisers Act section 206(2) are not scienter-based and can be adequately pled with only a showing of negligence. *Robare Group, Ltd., et al. v. SEC*, 922 F.3d 468, 472(D.C. Cir. 2019) ("Robare v. SEC"); *SEC v. Steadman*, 967 F.2d 636, 643, n.5 (D.C. Cir. 1992) (citing SEC v. Capital Gains, *supra* footnote 2) ("[A] violation of § 206(2) of the Investment Advisers Act may rest on a finding of simple negligence."); *SEC v. DiBella*, 587 F.3d 553, 567 (2d Cir. 2009) ("the government need not show intent to make out a section 206(2) violation"); *SEC v. Gruss*, 859 F. Supp. 2d 653, 669 (S.D.N.Y. 2012) ("Claims arising under Section 206(2) are not scienter-based and can be adequately pled with only a showing of negligence."). However, claims arising under Advisers Act section 206(1) require scienter. *See, e.g.*, Robare v. SEC; *SEC v. Moran*, 922 F. Supp. 867, 896 (S.D.N.Y. 1996); *Carroll v. Bear, Stearns & Co.*, 416 F. Supp. 998, 1001 (S.D.N.Y. 1976).

21 *See, e.g.*, Investment Advisers Act Release 2106, *supra* footnote 15. These duties were generally recognized by commenters. *See, e.g.*, Comment Letter of Consumer Federation of America (Aug. 7, 2018) ("CFA Letter"); Comment Letter of the Investment Adviser Association (Aug. 6, 2018) ("IAA Letter"); Comment Letter of Investments & Wealth Institute (Aug. 6, 2018); Comment Letter of Raymond James (Aug. 7, 2018); FPC Comment Letter. *But see* Dechert Letter (questioning the sufficiency of support for a duty of care).

objectives, or ends."[22] This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own. In other words, the investment adviser cannot place its own interests ahead of the interests of its client. This combination of care and loyalty obligations has been characterized as requiring the investment adviser to act in the "best interest" of its client at all times.[23] In our view, an investment adviser's obligation to act in the best interest of its client is an overarching principle that encompasses both the duty of care and the duty of loyalty. As discussed in more detail below, in our view, the duty of care requires an investment adviser to provide investment advice in the best interest of its client, based on the client's objectives. Under its duty of loyalty, an investment adviser must eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which is not disinterested such that a client can provide informed consent to the conflict.[24] We believe this is another part of an investment adviser's obligation to act in the best interest of its client.

A. Application of Duty Determined by Scope of Relationship

An adviser's fiduciary duty is imposed under the Advisers Act in recognition of the

[22] Arthur B. Laby, *The Fiduciary Obligations as the Adoption of Ends*, 56 Buffalo Law Review 99 (2008); *see also* Restatement (Third) of Agency, §2.02 Scope of Actual Authority (2006) (describing a fiduciary's authority in terms of the fiduciary's reasonable understanding of the principal's manifestations and objectives).

[23] Investment Advisers Act Release 3060, *supra* footnote 15 (adopting amendments to Form ADV and stating that "under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own," citing Investment Advisers Act Release 2106, *supra* footnote 15). *See SEC v. Tambone*, 550 F.3d 106, 146 (1st Cir. 2008) ("SEC v. Tambone") ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund…"); *SEC v. Moran*, 944 F. Supp. 286, 297 (S.D.N.Y 1996) ("SEC v. Moran") ("Investment advisers are entrusted with the responsibility and duty to act in the best interest of their clients."). Although most commenters agreed that an adviser has an obligation to act in its client's best interest, some questioned whether the Proposed Interpretation appropriately considered the best interest obligation as part of the duty of care, or whether it instead should be considered part of the duty of loyalty. *See, e.g.*, MMI Letter; Comment Letter of Investment Company Institute (Aug. 7, 2018) ("ICI Letter").

[24] *See infra* footnotes 67-70 and accompanying text for a more detailed discussion of informed consent and how it is generally considered on an objective basis and may be inferred.

nature of the relationship between an adviser and its client—a relationship of trust and confidence.[25] The adviser's fiduciary duty is principles-based and applies to the entire relationship between the adviser and its client. The fiduciary duty follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship by agreement, provided that there is full and fair disclosure and informed consent.[26] With regard to the scope of the adviser-client relationship, we recognize that investment advisers provide a wide range of services, from a single financial plan for which a client may pay a one-time fee, to ongoing portfolio management for which a client may pay a periodic fee based on the value of assets in the portfolio. Investment advisers also serve a large variety of clients, from retail clients with limited assets and investment knowledge and experience to institutional clients with very large portfolios and substantial knowledge, experience, and analytical resources.[27] In our experience, the principles-based fiduciary duty imposed by the Advisers Act has provided sufficient flexibility to serve as an effective standard of conduct for investment advisers, regardless of the services they provide or the types of clients they serve.

Although all investment advisers owe each of their clients a fiduciary duty under the Advisers Act, that fiduciary duty must be viewed in the context of the agreed-upon scope of the

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[25] *See, e.g.*, Hearings on S. 3580 before Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess. (leading investment advisers emphasized their relationship of "trust and confidence" with their clients); SEC v. Capital Gains, *supra* footnote 2 (citing same).

[26] Several commenters asked that we clarify that an adviser and its client can tailor the scope of the relationship to which the fiduciary duty applies through contract. *See, e.g.*, MMI Letter; Financial Engines Letter; ABA Letter.

[27] This Final Interpretation also applies to automated advisers, which are often colloquially referred to as "robo-advisers." Automated advisers, like all SEC-registered investment advisers, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients. *See* Division of Investment Management, Robo Advisers, IM Guidance Update No. 2017-02 (Feb. 2017), *available at* https://www.sec.gov/investment/im-guidance-2017-02.pdf (describing Commission staff's guidance as to three distinct areas under the Advisers Act that automated advisers should consider, due to the nature of their business model, in seeking to comply with their obligations under the Advisers Act).

relationship between the adviser and the client. In particular, the specific obligations that flow from the adviser's fiduciary duty depend upon what functions the adviser, as agent, has agreed to assume for the client, its principal. For example, the obligations of an adviser providing comprehensive, discretionary advice in an ongoing relationship with a retail client (*e.g.*, monitoring and periodically adjusting a portfolio of equity and fixed income investments with limited restrictions on allocation) will be significantly different from the obligations of an adviser to a registered investment company or private fund where the contract defines the scope of the adviser's services and limitations on its authority with substantial specificity (*e.g.*, a mandate to manage a fixed income portfolio subject to specified parameters, including concentration limits and credit quality and maturity ranges).[28]

While the application of the investment adviser's fiduciary duty will vary with the scope of the relationship, the relationship in all cases remains that of a fiduciary to the client. In other words, an adviser's federal fiduciary duty may not be waived, though it will apply in a manner that reflects the agreed-upon scope of the relationship.[29] A contract provision purporting to waive the adviser's federal fiduciary duty generally, such as (i) a statement that the adviser will not act as a fiduciary, (ii) a blanket waiver of all conflicts of interest, or (iii) a waiver of any

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28 *See, e.g., infra* text following footnote 35.

29 Because an adviser's federal fiduciary obligations are enforceable through section 206 of the Advisers Act, we would view a waiver of enforcement of section 206 as implicating section 215(a) of the Advisers Act, which provides that "any condition, stipulation or provision binding any person to waive compliance with any provision of this title. . . shall be void." *See also* Restatement (Third) of Agency, § 8.06 Principal's Consent (2006) ("[T]he law applicable to relationships of agency as defined in § 1.01 imposes mandatory limits on the circumstances under which an agent may be empowered to take disloyal action. These limits serve protective and cautionary purposes. Thus, an agreement that contains general or broad language purporting to release an agent in advance from the agent's general fiduciary obligation to the principal is not likely to be enforceable. This is because a broadly sweeping release of an agent's fiduciary duty may not reflect an adequately informed judgment on the part of the principal; if effective, the release would expose the principal to the risk that the agent will exploit the agent's position in ways not foreseeable by the principal at the time the principal agreed to the release. In contrast, when a principal consents to specific transactions or to specified types of conduct by the agent, the principal has a focused opportunity to assess risks that are more readily identifiable.").

specific obligation under the Advisers Act, would be inconsistent with the Advisers Act,[30] regardless of the sophistication of the client.[31]

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30 *See* sections 206 and 215(a). Commenters generally agreed that a client cannot waive an investment adviser's fiduciary duty through agreement. *See* Dechert Letter; Comment Letter of Ropes & Gray LLP (Aug. 7, 2018) ("Ropes & Gray Letter"), at n.20; *see also supra* footnote 29. In the Proposed Interpretation, we stated that "the investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty." One commenter disputed this broad statement, believing that it called into question "the ability of an investment adviser and client to define the scope of the adviser's services and duties." ABA Letter; *see also* Financial Engines Letter. We have modified this statement to clarify that a general waiver of the fiduciary duty would violate that duty and to provide examples of such a general waiver.

31 Some commenters mentioned a 2007 No-Action Letter in which staff indicated that whether a clause in an advisory agreement that purports to limit an adviser's liability under that agreement (a so-called "hedge clause") would violate sections 206(1) and 206(2) of the Advisers Act depends on all of the surrounding facts and circumstances. Heitman Capital Management, LLC, SEC Staff No-Action Letter (Feb. 12, 2007) ("Heitman Letter"). A few commenters indicated that the Heitman Letter expanded the ability of investment advisers to private funds, and potentially other sophisticated clients, to disclaim their fiduciary duties under state law in an advisory agreement. *See, e.g.*, ILPA Letter 1; ILPA Letter 2. The commenters' descriptions of the Heitman Letter suggest that it may have been applied incorrectly. The Heitman Letter does not address the scope or substance of an adviser's federal fiduciary duty; rather, it addresses the extent to which hedge clauses may be misleading in violation of the Advisers Act's antifraud provisions. Another commenter agreed with this reading of the Heitman Letter. *See* Comment Letter of American Investment Council (Feb. 25, 2019). In response to these comments, we express below the Commission's views about an adviser's obligations under sections 206(1) and 206(2) of the Advisers Act with respect to the use of hedge clauses. Accordingly, because we are expressing our views in this Final Interpretation, the Heitman Letter is withdrawn.

This Final Interpretation makes clear that an adviser's federal fiduciary duty may not be waived, though its application may be shaped by agreement. This Final Interpretation does not take a position on the scope or substance of any fiduciary duty that applies to an adviser under applicable state law. *See supra* footnote 3. The question of whether a hedge clause violates the Advisers Act's antifraud provisions depends on all of the surrounding facts and circumstances, including the particular circumstances of the client (*e.g.,* sophistication). In our view, however, there are few (if any) circumstances in which a hedge clause in an agreement with a retail client would be consistent with those antifraud provisions, where the hedge clause purports to relieve the adviser from liability for conduct as to which the client has a non-waivable cause of action against the adviser provided by state or federal law. Such a hedge clause generally is likely to mislead those retail clients into not exercising their legal rights, in violation of the antifraud provisions, even where the agreement otherwise specifies that the client may continue to retain its non-waivable rights. Whether a hedge clause in an agreement with an institutional client would violate the Advisers Act's antifraud provisions will be determined based on the particular facts and circumstances. To the extent that a hedge clause creates a conflict of interest between an adviser and its client, the adviser must address the conflict as required by its duty of loyalty.

B. Duty of Care

As fiduciaries, investment advisers owe their clients a duty of care.[32] The Commission has discussed the duty of care and its components in a number of contexts.[33] The duty of care includes, among other things: (i) the duty to provide advice that is in the best interest of the client, (ii) the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship.

1. Duty to Provide Advice that is in the Best Interest of the Client

The duty of care includes a duty to provide investment advice that is in the best interest of the client, including a duty to provide advice that is suitable for the client.[34] In order to

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32 *See* Investment Advisers Act Release 2106, *supra* footnote 15 (stating that under the Advisers Act, "an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting," which is the subject of the release, and citing SEC v. Capital Gains *supra* footnote 2, to support this point). This Final Interpretation does not address the specifics of how an investment adviser might satisfy its fiduciary duty when voting proxies. *See also* Restatement (Third) of Agency, § 8.08 (discussing the duty of care that an agent owes its principal as a matter of common law); Tamar Frankel & Arthur B. Laby, The Regulation of Money Managers (updated 2017) ("Advice can be divided into three stages. The first determines the needs of the particular client. The second determines the portfolio strategy that would lead to meeting the client's needs. The third relates to the choice of securities that the portfolio would contain. The duty of care relates to each of the stages and depends on the depth or extent of the advisers' obligation towards their clients.").

33 *See, e.g.*, Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Investment Advisers Act Release No. 1406 (Mar. 16, 1994) ("Investment Advisers Act Release 1406") (stating that advisers have a duty of care and discussing advisers' suitability obligations); Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters, Exchange Act Release No. 23170 (Apr. 28, 1986) ("Exchange Act Release 23170") ("an adviser, as a fiduciary, owes its clients a duty of obtaining the best execution on securities transactions"). We highlight certain contexts, but not all, in which the Commission has addressed the duty of care. *See, e.g.,* Investment Advisers Act Release 2106, *supra* footnote 15.

34 In 1994, the Commission proposed a rule that would have made express the fiduciary obligation of investment advisers to make only suitable recommendations to a client. Investment Advisers Act Release 1406, *supra* footnote 33. Although never adopted, the rule was designed, among other things, to reflect the Commission's interpretation of an adviser's *existing* suitability obligation under the Advisers Act. In addition, we do not cite Investment Advisers Act Release 1406 as the source of authority for the view we express here, which at least one comment letter suggested, but cite it merely to show that the Commission has long held this view. *See* Comment Letter of the Managed Funds Association and the Alternative Investment Management Association (Aug. 7, 2018) (indicating that the Commission's failure to adopt the proposed suitability rule means "investment advisers are not subject to an express 'suitability' standard

provide such advice, an adviser must have a reasonable understanding of the client's objectives. The basis for such a reasonable understanding generally would include, for retail clients, an understanding of the investment profile, or for institutional clients, an understanding of the investment mandate.[35] The duty to provide advice that is in the best interest of the client based on a reasonable understanding of the client's objectives is a critical component of the duty of care.

Reasonable Inquiry into Client's Objectives

How an adviser develops a reasonable understanding will vary based on the specific facts and circumstances, including the nature of the client, the scope of the adviser-client relationship, and the nature and complexity of the anticipated investment advice.

In order to develop a reasonable understanding of a retail client's objectives, an adviser should, at a minimum, make a reasonable inquiry into the client's financial situation, level of financial sophistication, investment experience, and financial goals (which we refer to collectively as the retail client's "investment profile"). For example, an adviser undertaking to formulate a comprehensive financial plan for a retail client would generally need to obtain a

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under existing regulation"). We believe that this obligation to make only suitable recommendations to a client is part of an adviser's fiduciary duty to act in the best interest of its client. Accordingly, an adviser must provide investment advice that is suitable for its client in providing advice that is in the best interest of its client. *See* SEC v. Tambone, *supra* footnote 23 ("Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund…."); SEC v. Moran*, supra* footnote 23 ("Investment advisers are entrusted with the responsibility and duty to act in the best interest of their clients.").

35 Several commenters stated that the duty to make a reasonable inquiry into a client's investment profile may not apply in the institutional client context. *See, e.g.,* Comment Letter of BlackRock, Inc. (Aug. 7, 2018); Comment Letter of Teachers Insurance and Annuity Association of America (Aug. 7, 2018); Comment Letter of Allianz Global Investors U.S. LLC (Aug. 7, 2018) ("Allianz Letter"); Comment Letter of John Hancock Life Insurance Company (U.S.A.) (Aug. 3, 2018). Accordingly, we are describing the duty as a duty to have a reasonable understanding of the client's objectives. While not every client will have an investment profile, every client will have objectives. For example, an institutional client's objectives may be ascertained through its investment mandate.

range of personal and financial information about the client such as current income, investments, assets and debts, marital status, tax status, insurance policies, and financial goals.[36]

In addition, it will generally be necessary for an adviser to a retail client to update the client's investment profile in order to maintain a reasonable understanding of the client's objectives and adjust the advice to reflect any changed circumstances.[37] The frequency with which the adviser must update the client's investment profile in order to consider changes to any advice the adviser provides would itself turn on the facts and circumstances, including whether the adviser is aware of events that have occurred that could render inaccurate or incomplete the investment profile on which the adviser currently bases its advice. For instance, in the case of a financial plan where the investment adviser also provides advice on an ongoing basis, a change in the relevant tax law or knowledge that the client has retired or experienced a change in marital status could trigger an obligation to make a new inquiry.

By contrast, in providing investment advice to institutional clients, the nature and extent of the reasonable inquiry into the client's objectives generally is shaped by the specific investment mandates from those clients. For example, an investment adviser engaged to advise on an institutional client's investment grade bond portfolio would need to gain a reasonable understanding of the client's objectives within that bond portfolio, but not the client's objectives

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[36] Investment Advisers Act Release 1406, *supra* footnote 33. After making a reasonable inquiry into the client's investment profile, it generally would be reasonable for an adviser to rely on information provided by the client (or the client's agent) regarding the client's financial circumstances, and an adviser should not be held to have given advice not in its client's best interest if it is later shown that the client had misled the adviser concerning the information on which the advice was based.

[37] Such updating would not be needed with one-time investment advice. In the Proposed Interpretation, we stated that an adviser "must" update a client's investment profile in order to adjust the advice to reflect any changed circumstances. We believe that any obligation to update a client's investment profile, like the nature and extent of the reasonable inquiry into a retail client's objectives, turns on what is reasonable under the circumstances. Accordingly, we have revised the wording of this statement in this Final Interpretation.

within its entire investment portfolio. Similarly, an investment adviser whose client is a registered investment company or a private fund would need to have a reasonable understanding of the fund's investment guidelines and objectives. For advisers acting on specific investment mandates for institutional clients, particularly funds, we believe that the obligation to update the client's objectives would not be applicable except as may be set forth in the advisory agreement.

Reasonable belief that advice is in the best interest of the client

An investment adviser must have a reasonable belief that the advice it provides is in the best interest of the client based on the client's objectives. The formation of a reasonable belief would involve considering, for example, whether investments are recommended only to those clients who can and are willing to tolerate the risks of those investments and for whom the potential benefits may justify the risks.[38] Whether the advice is in a client's best interest must be evaluated in the context of the portfolio that the adviser manages for the client and the client's objectives.

For example, when an adviser is advising a retail client with a conservative investment objective, investing in certain derivatives may be in the client's best interest when they are used to hedge interest rate risk or other risks in the client's portfolio, whereas investing in certain directionally speculative derivatives on their own may not. For that same client, investing in a particular security on margin may not be in the client's best interest, even if investing in that same security without the use of margin may be in the client's best interest. However, for

[38] Item 8 of Part 2A of Form ADV requires an investment adviser to describe its methods of analysis and investment strategies and disclose that investing in securities involves risk of loss which clients should be prepared to bear. This item also requires that an adviser explain the material risks involved for each significant investment strategy or method of analysis it uses and particular type of security it recommends, with more detail if those risks are significant or unusual. Accordingly, investment advisers are required to identify and explain certain risks involved in their investment strategies and the types of securities they recommend. An investment adviser needs to consider those same risks in determining the clients to which the adviser recommends those investments.

example, when advising a financially sophisticated client, such as a fund or other sophisticated client that has an appropriate risk tolerance, it may be in the best interest of the client to invest in such derivatives or in securities on margin, or to invest in other complex instruments or other products that may have limited liquidity.

Similarly, when an adviser is assessing whether high risk products—such as penny stocks or other thinly-traded securities—are in a retail client's best interest, the adviser should generally apply heightened scrutiny to whether such investments fall within the retail client's risk tolerance and objectives. As another example, complex products such as inverse or leveraged exchange-traded products that are designed primarily as short-term trading tools for sophisticated investors may not be in the best interest of a retail client absent an identified, short-term, client-specific trading objective and, to the extent that such products are in the best interest of a retail client initially, they would require daily monitoring by the adviser.[39]

A reasonable belief that investment advice is in the best interest of a client also requires that an adviser conduct a reasonable investigation into the investment sufficient not to base its advice on materially inaccurate or incomplete information.[40] We have taken enforcement action where an investment adviser did not independently or reasonably investigate securities before recommending them to clients.[41]

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39 *See* Exchange-Traded Funds, Securities Act Release No. 10515 (June 28, 2018); SEC staff and FINRA, Investor Alert, Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors (Aug. 1, 2009); SEC Office of Investor Education and Advocacy, Investor Bulletin: Exchange-Traded Funds (ETFs) (Aug. 2012); *see also* FINRA Regulatory Notice 09-31, Non-Traditional ETFs – FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds (June 2009).

40 *See, e.g.*, Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) (indicating that a fiduciary "has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information").

41 *See, e.g.*, In the Matter of Larry C. Grossman, Investment Advisers Act Release No. 4543 (Sept. 30, 2016) (Commission Opinion) ("*In re* Grossman") (in connection with imposing liability on a principal of a

The cost (including fees and compensation) associated with investment advice would generally be one of many important factors—such as an investment product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility, likely performance in a variety of market and economic conditions, time horizon, and cost of exit—to consider when determining whether a security or investment strategy involving a security or securities is in the best interest of the client. When considering similar investment products or strategies, the fiduciary duty does not necessarily require an adviser to recommend the lowest cost investment product or strategy.

Moreover, an adviser would not satisfy its fiduciary duty to provide advice that is in the client's best interest by simply advising its client to invest in the lowest cost (to the client) or least remunerative (to the investment adviser) investment product or strategy without any further analysis of other factors in the context of the portfolio that the adviser manages for the client and the client's objective. Rather, the adviser could recommend a higher-cost investment or strategy if the adviser reasonably concludes that there are other factors about the investment or strategy that outweigh cost and make the investment or strategy in the best interest of the client, in light of that client's objectives. For example, it might be consistent with an adviser's fiduciary duty to advise a client with a high risk tolerance and significant investment experience to invest in a private equity fund with relatively higher fees and significantly less liquidity as compared with a fund that invests in publicly-traded companies if the private equity fund was in the client's best

registered investment adviser for recommending offshore private investment funds to clients), *stayed in part,* Investment Advisers Act No. 4563 (Nov. 1, 2016), *response to remand*, Investment Advisers Act Release No. 4871 (Mar. 29, 2018) (reinstating the Sept. 30, 2016 opinion and order, except with respect to the disgorgement and prejudgment interest in light of the Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017)).

interest because it provided exposure to an asset class that was appropriate in the context of the client's overall portfolio.

An adviser's fiduciary duty applies to all investment advice the investment adviser provides to clients, including advice about investment strategy, engaging a sub-adviser, and account type.[42] Advice about account type includes advice about whether to open or invest through a certain type of account (*e.g.*, a commission-based brokerage account or a fee-based advisory account) and advice about whether to roll over assets from one account (*e.g.*, a retirement account) into a new or existing account that the adviser or an affiliate of the adviser manages.[43] In providing advice about account type, an adviser should consider all types of accounts offered by the adviser and acknowledge to a client when the account types the adviser offers are not in the client's best interest.[44]

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[42] In addition, with respect to prospective clients, investment advisers have antifraud liability under section 206 of the Advisers Act, which, among other things, applies to transactions, practices, or courses of business which operate as a fraud or deceit upon prospective clients, including those regarding investment strategy, engaging a sub-adviser, and account type. We believe that, in order to avoid liability under this antifraud provision, an investment adviser should have sufficient information about the prospective client and its objectives to form a reasonable basis for advice before providing any advice about these matters. At the point in time at which the prospective client becomes a client of the investment adviser (*e.g.*, at account opening), the fiduciary duty applies. Accordingly, while advice to prospective clients about these matters must comply with the antifraud provisions under section 206 of the Advisers Act, the adviser must also satisfy its fiduciary duty with respect to any such advice (*e.g.*, regarding account type) when a prospective client becomes a client.

[43] We consider advice about "rollovers" to include advice about account type, in addition to any advice regarding the investments or investment strategy with respect to the assets to be rolled over, as the advice necessarily includes the advice about the account type into which assets are to be rolled over. As noted below, as a general matter, an adviser's duty to monitor extends to all personalized advice it provides to the client, including, for example, in an ongoing relationship, an evaluation of whether a client's account or program type (for example, a wrap account) continues to be in the client's best interest. *See infra* text accompanying footnote 52.

[44] Accordingly, in providing advice to a client or customer about account type, a financial professional who is dually licensed (*i.e.,* an associated person of a broker-dealer and a supervised person of an investment adviser (regardless of whether the professional works for a dual registrant, affiliated firms, or unaffiliated firms)) should consider all types of accounts offered (*i.e.,* both brokerage accounts and advisory accounts) when determining whether the advice is in the client's best interest. A financial professional who is only a supervised person of an investment adviser (regardless of whether that advisory firm is a dual registrant or affiliated with a broker-dealer) may only recommend an advisory account the adviser offers when the account is in the client's best interest. If a financial professional who is only a supervised person of an

2. Duty to Seek Best Execution

An investment adviser's duty of care includes a duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades (typically in the case of discretionary accounts).[45] In meeting this obligation, an adviser must seek to obtain the execution of transactions for each of its clients such that the client's total cost or proceeds in each transaction are the most favorable under the circumstances. An adviser fulfills this duty by seeking to obtain the execution of securities transactions on behalf of a client with the goal of maximizing value for the client under the particular circumstances occurring at the time of the transaction. Maximizing value encompasses more than just minimizing cost. When seeking best execution, an adviser should consider "the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness" to the adviser.[46] In other words, the "determinative factor" is not the lowest possible commission cost, "but whether the transaction represents the best qualitative execution."[47] Further, an

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investment adviser chooses to advise a client to consider a non-advisory account (or to speak with other personnel at a dual registrant or affiliate about a non-advisory account), that advice should be in the best interest of the client. This same framework applies in the case of a prospective client, but any advice or recommendation given to a prospective client would be subject to the antifraud provisions of the federal securities laws. *See supra* footnote 42 and Reg. BI Adoption, *supra* footnote 3.

[45] *See* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (July 18, 2006) (stating that investment advisers have "best execution obligations"); Investment Advisers Act Release 3060, *supra* footnote 15 (discussing an adviser's best execution obligations in the context of directed brokerage arrangements and disclosure of soft dollar practices); *see also* Advisers Act rule 206(3)-2(c) (referring to adviser's duty of best execution of client transactions).

[46] Exchange Act Release 23170, *supra* footnote 33.

[47] *Id.*

investment adviser should "periodically and systematically" evaluate the execution it is receiving for clients.[48]

3. Duty to Provide Advice and Monitoring over the Course of the Relationship

An investment adviser's duty of care also encompasses the duty to provide advice and monitoring at a frequency that is in the best interest of the client, taking into account the scope of the agreed relationship.[49] For example, when the adviser has an ongoing relationship with a client and is compensated with a periodic asset-based fee, the adviser's duty to provide advice and monitoring will be relatively extensive as is consistent with the nature of the relationship.[50] Conversely, absent an express agreement regarding the adviser's monitoring obligation, when the adviser and the client have a relationship of limited duration, such as for the provision of a

[48] *Id*. The Advisers Act does not prohibit advisers from using an affiliated broker to execute client trades. However, the adviser's use of such an affiliate involves a conflict of interest that must be fully and fairly disclosed and the client must provide informed consent to the conflict. *See also* Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1732 (Jul. 17, 1998) (discussing application of section 206(3) of the Advisers Act to certain principal and agency transactions). Two commenters requested that we prescribe specific obligations related to best execution. Comment Letter of the Healthy Markets Association (Aug. 7, 2018); Comment Letter of ICE Data Services (Aug. 7, 2018). However, prescribing specific requirements of how an adviser might satisfy its best execution obligations is outside of the scope of this Final Interpretation.

[49] *Cf.* SEC v. Capital Gains, *supra* footnote 2 (describing advisers' "basic function" as "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments" (quoting Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 1, at 28)). *Cf.* Barbara Black, *Brokers and Advisers-What's in a Name?*, 32 Fordham Journal of Corporate and Financial Law XI (2005) ("[W]here the investment adviser's duties include management of the account, [the adviser] is under an obligation to monitor the performance of the account and to make appropriate changes in the portfolio."); Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 Villanova Law Review 701 (2010) ("Laby Villanova Article") (stating that the scope of an adviser's activity can be altered by contract and that an adviser's fiduciary duty would be commensurate with the scope of the relationship) (internal citations omitted).

[50] However, an adviser and client may scope the frequency of the adviser's monitoring (*e.g.*, agreement to monitor quarterly or monthly and as appropriate in between based on market events), provided that there is full and fair disclosure and informed consent. We consider the frequency of monitoring, as well as any other material facts relating to the agreed frequency, such as whether there will also be interim monitoring when there are market events relevant to the client's portfolio, to be a material fact relating to the advisory relationship about which an adviser must make full and fair disclosure and obtain informed consent as required by its fiduciary duty.

one-time financial plan for a one-time fee, the adviser is unlikely to have a duty to monitor. In other words, in the absence of any agreed limitation or expansion, the scope of the duty to monitor will be indicated by the duration and nature of the agreed advisory arrangement.[51] As a general matter, an adviser's duty to monitor extends to all personalized advice it provides to the client, including, for example, in an ongoing relationship, an evaluation of whether a client's account or program type (for example, a wrap account) continues to be in the client's best interest.[52]

C. Duty of Loyalty

The duty of loyalty requires that an adviser not subordinate its clients' interests to its own.[53] In other words, an investment adviser must not place its own interest ahead of its client's interests.[54] To meet its duty of loyalty, an adviser must make full and fair disclosure to its clients

[51] *See also* Laby Villanova Article, *supra* footnote 49, at 728 (2010) ("If an adviser has agreed to provide continuous supervisory services, the scope of the adviser's fiduciary duty entails a continuous, ongoing duty to supervise the client's account, regardless of whether any trading occurs. This feature of the adviser's duty, even in a non-discretionary account, contrasts sharply with the duty of a broker administering a non-discretionary account, where no duty to monitor is required.") (internal citations omitted).

[52] Investment advisers also may consider whether written policies and procedures relating to monitoring would be appropriate under Advisers Act rule 206(4)-7, which requires any investment adviser registered or required to be registered under the Advisers Act to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons.

[53] Investment Advisers Act Release 3060, *supra* footnote 15 (adopting amendments to Form ADV and stating that "[u]nder the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own," citing Investment Advisers Act Release 2106, *supra* footnote 15). The duty of loyalty applies not just to advice regarding potential investments, but to all advice the investment adviser provides to an existing client, including advice about investment strategy, engaging a sub-adviser, and account type. *See supra* text accompanying footnotes 42-43.

[54] For example, an adviser cannot favor its own interests over those of a client, whether by favoring its own accounts or by favoring certain client accounts that pay higher fee rates to the adviser over other client accounts. The Commission has brought numerous enforcement actions against advisers that allocated trades to their own accounts and allocated less favorable or unprofitable trades to their clients' accounts. *See, e.g.*, *SEC v. Strategic Capital Management, LLC and Michael J. Breton*, Litigation Release No. 23867 (June 23, 2017) (partial settlement) (adviser placed trades through a master brokerage account and then allocated profitable trades to adviser's account while placing unprofitable trades into the client accounts in

of all material facts relating to the advisory relationship.[55] Material facts relating to the advisory relationship include the capacity in which the firm is acting with respect to the advice provided. This will be particularly relevant for firms or individuals that are dually registered as broker-dealers and investment advisers and who serve the same client in both an advisory and a brokerage capacity. Thus, such firms and individuals generally should provide full and fair disclosure about the circumstances in which they intend to act in their brokerage capacity and the circumstances in which they intend to act in their advisory capacity. This disclosure may be accomplished through a variety of means, including, among others, written disclosure at the beginning of a relationship that clearly sets forth when the dual registrant would act in an advisory capacity and how it would provide notification of any changes in capacity.[56] Similarly, a dual registrant acting in its advisory capacity should disclose any circumstances under which its advice will be limited to a menu of certain products offered through its affiliated broker-dealer or affiliated investment adviser.

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violation of fiduciary duty and contrary to disclosures). In the Proposed Interpretation, we stated that the duty of loyalty requires an adviser to "put its client's interest first." One commenter suggested that the requirement of an adviser to put its client's interest "first" is very different from a requirement not to "subordinate" or "subrogate" clients' interests, and is inconsistent with how the duty of loyalty had been applied in the past. *See* Comment Letter of the Asset Management Group of the Securities Industry and Financial Markets Association (Aug. 7, 2018) ("SIFMA AMG Letter"). Accordingly, we have revised the description of the duty of loyalty in this Final Interpretation to be more consistent with how we have previously described the duty. *See* Investment Advisers Act Release 3060, *supra* footnote 15 ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own.") (citing Investment Advisers Act Release 2106, *supra* footnote 15). In practice, referring to putting a client's interest first is a plain English formulation commonly used by investment advisers to explain their duty of loyalty in a way that may be more understandable to retail clients.

55 *See* SEC v. Capital Gains, *supra* footnote 2 ("Failure to disclose material facts must be deemed fraud or deceit within its intended meaning."); Investment Advisers Act Release 3060, *supra* footnote 15 ("as a fiduciary, an adviser has an ongoing obligation to inform its clients of any material information that could affect the advisory relationship"); *see also* General Instruction 3 to Part 2 of Form ADV ("Under federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts relating to the advisory relationship.").

56 *See also* Reg. BI Adoption, *supra* footnote 3, at 99.

In addition, an adviser must eliminate or at least expose through full and fair disclosure all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.[57] We believe that while full and fair disclosure of all material facts relating to the advisory relationship or of conflicts of interest and a client's informed consent prevent the presence of those material facts or conflicts themselves from violating the adviser's fiduciary duty, such disclosure and consent do not themselves satisfy the adviser's duty to act in the client's best interest.[58] To illustrate what

[57] In the Proposed Interpretation, we stated that an adviser must seek to avoid conflicts of interest with its clients. Proposed Interpretation, *supra* footnote 6. Some commenters requested clarity on what it means to "seek to avoid" conflicts of interest. *See, e.g.,* Comment Letter of Schulte Roth & Zabel LLP (Aug. 8, 2018); ABA Letter (stating that this wording could be read to require an adviser to first seek to avoid a conflict, before addressing a conflict through disclosure, rather than being able to provide full and fair disclosure of a conflict, and only seek avoidance if the conflict cannot be addressed through disclosure). The Commission first used this phrasing when adopting amendments to the Form ADV Part 2 instructions. *See* Investment Advisers Act Release 3060, *supra* footnote 15 and General Instruction 3 to Part 2 of Form ADV ("As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship."). The release adopting this instruction clarifies the Commission's intent that it capture the fiduciary duty described in SEC v. Capital Gains and Arleen Hughes. *See* Investment Advisers Act Release 3060, *supra* footnote 15, at n.4 and accompanying text (citing SEC v. Capital Gains, *supra* footnote 2, and Arleen Hughes, *supra* footnote 18, as the basis of this language). Both of these cases emphasized that the adviser, as a fiduciary, should seek to avoid conflicts, but at a minimum must make full and fair disclosure of the conflict and obtain the client's informed consent. *See* SEC v. Capital Gains, *supra* footnote 2 ("The Advisers Act thus reflects . . . a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."); Arleen Hughes, *supra* footnote 18 ("Since loyalty to his trust is the first duty which a fiduciary owes to his principal, it is the general rule that a fiduciary must not put himself into a position where his own interests may come in conflict with those of his principal" but if a fiduciary "chooses to assume a role in which she is motivated by conflicting interests, . . . she may do so if, but only if, she obtains her client's consent after disclosure . . ."). We believe the Commission's reference to "seek to avoid" conflicts in the Form ADV Part 2 instructions is consistent with the Final Interpretation's statement that an adviser "must eliminate or at least expose all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested" as well as the substantively identical statements in SEC v. Capital Gains, *supra* footnote 2, and Arleen Hughes, *supra* footnote 18. While an adviser may satisfy its duty of loyalty by making full and fair disclosure of conflicts of interest and obtaining the client's informed consent, an adviser is prohibited from overreaching or taking unfair advantage of a client's trust.

[58] As noted above, an investment adviser's obligation to act in the best interest of its client is an overarching principle that encompasses both the duty of care and the duty of loyalty. *See* SEC v. Tambone*, supra* footnote 23 (stating that Advisers Act section 206 "imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund . . . and *includes* an obligation to provide 'full and fair disclosure of all material facts'") (emphasis added) (citing SEC v. Capital Gains*, supra* footnote 2). We describe

constitutes full and fair disclosure, we are providing the following guidance on (i) the appropriate level of specificity, including the appropriateness of stating that an adviser "may" have a conflict, and (ii) considerations for disclosure regarding conflicts related to the allocation of investment opportunities among eligible clients.

In order for disclosure to be full and fair, it should be sufficiently specific so that a client is able to understand the material fact or conflict of interest and make an informed decision whether to provide consent.[59] For example, it would be inadequate to disclose that the adviser has "other clients" without describing how the adviser will manage conflicts between clients if and when they arise, or to disclose that the adviser has "conflicts" without further description.

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above in this Final Interpretation how the application of an investment adviser's fiduciary duty to its client will vary with the scope of the advisory relationship. *See supra* section II.A.

59 Arleen Hughes, *supra* footnote 18, at 4 and 8 (stating, "[s]ince loyalty to his trust is the first duty which a fiduciary owes to his principal, it is the general rule that a fiduciary must not put himself into a position where his own interests may come in conflict with those of his principal. To prevent any conflict and the possible subordination of this duty to act solely for the benefit of his principal, a fiduciary at common law is forbidden to deal as an adverse party with his principal. An exception is made, however, where the principal gives his informed consent to such dealings," and adding that, "[r]egistrant has an affirmative obligation to disclose all material facts to her clients in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent."); *see also Hughes v. Securities and Exchange Commission*, 174 F.2d 969 (1949) (affirming the SEC decision in Arleen Hughes); General Instruction 3 to Part 2 of Form ADV (stating that an adviser's disclosure obligation "requires that [the adviser] provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest [the adviser has] and the business practices in which [the adviser] engage[s], and can give informed consent to such conflicts or practices or reject them"); Investment Advisers Act Release 3060, *supra* footnote 15; Restatement (Third) of Agency §8.06 ("Conduct by an agent that would otherwise constitute a breach of duty as stated in §§ 8.01, 8.02, 8.03, 8.04, and 8.05 [referencing the fiduciary duty] does not constitute a breach of duty if the principal consents to the conduct, provided that (a) in obtaining the principal's consent, the agent (i) acts in good faith, (ii) discloses all material facts that the agent knows, has reason to know, or should know would reasonably affect the principal's judgment unless the principal has manifested that such facts are already known by the principal or that the principal does not wish to know them, and (iii) otherwise deals fairly with the principal; and (b) the principal's consent concerns either a specific act or transaction, or acts or transactions of a specified type that could reasonably be expected to occur in the ordinary course of the agency relationship."). *See infra* footnotes 67-70 and accompanying text for a more detailed discussion of informed consent and how it is generally considered on an objective basis and may be inferred.

Similarly, disclosure that an adviser "may" have a particular conflict, without more, is not adequate when the conflict actually exists.[60] For example, we would consider the use of "may" inappropriate when the conflict exists with respect to some (but not all) types or classes of clients, advice, or transactions without additional disclosure specifying the types or classes of clients, advice, or transactions with respect to which the conflict exists. In addition, the use of "may" would be inappropriate if it simply precedes a list of all possible or potential conflicts regardless of likelihood and obfuscates actual conflicts to the point that a client cannot provide informed consent. On the other hand, the word "may" could be appropriately used to disclose to a client a potential conflict that does not currently exist but might reasonably present itself in the future.[61]

Whether the disclosure is full and fair will depend upon, among other things, the nature of the client, the scope of the services, and the material fact or conflict. Full and fair disclosure for an institutional client (including the specificity, level of detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity and more resources than

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[60] We have brought enforcement actions in such cases. *See, e.g.,* In the Matter of The Robare Group, Ltd., et al., Investment Advisers Act Release No. 4566 (Nov. 7, 2016) (Commission Opinion) (finding, among other things, that adviser's disclosure that it *may* receive a certain type of compensation was inadequate because it did not reveal that the adviser actually had an arrangement pursuant to which it received fees that presented a potential conflict of interest); *aff'd in part and rev'd in part on other grounds Robare* v. SEC, *supra* footnote 20; *In re Grossman*, *supra* footnote 41 (indicating that "the use of the prospective 'may' in [the relevant Form ADV disclosures] is misleading because it suggested the mere possibility that [the broker] would make a referral and/or be paid 'referral fees' at a later point, when in fact a commission-sharing arrangement was already in place and generating income"). *Cf. Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 640 (D.C. Cir. 2008) ("The Commission noted the critical distinction between disclosing the risk that a future event *might* occur and disclosing actual knowledge the event *will* occur.") (emphasis in original). For Form ADV Part 2 purposes, advisers are instructed that when they have a conflict or engage in a practice with respect to some (but not all) types or classes of clients, advice, or transactions, to indicate as such rather than disclosing that they "may" have the conflict or engage in the practice. General Instruction 2 to Part 2 of Form ADV.

[61] We have added this example of a circumstance where "may" could be appropriately used in response to the request of some commenters. *See, e.g.,* Pickard Letter; ICI Letter; Ropes & Gray Letter; IAA Letter.

retail clients to analyze and understand complex conflicts and their ramifications.[62] Nevertheless, regardless of the nature of the client, the disclosure must be clear and detailed enough for the client to make an informed decision to consent to the conflict of interest or reject it.

When allocating investment opportunities among eligible clients, an adviser may face conflicts of interest either between its own interests and those of a client or among different clients.[63] If so, the adviser must eliminate or at least expose through full and fair disclosure the conflicts associated with its allocation policies, including how the adviser will allocate investment opportunities, such that a client can provide informed consent.[64] When allocating investment opportunities, an adviser is permitted to consider the nature and objectives of the client and the scope of the relationship.[65] An adviser need not have *pro rata* allocation policies, or any particular method of allocation, but, as with other conflicts and material facts, the

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62 *Arleen Hughes, supra* footnote 18 (the "method and extent of disclosure depends upon the particular client involved," and an unsophisticated client may require "a more extensive explanation than the informed investor").

63 *See* Restatement (Third) of Agency, § 8.01 General Fiduciary Principle (2006) ("Unless the principal consents, the general fiduciary principle, as elaborated by the more specific duties of loyalty stated in §§ 8.02 to 8.05, also requires that an agent refrain from using the agent's position or the principal's property to benefit the agent or a third party.").

64 The Commission has brought numerous enforcement actions alleging that advisers unfairly allocated client trades to preferred clients without making full and fair disclosure. *See* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011), *available at* https://www.sec.gov/news/studies/2011/913studyfinal.pdf, at 23–24 (citing enforcement actions). This Final Interpretation sets forth the Commission's views regarding what constitutes full and fair disclosure. *See, e.g., supra* text accompanying footnote 59; *see also* Barry Barbash and Jai Massari, *The Investment Advisers Act of 1940; Regulation by Accretion*, 39 Rutgers Law Journal 627 (2008) (stating that under section 206 of the Advisers Act and traditional notions of fiduciary and agency law, an adviser must not give preferential treatment to some clients or systematically exclude eligible clients from participating in specific opportunities without providing the clients with appropriate disclosure regarding the treatment).

65 An adviser and a client may even agree that certain investment opportunities or categories of investment opportunities will not be allocated or offered to a client.

adviser's allocation practices must not prevent it from providing advice that is in the best interest of its clients.[66]

While most commenters agreed that informed consent is a component of the fiduciary duty, a few commenters objected to what they saw as subjectivity in the use of the term "informed" to describe a client's consent to a disclosed conflict.[67] The fact that disclosure must be full and fair such that a client can provide informed consent does not require advisers to make an affirmative determination that a particular client understood the disclosure and that the client's consent to the conflict of interest was informed. Rather, disclosure should be designed to put a client in a position to be able to understand and provide informed consent to the conflict of interest. A client's informed consent can be either explicit or, depending on the facts and circumstances, implicit.[68] We believe, however, that it would not be consistent with an adviser's fiduciary duty to infer or accept client consent where the adviser was aware, or reasonably should have been aware, that the client did not understand the nature and import of the conflict.[69]

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[66] In the Proposed Interpretation, we stated that "in allocating investment opportunities among eligible clients, an adviser must treat all clients fairly." Some commenters interpreted this statement to mean that it would be impermissible for an adviser to allocate a particular investment to one eligible client instead of a second eligible client, even when the second client had received full and fair disclosure and provided informed consent to such an investment being allocated to the first client. *See, e.g.,* Ropes & Gray Letter; SIFMA AMG Letter. We have removed that sentence from this Final Interpretation and replaced it with this discussion that clarifies our views regarding allocation of investment opportunities.

[67] *See, e.g.,* Comment Letter of LPL Financial LLC (Aug. 7, 2018); Ropes & Gray Letter.

[68] We do not interpret an adviser's fiduciary duty to require that full and fair disclosure or informed consent be achieved in a written advisory contract or otherwise in writing. For example, an adviser could provide a client full and fair disclosure of all material facts relating to the advisory relationship as well as full and fair disclosure of all conflicts of interest which might incline the adviser, consciously or unconsciously, to render advice that was not disinterested, through a combination of Form ADV and other disclosure and the client could implicitly consent by entering into or continuing the investment advisory relationship with the adviser.

[69] *See* Arleen Hughes, *supra* footnote 18 ("Registrant cannot satisfy this duty by executing an agreement with her clients which the record shows some clients do not understand and which, in any event, does not contain the essential facts which she must communicate."). In the Proposed Interpretation, we stated that inferring or accepting client consent to a conflict would not be consistent with the fiduciary duty where "the material facts concerning the conflict could not be fully and fairly disclosed." Some commenters expressed

In some cases, conflicts may be of a nature and extent that it would be difficult to provide disclosure to clients that adequately conveys the material facts or the nature, magnitude, and potential effect of the conflict sufficient for a client to consent to or reject it.[70] In other cases, disclosure may not be specific enough for a client to understand whether and how the conflict could affect the advice it receives. For retail clients in particular, it may be difficult to provide disclosure regarding complex or extensive conflicts that is sufficiently specific, but also understandable. In all of these cases where an investment adviser cannot fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent, the adviser should either *eliminate* the conflict or adequately *mitigate* (*i.e.,* modify practices to reduce) the conflict such that full and fair disclosure and informed consent are possible.

Full and fair disclosure of all material facts relating to the advisory relationship, and all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested, can help clients and prospective clients in evaluating and selecting investment advisers. Accordingly, we require advisers to deliver to their clients a "brochure," under Part 2A of Form ADV, which sets out minimum disclosure requirements, including disclosure of certain conflicts.[71] Investment advisers are required to

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agreement with this statement. *See, e.g.,* CFA Letter (agreeing that "advisers should be precluded from inferring or accepting client consent to a conflict" where the material facts concerning the conflict could not be fully and fairly disclosed). Other commenters expressed doubt that such disclosure could be impossible. *See, e.g.,* Allianz Letter ("[W]e have not encountered a situation in which we could not fully and fairly disclose the material facts, including the nature, extent, magnitude and potential effects of the conflict."). In response to commenters, we have replaced the general statement about an inability to fully and fairly disclose material facts about the conflict with more specific examples of how advisers can make such full and fair disclosure. *See supra* text accompanying footnotes 59-66.

70 As discussed above, institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications. *See supra* text accompanying footnote 62.

71 Investment Advisers Act Release 3060, *supra* footnote 15; General Instruction 3 to Part 2 of Form ADV ("Under federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts relating to the advisory relationship. As a fiduciary, you also must seek to avoid conflicts of

deliver the brochure to a prospective client at or before entering into a contract so that the prospective client can use the information contained in the brochure to decide whether or not to enter into the advisory relationship.[72] In a concurrent release, we are requiring all investment advisers to deliver to retail investors, at or before the time the adviser enters into an investment advisory agreement, a relationship summary, which would include, among other things, a plain English summary of certain of the firm's conflicts of interest, and would encourage retail investors to inquire about those conflicts.[73]

III. ECONOMIC CONSIDERATIONS

As noted above, this Final Interpretation is intended to reaffirm, and in some cases clarify, certain aspects of an investment adviser's fiduciary duty under the Advisers Act. The Final Interpretation does not itself create any new legal obligations for advisers. Nonetheless, the Commission recognizes that to the extent an adviser's practices are not consistent with the Final Interpretation provided above, the Final Interpretation could have potential economic effects. We discuss these potential effects below.

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interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship. This obligation requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them."). *See also* Robare v. SEC, *supra* footnote 20 ("[R]egardless of what Form ADV requires, [investment advisers have] a fiduciary duty to fully and fairly reveal conflicts of interest to their clients.").

72 Investment Advisers Act rule 204-3. *See* Investment Advisers Act Release 3060, *supra* footnote 15 (adopting amendments to Form ADV and stating that, "A client may use this disclosure to select his or her own adviser and evaluate the adviser's business practices and conflicts on an ongoing basis. As a result, the disclosure clients and prospective clients receive is critical to their ability to make an informed decision about whether to engage an adviser and, having engaged the adviser, to manage that relationship."). To the extent that the information required for inclusion in the brochure does not satisfy an adviser's disclosure obligation, the adviser "may have to disclose to clients information not specifically required by Part 2 of Form ADV or in more detail than the brochure items might otherwise require" and this disclosure may be made "in [the] brochure or by some other means." General Instruction 3 to Part 2 of Form ADV.

73 Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, Investment Advisers Act Release No. 5247 (June 5, 2019) ("Relationship Summary Adoption").

A. Background

The Commission's interpretation of the standard of conduct for investment advisers under the Advisers Act set forth in this Final Interpretation would affect investment advisers and their associated persons as well as the clients of those investment advisers, and the market for financial advice more broadly.[74] As of December 31, 2018, there were 13,299 investment advisers registered with the Commission with over $84 trillion in assets under management as well as 17,268 investment advisers registered with states with approximately $334 billion in assets under management and 3,911 investment advisers who submit Form ADV as exempt reporting advisers.[75] As of December 31, 2018, there are approximately 41 million client accounts advised by SEC-registered investment advisers.[76]

These investment advisers currently incur ongoing costs related to their compliance with their legal and regulatory obligations, including costs related to understanding the standard of conduct. We believe, based on the Commission's experience, that the interpretations set forth in this Final Interpretation are generally consistent with investment advisers' current understanding of their fiduciary duty under the Advisers Act.[77] However, we recognize that as the scope of the

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74 *See* Relationship Summary Proposal, *supra* footnote 5, at section IV.A (discussing the market for financial advice generally).

75 Data on investment advisers is based on staff analysis of Form ADV, particularly Item 5.F.(2)(c) of Part 1A for Regulatory Assets under Management. Because this Final Interpretation interprets an adviser's fiduciary duty under section 206 of the Advisers Act, this interpretation would be applicable to both SEC- and state-registered investment advisers, as well as other investment advisers that are exempt from registration or subject to a prohibition on registration under the Advisers Act.

76 Item 5.F.(2)(f) of Part 1A of Form ADV.

77 *See supra* section II.B.i. For example, some commenters asked that we clarify from the Proposed Interpretation that an adviser and its client can tailor the scope of the relationship to which the fiduciary duty applies, through contract. *See, e.g.,* MMI Letter; Financial Engines Letter; ABA Letter. *See supra* footnotes 67–69 and accompanying text, including clarifications addressing these commenters' concerns. More generally, some commenters requested clarifications from the Proposed Interpretation, and we are issuing this Final Interpretation to address those issues raised by commenters, as discussed in more detail above.

adviser-client relationship varies and in many cases can be broad, there may be certain current circumstances where investment advisers interpret their fiduciary duty to require something less, and other current circumstances where they interpret their fiduciary duty to require something more, than this Final Interpretation. We lack data to identify which investment advisers currently understand their fiduciary duty to require something different from the standard of conduct articulated in this Final Interpretation. Based on our experience over decades of interacting with the investment management industry as its primary regulator, however, we generally believe that it is not a significant portion of the market.

One commenter suggested that the Proposed Interpretation's discussion of how an adviser fulfills its fiduciary duty appeared to be based in the context of having as a client an individual investor, and not a fund.[78] This commenter indicated its concerns about the ability of a fund manager to infer consent from a client that is a fund, and that issues regarding inferring consent from funds could significantly increase compliance costs for venture capital funds.[79] Our discussion above in this Final Interpretation includes clarifications to address comments, and expressly acknowledges that while all investment advisers owe each of their clients a fiduciary duty, the specific application of the investment adviser's fiduciary duty must be viewed in the context of the agreed-upon scope of the adviser-client relationship.[80] This Final Interpretation, as compared to the Proposed Interpretation, includes significantly more examples of the application of the fiduciary duty to institutional clients, and clarifies the Commission's interpretation of what constitutes full and fair disclosure and informed consent, acknowledging a number of comments

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78 *See* Comment Letter of National Venture Capital Association (Aug. 7, 2018) ("NVCA Letter").

79 *Id.*

80 *See supra* section II.A.

on this topic.[81] We believe that these clarifications will help address some of this commenter's concerns with respect to increased compliance costs for venture capital funds, in part by clarifying how the fiduciary duty can apply to institutional clients. We continue to believe, based on our experience with investment advisers to different types of clients, that advisers understand their fiduciary duty to be generally consistent with the standards of this Final Interpretation.

B. Potential Economic Effects

Based on our experience as the long-standing regulator of the investment adviser industry, the Commission's interpretation of the fiduciary duty under section 206 of the Advisers Act described in this Final Interpretation generally reaffirms the current practices of investment advisers. Therefore, we expect there to be no significant economic effects from this Final Interpretation. However, as with other circumstances in which the Commission speaks to the legal obligations of regulated entities, we acknowledge that affected firms, including those whose practices are consistent with the Commission's interpretation, incur costs to evaluate the Commission's interpretation and assess its applicability to them. Further, to the extent certain investment advisers currently understand the practices necessary to comply with their fiduciary duty to be different from those discussed in this Final Interpretation, there could be some economic effects, which we discuss below.

Clients of investment advisers

The typical relationship between an investment adviser and a client is a principal-agent relationship, where the principal (the client) hires an agent (the investment adviser) to perform

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81 In particular, this Final Interpretation expressly notes our belief that a client generally may provide its informed consent implicitly "by entering into or continuing the investment advisory relationship with the adviser" after disclosure of a conflict of interest. *See supra* footnote 68.

some service (investment advisory services) on the principal's behalf.[82] Because investors and investment advisers are likely to have different preferences and goals, the investment adviser relationship is subject to agency problems, including those resulting from conflicts: that is, investment advisers may take actions that increase their well-being at the expense of investors, thereby imposing agency costs on investors.[83] A fiduciary duty, such as the duty investment advisers owe their clients, can mitigate these agency problems and reduce agency costs by deterring investment advisers from taking actions that expose them to legal liability.[84]

To the extent this Final Interpretation causes a change in behavior of those investment advisers, if any, who currently interpret their fiduciary duty to require something different from this Final Interpretation, we expect a potential reduction in agency problems and, consequently, a reduction of agency costs to the client.[85] For example, an adviser that, as part of its duty of loyalty, fully and fairly discloses[86] a conflict of interest and receives informed consent from its client with respect to the conflict may reduce agency costs by increasing the client's awareness of the conflict and improving the client's ability to monitor the adviser with respect to this conflict. Alternatively, the client may choose to not consent given the information the adviser

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82 *See*, *e.g.*, James A. Brickley, Clifford W. Smith, Jr. & Jerold L. Zimmerman, *Managerial Economics and Organizational Architecture* (2004), at 265 ("An agency relationship consists of an agreement under which one party, the principal, engages another party, the agent, to perform some service on the principal's behalf."); *see also* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 Journal of Financial Economics 305-360 (1976) ("Jensen and Meckling").

83 *See, e.g.*, Jensen and Meckling, *supra* footnote 82.

84 *See*, *e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 Journal of Law & Economics 425-46 (1993).

85 To the extent that this Final Interpretation clarifies the fiduciary duty for investment advisers, one commenter suggested it may then clarify what clients expect of their investment advisers. *See* Cambridge Letter (stating that "greater clarity on all aspects of an investment adviser's fiduciary duty will improve the ability to craft such policies and procedures, as well as support the elimination of confusion for retail clients and investment professionals").

86 As discussed above, whether such a disclosure is full and fair will depend upon, among other things, the nature of the client, the scope of the services, and the conflict. *See supra* section II.C.

discloses about a conflict of interest if the perceived risk associated with the conflict is too significant, and instead try to renegotiate the contract with the adviser or look for an alternative adviser or other financial professional. In addition, the obligation to fully and fairly disclose a current conflict may cause the adviser to take other actions, for example eliminating or adequately mitigating (*i.e.*, modifying practices to reduce) that conflict rather than taking the risk that the client will not provide informed consent or will look for an alternative adviser or other financial professional. The extent to which agency costs would be reduced by such a disclosure is difficult to assess given that we are unable to ascertain the total number of investment advisers that currently interpret their fiduciary duty to require something different from the Commission's interpretation,[87] and consequently we are not able to estimate the agency costs such advisers currently impose on investors. In addition, we believe that there may be potential benefits for clients of those investment advisers, if any, to the extent this Final Interpretation is effective at strengthening investment advisers' understanding of their obligations to their clients. Further, to the extent that this Final Interpretation enhances the understanding of any investment advisers of their duty of care, it may potentially raise the quality of investment advice and also lead to increased compliance with the duty to monitor, for example whether advice about an account or program type remains in the client's best interest, thereby increasing the likelihood that the advice fits with a client's objectives.

In addition, to the extent that this Final Interpretation causes some investment advisers to properly identify circumstances in which conflicts may be of a nature and extent that it would be

[87] One commenter did not agree that the discussion of fiduciary obligations in the Proposed Interpretation applied to advisers to funds as well as advisers to retail investors. *See* NVCA Letter. As discussed above, this Final Interpretation has clarified the discussion to address this commenter's concerns and acknowledges that the application of the fiduciary duty of an adviser to a retail client would be different from the specific application of the fiduciary duty of an adviser to a registered investment company or private fund.

difficult to provide disclosure to clients that adequately conveys the material facts or nature, magnitude, and potential effect of the conflict sufficient for clients to consent to it or reject it, or in which the disclosure may not be specific enough for clients to understand whether and how the conflict could affect the advice they receive, this Final Interpretation may lead those investment advisers to take additional steps to improve their disclosures or to determine whether adequately mitigating (*i.e.,* modifying practices to reduce) the conflict may be appropriate such that full and fair disclosure and informed consent are possible. This Final Interpretation may also cause some investment advisers to conclude in some circumstances that they cannot fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent. We would expect that these advisers would either eliminate the conflict or adequately mitigate (*i.e.,* modify practices to reduce) the conflict such that full and fair disclosure and informed consent would be possible. Thus, to the extent this Final Interpretation would cause investment advisers to better understand their obligations and therefore to modify their business practices in ways that (i) reduce the likelihood that conflicts and other agency costs will cause an adviser to place its interests ahead of the interests of the client or (ii) help those advisers to provide full and fair disclosure, it would be expected to ameliorate the agency conflict between investment advisers and their clients. In turn, this may improve the quality of advice that the clients receive and therefore produce higher overall returns for clients and increase the efficiency of portfolio allocation. However, as discussed above, we would generally expect these effects to be minimal because we believe that the interpretations we are setting forth in this Final Interpretation are generally consistent with investment advisers' current understanding of their fiduciary duty under the Advisers Act. Finally, this Final Interpretation would also benefit clients of investment advisers to the extent it assists the Commission in its oversight of investment advisers' compliance with their regulatory obligations.

Investment advisers and the market for investment advice

In general, we expect this Final Interpretation to affirm investment advisers' understanding of the fiduciary duty they owe their clients under the Advisers Act, reduce uncertainty for advisers, and facilitate their compliance. Further, by addressing in one release certain aspects of the fiduciary duty that an investment adviser owes to its clients under the Advisers Act, this Final Interpretation could reduce investment advisers' costs associated with comprehensively assessing their compliance obligations. We acknowledge that, as with other circumstances in which the Commission speaks to the legal obligations of regulated entities, affected firms, including those whose practices are consistent with the Commission's interpretation, incur costs to evaluate the Commission's interpretation and assess its applicability to them. Moreover, as discussed above, there may be certain investment advisers who currently understand their fiduciary duty to require something different from the fiduciary duty described in this Final Interpretation. Those investment advisers would experience an increase in their compliance costs as they change their systems, processes, disclosures, and behavior, and train their supervised persons, to align with this Final Interpretation. However, this increase in costs would be mitigated by potential benefits in efficiency for investment advisers that are able to understand aspects of their fiduciary duty by reference to a single Commission release that reaffirms—and in some cases clarifies—certain aspects of the fiduciary duty.[88] In addition, and as discussed above, in the case of an investment adviser that believed it owed its clients a lower

[88] As noted above, *supra* footnote 3, this Final Interpretation is intended to highlight the principles relevant to an adviser's fiduciary duty. It is not, however, intended to be the exclusive resource for understanding these principles.

standard of conduct, there will be client benefits from the ensuing adaptation of a higher standard of conduct and related change in policies and procedures.

Moreover, to the extent any investment advisers that understood their fiduciary duty to require something different from the fiduciary duty described in this Final Interpretation change their behavior to align with this Final Interpretation, there could also be some economic effects on the market for investment advice. For example, any improved compliance may not only reduce agency costs in current investment advisory relationships and increase the value of those relationships to current clients, it may also increase trust in the market for investment advice among all investors, which may result in more investors seeking advice from investment advisers. This may, in turn, benefit investors by improving the efficiency of their portfolio allocation. To the extent it is costly or difficult, at least in the short term, to expand the supply of investment advisory services to meet an increase in demand, any such new demand for investment advisory services could put some upward price pressure on fees. At the same time, however, if any such new demand increases the overall profitability of investment advisory services, then we expect it would encourage entry by new investment advisers—or hiring of new representatives by current investment advisers—such that competition would increase over time. Indeed, the recent growth in the investment adviser segment of the market, both in terms of number of firms and number of representatives,[89] may suggest that the costs of expanding the supply of investment advisory services are currently relatively low.

Additionally, we acknowledge that to the extent certain investment advisers recognize, as a result of this Final Interpretation, that their fiduciary duty is stricter than the fiduciary duty as they currently interpret it, it could potentially affect competition. Specifically, this Final

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89 *See* Relationship Summary Proposal, *supra* footnote 5, at section IV.A.1.d.

Interpretation of certain aspects of the standard of conduct for investment advisers may result in additional compliance costs for investment advisers seeking to meet their fiduciary duty. This increase in compliance costs, in turn, may discourage competition for client segments that generate lower revenues, such as clients with relatively low levels of financial assets, which could reduce the supply of investment advisory services and raise fees for these client segments. However, the investment advisers who already are complying with the understanding of their fiduciary duty reflected in this Final Interpretation, and who may therefore currently have a comparative cost disadvantage, could find it more profitable to compete for the clients of those investment advisers who would face higher compliance costs as a result of this Final Interpretation, which would mitigate negative effects on the supply of investment advisory services. Further, as noted above, there has been a recent growth trend in the supply of investment advisory services, which is likely to mitigate any potential negative supply effects from this Final Interpretation.[90]

One commenter discussed that, in its view, any statement in the Proposed Interpretation that certain circumstances may require the elimination of material conflicts, rather than full and fair disclosure or the mitigation of such conflicts, could lead to an effect on the market and costs to advisers, if such a requirement would cause advisers who had not shared that interpretation to change their business models or product offerings or the ways in which they interact with

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[90] Beyond having an effect on competition in the market for investment adviser services, it is possible that this Final Interpretation could affect competition between investment advisers and other providers of financial advice, such as broker-dealers, banks, and insurance companies. This may be the case if certain investors base their choice between an investment adviser and another provider of financial advice, at least in part, on their perception of the standards of conduct each owes to their customers. To the extent that this Final Interpretation increases investors' trust in investment advisers' overall compliance with their standard of conduct, certain of these investors may become more willing to hire an investment adviser rather than one of their non-investment adviser competitors. As a result, investment advisers as a group may become more competitive compared to that of other types of providers of financial advice. On the other hand, if this Final Interpretation raises costs for investment advisers, they could become less competitive with other financial advice providers.

clients.[91] We disagree that this Final Interpretation includes a requirement to eliminate conflicts of interest. As discussed in more detail above, elimination of a conflict is one method of addressing that conflict; when appropriate advisers may also address the conflict by providing full and fair disclosure such that a client can provide informed consent to the conflict.[92] Further, we believe that any potential costs or market effects resulting from investment advisers addressing conflicts of interest may be decreased by the flexibility advisers have to meet their federal fiduciary duty in the context of the specific scope of services that they provide to their clients, as discussed in this Final Interpretation.

The commenter also drew particular attention to the question of whether the Commission's discussion of the fiduciary duty in the Proposed Interpretation applied to advisers to institutional clients as well as those to retail clients. The same commenter indicated that failing to accommodate the application of the concepts in the Proposed Interpretation to sophisticated clients could risk changing the marketplace or limiting investment opportunities for sophisticated clients, increasing compliance burdens for advisers to sophisticated clients, or chilling innovation. As explained above, this Final Interpretation, as compared to the Proposed Interpretation, discusses in more detail the ability of investment advisers and different types of clients to shape the scope of the relationship to which the fiduciary duty applies.[93] In particular, this Final Interpretation acknowledges that while advisers owe each of their clients a fiduciary duty, the specific obligations of, for example, an adviser providing comprehensive, discretionary advice in an ongoing relationship with a retail client will be significantly different from the

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91 *See* Dechert Letter.

92 *See supra* section II.C.

93 *See supra* footnotes 78-81 and accompanying text.

obligations of an adviser to an institutional client, such as a registered investment company or private fund, where the contract defines the scope of the adviser's services and limitations on its authority with substantial specificity.[94]

Finally, to the extent this Final Interpretation causes some investment advisers to reassess their compliance with their duty of loyalty, it could lead to a reduction in the expected profitability of advice relating to particular investments for which compliance costs would increase following the reassessment.[95] As a result, the number of investment advisers willing to advise a client to make these investments may be reduced. A decline in the supply of investment adviser advice regarding these types of investments could affect efficiency for investors; it could reduce the efficiency of portfolio allocation for those investors who might otherwise benefit from investment adviser advice regarding these types of investments and are no longer able to receive such advice. At the same time, if providing full and fair disclosure and appropriate monitoring for highly complex products (*e.g.*, those with a complex payout structure, such as those that include variable or contingent payments or payments to multiple parties) results in these products becoming less profitable for investment advisers, investment advisers may be discouraged from supplying advice regarding such products. However, investors may benefit from (1) no longer receiving inadequate disclosure or monitoring for such products, (2) potentially receiving advice regarding other, less complex or expensive products that may be more efficient for the investor, and (3) only receiving recommendations for highly complex or high cost products for which an

94 *See supra* section II.A.

95 For example, such products could include highly complex, high cost products with risk and return characteristics that are hard for retail investors to fully understand, or where the investment adviser and its representatives receive complicated payments from affiliates that create conflicts of interest that are difficult for retail investors to fully understand.

investment adviser can provide full and fair disclosure regarding its conflicts and appropriate monitoring.

List of Subjects in 17 CFR Part 276

Securities.

Amendments to the Code of Federal Regulations

For the reasons set out above, the Commission is amending Title 17, chapter II of the Code of Federal Regulations as set forth below:

PART 276–INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT ADVISERS ACT OF 1940 AND GENERAL RULES AND REGULATIONS THEREUNDER

1. Part 276 is amended by adding Release No. IA–5428 and the release date of June 5, 2019, to the end of the list of interpretive releases to read as follows"

Subject	**Release No.**	**Date**	**Fed. Reg. Vol. and Page**
* * * * * * *			
Commission Interpretation Regarding Standard of Conduct for Investment Advisers	IA-5248	June 5, 2019	[Insert FR Volume Number] FR [Insert FR Page Number]

By the Commission.

Dated: June 5, 2019.

Vanessa A. Countryman,

Acting Secretary.

EXHIBIT 7

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Date of Report (Date of earliest event reported): July 1, 2022 (July 1, 2022)

NexPoint Diversified Real Estate Trust

(Exact name of registrant as specified in its charter)

DELAWARE	**001-32921**	**80-0139099**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

300 Crescent Court, Suite 700
Dallas, Texas 75201
(Address of principal executive offices, including zip code)

214-276-6300

(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Trading Symbol(s)**	**Name of each exchange on which registered**
Common Shares, $0.001 par value	NXDT	New York Stock Exchange
5.50% Series A Cumulative Preferred Shares, par value $0.001 per share ($25.00 liquidation preference per share)	NXDT-PA	New York Stock Exchange

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§ 230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§ 240.12b-2 of this chapter).

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Item 1.01. Entry into a Material Definitive Agreement.

On July 1, 2022 (the "Deregistration Date"), the Securities and Exchange Commission (the "SEC") issued an order pursuant to Section 8(f) of the Investment Company Act of 1940 (the "1940 Act") declaring that NexPoint Diversified Real Estate Trust, a Delaware statutory trust (the "Company," "we" or "our") has ceased to be an investment company under the Investment Company Act of 1940 Act, as amended (the "Deregistration Order"). The issuance of the Deregistration Order enables us to proceed with full implementation of our new business mandate to operate as a diversified real estate investment trust ("REIT") that focuses primarily on investing in various commercial real estate property types and across the capital structure, including but not limited to: equity, mortgage debt, mezzanine debt and preferred equity (the "Business Change").

Advisory Agreement

In connection with the Business Change and effective on the Deregistration Date, we terminated our investment advisory agreement (the "Former Advisory Agreement") with NexPoint Advisors, L.P. ("NexPoint") and entered into a new advisory agreement (the "Advisory Agreement") with NexPoint Real Estate Advisors X, L.P. (the "Adviser"), a subsidiary of NexPoint. We also terminated the investment advisory agreements (the "Subsidiary Advisory Agreements") between NexPoint and our wholly owned subsidiaries, NexPoint Real Estate Opportunities, LLC and NexPoint Real Estate Capital, LLC, effective on the Deregistration Date. A description of the Advisory Agreement follows:

Duties of the Adviser

Pursuant to the Advisory Agreement, subject to the overall supervision of our Board of Trustees, the Adviser manages our day-to-day operations, and provides investment management services to us.

Advisory Fee and Administrative Fee

As consideration for the Adviser's services under the Advisory Agreement, we pay our Adviser an annual fee (the "Advisory Fee") of 1.00% of Managed Assets (as defined below) and annual fee (the "Administrative Fee" and, together with the Advisory Fee, the "Fees") of 0.20% of the Company's Managed Assets, in each case paid monthly, in cash or at the election of the Adviser in shares of our common stock, subject to certain limitations.

Under the Advisory Agreement, "Managed Assets" means an amount equal to the total assets of the Company, including any form of leverage, minus all accrued expenses incurred in the normal course of operations, but not excluding any liabilities or obligations attributable to leverage obtained through (i) indebtedness of any type (including, without limitation, borrowing to purchase or develop real estate or other investments, borrowing through a credit facility, or the issuance of debt securities), (ii) the issuance of preferred stock or other preference securities, (iii) the reinvestment of collateral received for securities loaned in accordance with the Company's investment objectives and policies, and/or (iv) any other means. In the event the Company holds collateralized mortgage-backed securities ("CMBS") where the Company holds the controlling tranche of the securitization and is required to consolidate under generally accepted accounting principles all assets and liabilities of a specific CMBS trust, the consolidated assets and liabilities of the consolidated trust will be netted to calculate the allowable amount to be included as Managed Assets. In addition, in the event the Company consolidates another Person it does not wholly own as a result of owning a controlling interest in such Person or otherwise, Managed Assets will be calculated without giving effect to such consolidation and instead such Person's assets, leverage, expenses, liabilities and obligations will, on a pro rata basis consistent with the Company's percentage ownership, be considered those of the Company for purposes of calculation of Managed Assets. The Adviser computes Managed Assets as of the end of each fiscal quarter and then computes each installment of the Fees as promptly as possible after the end of the month with respect to which such installment is payable.

As of the Deregistration Date, no Fees have been paid to the Adviser pursuant to the Advisory Agreement.

Reimbursement of Expenses; Expense Cap

We are required to pay directly or reimburse the Adviser for all of the documented "operating expenses" (all out-of-pocket expenses of the Adviser in performing services for us, including but not limited to the expenses incurred by the Adviser in connection with any provision by the Adviser of legal, accounting, financial, due diligence, investor relations or other services performed by the Adviser that outside professionals or outside consultants would otherwise perform and our pro rata share of rent, telephone, utilities, office furniture, equipment, machinery or other office, internal and overhead expenses of the Adviser required for our operations) and any and all expenses (other than underwriters' discounts) paid or to be paid by us in connection with an offering of our securities, including, without limitation, our legal, accounting, printing, mailing and filing fees and other documented offering expenses (collectively, "Offering Expenses"), paid or incurred by the Adviser or its affiliates in connection with the services it provides to us pursuant to the Advisory Agreement. Direct payment of operating expenses by us together with reimbursement of operating expenses to the Adviser, plus compensation expenses relating to equity awards granted under our long-term incentive plan and all other corporate general and administrative expenses of the Company, including the Fees payable under the Advisory Agreement, may not exceed 1.5% of Managed Assets (the "Expense Cap"), calculated as of the end of each quarter, for the twelve-month period following the Company's receipt of the Deregistration Order; provided, however, that this limitation will not apply to Offering Expenses, legal, accounting, financial, due diligence and other service fees incurred in connection with extraordinary litigation and mergers and acquisitions or other events outside the ordinary course of our business or any out-of-pocket acquisition or due diligence expenses incurred in connection with the acquisition or disposition of certain real estate-related investments*;* provided, further, in the event the Company consolidates another entity that it does not wholly own as a result of owning a controlling interest in such entity or otherwise, expenses will be calculated without giving effect to such consolidation and instead such entity's expenses will, on a pro rata basis consistent with the Company's percentage ownership, be considered those of the Company for purposes of calculation of expenses. The Adviser may, at its discretion and at any time, waive its right to reimbursement for eligible out-of-pocket expenses paid on the Company's behalf. Once waived, these expenses are considered permanently waived and become non-recoupable in the future.

Term of the Advisory Agreement

The Advisory Agreement has an initial term of three years and is automatically renewed thereafter for successive additional one-year terms unless earlier terminated. We have the right to terminate the Advisory Agreement on 30 days' written notice for cause (as defined in the Advisory Agreement). The Advisory Agreement can be terminated by us or the Adviser without cause with 180 days' written notice to the other party. The Adviser may also terminate the agreement with 30 days' written notice if we have materially breached the agreement and such breach has continued for 30 days. In addition, the Advisory Agreement shall terminate in the event of an assignment (as defined in Section 202(a)(1) of the Investment Advisers Act of 1940) of the Advisory Agreement (an "Advisers Act Assignment"). A termination fee will be payable to the Adviser by us upon termination of the Advisory Agreement for any reason, including non-renewal, other than a termination by us for cause or a termination due to an Advisers Act Assignment. The termination fee will be equal to three times the Fees earned by the Adviser during the twelve month period immediately preceding the most recently completed calendar quarter prior to the effective termination date; provided, however, if the Advisory Agreement is terminated prior to the one year anniversary of the date of the Advisory Agreement, the Fees earned during such period will be annualized for purposes of calculating the Fee.

Liability and Indemnification of Manager

Under the terms of the Advisory Agreement, the Adviser will indemnify and hold harmless the Company and its subsidiaries, including the Company's Operating Partnership (defined below), from all claims, liabilities, damages, losses, costs and expenses, including amounts paid in satisfaction of judgments, in compromises and settlements, as fines and penalties and legal or other costs and expenses of investigating or defending against any claim or alleged claim, of any nature whatsoever, known or unknown, liquidated or unliquidated, that are incurred by reason of the Adviser's bad faith, fraud, willful misfeasance, intentional misconduct, gross negligence or reckless disregard of its duties; provided, however, that the Adviser will not be held responsible for any action of our Board of Trustees in following or declining to follow any written advice or written recommendation given by the Adviser. However, the aggregate maximum amount that the Adviser may be liable to us pursuant to the Advisory Agreement will, to the extent not prohibited by law, never exceed the amount of the Advisory Fees received by the Adviser under the Advisory Agreement prior to the date that the acts or omissions giving rise to a claim for indemnification or liability have occurred. In addition, the Adviser will not be liable for special, exemplary, punitive, indirect, or consequential loss, or damage of any kind whatsoever, including without limitation lost profits. The limitations described in the preceding two sentences will not apply, however, to the extent such damages are determined in a final binding non-appealable court or arbitration proceeding to result from the bad faith, fraud, willful misfeasance, intentional misconduct, gross negligence or reckless disregard of the Adviser's duties.

Other Activities of Manager and its Affiliates

The Adviser and its affiliates expect to engage in other business ventures, and as a result, their resources will not be dedicated exclusively to our business. However, pursuant to the Advisory Agreement, the Adviser is required to devote sufficient resources to our administration to discharge its obligations under the Advisory Agreement.

The foregoing description of the Advisory Agreement is not complete and is subject to and qualified in its entirety by reference to the full text of the Advisory Agreement, a copy of which is filed as Exhibit 10.1 to this Current Report on Form 8-K and is incorporated herein by reference.

Item 1.02 Termination of a Material Definitive Agreement.

Effective on the Deregistration Date, we terminated the Former Advisory Agreement and the Subsidiary Advisory Agreements pursuant to which NexPoint provided investment advisory services to us and certain of our subsidiaries. In addition, effective on the Deregistration Date, we terminated our administration services agreement with NexPoint (the "Administration Services Agreement") pursuant to which NexPoint previously performed administrative functions for us in connection with our operation as a closed-end investment company. Going forward, we expect our Adviser to perform advisory services and administrative functions for us in connection with the Business Change pursuant to the Advisory Agreement.

Former Advisory Agreement

In exchange for the investment advisory services provided by NexPoint under the Former Advisory Agreement, the Company paid the Adviser a fee for investment management services (the "Former Advisory Fee"), payable monthly, in an amount equal to 1.00% of the average weekly value of an amount (the "Former Managed Assets") equal to the total assets of the Company, including any form of investment leverage, minus all accrued expenses incurred in the normal course of operations, but not excluding any liabilities or obligations attributable to investment leverage obtained through (i) indebtedness of any type (including, without limitation, borrowing through a credit facility or the issuance of debt securities), (ii) the issuance of preferred stock or other similar preference securities, (iii) the reinvestment of collateral received for securities loaned in accordance with the Company's investment objectives and policies, and/or (iv) any other means. The Adviser was permitted to waive a portion of its fees.

For the fiscal year ended December 31, 2021, the Company incurred a Former Advisory Fee of $8.7 million, paid entirely in cash. From January 1, 2022 through May 31, 2022, the Company incurred a Former Advisory Fee of $4.1 million, paid entirely in cash.

Administration Services Agreement

In exchange for the administration services provided by NexPoint under the Administration Services Agreement, the Company paid to NexPoint an annual fee (the "Administration Services Fee"), payable monthly, in an amount equal to 0.20% of the average weekly value of the Former Managed Assets.

For the fiscal year ended December 31, 2021, the Company incurred an Administration Services Fee of $1.8 million, paid entirely in cash. From January 1, 2022 through May 31, 2022, the Company incurred an Administration Services Fee of $0.9 million, paid entirely in cash.

Item 3.03. Material Modifications to Rights of Security Holders.

The information contained under "Item 5.03. Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year" is incorporated herein by reference.

Item 4.01 Changes in Registrant's Certifying Accountant.

Effective on the Deregistration Date, the Audit Committee of our Board of Trustees approved the engagement of KPMG LLP ("KPMG") as our independent registered public accounting firm for our fiscal year 2022 and the dismissal of Cohen & Company, Ltd. ("Cohen") as our independent registered public accounting firm.

During the fiscal years ended December 31, 2021 and 2020, and the subsequent interim period through the Deregistration Date, we did not, nor did anyone on our behalf, consult with KPMG with respect to (a) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, and no written report or oral advice was provided to us that KPMG concluded was an important factor considered by us in reaching a decision as to any accounting, auditing or financial reporting issue or (b) any matter that was either the subject of a disagreement, as defined in Item 304(a)(1)(iv) of Regulation S-K promulgated under the Securities Act of 1933 (the "Securities Act"), and the related instructions, or a reportable event, as described in Item 304(a)(1)(v) of Regulation S-K.

The reports of Cohen on our financial statements for each of the two years ended December 31, 2021 and 2020, did not contain an adverse opinion or a disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles. For the fiscal years ended December 31, 2021 and 2020, and the subsequent interim period through the Deregistration Date, there were no "disagreements" (as that term is defined in Item 304(a)(1)(iv) of Regulation S-K and related instructions) between us and Cohen on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedures which, if not resolved to the satisfaction of Cohen, would have caused Cohen to make reference to the subject matter of the disagreement in their report. During the fiscal years ended December 31, 2021 and 2020 and the subsequent interim period through the Deregistration Date, there were no "reportable events" (as that term is defined in Item 304(a)(1)(v) of Regulation S-K).

We provided Cohen with a copy of the disclosures contained in this Current Report on Form 8-K and requested that Cohen furnish us with a letter addressed to the SEC stating whether it agrees with the statements contained herein. A copy of Cohen's letter, dated July 1, 2022, is filed as Exhibit 16.1 to this Current Report on Form 8-K.

Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

In connection with the Business Change, we also announced changes to our Board of Trustees and executive officers, effective on the Deregistration Date. The Board of Trustees appointed Brian Mitts as our Chief Financial Officer, Executive VP-Finance, Treasurer and Assistant Secretary, Matt McGraner as our Executive VP, Chief Investment Officer and Secretary and D.C. Sauter as our General Counsel. James Dondero will continue to serve as President and Dustin Norris will continue to serve as Executive Vice President. Frank Waterhouse resigned from his position as Treasurer, Principal Accounting Officer and Principal Financial Officer, Will Mabry resigned from his position as Assistant Treasurer, Rahim Ibrahim resigned from his position as Assistant Secretary, and Stephanie Vitiello resigned from her position as Secretary, Chief Compliance Officer, and Anti-Money Laundering Officer, effective as of the Deregistration Date.

In addition, John Honis, Bryan A. Ward, Ethan Powell and Dr. Bob Froehlich resigned as Trustees of the Company, effective as of the Deregistration Date. Mr. Powell also resigned in his capacity as Chairman of the Board of Trustees, effective as of the Deregistration Date. The resignations of the foregoing Trustees were not a result of any disagreement with the Company on any matter relating to the Company's operations, policies or practices. The Board of Trustees also increased the number of members comprising the Board of Trustees by one and declassified the Board of Trustees as of the Deregistration Date. Also on the Deregistration Date, the Board of Trustees appointed Mr. Mitts, Mr. Dondero, Scott Kavanaugh and Dr. Arthur Laffer to the Board of the Trustees and Mr. Dondero as Chairman of the Board of Trustees, each of whom will serve for a term that will expire at the next annual meeting of shareholders or until their successor has been elected and qualified. Beginning with the annual meeting of the Company's shareholders to be held in 2023, all Trustees will be elected to serve for terms that will expire at the next annual meeting of shareholders or until their successor has been elected and qualified. Each of Mr. Kavanaugh and Dr. Laffer has been named to the Company's Audit Committee, Nominating and Corporate Governance Committee and Compensation Committee.

Mr. Mitts, age 51, has served as our Chief Financial Officer, Executive VP-Finance, Treasurer and Assistant Secretary and as a member of our Board of Trustees since the Deregistration Date. Mr. Mitts co-founded NexPoint Real Estate Advisors, L.P. ("NREA"), which is an affiliate of our Adviser, as well as NexPoint Residential Trust, Inc. ("NXRT"), a publicly traded multi-family REIT, and other real estate businesses with Mr. McGraner and Mr. Dondero. Currently, Mr. Mitts leads our Adviser's financial reporting and accounting teams and is integral in financing and capital allocation decisions. Prior to co-founding NREA and NXRT, Mr. Mitts was Chief Operations Officer of Highland Funds Asset Management, L.P., the external advisor of open-end and closed-end funds where he managed the operations of these funds and helped develop new products. Mr. Mitts was also a co-founder of NexPoint. He has worked for NREA or its affiliates since 2007. He has also served as the Chief Financial Officer, Executive VP-Finance, Secretary and Treasurer of NexPoint Real Estate Finance, Inc. ("NREF"), a publicly traded commercial mortgage REIT, since February 2020 and as a member of the board of directors of NREF since June 2019; as the Chief Financial Officer, Executive Vice President-Finance and Treasurer of NXRT since March 2015, additionally as Secretary of NXRT since February 2019, and as a member of the board of directors of NXRT since September 2014; as Chief Financial Officer, Treasurer and Assistant Secretary of VineBrook Homes Trust, Inc. ("VineBrook"), a single-family rental REIT registered with the SEC under Section 12(g) of the Securities Exchange Act of 1934, since November 2018, additionally as Interim President of VineBrook since September 2021, and as a member of the board of directors of VineBrook since July 2018; as the Chief Financial Officer, Executive VP-Finance, Treasurer and Corporate Secretary of NexPoint Hospitality Trust, Inc. ("NHT"), a publicly traded hospitality REIT listed on the TSX Venture Exchange, since December 2018; and as Chief Financial Officer, Secretary and Treasurer of NexPoint Storage Partners, Inc., a private self-storage lending REIT, since November 2020. In addition, Mr. Mitts served as President and Treasurer of NREF from June 2019 to February 2020, President and Treasurer of NXRT from September 2014 to March 2015, and President and Treasurer of VineBrook from July 2018 to October 2018.

Matt McGraner, age 38, has served as our Executive VP, Chief Investment Officer and Secretary since the Deregistration Date. He has also served as the Executive VP and Chief Investment Officer of NREF since February 2020; as Executive VP and Chief Investment Officer of NXRT since March 2015; as Executive VP, Chief Investment Officer and Secretary of VineBrook since February 2019; and as President and a member of the board of directors of NexPoint Storage Partners, Inc. since November 2020. Mr. McGraner has also served as Chief Investment Officer of NHT since December 2018 and as a Managing Director at NexPoint since 2016. Mr. McGraner served as Secretary of NREF from June 2019 to February 2020; as Secretary of NXRT from September 2014 to March 2015; and as Chief Executive Officer, President and Secretary of VineBrook from October 2018 to February 2019. With over ten years of real estate, private equity and legal experience, his primary responsibilities are to lead the operations of the real estate platform at NexPoint, as well as source and execute investments, manage risk and develop potential business opportunities, including fundraising, private investments and joint ventures. Mr. McGraner is also a licensed attorney and was formerly an associate at Jones Day from 2011 to 2013, with a practice primarily focused on private equity, real estate and mergers and acquisitions. While at Jones Day, Mr. McGraner led the acquisition and financing of over $200 million of real estate investments and advised on $16.3 billion of mergers and acquisitions and private equity transactions. Since 2013, Mr. McGraner has led the acquisition and financing of approximately $11.8 billion of real estate investments.

Except as set forth below, none of Mr. Dondero, Mr. Mitts, Mr. Kavanaugh, Dr. Laffer and Mr. McGraner has a direct or indirect material interest in any transaction required to be disclosed pursuant to Item 404(a) of Regulation S-K.

Trustees who are officers of the Company do not receive compensation for their service as Trustees.

We provide the following compensation for non-management Trustees:

- each non-management Trustee receives an annual Trustee's fee payable in cash equal to $20,000;
- the chair of our Audit Committee receives an additional annual fee payable in cash equal to $15,000;
- the chair of our Compensation Committee receives an additional annual fee payable in cash equal to $7,500;
- the chair of our Nominating and Corporate Governance Committee receives an additional annual fee payable in cash equal to $7,500; and
- the lead independent trustee receives an additional annual fee payable in cash equal to $10,000.

We also reimburse Trustees for all expenses incurred in attending meetings of the Board of Trustees or committees thereof.

Because the Advisory Agreement provides that our Adviser is responsible for managing our affairs, our executive officers do not receive any cash compensation from us or any of our subsidiaries for serving as our executive officers. Additionally, we do not have any agreements with any of our named executive officers with respect to their cash compensation and do not intend to directly pay any cash compensation to them. We do not determine the cash compensation payable by the Adviser to our executive officers. The Adviser and its affiliates determine the salaries, bonuses and other wages earned by our named executive officers from our Adviser and its affiliates. The Adviser and its affiliates also determine whether and to what extent our executive officers will be provided with employee benefit plans.

Certain Relationships and Related Party Transactions

Advisory Agreement

The Company is externally advised by the Adviser pursuant to the Advisory Agreement. The Adviser is an affiliate of NexPoint, an investment adviser registered with the SEC that was founded by Mr. Dondero. Mr. Dondero serves as President of NexPoint, which is owned by a trust of which Mr. Dondero is the primary beneficiary and has a general partner owned by Mr. Dondero. The description of the Advisory Agreement under “Item 1.01. Entry into a Material Definitive Agreement” is incorporated herein by reference. The description of the Advisory Agreement is not complete and is subject to and qualified in its entirety by reference to the full text of the Advisory Agreement, a copy of which is filed as Exhibit 10.1 to this Current Report on Form 8-K and is incorporated herein by reference.

Former Advisory Agreement

The Company was formerly a party to the Former Advisory Agreement and the Subsidiary Advisory Agreements pursuant to which NexPoint provided investment advisory services to the Company and certain of its subsidiaries. The description of the Former Advisory Agreement and the Subsidiary Advisory Agreements under “Item 1.02. Termination of a Material Definitive Agreement” is incorporated herein by reference.

Administration Services Agreement

The Company was formerly a party to the Administration Services Agreement pursuant to which NexPoint previously performed administrative functions for us in connection with our operation as a closed-end investment company. The description of the Administration Services Agreement under “Item 1.02. Termination of a Material Definitive Agreement” is incorporated herein by reference.

Subsidiary Investment Management Agreement

An indirect wholly owned subsidiary of the Company (the “DAC”) is party to an agreement (the “DAC IMA”) with NexAnnuity Asset Management, L.P. (“NexAnnuity”) pursuant to which NexAnnuity provides investment management services to the DAC. Mr. Dondero serves as President of NexAnnuity, which is indirectly owned by a trust of which Mr. Dondero is the primary beneficiary.

In exchange for its services, the DAC IMA provides that NexAnnuity will receive a management fee (the “DAC Management Fee”) paid monthly in an amount equal to 1.00% of the average weekly value of an amount equal to the total assets of the DAC, including any form of leverage, minus all accrued expenses incurred in the normal course of operations, but not excluding any liabilities or obligations attributable to investment leverage obtained through (i) indebtedness of any type (including, without limitation, borrowing through a credit facility or the issuance of debt securities), (ii) the issuance of preferred stock or other preference securities, (iii) the reinvestment of collateral received for securities loaned in accordance with the investment objective, investment guidelines and policies under the DAC IMA, and/or (iv) any other means, plus any value added tax or any other applicable tax, if any, thereon. NexAnnuity may waive all or a portion of the DAC Management Fee.

For the fiscal year ended December 31, 2021, the DAC incurred a DAC Management Fee of approximately $0.4 million, paid entirely in cash. From January 1, 2022 through May 31, 2022, the Company incurred a DAC Management Fee of $0.3 million, paid entirely in cash.

Item 5.03. Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year.

In connection with the Business Change, the Board of Trustees authorized and adopted the Restated Certificate of Trust (the "Certificate of Trust") and amended and restated the Agreement and Declaration of Trust (the "Declaration of Trust") and the Bylaws (the "Bylaws"), to among other things, declassify the Board of Trustees, reflect our new name and provide for a trustee with a principal place of business in Delaware. The Certificate of Trust, Declaration of Trust and the Bylaws are effective on the Deregistration Date.

The foregoing summary of the Certificate of Trust, Declaration of Trust and Bylaws is qualified in its entirety by reference to the text of each of the same, which are attached hereto as Exhibit 3.1, Exhibit 3.2 and Exhibit 3.3, respectively, to this Current Report on Form 8-K and are incorporated herein by reference.

Item 5.05 Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics.

Effective on the Deregistration Date, the Company adopted a new code of business conduct and ethics that applies to the Company's officers, employees and members of the Board of Trustees, which satisfies the requirements included in Item 406(b) of Regulation S-K. The code of business conduct and ethics is available on our website nxdt.nexpoint.com in the Governance section. A copy of the code of business conduct and ethics is also available upon written request to our Corporate Secretary at c/o NexPoint Diversified Real Estate Trust, 300 Crescent Court, Suite 700, Dallas, Texas 75201, Attn: Corporate Secretary. We will post information regarding any amendment to, or waiver from, our code of business conduct and ethics on our website in the Governance section.

Item 8.01. Other Events.

Business Change

The information relating to our receipt of the Deregistration Order under "Item 1.01. Entry into a Material Definitive Agreement" is incorporated herein by reference.

On the Deregistration Date, the Company formed a wholly owned subsidiary, NexPoint Diversified Real Estate Trust Operating Partnership, L.P., a Delaware limited partnership (the "Operating Partnership"), to be the operating partnership through which the Company's operations as a REIT will be conducted. A copy of the Operating Partnership's limited partnership agreement is attached hereto as Exhibit 10.2.

The Company intends to elect to be treated as an equity REIT for U.S. federal income tax purposes commencing with its taxable year ended December 31, 2021 and intends to continue to be treated as an equity REIT for U.S. federal income tax purposes for the taxable year ending December 31, 2022 and for future taxable years.

The Company will file reports under the Securities Exchange Act of 1934 for its 2022 fiscal year as a smaller reporting company and a non-accelerated filer.

Termination of Dividend Reinvestment Plan

Effective on the Deregistration Date, the Company terminated its Dividend Reinvestment Plan. The Company's transfer agent and unaffiliated brokers are expected to have unaffiliated reinvestment plans available for participation by the Company's shareholders.

Item 9.01. Financial Statements and Exhibits.

(d) Exhibits

Exhibit Number	Description
3.1	Restated Certificate of Trust of NexPoint Diversified Real Estate Trust, effective July 1, 2022
3.2	Declaration of Trust of NexPoint Diversified Real Estate Trust, dated July 1, 2022
3.3	Bylaws of NexPoint Diversified Real Estate Trust, dated July 1, 2022
10.1	Advisory Agreement, dated July 1, 2022, by and between NexPoint Diversified Real Estate Trust and NexPoint Real Estate Advisors X, L.P.
10.2	Limited Partnership Agreement of NexPoint Diversified Real Estate Trust Operating Partnership, L.P., dated July 1, 2022
16.1	Letter of Cohen & Company, Ltd., dated July 1, 2022, to the Securities and Exchange Commission
104	Cover Page Interactive Data File (Embedded within the Inline XBRL document)

Cautionary Notice Regarding Forward-Looking Statements

This report contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on management’s current expectations, assumptions and beliefs. Forward-looking statements can often be identified by words such as “enable,” “proceed”, “focus,” “will,” “intend,” “expect” and similar expressions, and variations or negatives of these words. These forward-looking statements include, but are not limited to, statements regarding the Company’s ability to fully implement the Business Change, including the Company’s transition to a REIT, the Company’s intention to elect to be treated as an equity REIT for U.S. federal income tax purposes and the availability of unaffiliated reinvestment plans. They are not guarantees of future results and forward-looking statements are subject to risks, uncertainties and assumptions that could cause actual results to differ materially from those expressed in any forward-looking statement. Actual results may vary materially from those contained in forward-looking statements based on a number of factors including, without limitation, (1) risks related to the real estate industry, including (a) changes in general economic and market conditions; (b) changes in the value of real estate properties; (c) risks related to local economic conditions, overbuilding and increased competition; (d) increases in property taxes and operating expenses; (e) changes in zoning laws; (f) casualty and condemnation losses; (g) variations in rental income, neighborhood values or the appeal of property to tenants; (h) the availability of financing; (i) changes in interest rates and leverage and (j) recessions or general economic downturn where properties are located and (2) risks related to non-diversification and other focused strategies, including that a significant amount of the Company’s investments could be invested in the instruments of only a few companies or other issuers or that at any particular point in time one investment strategy could be more heavily weighted than the others. Readers should not place undue reliance on any forward-looking statements and are encouraged to review the Company’s filings with the SEC for a more complete discussion of risks and other factors that could affect any forward-looking statement. The statements made herein speak only as of the date of this report and except as required by law, the Company does not undertake any obligation to publicly update or revise any forward-looking statements.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Current Report on Form 8-K to be signed on its behalf by the undersigned hereunto duly authorized.

NexPoint Diversified Real Estate Trust
By: /s/ Brian Mitts
Name: Brian Mitts
Title: Chief Financial Officer, Executive VP-Finance, Treasurer and Assistant Secretary

Date: July 1, 2022

EXHIBIT 8

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COUNSEL FOR HIGHLAND CLO FUNDING LTD.

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

In re:	§	Case No. 18-30264-SGJ-11
	§	Case No. 18-30265-SGJ-11
ACIS CAPITAL MANAGEMENT, L.P. and	§	
ACIS CAPITAL MANAGEMENT GP, LLC,	§	(Jointly Administered Under Case No.
	§	18-30264-SGJ-11)
	§	
Debtors.	§	Chapter 11

JOINT OBJECTION OF HIGHLAND CAPITAL MANAGEMENT, L.P. AND HIGHLAND CLO FUNDING, LTD. TO FINAL APPROVAL OF DISCLOSURE STATEMENT AND TO CONFIRMATION OF THE JOINT PLAN FOR ACIS CAPITAL MANAGEMENT, L.P. AND ACIS CAPITAL MANAGEMENT GP, LLC

Highland Capital Management, L.P. ("**Highland**") and Highland CLO Funding, Ltd. ("**HCLOF**") hereby file their joint objection (the "**Objection**") to final approval of the disclosure statement [Doc. No. 442] (as amended, the "**Disclosure Statement**") and to confirmation of the *First Amended Joint Plan for Acis Capital Management, L.P. and Acis*

Capital Management GP, LLC [Doc. No. 441] (as amended, the "**Plan**"),[1] and respectfully state as follows:[2]

I.
PRELIMINARY STATEMENT

"If at first you don't succeed, try, try again." –*William Edward Hickson*

1. In proposing Plans A, B and C, it would appear that the Chapter 11 Trustee has taken this old adage to heart. Although originally penned as a motivator to would-be teachers, in the context of these bankruptcy proceedings, this approach by the Chapter 11 Trustee has proven to be a colossal waste of time and resources at a cost to the estates that eclipses not only the value of the estates' assets, but the very pre-petition claims the Chapter 11 Trustee is purportedly responsible for paying. The result of this case appears to be nothing more than functionally administratively insolvent estates with mountains of administrative claims continuing to accrue daily.

2. By their literal interpretation, the Chapter 11 Trustee's Plans, supported by unequivocal admissions in his pleadings, establish that post-petition, he has intentionally breached pre-petition contractual obligations of the Debtors to create a purported $100 million post-petition claim against the estates for an entity that had no claims against the estates when the Orders for Relief were entered. By his own account, he has rendered the estates administratively insolvent. Having thus admitted to putting the estates into this predicament—which under almost every other measure would be considered a flagrant breach of fiduciary

[1] Defined terms herein shall be as set forth in the Plan unless otherwise provided herein.

[2] HCLOF has filed no proof of claim in these cases, seeks no monetary relief from the Debtors, and has moved to amend its pending adversary proceeding claim to reflect that it no longer seeks the equitable claims that it sought previously (such claims are moot in any event). Nonetheless, HCLOF objects on the basis that the proposed plans propose either to take its property or alter its contractual and legal rights. HCLOF asserts no creditor standing in any of the objections set forth herein, and makes these objections as a party in interest given the substantial harm the plans propose to impose on it.

duty—he is now championing to "fix" the situation by either (i) taking non-estate property from the purported (involuntary) claimant and selling it along with some executory contracts of the estates that are otherwise valueless, then distributing the ill-gotten proceeds after carving off a substantial fee for himself, or (ii) re-writing multiple securities contracts to which the estates are not a party in order to not only insulate the estates from the consequences of his self-proclaimed intentional breach, but to radically alter the bargained-for rights of third party market participants in five collateralized loan obligation funds with over $2 billion at stake, none of which ever belonged to the Debtors.

3. What the Chapter 11 Trustee is proposing under each of Plans A, B and C violates some of the most basic tenets of Title 11 and ignores the very confines of this Court's jurisdiction. These Plans are patently unconfirmable with an unconscionable premise: that a Chapter 11 Trustee should be handsomely rewarded for an intentional post-petition breach of the estates pre-petition contractual obligations. Such a conclusion is beyond the pale no matter how allegedly noble the cause. These cases should be either dismissed or, at most, converted back to Chapter 7 liquidation.

II.
RELEVANT BACKGROUND

4. On January 30, 2018, Joshua N. Terry ("**Terry**") filed involuntary petitions for relief under Chapter 7, Title 11 of the United States Code (the "**Bankruptcy Code**") against Acis Capital Management, L.P. and Acis Capital Management GP, LLC ("**Acis GP**," and with Acis LP, the "**Debtors**"). A Chapter 7 Trustee was thereafter appointed.

5. On May 4, 2018, the Chapter 7 Trustee filed an *Expedited Motion to Convert Cases to Chapter 11* [Doc. No. 171] (the "**Motion to Convert**"). Also on May 4, 2018, Terry filed an *Emergency Motion for an Order Appointing Trustee for the Chapter 11 Estates of Acis*

Capital Management, L.P. and Acis Capital Management GP, LLC Pursuant to Bankruptcy Code Section 1104(a) [Doc. No. 173] (the "**Motion to Appoint Chapter 11 Trustee**").

6. On May 11, 2018, after a hearing on the matter, the Court entered orders granting the Motion to Convert [Doc. No. 205] and the Motion to Appoint Chapter 11 Trustee [Doc. No. 206]. Thereafter, the United States Trustee appointed Robin Phelan as Chapter 11 Trustee (the "**Chapter 11 Trustee**").[3]

7. On July 5, 2018, the Chapter 11 Trustee filed the initial Plan [Doc. No. 383], which proposed three (3) alternatives – Plans A, B and C. In summary, Plan A of the Chapter 11 Trustee's Plan proposes to transfer HCLOF's Equity Notes, along with the portfolio management agreements (the "**PMAs**") to which Acis LP is a counter-party, to a third party "plan funder," which is Oaktree. Through this transaction, the Chapter 11 Trustee claims that all creditors will be satisfied in full. Alternatively, the Chapter 11 Trustee has proposed Plans B and C, which are effectively identical in their treatment of creditors and call for Acis LP to retain the PMAs and pay out creditors from future cash flow streams therefrom, as well as potential recoveries from estates' causes of action. Both Plans B and C require radical modification to of the CLO Indentures, ostensibly to ensure the future income stream to the estates.

8. On July 13, 2018, the Chapter 11 Trustee filed (i) the Disclosure Statement [Doc. No. 405]; (ii) the *First Modification to the Joint Plan for Acis Capital Management, L.P. and Acis Capital Management GP, LLC* [Doc. No. 406]; and (iii) *the Motion for Entry of Order (A) Conditionally Approving Disclosure Statement; (B) Scheduling Combined Hearing on Final Approval of Disclosure Statement and Confirmation of Plan, and Setting Related Deadlines; (C)*

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[3] Mr. Phelan was initially appointed on May 11, 2018 as the Chapter 11 Trustee of Acis LP and was appointed on May 16, 2018 as the Chapter 11 Trustee of Acis GP.

Approving Forms for Voting and Notice; and (D) Granting Related Relief [Doc. No. 407] (the "**Motion for Conditional Approval**").

9. On July 24, 2018, Highland and HCLOF filed respective objections to the Motion for Conditional Approval, [Doc. No. 431] and [Doc. No. 432]. On July 28, 2018, Highland filed a supplement to such objection [Doc. No. 440]. In each objection, Highland and HCLOF reserved rights to object to the final approval of the Disclosure Statement.

10. On July 29, 2018, the Chapter 11 Trustee amended the Plan and Disclosure Statement following an expedited hearing on the Motion for Conditional Approval held earlier that day. Thereafter, on July 30, 2018, the Court entered the *Order (I) Conditionally Approving Disclosure Statement, (II) Scheduling Combined Hearing on Final Approval of Disclosure Statement and Confirmation of Plan, and Setting Related Deadlines, (III) Approving Forms for Voting and Notice, and (IV) Approving Related Matters* [Doc. No. 446] (the "**Conditional Approval Order**"), conditionally approving the Disclosure Statement, setting an August 21, 2018 combined hearing for final approval of the Disclosure Statement and confirmation of the Plan, and setting related deadlines, including a compressed and expedited discovery schedule (the "**Discovery Schedule**").

11. The Conditional Approval Order required the Chapter 11 Trustee to file a "**Limited Issues Brief**" on or before 4:00 p.m. on August 10, 2018, addressing: (a) issues related to section 1142 of the Bankruptcy Code in connection with the proposed transfer of HCLOF's subordinated notes under the Plan A alternative, and (b) issues related to sections 365 and 1123(a)(5)(F) of the Bankruptcy Code in connection with the proposed modification of the existing Indentures under the proposed Plan B and Plan C (collectively, the "**Limited Issues**").

Also as per the Conditional Approval Order, the deadline for parties to respond to the Limited Issues Brief is 4:00 p.m. on August 16, 2018.

12. Per the Discovery Schedule, the Chapter 11 Trustee filed the Limited Issues Brief on August 10, 2018 [Doc. No. 493]. Highland and/or HCLOF intend to timely respond to the Limited Issues Brief per the Discovery Schedule. As such, while certain Limited Issues are mentioned herein, Highland and HCLOF reserve all rights on those issues for subsequent objection. Per the Discovery Schedule, this joint objection is to cover matters other than the Limited Issues; provided, however, discovery is actually occurring after the deadline to file this objection. Thus, Highland and HCLOF reserve their rights to supplement these objections.

III.
OBJECTION

13. In order to confirm the Plan, the Chapter 11 Trustee bears the burden of establishing the various provisions of Bankruptcy Code section 1129 by a preponderance of the evidence. *See In re Couture Hotel Corp.*, 536 B.R. 712, 732 (Bankr. N.D. Tex. 2015). The Plan is deficient on almost every applicable subsection of 1129 and, as a result, the Plan is unconfirmable as a matter of law.

A. The Bankruptcy Court Lacks Subject Matter Jurisdiction to Confirm the Plan

14. The Bankruptcy Court lacks subject matter jurisdiction over this proceeding and, therefore, proceeding with confirmation of any plan will be void *ab initio*. This Court should have dismissed the involuntary petitions that were filed by Joshua Terry in bad faith, and because this Court lacks subject matter jurisdiction over essentially a two-party dispute subject to arbitration. *See* Brief of Appellant Neutra (Case No. 3:18-cv-01056 (N.D. Tex.), [Doc. No. 11].

15. Even assuming this Court has subject matter over this proceeding, the Plans violate the strictures of that jurisdiction in at least two critical and insurmountable ways:

a. Plan A is premised on the taking of non-estate property without its owners consent; and

b. Plans B and C are premised on radically altering non-estate executory contracts.

16. The Court's lack of subject matter jurisdiction is so fundamental, that frankly the Court need look no further. The Chapter 11 Trustee has presented the Court with patently unconfirmable Plans. Section 1129(a)(1) and (a)(2) require, respectively, that the plan and the plan proponent, comply with the applicable provisions of the Bankruptcy Code. The Chapter 11 Trustee's Plan A, however, asks this Court to exceed its constitutional and statutory authority to infringe upon the rights of a non-creditor and effect a taking of non-estate property (the "**Equity Notes**") via an equitable subrogation theory that is completely contrary to the law, and convert that non-estate property into "property of the estate," so that he can then sell it to a third party (Oaktree). This Court cannot approve this scheme because it has no jurisdiction to do so. Confirming Plan B or C likewise would require the Court to exceed its authority because both plans are premised on the nonconsensual alteration of non-executory contracts. Worse yet, the amendments will be to the determent of third parties who are not creditors of these estates and who are not remotely implicated in these proceedings. This Court simply has no such jurisdiction.

17. It is fundamental that bankruptcy courts do not have subject matter jurisdiction over property that does not belong to a debtor's estate. *See TMT Procurement Corp. v. Vantage Drilling Co. (In re TMT Procurement Corp.)*, 764 F.3d 512, 525 (5th Cir. 2014) (bankruptcy court did not have in rem jurisdiction over assets that were not "property of the estate"); *see also Scott v. Bierman*, 429 F. App'x. 225, 231 (4th Cir. 2011) ("[A] bankruptcy court's jurisdiction does not extend to property not part of a debtor's estate."); *see also NovaCare Holdings, Inc. v. Mariner Post-Acute Network, Inc. (In re Mariner Post-Acute Network, Inc.)*, 267 B.R. 46, 59

(Bankr. D. Del. 2001) (same); *In re Funneman*, 155 B.R. 197, 199-200 (Bankr. S.D. Ill. 1993) (partnership property was not property of the debtor-partner's estate and, therefore, outside the court's subject matter jurisdiction).

18. These jurisdictional principles exist to protect the very type of non-debtor property interests that are at issue in this case. And they apply even when the property would benefit a debtor's estate. *See, e.g., Vineyard v. McKenzie (In re Quality Holstein Leasing)*, 752 F.2d 1009, 1013 (5th Cir. 1985) (noting the limitations placed on the trustee's strong arm powers by section 541, and stating that "Congress did not mean to authorize a bankruptcy estate to benefit from property that the debtor did not own.").

19. Before the Court can order a transfer of the Equity Notes to Oaktree, it would necessarily have to find that they constitute "property of the estate." If the Court cannot conclude that the Equity Notes are property of the estate, then it will lack jurisdiction to order their transfer by any means. *See, e.g., In re Murchison*, 54 B.R. 721, 725 (Bankr. N.D. Tex. 1985). (finding that the court was without jurisdiction to approve the sale of property that was not property of the estate: "Because the criterion of § 541(a)(1) has not been satisfied, § 363(b)(1) cannot apply.").[4]

20. Section 541 of the Bankruptcy Code defines "property of the estate" as, in relevant part, (i) "all legal or equitable interests of the debtor in property as of the commence of the case," (ii) "[a]ny interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title," and (iii) "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. §§ 541(a)(1), (a)(3), (a)(7).

[4] Bankruptcy courts have been held to be without jurisdiction to order the sale of non-estate assets, even where the sale was entirely consensual. *See, e.g., First Nat'l Bank v. Community Trust Bank*, No. 05-1610, 2006 WL 724882, at *4 (W.D. La. Mar. 21, 2006) ("Since the property was not part of the bankruptcy estate, the Bankruptcy Court had no authority or jurisdiction to order the consensual sale and, therefore, the sale was void").

21. Neither the Chapter 11 Trustee nor his proposed transferee, Oaktree, dispute that the Equity Notes are the property of HCLOF. *See* July 6, 2018 Hrg. Tr. at 71:19-25; 119:11-18. Nor has the Chapter 11 Trustee obtained an interest in the Equity Notes via any of the Bankruptcy Code sections enumerated in section 541(a)(3). Thus, for the Equity Notes to be "property of the estate," they would necessarily have to be "property that the estate[s] acquire after the commencement of the case" under section 541(a)(7).[5]

22. Upon first blush, that would seem to require only that the Chapter 11 Trustee prevail upon his equitable subrogation theory, thereby converting the Equity Notes into "property of the estate." However, even if the Chapter 11 Trustee successfully can obtain ownership of the Equity Notes, such property acquired post-petition is not "property of the estate" under section 541(a)(7).

23. Under controlling Fifth Circuit law, section 541(a)(7) only applies to "property interest that are themselves traceable to 'property of the estate' or generated in the normal course of the debtor's business." *In re TMT Procurement Corp.*, 764 F.3d at 524-25 ("As we previously recognized in *In re McLain*, 'Congress enacted § 541(a)(7) to clarify its intention that § 541 be an all-embracing definition and to ensure that property interests created with or by property of the estate are themselves property of the estate") (citing *In re McLain*, 516 F.3d 301 (5th Cir. 2008)) (emphasis added); *see also In re Cent. Med. Ctr.*, 122 B.R. 568 (Bankr. E.D. Mo. 1990) ("Congress did not intend Section 541 'to enlarge a debtor's rights against others beyond those

[5] The Chapter 11 Trustee also does not, and cannot, dispute the axiom that the debtor in possession or trustee steps into the shoes of a debtor and possesses no greater rights than that of the debtor. *See Majestic Star Casino, LLC v. Barden Dev., Inc. (In re Majestic Star Casino, LLC)*, 716 F.3d 736, 748 (3d Cir. 2013) ("It is a given that the trustee or debtor-in-possession can assert no greater rights than the debtor himself had on the date the bankruptcy case was commenced.") (internal alterations omitted)); *In re Gibralter Res., Inc*., 197 B.R. 246, 253 (Bankr. N.D. Tex. 1996) ("the general rule is that a trustee has no greater rights than the debtor and stands in the shoes of the debtor"); *In re Brooks*, 60 B.R. 155, 160 (Bankr. N.D. Tex. 1986) ("Of course, a bankruptcy trustee can acquire no greater rights in property than the debtor possessed.") (citation omitted)). The Debtors had no right to sell the Equity Notes before the commencement of these bankruptcy cases and have no such rights now.

existing at the commencement of the case..'") (citing *In re N.S. Garrott & Sons*, 772 F.2d 462, 466 (8th Cir. 1985)). That is not the case with the Equity Notes, which are not traceable to any property of the estate, but under the Chapter 11 Trustee's (unsupportable) theory, are property of the estate as a result of a subrogation right that purportedly vested with the estates post-petition.

24. The property at issue in *In re TMT Procurement* was certain corporate shares that were pledged by a non-debtor third party into a court-ordered escrow that served as the collateral for the debtors' DIP loan. *In re TMT Procurement Corp.*, 764 F.3d at 524. The shares never belonged to the debtors at issue. *Id.* at 524-25. The corporation whose shares had been pledged appealed the orders of the district court (which had withdrawn the reference from the bankruptcy court), arguing that the district court did not have jurisdiction to issue orders with respect to the shares, which were not "property of the estate." *Id.* at 522-23.

25. The Fifth Circuit, vacating the district court's order, rejected the debtors' argument that the shares were property of the estate under section 541(a)(7). In doing so, the Fifth Circuit made clear that: "[T]he Vantage Shares are not 'property of the estate' under § 541(a)(7) because they were not created with or by property of the estate, they were not acquired in the estate's normal course of business, and they are not traceable to or arise out of any pre-petition interest included in the bankruptcy estate." *Id.* at 525 (rejecting also the argument that the tracing limitation did not apply to corporate debtors in chapter 11 bankruptcies).

26. The Plan does not satisfy sections 1129(a)(1) and (a)(2) because it seeks to impermissibly expand the scope of estate property and requires the Court to exceed its jurisdiction. The Equity Notes were not "property of the estate" at the commencement of these cases and the Chapter 11 Trustee has not obtained the Equity Notes through one of the

enumerated sections in Section 541(a)(3). Nor are the Equity Notes traceable to any property of the estate. Therefore, the Plan cannot be confirmed. *See In re Cent. Med. Ctr.*, 122 B.R. at 573 (holding that the plan failed to satisfy section 1129(a) "[b]ecause the Plan violates Section 541(a) due to its improper expansion of the estate's interest" in certain funds in which it only had a reversionary interest at the commencement of the case; the plan "baldly seeks to divest the bondholders of property which is rightfully theirs.").

B. Sections 1129(a)(1), (3) – The Plan Violates the Bankruptcy Code and Violates Other Applicable Law

27. Bankruptcy Code section 1129(a)(1) requires that a plan comply "with the applicable provisions of this title," and section 1129(a)(3) states that a plan cannot be proposed "by any means forbidden by law." As to section 1129(a)(1), the Plan violates well-accepted tenets of bankruptcy law because the Chapter 11 Trustee seeks to (i) take possession of non-estate property and (ii) fundamentally alter non-debtor executory contracts. These are included among the Limited Issues and will be set forth in the response to the Limited Issues Brief.

28. As to section 1129(a)(3), despite the Chapter 11 Trustee's obfuscations regarding "transfers" and other similar self-serving characterizations, the practical reality is that the Plan A transaction effects a sale of the Equity Notes to Oaktree. The Equity Notes are undoubtedly securities. *See Reves v. Ernst & Young*, 494 U.S. 56, 65 (1990); *Arco Capital Corps. Ltd. v. Deutsche Bank AG*, 949 F. Supp. 2d 532, 542-43 (S.D.N.Y. 2013) (finding sale of CLO notes to be a sale of a security under *Morrison v. Nat'l Australian Bank Ltd.*, 561 U.S. 247 (2010)). Any sale of securities must comport with the requirements of federal securities laws, including the Securities Act of 1933 (the "**'33 Act**").[6]

[6] Moreover, none of the Indentures or other relevant documents permit the Chapter 11 Trustee, on behalf of Acis, or otherwise, to market HCLOF's Equity Notes for sale. The Chapter 11 Trustee cannot sell the Equity Notes in violation of the terms of the Indentures, and seek at the same time to retain the benefits of the Indentures.

29. Section 77e of the '33 Act makes it unlawful "to offer to sell or offer to buy . . . any security, unless a registration statement has been filed as to such security." 15 U.S.C. § 77e(c).[7] The Chapter 11 Trustee has not filed a registration statement covering his proposed sale of the Equity Notes.

30. Section 1145(a)(1) and (a)(2) do not absolve the Chapter 11 Trustee from compliance with these requirements because Oaktree is not receiving the Equity Notes on account of claims against the estates. *See also SEC v. Universal Express, Inc.*, 475 F. Supp. 2d 412, 425 (S.D.N.Y. 2007) ("[T]he section 1145(a) exemption is available only when the offerees are receiving the securities, at least in part, in exchange for claims against or interests in the debtor which they hold." (internal citation omitted)).

31. The mechanism set forth in the Plan for the transfer of the Equity Notes makes plain that Oaktree is not the initial transferee (or subrogee). Instead, the initial transferee are the bankruptcy estates. As described, the estates will then transfer the notes to Oaktree. Because Oaktree will not be receiving the Equity Notes in exchange for claims or interests that Oaktree has against the Debtors, the section 1145(a) exemption cannot, and does not, apply.

32. Bankruptcy Code section 1145 provides a limited exemption when the Chapter 11 Trustee sells a security "of an issuer other than the debtor or an affiliate" 11 U.S.C. § 1145(a)(3). The exemption allows trustees to raise cash for an estate while protecting purchasers by requiring that adequate information about the securities is available. This "portfolio securities" exemption should be strictly construed because public policy strongly supports the registration of securities. *See Quinn & Co. v. S.E.C.*, 452 F.2d 943, 946 (10th Cir. 1971); 8

[7] In any litigation or enforcement action, it would be the Chapter 11 Trustee's burden to show the applicability of an exemption to this requirement. *E.g.*, *SEC v. Carrillo Huettell LLP*, No. 13 Civ. 1735(GBD)(JCF), 2017 WL 213067, at *3 n.7 (S.D.N.Y. Jan. 17, 2017). The Chapter 11 Trustee has not argued that any of these exemptions apply. *See* 15 U.S.C. § 77d (providing exemptions to registration requirements).

Collier on Bankr. ¶ 1145.02 (16th ed. 2018). This exemption requires that (1) the debtor own the security on the date the bankruptcy petition was filed; (2) any exempt securities are not securities of the debtor's affiliates; (3) the issuer of the securities is in full compliance with registration and disclosure laws; and (4) the volume of the securities sold be limited to less than 4% of shares outstanding. 11 U.S.C. § 1145(a)(3).

33. The Chapter 11 Trustee's Plan A transaction clearly does not qualify for this exemption. First, neither the Chapter 11 Trustee nor the Debtors owned the Equity Notes on the date the bankruptcy petition was filed, nor do they own them now. Second, the proposed sale would be far in excess of the 4% threshold permitted by the exemption. Because the section 1145 exemptions do not apply, the Chapter 11 Trustee will be in violation of the '33 Act.

34. In addition to violating the '33 Act, the Plan violates the Investment Advisors Act of 1940 (the "**IAA**"). It is clear that the Chapter 11 Trustee owes fiduciary duties to HCLOF and its investors. In agreeing to manage the CLO investments, Acis LP represented to the CLOs that it is "registered as an investment adviser" under the IAA and agreed to perform its portfolio management services consistent with the IAA. *See, e.g.*, 2013-1 PMA § 17(b)(i). The IAA imposes a fiduciary duty on Acis LP to act for the benefit of the CLO and its investors, including Equity Noteholders like HCLOF. *See Transamerica Mortg. Advisors v. Lewis*, 444 U.S. 11, 36 (1979) ("Congress intended to impose enforceable fiduciary obligations" in passing the Act); 15 U.S.C. § 80b-6.[8] The scope of Acis LP's (and thus the Chapter 11 Trustee's) fiduciary duties is broad. The Chapter 11 Trustee's obligations include a duty to refrain from conduct that directly harms the CLOs, as well as the more general duty of undivided loyalty. *See Bullmore v. Banc of*

[8] Acis LP also owes fiduciary duties as an investment advisor under New York's common law. *See Bullmore v. Ernst & Young Cayman Islands*, 846 N.Y.S.2d 145, 148 (N.Y. App. Div. 2007) ("Professionals such as investment advisors, who owe fiduciary duties to their clients, 'may be subject to tort liability for failure to exercise reasonable care, irrespective of their contractual duties . . . .'") (citations omitted).

Am. Sec. LLC, 485 F. Supp. 2d. 464, 471 (S.D.NY. 2007) (applying New York law). Each of the plans proposed by the Chapter 11 Trustee rest upon a flagrant violation of Acis LP's fiduciary duties: Plan A proposes to sell HCLOF's property without its consent and Plan B and Plan C propose to impermissibly modify the Indentures to strip HCLOF and the other noteholders of their right to call a redemption. These issues will be more thoroughly addressed in HCLOF and Highland's response to the Chapter 11 Trustee's Limited Issues Brief.

35. Moreover, the Chapter 11 Trustee cannot disclaim the duties he owes to the CLOs and the investors under the contracts and securities laws, including the IAA. In one analogous case, *In re New Center Hospital*, 200 B.R. 592 (E.D. Mich. 1996), the chapter 11 trustee sought to escape the duties of the debtor-hospital as the administrator of an employee benefit plan governed by ERISA. The chapter 11 trustee argued that if he were to administer the plan, he would be required to act solely in the interest of the ERISA plan beneficiaries which would be in conflict with his duties to the bankruptcy estates; therefore, he could not serve as an ERISA fiduciary and a bankruptcy estate fiduciary at the same time. *Id.* The district court rejected this argument and overturned the decision of the bankruptcy court, concluding that, "[t]he Bankruptcy Trustee assumes the positon of the debtor as to that debtor's many obligations. Courts have held that statutory obligations that bind the debtor will subsequently bind the bankruptcy estate." *Id.* (internal citations omitted). Likewise, the Chapter 11 Trustee is bound to perform the obligations and duties of Acis LP under relevant contract and applicable law, including the IAA. Because the Chapter 11 Trustee has put forth a Plan that violates such duties, he cannot meet the section 1129(a)(3) standard that the Plan is not "forbidden by law."

C. Section 1129(a)(3) – The Plan Was Not Proposed in Good Faith

36. Bankruptcy Code section 1129(a)(3) further provides that a plan must be proposed in good faith. The Chapter 11 Trustee, as proponent of the Plan, bears the burden of

demonstrating that it was filed in good faith. *In re Barnes*, 309 B.R. 888, 892 (Bankr. N.D. Tex. 2003). A good faith plan "must fairly achieve a result consistent with the [Bankruptcy] Code." *Id.* (quoting *In re Block Shim Dev. Co. – Irving*, 939 F.2d 289, 292 (5th Cir. 1991)). Good faith itself is "evaluated in light of the totality of the circumstances surrounding establishment of [the] plan, mindful of the purposes underlying the Bankruptcy Code." *In re Village at Camp Bowie I, L.P.*, 710 F.3d 239, 247 (5th Cir. 2013). The ultimate goal of the analysis is to determine the "subjective motive" of a plan proponent. *In re Texas Star Refreshments, LLC*, 494 B.R. 684, 694 (Bankr. N.D. Tex. 2013).

37. The record demonstrates there was virtually no negotiation of the economic terms of the Oaktree proposal, and in particular there was no effort by the Chapter 11 Trustee to secure the highest possible price for the Equity Notes.[9] The purported consideration for the PMAs was clearly based not on any actual metric of value for those contract rights, but on an amount necessary to pay Josh Terry's claim. Certainly as to the Equity Notes, this was not a negotiation between a willing seller and a willing buyer – the seller was not even present. It is instead a scheme, concocted in bad faith, to take property from one party and provide a windfall to other parties.

38. Moreover, improper motives have tainted these bankruptcy cases from the beginning. Joshua Terry initiated these proceedings on the eve of a state court hearing to consider the very relief he then requested from this Court. From the very beginning, Terry has made clear his motivation for initiating the involuntary bankruptcy: to prevent Acis LP from

[9] The Chapter 11 Trustee has testified that he engaged in no substantive negotiation concerning the sale price of the Equity Notes. *See* Transcript of July 6, 2018 hearing at 75:14-16; 76:6-8:

> MR. MALONEY. Was there any negotiation over the price formula that they were proposing for the subordinated notes?
> MR. PHELAN. No . . .
> . . .
> Q. Now you didn't ask that they increase that at all?
> A. No.

meeting its contractual obligation to effectuate the reset requested by the equity—so that the Debtors could continue to earn management fees they are not entitled to.[10]

39. The Chapter 11 Trustee has adopted Terry's cause.

40. At the end of the day, these bankruptcy cases and the Plan amount to nothing but a free option play by Terry, the Chapter 11 Trustee, and Oaktree to monetize PMAs with less than nominal value, at the expense of Highland (who is effectively funding the administrative expenses of these cases on account of the substantial management fees being withheld from it) and HCLOF (who is being denied its contractual rights with non-debtor parties and stripped of its own property against its will to fund that payment). The Chapter 11 Trustee has nothing to lose from this strategy – he can turn an asset with little or no value into a big pay day for Terry and himself. Oaktree similarly has nothing to lose – if it doesn't end up getting the Equity Notes, it walks away with all its expenses paid and a $2.5 million break-up fee for its time.

41. In these circumstances, the Court should not make a good faith finding.

D. Section 1129(a)(5) – The Plan Does Not Properly Disclose or Address Insider Issues

42. Bankruptcy Code section 1129(a)(5)(A)(i) requires a plan proponent to disclose "The identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan." Under both Plan B and Plan C, Terry is slated to receive 100% of the equity in the Reorganized Debtor (as well as, inexplicably, any residual assets of the Acis Trust upon payment in full of all creditors). Terry therefore clearly comes within the definition of individuals described in section 1129(a)(5)(A)(i).

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[10] Among the things acknowledged by Terry at the involuntary trial in March 2018 was the fact that he "had no issues with the rest or refinance transaction. [Rather,] the issue was that these collateral-management agreements were transferred for no consideration to Acis." March 21, 2018 Hrg. Tr. At 132:16-19. Note, however, that fees would not continue to be payable under the PMAs following a reset in any circumstance. *See also Id.* at 27:22-28:1: "Q: And you knew there was an extreme likelihood that the [reset] transaction was not going forward as a result of the bankruptcy filing, correct? MR. TERRY: Yes, that was our goal on filing the involuntary petitions."

While Terry's identity is disclosed in Plans B and C, his affiliations are not. Specifically, the Chapter 11 Trustee makes no effort to describe Terry's relationship and affiliations with other parties in interest in this case including (without limitation) Oaktree, Brigade Capital Management, L.P., and Cortland Capital Markets Services LLC. Furthermore, the Chapter 11 Trustee does not disclose or otherwise describe the post-petition affiliation between Terry and the Chapter 11 Trustee himself. Discovery in this matter has revealed, and evidence at the confirmation hearing will further demonstrate, that Terry has essentially acted as the co-trustee in this case. This includes: taking it upon himself to market the Debtors' assets, introducing the Chapter 11 Trustee to Oaktree, participating in most substantive communications with Oaktree, and participating in the formulation of a Plan that (under Plans B and C) hands control of the Debtors over to him. On this record, it is clear that Terry's affiliations have not been disclosed, in violation of section 1129(a)(5)(A)(i).

43. While Terry's undisclosed affiliations is a significant issue in and of itself, the relationship between Terry and the Chapter 11 Trustee raises yet another, troubling issue. The facts of this case lead inexorably to the conclusion that Terry is an insider of the Plan proponent (i.e., the Chapter 11 Trustee). The term "insider" is defined in Bankruptcy Code section 101(31) to "include" parties who have certain officer, director, or ownership interests in a debtor. However, the concept of a non-statutory insider has been recognized by many courts, including the Supreme Court. *See U.S. Bank N.A. v. Village at Lakeside, LLC,* 138 S. Ct. 960 (2018). The Fifth Circuit has identified the following factors to consider when determining whether a party is non-statutory insider: (1) the closeness of the relationship between the party and the debtor; and (2) whether the transactions between the party and the debtor were conducted at arms-length. *Browning Interests v. Allison (In re Holloway),* 955 F.2d 1008, 1011 (5th Cir. 1992).

Importantly, cases recognize that control over the debtor is not a requirement for determining non-statutory insider status. *See, e.g., In re The Village at Lakeridge, LLC*, 814 F.3d 993, 1001 (9th Cir. 2016); *Anstine v. Carl Zeiss Meditec AG (In re U.S. Med., Inc.)*, 531 F.3d 1272, 1277 n.5 (10th Cir. 2008).

44. The ultimate point of analyzing whether any party is an insider is to determine whether such party is using "their privileged position to disadvantage non-insider creditors." *See In re South Beach Secs., Inc.*, 376 B.R. 881, 888 (Bankr. N.D. Ill. 2007). Insider status is also critical for determining whether a party's desire to obtain, or maintain, control over a debtor is motivating the party. *See In re Rexford Props., LLC*, 557 B.R. 788, 799 (Bankr. C.D. Cal. 2016) (noting that insiders seeking to retain ownership of the reorganized debtor were "influenced by totally different considerations from those motivating the other creditors.") (quoting *In re Featherworks Corp.*, 25 B.R. 634, 640 (1st Cir. BAP 1982)).

45. In this case, the Chapter 11 Trustee is the proponent of the Plan. Plan proponent insiders should be scrutinized because they, like a debtor insider, may be using a plan process to benefit their "privileged position." For example, in *In re Allegheny Int'l, Inc.*, 118 B.R. 282 (Bankr. W.D. Pa. 1982), the court found that a non-debtor plan proponent (Japonica Partners, L.P.) was considered an insider because Japonica during the case had access to "voluminous and thorough" information available only to insiders. Moreover, the court noted that while Japonica "did not have actual control or legal decision making power [over the debtor] . . . [Japonica] attempted to influence, in not very subtle ways, decisions made by the debtor." *Id.* at 298.

46. Terry's actions fit perfectly into such a non-statutory insider analysis. A review of the Plan makes plain Terry's favorable treatment. His claim is separately classified, the claim is treated the same as an entirely secured claim would be, despite the fact that Terry did not even

alleged his claim was fully secured, he is being permitted to use $1 million to acquire Acis LP's equity, despite the fact that the claim on file is less than $1 million, and the Chapter 11 Trustee has made no indication that Terry's secured claim may be avoided, despite the fact that the garnishment took place well within the 90-day pre-petition preference period.

47. In addition, while Terry is not in formal "control" of the Chapter 11 Trustee, Terry had access to voluminous insider information during the pendency of this case and he clearly influenced decisions made by the Chapter 11 Trustee. Nothing about the relationship between Terry and the Chapter 11 Trustee suggests that they acted at arms-length. Moreover, Terry used his close relationship to further his non-creditor motivation to put into place provisions that will allow him to take sole control over the Reorganized Debtor. Thus, Terry meets every single element for establishing that he is a non-statutory insider of the Plan proponent in this case. Moreover, any attempt by the Chapter 11 Trustee to distinguish the facts and cases on the basis that the Chapter 11 Trustee is not the same entity as the Debtors is specious. Once again, the Chapter 11 Trustee is the Plan proponent in this case. If a Chapter 11 trustee were able to hide behind an "I am not the debtor" argument, then it would follow that parties could engage in all manner of inside dealing and wrongful acts with a trustee with impunity. That makes no sense. The non-statutory insider analysis is designed to identify whether a party has a close relationship that allows the party to influence the process to further non-creditor goals (i.e., control). Terry meets that test with respect to the Plan proponent in this case. And, as discussed below, the fact that Terry is a non-statutory insider means the Chapter 11 Trustee cannot cram down the Plan.

E. Sections 1129(a)(7) and 1129(b) – The Plan Is Not In the Best Interest of Creditors and Is Not Fair And Equitable

48. Bankruptcy Code sections 1129(a)(7) and 1129(b) require that a plan be in the best interest of creditors and otherwise fair and equitable. First and foremost, Plans A, B, and C are premised on actions that are not supported by the law. How could it ever be in the best interest of creditors for a plan proponent to act outside the law? The Plan is a legal fallacy and, even if confirmed, will be the subject of years of litigation and ever-increasing administrative expense claims. That is not in the creditors' best interests.

49. Also, included in a best interest of creditors analysis is a determination that creditors who have not accepted the plan will receive no less under the Plan then they would in a hypothetical Chapter 7 liquidation. *In re Briscoe Enters., Ltd. II*, 994 F.2d 1160, 1167 (5th Cir. 1993). This requires a valuation analysis comparing what the creditor would receive if the property were sold today versus the value such creditor would receive as a creditor in a Chapter 7 case. *Id.*

50. The Chapter 11 Trustee cannot meet his burden on this valuation issue with respect to HCLOF.[11] It is undisputable that HCLOF was not a creditor as of the Petition Date. That is, the basis for the Chapter 11 Trustee asserting that HCLOF is a creditor is the equitable relief sought in an adversary proceeding brought by HCLOF against the Chapter 11 Trustee after the Petition Date. In a hypothetical Chapter 7 case, there would simply be an orderly liquidation and therefore no need to twist the law of equitable relief and subrogation to support a plan process and HCLOF would keep its subordinated notes. As such, any liquidation analysis by the Chapter 11 Trustee is a non-sequitur from the beginning because it would be based on the facially incorrect assumption that HCLOF was a creditor on the Petition Date. Moreover, even if

[11] As noted, HCLOF asserts no creditor standing.

that flaw is simply ignored (and there is no reason to do so), the valuation numbers do not add up. The Plan proposes to pay HCLOF amounts based entirely on a May 2018 letter sent by Highland. Evidence has shown in this case that circumstances have changed dramatically since May 2018, and further, that HCLOF values its Equity Notes much higher than what is being proposed under the Plan. The Chapter 11 Trustee bears the burden of rebutting that valuation evidence and, based on the record of this case, he will not be able to meet such burden. In fact, the Chapter 11 Trustee has not even substantively included HCLOF in its analysis purporting to satisfy section 1129(a)(7)[12] and he has advanced no expert witness to address the valuation issues necessary to do so at the confirmation hearing. Therefore, the Chapter 11 Trustee cannot satisfy the required test under section 1129(a)(7).

F. Sections 1129(a)(8), (10) and 1129(b) – The Plan Does Not Meet the Requirements for Cram Down

51. Bankruptcy Code sections 1129(a)(8) requires that each impaired class vote in favor of a plan. Bankruptcy Code section 1129(a)(10) permits a plan proponent to cram down a plan on non-voting classes, as long as one class of impaired creditors votes in favor of the plan. Insider votes are not counted for the purposes of consent under 1129(a)(10). Section 1129(b), in turn, requires in a cram down plan that the plan not unfairly discriminate and is fair and equitable to the non-voting creditors. Based on the record of this case, it is assumed that Class 3 (the Terry Secured Claim) will be the only class with the claim amount and numerosity to be deemed (according to the Chapter 11 Trustee) a consenting class. Therefore, in order to meet the cram down confirmation requirements, the Chapter 11 Trustee has the burden of showing that: (i) Terry is impaired; (ii) Terry is not an insider; and (iii) cramming the Plan down solely on

[12] The Chapter 11 Trustee's liquidation analysis is attached as Exhibit 2-D to the Disclosure Statement. The amount of the Class 2 HCLOF claim is listed as "TBD." *Id.*

Terry's vote does not unfairly discriminate and is fair and equitable to other creditors. The Chapter 11 Trustee cannot meet such a burden.

52. The Fifth Circuit interprets the concept of impairment broadly to include any alternation of a creditor's rights. *In re Village at Camp Bowie I, L.P.*, 710 F.3d at 245. However, a broad interpretation does not mean that the concept of impairment does not exist. The policy reason for requiring an impaired class to accept the plan under a cram down is to ensure that at least one group of creditors that is "<u>hurt</u> . . . nonetheless favors the plan." *In re One Times Square Assocs. Ltd. P'ship*, 165 B.R. 773, 776-77 (S.D.N.Y. 1994) (emphasis added).

53. Here, no viable argument can be made that Terry is impaired under Plan A because Plan A proposes to pay Terry in full with interest. The interest element, of course, compensates Terry for any delay in receiving what he alleges he is owed. Paying a creditor in full with interest is the very definition of non-impairment. Using a lone creditor, let alone in insider such as Terry, should not be sufficient to fulfill the section 1129(a)(10) requirement. This is a textbook case of using artificial impairment to generate an impaired accepting class.

54. Moreover, even if Terry were considered impaired under Plan A, Terry's votes should not be counted under any of the plans (A, B, or C) because Terry is a non-statutory insider. The basis for deeming Terry a non-statutory insider is set forth above. Because of his status as such, the Chapter 11 Trustee is prohibited by the plain language of section 1129(a)(10) from relying on Terry's votes to support a plan.

55. The final requirement for a cram down plan is that it is fair and equitable and does not unfairly discriminate. Whether a plan is proposed in good faith is a critical element of this determination. *See In re Village at Camp Bowie I, L.P.*, 710 F.3d at 247 (citing *In re Sandy Ridge Dev. Corp.*, 881 F.2d 1346 (5th Cir. 1989)). Because, as set forth above, the Chapter 11

Trustee is unable to establish that the Plan was proposed in good faith, he likewise will be unable to establish that he meets the cram down standard. The Plan also unfairly discriminates on a number of different bases. Moreover, the Chapter 11 Trustee provides no basis for classifying Highland's claims separately under the Plan, other than to gerrymander the classes.

G. Section 1129(a)(10) – The Plan's Claim Classifications are Improper

56. A further requirement under section 1129(a)(10) and related case law is that claims be properly classified under a plan. *See, e.g., In re Greystone III Joint Venture*, 995 F.2d 1274, 1279 (5th Cir. 1991) (prohibiting the gerrymandering of classes to create a consenting impaired class). Claims that are "substantially similar" must be classified together. Terry's claim treatment under the Plan is a blatant example of gerrymandering. Terry has alleged a partial secured claim based on pre-petition garnishment of certain funds. However, the garnishment occurred within the 90-day preference period and is *per se* avoidable. As such, Terry is nothing more than a general unsecured creditor in this case. His claim should be classified alongside other general unsecured creditors in Class 4.

57. Highland is a general unsecured creditor in the case, but its claim has been separately classified from other general unsecured creditors. Similarly, HCLOF is a Class 2 claimant under Plan A, but is effectively a Class 5B claimant under Plan B and Plan C. Presumably, the Chapter 11 Trustee bases such separate classification and disparate treatment on his allegation that Highland and/or HCLOF are liable for a fraudulent transfer. However, that matter remains subject to an on-going adversary proceeding. In other words, the Chapter 11 Trustee has simply made an allegation and is yet to prove his case. Permitting separate classification based on unproven allegations would seem an invitation for plan proponents to

engage in all manner of mischief in order to craft around the requirement that substantially similar claims be classified together.[13]

H. Section 1129(a)(11) – The Plan is Not Feasible

58. Bankruptcy Code section 1129(a)(11) has been interpreted to require a finding that a plan is economically feasible. This requires the Chapter 11 Trustee to demonstrate that the plan has a "reasonable assurance of commercial viability." *In re Briscoe Enters., Ltd. II*, 994 F.2d at 1166. Moreover, the Chapter 11 Trustee must "present proof through reasonable projections that there will be sufficient cash flow to funder the [Plan]." *See In re Couture Hotel Corp.*, 536 B.R. 712, 737 (Bankr. N.D. Tex. 2015).

59. On the record before the Court, the Chapter 11 Trustee has failed to demonstrate sufficient funds to meet all the obligations set forth in the Plan. That includes the very substantial administrative expense burden that appears to have surpassed the total claims alleged by the Chapter 11 Trustee to be payable in this case.

I. The Plan Cannot Effect an Assumption and Assignment of the PMAs Without Consent.

60. The Plan A transaction cannot be confirmed because it proposes to assume and assign the PMAs to Oaktree (*see* Plan § 2.17(c)) in violation of section 365(c)(1) of the Bankruptcy Code and without the requisite consent. *See* 11 U.S.C. § 365(c)(1) (trustee "may not

[13] HCLOF and Highland object to the Chapter 11 Trustee's apparent attempt to litigate the fraudulent transfer claims currently pending in the adversary proceeding as part of the plan confirmation process. As set forth in their separately-filed joint motion to strike the expert report of Kevin Haggard of Miller Buckfire, any such attempts are procedurally improper and inconsistent with the parties' understanding and agreed-upon schedule. Highland and HCLOF have a right under the Bankruptcy Code and applicable rules to litigate the fraudulent transfer claims in a proceeding subject to the heighted procedural protections available in an adversary proceeding—not in the context of a harried and accelerated confirmation process (a process of the Trustee's own making). *See In re Mansaray-Ruffin*, 530 F.3d 230, 242 (3d Cir. 2008) ("[W]here the Rules require an adversary proceeding—which entails a fundamentally different, and heightened, level of procedural protections—to resolve a particular issue, a creditor has the due process right not to have that issue without one."). The Court should not condone this type of "litigation by ambush." *See In re Vidal*, No. 12-11758 BLS, 2013 WL 441605, at *5 (Bankr. D. Del. Feb. 5, 2013) (applying *Mansaray-Ruffin* to avoid "lien-stripping by ambush").

assume or assign any executory contract . . .if applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance from or rendering performance to an entity other than the debtor . . . and such party does not consent to such assumption or assignment"); *In re Cedar Chem. Corp.*, 294 B.R. 224, 232 (Bankr. S.D.N.Y. 2003) ("a contract otherwise unassignable under § 365(c)(1) can be assumed and assigned if the non-debtor party consents"). The IAA and New York state law provide the relevant "applicable law" prohibiting assignment and excusing HCLOF from accepting performance from anyone other than Acis and/or Highland.

61. The IAA prohibits the assumption and assignment of the PMAs to Oaktree without, among other things, the Equity Noteholders' consent. Section 205(a)(2) of the IAA prohibits investment advisers (i.e., Acis LP) from entering into an investment advisory contract with a client (here, the CLOs) that "fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party by the contract." 15 U.S.C. § 80b–5(a)(2). Section 202(a)(1) of the IAA defines "assignment" generally to include "any direct or indirect transfer . . . of an investment advisory contract" by an adviser. 15 U.S.C. § 80b–2(a)(1) (emphasis added).

62. Section 14 of the PMAs (titled "Delegations/Assignments") provides the provisions intended to satisfy section 205(a)(2) of the IAA. Those sections, in relevant part, prohibit Acis from assigning its responsibilities under the PMAs without the written consent of each relevant CLO, at least a majority of the Equity Notes of each CLO, at least a majority of the Controlling Class (as defined in the indentures), and satisfaction of the Global Rating Agency Condition. *See*, *e.g.*, 2013-1 PMA, § 14(a). Acis cannot transfer, either directly or indirectly, its responsibilities under the PMAs without first satisfying the requisite conditions, including

obtaining the written consent of a majority of the Equity Noteholders of each CLO (which the Chapter 11 Trustee has not obtained).

63. The *CWCapital Cobalt VR Ltd. v. CWCapital Invs. LLC*, No. 17 Civ. 9463, 2018 U.S. Dist. LEXIS 90174 (S.D.N.Y. May 23, 2018) case does not mandate a different result. First, the language the Trustee quotes is from a decades-old SEC no-action letter. *Id.* at *12 (quoting *SEC No-Action Letter, Am. Century Cos.*, 1997 WL 1879138, at *5 (Dec. 23, 1997)). SEC no-action letters are only binding with respect to the party requesting guidance, have no precedential value unless the SEC agrees to allow a party to rely on them, and the SEC is free to change their interpretation at any time. *See* SEC, Fast Answers, available at https://www.sec.gov/fast-answers/answersnoactionhtm.html. Second, CWCapital did not decide whether the IAA separately requires client consent. 2018 U.S. Dist. LEXIS 90174, at *12-13. Third, a reported case from a court in this District recently found to be well-pleaded a cause of action for "assigning the benefits of [an] agreement to provide investment advisory services to others" based on the IAA. *Douglass v. Beakley*, 900 F. Supp. 2d 736, 748 (N.D. Tex. 2012).

64. The proposed assumption and assignment undermines the public policy reasons for section 205(a)(2) of the IAA. The Chapter 11 Trustee's transfer of portfolio management duties to Oaktree thus violates section 205(a)(2) of the IAA, and in turn, violates section 365(c)(1) of the Bankruptcy Code. The Chapter 11 Trustee and this Court cannot ignore the dictates of the IAA. *Cf. In re Adelphia Commc'ns Corp.*, 359 B.R. 65, 78-79 (Bankr. S.D.N.Y. 2007) (local ordinances provided "applicable law" that prohibited assignment).

65. The PMAs are also a personal services contract that cannot be assigned under New York law without consent. *See Wien & Malkin LLP v. Helmsley-Spear, Inc.*, 6 N.Y.3d 471, 482 (N.Y. 2006) (hotel management contract held below to be personal services contract;

"personal services contracts generally may not be assigned absent the principal's consent") (citing 9 Corbin, Contracts § 865 [interim ed.]; 3 Farnsworth, Contracts §§ 11.4, 11.10 [3d ed]); *Marriott Int'l, Inc. v. Eden Roc, LLLP*, 104 A.D.3d 583, 584 (N.Y. App. Div. 1st Dep't 2013) ("The parties' detailed management agreement places full discretion with plaintiffs to manage virtually every aspect of the hotel. Such an agreement, in which a party has discretion to execute tasks that cannot be objectively measured, is a classic example of a personal services contract that may not be enforced by injunction"); *see also* 6A N.Y. Jur., Assignments § 11 ("[T]he principle that all ordinary business contracts are assignable is subject to the exception that executory contracts for personal services or those involving a relationship of personal confidence are not assignable by one party unless the other party consents or waives the right to object. Thus, as a general rule, an employment contract for the performance of personal duties or services is not assignable by the employer so as to vest in the assignee the right to the labor of someone who never agreed to such employment. In fact, generally, no executory contract for personal services can be assigned by either party.").

66. Under New York law, personal service contracts are generally those that depend on the skill or reputation of the performing party. *See In re Schick*, 235 B.R. 318, 323 (Bankr. S.D.N.Y. 1999) ("Faced with a state law restricting assignment . . . a court must inquire into its rationale and uphold the restriction under section 365(c) if the identity of the contracting party is material to the agreement"). As one bankruptcy court has stated with respect to New York law on the issue:

> It is well settled that when an executory contract is of such a nature as to be based upon personal services or skills, or upon personal trust or confidence, the debtor-in-possession or trustee is unable to assume or assign the rights of the bankrupt in such contract. . . . It is patently unfair in such cases to require a non-debtor third party to accept performance from anyone other than the original contract vendee,

> unless the contract clearly provides for the right to assign to another contract vendee.

In re Grove Rich Realty Corp., 200 B.R. 502, 510 (Bankr. E.D.N.Y. 1996); *see also Donald Rubin, Inc. v. Schwartz,* 559 N.Y.S. 2d 307, 310 (N.Y. App. Div. 1990) (describing a consulting agreement as being "in the nature of a personal services contract"); *Carbo Indus., Inc. v. Coastal Ref & Mktg., Inc*., 154 F. App'x 218, 220 (2d Cir. 2005) ("this case does not fall within the limited exception developed for 'personal services contracts'—*e.g.*, consulting contracts.") (citing *Donald Rubin*, 559 N.Y.S. 2d at 310) (emphasis added).

67. As has been previously explained, HCLOF and its investors invested in reliance on the skill and expertise of Highland to manage the CLOs. In this case, a witness put on by the Chapter 11 Trustee – Zach Alpern of Stifel, Niocolas – testified to the fact investors pick sub-advisors based on the fact that different advisors "have different styles and make different creditor choices."[14] Mr. Alpern further testified that "equity holders make an informed decision when they make their investment and their opinion of the advisor is one of the considerations that they may make at the time of their investment, and it's a consideration that they probably take into account whether they hold or sell that investment."[15]

68. Replacing Acis/Highland with Oaktree/Brigade frustrates the investment objective of the parties, denies them the benefit of their bargain, and undermines and violates the IAA as well as black-letter New York law relating to personal service contracts. The assumption and assignment of the PMAs cannot be approved.

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[14] *See* Transcript of August 1, 2018 hearing on the Chapter 11 Trustee's *Emergency Motion to Approve Replacement Sub-Advisory and Shared Services Providers, Brigade Capital Management, LP and Cortland Capital Markets Services LLC*, at 67:24-25.

[15] *Id.* at 69:9-14.

J. The Disclosure Statement Should Not be Finally Approved

69. As to the Disclosure Statement, Highland and HCLOF renew their objections to its final approval based on the fact that it describes a patently unconfirmable Plan. S*ee In re Quigley Co.*, 377 B.R. 110, 115-16 (Bankr. S.D.N.Y. 2007); *In re Arnold*, 471 B.R. 578, 586 (Bankr. C.D. Cal. 2002).

IV.
RESERVATION OF RIGHTS

70. Nothing herein shall be construed as an admission of, or concession to, any fact contained in the Disclosure Statement or the Plan, and Highland and HCLOF reserve all rights to contest and rebut any and all factual allegations at the Confirmation Hearing. As previously mentioned herein, because discovery is ongoing per the Discovery Schedule, Highland and HCLOF reserve their rights to amend these Objections.

WHEREFORE, Highland and HCLOF respectfully request entry of an order (i) denying confirmation of the Plan; (ii) denying final approval of the Disclosure Statement; and (iii) granting such other and further relief to which Highland and HCLOF are entitled.

Dated: August 13, 2018

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that on August 13, 2018, a true and correct copy of the foregoing was served electronically via the Court's ECF system on those parties registered to receive such service.

/s/ Melina Bales
Melina Bales

EXHIBIT 9

18-30264-sgj11 Acis Capital Management, L.P. - Court's Ruling on Plan Confirmation

Traci Ellison to: jbinford, honeil, emcgee, mbales, BBarnes, srosen, jprostok, rpatel, jwielebinski, achiarello, robin, jenright, mkleinsasser, MHurst, mmaloney, PBessette, RMatsumura, 08/30/2018 09:24 PM

From: Traci Ellison/TXNB/05/USCOURTS

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Dear Counsel:

The following is the court's ruling on the request of the Chapter 11 Trustee ("Acis Trustee") of Acis Capital Management, L.P. ("Acis") and Acis Capital Management GP, LLC (collectively, the "Debtors") to confirm the ***First Amended Joint Plan for the Debtors (the "Plan")***, as modified, which contains therein alternatives Plan A, Plan B, and Plan C.
The court will deny confirmation of Plans A, B, and C. Below is some of the court's reasoning.

<u>Plans B and C</u>

First, Plans B and C are unconfirmable because they contemplate the amendment of the various CLO Indentures to which Acis is not a party. Specifically, Section 3.24 (for Plan B) and Section 4.24 (for Plan C) each provide as follows:

"Amendment of Indentures. The Indentures shall be amended pursuant to section 1123(a)(5)(F) of the Bankruptcy Code to provide that the Acis CLOs cannot be called for redemption until the later of (a) the date on which all Allowed Claims against the Debtors have been paid in full, or (b) three (3) years after the Effective Date. In the event that the Acis CLOs are reset, any new indenture with respect to a reset CLO shall provide the reorganized Acis will continue as the portfolio manager and that the reset CLO cannot be called for redemption until the later of (y) the date on which all Allowed Claims against the Debtors have been paid in full, or (z) three (3) years after the Effective Date."

The court recognizes that section 1123(a)(5)(F) of the Bankruptcy Code provides that a Chapter 11 plan may provide for adequate means for the plan's implementation, ***such as cancellation or modification of any indenture*** or similar instrument. However, the court concludes that section 1123(a)(5)(F) applies only to an indenture on which the debtor is a party—namely the issuer. While the court understands that oftentimes multiple, intertwined agreements are sometimes read together and treated in many respects as one integrated document, and while the court recognizes that, in this case, the CLO Indentures and CLO PMAs (the latter of which Acis is party to) are very interrelated, the court does not believe that this gives Acis the right to amend the Indentures without every single party thereto otherwise agreeing. For this simple reason, the current Plans B and C will not be confirmed.

<u>Plan A</u>

Next, with regard to Plan A, the issues are much more complicated. But the court finds Plan A unconfirmable because—while HCLOF has repeatedly asked the Bankruptcy Court for relief, and has also made certain demands upon the CLO Issuers, the Indenture Trustee and the Acis Trustee with regard to optional redemptions—HCLOF is ***not the holder of a claim*** against Acis, as defined in Section 101(5) of the Bankruptcy Code, to which the doctrine of equitable subrogation can be applied.

Plan A, distilled to its essence, is premised upon: (1) treating HCLOF as an entity with a "claim" against Acis, pursuant to the Bankruptcy Code's definition in section 101(5)(B), that can be provided for in an Acis plan as an unsecured claim (Class 2); (2) monetizing or liquidating that claim—by calculating the amount HCLOF would realize if HCLOF received exactly what it has demanded from the CLO Issuers, the Indenture Trustee, and the Acis Trustee; (3) paying the monetized/liquidated claim of HCLOF in cash in full on the Effective Date of the Plan, with cash that the Acis Trustee would receive from Plan funder Oaktree; (4) after payment of HCLOF on its liquidated/monetized claim, the Acis Trustee would be entitled to step into the shoes of HCLOF, and be the new holder of HCLOF's Sub Notes, via the court's application of the common law doctrine of equitable subrogation to the Acis Trustee—it is argued that this would be equitable, since the Acis Trustee would essentially be paying the CLO Issuers' (a debtor's) obligations on the Sub Notes to HCLOF (a creditor) and, thus, should be able to step into that creditor's shoes to avert HCLOF's double recovery; and (5) the Acis Trustee, after acquiring the Sub Notes through equitable subrogation, would convey those Sub Notes to Oaktree, the plan funder.

HCLOF, Highland Capital Management ("Highland"), and the CLO Issuers object to this use of equitable subrogation—essentially arguing that, no matter what one calls it, this is forcing a non-debtor party to sell its property that is not property of the estate. The court does not find this to be an easy analysis at all. To be sure, this is a novel proposed application of the equitable subrogation doctrine. To be sure, the Acis Trustee's proposal, at first blush—and even after a second or third turn—looks a little like an effort to force a sale of non-debtor property. This would be a novel application of the equitable subrogation doctrine—which, admittedly, has grown from a somewhat narrow to a much broader doctrine over time, with the historical purpose always being to serve the interests of fairness and justice. It is worth noting that, initially, courts in New York attempted to limit the scope of equitable subrogation to apply only to persons standing directly in the place of a surety. Then, as courts in other states expanded the concept of equitable subrogation, so did the courts of New York, eventually expanding the concept to cover third party guarantors. It was further expanded to parties who pay off a mortgage and in the case of refinancing mortgagees. The doctrine essentially went from a narrow remedy only available to sureties, to a broad doctrine available to almost any party regardless of his legal interest.

But the court believes there are at least a couple of reasons the doctrine should not be applied here. First, the court does not believe HCLOF can be construed to have a "claim" against Acis, pursuant to section 101(5)(B) of the Bankruptcy Code.

The evidence (Exh. 38) was that HCLOF made statements in correspondence dated May 4, 2018, from HCLOF to U.S. Bank, the indenture trustee for all five Acis CLOs, arguing that Acis, as portfolio manager under the CLO-PMAs, was breaching its duties, and stating that both the CLO Issuer "and the Subordinated Noteholders have a claim for the losses caused by the actions of the Portfolio Manager and the Chapter 11 Trustee" and claiming setoff right against funds held by the indenture trustee belonging to the Debtors.

Additionally, the evidence was also that HCLOF has twice during the bankruptcy case purported to direct the CLO Issuers, the Indenture Trustee, and Acis "to effect an Optional Redemption of all Secured Notes and the Subordinated Notes in full." Exhs. 20 & 21. In the second notice, HCLOF added language that this would be "for the express purpose of placement of a portion of the portfolio assets held by the Co-issuers into a warehouse arrangement or a total return swap or other derivatives arrangement with Highland Capital Management, L.P." The end result of this, of course, would be that the Debtor Acis would no longer have any assets to manage and no revenue stream to potentially pay its creditors.

Then, after the Trustee refused to effectuate an optional redemption, both HCLOF and Highland filed, on May 30, 2018, an adversary proceeding against the Acis Trustee, demanding that the Acis Trustee specifically perform and effectuate an optional redemption (the "Adversary"--Adversary No. 18-03078-sgj). The Adversary Complaint states: ***"Under the [CLO] funds' governing documents, the investors [e.g. HCLOF] have the right to have their money returned upon demand. Consequently, to mitigate their on-going losses, the investors have instructed the Indenture Trustee and Acis LP, as the putative portfolio manager of the funds, to sell the funds' assets through a redemption process provided for in the Indenture, and return the investors' money to be invested elsewhere with higher yields . . . . The Debtors, which are controlled by a Chapter 11 Trustee, have refused to authorize the necessary processes to effectuate a redemption of the funds to allow the return of the investors' money . . . . The investors are suffering daily losses because of the Chapter 11 Trustee's inaction. . . . The Plaintiffs file this Complaint to protect their interests and urge the Court to promptly enter a preliminary injunction enjoining the Chapter 11 Trustee from interfering with the redemption process and allowing the investors to have their money returned before they incur further losses."*** Para. 2.

The Original Complaint went on to state that the ACIS CLO PMAs are valid and enforceable contracts between the CLOs and Acis LP. Under the PMAs, Acis LP provides investment advisory services to the CLOs. "Plaintiff HCLOF, who holds an equity position in the CLO, *is a third-party beneficiary of the PMA.* The Chapter 11 Trustee, as Acis LP's Chapter 11 trustee, has anticipatorily breached the PMA by communicating his refusal to effect the Subordinated Noteholders' requested redemption as required by the PMA. The Chapter 11 Trustee's breach has caused damage to HCLOF." Paragraphs 67-70. See also paras. 74-77; 81-84; 88-91; 95-98.

Subsequently, HCLOF withdrew its two sets of redemption notices and on August 10, 2018 (after appealing a bankruptcy court preliminary injunction in the Adversary and after also moving to withdraw the reference in the Adversary), moved to amend the Adversary to ask for only the following: ***"Pursuant to 28 U.S.C. § 2201, HCLOF seeks a declaration that the Chapter 11 Trustee has no authority to sell or transfer HCLOF's property without HCLOF's consent. HCLOF seeks no money damages or other relief not sought in this Amended Complaint."***

Is this all enough for HCLOF to have a "claim" against the Debtor, pursuant to section 101(5)—in other words, does it amount to an assertion of a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment"—particularly when HCLOF has now withdrawn its two notices requesting the Indenture Trustee and Debtor commence an optional redemption process and has also sought to amend the Original Complaint to specify that it is not seeking any damages?

The court believes no. The five CLO PMAs specifically provide that there are ***no third party beneficiaries*** (except that four of the five CLO PMAs carve out the Indenture Trustee as a third party beneficiary). Thus, HCLOF—although it alleged in the Original Complaint—that it was an alleged "third party beneficiary," never had any basis to state that or to complain of Acis's alleged "anticipatory breach" of the CLO PMAs, as it purported to do in the Original Complaint. Moreover, there is, of course, no longer a PMA between Acis and HCLOF (f/k/a/ as ALF), as of October 27, 2017, as a result of the series of transactions that "the Highlands" apparently orchestrated after the Josh Terry arbitration award and judgment. Thus, HCLOF cannot claim any breach of contract between Acis and HCLOF. Acis is technically not a party to the Indentures. Thus, as far as the court is aware, ***there is no contract between HCLOF and Acis whatsoever***. ***If there is some theory under which HCLOF can assert liability against Acis , it has not been articulated***.

In summary, the court does not believe HCLOF (though it has made many threats and demands and filed an Adversary) has ever articulated a viable claim against Acis. Without a viable claim, the court does not believe the equitable subrogation doctrine asserted by the Acis Trustee works. And, without some sort of claim being validly asserted against Acis, any payment by it on account of the Sub Notes would appear to be voluntary.

The court recognizes that some courts have applied the equitable subrogation doctrine where a party paid a debt on which it had no liability and seemed to do it somewhat voluntarily—despite there being a long-standing exception to the doctrine for "voluntary payment." The strongest example of this is the case of NY Stock Exchange v, Sloan, 1980 U.S. Dist. LEXIS 13316 (S.D.N.Y. Aug. 15. 2018). But it appears to this court that, in any case where a court has allowed equitable subrogation where "voluntariness" was somewhat in existence, ***there was a situation where there was a primary obligor who wasn't paying its obligation*** . Here, the CLO Issuers are perfectly willing and able to perform their obligations. Thus, applying equitable subrogation here seems a bridge too far. The Acis Trustee would appear to an "officious meddler" (although with good motives) and—with no real exposure to HCLOF, in the court's view—the payment of the Sub Notes obligations would be purely voluntary. The court recognizes that the Acis Trustee would be attempting to protect an interest of its own (the Acis PMA revenue stream) somewhat like the property developer in the Hamlet case. Hamlet v. Northeast, 64 A.D.3d 85 (N.Y App. Div. Second Dept. 2009). But, in Hamlet, the property developer who paid the Environmental fees to the town of Brookhaven, that the subcontractor had bonded and agreed to pay, was itself primarily liable on the Environmental fees (in other words, the Town had a claim against Hamlet). Again, equitable subrogation under the exact facts and circumstances of this case seems a bridge too far.

Miscellaneous Rulings

The court rules on a few miscellaneous matters that were contested, although it is denying confirmation. This may be useful for any future appeals or for any future proposed plans.

Assumption and Assignment of the PMAs would not violate section 365 of the Bankruptcy Code.

The court believes that the assumption of the CLO PMAs by the Acis Trustee and the assignment of the CLO PMAs to a third party (either Oaktree or Brigade or Cortland) would be permissible under section 365 of the Code. Section 365 of the Bankruptcy Code does not prohibit the Trustee from assigning its rights under the PMAs without the written consent of the CLOs, the Subordinated Noteholders, and others. Section 365(c)(1) of the Bankruptcy Code provides:

"The trustee may not assume or assign any executory contract . . . if . . . applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance or rendering performance to an entity other than the debtor or debtor in possession, whether or not such contract . . . prohibits or restricts assignment of rights; and . . . such party does not consent to such assumption or assignment[.]"

11 U.S.C. § 365(c)(1).

The court overrules any objection that there is some applicable law that excuses the counterparties to the PMAs (i.e., the CLO Issuers) from accepting performance from a party other than the debtor. First, these are not personal services contracts. Assessing whether a contract is a personal service contract "depends upon the subject of the contract, the circumstances of the case and the intent of the parties to the contract." Leonard v. Gen. Motors Corp. (In re Headquarters Dodge), 13 F.3d 674, 682-83 (3d Cir. 1993) (internal quotation marks omitted); see also In re Compass Van & Storage Corp., 65 B.R. 1007, 1011-12 (Bankr. E.D.N.Y. 1986) ("Ascertaining whether a contract is personal posits on close distinctions, e.g., the nature and subject matter of the contract, the circumstances of the case placed in juxtaposition with the intention of the parties."). Even "clauses in the contract . . . attesting to a personal relationship will not be dispositive." Leonard, 13 F.3d at 683. Ultimately, if "the identity of that person or entity [rendering performance under the contract] is an essential element of the contract, and if the contract is non-assignable under applicable non-bankruptcy law then the estate cannot assign the contract." Grove Rich Realty, 200 B.R. at 507. Accordingly, in order to determine whether the PMAs are personal service contracts, the court must assess the particular circumstances in the case, the nature of the services provided by Acis under the PMAs, and whether such services are nondelegable. Highland contends that because the PMAs "depend on the skill and reputation of the performing party," the PMAs are personal service contracts, and thus unassignable. If this were the standard, the exception would swallow the rule–any prudent party contracting for another's services considers the other party's skill, expertise, and reputation–and any contract for services premised on the skill and reputation of the party providing services would be a personal service contract. It is not whether the party providing services is skilled and reputable–it is whether such services are unique in nature. See Compass Van & Storage Corp., 65 B.R. at 1011. To support its contention, Highland cites New York cases under which hotel management contracts or consulting contracts were found to be personal service contracts. In the Marriott case cited by Highland, in which the court found the hotel management to be a personal service contract, the court observed that the hotel manager had "full discretion . . . to manage virtually every aspect of the hotel." Marriott Int'l, Inc. v. Eden Roc, LLLP, 104 A.D.3d 583, 584 (N.Y. App. Div. 1st Dep't 2013). Marriott is distinguishable. Here, Acis did not manage virtually every aspect of the CLOs. Pursuant to the Shared Services Agreement and Sub-Advisory Agreement, Acis LP delegated certain of its responsibilities under the PMAs to Highland. Accordingly, the personal qualities of Acis LP were not essential to performance under the PMAs. While the expertise of Acis LP was relevant to its selection as portfolio manager, such expertise is not unique–as demonstrated by the expertise and reputation of Oaktree, Brigade, and others who act as CLO portfolio managers. Also, importantly, the PMAs themselves provide that Acis may delegate the performance of its duties under the PMAs to third parties: "In providing services hereunder, the Portfolio Manager may employ third parties, including its Affiliates, to render advice (including investment advice), to provide services to arrange for trade execution and otherwise provide assistance to the Issuer, and to perform any of the Portfolio Manager's duties under this Agreement; provided that the Portfolio Manager shall not be relieved of any of its duties hereunder regardless of the performance of any services by third parties." 2014-3 PMA § 3(h)(iii). And although section 14 the PMAs requires consent for assignment, section 14 contemplates that an Affiliate assignee "has demonstrated ability, whether as an entity or by its personnel, to professionally and competently perform duties similar to those imposed upon the Portfolio Manager pursuant to this Agreement." Id. § 14(a). Further, sections 14 and 32 of the PMAs provide for merger, consolidation, or amalgamation of Acis with another company, where the resulting entity succeeds "to all or substantially all of the collateral management business of the Portfolio Manager." Pursuant to the terms of the PMAs themselves, the duties of Acis were not "so unique that the dut[ies were] thereby rendered nondelegable." See Compass Van & Storage, 65 B.R. at 1011 (citing RESTATEMENT (SECOND) OF CONTRACTS § 318(2) (1981)). As such, unlike personal service contracts, the PMAs do not "synthesize into those consensual agreements . . distinctive characteristics that commit to a special knowledge, unique skill or talent, singular judgment and taste." Compass

Van & Storage, 65 B.R. at 1011. Accordingly, because the duties of Acis LP under the PMAs are delegable (and were delegated) and are not unique, the PMAs cannot be personal service contracts that fall within the narrow exception of section 365(c)(1).

Additionally, Section 205(a)(2) of the Investment Advisors Act of 1940 ("IAA") is not a nonbankruptcy law that precludes assumption and assignment of the PMAs. Section 205(a)(2) of the IAA provides that a registered investment adviser (such as Acis) cannot enter into an investment advisory contract unless such contract provides "that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract[.]" 15 U.S.C. § 80b-5(a)(2). Thus, this provision of the IAA merely requires that the PMAs contain an anti-assignment provision–the IAA is not "applicable law" that prohibits assumption or assignment without consent of the counterparties to the PMAs. Indeed, in the Southern District of New York, the court held:

"Section 205(a)(2) of the [IAA] . . . does not . . . prohibit an investment adviser's assignment of an investment advisory contract without client consent. The section merely provides that the contract must contain the specified provision. Thus, the assignment of a non-investment company advisory contract, without obtaining client consent, could constitute a breach of the advisory contract, but not a violation of Section 205(a)(2)."

CWCapital Cobalt VR Ltd. v. CWCapital Invs. LLC, 2018 U.S. Dist. LEXIS 90174, at *12 (S.D.N.Y. May 23, 2018). Assignment of the PMAs without consent of the counterparties simply constitutes breach of the PMAs, but the IAA is not "applicable law" that excuses the counterparties to the PMAs from accepting or rendering performance without such consent. Accordingly, the assignment of the PMAs to Oaktree does not violate the IAA or section 365(c)(1) of the Bankruptcy Code.

<u>Preliminary Injunction</u>

The preliminary injunction in place preventing HCLOF from pursuing optional redemptions will remain in place for now. The court believes there are automatic stay implications (section 362(a)(3)) with regard to HCLOF pursuing optional redemptions. The effect of an optional redemption is to ***exercise control over the Acis PMAs and revenue stream*** (property of the estate–see, e.g., Hometown Valley View v. Prime, 847 F.3d 302 (5th Cir. 2017)). While HCLOF is not itself a creditor (and while "the Highlands" entity separateness is not being challenged, and is not being disregarded be either the Acis Trustee, the court, or anyone else at this juncture), the court notes that HCLOF, Highland, and other Highland-related parties seem to work in tandem. Highland asserts a claim against Acis. Actions taken by HCLOF could be construed to be actions of Highland, an actual creditor. There is also a basis for keeping the preliminary injunction in place pending determination of the Acis Trustee's fraudulent transfer lawsuits. The evidence thus far has been compelling that numerous transfers after the Josh Terry judgment denuded Acis of value–perhaps even the ability to control its own destiny when the ALF PMA was essentially terminated without cause and Acis was made to sell its shares in ALF/HCLOF back to ALF/HCLOF. In the face of these facts, the court will be reluctant to terminate the preliminary injunction until this litigation is fully resolved.

End of Ruling

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