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

CHARITABLE DAF FUND, L.P. AND CLO HOLDCO, LTD., DIRECTLY AND DERIVATIVELY	§	
Plaintiffs,	§	
v.	§	**Adv. Proc. No. 21-03067-sgj**
	§	**Civil Action No. 22-02802-S**
HIGHLAND CAPITAL MANAGEMENT, L.P., HIGHLAND HCF ADVISOR, LTD., AND HIGHLAND CLO FUNDING LTD., NOMINALLY,	§	
Defendants.	§	

PLAINTIFFS' MOTION FOR LEAVE TO FILE REPLY IN SUPPORT OF OBJECTION TO BANKRUPTCY COURT REPORT AND RECOMMENDATION TO THE DISTRICT COURT ON "RENEWED MOTION TO WITHDRAW THE REFERENCE" [BANKR. DOC. NO. 128]

Plaintiffs Charitable DAF Fund, L.P. and CLO HoldCo, Ltd. respectfully file this Motion for Leave to File a brief, seven-page reply brief in support of their *Objection to Report and Recommendation* denying their Renewed Motion to Withdraw the Reference (the "Objection").

Rule 9033 of the Federal Rules of Bankruptcy Procedure sets out the deadline for the filing of objections to a report and recommendation of a bankruptcy judge. Rule 9033 does not appear to authorize reply briefs as a matter of right; however, Local Rule 7.1(f) appears to allow it. "The purpose of a reply brief under local rule 7.1(f), is to rebut the nonmovants' response." *Pa.. Gen. Ins. Co v. Story*, No. 3:03-cv-0330, 2003 U.S. Dist. LEXIS 9923, at *1 (N.D. Tex. June 10, 2003) (citations and quotations omitted). Therefore, it is unclear whether leave to file a reply is required, and so this Motion is being made in an abundance of caution. No case Plaintiffs could find has

clarified the issue. If the Court decides that leave is not necessary, then Plaintiffs respectfully ask that their Reply be deemed timely filed as of the date of this filing.

Leave to file a reply is within the sound discretion of the district court to grant. *Montoya v. Bozeman Mach. & Salvage, L.P.*, No. 5:08-CV-049, 2008 U.S. Dist. LEXIS 140490, at *11 (N.D. Tex. 2008). Where it is not otherwise authorized by rule, a reply has generally been allowed where it addresses arguments or authorities raised in the opposition, "so as to avoid giving unfair advantage to the answering party." *See Bayway Ref Co. v. Oxygenated Mktg. & Trading A.G.,* 215 F.3d 219, 226-27 (2d Cir. 2000) (internal quotations omitted). Though this specific issue does not appear to have been raised before in this district, this district's analogous case law has generally adopted the same standard under Local Rule 7.1(f) for allowing a sur-reply. *See, e.g., ICI Constr., Inc. v. Hufcor, Inc.*, No. H-22-3347, 2023 U.S. Dist. LEXIS 37479, at *7 (S.D. Tex. Mar. 7, 2023) ("District courts may, in the exercise of sound discretion, allow a responding party to file a sur-reply when the movant raises new legal theories or attempts to present new evidence at the reply stage, and the responding party seeks leave of court to file the sur-reply.").

Accordingly, Plaintiffs' proposed Reply is limited to addressing the arguments raised in the Response. Specifically, the proposed Reply serves to:

1) Respond to the case law first cited by the Debtor in its Response in support of finding untimeliness (the cases are factually inapposite and/or stand for propositions radically different than what they are cited for);

2) Respond to arguments made for the first time in the Response and not raised in the Report and Recommendation that Plaintiffs' motion is prejudicial because it will cost judicial efficiency and allows for forum shopping;

3) Respond to the new arguments made in the Response that, under *Goldstein v. SEC*, the securities laws are well settled in non-movants' favor—which, as shown in the proposed Reply, is completely baseless.

4) And to give some context to the Response and help simplify the issues for the Court in light of what was argued in the Response.

The proposed Reply does not seek to introduce new evidence or raise new objections. It simply seeks to "avoid giving undo advantage" to the Defendant's Response, which cites to several authorities and arguments that are clearly incorrect. This short Reply clearly and succinctly shows why.

The proposed Reply is attached hereto as Exhibit A.

Dated: March 31, 2023

Respectfully submitted,

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CERTIFICATE OF CONFERENCE

I hereby certify that I conferred with opposing counsel who advised that they are opposed to the relief sought herein.

/s/ Mazin A. Sbaiti
Mazin A. Sbaiti

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I.

INTRODUCTION

Plaintiffs Charitable DAF Fund, L.P. and CLO HoldCo, Ltd. respectfully file this Reply in Support of their *Objection to Bankruptcy Court Report and Recommendation* denying their Renewed Motion to Withdraw the Reference (the "Objection"). This Reply is made only to point out a few simple things for the Court's benefit in determining whether to withdraw the reference:

First, the Debtor's Brief in Response to the Objection ("Response") focuses heavily on timeliness but cites case law that is factually and even legally divergent from the premise it seeks to establish. The cases Debtor cites either (i) dealt with motions to withdraw the reference after the specific federal issues had already been investigated in discovery and were being resolved by the bankruptcy court, and (ii) did not hold that the motion to withdraw was untimely. The bottom line is that Plaintiffs' motion to withdraw was filed right after the case was filed, although it wasn't decided then, and no discovery or other litigation has taken place in the bankruptcy court, such that one can accuse Plaintiffs of having implicitly consented or acquiesced to litigating the case there.

Second, the Debtor failed to identify any actual prejudice that would arise from litigating in this Court. The Debtor accuses Plaintiffs of forum shopping, forgetting that this case began in this Court, and *it was the Debtor* who sought a more favorable venue for this case. The Debtor calls for judicial efficiency, which is laughable because this Court will ultimately decide all substantive issues on appeal—thus doubling the work that will inevitably have to be done.

Third, the Debtor contends that this Court should ignore the cases cited in the Objection for why withdrawal is mandatory, because in this district, withdrawal only applies when the law is unsettled, whereas that is not the standard in those other jurisdictions. This is patently false and

completely unsupported. Those jurisdictions also apply the standard that mere rote application of federal law will not give rise to withdrawal. But the cases also find that where the issue is a securities law dispute—or another federal cause of action such as RICO, trademark or patent—even though the "law" is well settled, the application of the law to complex facts means that the court will not be "rotely" applying the law; it necessarily involves interpretation of federal law to determine whether a violation has occurred and what the appropriate remedy should be.

Nothing in the Response counters this proposition. The Response does not cite a single case denying withdrawal of the reference where a securities law issue was before the court—whereas every securities case found by Plaintiffs held withdrawal mandatory under 28 U.S.C. § 157(d).

II.

ARGUMENTS & AUTHORITIES

A. THE DEBTOR'S TIMELINESS ARGUMENTS MISCONSTRUE THE LAW AND THE RECORD

The Debtor contends that timeliness is the key reason to affirm the lower court's ruling, and then cites several cases of highly dubious relevancy and authority.

First, the Debtor cites *In re Fresh Approach, Inc.*, 51 B.R. 412, 415 (Bankr. N.D. Tex. 1985) for this proposition. However, the bankruptcy court held that the motion to withdraw the reference was untimely because it was filed sixteen days after the bankruptcy court had already decided the very federal issues that the motion to withdraw sought to remove from the bankruptcy court's consideration. *Id.* at 415 ("The motion [to withdraw the reference] was not filed until two weeks after the very event Section 157(d) was allegedly intended to avoid."). Here, the bankruptcy court has not decided the federal securities issues.

Second, the Debtor surprisingly cites *Sec. Farms v. Int'l Bhd. of Teamsters*, 124 F.3d 999, 1007 (9th Cir. 1997). It is surprising because that case *affirmed the district court's permissive withdrawal of the reference.* This is a material difference because the focus on judicial efficiency and forum shopping is irrelevant to mandatory withdrawal under § 157(d), it is only found in the permissive portion. *See* 28 U.S.C. § 157(d) ("The district court may withdraw . . . any case or proceeding referred [to the bankruptcy court] on its own motion or on timely motion of any party, for cause shown."). Therefore, the focus on the standards of permissive withdrawal is wholly inapposite. Moreover, the footnote cited in the Debtor's brief did not hold that the motion was untimely—rather, it affirmed the district court's finding that a motion filed early enough in the proceedings was timely. 124 F.3d at n.3 ("Accordingly, the district court did not abuse its discretion by determining that the motion was timely."). Just because the motion in *Teamsters* was timely does not mean that the motion in this case was untimely. Such bastardized logic has never carried the day.

As the Objection sets forth, the cases are myriad holding that motions to withdraw the reference are timely even after decisions on motions to dismiss. *See* Objection at pp. 11-12.

B. DEBTOR'S ARGUMENTS FOR PREJUDICE MISCONSTRUE THE LAW AND THE RECORD

The Debtor contends that it is prejudiced because the motion to withdraw is an attempt to forum shop and that judicial economy would be served by denying the motion. This platitude is unsupported and hypocritical. This case was originally filed *in this court*. *See* Dkt. 1, Case No. 3:21-cv-00842-B. Judge Boyle was assigned through the random assignment process under the Northern District of Texas. It is the *Debtor* who insisted on a more favorable judge. *See id.* Dkt. 22. Thus, the Plaintiffs asking for the case to be heard in front of this Court is a far cry from forum shopping, and surely the Debtor should not be rewarded for its prior acts of forum shopping.

Moreover, leaving this case—along with its complex legal and other issues—in front of the bankruptcy court is going to generate appeals of substantive rulings. All of those appeals will be decided by *this Court* in any event. Thus, withdrawal of the reference is the only way to *maximize* judicial efficiency, as was precisely found by the Ninth Circuit in *Sec. Farms v. Int'l Bhd. of Teamsters*—a case that the Debtor heavily relies on. 124 F.3d at 1009 ("In this case efficiency was enhanced by withdrawing the reference because…Inasmuch as a bankruptcy court's determination on non-core matters are subject to *do novo* review by the district court, unnecessary costs could be avoided by a single proceeding in the district court.").

None of the Debtor's other cases support its position either. *See* Response at 12. Each of those cases are quoted for seemingly helpful language, but a review of the facts show that they are a far from relevant. *See, e.g., Hupp v. Educ. Credit Mgmt. Corp.*, No. 07CV1232 WQH (NLS), 2007 U.S. Dist. LEXIS 68199, at *7-9 (S.D. Cal. 2007) (finding motion to withdraw untimely where plaintiff "chose to litigate this case extensively in the Bankruptcy Court by conducting discovery and filing numerous motions, including the pending and fully briefed motion for summary judgment"); *Drew v. Worldcom, Inc.*, 2006 U.S. Dist. LEXIS 52318, at *8-9 (S.D.N.Y. 2006) (finding motion untimely where case had been pending for 18 months, and all discovery had been conducted in bankruptcy court and motions for class certification and summary judgment were briefed and pending, giving rise to inference that plaintiff was seeking a more favorable forum). Here, no discovery has been commenced—indeed, the entirety of the time this case has been pending has been spent briefing, arguing and appealing preliminary matters, and the bankruptcy court has yet to rule on the merits of the federal issues.

Rather than address the obvious issues, Debtor attempts to construct a false narrative. In doing so, it elides the fact that the motion to withdraw the reference was originally filed in *this*

court as a cross-motion to the Debtor's motion to enforce the reference. Dkt 22, Case No. 3:21-cv-00842-B. It was not decided by this Court and appeared to have been decided by the bankruptcy court when Judge Jernigan said that she was "essentially acting as a magistrate for Judge Boyle in this action." APP_257 (103:2-14). When the bankruptcy court then only decided procedural defenses—i.e., issues that would not in and of themselves trigger mandatory withdrawal of the reference—the fact that those were seated in a final order and not in a Report and Recommendation, while admittedly confusing, could have been chalked up to the fact that Judge Jernigan only decided procedural issues that did not trigger the mandatory withdrawal provisions. It would have imprudent and nonsensical to appeal the form of the order on the basis of § 157(d). It therefore did not make the re-urging of the motion to withdraw the reference ripe.

Therefore, although the Debtor uses the word "prejudice" a lot in its Response, Debtor never explains what the prejudice is or why it inures. There is no delay to be had from the withdrawal of the reference. The cases cited by the Debtor have found prejudice where the bankruptcy court had already conducted discovery and other proceedings, and was on the precipice of ruling on summary judgment or some other motion, only to have that effort undone by a motion to withdraw. No such circumstances exist here.

C. DEBTOR'S ARGUMENTS ON THE STATE OF THE LAW MISCONSTRUE THE LAW

The Debtor doubles down on the premise with new citations that it is only if the federal law at issue is "unsettled" that mandatory withdrawal applies. *See* Response at 17-18. A species of this argument was initially addressed in the Objection. *See* Objection at 18-25.

Debtor's recast position creates a false dichotomy between this district and others that Debtor contends do not require unsettled law before withdrawing the reference. There is no evidence that the district courts which were cited in the Objection have a different standard. They

don't.

Because securities laws application is so intertwined with the underlying complex factual predicates, then the issues are always subject to judicial interpretation in applying the legal precepts to the evidence. *See* Objection at 20. Debtor clearly did not read the case law cited in the Objection, because if they had, they would have seen similar, if not identical, standards for withdrawing the reference applied there too—but the courts nonetheless found that the complexity of applying even well-settled law to the facts met the standard in securities law cases, because the application is not rote. *See e.g., Haigler v. Dozier (In re Dozier Fin., Inc.)*, No. 4:18-cv-1888, 2018 U.S. Dist. LEXIS 220354, at *5-6 (D.S.C. 2018); *In re Contemp. Lithographers, Inc.*, 127 B.R. at 127; *In re Am. Solar King Corp.*, 92 B.R. 207, 210-11 (W.D. Tex. 1988)); *Price v. Craddock*, 85 B.R. 570, 573 (D. Colo. 1988); *In re Bevill, Bresler & Schulman Asset Management Corp.*, 67 Bankr. 557, 563 (D. N.J. 1986), *aff'd*, 805 F.2d 120 (3d Cir. 1986). The Debtor fails to address this point at all.

These are all securities law cases. Did the Debtor cite to a single securities case where mandatory withdrawal of the reference was denied? They cited none.

And critically, when it comes to *this* securities case, the law is not "settled." The Advisers Act has many open questions as explicated in the Objection. Plaintiff respectfully takes issue with the Debtor's radical misstatement that the Advisers Act is well settled because "it is well-settled that Rule 206 of the Advisers Act…creates a fiduciary duty to an investment adviser's 'client'". Response at 17 (citing *Goldstein v. SEC*, 451 F.3d 873, 874 (D.C. Cir. 2006). Indeed, Highland has raised this case several times in other places. However, at issue in *Goldstein* was § 206(2) of the IAA—which explicitly uses the word "clients" (as does § 206(1)). *See* 451 F.3d at 881 (construing 15 U.S.C. § 80b-6(2)); *see also* 15 U.S.C. § 80b-6(1). Indeed, § 206(2) is the provision--in fact the

only provision--cited by *Goldstein* at the end of the sentence that Defendant quoted from, and it specifically established duties to "clients." On the other hand, § 206(3) and § 206(4), invoked in the action by Plaintiffs, *do not* use the word "clients." 15 U.S.C. § 80b-6(3)-(4). *Goldstein* invalidated an SEC rule that extended protections to investors in client funds, and the D.C. Circuit held that because § 206(2) explicitly used the term "client," the rule extending duties beyond that was invalid. The SEC, in reaction to *Goldstein*, promulgated 17 C.F.R. § 275.206(4)-8 ("Rule 206(4)-8"), which explicitly clarified that duties under § 206(4) are owed directly to investors in investment funds like Acis-6. *See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles,* 72 Fed. Reg. 44,756, 44,757 (Aug. 9, 2007) (codified at 17 C.F.R. pt. 275) (noting that proposed rule is in reaction to *Goldstein* and that *Goldstein* only addressed § 206(2) which used the term "clients", but § 206(4) was not so limited).

Thus, a question that will arise is whether a direct duty under 15 U.S.C. § 80b-6(4) and SEC Rule 206(4)-8 [17 C.F.R. § 275.206(4)-8] exists between Highland and Highland CLO Fund, Ltd. ("HCLOF"), and also with CLO Holdco as an investor in HCLOF. And, by way of application, the questions abound whether Rule 206(4)-8 and § 206(4) apply to Plaintiffs, what specific duties they entailed in the facts of this lawsuit, whether those general prohibitions have been violated, whether Plaintiffs' federal or state remedies are actionable, and what specific remedies there should be.

III.

CONCLUSION

The Debtor's failure to address any of these salient points should result in sustaining Plaintiffs' objection to the Report and Recommendation and withdrawal of the reference in full.

Dated: March 31, 2023

Respectfully submitted,

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ORDER

Having considered *Plaintiffs' Motion for Leave to File Reply in Support of Objection to Bankruptcy Court Report and Recommendation to the District Court on "Renewed Motion to Withdraw the Reference" [Bankr. Doc. No. 128]* (the "Motion"), the Court finds that the Motion should be GRANTED.

IT IS ORDERED that Plaintiffs' proposed Reply attached as Exhibit A to the Motion be deemed timely filed.

SO ORDERED this _____ day of _____, 2023.

_____
The Honorable Karen Gren Scholer
United States District Judge