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

IN RE:	§	
	§	Case No. 19-34054-sgj-11
HIGHLAND CAPITAL MANAGEMENT, L.P.	§	
	§	Chapter 11
Debtor.	§	
	§	
HIGHLAND CAPITAL MANAGEMENT, L.P.,	§	
	§	ADVERSARY NO. 20-03107
Plaintiff,	§	
v.	§	
PATRICK HAGAMAN DAUGHERTY	§	
Defendant.	§	

PATRICK H. DAUGHERTY'S ANSWER TO (I) OBJECTION TO CLAIM NO. 77 OF PATRICK HAGAMAN DAUGHERTY AND (II) COMPLAINT TO SUBORDINATE CLAIM OF PATRICK HAGAMAN DAUGHERTY

Patrick Hagaman Daugherty, Defendant in the above-referenced adversary proceeding, hereby files his Answer to (I) Objection to Claim No. 77 of Patrick Hagaman Daugherty and (II)

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Complaint to Subordinate Claim of Patrick Hagaman Daugherty, and in support thereof would respectfully submit the following:

1. Daugherty is a former limited partner of the Debtor and a former officer of Debtor's general partner, Strand Advisors, Inc. ("Strand"). On May 28, 2009, his employment by Strand was terminated for cause. Slightly over two years later, on September 28, 2011, he resigned from the Debtor. Litigation ensued in Texas state court (the "Texas Action"). The Debtor prevailed on claims for breach of contract and breach of fiduciary duty against Daugherty for non-monetary damages and obtained an award of $2.8 million in attorneys' fees. Each of Daugherty's claims against the Debtor was unsuccessful. He did, however, prevail on a third-party claim against the Highland Employee Retention Assets LLC ("HERA"), an employee deferred compensation vehicle. He was awarded the value of his ownership interests-$2.6 million-on a claim against HERA for breach of the implied covenant of food faith and fair dealing in connection with actions that allegedly deprived him of the value of those interests (the "HERA Judgment"). Daugherty was unable to collect on the HERA Judgment against HERA. Not wishing to return to Texas state court, he sued the Debtor, HERA, and others in the Delaware Chancery Court (the "Delaware Action"), alleging in part that HERA assets had been fraudulently transferred to the Debtor.

ANSWER: The first sentence of paragraph 1 is admitted. The second sentence of paragraph 1 is denied and Daugherty refers to paragraph 66 of the Debtor's Answer to Daugherty's Second Amended Verified Complaint in the Delaware Action in which the Debtor "admit[ted] that Daugherty served as an officer and agent of Strand from 2004 until he resigned from Highland in 2011." The third, fourth and fifth sentences of paragraph 1 are admitted. The sixth sentence of paragraph 1 is denied. The seventh sentence of paragraph 1 is admitted. The eighth sentence of paragraph 1 is denied. The ninth sentence of paragraph 1 is admitted. The tenth sentence of paragraph 1 is denied except that it is admitted that Daugherty sued the Debtor, and others in the Court of Chancery in Delaware and included a claim for fraudulent transfer against the Debtor among other claims.

2. The Daugherty Claim attaches and incorporates his operative complaint in the Delaware Action, which was in trial on the Petition Date (as defined below), to which he adds two new claims to reach an asserted total of "at least $37,483,876.62." The Daugherty Claim has the following components:

(i) In the Delaware Action, he sought: (a) to collect the HERA Judgment of $2.6 million plus interest of $1.13 million; (b) a distribution of HERA assets, which he

values at $26 million, on account of what he contends is his still-existing interest in HERA, notwithstanding that he was already awarded the value of that interest in the Texas Action; and (c) indemnification for his attorneys' fees incurred in the Texas Action and the Delaware Action under the Debtor's partnership agreement.

(ii) Defamation in a November 30, 2017, press release.

(iii) Indemnification as a former partner of the Debtor for any personal tax liability arising from a pending 2008/09 IRS audit of the Debtor that may result in additional pass-through income to the Debtor's partners. He values this claim at $6,751,902.41, plus interest of $992,790.40.

ANSWER: The first sentence of paragraph 2 is admitted. The remainder of the allegations in paragraph 2 are denied except that it is admitted that Daugherty's claim consists of liabilities arising from the claims in the Delaware Action, defamation and indemnification.

3. As addressed herein: (i) the Debtor will not object to allowance of Daugherty's claim for the value of his HERA Judgment plus interest to the Petition Date-totaling $3,722,019; (ii) the Debtor objects to Daugherty's $26 million claim for a distribution of his asserted interest in HERA's assets on the basis that it would constitute a double recovery on his HERA Judgment, and in any event could be no more than $4,967,828; (iii) the Debtor objects to indemnification of Daugherty's attorneys' fees in his personal litigation with the Debtor; (iv) the Debtor objects to Daugherty's defamation claim as time-barred under the "single publication rule", and (v) the Debtor objects to Daugherty's claim that the Debtor is required to pay his personal taxes; furthermore, any such claim approximates $740,000 and not $6.7 million, and any such claim is subordinated under Bankruptcy Code § 510(b).

ANSWER: Daugherty lacks knowledge regarding the intentions of the Debtor and denies the allegations in paragraph 3 on that basis and denies the allegations on the further basis that the objections recited lack merit.

4. Accordingly, this adversary proceeding is brought pursuant to Rules 7001(1), (8) and (9) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and sections 502, 510(b), and 541 of title 11 of the United States Code (the "Bankruptcy Code") to (i) disallow the Daugherty Claim under section 502(a) as unenforceable under applicable law and (ii) subordinate the Daugherty Claim under section 510(b).

ANSWER: The allegations in paragraph 4 consist of legal conclusions to which no answer is required. To the extent an answer is required, Daugherty denies that the Debtor is entitled to the relief recited in paragraph 4.

5. This adversary proceeding arises in and relates to the Debtor's case pending before the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (the "Court") under chapter 11 of the Bankruptcy Code.

ANSWER: Admitted.

6. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334.

ANSWER: Admitted.

7. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b), and, pursuant to Rule 7008 of the Bankruptcy Rules, the Debtor consents to the entry of a final order by the Court in the event that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments consistent with Article III of the United States Constitution.

ANSWER: Daugherty admits that this matter is a core proceeding. The remainder of the allegations in this paragraph consist of legal conclusions to which no answer is required. To the extent a response is required, Daugherty admits that the Debtor has consented pursuant to Rule 7008 of the Bankruptcy Rules to the entry of a final order by the Court in the event that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments consistent with Article III of the United States Constitution.

8. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.

ANSWER: Admitted.

9. The Debtor is a limited partnership formed under the laws of Delaware with a business address at 300 Crescent Court, Suite 700, Dallas, Texas 75201.

ANSWER: Admitted.

10. Defendant Patrick Hagaman Daugherty is an individual with an address at 3621 Cornell Avenue, Suite 830, Dallas, Texas 75205.

ANSWER: Admitted.

11. On October 16, 2019 (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the "Delaware Court"), Case No. 19-12239 (CSS) (the "Bankruptcy Case").

ANSWER: Admitted.

12. On October 29, 2019, the United States Trustee in the Delaware Court appointed an Official of Unsecured Creditors.

ANSWER: Admitted.

13. On December 4, 2019, the Delaware Court entered an order transferring venue of the Bankruptcy Case to this Court [Docket No. 186].

ANSWER: Admitted.

14. On January 9, 2020, this Court entered an Order [Docket No. 339] on the *Motion of the Debtor for Approval of Settlement with the Official Committee of Unsecured Creditors Regarding Governance of the Debtor and Procedures for Operations in the Ordinary Courts* [Docket No. 281] pursuant to which an independent board of directors (the "Independent Board") was appointed at the Debtor's general partner, Strand.

ANSWER: Admitted.

15. The Debtor has continued in the possession of its property and has continued to operate and manage it business as a debtor-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in this chapter 11 case.

ANSWER: Daugherty lacks knowledge sufficient to admit or deny the allegations in paragraph 15 except that it is admitted that no docket entry in the Debtor's bankruptcy case has appointed a trustee or examiner to date.

16. The Bankruptcy Code establishes a burden-shifting framework for proving the amount and validity of a claim. "A claim…, proof of which is filed under section 501 [of the Bankruptcy Code], is deemed allowed, unless a party in interest…objects." 11 U.S.C. § 502(a). "A proof of claim executed and filed in accordance with the [Bankruptcy Rules] shall constitute *prima facie* evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f); see also *In re Armstrong*, 347 B.R. 581, 583 (Bankr. N.D. Tex. 2006). However, the ultimate burden of proof for a claim lies with the claimant. *Armstrong*, 347 B.R. at 583 (citing *Raleigh v. Ill Dep't of Rev.,* 530 U.S. 15 (2000)).

ANSWER: Admitted, except that the citation of *In re Armstrong* is 320 B.R. 97 (Bankr. N.D. Tex. 2005).

17. Daugherty asserts a claim against the Debtor for allegedly "defaming him on its website pursuant to its November 30, 2017 press release titled *Matt Wirz, Wall Street Journal Fake News, Sloppy and Malicious Reporting."* As of the Petition Date, Daugherty had not filed a lawsuit against the Debtor or any other party on the basis of defamation.

ANSWER: Admitted.

18. Defamation carries a one-year statute of limitations. Tex. Civ. Prac. & Rem. Code § 16.002(a) ("A person must bring a suit for malicious prosecution, libel, slander, or breach of promise of marriage not later than one year after the day the cause of action accrues.") The statute

runs from the date of first publication of the allegedly defamatory statement on the defendant's website. *Glassdoor, Inc. v. Andra Group, LP,* 575 S.W. 3d 523, 528-29 (Tex. 2019); *Mayfield v. Fullhart*, 444 S.W. 3d 222, 230 (Tex. App.- Houston [14th Dist.] 2014, no pet). The "single publication rule" serves to "avoid [ ] the potential for endless retriggering of the statute of limitations, multiplicity of suits, and harassment of defendants, along with the corresponding chilling effect on internet communications." *Glassdoor*, 575 S.W. 3d at 528-529 (internal citations omitted). Accordingly, Daugherty was time-barred from asserting a defamation claim on December 1, 2018.

ANSWER: Admitted. By way of further response, Daugherty does not intend to seek monetary relief for the Debtor's continuing defamation, but reserves all rights regarding the use of or reference to Debtor's continuing defamation as evidence or otherwise as appropriate.

19. The Debtor believes this issue is dispositive but reserves the right to object on any other basis if necessary.

ANSWER: Daugherty lacks knowledge as to Debtor's belief and denies paragraph 19 on that basis.

20. The Daugherty Claim has a damages breakdown that contains what is referred to as an indemnification claim of $992,790.40, including interest and penalties, on account of a pending IRS audit of the Debtor. Daugherty states:

> Daugherty is a former senior partner of Highland Capital Management, LP and this claims arises out of a 2008/2009 pending undecided audit/dispute (062520180028) between the Debtor and the Internal Revenue Service that remains unresolved.

ANSWER: The first sentence of paragraph 20 is denied. The second sentence refers to Daugherty's claim, which Daugherty refers to for its complete and accurate contents, except it is admitted that the excerpt provided in the second sentence of paragraph 20 is contained within Daugherty's claim.

21. The IRS audit of the Debtor's return for 2007-2008 (not 2008-09 as erroneously stated in the Daugherty Claim) resulted in a determination that additional pass-through distributions were required to be made to the Debtor's partners. The audit determination is subject to appeal. Daugherty's 4% share of the additional distributions comes to $1,475,860. Assuming a 35% marginal rate ($440, 227), and adding penalties ($88,045) and interest ($212,035), his total exposure approximates $740,307 at this time-not $992,790.

ANSWER: The allegations of paragraph 21 are denied.

22. Regardless of amount, Daugherty has no right to mandatory indemnification of his personal tax liability as a former partner of the Debtor. Section 4.1(h) of the Partnership Agreement

provides for indemnification of limited partners in the "sole and unfettered discretion" of the general partner. It does provide for mandatory indemnification of the general partner, Strand, of which Daugherty was an officer, but that provision is inapplicable to his personal tax liabilities. In relevant part, Section 4.1(h) reads as follows:

> Indemnification. The Partnership shall indemnify and hold harmless the General Partner and any director, officer, employee, agent or representative of the General Partner (collectively, the "***GP Party***"), against all liabilities, losses, and damages incurred by any of them by reason of any act performed or omitted to be performed in the name of or on behalf of the Partnership, or in connection with the Partnership's business, including, without limitation, attorneys' fees and any amounts expended in the settlement of any claims or liabilities, losses, or damages, to the fullest extent permitted by the Delaware Act; provided, however, the Partnership shall have no obligation to indemnify and hold harmless a GP Party for any action or inaction that constitutes gross negligence or willful or wanton misconduct.

ANSWER: The allegations of paragraph 22 are denied except that the last sentence referring to Section 4.1(h) of the Partnership Agreement is referred to for its complete and accurate contents.

23. Daugherty's personal income taxes on distributions received in his capacity as a limited partner of the Debtor do not fall within the Debtor's indemnification of its general partner for "liabilities, losses, and damages incurred… by reason of any act performed or omitted to be performed in the name of or no behalf of the Partnership, or in connection with the Partnership's business…." Daugherty incurred personal taxes on his income. The closest nexus to the Debtor would be that an indeterminate portion of that income came from the Debtor. He did not incur any loss or liability in his asserted capacity as a "GP Party," *i.e.,* an officer of Strand, the indemnified general partner. Therefore the indemnity clause does not apply as a matter of common sense and by its express terms.

ANSWER: Denied.

24. Nor does Daugherty have a claim for a tax distribution from the Debtor. The last Partnership Agreement to which Daugherty was a signatory was the *Second Amended and Restated Agreement of Limited Partnership.* Distributions are addressed in section 3.9, which provides in part:

> (a) General. The General Partner shall review the Partnership's accounts at the end of each calendar quarter to determine whether distributions are appropriate. The General Partner may make such pro rata or non-pro rata distributions as it may determine in its sole and unfettered discretion, without being limited to current or accumulated income or gains, but no such distribution shall be made out of funds required to make current payments on Partnership indebtedness. The Partnership has entered into one or more credit facilities with financial institutions that may limit the amount and timing of distributions to the

> Partners. Thus, the Partners acknowledge that distributions from the Partnership may be limited…
>
> (b) Tax Distributions. The General Partner shall promptly declare and make cash distributions pursuant hereto to the Partners to allow the federal and state income tax attributable to the Partnership's taxable income that is passed through the Partnership to the Partners to be paid by such Partners (a "Tax Distribution"). To satisfy this requirement, the Partnership shall pay to each Partner on or before April 14 of each Fiscal Year…

ANSWER: The allegations in the first sentence of paragraph 24 are denied. The allegations of the second sentence of paragraph 24 are admitted in that the last Partnership Agreement to which Daugherty was a signatory was the Second Amended and Restated Agreement of Limited Partnership of the Debtor and Daugherty refers to that agreement and section 3.9 thereof for its complete and accurate contents. The allegations of the third sentence of paragraph 24 are denied except that Daugherty refers to the Second Amended and Restated Agreement of Limited Partnership of the Debtor and section 3.9 thereof for its complete and accurate contents.

25. Partners do not have a right to distributions as if they were creditors. That is why section 3.9 (a) clearly states that distributions will be limited if funds are insufficient to pay current debt. A partnership agreement is simply an agreement between partners as to when and how distributions may be made if the partnership has the funds to do so. Even if there were such an obligation, the Debtor had not made any distributions that would be subject to tax, and so would have had no obligation *at that time* to make tax distributions. And even if the Partnership Agreement were interpreted to call for a tax distribution to be made on account of income that is imputed to its partners ten years later as a result of the IRS audit (which is still contingent), the Debtor does not have funds in excess of current debt. Thus Daugherty has no claim for tax indemnification or a tax distribution.

ANSWER: The allegations in paragraph 25 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim.

26. Even if Daugherty had a claim under the Partnership Agreement, it would be subordinated under Bankruptcy Code § 510(b), which provides:

> (b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under

> section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

ANSWER: The allegations in paragraph 26 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies the allegations as applied to Daugherty's claim and Daugherty refers to Section 510(b) of the Bankruptcy Code for its complete and accurate contents.

27. Section 510(b) applies to the ownership interest in a limited partnership. See *In re SeaQuest Driving LP,.* 5709 F.3d 411 (5th Cir. 2009); *Templeton v. O'Cheskey (In re Am. Hous. Found.),* 785 F.3d 143, 154 (5th Cir. (2015); *In re Garrison Mun. Partners, LP*, 2017 Bankr. LEXIS 3765, *8 (Bankr. S.D. Tex. Oct. 31, 2017).

ANSWER: The allegation in paragraph 27 consists of a legal conclusion to which no response is required. To the extent a response is required, Daugherty denies the allegation as applied to his claim.

28. Thus, there are three distinct categories of claims subject to mandatory subordination under section 510(b): (1) a claim arising from rescission of a purchase or sale of a security of the debtor (the rescission category); (2) a claim for damages arising from the purchase or sale of a security of the debtor (the damages category); and (3) a claim for reimbursement or contribution allowed under 11 U.S.C. § 502 on account of either (1) or (2). SeaQuest, 579 F. 3d at 418.

ANSWER: The allegation in paragraph 28 consists of a legal conclusion to which no response is required. To the extent a response is required, Daugherty denies the allegation as applied to his claim.

29. Even if Daugherty had a claim under the Partnership Agreement to cover his taxes, such a claim would be for damages "arising from" the purchase of a security (category 2). The category covers claims arising from not just the purchase itself but all claims arising thereafter as incidents of ownership, except where the claim is genuinely a "debt"-*e.g.,* where it arises from a documented loan or other distinct transaction between the partner and the partnership.

> For purposes of the damages category, the circuit courts agree that a claim arising from the purchase or sale of a security can include a claim predicated on post-issuance conduct, such as breach of contract. They also agree that the term "arising from" is ambiguous, so resort to the legislative history is necessary. For a claim to "arise from" the purchase or sale of a security, there must be some nexus or causal relationship between the claim and the sale. Further, the fact that the claims in the case seek to recover a portion or claimants' equity investment is the most important policy rationale.

SeaQuest, 579 F.3d at 421 (internal citations omitted). In *SeaQuest,* the Fifth Circuit ruled that a settlement that essentially effected a rescission and, when breached, resulted in a judgment, was nonetheless subordinated under section 510(b). *Id.* At 423-26 ("For purposes of § 510(b), we may look behind the state court judgment to determine whether the…claim 'arises from' the rescission of a purchase or sale of a security of the debtor.")

ANSWER: The allegations in paragraph 29 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies the allegations as applied to his claim.

30. In Garrison Municipal Partners, a redemption claim arising from withdrawal from the partnership was subordinated under section 510(b). The situations identified by the court in which section 510(b) *would not* apply illustrate why it would likely apply here:

> Debtor's failure to pay the Greens' claim upon withdrawal is a claim for breach of contract arising from the withdrawal. The Greens are seeking to recover their equity investment. Thus, under Section 510(b), their claim is subordinated and has the same priority as the other prepetition investors.
>
> The Greens' argument that their notice of withdrawal is a redemption claim similar to those in *In re Montgomery Ward Holding Co.* 272 B.R. 836 (Bankr. D Del. 2001), *abrogated on other grounds: by re Telegroup, Inc.,* 281 F.3d 133 (3d Cir. 2002) lacks merit. A redemption claim requires a separate note, *see SeaQuest*, 579 F.3d, at 423, and must be independent of the partnership agreement. See *In re American Housing Foundation*, 785 F.3d 143 (5th Cir. 2015). In this case, the notice of withdrawal was not self-executing so as to give the Greens an interest in the assets of the partnership. The partnership agreement required action on the part of the general partner to repay the Greens equity interests.

Garrison Mun. Partners, 2017 Bankr. LEXIS 3765 at *9, *see also Official Comm. Of Unsecured Creditors v. FLI Deep Marine LLC (In re Deep Marine Holdings, Inc),* 2011 Bankr. LEXIS 579 (Bankr. S.D. Tex. Jan. 19, 2011) (claims for right of appraisal, fraud, and accounting were causally linked to status as shareholders and so were subordinated); *Queen v. Official Comm. Of Unsecured Creditors (In re Response U.S.A., Inc.)* 288 B.R. 88 (D.N.J. 2003) (shareholder cannot avoid subordination under 11 USC § 510(b) by placing risk-limiting provision in stock purchase agreement in order to claim creditor status in bankruptcy proceedings).

ANSWER: The allegations in paragraph 30 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies the allegations as applied to his claim.

31. By comparison, *Stucki v. Orwig,* No. 3:12-CV-1064-L, 2013 U.S. Dist. LEXIS 53139, at *15-19 (N.D. Tex. Apr. 12, 2013) found section 510(b) inapplicable where the claim arose from breach of a settlement agreement by which the shareholders withdrew a lawsuit seeking to compel a shareholders' meeting and election of directors. *Id.* At *17. The court reasoned as

follows: "[I]n both *In re SeaQuest* and *In re Deep Marine Holdings,* the claims essentially sought to recover the claimants' equity interests in the debtor. There is no suggestion in the record that the shareholders sought to do the same here. The court therefore concludes that the connection or causal relationship between the Breach Claim and the actual or virtual purchase or sale of any security interests in FirstPlus is too attenuated to bring it within § 510(b)'s reach." *Id.* At *19. That decision seems debatable, but in any event, it is a far cry from this case, where what Daugherty is effectively demanding is a distribution on account of his partnership interest. Such a claim should fall squarely under section 510(b).

ANSWER: The allegations in paragraph 31 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies the allegations as applied to his claim.

32. Daugherty is asserting a right under the Partnership Agreement to cover the taxes on his distribution from the partnership. To the extent he has such a right, it is an incident of ownership arising from the Partnership Agreement and not from any ancillary transaction such as a loan. It is in the nature of a "partner claim," not a creditor claim, and must be subordinated.

ANSWER: The allegations in the first sentence of paragraph 32 are denied. The remainder of the allegations in paragraph 32 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies the allegations as applied to his claim.

33. Daugherty was an officer of Strand and a limited partner of the Debtor. On May 28, 2009, his employment by Strand was terminated for cause. On September 28, 2011, he resigned from the Debtor. At the time he resigned, Daugherty owned units of HERA, which was a deferred compensation plan that held interests in certain Highland-related entities. Daugherty owned (and in his view still owns) 19.1% of the HERA units. The other 80.91% is owned by the Debtor.

ANSWER: The first sentence of paragraph 33 is admitted. The second sentence of paragraph 33 is denied and Daugherty refers to paragraph 66 of the Debtor's Answer to Daugherty's Second Amended Verified Complaint in the Delaware Action in which the Debtor state that the Debtor "admit[s] that Daugherty served as an officer and agent of Strand from 2004 until he resigned from Highland in 2011." The third sentence of paragraph 33 is denied except that it is admitted that at the time he resigned, Daugherty owned units of HERA and that HERA held interests in certain Highland-related entities. The fourth sentence of paragraph 34 is admitted. The fifth sentence of paragraph 34 is admitted except that Daugherty maintains that he is the sole

rightful holder of 100% of the HERA interests and not merely a 19.1% membership interest holder. The sixth sentence of paragraph 33 is denied.

34. On February 16, 2012, HERA enacted a *Second Amended and Restated LLC Agreement* (the "HERA Agreement"). Section 12.1 provided that legal fees incurred in a lawsuit relating to the HERA Agreement may be offset against the capital balance of the LLC member bringing the lawsuit.

ANSWER: The allegations in the first sentence of paragraph 34 are denied. The allegations in the second sentence of paragraph 34 purport to characterize Section 12.1 of the Second Amended and Restated LLC Agreement of HERA and Daugherty refers to Section 12.1 of the Second Amended and Restated LLC Agreement of HERA for its complete and accurate contents. To the extent a response is required, Daugherty denies that HERA, the Debtor or any other person has ever been permitted to offset legal fees against Daugherty.

35. After Daugherty filed claims against HERA and the Debtor in the Texas Action, the Debtor bought out all other members of HERA and, based on Section 12.1, issued a capital balance statement of "zero" to Daugherty for his HERA membership units. On April 30, 2013, HERA assigned to the Debtor all of HERA's remaining assets, consisting of (i) $9,527,375 in limited partnership interests in Highland Restoration Capital Partners, L.P. ("RCP"); (ii) 5,424 shares in stock in NexPoint Credit Strategies Fund ("NHF"); and (iii) $6,338,702 in cash (the "Distribution Assets").

ANSWER: The first sentence of paragraph 35 is denied. The second sentence of paragraph 35 is denied except it is admitted that the Debtor purported to effect such assignment and dated the documents related to such assignment as of April 30, 2013.

36. In December 2013, the Debtor placed in escrow Daugherty's alleged ratable 19.1% share of the Distribution Assets, namely (i) $1,820,050 in RCP units, (ii) the cash equivalent of 1,088 shares of NHF, and (iii) $1,201,502 in cash (the "Escrow Assets"). The escrow agreement stated that if Daugherty prevailed against HERA, the Debtor would return the Escrow Assets to HERA.

ANSWER: The first sentence of paragraph 36 is denied. The second sentence of paragraph 36 purports to characterize the terms of the escrow agreement and Daugherty refers to the escrow agreement for its complete and accurate contents. To the extent a response is required, Daugherty denies the allegations of the second sentence of paragraph 36.

37. Daugherty prevailed against HERA in the Texas Action. The jury found that HERA used Section 12.1 to deny Daugherty the value of his HERA units, that this breached HERA's duty of good faith and fair dealing, and that the market value of the HERA units was $2.6 million. On July 14, 2014, the Texas court rendered the HERA Judgment, comprising a judgment against HERA of $2.6 million, plus prejudgment and post-judgment interest at 5%.

ANSWER: The first sentence of paragraph 37 is admitted. The second sentence of paragraph 37 is denied except that it is admitted that the jury found that the amendment to the HERA Agreement to include Section 12.1 constituted a breach of good faith and fair dealing and that $2.6 million would compensate Daugherty for his damages that resulted from such breach. The third sentence of paragraph 37 is denied except that Daugherty admits that on July 14, 2014, the Texas court rendered its final judgment in the Texas Action and included in the judgment, among other things, a judgment of $2,600,000 against HERA, with pre-judgment interest at 5% simple interest from May 22, 2012 until July 13, 2014 and 5% interest per annum, compounded annually, form the date of the judgment until paid.

38. Daugherty was unable to collect the HERA Judgment from HERA. On December 1, 2016, the escrow agent resigned and returned the Escrow Assets to the Debtor rather than HERA, leaving HERA without assets. In the Delaware Action, Daugherty asserts, *inter alia*, claims against the Debtor, HERA, and Highland ERA Management, LLC for fraudulent transfer, promissory estoppel, and unjust enrichment. Daugherty alleges the Escrow Assets were pledged as security against his claims and should have been transferred to HERA and then to him after confirmation of the HERA Judgment on appeal.

ANSWER: The first sentence of paragraph 38 is admitted. The second sentence of paragraph 38 is denied. The third sentence of paragraph 38 is admitted except that Daugherty intends to appeal the dismissal of James Dondero as a defendant with respect to his claims in the Delaware Action. The fourth sentence of paragraph 28 is denied.

39. The Debtor has defenses to the constructive fraudulent transfer claims. It contends there was no transfer from HERA to the Debtor, because it was the Debtor that placed the Escrow Assets in escrow, not HERA. Second, the Debtor claims it could retain the Escrow Assets because it paid HERA's legal fees after April 30, 2013 in an amount ($9 million) exceeding the amount of the Escrow Assets and, therefore, (i) had a right as a creditor of HERA to recoup those fees and/or (ii) gave reasonably equivalent value. The Debtor contends promissory estoppel and unjust

enrichment should not apply because a written contract governed the disposition of the Escrow Assets.

ANSWER: The first sentence of paragraph 39 is denied. The second sentence of paragraph 39 is admitted that the Debtor has made such contentions and denied that such contentions have merit or factual basis. The third sentence of paragraph 39 is admitted that the Debtor has made such contentions and denied that such contentions have merit or factual basis. The fourth sentence of paragraph 39 is admitted that the Debtor has made such contentions and denied that such contentions have merit or factual basis.

40. Nonetheless, after review of these defenses by the Independent Board and based on rulings in the Delaware Action supportive of Daugherty's actual fraudulent transfer claim, the Debtor has determined not to object to allowance of the Daugherty Claim in the amount of the HERA Judgment ($2.6 million), plus prejudgment interest ($279,500) and post-judgment interest to the Petition Date ($842,519), totaling $3,722,019.

ANSWER: Admitted that the Debtor has taken the position set forth in paragraph 40, but denied that $3,722,019 addresses the HERA Judgment aspect of Daugherty's Claim in full.

41. However, the Daugherty Claim *also* asserts that Daugherty is entitled to the value of the Distribution Assets, which Daugherty alleges is $26,009,573. This would constitute a double recovery on the HERA Judgment to which the Debtor objects. In addition, the amount is grossly overstated. Under no theory would Daugherty ever be entitled to more than his 19.1% share of the Distribution Assets. Consistent with the opinion of Daugherty's own expert in the Delaware Action, Paul Wazzan, **he would be entitled to 19.1% of the claimed value of $26,009,573, or $4,967,828.**

ANSWER: The first sentence of paragraph 41 is admitted except that the amount recited is an estimate subject to revision. The second sentence of paragraph 41 is denied. The third sentence of paragraph 41 is denied. The fourth sentence of paragraph 41 is denied. The fifth sentence of paragraph 41 is denied and Daugherty further responds that the Wazzan opinion did not address the damages related to claims in the Delaware Action that were dismissed but that Daugherty has a right to appeal or other aspects of damages.

42. Moreover, any such recovery should be disallowed as a double recovery, because the HERA Judgment was based on Daugherty having been deprived of the value of his interest in HERA. Logically, therefore, that interest had no further value.

ANSWER: The first sentence of paragraph 42 is denied and Daugherty refers to the appellate decision in the Texas Action that specifically rejected the Debtor's allegations in the first sentence of paragraph 42. The second sentence of paragraph 42 is denied.

43. Daugherty contends that he retained his former 19.1% interest in HERA notwithstanding the award, because the court struck-through language in the judgment that would have made express that Daugherty had no further interest in HERA:

[HERA Judgment excerpt]

ANSWER: The first sentence of paragraph 43 is denied and Daugherty refers to the appellate decision in the Texas action that specifically validated Daugherty's contentions and rejected the Debtor's contentions regarding purported double recovery. It is admitted that the purported excerpt from the judgment in the Texas action is an excerpt from the judgment in the Texas Action.

44. Although Daugherty divines that the Texas court intended to confirm that he still owns 19.1% of HERA, it is far more likely that the court struck the language because it was outside the scope of the jury's findings, concerning instead the prospective effect of the judgment, which was not before the court. The very nature of Daugherty's claim was that the actions that the jury found had breached the implied covenant and fair dealing had deprived him of the value of his membership units in HERA. Even if those membership units were not extinguished, Daugherty's capital account would have been reduced to zero by the award, entitling him to no further distributions. It would be a double recovery to Daugherty if he also retained that ownership interest and recovered the value of the Distribution Assets *again.* Such an outcome would be fundamentally inequitable to the interests of other creditors in this case and should not be allowed.

ANSWER: The allegations of paragraph 44 are denied and Daugherty refers to the appellate decision in the Texas Action that specifically validated Daugherty's contentions and rejected the Debtor's contentions regarding purported double recovery.

45. Finally, Daugherty also asserts two indemnification claims against the Debtor for fees incurred defending claims against him by the Debtor in the Texas Action based on his employment performance, which he states were nonsuited, and for "fees on fees" for prosecuting

his asserted right to indemnification in the Delaware Action. It appears from the proof of claim that these claims are represented by two line items of $3,139,452 and $3,479,318. These portions of the Daugherty Claim should be disallowed.

ANSWER: The allegations of the first sentence of paragraph 45 is denied. The allegations of the second sentence of paragraph 45 is denied except that it is admitted that Daugherty has made claims for two line items of $3,139,452 and $3,479,318. The allegations of the third sentence of paragraph 45 are denied.

46. The claims in the Texas Action for which Daugherty allegedly is entitled to indemnification, as reflected on the jury verdict (referenced as Exhibit O to the Daugherty Claim) are as follows:

Claim	**Description of Claim**	**Outcome**
Highland 1	Declaratory judgment that Highland did not owe Daugherty any compensation or payments under Highland's long-term incentive plan ("LTIP") because his conduct forfeited his rights. Ex. O at 8.	Voluntarily dismissed pretrial
Highland 2	Breach of employment agreement and a buy-sell agreement relating to purported complaints from other Highland employees about Daugherty and purported disclosures of confidential information that "violated his common law duties to Highland, as well as several agreements between him and Highland." Ex. O at 9.	Jury found Daugherty liable.
Highland 3	Breach of fiduciary duty and a claim of entitlement to "all compensation paid to Daugherty during the time he was breaching his duties, as well as to an award of exemplary and punitive damages." Ex. O at 9.	Jury found Daugherty liable.

Highland 4	A claim for violation of the Texas Theft Liability Act related to purported theft of Highland's trade secrets.	Voluntarily dismissed pre-trial
Highland 5	Tortious interference with Highland's business relations seeking exemplary and punitive damages	Jury found Daugherty not liable.
Highland 6	Defamation related to Daugherty's purported statements about Highland to potential investors	Jury found Daugherty not liable.
Highland 7	Misappropriation of trade secrets and other confidential information, including on behalf of Cornerstone	Voluntarily dismissed pre-trial
Highland 8	Conversion related to purported conversion of confidential information, including on behalf of Cornerstone	Voluntarily dismissed pre-trial
Highland 9	Business disparagement, including on behalf of Cornerstone. *Id*. at 13-15	Voluntarily dismissed pre-trial

ANSWER: The allegations in paragraph 46 are denied and Daugherty seeks indemnification to the fullest extent of his entitlement, which is not limited to the claims listed in paragraph 46.

47. The Debtor prevailed on claims for breach of the Employment Agreement and for breach of fiduciary duty, which Daugherty minimizes as "only" having to do with confidential information with no compensatory damages, but on which the Debtor was awarded $2.8 million in attorneys' fees. The Debtor was found to have complied with the Employment Agreement and honored all obligations concerning the LTIP Plan, the HERA Agreement, and severance pay.

ANSWER: The allegations of the first sentence of paragraph 47 are denied except that Daugherty admits that pursuant to a contractual fee-shifting provision, the Debtor was awarded $2.8 million in attorneys' fees for breach of contract and that the jury found that Daugherty's

retention of information constituted a breach of contract and fiduciary duty and awarded the Debtor $0 in damages on any claims. The allegations of the second sentence of paragraph 47 are denied.

48. As discussed above in connection with Daugherty's attempt to be indemnified for his personal tax liability, indemnification of limited partners is discretionary under the Debtor's Partnership Agreement, hence, Daugherty relies upon its mandatory indemnification of the general partner, Strand, under Section 4.1(h). He claims to be a "GP Party," which is " any director, officer, employee, agent, or representative of the General Partner." GP Parties are indemnified for:

> all liabilities, losses, and damages incurred… [including attorneys' fees] by reason of any act performed or omitted to be performed in the name of or on behalf of [the Debtor] or in connection with the Partnership's business…to the fullest extent permitted by the Delaware Act…[except] for any action or inaction that constitutes gross negligence or willful or wanton misconduct.

ANSWER: The allegations of the first sentence of paragraph 48 are denied except that it is admitted that Daugherty claims a right to mandatory indemnification. The allegations of the second sentence of paragraph 48 refer to the Partnership Agreement and Daugherty refers to the Partnership Agreement for its complete and accurate contents. To the extent a response is required, Daugherty denies that the Partnership Agreement is inconsistent in any way with Daugherty's claim for indemnification.

49. Daugherty claims he is entitled to indemnification as a GP Party because all of his litigation expense was purportedly "in connection with [the Debtor's] business." He contends there is no limitation to defensive litigation expenses, nor any even any requirement that he be successful.

ANSWER: Admitted.

50. ***Daugherty was a GP Party as an officer of Strand only until May 29, 2009, and he resigned from the Debtor on September 28, 2011. Other than the first non-suited claim, which relates to his personal compensation, all of the claims for which he was not found liable involve actions taken well after he left Strand and even after he left the Debtor, as to which he was not a GP Party. None of the Debtor's claims against Daugherty related to his time as an officer of Strand, when he was a GP Party.***

ANSWER: Daugherty denies the allegations of paragraph 50 and Daugherty refers to paragraph 66 of the Debtor's Answer to Daugherty's Second Amended Verified Complaint in the

Delaware Action in which the Debtor "admit[ted] that Daugherty served as an officer and agent of Strand from 2004 until he resigned from Highland in 2011."

51. Second, Daugherty was not an "agent" for any purpose that would make him an indemnified GP Party for these purposes. None of the actions for which the Debtor sued him were taken at the instruction or on behalf of the General Partner as its "agent or representative." *See Fasciana v. Elec. Data Sys. Corp.,* 829 A.2d 160, 163 (Del. Ch. 2003) (in reference to 8 Del. C § 145, governing indemnification of corporate officers, "I read § 145 as embracing the more restrictive common law definition of agent, which generally applies only when a person (the agent) acts on behalf of another (the principal) in relations with third parties."). Furthermore, Delaware "[c]ourt[s] limit agency in the indemnification context to only those situations when an outside contractor can be said to be acting as an arm of the corporation vis-à-vis the outside world." *Passternack v. N.E. Aviation Corp.,* No. 12082-VCMR, 2018 WL 589827, at *8 (Del. Ch. Nov. 9, 2018).

ANSWER: The allegations in paragraph 51 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim.

52. Third, even if Daugherty were to prove he was a GP Party at a relevant time, and even if he were to prove that he was acting in the capacity of an agent-*i.e.* interacting on behalf of Strand with third parties-decisions under the Delaware General Corporation Law (DGCL") hold that a director is not entitled to indemnification in respect of employment litigation between the director and the corporation. *See Shearin v. E.F. Hutton Group, Inc.,* 652 A.2d 578, 594 (Del. Ch 1994) (holding that former officer was not entitled to indemnification for claims relating to breach of her employment contract because those claims did not involve the officer's duties to the corporation and its shareholders); Stifel Fin. Corp. v. Cochran 809 A.2d 555, 562 (Del. 2002) ("Although Cochran's termination is the event that triggered the relevant provisions of the employment contract, Cochran's decision to breach the contract was entirely a personal one, pursued for his sole benefit.")

> When a corporate officer signs an employment contract committing to fill an office, he is acting in a personal capacity in an adversarial, arms-length transaction. To the extent that he binds himself to certain obligations under that contract, he owes a personal obligation to the corporation. When the corporation brings a claim and proves its entitlement to relief because the officer has breached his individual obligations, it is problematic to conclude that the suit has been rendered an "official capacity" suit subject to indemnification under § 145 and implementing bylaws.

Paolino v. Mace Sec. Int'l Inc., 985 A.2d 392, 404 (Del. Ch. 2009) (citing the *Cochran* Chancery Court decision, 2000 Del. Ch. LEXIS 179, 2000 WL 1847676, at *6 (reversed in part on other grounds).

ANSWER: The allegations in paragraph 52 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim.

53. The Daugherty Claim anticipates the defense under *Cochran* that the subject claims were "personal employment-related" claims, and attempts to distinguish it on the basis that the Delaware Revised Uniform Limited Partnership Act ("DRULPA") is more permissive than the DGCL and does not preclude indemnification even when the indemnitee has been adjudged liable to the partnership (if a court deems it fair in view of all the circumstances). If it provides for coverage to the full extent permitted under law, then it is to be provided unless the partnership agreement or law provide otherwise.

ANSWER: The allegations in paragraph 52 consist of legal conclusions to which no response is required. To the extent a response is required, it is admitted that the DRULPA is more permissive than the DGCL and that Daugherty is entitled to indemnification to the fullest extent permitted by law and otherwise denies each of the allegations as applied to Daugherty's Claim.

54. Citing *Paolino, supra,* Daugherty specifically argues that *Cochran* is inapplicable because his employment conduct was not "personal" in distinction from the compensation issues in *Cochran.* Regardless, he did not incur losses "by reason of any act performed or omitted to be performed…in connection with the Partnership's business" under section 4.1 of the Partnership Agreement. The "by reason of the fact" standard is not met where the claims at issue do not involve the exercise of judgment, discretion, or decision-making authority on behalf of the corporation. *Batty v. UCAR Int'l Inc.*, No. 2018-0376-KSJM, 2019 Del Ch. LEXIS 114, at *19 (Del. Ch. Apr. 3, 2019) (quoting *Paolino*). Here, the Debtor's Claims 4-9 related solely to conduct after Daugherty left the Debtor's employ. Daugherty was found liable on Claims 2 and 3, and the Partnership Agreement provides that "the Partnership shall have no obligation to indemnity and hold harmless a GP Party for any action or inaction that constitutes gross negligence or willful or wonton misconduct.")

ANSWER: The allegations in paragraph 54 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim.

55. Even if Daugherty were to surmount all other hurdles, even under his construction, any rights to fees would be discretionary. The Debtor respectfully submits that the facts do not support penalizing other creditors by awarding Daugherty fees in his personal litigation with the Debtor on account of his status as an officer of Strand, relating to conduct that had nothing to do with actions taken or not taken in his capacity as an officer of Strand, and largely post-dating that tenure.

ANSWER: The allegations in paragraph 55 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim.

56. Finally, Daugherty should have to segregate his attorneys' fees between those incurred on any indemnifiable claims and other claims, in particular those on his counter-and third-party claims. Indemnification under Partnership Agreement § 4.1(h) relates to acts performed or not performed by Daugherty (as an agent of Strand) in connection with the Debtor's business. Daugherty's counter-and third-party claims in the Texas Action related to (i) his departure from the Debtor (defamation and breach of employment agreement by the Debtor relating to severance, all of which Daugherty lost), (ii) a separate incentive vehicle called Sierra Verde which was wound down separate from Daugherty's resignation, (iii) claims related to Daugherty's value in HERA, and (iv) claims in relation to his LTIP. Of these, categories (ii) and (iii) related to third-party claims against compensation vehicles, and Daugherty lost claims in categories (i) and (iv). In fact, Daugherty succeeded on only one of his twenty total affirmative claims.

ANSWER: The allegations in the first and second sentences of paragraph 56 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim. The allegations in the third sentence of paragraph 56 are denied except that Daugherty refers to the pleadings, verdict and judgment in the Texas Action for their complete and accurate contents. The allegations in the fourth sentence of paragraph 56 are denied.

57. The Debtor repeats and re-alleges as if set forth herein all of the foregoing factual allegations.

ANSWER: Daugherty repeats his responses to the foregoing allegations.

58. Even if Daugherty had a claim under the Partnership Agreement, it would be subordinated under Bankruptcy Code § 510(b), which provides:

> (b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

ANSWER: The allegations of paragraph 58 are denied, except that Daugherty refers to Section 510(b) of the Bankruptcy Code for its complete and accurate contents.

59. Section 510(b) applies to the ownership interest in a limited partnership. *See SeaQuest, 579 F. 3d 411; Templeton,* 785 F.3d at 154; *Garrison Mun. Partners*, 2017 Bankr. LEXIS 3765 at *8. Accordingly, judgment should issue declaring that the Daugherty Claim is subordinated pursuant to 11 U.S.C. § 510(b) and shall, subject to such other defenses or objections as may exist with respect to the Daugherty Claim, have the same rank and priority as all partnership interests.

ANSWER: The allegations in paragraph 59 consist of legal conclusions to which no response is required. To the extent a response is required, Daugherty denies each of the allegations as applied to Daugherty's Claim.

Dated: September 29, 2020.

Respectfully submitted,

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