Docket #0164 Date Filed: 2/21/2023

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.

LIBERTY TRANSCRIPTS
7306 Danwood Drive
Austin, Texas 78759
E-mail: DBPATEL1180@GMAIL.COM
(847) 848-4907

APPEARANCES VIA WEBEX:

For the Plaintiffs:

Sbaiti & Company PLLC
BY: MAZIN AHMAD SBAITI, ESQUIRE
JP Morgan Chase Tower
2200 Ross Avenue, Suite 4900 W
Dallas, Texas 75201

Kelly Hart & Pitre
BY: LOUIS M. PHILLIPS, ESQUIRE
301 Main Street, Suite 1600
Baton Rouge, Louisiana 70801

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

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EXHIBITS **ID** **EVD**

Motion for withdrawal of reference filed by Plaintiff CLO Holdco, Ltd., Plaintiff Charitable DAF Fund, LP (128)

FOR THE PLAINTIFFS:
(None)

FOR THE DEFENDANTS:

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Defendant Highland Capital Management, L.P.'s Renewed Motion to Dismiss Complaint (122) DAF Fund, LP (128)

FOR THE PLAINTIFFS:
(None)

FOR THE DEFENDANTS:

1 through 14 58 58

(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 Transamerica 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 Reading (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 Transamerica. They quoted Transamerica. They said the Supreme Court held there that there is no private right of action under Section 206. Transamerica 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 Hsin-chi-Su v. Vantage Drilling, 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.)

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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