CASE NO. 21-90011

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NEXPOINT ADVISORS, L.P. and HIGHLAND CAPITAL MANAGEMENT FUND ADVISORS, L.P.,

APPELLANTS

v.

HIGHLAND CAPITAL MANAGEMENT, L.P.

APPELLEE

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION
BANKRUPTCY CASE NO. 19-34054-11 (SGJ)

APPEAL PENDING AS CIVIL ACTION NO. 3:21-CV-00538-N
IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION

APPELLEE'S RESPONSE TO APPELLANTS' PETITION FOR PERMISSION TO APPEAL (DIRECT APPEAL FROM BANKRUPTCY COURT, 28 U.S.C. § 158(d))

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CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities, as described in the fourth sentence of Rule 28.2.1, have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

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APPELLEE'S RESPONSE TO APPELLANTS' PETITION FOR PERMISSION TO APPEAL (DIRECT APPEAL FROM BANKRUPTCY COURT, 28 U.S.C. § 158(d))

Appellee Highland Capital Management, L.P. (the "Debtor" or "Appellee") respectfully submits the following response (the "Response") to the *Petition for Permission to Appeal (Direct Appeal from Bankruptcy Court, 28 U.S.C. § 158(d))* (the "Petition") filed by Appellants NexPoint Advisors, L.P. and Highland Capital Management Fund Advisors, L.P. ("Appellants" or the "Advisors"):

INTRODUCTION

1. On February 22, 2021, the United States Bankruptcy Court for the Northern District of Texas (the "Bankruptcy Court") entered the *Order Confirming the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified) and (ii) Granting Related Relief* [Bankr. Docket No. 1943] (the "Confirmation Order"). Appellants timely appealed from the Confirmation Order.

2. In brief, the Plan[1] provides for the restructuring of the ownership of the Debtor and the creation of a Claimant Trust that will monetize the Debtor's assets and distribute the proceeds to the creditors of the Debtor in accordance with the Plan. The beneficiaries of the Claimant Trust will be the Debtor's unsecured

[1] The term "Plan" means the *Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified)* [Bankr. Docket No. 1808] (as amended, the "Plan"). The confirmed Plan included certain amendments filed on February 1, 2021. *See Debtor's Notice of Filing of Plan Supplement to the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified)*, Bankr. Docket No. 1875, Ex. B (the "Plan Amendments"). All capitalized terms used herein that are not otherwise defined, have the meaning ascribed to them in the Plan.

creditors who will direct and control management of the Claimant Trust through their designated Claimant Trustee and the Claimant Trust Oversight Board, which includes four of the Debtor's largest creditors (who currently sit on the Committee) and an independent member unaffiliated with the Debtor with experience in the liquidation of assets of the type owned by the Debtor.

3. On March 16, 2021, the Debtor and the Advisors (along with other entities related to the Advisors who are also appealing the Confirmation Order but currently, are not parties to the Petition) jointly filed the *Joint Motion for Certification of Appeals of Confirmation Order for Direct Appeal to the Fifth Circuit* [Bankr. Docket No. 2033] (the "Joint Motion").

4. The sole basis for the direct appeal as set forth in the Joint Motion was the parties' agreement that "a direct appeal may materially advance the progress of the case or proceeding in which the appeal is taken, within the meaning and operation of 28 U.S.C. § 158(d)(2)(A)(iii)." This is because it is virtually certain that whichever parties lost at the District Court would appeal any adverse ruling to the Fifth Circuit. Prompt resolution of the appeals will eliminate the uncertainty surrounding the implementation of the Plan.

5. On March 16, 2021, the Bankruptcy Court entered the *Order Certifying Appeals of the Confirmation Order for Direct Appeal to the United States Court of Appeals for the Fifth Circuit* [Bankr. Docket No. 2034].

6. Appellants filed the Petition pursuant to Federal Rule of Bankruptcy Procedure 8006(d) (the "Bankruptcy Rules"). In the Petition, Appellants assert that in addition to the "materially advance" prong of 28 U.S.C. § 158(d)(2)(A)(iii), the appeal should proceed directly to the Fifth Circuit pursuant to sections 158(d)(2)(A)(i) and (ii) as well.

7. The Debtor agrees the Appellants' appeal of the Confirmation Order should proceed directly to this Court based upon the "materially advance" prong. The Debtor files this Response because it disagrees with the other bases Appellants cite for why there should be a direct appeal. Specifically, the Confirmation Order does not involve a question of law as to which there is no controlling decision in this Circuit or involve a matter of public importance.[2] Nor does the appeal of the Confirmation Order involve a question of law requiring resolution of conflicting decisions.[3]

DIRECT APPEAL IS NOT JUSTIFIED UNDER 28 U.S.C. § 158(d)(2)(A)(i) or (ii)

8. Appellants argue that the Bankruptcy Court's rejection of their Plan objection based upon a violation of the absolute priority rule is contrary to Supreme Court precedent and involves an issue that will have broad reaching implications to the restructuring process. Similarly, Appellants argue that the

[2] 28 U.S.C. § 158(d)(2)(A)(i).
[3] 28 U.S.C. § 158(d)(2)(A)(ii).

Bankruptcy Court's approval of the Plan's Injunction, Exculpation and Gatekeeper Provisions violates Fifth Circuit precedent and expands the permissible scope of the Bankruptcy Court's post-confirmation jurisdiction. For the reasons discussed below, the Debtor disagrees with Appellants' characterization of the Bankruptcy Court's rulings and none of those rulings justify a direct appeal under 28 U.S.C. Section 158 (d)(2)(A)(i) or (ii).

A. The Absolute Priority Rule[4]

9. Advisors contend that providing Class 10 and Class 11 interest holders with a Contingent Claimant Trust Interest which will only vest if Class 8 and Class 9 creditors are paid in full, with interest, violates the absolute priority rule and is inconsistent with Supreme Court precedent. The Bankruptcy Court's response to that argument was that it bordered on being frivolous.[5] The issue neither involves a matter of public importance nor requires the Court to resolve any conflicting decisions, and it results from the Appellants' misinterpretation of the

[4] As an initial matter and as will be discussed fully in Appellee's principal brief, the Advisors do not have standing to raise this issue on appeal. In the context of a confirmation order, a party only has standing to object to those portions of the plan that "directly implicate its own rights and interests." *In re Cypresswood Land Partners, I*, 409 B.R. 396, 418 (Bankr. S.D. Tex. 2009) (citing *In re Quigley Co., Inc.,* 391 B.R. 695, 705 (Bankr. S.D.N.Y. 2008)). ***The Advisors are not creditors of the Debtor.*** Therefore, none of the rights or interests of the Advisors could possibly be implicated by the alleged violations of the absolute priority rule or section 1129(b)(2) of the Bankruptcy Code. *See also In re Johns-Manville Corp.*, 68 B.R. 618, 623 (Bankr. S.D.N.Y. 1986) ("[N]o party may successfully prevent the confirmation of a plan by raising the rights of third parties who do not object to confirmation."), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd sub nom. Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.),* 843 F.2d 636, 644 (2d Cir. 1988).

[5] Transcript, March 19, 2021 Hearing on Motion of Appellants for Stay Pending Appeal of Confirmation Order, 70:5-6.

requirements of the absolute priority rule. The only reported case dealing with facts similar to the case at bar held that a liquidating plan that provides a contingent trust interest to equity conditioned upon payment of all creditors in full does not violate the absolute priority rule. *In re Introgen Therapeutics*, 429 B.R. 570 (Bankr. W.D. Tex. 2010).

10. Under the Plan, the Claimant Trust will monetize assets, which include the proceeds of certain causes of action which will be prosecuted by a Litigation Sub-Trust. At confirmation of the Plan, the value of these causes of action was unknown. It is possible that the proceeds of these causes of action, based upon their value as of confirmation, could result in holders of claims in Classes 8 and 9 receiving more than payment in full plus interest. To account for this possibility and comply with the absolute priority rule, the Plan provides that holders of equity interests in Classes 10 and 11 will receive Contingent Claimant Trust Interests. Those Contingent Claimant Trust Interests, however, will vest ***only*** if "the Claimant Trustee Files a certification that all holders of Allowed General Unsecured Claims . . . have been paid in full [including] all accrued and unpaid post-petition interest from the Petition Date at the Federal Judgment Rate and all Disputed Claims in Class 8 and Class 9 have been resolved." Plan, Art. I.B. Def. 44. The Contingent Claimant Trust Interests, therefore, will not be entitled to any distribution unless and until all senior claims have been paid in full, with

interest. The Contingent Claimant Trust Interests also will ***never*** have any control rights (even if vested). Claimant Trust Agreement §§ 4.9; 4.10.

11. This provision is consistent with the absolute priority rule which is embodied in the "fair and equitable" test in 11 U.S.C. § 1129(b)(2). The "fair and equitable test" has two components: (a) the absolute priority rule and (b) the rule that no creditor can receive more than 100% of its claim. *See* 7 COLLIER ON BANKRUPTCY ¶ 1129[4][a]; *see also In re Idearc, Inc.*, 423 B.R. 138, 170 (Bankr. N.D. Tex. 2009) ("The corollary of the absolute priority rule is that senior classes cannot receive more than a one hundred percent (100%) recovery for their claims"); *In re MCorp Fin., Inc.*, 137 B.R. 219, 235 (Bankr. S.D. Tex. 1992), *appeal dismissed and remanded* 139 B.R. 820 (S.D. Tex. 1992) (same).

12. This exact fact pattern was addressed in *Introgen Therapeutics*, 429 B.R. at 585. In *Introgen Therapeutics*, the court addressed whether a debtor's liquidating plan violated the absolute priority rule by allowing equity to receive cash distributions "solely to the extent that all [senior] interest holders . . . [had] been paid in full." *Id.,* at 585. The court "appeal[ed] to common sense" and found:

> Creditors question whether the right to receive a contingent interest in a liquidating trust, when the contingency is "payment in full of all senior classes," is really property. . . . Creditors appear to be trying to have it both ways. Either they will ultimately receive adequate property to satisfy their claims as contemplated in the Plan, or this property does not now, and will never exist. The right to receive

> something imaginary is not property. The only way Class 4 will receive anything is if Class 3 in fact gets paid *in full,* in satisfaction of § 1129(b)(2)(B)(i), meaning the absolute priority rule would not be an issue. If Class 3 is not paid in full, Class 4's "property interest" is not just valueless, as Creditors argue, it simply does not exist.

Id. (emphasis in original).

13. This provision of the Confirmation Order is also consistent with Supreme Court precedent. In *Norwest Bank Worthing v. Ahlers*, 485 U.S. 197 (1988), the Supreme Court rejected an argument that the owner of a debtor should be able to retain its interest in the debtor without paying senior creditors in full because that interest had no value. The Supreme Court rightfully concluded that the determining factor is not whether a property interest has value; rather, courts should look to whether equity is retaining value without senior creditors being paid in full. As the Supreme Court stated: "[W]hether the value is 'present or prospective, for dividends or only for purposes of control' a retained equity interest is a property interest ***to 'which the creditors [are] entitled . . . before the stockholders [can] retain it for any purpose whatever.***'" (citation omitted) (emphasis added). The Plan is entirely faithful to this rule of law. Class 10 and 11 interest holders will not retain equity under the Plan – their partnership interests are being canceled – and they will not receive anything that senior creditors would be entitled to receive because by definition the Contingent Claimant Trust Interests

can only vest and receive distributions after Class 8 and Class 9 claimants are paid in full, plus interest.

14. Appellants argue that the public interest is implicated because if the Confirmation Order is left to stand there will be a "permanent work around" to the absolute priority rule. They argue, somewhat nonsensically, that all plans will now provide that, after all creditors are paid in full, with interest, equity holders might receive a recovery. Again, Appellants misinterpret the Plan and the reason why holders of Class 10 and Class 11 interests are receiving a Contingent Claimant Trust Interest. As discussed above, the value of the Debtor's assets ***at confirmation*** was unknown. Because Class 8 and 9 creditors may receive more than full payment on account of their claims based upon such value ***at confirmation***, the Plan must provide for equity to recover any value in excess of creditor claims based upon value ***at confirmation***. That is precisely what the Plan does and what the Bankruptcy Code requires. This is neither a remarkable result nor one that will change chapter 11 practices in any way.

B. Injunction and Gatekeeper Provisions

15. The Advisors contend the Gatekeeper and Injunction Provisions are vague and ambiguous and prohibit the Advisors[6] and their clients from being able

[6] Notably, the Advisors make this argument despite not having any interest in the contracts at issue. Because they have no interest in the contracts at issue, the Advisors will not be affected by the Injunction and Gatekeeper Provisions.

to enforce their rights under contracts the Debtor assumed under the Plan. The Advisors misconstrue the effect of these provisions. These provisions – preventing the Enjoined Parties from interfering with the implementation or consummation of the Plan – are neither vague nor ambiguous under applicable law.[7] Moreover, the Debtor has consistently stated on the record that the Plan does not interfere with the ability of the Advisors' clients to exercise their rights after the Effective Date under contracts assumed under the Plan. Litigation is currently pending before the Bankruptcy Court regarding whether the Bankruptcy Courts' prior orders[8] prevent or limit the Advisors' clients' rights under the assumed contracts in a manner that would restrict the ability of the Advisors' clients to terminate such contracts.[9] But the Plan Injunction Provision has no such effect.

16. As such, the Injunction Provision (i) does not involve a question of law as to which there is no controlling Fifth Circuit decisions, (ii) does not

[7] The Injunction Provision is similar to plan injunctions approved in hundreds of chapter 11 cases by courts in this Circuit and around the country, and it is supported by sections 1123(a), 1123(a)(6), 1141(a) and (c), and 1142 of the Bankruptcy Code.

[8] *See Order Approving Settlement with Official Committee of Unsecured Creditors Regarding Governance of the Debtor and Procedures for Operations in the Ordinary Course* entered January 9, 2020 [Bankr. Docket No. 339] (the "January 9 Order") and *Order Approving Debtor's Motion under Bankruptcy Code Sections 105(a) and 363(b) for Authorization to Retain James P. Seery, Jr., as Chief Executive Officer, Chief Restructuring Officer and Foreign Representative Nunc Pro Tunc to March 15, 2020* entered July 16, 2020 [Bankr. Docket No. 854] (the "July 16 Order").

[9] *Highland Capital Management, L.P. v. Highland Capital Management Fund Advisors, L.P., NexPoint Advisors, L.P., Highland Income Fund, NexPoint Strategic Opportunities Fund, NexPoint Capital, Inc., and CLO Holdco, Ltd.*, Adv. Proc. No. 21-03000-sgj (Bankr. N.D. Tex. 2021)

involves a matter of public importance, and (iii) does not require resolution of any conflicting circuit court decisions.

17. The Gatekeeper Provision does require that if the Advisors' clients want to assert a claim against the post-Effective Date Debtor or its successors, they must first seek Bankruptcy Court approval to do so.[10] If the Bankruptcy Court determines the claim is colorable, the Bankruptcy Court will make a secondary determination of whether or not it has jurisdiction to adjudicate the claim on the merits, after which, the claimant will either be required to file the proposed

[10] The Gatekeeper Provision provides:

> Subject in all respects to ARTICLE XII.D, no Enjoined Party may commence or pursue a claim or cause of action of any kind against any Protected Party that arose or arises from or is related to the Chapter 11 Case, the negotiation of the Plan, the administration of the Plan or property to be distributed under the Plan, the wind down of the business of the Debtor or Reorganized Debtor, the administration of the Claimant Trust or the Litigation Sub-Trust, or the transactions in furtherance of the foregoing without the Bankruptcy Court (i) first determining, after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind, including, but not limited to, negligence, bad faith, criminal misconduct, willful misconduct, fraud, or gross negligence against a Protected Party and (ii) specifically authorizing such Enjoined Party to bring such claim or cause of action against any such Protected Party; *provided, however,* the foregoing will not apply to a claim or cause of action against Strand or against any Employee other than with respect to actions taken, respectively, by Strand or by such Employee from the date of appointment of the Independent Directors through the Effective Date. The Bankruptcy Court will have sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable and, only to the extent legally permissible and as provided for in ARTICLE XI, shall have jurisdiction to adjudicate the underlying colorable claim or cause of action.

Plan, Art. IX.F.

litigation in the Bankruptcy Court or be permitted to file in such other court of appropriate jurisdiction.

18. The Advisors claim that because the Bankruptcy Court ***may*** not have jurisdiction to determine certain types of claims on the merits, the Bankruptcy Court is precluded from acting as the gatekeeper and making the initial determination as to whether a claim is colorable. That, however, is not the law in this Circuit.

19. The Gatekeeper Provision is not an impermissible extension of the Bankruptcy Court's post-confirmation jurisdiction. This Court has determined that, where post-confirmation acts would impact the ability of the reorganized debtor to perform under the plan or recoveries under the plan, the bankruptcy court retains jurisdiction.[11] The fact that the Bankruptcy Court may not have jurisdiction to adjudicate a potential claim once the claim is determined to be colorable does not prevent the Bankruptcy Court from having jurisdiction to determine if the

[11] *See United States Brass Corp. v. Travelers Ins. Group, Inc. (In re United States Brass Corp.)*, 301 F.3d 296, 305 (5th Cir. 2002) (holding that bankruptcy court had jurisdiction to determine whether arbitration could be used to liquidate claims post-effective date; while the plan had been substantially consummated, it had not been fully consummated, the dispute related directly to the plan, the outcome would affect the parties' post confirmation rights and responsibilities and the proceeding would impact compliance with, or completion of the plan; specifically referencing section 1142(b)); *Bank of La. v. Craig's Stores of Tex., Inc. (In re Craig's Stores of Tex., Inc.)*, 266 F.3d 388, 390 (5th Cir. 2001) (post-confirmation bankruptcy jurisdiction continues to exist for "matters pertaining to the implementation or execution of the plan."); *EOP-Colonnade of Dallas Ltd. P'ship v. Faulkner (In re Stonebridge Techs., Inc.)*, 430 F.3d 260, 266-67 (5th Cir. 2005) (bankruptcy court had jurisdiction over lawsuit brought by post-confirmation trustee against landlord over letter of credit draw where trustee was assignee of bank claim against landlord).

claim is colorable in the first instance. This Circuit has held that a bankruptcy court has jurisdiction under the *Barton Doctrine* to determine if a claim may be brought against a trustee even if the bankruptcy court may not have authority to adjudicate the underlying claim under *Stern v. Marshall*.[12] *See Villegas v. Schmidt*, 788 F.3d 156, 158-59 (5th Cir. 2015). Thus, the Bankruptcy Court has jurisdiction to determine if a claim is colorable, and the Gatekeeper Provision merely requires the Bankruptcy Court to make the same type of analysis done by bankruptcy courts in this Circuit to determine if a cause of action owned by a debtor may be brought by a creditors' committee.[13]

20. Nor, as the Advisors allege, does the Gatekeeper Provision violate the due process rights of any potential litigant. The Gatekeeper Provision balances the due process rights of both the parties protected by it and any potential litigants. The Fifth Circuit has recognized that in appropriate circumstances, a federal court can enjoin or issue other appropriate sanctions against vexatious litigants – persons who have a history of filing repetitive and spurious litigation for the purposes of harassment and intimidation.[14] *See* ALL WRITS ACT, 28 U.S.C. §1651; *see Baum v. Blue Moon Ventures, LLC*, 513 F.3d 181, 189 (5th Cir. 2008) (injunction entered

[12] 564 U.S. 462 (2011)

[13] *See, e.g., La. World Exposition v. Fed. Ins. Co.,* 858 F.2d 233 (5th Cir. 1988) (bankruptcy court must first determine that claim is colorable before authorizing a committee to sue in the stead of the debtor).

[14] The facts supporting these findings are set forth in the Confirmation Order and the record of the bankruptcy case as a whole. *See generally* Confirmation Order ¶¶ 76-81.

preventing the filer of serial vexatious, abusive and harassing litigation from filing litigation without the consent of the district court judge).

21. Thus, a determination of this issue does not implicate the public interest, does not require this Court to resolve a conflict in decisions, and is consistent with prior rulings of this Court.

C. Exculpation Provision

22. The Advisors allege the Exculpation Provision contained in the Plan is inconsistent with this Court's opinion in *Pacific Lumber*. The Bankruptcy Court, however, performed a detailed analysis of that portion of the *Pacific Lumber* opinion dealing with exculpation clauses and concluded that the Exculpation Provision in the Plan was consistent with this Court's ruling in that case because of factual distinctions and the policy analyses performed by this Court. Appellants conveniently ignore this analysis in the Petition.

23. Significantly, the Bankruptcy Court, citing this Court's opinion in *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987),[15] also found that Appellants' attack on the Exculpation Provision was an impermissible collateral attack on the Bankruptcy Court's January 9 and July 16 Orders which exculpated the vast majority of parties covered by the Exculpation Provision, were never

[15] In *Pacific Lumber*, the Fifth Circuit recognized the viability of *Shoaf* even in the context of third-party releases. 584 F.3d at 252 n.27.

appealed and are the law of the case. This Court has made clear that if a party fails to object to or appeal from a final order – even one that grants a third-party release – the order becomes the law of the case and is not subject to collateral attack. *Id.*; *see also In re Moye*, 437 Fed. Appx. 338, 341 (5th Cir. 2011) (under the law of the case doctrine, a court may not address issues that have been litigated and decided in earlier proceedings in the same case.).

24. Importantly, the Bankruptcy Court found that *Pacific Lumber* did not contain a bright line rule against exculpation provisions. Rather, *Pacific Lumber* held that while public policy justified exculpation of creditors' committees and their members, it did not justify exculpation of incumbent prepetition officers or directors or non-debtor plan sponsors. The Bankruptcy Court concluded that *Pacific Lumber*'s rationale for exculpation of committees and their members – to encourage their active participation in the chapter 11 process – justified exculpation for the Independent Directors and the CEO/CRO in this case. Here, unlike in both *Pacific Lumber* and *In re Thru*,[16] the Independent Directors and the CEO/CRO were not prepetition officers or directors of the Debtor. The Independent Directors were appointed post-petition by the Bankruptcy Court pursuant to the January 9 Order as an urgent measure to address serious concerns

[16] *Dropbox, Inc. v. Thru, Inc. (In re Thru, Inc.)*, 2018 U.S. Dist. LEXIS 179769, 2018 WL 5113124 (N.D. Tex. October 19, 2018), *aff'd., In re Thru, Inc*., 2019 U.S. App. LEXIS 32405, 2019 WL 5561276 (5th Cir. Tex., Oct. 28, 2019).

raised by the Committee and the U.S. Trustee as to extensive breaches of fiduciary duty and lack of disinterestedness by the Debtor's prepetition management.

25. Accordingly, contrary to Appellants' argument, the Bankruptcy Court's ruling is consistent with the policy rationale underlying the *Pacific Lumber* decision and does not require this Court to resolve a conflict in decisions.

CONCLUSION

26. While resolution of the issues raised on appeal by Appellants by direct appeal will materially advance the progress of the case, none of these issues are contrary to applicable Fifth Circuit law, involve matters of public importance, or require resolution of conflicting circuit court opinions. Therefore, the Fifth Circuit should authorize direct appeal of the Confirmation Order solely because it will materially advance the progress of the case.

WHEREFORE, BASED ON THE FOREGOING, Appellees respectfully request that this Court permit the appeal to proceed directly to this Court pursuant to 28 U.S.C. § 158(d)(2)(A)(iii).

RESPECTFULLY SUBMITTED ON THIS 9th DAY OF APRIL, 2021.

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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMIT, TYPEFACE REQUIREMENTS, AND TYPE-STYLE REQUIREMENTS

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Dated: April 9, 2021