

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF TEXAS  
DALLAS DIVISION

<b>In re:</b>	§	
	§	
<b>Highland Capital Management, L.P.,</b>	§	Case No. 19-34054
	§	
<b>Debtor.</b>	§	
<hr/>		
<b>NexPoint Advisors, L.P. et al.,</b>	§	
	§	
<b>Appellants,</b>	§	Civil Act. No. 3:22-cv-02170-S
	§	
<b>v.</b>	§	<i>Appeal from the United States Bankruptcy</i>
	§	<i>Court for the Northern District of Texas</i>
<b>Highland Capital Management, L.P.,</b>	§	<i>Adv. No. 21-03010</i>
	§	
<b>Appellee.</b>	§	

**NOTICE OF STIPULATED SUPPLEMENTAL RECORD ON APPEAL**

TO THE HONORABLE KAREN GREN SCHOLER,  
UNITED STATES DISTRICT COURT JUDGE:

NOW COME appellants NexPoint Advisors, L.P. and Highland Capital Management Fund Advisors, L.P., along with appellee Highland Capital Management, L.P. and file this *Notice of Stipulated Supplemental Record on Appeal*, to wit:

This is an appeal from the Bankruptcy Court’s final judgment in Adversary Proceeding No. 21-03010 (the “Adversary Proceeding”). It has come to the parties’ attention that the following two material items from the docket in the Adversary Proceeding were inadvertently omitted from the record on appeal in this matter (collectively, the “Omitted Transcripts”):

- April 12, 2022 Trial Transcript, 9:30 a.m. to 2:19 p.m. (Adv. Dkt. No. 110); and
- April 13, 2022 Trial Transcript, 9:39 a.m. to 11:17 a.m. (Adv. Dkt. No. 114).

Under the Federal Rules of Bankruptcy Procedure, “[i]f anything material to either party is omitted from or misstated in the record by error or accident, the omission or misstatement may be



corrected, and a supplemental record may be certified and transmitted: (A) on stipulation of the parties ....” Fed. R. Bankr. P. 8009(e)(2)(A).

The parties hereby stipulate that the Omitted Transcripts should be included in the record on appeal. Accordingly, true and correct copies of the Omitted Transcripts are attached hereto for inclusion in the record on appeal, including consecutive pagination continued from the exiting record, beginning with page 002905 and ending with page 003143.

RESPECTFULLY SUBMITTED this 5th day of January, 2023.

MUNSCH HARDT KOPF & HARR P.C.

*/s/ Julian P. Vasek*

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Julian P. Vasek  
Texas Bar No. 24070790  
500 N. Akard St., Ste. 3800  
Dallas, TX 75201  
214-855-7500  
[drukavina@munsch.com](mailto:drukavina@munsch.com)  
[jvasek@munsch.com](mailto:jvasek@munsch.com)

COUNSEL FOR APPELLANTS

-and-

PACHULSKI STANG ZIEHL & JONES,  
LLP

*/s/ John A. Morris*

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John A. Morris  
10100 Santa Monica Blvd., 13th Floor  
Los Angeles, CA 90067  
(310) 277-6910  
[jmorris@pszjlaw.com](mailto:jmorris@pszjlaw.com)

COUNSEL FOR APPELLEE

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that, on January 5, 2023, he caused a true and correct copy of this document (including attachments) to be served on the following recipient(s) via the Court's CM/ECF system:

Case Admin Sup [txnb\\_appeals@txnb.uscourts.gov](mailto:txnb_appeals@txnb.uscourts.gov)

Melissa S. Hayward [mhayward@haywardfirm.com](mailto:mhayward@haywardfirm.com), [mholmes@haywardfirm.com](mailto:mholmes@haywardfirm.com)

Stacey G.C. Jernigan [sgj\\_settings@txnb.uscourts.gov](mailto:sgj_settings@txnb.uscourts.gov), [anna\\_saucier@txnb.uscourts.gov](mailto:anna_saucier@txnb.uscourts.gov)

Zachery Z. Annable [zannable@haywardfirm.com](mailto:zannable@haywardfirm.com), [zannable@franklinhayward.com](mailto:zannable@franklinhayward.com)

*/s/ Julian P. Vasek*

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Julian P. Vasek

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

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In Re:	)	<b>Case No. 19-34054-sgj-11</b>
	)	Chapter 11
	)	
HIGHLAND CAPITAL	)	Dallas, Texas
MANAGEMENT, L.P.,	)	Tuesday, April 12, 2022
	)	9:30 a.m. Docket
Debtor.	)	
<hr/>		
HIGHLAND CAPITAL	)	<b>Adversary Proceeding 21-3010-sgj</b>
MANAGEMENT, L.P.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	TRIAL
	)	
HIGHLAND CAPITAL MANAGEMENT	)	ADVISORS' ADMINISTRATIVE CLAIM
FUND ADVISORS, L.P.,	)	
et al.,	)	<i>Excerpt: 9:38 a.m. to 2:19 p.m.</i>
	)	
Defendants.	)	
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TRANSCRIPT OF PROCEEDINGS  
BEFORE THE HONORABLE STACEY G.C. JERNIGAN,  
UNITED STATES BANKRUPTCY JUDGE.

WEBEX APPEARANCES:

For the Plaintiff:	John A. Morris
	Gregory V. Demo
	Hayley Winograd
	PACHULSKI STANG ZIEHL & JONES, LLP
	780 Third Avenue, 34th Floor
	New York, NY 10017-2024
	(212) 561-7700
For the Plaintiff:	Zachery Z. Annable
	HAYWARD, PLLC
	10501 N. Central Expressway,
	Suite 106
	Dallas, TX 75231
	(972) 755-7108

1 APPEARANCES, cont'd.:

2 For the Defendants: Davor Rukavina  
3 Thomas Daniel Berghman  
4 MUNSCH HARDT KOPF & HARR, P.C.  
5 500 N. Akard Street, Suite 3800  
6 Dallas, TX 75201-6659  
7 (214) 855-7587

8 Recorded by: Michael F. Edmond, Sr.  
9 UNITED STATES BANKRUPTCY COURT  
10 1100 Commerce Street, 12th Floor  
11 Dallas, TX 75242  
12 (214) 753-2062

13 Transcribed by: Kathy Rehling  
14 311 Paradise Cove  
15 Shady Shores, TX 76208  
16 (972) 786-3063

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Proceedings recorded by electronic sound recording;  
transcript produced by transcription service.

1                   DALLAS, TEXAS - APRIL 12, 2022 - 9:38 A.M.

2                   THE CLERK: All rise. The United States Bankruptcy  
3 Court for the Northern District of Texas, Dallas Division, is  
4 now in session, The Honorable Stacey Jernigan presiding.

5                   THE COURT: Good morning. Please be seated. All  
6 right. We have a two-day setting in Highland. It's both  
7 Adversary 21-3010 as well as the Funds' request for  
8 administrative claim. Let's get appearances from the lawyers  
9 first.

10                  MR. MORRIS: Good morning, Your Honor. John Morris  
11 from Pachulski Stang Ziehl & Jones for Highland Capital  
12 Management, LP. I'm here this morning with my colleagues Greg  
13 Demo, Hayley Winograd, and Zachery Annable.

14                  THE COURT: Okay. Good morning.

15                  MR. RUKAVINA: Your Honor, good morning. Davor  
16 Rukavina and Thomas Berghman here for the Advisors: NexPoint  
17 Advisors, LP and Highland Capital Management Fund Advisors,  
18 LP.

19                  THE COURT: Good morning. All right. Do we have any  
20 other appearances? These are, of course, the only parties,  
21 but ...

22                  (No response.)

23                  THE COURT: All right. Well, you all have given me a  
24 lot of paper to prepare me. Before we ask for opening  
25 statements, I'm going to ask for housekeeping matters. I see

1 we have exhibit lists that have been filed and some written  
2 objections, and I think your scheduling order said that if  
3 there were no written objections then they were waived except  
4 for relevance and privilege, I guess. So do we have  
5 stipulations on exhibits?

6 MR. MORRIS: We do, in fact, Your Honor. I apologize  
7 for the late notice. Mr. Rukavina and I just reached an  
8 agreement about an hour ago that resolves all objections to  
9 documents, --

10 THE COURT: Okay.

11 MR. MORRIS: -- as well as the objection to the  
12 subpoenas that Highland had served upon the Advisors, --

13 THE COURT: Okay.

14 MR. MORRIS: -- which were the subject of the  
15 objection that was filed at Docket No. 98 and the response  
16 that was filed at Docket No. 101. So, if I may, I'd just like  
17 to read the stipulation into the record --

18 THE COURT: All right.

19 MR. MORRIS: -- and tell you where we go from there.

20 THE COURT: That's fine.

21 MR. MORRIS: So, the parties stipulate to the  
22 admissibility of a single document, which will be marked as  
23 Highland's Exhibit 161. That document, Your Honor -- this is  
24 not part of the stipulation -- but that document sets forth  
25 amounts that were paid to certain former Highland employees

1 postpetition. And so that document is going to be marked as  
2 161, and the parties stipulate that the Advisors acknowledge  
3 that they have no basis to challenge the facts that are  
4 recited and reflected in the document.

5 THE COURT: Okay.

6 MR. MORRIS: Based on the foregoing, the parties  
7 agree and stipulate that the objection to the trial subpoenas  
8 that was filed at Docket No. 98 shall be deemed resolved. I  
9 don't know if Your Honor would like us to file some kind of  
10 order or stipulation to that effect, or if this is sufficient.

11 THE COURT: I think this is sufficient on the record.

12 MR. MORRIS: Okay.

13 THE COURT: Thank you.

14 MR. MORRIS: The parties also agree that the Advisors  
15 shall withdraw all of their objections to Highland's exhibits,  
16 which were also filed on the docket. And forgive me, but I  
17 don't have that docket number.

18 THE COURT: Let's see. Docket 82 --

19 MR. MORRIS: Okay.

20 THE COURT: -- is where the Advisors' objection to  
21 the Debtor's exhibits is.

22 MR. MORRIS: Right. And then, finally, Highland  
23 stipulates that it does not contest the accuracy of the  
24 mathematical calculations in the Advisors' Exhibits G and H  
25 and that the charts are based on compensation information that



1 was maintained by Highland and that is accurate only as to the  
2 compensation numbers paid to the listed employees.

3 MR. RUKAVINA: And Your Honor, that is correct, and  
4 you'll see as the trial progresses Exhibit G is a PDF of  
5 Exhibit H, which is an Excel spreadsheet which is our damages  
6 calculation. So I think, with that, with that stipulation --  
7 I understand that Highland has other objections -- but I think  
8 that that stipulation will go some way. And then there's a  
9 couple more of my exhibits that are objected to. We'll just  
10 take those in due course.

11 THE COURT: Okay. All right. So, are you asking me,  
12 then, to pre-admit all of the exhibits that are not objected  
13 to at this point?

14 MR. MORRIS: Highland does move for the admission of  
15 Exhibits 1 through 161, and at this point I understand there  
16 are no objections.

17 THE COURT: Okay. And you confirm, Mr. Rukavina?

18 MR. RUKAVINA: I do.

19 THE COURT: All right. So Highland Exhibits 1  
20 through 161 are now admitted.

21 (Plaintiff's Exhibits 1 through 161 are received into  
22 evidence.)

23 THE COURT: And then turning to the Advisors' -- I  
24 think I called them the Funds earlier. Sorry. I get my  
25 nicknames mixed up at times. The Advisors' Exhibits, it looks

1 like --

2 MR. RUKAVINA: Your Honor, it's Exhibit A through DD.  
3 I'd move for the admission of all of those, except G, H, L, Z,  
4 CC.

5 THE COURT: Okay. So you aren't actually moving for  
6 admission of G and H, which you just talked about?

7 MR. RUKAVINA: Correct.

8 THE COURT: There's just a stipulation about --

9 MR. RUKAVINA: Correct. Yeah.

10 THE COURT: -- the correctness?

11 MR. RUKAVINA: We'll address -- yeah. We'll address  
12 that admissibility tomorrow when Mr. Norris testifies.

13 THE COURT: Okay.

14 MR. RUKAVINA: But with respect to all other exhibits  
15 other than G, H, L, Z, and CC, I'd move to admit them now.

16 THE COURT: Okay. So except for, you said, L, Z, CC?

17 MR. RUKAVINA: Correct.

18 THE COURT: Okay. And you agree?

19 MR. MORRIS: No objection to those exhibits.

20 THE COURT: Okay. So those are admitted by  
21 stipulation as well.

22 (Defendants' Exhibit A through DD, exclusive of G, H, L,  
23 Z, and CC, are received into evidence.)

24 THE COURT: All right. Is that all of our  
25 housekeeping matters?

1 MR. MORRIS: It is. I do have a copy of Exhibit 161,  
2 if I can approach --

3 THE COURT: You may.

4 MR. MORRIS: -- and give that to the Court.

5 THE COURT: And hopefully you have --

6 MR. MORRIS: And I have a couple of copies.

7 THE COURT: -- two copies. One for Nate over here.

8 MR. MORRIS: Yeah.

9 THE COURT: Thank you. All right. You may proceed  
10 when you're ready.

11 MR. MORRIS: Okay. Before I begin, I just do want to  
12 give the Court some sense of what we expect to do today and  
13 tomorrow.

14 THE COURT: Okay.

15 MR. MORRIS: We'll have our openings this morning.  
16 Highland intends to call as its first witness David Klos. Mr.  
17 Klos will be followed by Mr. Waterhouse. If time permits,  
18 we'll examine Mr. Seery. And then, regardless of what time we  
19 complete, if we complete a little bit early, we'd like to stop  
20 for the day. We're trying to manage a lot of schedules --

21 THE COURT: Uh-huh.

22 MR. MORRIS: -- and witnesses and third-party people  
23 who have said, I can do it Tuesday but not Wednesday, I can do  
24 it Wednesday but not Tuesday.

25 THE COURT: Uh-huh.

1 MR. MORRIS: So that's the plan, and I hope, I really  
2 do hope that we're able to get through those three witnesses  
3 today.

4 THE COURT: All right. Well, you've answered one  
5 question I had: Who goes first? Because we, you know, could  
6 go either way because we have the breach of contract claim in  
7 the adversary and the request for administrative expense.  
8 There's an agreement that you go first?

9 MR. MORRIS: We do have an agreement --

10 THE COURT: Okay.

11 MR. MORRIS: -- that Highland will call the witnesses  
12 that are on its witness list, to the extent that it decides to  
13 do so, first. And Mr. Rukavina will then cross without  
14 restriction to my direct.

15 MR. RUKAVINA: Exactly. Rather than me recalling  
16 them, we'll just handle it all at one time, get the subpoenaed  
17 witnesses out of here.

18 MR. MORRIS: Because it's really the flip side of the  
19 same coin.

20 THE COURT: Okay. All right. Well, I have  
21 flexibility as far as when and how long we stop for lunch, as  
22 well as when we stop tonight.

23 MR. MORRIS: Right.

24 THE COURT: So it sounds like you're wanting maybe a  
25 definite stopping point tonight, or no?

1 MR. MORRIS: No, not really.

2 THE COURT: Okay.

3 MR. MORRIS: The only -- the most important thing for  
4 me is to get Mr. Waterhouse off the stand.

5 THE COURT: Okay.

6 MR. MORRIS: Because he's not available tomorrow.

7 THE COURT: Gotcha. I've got you.

8 MR. RUKAVINA: Yeah. I think that the -- that's  
9 exactly right. Really, the concern that I have is that we  
10 actually finish early today. So we're just informing the  
11 Court that, if we finish early, we ask the Court's permission  
12 to just resume tomorrow morning, because, again, we subpoenaed  
13 certain witnesses tomorrow that are not available today.

14 THE COURT: Okay.

15 MR. RUKAVINA: So we may finish early. We may finish  
16 late. Either way, we only have three witnesses for today, and  
17 the other ones are going to appear tomorrow.

18 THE COURT: Okay. Gotcha. All right.

19 MR. MORRIS: So, with that, I'd like to just proceed  
20 to my opening.

21 THE COURT: Uh-huh.

22 MR. MORRIS: And I do have -- I do have a slide deck  
23 for use, if I can approach.

24 THE COURT: Okay. You may. Thank you.

25 OPENING STATEMENT ON BEHALF OF THE PLAINTIFF

1 MR. MORRIS: All right. I don't -- I don't know if  
2 Ms. Canty is putting this on the screen. Maybe it's blank  
3 because we're in the courtroom.

4 THE COURT: Ms. Canty?

5 MR. MORRIS: Ah, there we go. Yeah.

6 THE COURT: Ah.

7 MR. MORRIS: All right. So the expectation was that  
8 Ms. Canty would help me out in going through the slide deck.

9 This is going to be, you know, a somewhat lengthier  
10 opening than I'm used to, but this is a pretty fact-intensive  
11 case.

12 THE COURT: Uh-huh.

13 MR. MORRIS: We submitted what we thought was a  
14 fulsome description of the evidence in our proposed findings  
15 of fact and conclusions of law. You know, the Court either  
16 has or will read that. There is other evidence, obviously,  
17 that's going to be in the record that we didn't include there.  
18 And what I would do is I would describe what I'm about to say  
19 for the next hour or so --

20 THE COURT: Okay.

21 MR. MORRIS: -- is the greatest hits. It's kind of a  
22 summary of what we think the evidence is going to show.

23 THE COURT: Okay.

24 MR. MORRIS: So if we can go to the next slide, Your  
25 Honor. This is just a quick overview of the parties'

1 competing positions. Highland is here to recover for breach  
2 of contract damages under an assortment of contracts. There's  
3 five different contracts at issue. It believes that it's  
4 entitled to unpaid fees and that it was -- that it will be  
5 entitled to recover attorneys' fees.

6 Highland believes that the Advisors' claims, such as they  
7 are, are without merit, and we take that position for the  
8 following reasons.

9 We believe that the contracts are clear and unambiguous on  
10 their face and they entitle Highland to a judgment. But the  
11 overwhelming evidence, Your Honor, we believe that even if the  
12 Court found an ambiguity, that the parol evidence -- really,  
13 the contemporaneous evidence at the time these contracts were  
14 entered into, the parties' unequivocal, uninterrupted course  
15 of dealing, and all of the surrounding circumstances, will  
16 lead the Court to conclude that only Highland's interpretation  
17 is reasonable.

18 Highland is going to prove that it fully performed, and  
19 it's going to prove that performance not just through its own  
20 witnesses but through the documentary evidence and through the  
21 Advisors' witnesses, the Retail Board minutes. Mr. Waterhouse  
22 is going to acknowledge that.

23 Your Honor is going to have to deal with the fact that the  
24 allegations of breach are particularly vague when it comes to  
25 what it is that Highland supposedly did or didn't do and when

1 and how it didn't do it.

2 There's lawyers' letters that are part of the evidence of  
3 performance, because from October 16th until December 31st the  
4 Advisors sent five different letters by lawyers asserting all  
5 kinds of things except breach of contract, which is kind of  
6 telling.

7 The evidence is going to show that the Advisors had all of  
8 the information that they claim Highland used to hide the  
9 ball. The evidence is going to show that they knew what  
10 payments were projected. They knew what payments were made.  
11 They -- it's in their books, their own books and records, the  
12 evidence is going to show. They knew exactly when every dual  
13 employee was terminated. Right? They told the Retail Board  
14 time, time, time, time, and probably five more times again  
15 that they knew exactly -- that they were monitoring the  
16 services.

17 So we don't think -- we don't think the evidence is going  
18 to show anything other than full performance. But even if  
19 they -- even if they had some basis for a claim, they've  
20 either waived that claim or it's barred by the voluntary  
21 payment rule.

22 If we can move to the next slide, please.

23 This is just the contractual language of the payroll  
24 reimbursement agreements, Your Honor, and we believe that this  
25 is clear and unambiguous on its face. Paragraph -- Section



1 2.01 specifically states that NexPoint shall reimburse  
2 Highland for the actual cost to HCMLP. But note, Your Honor,  
3 actual cost is not lower case, it's upper case. It's a  
4 defined term. They could have used hamburger. They could  
5 have used tofu, if that's really to your liking. Actual cost  
6 has a meaning, a very specific meaning under this contract,  
7 and that's in the box below.

8 Originally, the Advisors wanted to read out that second  
9 sentence. You know, Mr. Norris, I think, is going to testify  
10 that he just assumed that Highland was adjusting the amounts  
11 paid as each dual employee left. There's no basis for that  
12 assumption, and that assumption is completely undermined by  
13 the second sentence of the definition of actual cost, which  
14 says specifically that, absent changes pursuant to 2.02, this  
15 is the fee. Such costs and expenses are equal to \$252,000 per  
16 month. Clear and unambiguous.

17 If we can go to the next slide, please.

18 Let's look at 2.02. Right? The argument is made, well,  
19 Highland had a unilateral obligation to make adjustments.  
20 Highland had a unilateral obligation to adjust the payments.  
21 Highland had a unilateral obligation to do this, that, and the  
22 other thing. Where does the word Highland even appear in  
23 2.02? It refers to the parties. It refers to the parties  
24 reaching an agreement. Highland can't act uni... not only is  
25 it not required to, it can't. It just can't. The parties may

1 agree. That's what 2.02 says.

2 If we can go to the next slide, please.

3 As Your Honor may have seen from the evidence from the  
4 pretrial findings, proposed findings of fact, the parties  
5 actually amended their agreement just seven months after they  
6 signed it. And I'm talking specifically about the payroll  
7 reimbursement agreements. And that payroll reimbursement  
8 amendment specifically refers to what? I mean, it does refer  
9 to Section 2.02, which is stated in the paragraph above, I  
10 believe. But they're going to pay a flat fee of \$168,000.

11 The evidence is going to show that this payment was not  
12 based on any calculation of actual cost with an upper A and an  
13 upper C or a lower A and a lower C. There's no analysis  
14 whatsoever.

15 You're going to hear an assertion that it was based on a  
16 true up. I think Dustin Norris is going to say that David  
17 Klos conducted some true up in December of 2018. No true up  
18 exists. Mr. Norris has absolutely no personal knowledge about  
19 what happened in December of 2018.

20 Mr. Waterhouse, who signed the amendment, is going to  
21 testify that he has no idea where the number came from.

22 So, so I actually think I'm a little bit confused. The  
23 \$168,000, and I'm going to clear this up right now, the  
24 \$168,000 is the monthly charge in the original document. So  
25 we actually confused that. This is the -- this is Paragraph

1 3.01 from the original payroll reimbursement agreement, and  
2 that's the flat fee from that particular document. I think  
3 that's the -- the HCMFA document.

4 So, here's the story, Your Honor. The story is pretty  
5 simple. Late 2017, Highland had a horrible year. They had to  
6 get more cash to Highland. Mr. Dondero knew that he had  
7 personal tax exposure at the Advisors. And so he just wanted  
8 to push money from the Advisors to Highland. It knocked off  
9 two birds with one stone, right? It got him a tax deduction  
10 at the Advisors level. It got more cash into the Highland  
11 bank accounts.

12 And the way they originally did that was to say, let's  
13 just do a subservice agreement. The evidence is going to be  
14 undisputed that prior to 2018 Highland provided subadvisory  
15 front office services to both Advisors and never got paid a  
16 nickel. Okay? But now they needed to get some more money to  
17 Highland, so they came up with the concept of a subadvisory  
18 agreement.

19 And what's on the screen, if we can go to Slide 5, is a  
20 page from a deck that was presented to Mr. Dondero in January  
21 of 2018 that showed -- the next slide, please, 5 -- that  
22 showed that NexPoint and subs and subsidiaries would be --  
23 would be paying \$6 million for subadvisory and shared  
24 services. That was an increase from less than \$2 million. It  
25 was a number that Mr. Dondero personally dictated. Mr. Klos

1 is going to testify that Mr. Dondero came up with that number  
2 and that they had to use these various agreements to come up  
3 with a \$6 million fee. It's reflected in the document. It's  
4 reflected in the contracts. \$6 million doesn't change from  
5 December 2017 until termination. It's exactly what NexPoint  
6 paid.

7 Interestingly, Your Honor, below it there's a reference to  
8 Acis. Acis, I know you're familiar with. This is January  
9 2018. Highland is in control of Acis. Acis has its own  
10 subadvisory and shared services agreements with Highland.  
11 It's not based on actual costs. Nobody cares what the actual  
12 cost. It's based on basis points.

13 So they've got all of these -- you're going to hear  
14 testimony that they've got a myriad of ways of compensating:  
15 flat fees, percentage of assets under management, these basis  
16 points. There's no rhyme or reason to it. But the evidence  
17 is going to show and there'll be no dispute that in December  
18 2017 the number was fixed at \$6 million and never changed.

19 If we can go to the next slide.

20 So, Mr. Klos is going to testify that each January, maybe  
21 early February, there was a meeting. And the meeting was with  
22 Mr. Klos, Mr. Waterhouse, Mr. Dondero, and Mr. Okada. The  
23 purpose of the meeting was to look back at the prior year and  
24 to talk about the future year. And the meeting would take  
25 place at that particular moment in time because February 28th

1 was bonus day and they used this information to decide how  
2 much, you know, how the pie was going to be divided and what  
3 bonuses were going to be paid.

4 So the documents that we're looking at right now come from  
5 the deck that was prepared by Mr. Klos, under Mr. Waterhouse's  
6 review, and was gone over with Mr. Dondero and Mr. Okada in  
7 this meeting.

8 And this is -- this slide here shows Highland's projected  
9 continued losses. You see that they were projected to lose  
10 \$12 million on an operating basis in 2018. Mr. Klos will  
11 testify that they weren't projected to change that much at  
12 all, but that -- you see the flip to a positive \$46 million?  
13 That \$56 million, between a negative 12 and a positive 46 --  
14 is I guess \$58 million -- is really answered up above in 2019  
15 by those incentive fees.

16 Those incentive fees were projected to occur. That was  
17 supposed to be the incentive fee for MGM. If you remember,  
18 Your Honor, that was going to be MGM. It didn't happen. And  
19 Your Honor knows, if it had happened, Highland would have  
20 gotten that \$55 million, but according to Mr. Dondero and  
21 Nancy Dondero, Highland would have had to cancel the \$70  
22 million of notes that they had signed. But neither one of  
23 those things ever happened. Right?

24 The fact of the matter is if you reduce, if you eliminate  
25 that \$55 million, and you should, they still would have been

1 losing more than \$12 million on an annualized basis.

2 If we can go to the next slide, please. Because this is  
3 another critical piece of evidence here. You've got the  
4 subadvisor fees and the shared services expenses. You'll  
5 recall, Your Honor, I said that they reached an agreement on  
6 the \$6 million number in December. Well, here's the January  
7 annual review. It's presented to Mr. Dondero. And we've  
8 highlighted for you the projected subadvisor and shared  
9 services expenses. And if you add those two numbers up, it's  
10 not a coincidence that they add up to \$6 million. And the  
11 \$3,024,000 number, divide it by 12, you come up with the  
12 \$252,000 that was in the subadvisory agreement and that  
13 ultimately became the payroll reimbursement agreement.  
14 \$3,024,000 divided by 252 -- divided by 12 equals \$252,000.

15 And the shared services expenses, there are actually two  
16 pieces there. And one of the things that I think is very  
17 important for the Court to know is that, prior to 2018,  
18 NexPoint's shared service agreement with Highland had a  
19 complicated mechanism for calculating the fee for the shared  
20 services. One option was actually actual cost. But Mr. Klos  
21 is going to tell the Court, he's going to testify that they  
22 didn't use that option, they used a different option, and they  
23 wound up paying based on a percentage of AUM, A-U-M, Assets  
24 Under Management.

25 But here's the important point. At this moment in time,

1 to get to Mr. Dondero's \$6 million number, they amend the  
2 shared services agreement for NexPoint to provide for a flat  
3 fee. And when you combine the flat in the NexPoint shared  
4 services agreement with the \$80,000 flat fee in the NexPoint  
5 Real Estate Advisors' shared services agreement, which is a  
6 subsidiary of NexPoint, that's how you get to the \$2,976,000.  
7 Not a coincidence here. It's three agreements. It's the  
8 subadvisory agreement. It's the newly-amended and restated  
9 shared services agreement with NexPoint. It's the new shared  
10 -- the newly-amended shared services agreement with NexPoint  
11 Real Estate Advisors. Add them up. \$6 million. Right?

12 So, they're telling -- picture it. They're in a meeting  
13 room at Highland's offices. Everybody's sitting in Mr.  
14 Dondero's office. They're walking through this. And Mr. Klos  
15 is going to testify that here's where we told Jim this is how  
16 we're going to execute your plan. You've given us an  
17 instruction to get to \$6 million. Here's the plan. Okay? No  
18 dispute.

19 So, a funny thing happens. Right? No so funny, actually.  
20 The deck is dated January 26th. I think Mr. Klos says the  
21 meeting happened at or around that time. But as Your Honor  
22 knows, just a couple of days later, Josh Terry filed Acis for  
23 bankruptcy. And what you're going to see in the deck, which I  
24 don't have the slide for, is that Highland had projected that  
25 it was going to receive almost \$10 million in revenue through

1 the Acis shared services and subadvisory agreement and that  
2 the Acis revenue represented Highland's second-largest  
3 projected source of revenue for 2018. And days after they  
4 have this meeting and go through this, Josh Terry files Acis  
5 for bankruptcy and all of a sudden all of that revenue is  
6 threatened.

7 So the very first thing they do in March, not in this deck  
8 but it's in the proposed findings, the very first thing they  
9 do when they realize all of this revenue is at risk is they  
10 say, let's duplicate that subadvisory agreement that we just  
11 prepared for NexPoint for HCMFA. The projections that we just  
12 looked at, you'll never find a projection showing that there  
13 was any expectation in January 2018 that HCMFA was going to  
14 pay subadvisory agreements. They were supposed to just  
15 continue getting them for free. But after the Acis bankruptcy  
16 was filed and there was a loss, a potential loss of up to \$10  
17 million in revenue, they needed to get more money to Highland,  
18 because that revenue was going to be -- was threatened and  
19 could be frozen. So that this was the plan they came up with.  
20 Just duplicate that agreement for HCMFA. And that's what they  
21 did, and that's what the evidence shows.

22 And the interesting thing, Your Honor, because I don't  
23 remember what the exhibit number is, but you'll look -- we'll  
24 look at the subadvisory agreement that was prepared. There's  
25 nothing about actual cost. It is flat fee agreements. And



1 for NexPoint it was \$252,000. Right? This was the first way  
2 they were going to address the crisis that was presented by  
3 Acis.

4 Days later, after coming to that solution, a new problem  
5 emerged. Lauren Thedford, an attorney at Highland who also  
6 served as the secretary of the Advisors -- she was a lawyer,  
7 she was an officer of the Advisors -- she was told by outside  
8 counsel, you can't use the subadvisory agreement. Why?  
9 Because (a) it can't be retroactive to January 1st; and (b) it  
10 can only be used if it's approved at an in-person meeting of  
11 the Retail Board. And they realized that that meeting  
12 wouldn't take place until June.

13 And so that meant Highland was going to be without all of  
14 this revenue that it desperately needed at the time that they  
15 intended to make retroactive to January 1st, they were going  
16 to go six months without any of the subadvisory revenue that  
17 they were hoping to place in Highland's lap through NexPoint  
18 and HCMFA.

19 Needed a solution. They came up with the payroll  
20 reimbursement agreement. It's the only reason it exists. Had  
21 they -- had Lauren Thedford not gotten the advice, and Mr.  
22 Klos will testify to this, had Lauren Thedford not gotten the  
23 advice that the subadvisory agreements couldn't be retroactive  
24 and couldn't be adopted without Retail Board approval in an  
25 in-person meeting, payroll reimbursement agreements would

1 never exist. And so she said the only way around it is to use  
2 this payroll reimbursement agreement, because that can be  
3 retroactive and it doesn't need Retail Board approval.

4 And so if you go to Slide 8, please. This is -- this is  
5 the most classic parol evidence I have ever seen. Because,  
6 remember, the payroll reimbursement agreements aren't signed  
7 until May. And this is an email exchange between Mr. Klos and  
8 Ms. Thedford, a lawyer, an officer of the Advisors. And I'm  
9 not going to read it here, Your Honor, but it shows Mr. Klos  
10 saying, actual -- let's just start at the top. He's  
11 protesting. He says, What do you mean, actual costs? It  
12 would be creating a ton of internal work that isn't adding any  
13 value to the overall complex. It would involve subjective  
14 assumptions. He doesn't want to do this.

15 And Lauren says, look, I'm open to changing the  
16 definition, but we have to treat it as reimbursement.

17 And Dave's response at 10:56 the same day is, Could we say  
18 Actual Cost? Now he's using uppercase letters. Can we say  
19 Actual Cost is determined at the outset of the agreement?  
20 Have a schedule as of January 1, 2018 and say the actual cost  
21 will be set out in the schedule and paid in monthly  
22 installments for the term of the agreement? That way, the  
23 exercise is performed only once.

24 And then he says, and if the parties don't like it, they  
25 can terminate or renegotiate.

1 And that's exactly what the payroll reimbursement  
2 agreement says. She says -- Lauren's response is, I think  
3 that's workable. Do you have a methodology for the outset  
4 determination?

5 And you'll see the rest of the email during Mr. Klos's  
6 testimony. He actually does create a list of dual employees  
7 with allocations of how much time they're going to work with  
8 these entities, but he's going to explain to you very clearly  
9 it's just his own subjective numbers in his head. And what he  
10 -- the point of the exercise was to back into the \$252,000  
11 that was necessary so that we could get to the \$6 million that  
12 Mr. Dondero determined.

13 It's not a coincidence that you have a list of two dozen  
14 or more employees, with allocations as random as nine percent,  
15 that you wind up with a \$252,000 number. It's not a  
16 coincidence. It was, Mr. Klos is going to tell you, that was  
17 the point of the exercise. Okay? This is parol evidence like  
18 I've never seen before.

19 So they signed the agreement in May. And you have to  
20 understand -- this will be more evidence, Your Honor --  
21 everybody -- nobody's going to contest this evidence. The  
22 dual employees on Exhibits A to the payroll reimbursement  
23 agreements, they're being terminated before the document was  
24 even signed. Four of the dual employees had been terminated  
25 before the document was even signed. So they created a

1 document based on employees who weren't even there when Mr.  
2 Waterhouse signed this agreement on behalf of the Advisors.

3 But wait. There's more. During the course of 2018, more  
4 dual employees left. So that by the time you get to December,  
5 nine of the 26 dual employees have been terminated. More than  
6 a third of the people on the list have been terminated. And  
7 what do they do? They amend the agreement. This is the  
8 amendment that I was mistakenly referring to earlier. This is  
9 the amendment, Your Honor, on Slide 9. They amend the  
10 agreement, because Highland was still needing cash, the  
11 Advisors still had taxable income, so Mr. Dondero realized, I  
12 can kill two birds with one stone again. Let me shelter more  
13 of the income, let me get some more cash to Highland because  
14 they need some more cash. And so he decides, send \$2.5  
15 million from Highland -- from the Advisors to Highland. And  
16 they do that with two amendments to the payroll reimbursement  
17 agreements, one for \$1.3 million, one for \$1.2 million.

18 Mr. Klos is going to testify no true up -- this is the  
19 point of the true up. I think Mr. Norris is going to say that  
20 Dave told him that there was a true up in December 2018.  
21 These are random numbers that are designed just to keep  
22 Highland chugging along and giving Mr. Dondero a tax break.  
23 There's no analysis.

24 And it makes no sense. The concept that there was a true  
25 up is just categorically ridiculous. Why? Mr. Waterhouse is

1 going to tell you that NexPoint was paying on an annualized  
2 basis an additional 40 percent over the annual cost based on  
3 the \$252,000 and that HCMFA was paying almost 25 percent more.  
4 So they're paying 40 percent more, 25 percent more, at a time  
5 when more than one-third of the dual employees have been  
6 terminated. How could that possibly be a true up? How could  
7 that possibly reflect actual costs? It doesn't. And it  
8 didn't.

9 Dual employees continue to be terminated. The calendar  
10 turns to 2019. By the time Highland files for bankruptcy, I  
11 believe the number is 14. Fourteen of the 26 dual employees  
12 have been terminated. And here is undisputed fact. Not one  
13 time -- you know what, I want to take a step back for a  
14 second, Your Honor. I'm talking quickly.

15 These agreements were in effect for three years. They're  
16 signed as of January 1, 2018, and they're in effect basically  
17 until the end of 2020. It's a three-year period. It's 36  
18 months. There's no dispute that Mr. Dondero controlled the  
19 Advisors and Highland for two of those three years. For 2018,  
20 even after the bankruptcy was filed, through the end of 2019,  
21 Mr. Dondero was in sole control of everything.

22 Why is that important? That's the course of dealing, Your  
23 Honor. The unequivocal, uninterrupted course of dealing. In  
24 those first two years, the Advisors paid a flat fee under the  
25 payroll reimbursement agreement. Nobody cared that dual

1 employees were leaving. There will be no evidence that  
2 anybody said, how come we're not paying actual costs? They  
3 just did it, and they did it because that was the plan. And  
4 they have a document and an agreement that effectuated that  
5 plan, and everybody stuck to the plan. For two years. And  
6 the undisputed evidence is going to show that nothing changed  
7 after the bankruptcy, that the Advisors were charged and paid  
8 the exact same amounts in the 12 months in 2020 that they paid  
9 in the 24 months in 2018 and 2019. Nothing changed.

10 Nobody asked for a change in 2018. Nobody suggested that  
11 -- because everybody knew -- here's another piece of evidence.  
12 It's enormous. Your binders have dozens of what are called  
13 monthly headcount reports. Right? And we may look at one of  
14 them, but I'm going to tell you what they are right now in  
15 case we don't. Those monthly headcount reports identify --  
16 name every single employee who ever worked for Highland since  
17 like 2007. It tells you when they were hired. It tells you  
18 when they were fired. It tells you what position they had.  
19 And it was distributed to a whole host of people, including  
20 D.C. Sauter, Dennis Norris, Lauren Thedford, Frank Waterhouse  
21 -- *i.e.*, every single officer of the Advisors. Every single  
22 officer of the Advisors got a report every single month that  
23 told them exactly who was terminated. And the reports would  
24 actually highlight the terminations in yellow in case somebody  
25 didn't know. So that everybody, every one of the officers

1 knew, Frank Waterhouse knew, had the information in his lap  
2 when he signed the agreements, that four of the 26 dual  
3 employees had already been terminated.

4 There's going to be so much more evidence about what they  
5 knew.

6 But fast forward to 2020. So, Highland files for  
7 bankruptcy. Most of the dual employees are already gone.  
8 Nobody is saying a word about it. Nobody cares. Why?  
9 Because this is a pay-for-service agreement. It has nothing  
10 to do with who provides the services. It's important that the  
11 services be provided. And Highland continued to perform.

12 There will be no evidence, there's been no allegation,  
13 they filed an administrative claim, they have filed two  
14 different -- a response, they filed their pretrial brief.  
15 They don't make any allegation that Highland failed to perform  
16 front office investment advisory services. As their pleading  
17 says, their position is simple. Dual employees left. We  
18 shouldn't have to pay for dual employees that left.

19 The Advisors are not in the business of consuming dual  
20 employees. They're in the business of providing investment  
21 advisory services to the Retail Funds and to other investment  
22 vehicles. That's the point of the exercise. They are going  
23 to testify that is the reason they exist, is to serve their  
24 clients.

25 And so does it matter to the Advisors if one person or six

1 people or 24 people provide the services? It shouldn't. The  
2 important thing is that they're getting the services that  
3 allow them to satisfy their contractual obligations to their  
4 clients.

5 This is all -- it's just -- it's just all so simple. It's  
6 a lot of facts, but it's all just so simple. They continued  
7 to pay not because they didn't know dual employees had left.  
8 They knew that. They continued to pay because they were  
9 getting uninterrupted service, as they told the Retail Board  
10 time and time and time again.

11 If we can go to Slide 10, I'm going to try and pick it up  
12 just a bit here.

13 The calendar turns to 2020, Your Honor. This is more, you  
14 know, particularly relevant evidence because it's another  
15 back-and-forth between Ms. Thedford and Mr. Klos. It's  
16 January 2020. And I note the timeline, Your Honor, because,  
17 you know, this is the moment that Mr. Dondero is about to  
18 surrender control to the Independent Board. But there's no  
19 disputes. There's no disputes. And that's the beauty of this  
20 particular email exchange. Nobody is questioning, how much am  
21 I paying? Nobody is questioning, what services are you  
22 providing? But Lauren does have some questions about --  
23 because the Retail Board. That's what prompts this. This has  
24 nothing to do with the Advisors or anything. The Retail  
25 Board. And you'll see it in the full email. The Retail Board



1 has asked some questions about, you know, how does the  
2 Advisors pay for expenses?

3 And Lauren said to Dave, and you'll see it in the email,  
4 wasn't there something about those Exhibit As? And Dave's  
5 response is, Those were a point-in-time estimate as of the  
6 beginning of 2018. Half the people are gone now. And if you  
7 were to reallocate them now, all the percentages would be  
8 different.

9 And Mr. Klos is going to testify that the reason that the  
10 percentages would be different is exactly what I just said,  
11 and that is this is a pay-for-service agreement. When the  
12 dual employees were terminated, Highland didn't just stop  
13 providing the services that those people were performing.  
14 They reallocated them. That's exactly what he's telling her.  
15 It's exactly what everybody knew to be true.

16 So if in January 2018 one of the dual employees was  
17 terminated and his job, let's say, was to give investment  
18 advice on Asset A, Highland didn't just suddenly stop  
19 providing investment advice on Asset A. Somebody was given  
20 the responsibility to do that. And that's exactly -- Mr. Klos  
21 is going to tell you that's exactly what that means there,  
22 that all the percentages would be different if you did it  
23 again today because you had the departure of all of these dual  
24 employees and somebody picked up the slack. Makes total  
25 sense. It's a pay-for-service contract. That's what it is.

1 It's a flat fee contract.

2 Later the same month -- if we can go to the next slide --  
3 Mr. Waterhouse, who is the CFO, asks Mr. Klos, how much --  
4 remind me again, how much is paid under those agreements?  
5 Without equivocation, without ambiguity, flat, flat, flat.  
6 Except for the one HCMFA shared services agreement that had a  
7 very, very narrow band, and Mr. Klos will testify as to why  
8 that band existed.

9 But there's that \$6 million number again, if you look at  
10 NPA. That's NexPoint. \$252,000 plus \$248,000 equals \$500,000  
11 times 12. Six million. The \$248,000 is for shared services.  
12 It's broken out, as I mentioned earlier, between NexPoint and  
13 NexPoint Real Estate Advisors. Here we are, January 2020, Mr.  
14 Klos again confirming for Mr. Waterhouse, flat fee, flat fee,  
15 flat fee, \$6 million.

16 If we can go to the next slide.

17 I've alluded to some of this, Your Honor. The Advisors  
18 contemporaneously had all of the relevant facts. This is  
19 just, again, the highlights here.

20 If you look at Exhibit 14, it's the Advisors' responses to  
21 the Debtor's interrogatories. And if you look at  
22 Interrogatory 3 and 4, it's going to provide a list of each of  
23 the dual employees that were attached as the Exhibit As to the  
24 payroll reimbursement agreements and it's going to give you  
25 the date of termination for each person. And then

1 Interrogatory -- the response to Interrogatory No. 4 simply  
2 says, we knew contemporaneously when these people left.  
3 They've admitted it.

4 The monthly headcount reports, as I said, there's 12 plus  
5 27, there's at least 39 of them. Thirty-nine monthly.  
6 Because I took it back to October 2017. I think it goes back  
7 much earlier, but that's what we produced, just to make sure  
8 the Court had the evidence, that this was a process of  
9 disclosure of hires and terminations that was provided before  
10 these contracts even existed. And it's a practice that  
11 continued right up until January 2021, when these contracts  
12 ended. Every single month. The same analysis. Went to every  
13 single officer of the Advisors.

14 And they're -- and Mr. Norris is going to sit in that box  
15 tomorrow and he's going to say he was shocked, shocked, that  
16 Highland was charging this money for these employees who were  
17 terminated. We'll see how that goes.

18 Annual reviews. Exhibits 86 and 142. These are portions  
19 of the annual reviews where Mr. Dondero is just given a wealth  
20 of information about hires, termination, compensation budgets,  
21 everything one would need to know from the human resources  
22 department. If Mr. Collins comes in and testifies, he's going  
23 to testify -- and I didn't depose him -- but he had no choice.  
24 He's the human resources officer reporting to the owner of the  
25 company. If he says anything other than I kept him fully

1 informed about staffing issues, I'll be shocked.

2 Representations to the Retail Board. They represented to  
3 the Retail Board a couple of times that there has been no  
4 material attrition in employees. How can they make that  
5 representation if it's uninformed? They didn't. It was  
6 completely informed. The Advisors knew exactly what was going  
7 to be paid.

8 We looked at the projections in the annual review that was  
9 given to Mr. Dondero. Mr. Waterhouse is going to testify that  
10 there were 13-week forecasts that were prepared. The  
11 forecasts showed every single payment that was going to be  
12 made by the Advisors under these intercompany agreements.  
13 He's going to testify that before the Independent Board was  
14 appointed he would go through those forecasts with Mr. Dondero  
15 every week, and then after the Independent Board was appointed  
16 he would still do it with Mr. Dondero, although with less  
17 frequency. And Mr. Waterhouse started going through those  
18 forecasts with the Independent Board, and sometimes Mr.  
19 Dondero would participate. Right? In the early -- in the  
20 first six months of this case, everybody was looking to  
21 cooperate. Right? Before the board said, we need to get this  
22 done.

23 They knew what was going to be paid. Mr. Waterhouse, the  
24 unequivocal evidence will be that Mr. Waterhouse approved all  
25 payments. You may hear some argument about the shared

1 services agreement, and Highland was supposed to do this or  
2 supposed to do that. You're going to have the evidence in  
3 front of you. Mr. Waterhouse is going to admit he had to  
4 approve all of the payments. He is not just the CFO of  
5 Highland. He is the treasurer of the Advisors, charged with  
6 the responsibility of finance and accounting. He's the  
7 approval person.

8 You're going to see emails from Kristen Hendrix that say,  
9 Frank, here's the payments I'm going to make today. Is it  
10 okay? And he would say, go ahead. And you're going to see,  
11 and we just have a couple of examples, but he's going to  
12 testify that was the practice. And you'll see in the examples  
13 it says \$252,000, payroll reimbursement. Or subadvisory.  
14 Right? Mr. Waterhouse -- how do we know the Advisors knew  
15 what would be paid? From the projections. How do we know  
16 that they knew what would be paid? Mr. Waterhouse approved  
17 it.

18 But wait, there's more. Mr. Waterhouse is also going to  
19 admit that every single payment that was made by the Advisors  
20 under these intercompany agreements is reflected in the  
21 Advisors' books and records. Right? Their own books and  
22 records.

23 They represented to the Retail Board on October 23rd that  
24 all amounts due and payable under these agreements were paid  
25 in full. How do you make that representation if you don't do

1 the due diligence to know what was paid and whether -- whether  
2 it should have been paid. Right?

3 So they -- they've either got to -- Your Honor is going to  
4 have to decide, did they lie to the Retail Board or are they  
5 lying in this courtroom? Because they can't be true. You  
6 can't reconcile what they told the Retail Board with what they  
7 may tell you today and tomorrow. It can't be reconciled. You  
8 can't tell the Retail Board Highland is fully performing,  
9 we've paid everything we're supposed to pay Highland, and then  
10 come into this courtroom with a contrived administrative claim  
11 to say, oh, gee, they didn't provide services and we overpaid.  
12 You can't reconcile the two.

13 I ask the Court to listen carefully to the testimony and  
14 see if there's a credible witness for the Advisors who can  
15 explain how they told the Retail Board fifty times that  
16 Highland was performing and that they paid everything, and yet  
17 somehow something fell through the cracks.

18 Again, think about the whole purpose of this. The purpose  
19 is for Highland to provide services to enable the Advisors to  
20 fulfill their obligations to the Retail Board, to the Retail  
21 Funds, and the other investment vehicles who were their  
22 clients. That's the purpose. And that's exactly what  
23 happened.

24 They knew what services were provided. We're just going  
25 to do a quick greatest hits here of some of the retail

1 representations by the Advisors. You know, there had been an  
2 objection that some of the statements were made by people  
3 other than Advisors' representatives, so I took -- I took a  
4 little timeline here and focused really solely on the  
5 representations that were made by the Advisors and their  
6 officers.

7 In June, Mr. Post told the Retail Board, the level and  
8 quality of services are being monitored. I mean, think about  
9 that. Being monitored. It's a very active word. He is not  
10 aware of any disruptions in the service levels provided to the  
11 Funds.

12 A couple of months later, Mr. Norris -- we'll hear from  
13 him tomorrow -- he noted that there have been no issues or  
14 disruptions, no issues or disruptions in the services as a  
15 result of the bankruptcy.

16 The next month, the Advisors state in a memo -- I believe  
17 it's in a memo -- the Advisors and HCMLP believe the current  
18 shared services being provided are generally consistent with  
19 the level of service that has historically been received. How  
20 do they come into this Court and tell you we breached the  
21 agreement by failing to perform when they have told their  
22 clients exactly the opposite?

23 On October 13th, Mr. Sauter, a lawyer, the general counsel  
24 of the Advisors, noted that there has been no material  
25 attrition to date with respect to employees.

1           Somebody's going to come in here and say, oh, because of  
2 the bankruptcy, Highland was firing people? That's not true,  
3 as a practical matter. Maybe a couple people on a net basis.  
4 Didn't have a material impact.

5           Ten days later, the Advisors told their Retail Board, all  
6 amounts owed by each of the Advisors pursuant to the shared  
7 services arrangement -- that's not a mistake there, it's a  
8 lower case S, a lower case S, a lower case A, because it  
9 encompasses both shared services and front office investment  
10 advisory services -- all amounts owed pursuant to the shared  
11 services arrangement with HCMLP have been paid as of the date  
12 of this letter. That's October 23rd.

13           Go to the next slide. It continues. Five days later, the  
14 Advisors represent that the quality and level of services  
15 provided to the Funds by the Advisors and pursuant to the  
16 shared services arrangements have not been negatively impacted  
17 to date. No negative impact. October 28th. No negative  
18 impact.

19           November 5. Mr. Norris noted that there had not been any  
20 disruption to the services provided to the Funds by HCMLP  
21 pursuant to the shared services agreement and that he expects,  
22 his expectation, is that such services will continue to be  
23 provided in the normal course.

24           Your Honor may remember that on November 30th Highland  
25 gave notice of termination. We had just gotten our disclosure



1 statement approved and time to execute. Right? The world is  
2 going to change. So we give notice of termination on November  
3 30th. And the next day, the Advisors do what they're supposed  
4 to and they tell the Retail Board, we finally got that notice  
5 of termination that we were planning for. And they say, we're  
6 going to -- Mr. Post states that the Advisors expect to be  
7 able to continue to receive the services through a transfer of  
8 personnel.

9 You can't expect to continue to receive services that  
10 you're not receiving. Right? This is the morning after.  
11 This is what they report to the Retail Board. Don't worry.  
12 They've terminated. Don't worry. We're going to continue to  
13 receive these services.

14 As late as December 10th and 11th, Mr. Sauter noted that  
15 there had been no material attrition to date with respect to  
16 the employees. And they're here suing on a breach of contract  
17 theory for failure to provide services?

18 Mr. Waterhouse, the Advisors' treasurer, is going to  
19 testify that he knows of no services that Highland failed to  
20 perform postpetition.

21 These are excerpts from his deposition, but you can  
22 imagine that I might turn that into leading questions that'll  
23 go something like this: You were unaware of any specific  
24 service under the shared service agreements that Highland  
25 failed to perform at any time from the petition date until

1 they were terminated in early 2021; isn't that correct? And  
2 he's going to have to say, I'm not aware of any.

3 Mr. Waterhouse is going to have to answer the question  
4 this afternoon: You never had any discussion with anybody at  
5 any time about Highland's failure or alleged failure to  
6 provide services under the shared services agreement at any  
7 time from the petition date until they were terminated in  
8 early 2021; isn't that correct, sir? He's going to have to  
9 say, I have no recollection of that.

10 This is their officer.

11 Last slide, 16. It's really important that the Court  
12 appreciate the complete change of position that the Advisors  
13 have undertaken here, because until they filed their pretrial  
14 brief their whole theory of the case was that, you know, the  
15 -- Highland failed to perform some services under -- some  
16 unidentified, vague services under the shared services  
17 agreement and that Highland overcharged them and they overpaid  
18 under the payroll reimbursement agreement because all these --  
19 all these dual employees were gone. That was their theory of  
20 the case.

21 Their theory of the case was that we had the obligation,  
22 right, Mr. Norris testified on March 5th and he's going to  
23 testify tomorrow that he believed that Highland had the  
24 obligation to charge the right fees based on the dual  
25 employees.

1           In their pretrial brief, they've now completely changed  
2 their position, and they're -- I think they're basically  
3 agreeing with our interpretation of the contract, that it was  
4 a fixed fee unless changed by the parties. Because on March  
5 28th or March 29th, I took Mr. Waterhouse's deposition and he  
6 told -- he told -- you know, he testified. I don't want to be  
7 pejorative. He testified that he recalled that in December  
8 2019 Dave Klos did an analysis that showed that Highland was  
9 making millions of dollars off these agreements and that --  
10 and that Mr. Waterhouse took that information and went to  
11 Isaac Leventon and Scott Ellington and Fred Caruso -- Mr.  
12 Caruso was an employee of DSI, the Debtor's then-financial  
13 advisor -- and he spoke to the three of them and he said,  
14 guys, we're overpaying, the Advisors are overpaying. And all  
15 three uniformly told him: Can't do anything about it because  
16 of the automatic stay. You can't do anything about it because  
17 of the automatic stay. That's what he's going to testify to.  
18 That's what he said took place.

19           Now, complete about-face, and so now they're saying that  
20 they should be relieved of any obligation to pay and they  
21 should get all their money back because Highland breached its  
22 duty under Section 2.02 of the payroll reimbursement agreement  
23 that says the parties shall negotiate in good faith. So  
24 they're saying Highland didn't negotiate in good faith because  
25 Frank spoke to Fred Caruso and Fred Caruso said there's

1 nothing we can do about it because of the automatic stay.

2 That's the story. That's their -- that's their theory today.

3 There's no excuse for them being surprised by Mr.

4 Waterhouse's testimony. None. You may hear somebody say we

5 couldn't speak to Mr. Waterhouse. And I know that his counsel

6 has done the right thing, because he has an obligation under

7 his agreement with Highland not to cooperate in claims against

8 them, so he's done the right thing. But that, that advice,

9 Mr. -- I don't know when the advice was given, obviously, but

10 I know from the representations that have been made by counsel

11 to the Advisors, that wall came down between them and Mr.

12 Waterhouse last summer.

13 And we know it didn't come down before that because Your

14 Honor already has a litany of evidence showing that D.C.

15 Sauter had multiple conversations with Mr. Waterhouse in the

16 spring of 2021. Remember, he submitted not one but two

17 declarations in support of HCMFA's notes defense. And

18 remember that? We'll talk about this more next week. Mr.

19 Sauter conducted an internal investigation in the spring of

20 2021 to try to figure out where did these HCMFA notes come

21 from. And remember, Frank Waterhouse told him those notes

22 exist because we needed to document it for the auditors. Mr.

23 Waterhouse knew exactly why those notes existed.

24 And so how do the Advisors do an investigation, interview

25 Mr. Waterhouse three times in the spring of 2021 about the

1 notes, and never ask him a question about this? And Mr.  
2 Waterhouse is going to testify he's never seen the  
3 administrative claim and he's never spoken to anybody in the  
4 world about the administrative claim until I deposed him,  
5 other than his counsel.

6 How do they do that? Frank Waterhouse is in their  
7 offices. There's investigations being conducted about HCMFA's  
8 notes. They're trying to figure out the origin of the notes.  
9 D.C. Sauter. And nobody asks him, what about this  
10 administrative claim? Do you know why we kept paying that  
11 money? Never happened. Maybe they would have learned at that  
12 time that Mr. Waterhouse thought that something happened in  
13 December of 2019 that was relevant.

14 The story that they've now adopted completely contradicts  
15 their early version, earlier theory of the case. Their  
16 earlier of the case, Your Honor, if you look at their  
17 response, which was filed in December, it's filed as Exhibit  
18 13, at Paragraph 6, their response to our waiver argument was  
19 we could not have waived, we could not have waived because the  
20 issue didn't crystallize until November 2020. That's when  
21 they said they first learned about all these problems. And  
22 now they've done a complete about-face and they say no, wait,  
23 Frank knew about it, Frank -- Dave Klos told him about the  
24 overpayments, Dave Klos told Frank, and Frank went to Caruso,  
25 and Caruso said nothing we can do about it, and that's a

1 violation of 2.02. And that's their theory. Really.

2 Completely contradicts.

3 So all they've actually done now, if the Court actually  
4 buys that argument, is strengthen our waiver argument even  
5 more. Because now Frank knew in December 2019 -- I don't  
6 think the Court's ever going to credit his testimony, but if  
7 the Court did so, okay, fine, heads I win, tails they lose.  
8 It's just waiver. He knew -- he knew at the outset of the  
9 overpayments.

10 And here's the really interesting thing. He never told  
11 Mr. Dondero. And he never told Mr. Norris and he never told  
12 Mr. Sauter and he never told Ms. Thedford and he never told  
13 the Independent Board. He never told anybody. But if you buy  
14 the story, you have to buy the whole story. You can't just  
15 buy the fact that Mr. Waterhouse didn't tell anybody. You  
16 also have to buy the fact that apparently Mr. Leventon never  
17 told Mr. Dondero. Mr. Ellington never told Mr. Dondero.  
18 Because if they had told Mr. Dondero, we would have had this  
19 story -- we would have heard about this story in the  
20 administrative claim or we would have heard about the story in  
21 the response. Instead, we're told the issue didn't  
22 crystallize until November 2020.

23 So not only did Mr. Waterhouse simply accept the advice of  
24 two in-house counsel and a financial restructuring  
25 professional, he didn't tell anybody, and nobody who he told

1 told anybody. Kind of funny. Kind of interesting. I'll use  
2 interesting.

3 There will not be a document or a witness who will  
4 corroborate Mr. Waterhouse's assertions. The contemporaneous  
5 documents will actually completely contradict Mr. Waterhouse's  
6 assertion.

7 Which documents am I referring to? There actually was an  
8 analysis that Mr. Klos prepared in December 2019. He's going  
9 to share with the Court what that analysis was. And what that  
10 analysis shows is that, after making adjustments to present  
11 the analysis in the most positive light for the UCC, Highland  
12 was still losing a million and a half dollars a year under  
13 these intercompany agreements.

14 I can't explain Mr. Waterhouse's testimony. I thought  
15 originally when I was asking him about it that he was confused  
16 with a later analysis that was prepared in December 2020 that  
17 we'll talk about. He insists it was in December 2019. I  
18 don't know what to say. But there will be nothing that  
19 corroborates it. There won't be a witness in this courtroom  
20 who corroborates it. There's going to be -- it's going to be  
21 challenged by Mr. Klos. We're going to have documentary  
22 evidence that shows he's mistaken.

23 I don't need to ascribe bad motive. This guy's just  
24 mistaken. And given his lack of recollection about so many  
25 things, it's not terribly surprising.

1           Subsequent communications are inconsistent. There's  
2 another couple of exhibits. And we just looked at one, the  
3 one with Ms. Thedford from January. Like a couple of weeks  
4 after Dave supposedly told Frank that there's millions and  
5 millions of dollars of profit being made under these  
6 contracts, he's turning around and saying to Ms. Thedford,  
7 we're not doing actual cost, it's a flat fee agreement. He's  
8 just ratifying everything that the parties have been doing for  
9 the 24 months under Mr. Dondero's control.

10           I'm about done, Your Honor. I just want to talk for a  
11 moment about a couple of the witnesses. You are going to hear  
12 from Mr. Klos, and I'm delighted that you're going to do so.  
13 Nobody is going to take Mr. Klos on. He's a man of integrity.  
14 And I know, I know the Court will find him very credible.  
15 You'll find him credible for three reasons.

16           Number one, his story makes sense. Every single thing  
17 that he says, he's going to say, that makes sense on a  
18 timeline, that makes sense from an economic perspective, that  
19 makes sense based on what I know of this institution and these  
20 individuals.

21           You're going to find him credible for the second reason.  
22 His story is consistent. There's no equivocation. There's no  
23 change of story. I'm not worried about him being cross-  
24 examined with his deposition transcript. His story is going  
25 to be consistent. It's going to make sense. It's going to be



1 consistent.

2 And the third reason is that it's all going to be  
3 corroborated by the contemporaneous documentation.

4 So I look forward to presenting Mr. Klos. I think that he  
5 has more knowledge about these issues than anybody. He was  
6 involved in structuring the entire economic relationship  
7 between the parties. He was involved in the drafting of the  
8 agreements. And he was the person primarily responsible for  
9 the administration of the agreements.

10 So that's one witness I hope the Court will pay particular  
11 attention to.

12 Mr. Waterhouse, obviously. He wore dual hats. He's going  
13 to say he wore dual hats. He's going to tell you that Mr.  
14 Dondero gave him all of those hats. But the Advisors can't  
15 get away from the fact that two of those hats were as the  
16 treasurer of HCMFA and as the treasurer of NexPoint. There's  
17 nothing that's in his head that can be attributable to  
18 Highland that cannot also be attributable to him as an officer  
19 and the treasurer of the Advisors. Right? So anything he  
20 knows, anything they want to put in his head, he knew not just  
21 for Highland but he knew for the Advisors.

22 And then there's Mr. Norris. I mean no ill will to Mr.  
23 Norris, but he has very little to offer here. And why is  
24 that? Because he's the executive vice president of the  
25 Advisors, and his responsibility was marketing.

1           You're going to hear Mr. Klos and I believe you will hear  
2 Mr. Waterhouse testify that Mr. Norris had absolutely no  
3 responsibility or involvement in the structuring of the  
4 economic relationship between the parties. They are going to  
5 testify that Mr. Norris had no involvement or personal  
6 knowledge about how these contracts were executed.

7           Mr. Norris comes on the scene at the very last second.  
8 And like Mr. Sauter did in the spring of 2021 when he insisted  
9 that Mr. Waterhouse, the officer whose name appears on the  
10 HCMFA's notes, made a mistake, even though Mr. Waterhouse had  
11 absolutely no personal knowledge of anything, you're going to  
12 hear Mr. Norris testify that he came onto the scene in October  
13 or November and December 2020 and he was shocked, shocked, at  
14 how much was being charged. Where have you been? Where have  
15 you been? Did you look? Did you look in 2018 when Mr.  
16 Dondero was in control and all of the dual employees were  
17 leaving? Did you say, hey, hey, what are we doing here? No.  
18 Did you do it in 2019? No. He did in Month 35 of a 36-month  
19 relationship, without having had any involvement or  
20 responsibility for the negotiation or administration of these  
21 contracts.

22           I will be objecting as appropriate on foundation grounds,  
23 because a witness can only testify based on personal  
24 knowledge. And he can testify to whatever he did, but he  
25 should not be permitted to testify about the parties' intent.

1 I have nothing further, Your Honor.

2 THE COURT: All right. Thank you. Mr. Rukavina?

3 OPENING STATEMENT ON BEHALF OF THE DEFENDANTS

4 MR. RUKAVINA: Respectfully, Your Honor, what you  
5 just heard was misdirection, irrelevancy, things that are not  
6 going to be in the record, things that are not in the record,  
7 and parol evidence.

8 What Highland is trying to do here today is to ignore the  
9 fact that there are four contracts. Two of them are payroll  
10 reimbursement agreements; two of them are shared services.  
11 They are different contracts that provide for different  
12 things. And what you just heard was confusing the two, and I  
13 think you even heard Mr. Morris say that the PRAs were  
14 actually pay-for-services agreements.

15 They're trying to read these contracts into something that  
16 they're not, using parol evidence. And I find it particularly  
17 ironic given that in all those promissory note cases Highland  
18 is here hitting this table saying, follow those notes to the  
19 letter, ignore everything else, and now they're trying to  
20 shoehorn what is a very clear, unambiguous payroll  
21 reimbursement agreement into some kind of parol evidence, it  
22 was meant to be a flat payment every month for services.

23 What I first want you to focus on, because I really  
24 believe that it's unbelievable misdirection, are all of these  
25 references to representations that my clients made to the

1 board. And if you have Slide 13 of the deck, Your Honor --  
2 did Mr. Morris give you Slide 13 -- you see -- you see, for  
3 example -- are you there, Your Honor?

4 THE COURT: Uh-huh.

5 MR. RUKAVINA: You see the first one, June 18th to  
6 19th, level and quality of services are being monitored.

7 August 13th. No disruptions in the services.

8 September 17th. Current shared services are being  
9 provided.

10 October 23rd. Pursuant to the shared services agreements.

11 Yes, Highland performed under the shared services  
12 agreements, except for two minor things that we've put in our  
13 trial brief and that we'll talk about that total about \$1.3  
14 million in damages.

15 What we're talking about here today, the bulk of our claim  
16 is under the payroll reimbursement agreement. So as we  
17 proceed with the evidence, the Court needs to be careful to  
18 have that separation. Because the fact that we told the board  
19 the truth, that under shared services we were being provided  
20 shared services, does not mean that we told the board that,  
21 oh, wait, there's a problem under payroll reimbursement. The  
22 two are separate.

23 And I really want to point out two exhibits to Your Honor,  
24 if Ms. Canty would do me the favor, or if Your Honor wants to  
25 look at them in her binder. It's Highland Exhibit 58. Ms.

1 Canty, is it possible -- Mr. Morris, are you willing to share  
2 Ms. Canty?

3 Yes. Ms. Canty, if you have your own Exhibit 58.

4 She might not even be listening.

5 (Pause.)

6 MR. RUKAVINA: Is it just easier, Your Honor, if Your  
7 Honor gets a binder?

8 THE COURT: I can do that.

9 MR. RUKAVINA: Your Honor, it's -- I believe it's --  
10 it's Volume 2. Volume 2 of the Highland exhibits.

11 That's okay, Ms. Canty. Thank you. I think this will be  
12 faster if we just use binders.

13 Your Honor, it's Exhibit 58, when you're ready.

14 THE COURT: Minutes?

15 MR. RUKAVINA: Yes, Your Honor. On the bottom, it's  
16 Page 20. Just it's a few pages in. The bottom, it says Page  
17 20.

18 THE COURT: Okay.

19 MR. RUKAVINA: So, it says Mr. Post also discussed  
20 the quality and continuity of services provided to the Funds  
21 by HCMLP pursuant to shared services agreements with the  
22 Advisors. And then you'll see that he says that there's no  
23 material disruptions in services.

24 What about that is not true? What about that has anything  
25 to do with a multimillion-dollar overpayment under payroll

1 reimbursement? But that's what you're being told. Again,  
2 they're trying to confuse the issues.

3 And if Your Honor will quickly flip to Exhibit 61.

4 THE COURT: Okay.

5 MR. RUKAVINA: And it's the bottom of Page 3. And in  
6 the very middle you'll see it says, Mr. Sauter also discussed  
7 the status of the shared services agreements.

8 THE COURT: Okay. The one I have is redacted.

9 MR. RUKAVINA: Page -- the bottom of Page 3, Your  
10 Honor?

11 THE COURT: Yes.

12 MR. RUKAVINA: Of this? The top should not be  
13 redacted.

14 THE COURT: It's not. Oh, okay. Yes. Mr. Morris  
15 discussed.

16 MR. RUKAVINA: And then, yeah, in the middle it says,  
17 Mr. Sauter also discussed the status of the shared services.

18 THE COURT: Okay. Gotcha.

19 MR. RUKAVINA: But look at what they say on Slide 13.  
20 They say Sauter noted that there has been no material  
21 attrition to date with respect to employees. Where is that in  
22 this document? We'll talk about that later. That's nowhere  
23 in this document.

24 Again, they're intentionally conflating shared services,  
25 that we're not saying we didn't get shared services, with

1 payroll reimbursement.

2 The facts here matter, Your Honor. And I caution the  
3 Court to be careful because, again, these are separate  
4 contracts that have separate provisions and they work  
5 separately.

6 You're also going to be told about, oh, well, a lot of  
7 these employees weren't even there when the payroll  
8 reimbursement agreements were made. I think Mr. Morris said  
9 four. Yeah, except that they were signed in May to be  
10 effective as of January 1. And if Mr. Klos really is this  
11 impeccable, unbribeable character of pristine morals, well, did  
12 he create a fake agreement? Did he lie? Of course not.

13 Again, misdirection. Misdirection.

14 You are told, well, a lot of these employees left. What  
15 you're going to hear is that a lot of those payroll  
16 reimbursement employees, those dual employees, left because  
17 the Advisors changed their business model to a real estate-  
18 heavy business model, whereas before they had a lot of credit,  
19 they had debt, equities. They changed to real estate. So  
20 that's why 20 out of 25 employees that were dual employees  
21 left, because they saw the writing on the wall, not for these  
22 other reasons. Because the argument that you're hearing is,  
23 well, don't look at these two contracts, Judge, the payroll  
24 contracts. Consider it a services agreement. And even though  
25 those 20 employees were no longer there, Highland made it up

1 with other employees that were there. Therefore, the spirit  
2 and intent of the agreement is honored.

3 No. No, Your Honor. No. Highland did not make up those  
4 services. Highland was providing those services pursuant to  
5 the shared services agreements, and those dual employees left  
6 and they were not replaced, their services were not replaced,  
7 because they were no longer needed. Except guess what?  
8 Highland never told us that. The one we contracted with to  
9 review our contracts, to review our bills, to review our  
10 invoicing, to make sure that we're paying only appropriate  
11 amounts. You're going to hear from everyone that that was one  
12 of the services that we were paying pursuant to shared  
13 services. Highland never bothered telling anyone, oh, we're  
14 still going to bill you for these 20 employees that are gone.

15 You've been told that everyone in the world knew those  
16 employees were gone. Of course. But not that we were still  
17 being billed for it. Because it was only Highland people that  
18 billed us for that and paid themselves from our bank accounts  
19 which they have control over.

20 Mr. Dondero didn't know. No officer of the Advisors knew.  
21 Mr. Waterhouse knew. And yes, Mr. Waterhouse was an officer  
22 of the Advisors and an officer of the Debtor. And you're  
23 going to hear from Mr. Waterhouse what he tried to do about  
24 that.

25 But, again, don't allow that misdirection to color the



1 true record here. Our contractual counterparty, the one  
2 providing services to us, a debtor in bankruptcy, every month  
3 was billing us and paying itself from our funds for 20  
4 employees who weren't there.

5 And Mr. Klos -- again, the man that we've all be told is  
6 the most credible man in this court -- will confirm that. And  
7 he calculated our damages for us. You're going to see all  
8 that.

9 So let's, again, stick to the facts. The payroll  
10 reimbursement agreements are reimbursement agreements.  
11 Everyone in the world knows what the word reimburse means.  
12 There was not to be any profit margin on there. We are to  
13 reimburse for actual cost. Actual cost means the actual cost  
14 to Highland of a dual employee.

15 Yes, there are some issues with notices and when did we  
16 know, when did we act? You're going to hear all about that.  
17 But at the end of the day, if the Court is looking for the  
18 intent and purpose of the contract, it is a reimbursement.  
19 And each of those have a schedule of 25 employees that was  
20 accurate and current -- Mr. Klos himself performed those  
21 percentages -- that was accurate and current when those  
22 contracts were done.

23 You are then going to hear that Highland, pursuant to its  
24 general practices, did a true up or a reconciliation of all of  
25 its contracts on an annual basis.

1           There is language in these contracts that talks about,  
2 well, why don't the parties look at the actual costs every  
3 month. There is that language. We will discuss that. But  
4 the course of conduct at Highland, both generally and in this  
5 case, was to do it once a year at the end, because to do it  
6 monthly was burdensome.

7           In the first year of that contract, the parties did a true  
8 up, and my clients ended up paying \$2.5 million more in  
9 because we underpaid. You're going to hear some fiction that  
10 this was some means of getting a tax deduction for Mr.  
11 Dondero. Well, the contracts, again, say what they say, and  
12 they say we did a true up -- they don't say that. We did an  
13 analysis and the Advisors underpaid, so now the Advisors are  
14 going to pay \$2.5 million.

15           So, again, is that a fraudulent document? Is that  
16 Highland document a fraudulent document? Were people lying on  
17 these documents?

18           Then the bankruptcy happens, and it's time for the next  
19 true up in late 2019. Coincidentally, at the same time that  
20 the Committee, appropriately so, is asking DSI and asking the  
21 Debtor, what are these intercompany agreements? This -- these  
22 are insider agreements. Explain to us. Is Highland losing  
23 money? Is Highland making money?

24           So what happens next? Mr. Klos -- again, the most  
25 credible man in this room, we're told -- does an analysis, and

1 he says that at that point in time Highland is making a \$3  
2 million annualized profit on the payroll reimbursement  
3 agreements. Okay. He also says that Highland is losing money  
4 on the shared services agreements. That's true. But, again,  
5 don't allow that misdirection. On the payroll agreements,  
6 Highland is at that point in time making a \$3 million profit.

7 He tells Mr. Waterhouse, his boss, did you know about  
8 these overpayments? You should do something about that. And  
9 Mr. Waterhouse, a professional man, does what he should do.  
10 He talks to the general counsel at Highland and he talks to  
11 the CRO and DSI and says, it's time that we revise these  
12 numbers, because we're overpaying, the Advisors are overpaying  
13 by \$3 million a year, and that's not fair, it's not right.  
14 That's extra-contractual. The general counsel, the associate  
15 general counsel, and the man who's been in bankruptcy for 30  
16 years tell him there's nothing we can do because of the  
17 automatic stay. We will address it and deal with it in due  
18 course.

19 What more was Mr. Waterhouse supposed to do at that time?  
20 Call Mr. Dondero? His own general counsel and his own CRO  
21 just told him what the law is, and he relied on that and  
22 believed them and said, okay, there's nothing to be done at  
23 this time, we'll address it in due course.

24 Months go by. Months go by. The overpayments become  
25 greater and greater and greater as there's fewer and fewer

1 employees. Mr. Waterhouse is still acting in reliance on  
2 this. You know that there were negotiations on a global plan.  
3 Well, at some point in September or October 2020, the  
4 situation was no longer tenable. That's when Mr. Norris comes  
5 in, my client's officer. Yes, he's a marketing guy, but he's  
6 a very sophisticated businessman with a lot of education, and  
7 he's tasked with this.

8 He starts talking to Mr. Kos. He starts talking to Mr.  
9 Waterhouse. He starts talking again to the lawyers. Hey, we  
10 are overpaying. And Mr. Klos, you'll hear, repeatedly  
11 acknowledged the fact of overpaying. But he's again told the  
12 automatic stay applies, you can't do nothing. If you send a  
13 letter, if you do anything, it's going to be a stay violation.

14 You'll recall we had a preliminary injunction hearing at  
15 which the Court was none too happy about a letter sent from  
16 K&L Gates to the Pachulski firm threatening action subject to  
17 the -- subject to the automatic stay. They hauled us in front  
18 of Your Honor on an emergency hearing on that. Imagine if we  
19 sent them a letter saying, we're going to revise this  
20 contract, or we're going to terminate this contract. That  
21 would have been a stay violation.

22 But all along, the contract says that once the issue is  
23 raised, once a change is requested, the parties shall  
24 negotiate in good faith. Shall negotiate in good faith.  
25 That's not meaningless language. And there was no

1 negotiation. Repeated admissions of overpayments, no  
2 negotiations, but hiding behind the automatic stay, perhaps  
3 appropriately, perhaps not.

4 And then finally in December 2020 I think the key evidence  
5 here will come out, because it happened before litigation. It  
6 happened by a professional, honorable man of integrity that  
7 you've heard, Mr. Klos. It happened when we were not  
8 contemplating being here today. Mr. Klos was asked by Mr.  
9 Waterhouse to calculate the profitability or the loss of  
10 Highland on these four contracts. He was told, or he assumed,  
11 or he may -- well, the evidence differs. Mr. Klos will say  
12 Mr. Waterhouse told him to make assumptions. Mr. Waterhouse  
13 will say it was Mr. Klos's assumptions. It doesn't matter.  
14 There were two assumptions in the work product that Mr. Klos,  
15 this professional accountant, prepared. Use actual headcount  
16 today. Not the original 25, but the actual headcount today,  
17 which was five. And do not include bonuses. Highland didn't  
18 pay insider bonuses, which were a huge amount. There were  
19 other bonuses paid, so the numbers need to be adjusted a  
20 little bit. Mr. Klos didn't include any bonuses.

21 And he said at that point in time, in December 2020,  
22 Highland was making an annualized \$6.6 million profit on the  
23 payroll reimbursement agreements and a \$1 million annualized  
24 profit on the shared services agreements, even though you  
25 heard in this Court repeatedly from Highland employees and

1 witnesses that, oh, we're losing money on all these contracts.

2       So, is Mr. Klos a liar? Is he -- is he a nincompoop who  
3 can't do his job? Is he changing his story now? How could  
4 there have been a \$6.6 million profit on one and a \$1 million  
5 profit on the others when the contracts (inaudible) profits  
6 then? Did he create a fictitious document then? No. He did  
7 his job as he should have, and that is the key evidence here.  
8 That is the key evidence.

9       What this trial will come down to, Your Honor, is the  
10 contract. Whether my clients had an obligation under the  
11 contract -- because, again, the fact of overpayment cannot and  
12 will not be disputed. Twenty of twenty-five employees weren't  
13 there. We can quibble about damages, but the fact of  
14 overpayment will not be disputed. Cannot be disputed. The  
15 question is, again, did my clients waive their rights because  
16 they did not more frequently or more formally trigger the  
17 process of revisiting the actual cost formula?

18       Those contracts are very clear. There's no need for parol  
19 evidence. There's no ambiguity. The fixed monthly amount  
20 stays unless changed at the request of either party, upon  
21 which time the parties shall negotiate such change in good  
22 faith.

23       We requested it repeatedly. They stood behind the  
24 automatic stay. And the Court will have to construe that  
25 contract as a matter of law and decide whether that is a

1 waiver or not.

2 There's no other waiver. There's no voluntary payment  
3 rule. The voluntary payment rule doesn't apply to contracts.  
4 And we weren't paying these bills. Highland was paying  
5 itself.

6 And that's the thought I want to leave you with, Your  
7 Honor. That's the thought I want to leave you with, that your  
8 Debtor, who has gotten immense protections from this Court,  
9 fiduciaries to the estate, every single month billed my client  
10 for almost a million dollars more than they were entitled to  
11 under these contracts because there was no reimbursement by  
12 this Debtor of its own employees. Month after month, with  
13 knowledge that these employees weren't there, with knowledge  
14 that Highland was making a profit on these contracts when it  
15 was not allowed to, they billed my clients and paid themselves  
16 for employees who were not there. Whether it's contract or  
17 equity or just good business ethics or just being a good  
18 debtor-in-position, that ought to bother the Court. That  
19 ought to bother the Court, and that's why we have an  
20 administrative claim.

21 Thank you.

22 THE COURT: All right. Thank you. It's 11:01.  
23 We'll take a ten-minute break and come back and hear the  
24 evidence.

25 THE CLERK: All rise.

1 (A recess ensued from 11:01 a.m. until 11:15 a.m.)

2 THE CLERK: All rise.

3 THE COURT: All right. Please be seated. We're back  
4 on the record in the Highland matter.

5 Mr. Morris, are you ready to call your witness?

6 MR. MORRIS: Good morning. Yes, Your Honor.

7 Highland calls as its first witness David Klos.

8 THE COURT: All right. Mr. Klos? Okay. If you  
9 could approach the witness box, I'll swear you in. Please  
10 raise your right hand.

11 (The witness is sworn.)

12 THE COURT: All right. Thank you. You may be  
13 seated.

14 DAVID KLOS, DEBTOR'S WITNESS, SWORN

15 DIRECT EXAMINATION

16 BY MR. MORRIS:

17 Q Good morning, Mr. Klos.

18 A Good morning.

19 Q So, I'm going to ask you some questions this morning. And  
20 I would ask you to listen carefully to my questions and do the  
21 best you can to answer them. Okay?

22 A Absolutely.

23 Q I've put before you, or Mr. Rukavina and I have put before  
24 you some binders. There is two binders that have Highland's  
25 exhibits and there is one binder that has the Advisors'



1 exhibits. And from time to time I may ask you to pull  
2 documents out. But that's what those -- that's what those big  
3 binders are in front of you.

4 A Okay.

5 Q Are you comfortable? Are you prepared to proceed?

6 A Yes.

7 Q Okay. Mr. Klos, you're familiar with Mr. Waterhouse,  
8 obviously, right?

9 A Yes.

10 Q Okay. And did you understand that Mr. Waterhouse served  
11 as Highland's chief financial officer at least for the five-  
12 year period through 2021?

13 A Yes. He -- he elevated to that role in the 2011-2012 time  
14 frame.

15 Q Okay. And are you aware that at the same time he served  
16 as Highland's CFO he also served as the treasurer of each of  
17 the Advisors?

18 A Yes.

19 Q And are you aware that Mr. Waterhouse, in his dual  
20 capacity as the CFO of Highland and as the treasurer of the  
21 Advisors, he's the one who signed the payroll reimbursement  
22 agreements?

23 A Yes. That's correct.

24 Q And the payroll -- do you recall that the payroll  
25 reimbursement agreements had the list of dual employees?

1 A Yes.

2 Q And from the time the -- for the three-year period from  
3 December -- from January 1, 2018 until the end of 2020, was it  
4 Mr. Waterhouse's practice to approve each and every payment  
5 that was made on behalf of the Advisors pursuant to not just  
6 the payroll reimbursement agreements but all of the  
7 intercompany agreements?

8 A Yes. That was the general practice.

9 Q Can you just describe for the judge your understanding of  
10 how that practice operated?

11 A For making the payments?

12 Q Yes.

13 A Yes.

14 Q Approval. Approval of the payments.

15 A Yes. Yeah, I mean, generally speaking, our assistant  
16 controller, usually Kristin Hendrix, would -- would prep wires  
17 on an ongoing basis, whether first of the month or just weekly  
18 type wires. She'd send an approval email to Frank saying,  
19 here are the wires for today. Okay to release? Or something  
20 like that. And Frank would respond with yes, or if he had  
21 questions then he might -- he might chime in. But usually  
22 just an approval.

23 Q Okay. Can you just -- are you currently employed, sir?

24 A Yes.

25 Q And who's your employer?

1 A Highland Capital.

2 Q And what's your title today?

3 A CFO and COO.

4 Q And when did you first join Highland?

5 A End of March 2009.

6 Q And during the period -- let's -- I'm going to use the  
7 phrase "the relevant period" to mean from January 1, 2018  
8 until the end of 2020, that three-year period. Is that okay?

9 A That's fine.

10 Q Okay. During the relevant period, what titles did you  
11 hold at Highland?

12 A I was controller through April of '20, and then I was  
13 chief accounting officer from April '20 forward.

14 Q Okay. And you reported to Mr. Waterhouse, correct?

15 A Yes. Throughout.

16 Q Okay. Now, can you describe generally for Judge Jernigan  
17 what your duties and responsibilities were as the controller  
18 and the chief accounting officers during the relevant time?

19 A Sure. And I'll qualify that I had responsibilities over  
20 different departments. But as it pertains to this matter, I  
21 was the department head for corporate accounting group, so the  
22 group that does the Advisor accounting both for HCMLP as well  
23 as other call it non-fund advisor or proprietary-type  
24 entities, and oversaw a team of -- that encompassed the A/P  
25 and the general accounting function for those entities.

1 Q I'm going to use another term, I'll just call it "the  
2 intercompany agreements," to refer to the payroll service  
3 agreements and the shared services agreements between Highland  
4 and the Advisors. Is that okay?

5 A Yes, that's fine.

6 Q Okay. Did you personally play any role in the  
7 preparation, creation, and administration of the intercompany  
8 agreements during the relevant period?

9 A Yes. And even outside the relevant period, because one of  
10 the shared services agreements is long in the tooth and goes  
11 back to the 2012 time frame, and I was -- I was involved in  
12 that one as well.

13 Q Okay. And can you just describe generally -- well, we'll  
14 talk about the details of it. Let's take you back to December  
15 2017, the month before the beginning of the relevant period.  
16 Do you have a recollection as to how Highland was performing  
17 on an operating basis in 2017?

18 A Yes. It was performing poorly. Assets were being shed.  
19 A lot of our business had been CLOs, which had been steadily  
20 declining over the years. They were past their reinvestment  
21 period, so assets declined, cash flow declined, and by that  
22 time we were cash flow negative. At HCMLP proper.

23 Q Okay. And did you participate in any discussions within  
24 Highland in December 2017 as to how Highland might address  
25 these operating losses?

1 A Yes. So we had standing weekly cash -- cash meetings  
2 between myself, the CFO, and usually Kristin would participate  
3 in those, and then we would also meet with Mr. Dondero from  
4 time to time on those cash meetings. And we did have such a  
5 meeting in December of 2017.

6 Q Can you describe for Judge Jernigan your recollection of  
7 the meeting that was had in December of 2017 where the issue  
8 of -- how the losses were going to be addressed?

9 A Absolutely. And I caution, I don't remember the  
10 specifics, the specifics in terrible detail of that meeting,  
11 but I'm certain that it was me, Frank, and Jim Dondero. And  
12 that the substance of that meeting -- again, I don't know if  
13 this was coming from Jim or from Frank and I -- was we're  
14 really bleeding cash quickly. We need more cash at Highland  
15 to operate, to pay bills, to do what we need to do, because we  
16 always operated very lean across the entire structure. And,  
17 you know, Jim, can you -- can you help with that? Help us  
18 solve this problem. And the solution that was given to us, my  
19 recollection, I think that the -- the idea was that you would  
20 just increase the shared services agreement that was already  
21 in place with NexPoint, and Mr. Dondero had this idea of  
22 bifurcating it, create a new agreement, such that NexPoint is  
23 paying Highland six in the aggregate on a prospective basis.

24 Q And six meaning \$6 million?

25 A \$6 million. I apologize.

1 Q And is your recollection that Mr. Dondero gave the  
2 instruction to increase the amount that NexPoint was paying to  
3 Highland for the services rendered, should be -- should be  
4 increased to \$6 million?

5 A Yes. Because at the time, NexPoint was paying Highland  
6 about, annualized, \$1.2 [million] per year. So this was a  
7 significant step up.

8 Q Okay. And did you personally do any work to try to figure  
9 out how to execute on Mr. Dondero's instruction?

10 A Just in the sense of -- I think I passed that off to one  
11 of the employees that worked under me to work with Legal to  
12 work through drafting of agreements to update to reflect that,  
13 that desire.

14 Q Okay. I'm going to ask you to turn to Exhibit 130.  
15 1-3-0.

16 A Okay. I'm there.

17 Q And I'll just ask generally -- take a moment to look at  
18 it.

19 A Yep. I'm there.

20 Q Do you recall that in late December, early January of the  
21 relevant period, you were engaged in discussions with some of  
22 your colleagues about how to document the \$6 million  
23 direction?

24 A Yes.

25 Q Okay. Directing your attention to the email that you sent

1 on January 4th at 3:16 p.m., which can be found on the  
2 document ending in Bates No. 47, --

3 A I'm there.

4 Q -- I see there's a chart. Can you explain to the judge  
5 what you're conveying in that chart?

6 A Sure. There are -- there are four agreements that are  
7 going to be put in place to get to the -- to the \$6 million  
8 number in the aggregate. You see one of them, the one that's,  
9 at least on my thing, is highlighted, there's one that's an  
10 intercompany between parent and sub, NexPoint/NREA. For our  
11 purposes today, that's kind of irrelevant.

12 But for the other three, you have Highland HCMLP as the  
13 service provider, and you see the breakdown of those -- those  
14 three agreements between \$252,000 per month for subadvisory --  
15 sorry. \$168,000 to NexPoint Advisors for shared services.  
16 And then \$80,000 for -- from NexPoint to NREA for shared  
17 services.

18 And so the sum of those of three amounts to HCMLP,  
19 \$252,000 plus \$168,000 plus \$80,000, equals \$500,000 a month,  
20 times 12 is the \$6 million number that we had talked to Jim  
21 about, you know, within a month.

22 Q Okay. So, as of January 4, 2018, this was the idea that  
23 you and your colleagues came up with on how to execute the \$6  
24 million directive; is that fair?

25 A That's -- that's -- generally. That's right.

1 Q Okay. I just want a stop for a second. You know, you  
2 refer in this to subadvisory, SubADV. Can you just explain to  
3 Court what your understanding is of what subadvisory services  
4 are and -- I'll just stop there.

5 A In the most general sense, investment advice to client  
6 funds. So, in the context of this, you have the Retail  
7 Advisors that are the named advisor, but you also have  
8 Highland people, HCMLP employees that are providing services.  
9 So this is a mechanic for those employees to give that service  
10 to the Funds, give investment advice, which is a little bit  
11 different than the shared service, which tends to be back and  
12 middle-office operational-type services.

13 Q Okay. Do you know if Highland provided subadvisory  
14 services to the Advisors prior to January 1, 2018?

15 A Yes. Not pursuant to an agreement, but the services were  
16 provided going back to -- to when those contracts were moved  
17 from Highland back in the twenty -- I want to say 2012 time  
18 frame.

19 Q So, for approximately six years, Highland had provided  
20 subadvisory services to the Advisors for no compensation? Do  
21 I have that right?

22 A That's correct.

23 Q Okay. Did anybody during that six-year period from  
24 Highland say, oh, gee, we should be getting paid for  
25 subadvisory services?



1 A No. No one said that.

2 Q At this time, Mr. Dondero controlled the Advisors and  
3 Highland, correct?

4 A That's right.

5 Q Why the change at this time, then? Why go, after six  
6 years of not paying for subadvisory services, to all of a  
7 sudden creating an agreement pursuant to which subadvisory  
8 services -- fees would be paid?

9 MR. RUKAVINA: Your Honor, object. There's a lack of  
10 foundation. He didn't sign those contracts and there's no  
11 predicate been laid as to why.

12 THE COURT: Response?

13 MR. MORRIS: The witness has already testified that  
14 he's the person -- I mean, look at his email. He's the one  
15 who's responsible for allocating money under these various  
16 agreements. I can -- I'll ask -- I'll ask a foundational  
17 question.

18 THE COURT: Okay. He'll ask --

19 BY MR. MORRIS:

20 Q As part of the discussions, did anybody talk about why the  
21 subadvisory agreement was going to be adopted at that moment  
22 in time?

23 A In a general sense, yes. It was going to be providing for  
24 the services that had already been provided, but to have  
25 Highland be able to start earning a fee for that service.

1 Q And was there discussion at that time that the fee that  
2 would be paid to Highland would not only give Highland access  
3 to needed capital but it would also provide a shield to the  
4 taxable income of the Advisors?

5 MR. RUKAVINA: Your Honor, that's leading.

6 THE COURT: Sus...

7 MR. RUKAVINA: And again, what is the -- I'm sorry.  
8 I'm sorry, Your Honor.

9 THE COURT: I'm going to sustain on leading.

10 MR. MORRIS: Okay. Fine.

11 BY MR. MORRIS:

12 Q Can you tell me what the reasons were for entering into  
13 these agreements? What were the -- what were all of the  
14 reasons that were discussed at that time?

15 A Yeah. The reasons I remember specifically were need for  
16 cash flow at Highland, because Highland was negative on cash  
17 flow, and need for a deduction at NexPoint, because NexPoint  
18 was generating taxable income that indirectly flowed -- flowed  
19 up to Mr. Dondero.

20 Q And when you wrote your email and you said that the  
21 subadvisory fee should be \$252,000 a month, had you done an  
22 analysis of the actual cost to Highland of providing those  
23 services?

24 A No.

25 Q Did anybody ask you to make sure that the \$252,000 was

1 tied to the actual cost of services being delivered?

2 A Not at all.

3 Q Was the \$252,000 number that was allocated to the  
4 subadvisory agreement related in any way to the cost of  
5 providing services?

6 A No, just in the sense that it was a -- you know, that  
7 there was service being provided for value. But in terms of  
8 the actual number, no.

9 Q Did the Advisors -- do you know whether Highland went out  
10 and tried to determine what the value of their services were  
11 to make sure that they were getting fair value for the  
12 services?

13 A Absolutely not. It would have been a preposterous  
14 proposition to do that.

15 Q Was there any discussion at any time as to whether or not  
16 the Advisors should go out into the marketplace to see whether  
17 they could obtain these subadvisory services at a price less  
18 than \$252,000?

19 A No discussion. And you have to keep it in context,  
20 because this all was a single complex. So you had people that  
21 were being used across different Advisors to support the  
22 complex's goals. And they were being used that way. And, you  
23 know, I think -- I think Mr. Dondero was generally happy with  
24 the people and the team. And so this is all behind the  
25 scenes, just transferring money between, you know, pockets

1 that he -- that he has.

2 Q Was there any discussion at that time as to whether or not  
3 Highland would make a profit off of a \$252,000 subadvisory  
4 contract?

5 A No.

6 Q Was there any discussion at that time as to whether  
7 Highland should or shouldn't make a profit under the  
8 subadvisory agreement?

9 A No.

10 Q You mentioned that -- in your email that the sub -- the  
11 shared services would be at \$168,000. Do I have that right?

12 A Correct. With respect to the NexPoint Advisors, LP  
13 agreement, --

14 Q Okay.

15 A -- yes.

16 Q And do you have an understanding as to whether or not that  
17 --

18 MR. RUKAVINA: Your Honor, again, objection.  
19 Leading. The question should be, What is your understanding,  
20 not, Do you have an understanding that--?

21 THE COURT: Well, I'll let him ask the whole  
22 question.

23 MR. RUKAVINA: But that's the problem, because then  
24 the witness will hear the question, and then my objection will  
25 be irrelevant.

1 MR. MORRIS: Okay.

2 THE COURT: I'll sustain. I'll let you rephrase the  
3 question.

4 MR. MORRIS: Okay.

5 BY MR. MORRIS:

6 Q Was the hundred and -- so, were these -- were these  
7 numbers -- did you intend, when you wrote these numbers, --

8 MR. RUKAVINA: Objection, Your Honor. Again,  
9 leading. Did you intend? It's -- the question should be,  
10 What did you intend?

11 MR. MORRIS: I don't --

12 MR. RUKAVINA: It's a leading question. Did you  
13 intend that--? The question, the question has the answer  
14 within it, Your Honor.

15 THE COURT: Okay.

16 MR. MORRIS: Mr. Klos, --

17 THE COURT: Sustained.

18 BY MR. MORRIS:

19 Q -- were these numbers intended to be variable?

20 A No.

21 Q And when you say that, what do you mean?

22 A What I mean by that is we already had the direction, \$6  
23 million was going to be the number from NexPoint Advisors,  
24 including subsidiaries, to HCMLP. So the numbers were already  
25 known. And just as I was explaining before, there's three

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1 components to it, but \$252,000, \$168,000, and \$80,000 gets you  
2 to the \$500,000 per month or \$6 million per year.

3 Q And was the \$168,000 for shared services by NexPoint, was  
4 that a change in the methodology by which the fee would be  
5 calculated?

6 A Yes. Yeah. Yeah, it was a change.

7 Q Can you get -- please turn to Exhibit 29?

8 A Okay. I'm there.

9 MR. MORRIS: All right. Let me know when you have  
10 that, Your Honor.

11 THE COURT: Uh-huh.

12 BY MR. MORRIS:

13 Q Okay. Do you know what that document is, Mr. Klos?

14 A I do. This appears to be the original shared services  
15 agreement between Highland Capital Management, LP and NexPoint  
16 Advisors that went all the way back to 2013. So this was the  
17 predecessor for the 2018 amendment.

18 Q And can you turn to Page 4, Section 4.01?

19 A Okay. I'm there.

20 Q Do you have an understanding as to how NexPoint paid  
21 Highland for shared services prior to January 1, 2018 under  
22 this provision?

23 A Yes. It was all -- it was all pursuant to 4.01(c) that  
24 has a little bit of a long, convoluted discussion, but at the  
25 end of the day, just boiling it down, what this -- what this

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1 section means is that Highland was going to be charging  
2 NexPoint Advisors 10 basis points on assets managed by the --  
3 I think it was NHF at the time, NexPoint Strategies Fund, and  
4 it was going to be charging 15 basis points on basically all  
5 other assets of that fund, and that that was going to be --  
6 that was, I think it's a defined term, that was actual cost,  
7 notwithstanding that that concept is completely divorced from  
8 cost.

9 Q And how is the issue of actual cost completely divorced  
10 from cost?

11 A Because the charge itself was being generated off of the  
12 assets managed by a single fund, and that -- I don't know how  
13 else to say it other than that has -- that has nothing to do  
14 with cost.

15 Q Okay.

16 A What it does have to do with was that that was a charge --  
17 that was a fund that charged 120 basis points, so NexPoint was  
18 earning 120 basis points and it was paying some blend of 10 to  
19 15, so it was pocketing 90 percent of the revenue.

20 Q And can you explain to the judge why the change was made  
21 from a formula depending on asset values to a fixed fee of  
22 \$168,000 a month?

23 A Yeah.

24 MR. RUKAVINA: Your Honor, objection, based on  
25 foundation.

1 MR. MORRIS: Your Honor, he has testified to  
2 everything already.

3 MR. RUKAVINA: No, he hasn't, Your Honor. He hasn't  
4 testified that he knows why this change was made or that  
5 anyone told him why this change was made or that he made this  
6 change. He's speculating.

7 THE COURT: I overrule the objection.

8 THE WITNESS: So, the reason to switch it to fixed  
9 is, again, you already know the answer, so the answer is \$6  
10 million, the answer -- the split is going to be roughly 50/50.  
11 It's a little bit -- it's a little bit weighted to the -- to  
12 the subadvisory. Why are you introducing any variability when  
13 you already know the answer?

14 BY MR. MORRIS:

15 Q Okay. And the answer here was what?

16 A The answer here was \$168,00 with respect to NexPoint  
17 Advisors, \$80,000 with respect to NexPoint Real Estate  
18 Advisors. And then, like I said, on the subadvisory,  
19 \$252,000.

20 Q Okay. Can you turn to Exhibit 3, please? And can you  
21 describe for the Court your understanding of what that  
22 document is?

23 A Exhibit 3, you said?

24 Q Yes.

25 A Ah. So this, this is the amended and restated agreement



1 for NexPoint Advisors.

2 Q Okay.

3 A So this, this is the agreement that updates to the fixed  
4 \$168,000.

5 Q Okay. And if you can turn to last page, the one ending at  
6 Bates No. 647. Are you familiar with those signatures?

7 A Yes, I am.

8 Q And what's your understanding of who signed this contract?

9 A So, this contract was by Frank Waterhouse.

10 Q Okay. And when was this contract effective?

11 A This was effective January 1st of 2018. I believe it was  
12 executed in the early part, around -- on or around January  
13 11th, my recollection.

14 Q Okay. Can you turn to Page 9, please?

15 A I'm there.

16 Q In Section 3.01, is that the section that sets forth the  
17 provision for compensating Highland for shared services by  
18 NexPoint?

19 A I'm sorry. What's the exhibit again?

20 Q It's Exhibit 3, Page 9.

21 A Oh. I'm sorry. I went to Exhibit 9.

22 Q I may have -- I may have misspoken.

23 A Exhibit 3, Page 9?

24 Q Right.

25 A Okay. Okay. I'm there.

1 Q And can you describe for the Court your understanding of  
2 what Section 3.01 provides?

3 A Yes. It's providing for what I was -- what I was just  
4 explaining, which is the flat fee of \$168,000 per month.

5 Q So, did this agreement put into practice what was in your  
6 email?

7 A Yes.

8 Q Okay. Did you personally, as the controller of Highland  
9 at the time, did you have any view as to whether or not \$6  
10 million was the right number of compensation for subadvisory  
11 and shared services by NexPoint?

12 A I don't know that I had a view on that that was the right  
13 number, but it was certainly a number in the right direction,  
14 because the previous charges, like -- as you mentioned  
15 earlier, there were no previous charges for any of the front  
16 office services, and the back office services were locking in  
17 a 90 percent profitability. So it was -- it was a step in the  
18 right direction. Hard to say if that was the perfect number,  
19 but a stopped clock tells the right time twice a day, so at  
20 some point maybe.

21 Q Did you personally do any analysis in late 2017 or early  
22 2018 to determine whether \$6 million was fair value for the  
23 subadvisory services and shared services that Highland was  
24 providing?

25 A No.

1 Q Are you aware of anybody doing any such analysis?

2 A No.

3 Q Did you do any analysis to assess on a holistic basis  
4 whether Highland was going to make a profit off of the \$6  
5 million for shared and subadvisory services?

6 A In a way. Maybe not directly, but, you know, around that  
7 same time we were preparing our annual presentation for Jim,  
8 so we had a sense of what the Advisors were -- where they were  
9 shaking out in the future.

10 Q Okay. We'll look at that in a moment. On your email,  
11 there was the \$80,000 for NREA. Do I have that right?

12 A Yes.

13 Q Can you just explain to the Court what that referred to  
14 and why that was part of your email?

15 A Yes. So, NREA, NexPoint Real Estate Advisors, LP, is a  
16 wholly-owned subsidiary of NexPoint Advisors. At the time, I  
17 believe it just had a single entity that it provided services  
18 for, which was a public REIT with a ticker NXRT. And so there  
19 were services being provided by Highland people to that  
20 advisor to basically keep that REIT functioning.

21 Q Okay. You just mentioned an annual review. Did you  
22 participate in an annual review?

23 A Yes.

24 Q And can you describe for the Court the process of the  
25 annual review?

1 A Yes. So, going back to I want to say 2013, myself and  
2 Frank would generally meet with Mr. Dondero and Mr. Okada at  
3 the end of the -- at the beginning of the year. And, really,  
4 the purpose of that agreement, or that meeting, was to sit  
5 down, review the year that we just had, what happened, who  
6 came, who went, what were our wins, what were our losses, and  
7 then -- and then talk about the year to come, how we're  
8 projecting what's on the horizon, and then also, you know, we  
9 had -- our bonus process culminated at the end of February, so  
10 this was a good opportunity to start getting initial feedback  
11 from Jim on where he saw the compensation pool for that coming  
12 year. And this was a good way to wrap that all together, try  
13 to be objective, and give him the data to kind of do his own  
14 evaluation of what kind of a year we just had.

15 Q Okay. In connection with the annual review, did you  
16 prepare written information?

17 A Yes.

18 Q Can you describe for Judge Jernigan what information you  
19 prepared and how you went about preparing it?

20 A Yes. So, the information, my recollection, it was usually  
21 like a 40 to -- 40- to 60-page type presentation, a slide  
22 deck. And it would include financials from the previous year,  
23 a section on HR, a section on forward-looking projections, a  
24 section on fund performance across the platform, and probably  
25 a few other things that I'm forgetting up here.

1 Q And did you obtain information from other areas of the  
2 enterprise?

3 A Yes. So that was a -- it was a collaborative process. I  
4 would work on it, I would delegate some parts of it to my  
5 team, and then also go to other departments for some of the  
6 information as well.

7 Q Would Mr. Waterhouse have an opportunity to review the  
8 deck before it was presented to Mr. Okada and Mr. Dondero?

9 A Yes. Absolutely. We would meet on it ahead of time, he  
10 would provide comments, and we would -- I would work through  
11 incorporating those comments.

12 Q So do you recall preparing a deck for the review of 2017  
13 and for the outlook of 2018?

14 A Yes.

15 Q Okay. Let's take a look at Exhibit 86, please.

16 A Okay.

17 Q Do you know what this is?

18 A Yes. This is -- these are materials I was just referring  
19 to.

20 Q And do you recall meeting -- having the annual review  
21 meeting on or around January 26, 2018?

22 A Yes. Right around that time.

23 Q And can you describe for the Court just the setting that  
24 you recall about this meeting?

25 A Yes. This was always an in-person meeting, so this would

1 have been in Jim's adjacent conference room, with, again, me,  
2 Frank, Jim, Mark. I can't remember, it's possible that Sean  
3 Fox might have sat in, but I don't remember specifically.

4 Q Okay. Let's just take a look at some of the information  
5 in here. If we can turn to the second page, the executive  
6 summary.

7 A Okay. I'm there.

8 Q Do you see there's a bullet point that begins, The  
9 platform will continue experiencing operating cash shortfalls?

10 A Yes. I see that.

11 Q Can you just tell the judge what that and the bullet point  
12 underneath were intended to convey?

13 A Yes. So, by cash shortfalls, hopefully self-explanatory.  
14 On an operating basis, we're burning cash. And what the sub-  
15 bullet is saying is that overall operating income -- and by  
16 that I mean operating income across all of the affiliate  
17 Advisors -- is projected at, you know, positive \$.9 million.  
18 But on a standalone basis for HCMLP, it's negative 12.

19 Q Uh, --

20 A And I -- if I can add one more thing. The clause at the  
21 end there is just -- is -- this is -- this is kind of a  
22 tickler for Jim to remind him you have substantial other  
23 investment commitments. You're invested in private equity  
24 funds that call capital. So Highland is losing 12, but then  
25 you're also going to need to generate more cash to fund those

1 commitments as well.

2 Q Can you turn to Slide 6 in this deck, the one with Bates  
3 No. 308?

4 A I'm there.

5 Q Can you describe for the Court what this shows? Just  
6 generally?

7 A Yes. So this is a balance sheet, so it's a point-in-time  
8 look at the assets and liabilities of -- we're saying  
9 consolidated, meaning Highland -- it's in the -- it's  
10 contained in the Footnote 1. Highland, Highland Capital  
11 Management Fund Advisors, NexPoint, including its  
12 subsidiaries, Acis Capital Management, and then three other  
13 kind of rounding error-type Advisors: Falcon, Granite Bay,  
14 and Highland Healthcare Advisors.

15 Q And was it the practice in Highland at this time to look  
16 at the enterprise from a holistic point of view?

17 A Absolutely.

18 Q Okay. And if we could just flip some of the pages here,  
19 would the same holistic enterprise view be reflected on Slide  
20 11 and being in Bates No. 313?

21 A Let me just make sure I'm on the right slide. The -- it  
22 has Consolidated P&L --

23 Q Yes.

24 A -- with a footnote? Yes. That's correct. Same -- same  
25 view. Same entities incorporated.

1 Q Meaning -- does that mean that the view on this slide was  
2 looking at the profits and loss for the Highland enterprise at  
3 a whole -- as a whole, without regard to its component pieces?

4 A Correct. And along those same lines, all -- it's part of  
5 the reason we refer to them as intercompany. They're all  
6 intercompany, so they all just eliminate. So that activity  
7 isn't even shown on here because it all cancels each other  
8 out.

9 Q All right. We'll talk about that more in a moment. And  
10 the same would be true of Slides -- tell me if it's different  
11 or if you can confirm that the following slides are also  
12 presented on a consolidated basis: Slide 13, 14, 15, 16, 17,  
13 18?

14 A Um, yes, yes to all, although I'm not sure on 18, if you'd  
15 just bear with me for a moment.

16 Q Uh-huh.

17 (Pause.)

18 A It -- it appears 18 is consolidated, but I'm not a hundred  
19 percent sure. I'm 90 percent sure.

20 Q Okay. Can you go to Slide 29, please? Can you describe  
21 for the Court what Slides 29 to 30 -- through 33 convey, what  
22 type of information?

23 A Yes. So this was what I was referring to in terms of some  
24 of the -- a refresh on what happened over the course of the  
25 year. So, hey, Jim, here's -- here's what happened over the



1 course of the year from an HR perspective. Here are people  
2 that transferred roles. Here are people that were promoted  
3 during the year. Here's a view on headcount. I'm flipping  
4 from Slide 29 to Slide 30.

5 31, here's a summary of all the people we hired over the  
6 year. And, again, this is agnostic as to Highland Capital  
7 Management versus the other Advisors. This is looking at it  
8 all holistically. Although it is subdividing between our  
9 broker-dealer and everybody else, so I should -- I should  
10 point that out.

11 And then Slide 32, 2017 Terminations. Here's a summary of  
12 all the people that terminated over the course of the year.

13 Q Did Brian Collins participate in these meetings at all?

14 A He didn't participate in the meetings, but he would help  
15 on some of the document-gathering and helping me validate the  
16 accuracy.

17 Q Okay. Let's go to Slide 34, please. The first bullet  
18 point is about CLOs. Can you explain to the Court what you  
19 were conveying in the first bullet point about Acis CLOs?

20 A Yes. So what's being conveyed here was the current  
21 thinking at the time, which was that the likely outcome for  
22 the Acis CLOs -- and just for additional background, the Acis  
23 CLOs were CLOs managed by Acis Capital Management that were  
24 subadvised and shared services provided by HCMLP. And so what  
25 this bullet is saying is we expect that 3 through 6 are going

1 to reset, they're going to reset under Highland, and --  
2 directly or indirectly, and the reinvestment period and  
3 maturity is going to shift out by two and a quarter years.

4 Q Do you know if the expected reset was intended to have any  
5 implications for the shared services and subadvisory  
6 arrangement?

7 A Up until the reset, the assumption was that Highland would  
8 continue earning subadvisory and shared services, then post-  
9 reset it would be -- I don't frankly recall if it was direct  
10 or if it was indirect, but effectively Highland was going to  
11 retain the management fees on a go forward basis.

12 And I should point out, there is a second bullet here  
13 that's talking about new issuance. So it's assuming that CLOs  
14 continue to be churned out over the next several years and  
15 that -- and that all that AUM goes to HCMLP.

16 Q Okay. Can you go to the next slide, please? Can you  
17 describe generally what Slide 34 depicts? 35 depicts?

18 A Yes. I can. One moment. Yeah. So, 35 is depicting the  
19 revenue that's coming in from all the various funds. Again,  
20 this is Highland as well as the affiliate Advisors. And it's  
21 just breaking it out by either fund or it's lumping the 2.0  
22 and the 1.0 CLOs together to give you a picture of where's all  
23 the revenue coming in from the complex from all these  
24 different sources.

25 Q And what is the second rank, the Highland 2.0 CLOs? Do

1 you know what that's referring to?

2 A Yes. That's referring to the Acis deals that were assumed  
3 to be up for reset, 2.0 meaning the post -- post prices.

4 Q So am I reading this correctly that the Acis CLOs were  
5 expected to generate fees for Highland in 2018 of  
6 approximately \$9.7 million?

7 A Yeah, in that ballpark.

8 Q Okay.

9 A That's the projection.

10 Q And was that projected to be approximately 12 percent of  
11 Highland's entire revenue in 2018?

12 A The royal Highland. Not HCMLP, but the overall complex,  
13 yes.

14 Q Okay. As part of this presentation, did you and your team  
15 present forecasts?

16 A We did.

17 Q Okay. And are those forecasts in this deck?

18 A They are.

19 Q Okay. Let's go to Slide 36. That's entitled Assumptions  
20 in the Forecast. Can you just describe for the Court what  
21 assumptions are listed in the first piece concerning material  
22 intercompany arrangements?

23 A Yes. So, the first piece on intercompany is describing  
24 the HCMFA, NexPoint, and Acis relationships, and it's saying  
25 that at this time we're projecting -- or, we're assuming for

1 purposes of the forecast that HCMFA will pay 2.7 to Highland.  
2 NexPoint and subsidiaries will pay 6. That's the same 6 that  
3 we've already spent some time on. And then the third bullet  
4 point being Acis, saying that it'll continue to pay the then-  
5 rates in effect of 20 basis points subadvisory, 15 shared  
6 services. And then the Up to Reset is an allusion to the fact  
7 that once they reset it'll just -- it'll be to Highland and  
8 that mechanism goes away.

9 Q Okay. Let's go to Slide 44, please. Can you describe for  
10 the Court what Slide 44 is?

11 A Slide 44, it's looking at a three-year forward forecast  
12 for HCMLP. This is just HCMLP. Excuse me. So this is a  
13 single -- a single entity view. And so, as a result, you do  
14 have -- you have the intercompany agreements that are picked  
15 up in this agreement. And the total operating income number  
16 of 12 is -- is the very same that we were looking at on the  
17 executive summary.

18 Q And I see in 2019 the operating income is supposed to go  
19 -- projected to go from negative 12 to positive 46. Do I have  
20 that right?

21 A Yes.

22 Q And do you have an understanding as to what the cause of  
23 that \$58 million flip is?

24 A Yes. So it's primarily driven by the lines, the second  
25 line called Incentive Fees.

1 Q Uh-huh.

2 A And what we were using in this forecast -- again, it's  
3 just a forecast, you know, it's -- it's never going to be  
4 exactly right -- but this was assuming a monetization of MGM  
5 that would trigger a large fee in 2019. Obviously, that  
6 didn't happen, but that was what was assumed in the  
7 projections.

8 Q And if you remove that assumption, where does that --  
9 where does that leave Highland on a projected operating income  
10 basis for 2019?

11 A It would be -- it would be a dollar-for-dollar reduction,  
12 so you'd just take the 45,919 of operating less the 55,298.

13 Q Okay.

14 A So, call it -- call it 10 negative. I'm not going to do  
15 the math.

16 Q And these -- withdrawn. Does the 2018 projection of \$12  
17 million loss, does that take into account the \$6 million, --

18 A It -- it does.

19 Q -- or it does not?

20 A It does. It takes into account the \$6 million from  
21 NexPoint. It -- those -- that amount is a component part of  
22 the line that says Shared Services & Subadvisory Fee. So it's  
23 6 of the 10.

24 Q So is my math right that if the amount hadn't been  
25 increased from, let's say, 1.5 to 6, then the \$12 million loss

1 would have been increased --

2 A Be close to 17.

3 Q -- by 4-1/2?

4 A Yeah. Yes. Call it 16, 17.

5 Q Okay. Let's go to the next slide, please, which is Slide  
6 45. What's being depicted there?

7 A So, again, this is a -- going to a standalone view, so  
8 Highland Capital Management Fund Advisors standalone. And it  
9 -- it looks like this is also consolidating the broker-dealer  
10 that sits under it. But that's somewhat irrelevant. But it's  
11 depicting a three-year forecast for HCMFA. Again, '18, '19,  
12 '20. And it's got a line item for shared services expenses,  
13 which I believe is a reference to HCMLP, at least 2.7 of it,  
14 if not the full 2.8.

15 Q And there's a reference there to subadvisor fees, do you  
16 see that, for several hundred thousand dollars?

17 A I do.

18 Q Does that relates the Highland or to somebody else?

19 A No, no, that relates to -- there was a subgroup of -- I  
20 think there was around three at the time -- of funds that were  
21 subadvised by an actual -- an actual outside subadvisor. And  
22 so those are -- those are fees to that outside subadvisor, not  
23 fees to Highland.

24 Q As of the date of this deck, January 26, 2018, was HCMFA  
25 projected to pay any subadvisory fees to Highland?

1 A No.

2 Q Let's go to Slide 46, please.

3 A Okay. I'm there.

4 Q Is this just the same three-year P&L for, this time,  
5 NexPoint?

6 A Yeah.

7 Q Okay. And focusing your attention to the lines Subadvisor  
8 Fees and Shared Service Expenses, can you describe for the  
9 Court what those line items reflect?

10 A Yes. Those are reflecting amounts to HCMLP for  
11 subadvisory and shared services. And we've spent a lot of  
12 time talking about \$6 million, but this is the \$6 million.  
13 \$3,024,000 plus \$2,976,000. There's the six. So that's  
14 what's being assumed as far as the intercompany.

15 Q And do you recall that the subadvisory agreement was  
16 already in place at the time of this meeting?

17 A Yes. Yeah, it was.

18 Q Okay. And let's just -- let's just take a look at Exhibit  
19 130 quickly.

20 A Okay. I'm there.

21 Q Do you know what that is?

22 A 130. This looks to be a continuation of the chain that we  
23 were discussing earlier, going back and forth with the  
24 internal attorneys on having these agreements executed in the  
25 very early part of January and then culminating with the

1 actual execution of those agreements, it looks like, on  
2 January 11th of '18.

3 Q And are you specifically referring to Mr. Fox's email as  
4 of January 11th, the very last email in the chain, looking in  
5 reverse order?

6 A Yes.

7 Q Okay.

8 A That's right.

9 Q Okay. So let's talk about the subadvisory agreement for  
10 just a moment, if you can turn to Exhibit 5.

11 A Okay. I'm there.

12 Q And if you can -- if you can, just tell the Court what  
13 your -- do you have an understanding of what that document is?

14 A Yes. This is the subadvisory agreement between NexPoint  
15 Advisors, LP and Highland Capital Management, LP.

16 Q And can you turn to the page that ends in Bates No. 580?

17 A I'm there.

18 Q And do you -- are you familiar with the signatures on that  
19 page?

20 A Yes. It's Frank's. Frank Waterhouse.

21 Q Okay. And can you go back to the first page of the  
22 document and let the Court know if you have an understanding  
23 as to when this subadvisory agreement became effective?

24 A It became effective January 1st of 2018. But, as  
25 discussed, it was -- it was executed, you know, a little -- a



1 little less than two weeks later, but to be effective January  
2 1st of '18.

3 Q Okay. And if you can turn, please, to Section 2 on the  
4 page ending in Bates No. 570.

5 A I'm there.

6 Q And can you explain to the Court what Section 2 provides?

7 A So, Section 2(a) provides for a monthly fee in the amount  
8 of \$252,000.

9 Q And is that fee variable or fixed?

10 A No, it's fixed. It's just \$252,000 a month.

11 Q And is that -- do you recall if that's consistent with the  
12 number that was in your earlier email at Exhibit 130?

13 A I don't remember the exhibit number, but yes, it's  
14 consistent with the email.

15 Q Okay. Is it fair to say that this agreement is another  
16 agreement intended to execute on the direction that you  
17 received from Mr. Dondero?

18 A Absolutely.

19 Q Is there anything in the subadvisory agreement that's  
20 before you that concerns or relates to Highland's actual cost  
21 of providing subadvisory services?

22 A No.

23 Q Do you recall anyone ever suggesting in late 2017 or early  
24 2018 that NexPoint should only pay its allocable share of  
25 actual costs for subadvisory services?

1 A No. Nobody said that.

2 Q Okay. So the meeting takes place on or around January  
3 26th. Does anything happen to upset the projections or any of  
4 the information that you had just conveyed to Mr. Dondero and  
5 Mr. Okada?

6 A Yes. So, contemporaneous, within days of that, of that  
7 presentation, Acis is put into an involuntary by Mr. Terry.  
8 And so this is -- at best case, we understood that a critical  
9 fee stream was going to be tied up a while. And worst case,  
10 it might be -- it might be gone forever. And so definitely an  
11 important moment, and a big change relative to the  
12 projections, because, as you pointed out, there was a \$10  
13 million assumption in there that, like I said, at least  
14 temporarily is going poof, if not forever going poof.

15 Q And did you personally participate in discussions about  
16 how to address that development?

17 A Yes. So, you know, this wasn't a mystery to anybody, that  
18 Acis had just been put into involuntary, so by the beginning  
19 part of March we met again with Jim. Kind of a similar  
20 conversation to the December 2017 conversation of we're not  
21 going to get any Acis fees for a while, if not forever. We  
22 need help to operate. What do you want, you know, what --  
23 what do you want to do?

24 And the response was, well, just do the same thing that  
25 you guys just did for NexPoint. Put in place a subadvisory

1 agreement and -- and that's the -- it's not the solution  
2 because it doesn't -- it doesn't completely cushion the fall,  
3 but it at least mitigates the -- some of the loss that we  
4 would be experiencing.

5 Q And did you personally participate in the conversation and  
6 the follow-up to that meeting?

7 A Yes.

8 Q Okay. And do you recall whether a subadvisory agreement  
9 was created for HCMFA?

10 A It wasn't ultimately, no.

11 Q Okay. Let's turn to Exhibit 87. And I apologize. Before  
12 you look at that, when you say it wasn't, do you mean it  
13 wasn't drafted, or it was never executed?

14 A It --

15 Q If you recall.

16 A It was -- I don't remember if it was drafted. What I  
17 recall was that there was communication with in-house counsel  
18 to draft it and there were -- there were concerns expressed  
19 about whether that agreement would -- would work, for lack of  
20 a better term.

21 Q Okay. Do you recall how much was initially discussed that  
22 HCMFA would pay for subadvisory services?

23 A It was around \$5 million. I have a recollection of  
24 exactly \$5 million, but I have seen other emails that refer to  
25 \$450,000 a month, which annualizes to a little bit more than

1 5, around 5.4. But the number that I remember was 5, which  
2 was the -- \$5 million, which was the number that was  
3 ultimately landed on.

4 Q Okay. Did there come a time after this discussion with  
5 Mr. Dondero about duplicating that NexPoint subadvisory  
6 agreement for HCMFA, did there come a time when you learned  
7 that that wasn't a viable option?

8 A Yes. It was -- it was sometime in the late March, early  
9 April time frame. And the thinking going into that was this  
10 shouldn't be a very difficult exercise, you've already got a  
11 template, it's going to look exactly the same save for the  
12 number on the page. So the expectation was that that would be  
13 a pretty quick and easy process to get documented through  
14 Legal. But, you know, when concerns were raised, obviously,  
15 we had to pivot.

16 Q And do you recall what those concerns were?

17 A Yeah. So the concerns as I understood them were that our  
18 internal legal team, mainly Lauren Thedford, who is a -- she's  
19 an HCMLP employee and an officer of the Advisors, and the  
20 Funds, I believe. But she, she highlighted a potential issue  
21 that because it's -- it's subadvisory, that it would -- the  
22 only way to have an agreement like that ratified was going to  
23 be to go to the board in an in-person meeting. The next such  
24 meeting was going to be in June, later that year. And that --  
25 and that it couldn't be made retroactive. It had to only be

1 prospective.

2 Q And just take a look at Exhibit 87 now. Does that -- does  
3 that comport with the recollection you just described for the  
4 Court?

5 A I'm sorry. 87?

6 Q Yes.

7 A Okay. Ah, yes. Yes, it does. I was looking at the older  
8 part of the chain. But, yes, this is the email from Lauren  
9 saying that it's in person, it can't be made retroactive. So  
10 that's, you know, that's the problem.

11 And another problem is that it also means that the  
12 NexPoint agreement that was already in place doesn't work and  
13 that needs to be -- that needs to be fixed as well.

14 Q And what's the implications of being unable to use the  
15 subadvisory agreements under those circumstances?

16 A So, without being able to go back, you're talking about \$5  
17 million with respect to HCMFA and \$3 million with respect to  
18 NexPoint. And the earliest you're going to be able to  
19 implement that is the middle part of the year. So, call it \$8  
20 million times 50 percent is the -- is the implication there.

21 Q And you're getting those numbers by -- how are you getting  
22 those?

23 A Yeah. Sorry.

24 Q Yeah. It's a little shorthand.

25 A The \$252,000 annualizes to \$3,024,000. The \$416,000 for

1 HCMFA annualizes to \$4,994,000. So the sum of those two is  
2 approximately \$8 million per year. Fifty percent of the year  
3 is \$4 million.

4 Q Had -- was there any discussion prior to Ms. Thedford  
5 sending her mail on March 15th, had there been any discussion  
6 of using a model for the payment of subadvisory fees other  
7 than the subadvisory agreements that had been drafted?

8 A No, not that I can remember.

9 Q Had anybody expressed any concern prior to March 15th that  
10 the Advisors should be paying fees based on actual costs?

11 A No.

12 Q Had anybody done an analysis before March 15th about what  
13 the cost was to Highland for providing subadvisory services to  
14 the Advisors?

15 A No.

16 Q Okay. After getting this news from Ms. Thedford, what  
17 happened?

18 A Um, definitely a reaction. This is -- this is a problem.  
19 That as we just looked at, we're already operating quite  
20 negatively. We're no longer getting a fee stream from Acis.  
21 We're being told that we're not going to be able to start  
22 getting a fee stream from these other Advisors for several  
23 months, at the cost of millions more dollars. So this needs  
24 to be addressed.

25 Again, this is all in the spirit of one big happy family,

1 one complex, so the whole exercise itself seems somewhat  
2 silly, for someone who just wants to move money from his right  
3 pocket to his left pocket, to have to go through all this  
4 brain damage, but we need to go through the brain damage to  
5 get this done.

6 Q And did you see a draft of a payroll reimbursement  
7 agreement after March 15th?

8 A Yes. I think towards the end of April, to the best of my  
9 recollection.

10 Q And did you participate in discussions with Ms. Thedford  
11 about the terms and provisions of the draft agreement that you  
12 saw?

13 A Yes, I did.

14 Q And did you communicate with Ms. Thedford in writing about  
15 -- about that draft agreement that you saw?

16 A I did.

17 Q Okay. Can we turn to Exhibit 129, please? And I'm going  
18 to start at the beginning, which is at the page with Bates No.  
19 425. Did -- do you recall in mid-April that Mr. Fox sent you  
20 a draft of the payroll reimbursement agreement?

21 A Yes.

22 Q And can you review and then describe for the Court what  
23 you told Ms. Thedford after you obtained a copy of the initial  
24 draft of the payroll reimbursement agreement?

25 A Yes. So I think, similar to NexPoint, I had tasked Sean

1 with running it down through Legal. It looks like Sean was on  
2 vacation, so he passed it along to me to review as well. And  
3 my -- from email and from my recollection, recall the way that  
4 the agreement was stated being very clunky, because we don't  
5 have a way to actually track actual costs in any sort of  
6 scientific way.

7 And so I make the suggestion to Lauren that -- and it's  
8 kind of a parenthetical; it's not necessarily apparent in the  
9 email -- but can we just do this once? Can we do an estimate  
10 of cost as of some point in time, done in good faith, you  
11 know, with a reasonable estimate, and not have to do it ever  
12 again?

13 Because, again, there's not a way to really validate any  
14 of the assumptions in such an analysis, and all it's going to  
15 be doing is churning up a lot of work for people to do  
16 internally to track amounts that ultimately benefit Jim. It's  
17 just not a -- it's not a useful -- it's not a good use of  
18 time.

19 Q And is that essentially what you're -- is that a fair  
20 description of what you're saying to Ms. Thedford at 10:48  
21 a.m. on April 17th?

22 A Yeah. That's exactly right. Too much subject -- too much  
23 subjectivity. Too much time involved. We already know what  
24 the number is going to be. So this is creating a lot of  
25 unnecessary scrambling around.



1 Q And what did -- do you recall or can you read what Ms.  
2 Thedford said in response?

3 A So, she responds, she says she's open to changing the  
4 definition. There needs to be some method of determining  
5 amounts. To which I say, can we -- can we set it out as of  
6 the beginning of the agreement, have a schedule, never update  
7 that schedule unless -- with the only update ever being if the  
8 -- if the parties come to a consensus and want to change it at  
9 some point in the future.

10 Q And is it your understanding that that's what became the  
11 actual agreement that was signed?

12 A Yes.

13 Q And did you subsequently perform the -- create the numbers  
14 that are reflected in the email above on Pages 423 and the top  
15 of 424?

16 A I did.

17 Q Okay. Why did you create that?

18 A Well, you know, per the -- per the email chain, that was  
19 going to check the box for what we needed to check the box.  
20 So we were -- we were going to have a schedule that had  
21 percentages set out. And, you know, I was able to, you know,  
22 work through a spreadsheet and put percentages in that ended  
23 up resulting in the \$252,000 a month number for NexPoint and  
24 the \$416,000 a month number for FA.

25 Q Okay.

1 A HCMFA.

2 Q And when you are having these -- did you speak with Ms.  
3 Thedford beyond the emails, or does the emails --

4 MR. MORRIS: God bless you, Your Honor.

5 BY MR. MORRIS:

6 Q Or do the emails reflect the entirety of your  
7 communications?

8 A I think they reflect the substance of it. There may have  
9 been some -- some additional -- some minor additional  
10 discussion. I don't remember specifically.

11 Q And are these, are these allocations -- can I call these  
12 allocations? Is that fair?

13 A That's okay.

14 Q Okay. Are the allocations on this email the allocations  
15 that were ultimately adopted in what became Exhibit As to the  
16 two --

17 A Yes.

18 Q -- payroll reimbursement agreements?

19 A Yes.

20 Q Did anybody change it?

21 A No.

22 Q Did anybody ask you how you calculated the numbers?

23 A No.

24 Q Did anybody ask to see your work?

25 A No.

1 Q Did anybody suggest that maybe these allocations weren't  
2 right?

3 A No.

4 Q Did anybody -- did you have any discussion with anybody at  
5 any time as to how you came to these numbers?

6 A Not that I remember.

7 Q In this time period?

8 A No, not that I can remember.

9 Q Okay. At the top of Page 423, which is really the  
10 beginning of your email that contains the allocations, there's  
11 -- can you just read out loud what that sentence says or what  
12 those two sentences say?

13 A I'm sorry. It's this that starts, Here are the listings?

14 Q Yes.

15 A Yes. It says, Here are the listings for the reimbursement  
16 agreements. Monthly amounts should be \$416,000 for HCMFA and  
17 \$252,000 for NPA.

18 Q And how did you come up with those numbers?

19 A So, these were already-known numbers. The \$252,000 in  
20 respect of NPA, consistent with what we had talked about for  
21 the past several months and what was already in effect via the  
22 subadvisory agreement, and then the \$416,000 based on further  
23 conversation in the March time period where he was comfortable  
24 to do a \$5 million a year run rate payment from FA.

25 Q So the \$252,000 is the same \$252,000 that was in your

1 December email, in the January deck, in the subadvisory  
2 agreement, --

3 A Yes.

4 Q -- and now it's still there?

5 A Yes. Of course.

6 Q The allocations there, what information did you rely on to  
7 create those allocations?

8 A So, I relied on compensation information for the -- for  
9 the list of employees. And then the, in terms of the  
10 percentages, it was at the time, I believe, based in part for  
11 some people on AUM across the platform, and then for some  
12 other people it was just -- basically, just subjective  
13 percentages based on my general understanding of what those  
14 people tended to work on.

15 Q Did you -- did you speak to any of the dual employees to  
16 see if those allocations were accurate from their perspective?

17 A No.

18 Q Did you have any records that you could rely upon to  
19 confirm your subjective assessments?

20 A No. There were no such records.

21 Q If we wanted to know today how much time each dual  
22 employee spent working on matters for the Advisors, how would  
23 we create such an analysis?

24 A There's not a -- there's not a good way to do it.

25 Q Is there -- is there any way to do it?

1 A No. Not -- not any -- not any good way. The reason I'm  
2 hedging a little bit is, if it was important enough, you could  
3 talk to every single employee, ask them how they think they  
4 spend their time. And then even that's flawed, because  
5 people's compensation isn't necessarily tied to how they were  
6 -- to how much time they spend on something. They could have  
7 spent a little time on something, had a great return, got paid  
8 a huge bonus, and it has nothing to do with time.

9 So no matter how you do it, it's going to be incredibly  
10 subjective and really fatally flawed.

11 Q Is this fatally flawed?

12 A It's -- it's maybe flawed -- it's flawed from the  
13 standpoint that it has all those subjective assumptions baked  
14 into it. It's not fatally flawed from the standpoint that  
15 there's a -- there was a general effort to assess where people  
16 were likely spending their time.

17 Q Were investment professionals ever asked to keep time  
18 entries so that actual costs could be accurately calculated?

19 A No.

20 Q Did you ever update Exhibit -- withdrawn. So I think  
21 you've testified, these -- this analysis became the Exhibit  
22 As. Do I have that right?

23 A Yes, that's right.

24 Q Okay. Did you ever update Exhibit A at any time from the  
25 date of this email until today?

1 A No.

2 Q Did anyone ever ask you or instruct you to update Exhibit  
3 A from the time you sent this email to today?

4 A No.

5 Q Are you aware of anybody at Highland or the Advisors ever  
6 making any effort --

7 A If I could take a step back, there was -- there was a  
8 request from Lauren in the early 2020 time range. So I should  
9 be fair, she did ask the question, and I basically pushed back  
10 and said that's a ridiculous exercise, we should do it a  
11 different way.

12 Q Okay.

13 A I didn't really take that as a request to update it, but  
14 she was -- she was implicitly asking for that information, --

15 Q All right.

16 A -- so I should qualify that.

17 Q We'll take a look at that. You're aware that a number of  
18 investment professionals, these dual employees, were  
19 terminated even at the time you wrote this email, right?

20 A Yes. Yes.

21 Q Why would you include dual employees in this analysis if  
22 they'd already been terminated?

23 A So, I'm not sure if it's in this email chain, but as I  
24 mentioned in one of the email chains, we were going to be  
25 doing a roster as of a specific point in time, that time being

1 the effective date of the agreement, or January 1st.

2 Q And I think, just to be clear, if you can look back at  
3 your April 17 email sent at 10:56 a.m., is that the one you're  
4 referring to?

5 A 10:56? Yes. That's -- that's exactly right. That's the  
6 one.

7 Q And can you just explain to the judge what you're telling  
8 Ms. Thedford in that email?

9 A Yes. So I'm really laying out what would ultimately be  
10 the agreement, which is that we're going to have a schedule,  
11 it's going to be as of January 1st, it's going to have the  
12 roster that was in place at that time, and that's -- that's  
13 where the schedule's going to originate, and we'll -- we're --  
14 we're not planning to update. We're only going to perform  
15 this exercise once.

16 Q Okay. Did anyone express any concern to you that you were  
17 using a -- you were setting the costs of subadvisory services  
18 based on employees that were known to have already been  
19 terminated?

20 A No. No concern.

21 Q Did that ever come up before December 2020?

22 A I don't know if I would go so far as December. Certainly,  
23 by summer of 2020, no one had ever brought it up.

24 Q Okay. During the two-year period that Mr. Dondero was in  
25 control of Highland and the Advisors, did anybody ever ask you

1 if that number should be adjusted to take into account  
2 terminated dual employees?

3 A No.

4 Q Okay. Do you recall that, after the payroll reimbursement  
5 agreements are entered into, that dual employees continue to  
6 be terminated throughout 2018?

7 A Yes.

8 Q And do you have a recollection to the magnitude of the  
9 dual employees on the Exhibit As that were terminated as of  
10 December 2018?

11 A Yes. It was -- it was around ten, nine or ten.

12 Q Okay. Can we just take a quick look at Exhibit 14,  
13 please?

14 A 14?

15 Q And I'll represent to you that these are the Advisors'  
16 responses to interrogatories. If you could turn to Page 12 of  
17 18.

18 A Okay. I'm there.

19 Q Okay. Do you recall that this list of people here that  
20 continues to the top of the next page, that's the list of --  
21 is that the list of dual employees?

22 A It appears to be. I can't quickly reconcile it, but it  
23 looks to be the same list.

24 Q Okay. And do you have any reason to doubt the dates of  
25 termination set forth in the Advisors' response to



1 Interrogatory No. 3?

2 A No, no reason to doubt any of those.

3 Q Okay. And if you can turn the page to Interrogatory No.  
4 4, do you see the Advisors stated that they were, quote,  
5 generally aware of the employees' terminations and departures  
6 as they occurred?

7 A Yes.

8 Q And is that consistent with your understanding of how  
9 information was shared and conveyed within Highland?

10 A Yes. Absolutely. Both informally and formally.  
11 Informally, you had everyone sharing the same office space,  
12 sitting next to each other. More formally, there were --  
13 there were things like monthly reports that would go out,  
14 again, agnostic as to HCMLP versus NexPoint or others, just  
15 looking at it all as a complex, that would be distributed  
16 pretty broadly to -- to, you know, among others, officers of  
17 HCMFA and NexPoint, but also including a pretty wide swath of  
18 the rest of the overall complex for multiple different  
19 entities.

20 Q Okay. So do you recall that in December 2018 the payroll  
21 reimbursement agreements that had just been signed the prior  
22 May were amended?

23 A Yes.

24 Q Okay. Did you participate in discussions concerning those  
25 amendments?

1 A Yes.

2 Q Can you describe for the Court what you recall about the  
3 discussions that led to the execution of the December 2018  
4 amendments?

5 A Yes. I remember a meeting early December of 2018,  
6 early/mid-December, I can't remember the specific date, with  
7 -- with Jim and Frank. I don't believe anyone else was in  
8 that meeting. And part of the concern expressed in that  
9 meeting was that NexPoint in particular, but both Advisors,  
10 but particularly NexPoint, taxable income was -- was looking  
11 like it was running a little too hot for 2018. Too hot as in  
12 too high, so too much tax liability. And, you know, should  
13 there be -- what can be -- what can be done over the course of  
14 the next several weeks to generate taxable deductions for  
15 those Advisors?

16 Q And what was the solution?

17 A So, the solution was to amend the two payroll  
18 reimbursement agreements. I don't think we got into that  
19 level of detail in the meeting with Jim, but when we -- we  
20 took that away and worked with internal Legal, the amendment  
21 that was ultimately produced was just an amendment to add an  
22 additional amount for both of the Advisors in the sum of 2.5  
23 in the aggregate. And the split amount was 1.3 and 1.2 to the  
24 two respective Advisors. I can't remember which one was 1.3  
25 and which one was 1.2.

1 Q Okay. Let's take a look at Exhibit 7, please. Can you  
2 tell the Court what that is?

3 A Yes, it's the amendment itself. And I can clarify that  
4 the 1.3 was for NexPoint Advisors, the 1.3 of additional  
5 annual costs as it's defined in the amendment. And that tells  
6 me that the identical agreement for Fund Advisors was also put  
7 in place except with the amount being 1.2 even.

8 Q Okay. Did you update Exhibit A before executing -- before  
9 Mr. Waterhouse executed this document?

10 A No.

11 Q Do you know if anyone took any steps to try to determine  
12 HCMLP's actual costs of providing front office services before  
13 signing this?

14 A No.

15 Q Did you do a true up?

16 A No.

17 Q Did you ever do a true up in your life?

18 A I suppose I've done true ups, but not as it pertains to  
19 this agreement. This was -- this was a mechanism to send  
20 another \$2-1/2 million of cash --

21 Q Did you --

22 A -- from these Advisors.

23 Q Did you tell Dustin Norris at any time that the amounts  
24 set forth in the amendments were the result of a true up?

25 A Not that I remember. I'm sure I told him that there was

1 an end-of-the-year amendment, so it's possible that he mistook  
2 me or misunderstood. But no, never a true up. This was an  
3 end-of-the-year amendment.

4 Q Do you know whether the \$2.5 million, or the amount that  
5 each of the Advisors paid, was that in any way based on any  
6 assessment of actual costs?

7 A No. (Pause.) If I can -- the answer is no, but if I can  
8 expand on that. There wasn't an analysis done. However, we  
9 had a current view of who's making money and who's not making  
10 money. And the reality is that, at this point in time, much  
11 of the revenue at Highland Capital Management, LP is coming  
12 from these intercompany agreements. Highland Capital  
13 Management, LP is losing money hand over fist. The other  
14 Advisors are making money.

15 So that's not an analysis, obviously, that 2.5 is the  
16 right number, but it tells you that it's directionally right,  
17 because these are effectively the same people doing the same  
18 type of business for the same types of client, earning a fee.  
19 In what -- on what planet does one of those operate at a  
20 massive operating loss while the other two operate really  
21 strongly?

22 Q Did anybody suggest that it was terribly unfair that  
23 Highland was performing these services at an operating loss?

24 A I don't -- no. I don't remember anyone saying that.

25 Q Was there any guarantee in any agreement that you're aware

1 of that prevented Highland from incurring operating losses  
2 through the performance of these intercompany agreements?

3 A No.

4 Q By the time Highland filed for bankruptcy in October of  
5 2019, more investment professionals or dual employees had been  
6 terminated, correct?

7 A Yes. A handful. Maybe four or five.

8 Q And do you --

9 A In that area.

10 Q Do you have a recollection as to how many of the dual  
11 employees, roughly how many of the dual employees had been  
12 terminated in the 21-month period between January of 2018 and  
13 the end of September 2019, just prior to the petition date?

14 A It was -- it was on the magnitude of half.

15 Q So roughly half of the dual employees were already gone?  
16 During that period, did anyone request an analysis of actual  
17 costs?

18 A This is around the time of the petition date?

19 Q Yep.

20 A Um, --

21 Q Up to the petition date.

22 A Up to the petition date? No.

23 Q Okay. Up to the petition date, did anyone request that  
24 Exhibit A be updated?

25 A No.

1 Q Up to the petition date, did anybody ever suggest that the  
2 Advisors should only be paying the actual costs under the  
3 payroll reimbursement agreement?

4 A No, other than the amounts were fixed per the agreement,  
5 so that what's had been paid all along.

6 Q In fact, do you recall if, during this two-year period  
7 when Mr. Dondero was in control, the Advisors made monthly  
8 payments under the PRAs that differed in any way from the  
9 initial amounts set forth in those agreements?

10 A No. They paid exactly the amounts, those amounts each  
11 month.

12 The one caveat on that is, because it was executed a few  
13 months in arrears, I think there was some sort of a catch-up.  
14 But notwithstanding that initial catch-up, it was exactly the  
15 same amount per the agreements every single month.

16 Q And did that practice continue after the bankruptcy as  
17 well?

18 A Yes. It continued until November of 2020.

19 Q And what happened in November?

20 A So, on November 30th, there were notices of termination of  
21 the shared services agreement, and shortly thereafter there  
22 was a directive that I understood to have come through Mr.  
23 Dondero to stop all payments.

24 Q Do you have an understanding as to who that directive was  
25 given to?

1 A Yes. To Frank.

2 Q And did Mr. Waterhouse follow that directive?

3 A Yes. He conveyed that to the accounting team, and -- in  
4 uncertain terms, that that's the -- that's the directive from  
5 Mr. Dondero.

6 Q So when Mr. Dondero wanted the payments stopped, was he  
7 able to effectuate that desire?

8 A Yes.

9 Q Okay. So, Highland files for bankruptcy in October 2019.  
10 Were you given any instructions by anybody concerning the  
11 continued administration of these agreements post-bankruptcy?

12 A I don't remember specific to these agreements, but more  
13 generally there was a business as usual, keep -- Team, keep  
14 doing what you're -- what you've been doing. That was the --  
15 that was the go-forward direction.

16 Q Do you recall the intercompany agreements being the topic  
17 -- a topic of discussion with the UCC and FTI after the  
18 bankruptcy filing?

19 A Yes. It was a -- it was a very -- it was immediately a  
20 point of issue. I had conversations with Fred Caruso as well  
21 as Jack Donoghue from the DSI team. And it was my  
22 understanding that this was a -- this was an issue that was  
23 very hot on the minds of both the UCC as well as their  
24 financial advisors, FTI, and that there was -- there was going  
25 to be -- there was going to need to be some work done to get,

1 you know, help them get comfortable with where we stood on  
2 those agreements.

3 Q When you say the issue was hot, can you just explain for  
4 Judge Jernigan specifically what the hot issue was, as you  
5 understood it?

6 A Yes. So, I mean, the hot issue was really just that these  
7 were all agreements with affiliates. These are -- these are  
8 creditors who have been fighting with Jim for years. And the  
9 fear on their part would have been these are wildly  
10 unprofitable contracts for Highland, value is siphoning out to  
11 these other advisors that he owns and controls and that are  
12 separate and apart from the bankruptcy, so if that is in fact  
13 happening, we, the UCC, need to intervene quickly.

14 Q Did you undertake any analysis of these contracts in  
15 response to the issues and concerns raised by the UCC?

16 A Yes.

17 Q And who did you work with on that analysis?

18 A I worked with a number of people. That included the two  
19 gentlemen from DSI that I just mentioned, Fred and -- Fred and  
20 Jack, as I recall. Frank, internally, as well as Isaac. And  
21 then it was my understanding -- I don't know that I had direct  
22 conversations with Scott Ellington, but it was my  
23 understanding that he had at least -- kind of was aware of the  
24 analysis. Put it that way.

25 Q Okay. Can you turn to Exhibit 144, please? And can you



1 tell the Court what's depicted on that analysis there?

2 A So, this is -- sorry. This is a -- this is an early  
3 iteration of that analysis sent to Isaac with the overall  
4 summary of the output of that analysis. And I'd be happy to  
5 walk through it.

6 Q Yes, please.

7 A Okay.

8 Q Well, let me try and speed this up a little bit. Can you  
9 just explain for the judge the portion of the analysis that  
10 deals with the intercompany agreements?

11 A Yes. So, the portion that deals with the intercompany  
12 agreements is, if you have it in front of you, it's the top --  
13 it's the top box. And that box is summarizing what was being  
14 paid and charged under those agreements. It's the four  
15 agreements -- there's technically five here because the  
16 NexPoint and NREA are both being included as a single number.  
17 But this box is showing you the 6 that's being charged to  
18 NexPoint and then the 8.6 that's being charged to Fund  
19 Advisors, broken out between five of -- we're calling it  
20 investment support fee here, but that's a reference to the  
21 PRA. And then 3.6 of shared services. So a total of 14.6  
22 being charged.

23 And then the other number that I suppose indirectly  
24 pertains to the agreements is the number directly below that  
25 of estimated cost to provide services of 16.9.

1 Q Okay. So, under this analysis, how does the cost of  
2 providing services under the intercompany agreements compare  
3 with the revenue?

4 A So, the cost is higher by approximately \$2.3 million,  
5 which is just the 16.9 less the 14.6.

6 Q Okay. And why is that 16.9, why is there a, you know,  
7 really a reduction of \$900,000 to the 1.4?

8 A Yes. So this is -- you know, with this being a hot issue  
9 for the UCC, projecting this in the best possible light, there  
10 were -- Highland had a few other small shared services  
11 agreements with other parties that it was generating it looks  
12 like less than a million dollars a year of shared services  
13 revenue.

14 So, for presentation purposes, the takeaway is,  
15 notwithstanding that Highland might be -- might, again, very  
16 subjective, might be losing \$2.3 million on these contracts  
17 collectively, well, we're getting some fees from other places,  
18 too, so it's not really 2.3, it's really 1.4, which -- which  
19 is a little bit of a stretch.

20 Q Until the time that you prepared this analysis for the  
21 UCC, had you ever undertaken any attempt to try to look at how  
22 the costs of providing services compared to the revenue under  
23 the intercompany agreements?

24 A No. No, this was the -- this was the first.

25 Q Until the UCC made this request, had anybody in the world

1 ever asked you at any time whether you could analyze the costs  
2 under the intercompany agreements as compared to the revenues?

3 A No.

4 Q Okay. Did you give this document to the UCC?

5 A Not this document, no.

6 Q How come?

7 A So, like I said, this was an iteration. We're within a  
8 few weeks of having filed. So this analysis continued to get  
9 refined over the next couple weeks. And ultimately an updated  
10 version was presented to FTI in the offices in December of  
11 '19.

12 Q Okay. Can you tell me how you calculated, how you -- it  
13 says estimated costs to provide services. What's -- how do  
14 you get to that \$16.9 million number?

15 A Yeah. So, the methodology that was used, and I don't  
16 think I'm underestimating when I said I mentioned this to FTI  
17 probably 50 times in the thee-hour call -- was goalposts.  
18 Subjective ranges of how people might have been spending their  
19 time around the time of the bankruptcy.

20 So we took a September -- sorry. We took an October 15th  
21 roster at the time and we put -- we put big ranges on people.  
22 This, you know, Person A, they might be spending between 30  
23 and 70 percent of their time on NexPoint-related matters. And  
24 so we had a low end of the goalpost and a high end of the  
25 goalpost. And the sausage that's being made to have the 16.9

1 spit out is the midpoint of those huge goalposts.

2 Q Did you do this analysis only for the dual employees, or  
3 did you do it for all employees?

4 A Everybody. And also including the people that were  
5 brought in to replace the dual employees that had left between  
6 2018 and 2019.

7 Q Does this have anything to do with an analysis of the  
8 actual costs of any particular contract?

9 A Only in the sense that all the contracts are spelled out.  
10 It's not necessarily apparent on this page.

11 Q Uh-huh.

12 A But they are, they are spelled out within the body of the  
13 analysis.

14 Q And when you did the analysis for the payroll  
15 reimbursement agreements, did that include -- did that exclude  
16 all of the terminated employees?

17 A It excluded anybody that would have terminated up until  
18 the petition date.

19 Q Okay. And did you have a conversation with the UCC about  
20 what was being paid under the agreements at that time?

21 A Not with -- not with the UCC. But we -- but we met with  
22 FTI, their financial advisor, in December and discussed, you  
23 know, what was being paid at the time.

24 Q Okay. Did you modify this analysis in the future?

25 A The updated analysis that was done was from -- I just want

1 to make sure I'm on the same page -- but from this November  
2 iteration to Isaac for the actual version that was presented  
3 to the -- to the -- to FTI.

4 Q Okay.

5 A In December. Mid-December of 2019.

6 Q Okay. Let's go to --

7 THE COURT: Mr. Morris, I had hoped to --

8 MR. MORRIS: Yes?

9 THE COURT: -- break for lunch when the direct is  
10 over. How much more, do you think?

11 MR. MORRIS: I've got a bit. I would suggest that we  
12 break for lunch now. I would respectfully request that we try  
13 to limit that to maybe a half hour or 45 minutes, if we could.

14 THE COURT: Well, it's easier for us to take a short  
15 lunch break than it is for you all.

16 MR. MORRIS: Yeah.

17 MR. RUKAVINA: Your Honor?

18 THE COURT: Mr. Rukavina?

19 MR. RUKAVINA: Your Honor, I think the cafeteria  
20 downstairs -- the cafeteria downstairs is closed, so we're  
21 going to -- we didn't bring a box lunch, not knowing that, so  
22 --

23 THE COURT: Okay.

24 MR. RUKAVINA: We'll go to the nearest place, though.

25 THE COURT: Okay.

1 MR. RUKAVINA: Post-pandemic, I'm not even sure  
2 what's here anymore.

3 THE COURT: Well, let's take a 45-minute break.  
4 We'll come back at 1:30.

5 MR. MORRIS: Okay.

6 THE COURT: Okay.

7 MR. MORRIS: Thank you, Your Honor.

8 THE COURT: Thank you.

9 THE CLERK: All rise.

10 (A luncheon recess ensued from 12:45 p.m. to 1:35 p.m.)

11 THE CLERK: All rise.

12 THE COURT: All right. Please be seated. We're  
13 going back on the record in the Highland matter. Let's see.  
14 Are we ready to proceed?

15 MR. MORRIS: Yes, Your Honor.

16 THE COURT: Okay. Mr. Klos, you're still under oath.

17 THE WITNESS: Yes.

18 THE COURT: Thank you.

19 MR. MORRIS: Okay. May I go ahead, Your Honor?

20 THE COURT: You may.

21 MR. MORRIS: Okay.

22 DIRECT EXAMINATION, RESUMED

23 BY MR. MORRIS:

24 Q Mr. Klos, just to kind of reset after the lunch break,  
25 before we left we had looked at a November 2019 analysis that

1 you had prepared and had shared with Isaac Leventon. Do you  
2 remember that?

3 A Yes.

4 Q And did you revise that analysis in December of 2019?

5 A Yes.

6 Q Can you turn to Exhibit 145 in your binder? Oh, you know  
7 what, hmm, I think we need Ms. -- oh, no.

8 THE COURT: Mine says, Document provided in native  
9 format.

10 MR. MORRIS: Yes. Okay. So we're just going to have  
11 to wait a moment for Ms. Canty, because that's an Excel  
12 spreadsheet.

13 THE COURT: Okay.

14 MR. MORRIS: So I'm going to cross my fingers and  
15 hope --

16 MS. CANTY: Which document, John? I'm sorry.

17 MR. MORRIS: 145.

18 (Pause.)

19 MS. CANTY: I'm sorry, John. I'll need a minute for  
20 that one. It's not in my -- yeah, I'll need a minute on that  
21 one.

22 MR. MORRIS: Okay.

23 MR. RUKAVINA: John, we have it ready right now, if  
24 you want.

25 MR. MORRIS: If you can -- in hard copy, or you can

1 put it on the screen?

2 MR. BERGHMAN: Well, I have to be able to share my  
3 screen on WebEx.

4 MR. MORRIS: Yeah.

5 MR. RUKAVINA: We just printed it out and just  
6 brought it to court.

7 (Pause.)

8 MR. RUKAVINA: I mean, yeah, John, if you want Thomas  
9 to screen-share, we can put it up.

10 MR. MORRIS: You know, I'm just going to wait for Ms.  
11 La Asia, and I'm going to -- I'm going to detour for a second  
12 --

13 THE COURT: Okay.

14 MR. MORRIS: -- while we wait for her.

15 THE COURT: Okay.

16 BY MR. MORRIS:

17 Q Mr. Klos, do you remember having a conversa... or,  
18 communicating with -- with Ms. Thedford in approximately  
19 January of 2020 concerning the payroll reimbursement  
20 agreements?

21 A Yes.

22 Q And do you recall generally -- so we're going to just jump  
23 a little bit in time, we're going to come back to your revised  
24 analysis in December of 2019. But after you prepared that, do  
25 you recall talking to Ms. Thedford about the payroll



1 reimbursement agreements?

2 A Yes, I do.

3 Q And what do you recall about that?

4 A I recall, generally speaking, around that January time  
5 frame, the Retail Board that's the trustees over the Retail  
6 Funds understandably was asking questions about who's  
7 providing services and digging in maybe more than they had  
8 previously.

9 And one of the questions and where I got pulled into it  
10 with Lauren was asking about the schedule, the Schedule A, if  
11 we're able to provide an update to the Retail Board on that,  
12 on that schedule, to which I basically responded to say it  
13 doesn't exist. You know, again, as a refresher from when we  
14 put this agreement in in the first place, this was a -- this  
15 was a one-and-done deal. This was something that we were  
16 going to do as of January. We can be more general and say,  
17 you know, these are the amounts that are being paid for these  
18 services, but not get to the granularity of employee by  
19 employee.

20 Q So your recollection is that this was an exchange that was  
21 intended to provide information to the Retail Board; is that  
22 right?

23 A That's my recollection.

24 Q All right. Can you go to Exhibit 151 in your binder?

25 Okay. And do you see Lauren's email at the bottom of the

1 first page? She's got some boxes there.

2 A Uh-huh. Yes.

3 Q And do you recall what -- what it is she was asking to be  
4 done here?

5 A Yes, although just give me one moment to --

6 Q Yeah. Take your time.

7 A -- to refresh myself on this one.

8 Q Sure.

9 (Pause.)

10 A Yeah. So, this is the -- oh, this is actually -- this is  
11 an interesting example. So this is -- just starting at the  
12 back of the chain, this is that monthly process that we were  
13 describing earlier with the effective headcount report that's  
14 -- that's pushing out to a number of people within the  
15 organization anybody who is termed hired during that period.  
16 And so, responding to that email that would have gone out  
17 every month, Lauren is saying to Brian and Kelly, who are the  
18 HR department at Highland, we have a request from the Retail  
19 Board. You know, they want to understand the contractual  
20 employer, the ultimate payor, and their starting point is  
21 going to be -- is going to be headcount. So, you know, I  
22 explained that the payment is accomplished through the shared  
23 services and the expense reimbursement. That's a reference to  
24 the PRAs, as we've been describing them.

25 Q Uh-huh.

1 A And then Lauren asked me to fill out a chart that says --  
2 although actually I'm not sure if this was directed at me or  
3 HR -- but saying, can we have a list of employees, show their  
4 contractual employer? And then she's asking for, can we do  
5 the percentages like you did for Schedule A? And I'm sorry,  
6 this is a lot of background, but it's helpful for me to see  
7 it. Where I say, basically, it doesn't exist. It was a  
8 point-in-time estimate.

9 And that's the email that's at 11:45 a.m., where I say,  
10 this was a point-in-time estimate. January 1. Estimate is --  
11 is definitely the word.

12 Q Can you just read the email?

13 A Sure. Sure.

14 Q I'm sorry to interrupt, but --

15 A Sure. Sure. Sure.

16 Q -- let's make sure the record is clear.

17 A Yeah.

18 Q Go slowly, because --

19 A Yeah. Yeah.

20 Q -- I know that you know this stuff, but Judge Jernigan  
21 didn't live it like you did.

22 A Yes. Yeah.

23 Q So can you just read your 11:45 a.m. email to Ms.  
24 Thedford?

25 A Yes. So, in response to Lauren asking, wouldn't this just

1 be the Exhibit A percentages, I say, Those were a point-in-  
2 time estimate as of beginning of 2018. Half the people are  
3 gone now. If you were to reallocate them, all their  
4 percentages, all the percentages would be different. On top  
5 of that, we don't have anything comprehensive that is  
6 comparable for back office people. So the only thing we can  
7 really provide is a stale percentage on a small subset of the  
8 overall population. It would be much more logical to do  
9 Yes/No and then have a -- and then as a blanket statement say  
10 that NPA/HCMFA pay x and y dollars annually to HCMLP for these  
11 employees' services and overhead.

12 Q And from your perspective, is that consistent with the  
13 email communication and exchange you had with Ms. Thedford in  
14 April of 2018 before the payroll reimbursement agreements were  
15 signed?

16 A Yes, it's consistent.

17 Q And did -- did Ms. Thedford accept your response?

18 A Yes. She said, Got it. Thanks. And I don't remember  
19 ever having any follow-up beyond that.

20 Q Okay. So did -- do you know, to the best of your  
21 knowledge, did Highland or the Advisors ever provide to the  
22 Retail Board any updated analysis of the allocation of costs?

23 A No.

24 Q To the best of your recollection, did Highland or the  
25 Advisors ever provide to the Retail Board any assessment of

1 the costs that the Advisors were bearing under the payroll  
2 reimbursement agreements?

3 A No, not specifically. No. No. The answer is no.

4 Q And why is it not specifically?

5 A Because, as part of the 15(c) process that happens every  
6 year, there is some disclosure to the board about the  
7 profitability of the Retail Advisors. And so kind of implicit  
8 in that is some of the underlying information from what  
9 they're paying under these -- the PRAs and the SSAs.

10 Q And --

11 A So, that's why I was a little hesitant there.

12 Q And so I really appreciate the specificity. Within the  
13 analysis that you're thinking of, would the flat monthly fees  
14 that were paid under the payroll reimbursement agreements,  
15 would that be one component of the profitability of the  
16 Advisors?

17 A Yes.

18 Q And that's what you were referring to, --

19 A That's right.

20 Q -- right?

21 A That's right.

22 Q Okay. Let's go back. Now we've got the document up on  
23 the screen. This is Exhibit 145. Can you just describe for  
24 the Court what's happened here? And, again, just to level  
25 set, this is an update of the analysis that we looked at

1 before lunch that you did in November, right?

2 A Yes.

3 Q What's -- what's changed? What is this?

4 A Yes. So this is the same summary output in terms of the  
5 overall presentation. I'm looking at these side by side, so  
6 I'll try to -- try to walk through.

7 Q Uh-huh.

8 A But you have the same top box with the same number, 14.6.  
9 This is what's being charged, \$14.6 million, across the -- the  
10 several contracts.

11 Q Uh-huh.

12 A You have the same line just below it of estimated cost to  
13 provide services. This number has come in between iterations,  
14 so what was 16.9 on the previous analysis is now 16.1.

15 And then the other difference that's rolling through here  
16 is that there is another offset that doesn't really have,  
17 really, relation to these agreements, which is an offset of  
18 nondebtor employees that are -- were providing services. So  
19 that's the -- that's the .9. And it looks like we did a sign  
20 flip on the -- on the shared services agreement.

21 So, net-net, our loss went from -- estimated loss went  
22 from 2.3 on the original analysis to 1.5. And then when you  
23 start to take in these factors that are outside of the  
24 agreements, we picked up another \$900,000 of offsets.

25 And this was the version that was ultimately presented to

1 FTI, showing that -- what, net, net, net, with all the -- with  
2 all the disclaimers about subjectivity, these shared services  
3 agreements -- and when I say shared services, I'm lumping in  
4 the lot of them -- all of the intercompany are kind of a net,  
5 it's kind of a net neutral. It's basically a breakeven,  
6 understanding that there's tremendous subjectivity.

7 Q And did you have a goal? Like, were you trying to  
8 accomplish anything other than running numbers when you  
9 prepared this analysis for the UCC?

10 A Yeah. Absolutely. The goal here was to be able to, in  
11 good faith, be able to come up with an analysis that we could  
12 share with the UCC that would effectively buy time in the  
13 bankruptcy process. We were still very early. We understand  
14 Jim Dondero was working really hard to come to some sort of a  
15 resolution. And we really wanted space before something  
16 drastic would happen. So there was definitely a bias in this  
17 exercise to put the profitability of these contracts in the  
18 best possible light that we could and still -- and still have  
19 our credibility.

20 Q Okay. I appreciate that. So, in the span of the one  
21 month, the difference between the -- the deficit or the loss  
22 under the intercompany agreements was reduced by \$800,000,  
23 right? 6.9 to -- \$800,000, right?

24 A \$800,000. Yeah. 16.9 to 16.1.

25 Q And you got there solely by adjusting the expense side,

1 right?

2 A Correct. Correct. The fee side stayed exactly the same.

3 Q Right? Because the fee side is fixed and that can't  
4 change, right?

5 A Correct. That's the 15.6 --

6 Q Okay.

7 A -- in the box in both analyses.

8 Q And so did anything actually happen between November and  
9 December to change the expenses?

10 A No. I think we had one employee who left right at the end  
11 of December who was a -- not a highly-compensated employee.

12 Q So that -- so that the difference is the result solely of  
13 the change in assumptions that you were making; is that fair?

14 A Right. More tweaking and -- yeah, that's right.

15 Q Okay. And can -- okay. Fine. So you prepared this  
16 analysis. You give it to the UCC. You speak with Ms.

17 Thedford. We looked at that. And I'm just trying to finish  
18 this up. Do you recall that at the end of November Highland  
19 had given notice of termination of the shared services  
20 agreements?

21 A Yes.

22 Q Okay. Do you recall the very next day you exchanged some  
23 emails with Dustin Norris?

24 A Yes.

25 Q You knew Dustin, right?



1 A Yes.

2 Q Okay. And how did you know him?

3 A We -- we've worked together for a long time. Never  
4 particularly closely, but he was hired at Highland in the  
5 2010-2011 time frame, and then a few years in moved to  
6 Highland Capital Management Fund Advisors. And then in 2019  
7 transferred again from Highland Capital Management Fund  
8 Advisors to NexPoint Advisors, LP. And so we've interfaced  
9 from time to time on a variety of issues.

10 Q Do you have an understanding of what his role is at the  
11 Advisors?

12 A Yes. You know, generally speaking, marketing and  
13 distribution and investor and wirehouse interface for the  
14 (inaudible) funds, as well as for some of the private  
15 offerings done through NexPoint.

16 Q To the best of your recollection, did Mr. Norris  
17 participate in any way in the discussions in late 2017 through  
18 May 2018 about the creation of these agreements and the  
19 economic relationship between the Advisors and Highland?

20 A No.

21 Q To the best of your recollection as you sit here today,  
22 did Mr. Norris play any role at all in formulating, drafting,  
23 or administering the subadvisory agreements that were  
24 originally prepared for NexPoint and HCMFA in early 2018?

25 A No.

1 Q To the best of your recollection, did Mr. Norris play any  
2 role at all in the formulation, drafting, or administration of  
3 the payroll reimbursement agreements?

4 A No.

5 Q To the best of your recollection, did Mr. Norris play any  
6 role in formulating, drafting, or executing the amendments to  
7 the payroll reimbursement agreements in December 2018?

8 A No.

9 Q To the best of your recollection, did Mr. Norris play any  
10 role at all in the formulation, drafting, or administration of  
11 the NexPoint or HCMFA shared services agreements?

12 A No.

13 Q Prior to December 2020, had you ever discussed with Mr.  
14 Norris how the amounts paid under the payroll reimbursement  
15 agreements were calculated?

16 A Not that I can remember, no.

17 Q Prior to December 2020, had Mr. Norris ever asked you any  
18 questions about the actual costs of services rendered under  
19 the shared services or payroll reimbursement agreements?

20 A Maybe -- maybe in the November time frame, but it really  
21 became acute in December and January.

22 Q Okay. If Mr. Norris testifies that the December 2018  
23 amendments to the PRAs was the result of a true up that you  
24 prepared, what would you say?

25 A I would say there was -- there was no true up. There was

1 no analysis done. And I'm sorry to put it so bluntly, but you  
2 weren't there, and so it just didn't happen.

3 Q And did you ever tell him that?

4 A Not -- certainly not in those -- in those words, no.

5 Q Okay. Let's go -- let's grab the Advisors' binder and go  
6 to Exhibit P, please. P as in Peter. I think -- I think you  
7 testified that you recall the notice of termination of the  
8 shared services agreement was November 30th. Do I have that  
9 right?

10 A Yes.

11 Q Okay.

12 A Yes, you do.

13 Q Let's take a look at this. If you could just -- are you  
14 familiar with this email exchange?

15 A Yes. Yes.

16 Q Okay. And can you describe generally for Judge Jernigan  
17 what's happening on December 1, 2020, the morning after notice  
18 of termination is given?

19 A Yes. So, I think there's a lot of running around, hair on  
20 fire going on around that time, particularly for the Retail  
21 Advisors. So the notice was I think the evening of November  
22 30th. And it's my understanding that that notice was quickly  
23 provided to the -- to the Retail Board, who certainly,  
24 understandably, wanted assurance that there would be no  
25 disruption in services and that there would be a smooth

1 transition.

2 So I think there was a flurry of activity right after that  
3 point to help, you know, answer those types of questions that  
4 the Retail Board had. And then also really get serious about  
5 an actual transition plan.

6 Q And if you look on the page ending in Bates No. 107,  
7 you'll see an email from Mr. Norris at 8:53 a.m. Do you see  
8 that?

9 A Yes.

10 Q Okay. And is -- are the emails that followed a discussion  
11 about kind of amounts that were paid under the payroll  
12 reimbursement agreements?

13 A Yes. As well as the shared services agreements.

14 Q Okay. And do you see Mr. Norris included a chart there of  
15 fees?

16 A I do.

17 Q And did you give him that information?

18 A I don't believe so. Based on the date being 6/30 of 2020,  
19 I assume he -- he likely pulled it himself from the 15(c)  
20 materials that I was discussing earlier, because those  
21 materials were presented each year through 6/30. So that  
22 would have been -- that's my guess, is that that's where he  
23 pulled those, those numbers.

24 Q Any idea why NexPoint paid \$5,040,000, why it's shown as  
25 -- for the 12-month period, and not the \$6 million?

1 A Yes. And actually, that's contained in my response at  
2 9:00 o'clock a.m.

3 Q Uh-huh.

4 A So, yeah, so he sent this at 8:53. And it looks like,  
5 from his -- from his email, he's wanting to, first and  
6 foremost, make sure the numbers are right, but -- but is  
7 starting to think about these termination notices. So the  
8 reason it's -- to answer your question, the reason it's  
9 \$5,040,000 is because the numbers that he pulled were NexPoint  
10 standalone, and so it's missing the \$80,000 a month from  
11 NexPoint Real Estate Advisors. And that's what I clarify in  
12 the email that I sent back to him seven minutes later, is just  
13 saying that, you know, note that while these, you know, these  
14 amounts are what they are, there is an additional \$960,000 per  
15 year in shared services through NREA.

16 Q So, if we went back and looked at your -- not that I'm  
17 going to do this -- but if we went back and looked at your  
18 December 2017 email that we started a couple of hours ago  
19 with, it would show the exact same numbers that are on this,  
20 but for the addition of that \$80,000 a month from the NexPoint  
21 Real Estate Advisors shared services agreement. Do I have  
22 that right?

23 A Yes. And that was -- and that was there, too. It's just  
24 that it's not included in this specific chart.

25 Q Okay. Now, do you see Mr. Norris's email at the top?

1 A Yes.

2 Q Okay. And can you just describe for the judge what your  
3 recollection and understanding is of what the back-and-forth  
4 here, what's going on?

5 A Yeah. So he's -- he's highlighting the fact that some of  
6 the people that were originally part of schedules aren't there  
7 anymore. Mark, which that's a reference to Mark Okada. Jim.  
8 That's a reference to Jim Dondero. Pogs. That's a reference  
9 to Jon Poglish, who -- who term'd in, I think, September of  
10 2020.

11 Q Uh-huh.

12 A Trey is a reference to Trey Parker, who term'd in February  
13 of 2020. Parm is a reference to Andrew Parmentier, who term'd  
14 in May -- May-ish 2019. And many others. So he's -- he's  
15 asking me about, are we still paying the same amounts because  
16 of the BK?

17 Q Okay. And what's your response? What do you tell Mr.  
18 Norris at this point?

19 A So, I say the amounts have not changed since BK. And then  
20 I go on to point out that -- that given the changes in  
21 headcount, profitability would have increased from HCMLP's  
22 perspective.

23 Q And why did you -- why did you tell Dustin that?

24 A I think mainly it's -- it's a statement that's somewhat  
25 obvious, which is that if revenue stays exactly the same and

1 expensive people leave, then profitability is going to  
2 increase for the -- for the party that's receiving the revenue  
3 and bearing the burden of the expense. So it's -- I think  
4 it's a pretty straightforward statement. And recognizing  
5 that, you know, we have been paying -- sorry, we had been  
6 receiving those flat amounts throughout the period.

7 Q And is it your understanding, after your negotiations --  
8 withdrawn. I'll just leave it.

9 After you had this exchange with Mr. Norris, do you recall  
10 being asked by Mr. Waterhouse to update the analysis that you  
11 had prepared in December 2019?

12 A Yes. So, about a week later, December -- I think it was  
13 December 8th, --

14 Q Uh-huh.

15 A -- I got a call from Frank with a request to update the  
16 analysis that we had done for the UCC the previous year.

17 Q And do you recall discussing that with Frank?

18 A Yes. I'll say, this -- the agreements had just been  
19 terminated the week before. It was, I guess, my -- my Spidey  
20 senses were up a little bit. It was -- it seemed like an odd  
21 request. We hadn't -- we hadn't looked at this in a long  
22 time. And so I did, I asked him in that moment what are --  
23 can you -- can you confirm for me that this is not for any  
24 sort of adverse purpose? And he told me that -- that it  
25 wasn't.

1 And then in terms of the actual analysis, the analysis  
2 that was requested was, you know, roll forward that schedule  
3 from last year that you shared with the UCC, update it for the  
4 current headcount -- so remove people who terminated; add  
5 people who were hired -- and delete everyone's bonus, and  
6 don't touch any of the percentages.

7 Q And do you understand that that became the foundation of  
8 the administrative claim that was filed the following a month?

9 A I believe it probably was.

10 Q And the assumptions that you were just asked to make, were  
11 those assumptions that you on your own decided to make, or  
12 were those assumptions that Mr. Waterhouse asked you to make?

13 A They were -- they were given.

14 Q Did you believe -- let's see. Let's take a look. We're  
15 at Exhibit Q. That's your email to Mr. Waterhouse. Do I have  
16 that right?

17 A Yes.

18 Q Okay. And let's look at the attachment for a second. So,  
19 the attachment -- tell -- explain to Judge Jernigan what's  
20 happening in this attachment to Exhibit Q.

21 A Yes. So this attachment, it actually -- it looks  
22 different from some of the other analyses that we were looking  
23 at before. In reality, it's just another tab on the same  
24 analysis in the Excel spreadsheet.

25 And so what it is, what it is doing is it's doing a -- the



1 -- I'll point out the individual numbers. The front office  
2 current charge is a reference to the -- to the PRAs of \$8  
3 million a year. So, \$3 million for NexPoint, \$5 million for  
4 HMCFA. And then the shared services, again, current charge is  
5 the \$3 million of shared services to NexPoint plus NREA and  
6 the \$3.6 million for HCMFA that was running around -- it was  
7 300 a month-ish, but it would vary slightly from month to  
8 month.

9 And then all the other numbers that are -- that are -- for  
10 example, the investment support, directly below current  
11 charge, is -- is the build up from the assumptions that I had  
12 layered in: namely, updating the headcount, not touching the  
13 percentages, and deleting everyone's bonuses.

14 Q Did you ever discuss this document with anybody prior to  
15 confirmation of the Debtor's plan on February 2, 2021?

16 A I don't believe so, other than Frank.

17 Q Do you know what Frank did with the document?

18 A No, I don't.

19 Q Did you believe at that time that this document accurately  
20 and fairly reflected Highland's profitability under the  
21 payroll reimbursement agreements or the shared services  
22 agreements?

23 A Absolutely not.

24 Q And why is that?

25 A Well, bonuses are a big component of compensation for

1 asset managers. So there are some -- there are some definite  
2 flaws here in terms of leaving that out, both the bonuses as  
3 well as the deferred bonuses, which were material for some  
4 people.

5 Another factor that would have skewed this result is not  
6 touching any of the allocations, because the reality is, after  
7 the petition date, investment activity of Highland, at HCMLP-  
8 managed funds, dropped tremendously, because you had investor  
9 redemptions, you had funds getting closed. So those same  
10 employees were -- would have been spending more time and  
11 working more on Retail Advisor issues. And you also did have  
12 people whose roles changed in the interim time period.

13 For example, Trey Parker left, who was an investment  
14 professional, and his roles and responsibilities were  
15 transferred to the legal team which took over the distressed  
16 PE management, which was pretty active for the -- for the  
17 Retail Funds.

18 Q So, on that topic, can you go to -- let's flip through  
19 these real quick -- Exhibit 36?

20 A Bear with me.

21 MR. MORRIS: Your Honor, this is a good time to tie  
22 one other tiny loose end. I think on Friday the Reorganized  
23 Debtor filed an emergency motion to I think redact or file  
24 under seal certain documents. The documents we're about to  
25 look at are those documents.

1 THE COURT: Okay.

2 MR. MORRIS: And they have been redacted to take out  
3 addresses, home addresses of certain people. I just want you  
4 to know that what you have in your binder is not going to be  
5 the official exhibit, --

6 THE COURT: Okay.

7 MR. MORRIS: -- the only difference being that if  
8 that motion is granted -- I don't think Your Honor has tended  
9 to it yet -- but we're just going to redact addresses. That's  
10 the only purpose of the motion.

11 THE COURT: Okay. I have not tended to it, --

12 MR. MORRIS: Yet.

13 THE COURT: -- but I presume it's not opposed.

14 MR. MORRIS: I just -- correct.

15 THE COURT: Okay.

16 MR. MORRIS: He certainly is familiar with all these  
17 people.

18 THE COURT: Okay. Mr. Rukavina, you're --

19 MR. RUKAVINA: No, Your Honor, of course --

20 THE COURT: The motion to redact is not opposed?  
21 It's just addresses?

22 MR. RUKAVINA: No, of course not.

23 THE COURT: All right.

24 MR. RUKAVINA: Yeah.

25 THE COURT: All right. I'll be signing an order on

1 that.

2 MR. MORRIS: Okay.

3 BY MR. MORRIS:

4 Q So, starting with -- we're just going to look at these  
5 very quickly. In February 2020, do you recall that the titles  
6 of certain employees at Highland were changed?

7 A Yes. For a number of people.

8 Q And were the -- were the title changes related in any way  
9 to the changing responsibilities that these employees  
10 undertook?

11 A Yes. And specifically for the ones that I think we're  
12 about to look at, it's -- it was in relation to Trey Parker  
13 leaving, who he was the head of private equity at Highland,  
14 and so his responsibilities were carved up amongst a number of  
15 people.

16 Q So, did Ms. Irving take on responsibility as a managing  
17 director of distressed, as reflected in Exhibit 36?

18 A Yes.

19 Q And let's go to Exhibit 37. As of February 28th, was Ms.  
20 Vitiello given responsibility in the area of distressed?

21 A Yes.

22 Q Exhibit 38. Was Mr. DiOrio made a managing director of  
23 private equity?

24 A Yes.

25 Q The next exhibit is 39. Was Mr. Leventon, in February

1 2020, given the new title, the new additional title of  
2 managing director, distressed?

3 A Yes.

4 Q Exhibit 40, Mr. Cournoyer. Was he also given a new title,  
5 co-head of private equity?

6 A Yes.

7 Q And were all of these changes related to changes in  
8 responsibilities?

9 A Yes. Expansion of responsibilities and, you know,  
10 coinciding with the termination of Mr. Parker, which was on  
11 the same date as all these letters, February 28th of 2020.

12 Q And did those individuals we just looked at, do you know  
13 if those individuals kind of filled the void of Mr. Parker's  
14 departure?

15 A Yes. Again, group effort, so it's not -- it's one  
16 person's big responsibilities getting carved up amongst a  
17 number of different people.

18 Q So when you talked about with Ms. Thedford, really, in the  
19 exact -- I guess the month before all of this happened, you  
20 mentioned that there would be reallocations if somebody was  
21 actually to go back and look and review the exhibit, the  
22 exhibits. Do I have that right?

23 A Yeah. That's -- that's correct. Everyone's role -- and  
24 this was true prepetition and postpetition -- people's roles  
25 evolved and changed. And so any sort of a point-in-time

1 estimate, however flawed, is just that. It's a point in time.

2 Q Are you aware of any -- the changes that you just  
3 described for the individuals that you just described, would  
4 it be fair to describe those new responsibilities as  
5 investment advisory services?

6 A I believe so.

7 Q And they were within Trey Parker's bailiwick; is that  
8 right?

9 A Yeah, within his bailiwick. You know, managing and  
10 monitoring those PE investments.

11 Q Okay. Are you aware of anybody ever saying at any time  
12 prior to November 2020 that Highland was failing to provide  
13 investment advisory services of the type that they provided  
14 for a decade before?

15 A No, with the only small exception was that there was a --  
16 there was a conflict identified on a single private equity  
17 asset in the summer, call it August-ish time frame.

18 Q What's the name of that asset?

19 A That one was OmniMax.

20 Q So, other than with respect to OmniMax, did -- are you  
21 aware of any statement, suggestion, allegation prior to  
22 November 2020 where somebody alleged that Highland was failing  
23 to provide investment advisory services?

24 A Never.

25 Q Okay. Two very short topics. Let's turn to Exhibit 159.

1 Can you tell Judge Jernigan what that is?

2 A Sorry. Bear with me. 1-5-9?

3 Q Yes.

4 A Okay. I'm there.

5 Q Can you just describe for the Court what that document is?

6 A Yes. This is the September monthly invoice from Highland  
7 Capital Management, LP to Highland Capital Management Fund  
8 Advisors under the shared services agreement. We haven't  
9 spent too much time on it, but most of the agreements were  
10 fixed. This was the one that did have a little bit of  
11 variability because we would -- we would charge these invoices  
12 each month.

13 Q Okay. And that was the practice going back to about 2013;  
14 is that right?

15 A Might have even been 2012, but a long way back.

16 Q Okay. And when we talk about the five intercompany  
17 agreements today, is this the only one that was variable?

18 A Yes.

19 Q Okay. And did you have any responsibility for the --  
20 would Highland prepare four HCMFA monthly invoices for shared  
21 services?

22 A Yes.

23 Q And did you have any responsibility for the preparation of  
24 those invoices?

25 A Like I said, this was a practice for many years, so early

1 on I did, maybe the first year or two. And then that became a  
2 task that was passed among the team. And so for years that  
3 process rolled up through me as the -- as the head of the  
4 department.

5 Q Okay. And did -- did the invoiced amount stay fairly  
6 consistent within a small band over time? During the relevant  
7 period?

8 A Yeah. During the relevant period, during the relevant  
9 period it would have crept up a little bit as compensation  
10 went up, and I believe there was a small net increase in  
11 headcount. Postpetition, it barely moved. It was always  
12 between call it \$290,000 and maybe just over \$300,000 per  
13 month.

14 Q Okay. I just want to ask about one particular entry on  
15 here. There's an entry in the middle for legal. Do you see  
16 that?

17 A Yes.

18 Q And it's \$10,000?

19 A Yes.

20 Q Does that mean that for legal services rendered by  
21 Highland under the shared service agreement HCMFA paid \$10,000  
22 per month?

23 A Yes. At this time, that's right.

24 Q That's the total of what they paid?

25 A Yes.



1 Q So, \$120,000 for a whole year?

2 A Yes. There's a five percent markup on it, so it's \$10,500  
3 per month times 12.

4 Q How did that -- did anybody do an analysis to see if HCMFA  
5 was actually responsible for \$10,000 a month --

6 A No.

7 Q -- in legal fees?

8 A No.

9 Q Anybody ever say at Highland, gee, we should be charging  
10 HCMFA more money because the actual cost of their services is  
11 much greater?

12 A No. Nobody said that.

13 Q Finally, let's just talk about damages. Have you done an  
14 analysis of the damages that Highland alleges that it has  
15 sustained from the Advisors' breach of contract?

16 A Yes, in part.

17 Q Okay. Let's talk about the part that you prepared. Can  
18 you describe for the Court your damage analysis?

19 MR. RUKAVINA: And Your Honor, I do have to object  
20 here. This witness has not been qualified as an expert,  
21 designated as an expert. There's no expert report.

22 Now, if the damages are just they didn't pay per month and  
23 they owe us for that month, that's not an expert deal. But I  
24 hear damages analysis and I hear that this person did an  
25 analysis, so --

1 MR. MORRIS: He's going to -- he's going to add the  
2 amounts in the contracts, multiply them by the number of  
3 months that weren't paid, and come up with a number.

4 MR. RUKAVINA: That's -- that's easy.

5 THE COURT: Okay.

6 MR. RUKAVINA: We know what that number is. That's  
7 easy.

8 THE COURT: Okay.

9 MR. MORRIS: So will you stipulate?

10 MR. RUKAVINA: Huh?

11 THE COURT: Okay. I overrule the objection if  
12 there's still one pending.

13 MR. MORRIS: Okay. All right.

14 BY MR. MORRIS:

15 Q Mr. Klos, can you describe for the Court how we arrive at  
16 our breach of contract damages?

17 A So, to summarize, NexPoint was paying \$500,000 per month.  
18 It didn't pay for two months. So that's a million from  
19 NexPoint.

20 HCMFA had the payroll reimbursement, the \$416,000 per  
21 month. It didn't pay for two months. So that's \$832,000.

22 And then on the shared services agreement, HCMFA actually  
23 didn't pay for three months, because the -- the November of  
24 twenty -- let get my year right -- November of 2020, HCMFA  
25 invoice hadn't been created at the Mr. Dondero said to stop

1 payments.

2 So three months of HCMFA shared services, two months of  
3 PRA, and then two months of NexPoint for everything.

4 Q And if we could just quickly look at Exhibit I in the  
5 Advisors' exhibits so we can get a number for the HCMFA shared  
6 services three-month piece.

7 A I?

8 Q Yes.

9 A Do you have a page, by any chance? Is it in the back?

10 Q It's the last page.

11 A In the last --

12 Q It's Exhibit A. And I'll just represent to you that this  
13 is the Debtor's responses to the Advisors' discovery requests.

14 A This -- this, to me, looks like payments made as opposed  
15 to amounts outstanding.

16 Q I understand that.

17 A Okay.

18 Q Okay. So, so the Advisors -- did the Advisors pay for  
19 shared services in November, December of 2020, or January of  
20 2021?

21 A Oh, I understand. Not as it pertained to Highland Capital  
22 Management Fund Advisors shared services.

23 Q Okay. And if you look at the middle of the page, the  
24 amount that was paid each month for the preceding six months  
25 is approximately two hundred and -- \$308,000 or \$305,000? Is

1 that right?

2 A I'm sorry. One -- can you ask that again, please?

3 Q The amount -- do you know what Exhibit A is?

4 A Yes. Exhibit A is a listing of all the payments that were  
5 made postpetition by the Retail Advisors.

6 Q Okay. So in the middle of the page, there are payments  
7 that were made each month by HCMFA under the shared services  
8 agreements. Am I reading that correctly?

9 A Yes. Yes, you are.

10 Q And how much were they paying in 2020?

11 A Got it. Yes. So they were paying, just looking at it  
12 quickly, it looks like the lowest was about \$294,000 and the  
13 highest was around \$308,000.

14 Q Okay. And how would you calculate the damages for the  
15 three months that they didn't pay, looking at this?

16 A It would be approximately -- the best proxy for it would  
17 be the November payment, so it would be approximately three --  
18 three more of the November 30th payment of about \$308,000.

19 Q Okay. So 308 times three?

20 A Yes.

21 Q Plus the million dollars from NexPoint?

22 A Yes. Plus the 832 of PRAs.

23 Q Ah. Correct. Okay. And is it your understanding that  
24 Highland also seeks to recover its attorneys' fees, costs, and  
25 expenses under the contracts?

1 A That's my understanding.

2 Q Okay.

3 MR. MORRIS: Your Honor, I have no further questions.

4 THE COURT: All right. Pass the witness. Mr.

5 Rukavina?

6 (Transcript excerpt concluded at 2:19 p.m. Proceedings

7 concluded at 6:19 p.m.)

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CERTIFICATE

20 I certify that the foregoing is a correct transcript from  
21 the electronic sound recording of the proceedings in the  
above-entitled matter.

22 **/s/ Kathy Rehling**

**04/14/2022**

23

24 \_\_\_\_\_  
Kathy Rehling, CETD-444  
Certified Electronic Court Transcriber

\_\_\_\_\_  
Date

25

Klos - Direct

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

IN RE

HIGHLAND CAPITAL MANAGEMENT, L.P.	§	
	§	CASE NO. 19-340540SGJ11
	§	DALLAS, TEXAS
Debtor	§	WEDNESDAY, APRIL 13, 2022
	§	9:39 A.M.- 11:17 A.M.
HIGHLAND CAPITAL MANAGEMENT, L.P.,	§	
Plaintiff,	§	
vs.	§	ADVERSARY PROCEEDING
	§	NO. 21-03010-SGJ
HIGHLAND CAPITAL MANAGEMENT FUND	§	
ADVISORS, L.P., et al.	§	
Defendants.	§	

TRIAL - DAY TWO

BEFORE THE HONORABLE STACEY G. JERNIGAN  
UNITED STATES BANKRUPTCY JUDGE

Proceedings recorded by electronic sound recording;  
transcript produced by transcription service.

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APPEARANCES:

FOR HIGHLAND CAPITAL MANAGEMENT,  
LP

JOHN A. MORRIS, ESQ.  
HAYLEY R. WINOGRAD, ESQ.  
PACHULSKI STANG ZIEHL &  
JONES, LLP  
10100 SANTA MONICA BVD  
13<sup>TH</sup> FLOOR  
LOS ANGELES, CA 900067

FOR HIGHLAND CAPITAL MANAGEMENT  
FUND ADVISORS, L.P.

DAVOR RUKAVINA, ESQ.  
THOMAS D. BERGHMAN, ESQ.  
MUNSCH, HARDT, KOPF & HARR  
500 N. AKARD STREET  
SUITE 3800  
DALLAS, TX 75201

COURT RECORDER:

ME  
Clerk's Office  
U.S. Bankruptcy Court  
501 W. 10<sup>th</sup> Street  
Fort Worth, TX 76102

TRANSCRIPTION SERVICE:

ACORN TRANSCRIPTS, LLC  
3572 Acorn Street  
North Port, FL 34286



1 DALLAS, TEXAS; WEDNESDAY, APRIL 13, 2022; 9:39 A.M.

2 THE MARSHAL: All rise.

3 (Call to Court)

4 THE COURT: Good morning, please be seated. All  
5 right. We're back for day two of our trial in Highland  
6 Capital Management versus the advisors, Highland Capital  
7 Management Fund Advisors and NexPoint Advisors.

8 All right. We have everyone here we need. We got  
9 plaintiff -- well, debtor's counsel and the advisor's  
10 counsel. All right. Do you have something to present,  
11 counsel?

12 MS. WINOGRAD: Good morning, Your Honor, Highland  
13 is calling the retail board.

14 THE COURT: Okay.

15 MS. WINOGRAD: And the representative Ethan Powell  
16 hasn't yet arrived.

17 THE COURT: Okay.

18 MR. RUKAVINA: He's right here.

19 UNIDENTIFIED: He's right here.

20 MS. WINOGRAD: Oh, I'm sorry about that. Okay.

21 THE COURT: Okay. Is that our first --

22 MS. WINOGRAD: Yes.

23 THE COURT: -- witness today?

24 MS. WINOGRAD: Highland would like to call Ethan  
25 Powell please.

1 THE COURT: Okay. Tell me the name again.

2 MS. WINOGRAD: Ethan Powell.

3 THE COURT: Ethan Powell. Okay. Welcome. If you  
4 could approach our witness box. That box right there, if  
5 you'll -- I'll swear you in before you take a seat. Please  
6 raise --

7 MR. POWELL: Okay. So --

8 THE COURT: If you could stand and I'll swear you  
9 in first.

10 MR. POWELL: Oh, sorry.

11 ETHAN POWELL, WITNESS, SWORN

12 THE COURT: All right. Now you may be seated.

13 THE WITNESS: Thanks.

14 DIRECT EXAMINATION

15 BY MS. WINOGRAD:

16 Q Good morning, Mr. Powell.

17 A Good morning.

18 Q My name is Hayley Winograd, I'll be asking you some  
19 questions over the next few minutes. Thank you for being  
20 here.

21 A Okay. Of course.

22 Q You're a member of the board of trustees or the board  
23 of directors of certain retail funds, correct?

24 A I am, yes.

25 Q Can I refer to these retail funds as the funds?

1 A You may.

2 Q Are you familiar with an entity called Highland Capital  
3 Management Fund Advisors LP?

4 A I am.

5 Q Can I refer to them as HCMFA?

6 A You may.

7 Q And are you familiar with an entity called NexPoint  
8 Advisors LP?

9 A I am.

10 Q Can I refer to them as NexPoint?

11 A You may.

12 Q And can I refer to them collectively as the advisors?

13 A Sure.

14 Q These two entities -- the funds are managed by the  
15 advisors, correct?

16 A Correct.

17 Q And I want to talk a little bit about the relationship  
18 between the regional funds and the advisors. The funds  
19 entered into certain investment advisory agreements with  
20 each of the advisors, correct?

21 A Correct.

22 Q And pursuant to those advisory agreements, the advisors  
23 provide advisory services to the funds, correct?

24 A Correct.

25 Q And the regional board was aware that Highland filed

1 for bankruptcy in October 19th of 2019, correct?

2 A Yep.

3 Q And the retail board is aware that Highland provided  
4 certain shared services to the advisors, correct?

5 A Correct.

6 Q And Highland provided these services pursuant to  
7 various shared services agreements, correct?

8 A Correct.

9 Q And the retail board was aware that these shared  
10 service contracts enabled the advisors to satisfy their  
11 obligations under the investment advisory contracts,  
12 correct?

13 A Correct.

14 Q And the retail board was aware that at some point in  
15 February of 2021 the shared services agreements between  
16 Highland and the advisors were terminated, correct?

17 MR. RUKAVINA: Your Honor, at this time I will  
18 object. We're past the preliminaries, counsel is leading,  
19 this is not a hostile witness or a party opponent, so I  
20 object on leading.

21 THE COURT: Sustained.

22 MS. WINOGRAD: Okay.

23 BY MS. WINOGRAD:

24 Q Can I refer to the period between Highland's bankruptcy  
25 filing and the termination of the shared services agreement

1 as the relevant period?

2 A You may.

3 Q Okay. And during the relevant period, did the retail  
4 board regularly hold meetings?

5 A We did.

6 Q Did the retail board keep minutes of its meetings?

7 A We do.

8 Q And did those minutes generally reflect the  
9 conversations that were had at those meetings?

10 A Correct.

11 Q And one of -- did -- was one of the topics that was  
12 covered at those board meetings Highland's performance under  
13 the shared services arrangements?

14 A Collectively with the advisors, yes.

15 Q Okay. And do the board minutes reflect all material  
16 communications between the retail board members concerning  
17 Highland's performance under these shared services  
18 arrangements?

19 A It represents the conclusions reached.

20 Q Okay. Can you think of any material communications  
21 that weren't represented in those meetings?

22 A Well, the meeting minutes are --

23 Q In the meeting -- in the minutes, I'm sorry.

24 A Yeah, the meeting minutes themselves aren't intended to  
25 be a transcript.

1 Q Uh-huh.

2 A And our meetings sadly can go very, very long. So  
3 oftentimes there will be material considerations that are  
4 presented that aren't necessarily documented in the meeting  
5 minutes, but the conclusions reached are.

6 Q Okay. During the relevant period, did the retail board  
7 ever allege that either of the advisors ever breached any of  
8 their obligations owed to the funds under the investment  
9 advisory agreements?

10 A Can you repeat that question?

11 Q During the relevant period, did the retail board ever  
12 allege that either of the advisors breached their  
13 obligations under the investment advisory agreements?

14 A No, we did not.

15 Q Did the retail board ever notify the advisors of any  
16 breach of their obligations under the investment advisory  
17 agreements?

18 A No.

19 Q From the retail board's perspective, were the advisors  
20 fully able to perform their obligations under the investment  
21 advisory agreements?

22 A Yes.

23 Q Do the board meetings substantively reflect the  
24 communications between the board members and the advisors  
25 concerning Highland's performance under these shared

1 services arrangements?

2 A Our assessment was never Highland versus the advisors,  
3 it was always collectively. And we were always given  
4 assurances that collectively they could fulfill the  
5 obligations.

6 Q Do the board minutes materially reflect the  
7 communications between the board members and the advisors  
8 concerning the advisors' performance under the investment  
9 advisory agreements?

10 A They do.

11 Q Now, I want to talk to you a little bit about the board  
12 meetings and the minutes, and specifically the process that  
13 went into them.

14 A Uh-huh.

15 Q Was there a process in place to prepare and finalize  
16 the board minutes?

17 A There is.

18 Q And as part of this process, did the funds  
19 administrator FTI send the draft minutes to certain  
20 individuals and entities for review?

21 A They do.

22 Q Did one of these entities include the funds counsel?

23 A It did.

24 Q And did one of these entities also include the  
25 advisors?

1 A Yes.

2 Q Was this to give the advisors the opportunity to review  
3 the minutes before they were finalized?

4 A Yes.

5 Q And it was the -- was it the secretary of the advisors  
6 who reviewed the board minutes on behalf of the advisors?

7 A I'm not sure.

8 Q Okay.

9 A But that would be typical.

10 Q Okay.

11 A Yeah.

12 Q Was that person, to the best of your recollection,  
13 Lauren Bedford?

14 A She was the secretary during the period.

15 Q Did the -- did SCI send the draft board minutes to the  
16 advisors to give the advisors the opportunity to provide  
17 feedback on those minutes?

18 A They did.

19 Q Did they specifically do this so that the advisors  
20 could confirm the accuracy of those minutes?

21 A They did.

22 Q Was this process for finalizing the board minutes  
23 generally the same throughout the relevant period?

24 A It was.

25 Q I'm going to ask you now about the advisors'



1 representations to the retail board about Highland's  
2 performance under the shared services arrangements.

3 Did the advisors provide regular updates to the retail  
4 board concerning the quality and continuity of the services  
5 provided to the advisors pursuant to these shared services  
6 arrangements?

7 A Collectively with the advisors, yes, but individually  
8 as HCMLP service provider, no.

9 Q I'm going to turn your attention to some documents that  
10 I'll be referring to for a few minutes and those documents  
11 are located in the binders as exhibits in front of you in  
12 Volume 1 and 2. So I might ask you to open one.

13 Can you please turn to Exhibit 58?

14 A So that would be binder --

15 Q That would be Volume 2 I believe.

16 A Volume 2, all right. 58. I should have brought my  
17 glasses. Okay.

18 Q Are these the June 18th to 19th of 2020 board minutes?

19 A They appear to be.

20 Q Okay. Can you please turn to page 20?

21 A Page 20. Okay.

22 Q Do you see there in a June 2020 board meeting Mr. Klos,  
23 the advisors' chief compliance officer represented to the  
24 board that the advisors were monitoring the level and  
25 quality of the shared services being provided by Highland?

1 A Give me one second, I'm not finished reading.

2 Q Uh-huh.

3 A Yep, I see that.

4 Q Did the board rely on the advisors to monitor the  
5 quality of those shared services?

6 A We did.

7 Q Does the retail board conduct an annual 15-C review  
8 process?

9 A We do.

10 Q Is this the process whereby the retail board decides  
11 whether or not to extend its --

12 MR. RUKAVINA: Objection, Your Honor, leading.  
13 The proper question is what is that process.

14 THE COURT: Sustained.

15 BY MS. WINOGRAD:

16 Q What's the process whereby the regional board decides  
17 whether or not to extend its investment advisory agreements?

18 A It's very long and arduous process, I don't think we  
19 want to get into the details here but --

20 Q But is that called the 15-C process?

21 A It is the 15-C, yes, that's right.

22 Q Okay. Can you please turn to Exhibit 59?

23 A Okay.

24 Q Are these the August 13th of 2020 board minutes?

25 A They appear to be.

1 Q Can you turn to page 6 please? Do you see that Mr.  
2 Norris, the executive vice-president of the advisors, quote,  
3 "provided an overview of the 15-C review materials and  
4 process and discussed the expected timeline with respect to  
5 board consideration of approval of the renewals?" He noted  
6 that there had been no issue or disruption in services as a  
7 result of the HCMLP bankruptcy matter. Do you see that?

8 A I do.

9 Q Did the retail board rely on this statement?

10 A We would have.

11 Q Did the retail board expect that the statement was made  
12 on an informed basis?

13 A We would have.

14 Q Can you please now turn to Exhibit 60? Do you see that  
15 these are the board minutes from September 17th and 18th of  
16 2020?

17 A I do.

18 Q Can you please turn to the bottom of page 12, which --  
19 and going on to the rest of 13. In September of 2020, Mr.  
20 Surgent, the chief compliance officer of the advisors  
21 assured the retail board that it -- that in response to  
22 certain 15-C follow-up questions that at that time, quote,  
23 "it was business as usual with respect to the services  
24 provided to the funds and that the board would be notified  
25 immediately of any developments." Do you see that?

1 A Give me one second, finish reading.

2 I do see it.

3 Q Okay. As part of the 15-C review process, was the  
4 retail board also required to assess the financial  
5 wherewithal of the advisors?

6 A We were.

7 Q Can you please turn to Exhibit 22?

8 A 22, so that's Volume 1?

9 Q Yeah.

10 A Okay. I'm there.

11 Q Do you see that these are the advisors October 23rd of  
12 2020 responses to questions raised by the retail board to  
13 the advisors in connection with the 15-C review process?

14 A I do.

15 Q If you could turn your attention to question 2, please.  
16 Do you see that the regional board asked the advisors  
17 whether there were any amounts payable or due to Highland  
18 from either of the advisors?

19 A I see that.

20 Q Do you see that the advisors represented in their  
21 response to the regional board that as of the date of that  
22 letter, all amounts owed by each of NexPoint and HCMFA  
23 pursuant to the shared services arrangement with HCMLP have  
24 been paid as of that date?

25 A I do see that.

1 Q Did the retail board rely on the accuracy of this  
2 statement in making its decision as to whether or not to  
3 extend the advisory agreements?

4 A We would have.

5 Q And did the retail board assume that that statement was  
6 true and accurate?

7 A We would have.

8 Q Did the retail board assume that the statement was  
9 based on the advisor's due diligence and actual knowledge?

10 A Correct.

11 Q Can you please turn to Exhibit 62?

12 A Yes. Okay.

13 Q These are the October 28th of 2020 board minutes. Do  
14 you see that?

15 A I do.

16 Q Directing your attention to page 3 about halfway  
17 through the second paragraph, do you see that the advisors  
18 represented to the board at the end of October of 2020 that  
19 quote, the quality and level of services provided to the  
20 funds by the advisors and pursuant to the shared services  
21 arrangements have not been negatively impacted to date?

22 A Oh, boy, I'm going to have to find that. Give me one  
23 second.

24 (Pause)

25 Q Uh-huh.

1 A You said halfway through?

2 Q It's about halfway through the second big paragraph.

3 A Oh, the second paragraph --

4 Q Uh-huh.

5 A -- okay, I got you. Okay. I see it.

6 Q Did the retail board assume that this representation as  
7 made on an informed basis?

8 A We would have, yes.

9 Q Did the retail board rely on this representation in  
10 deciding whether to extend its advisory contracts?

11 A Among other things, but yes.

12 Q Was one of the retail board's concerns during the  
13 relevant period related to the continuation of material  
14 services to the funds?

15 A Correct.

16 Q Was one of the assurances the retail board had been  
17 asking for related to the sufficient employees at Highland,  
18 whether there was a sufficient amount of employees at  
19 Highland to be able to provide services that the advisors  
20 needed in order to fulfill its obligations under the  
21 investment advisory contracts?

22 A It would have been at the advisors and Highland.

23 Q Uh-huh. Can you please turn to Exhibit 64? This is  
24 December of 2020 minutes, correct?

25 A Yep.

1 Q If you could turn to page 7 at the very bottom. Do you  
2 see there that the advisors assured the retail board that  
3 there was sufficient personnel to continue the shared  
4 services to the regional funds?

5 A I see that.

6 MS. WINOGRAD: Your Honor, can I confer with  
7 counsel for a minute?

8 THE COURT: Sure.

9 (Pause)

10 MS. WINOGRAD: That's all I have. Thank you very  
11 much.

12 THE COURT: Okay.

13 THE WITNESS: Thank you.

14 THE COURT: Pass the witness. Wait. I can tell  
15 you don't do this very often, right?

16 THE WITNESS: I try not to to the extent possible.

17 THE COURT: All right. Mr. Rukavina, you have  
18 questions?

19 MR. RUKAVINA: Yes, I do, Your Honor.

20 CROSS-EXAMINATION

21 BY MR. RUKAVINA:

22 Q Mr. Paul, good morning.

23 A Good morning.

24 Q Just to confirm, you're on the board of those retail  
25 funds, right?

1 A Correct.

2 Q Okay. And would Mr. Seery sometimes participate in  
3 these board meetings during the period that counsel has  
4 called the relevant period?

5 A He would.

6 Q Do you have an understanding as to why Mr. Seery would  
7 participate?

8 A I do.

9 Q What's your understanding?

10 A To provide updates on the HMLP bankruptcy/implications  
11 to HCMLP's services provided under the services agreement.

12 Q And what did you understand generally to be the  
13 services that HCMLP was provided to the advisors under the  
14 shared services agreements?

15 A Primarily back-office accounting, finance, HR, IT,  
16 support services.

17 Q Was that of relevance to the funds?

18 A It would have been, yeah.

19 Q Why?

20 A So our primary focus is the nature and quality of  
21 services being provided to the investors, particularly as it  
22 relates to investment selection monitoring of the funds and  
23 ensuring that the financial outcomes to our investors are  
24 maximized.

25 There are lots of service providers involved and it's



1 our job to assess each service provider's role and whether  
2 or not they are fulfilling their role within the context of  
3 an agreement we have with them, we being the investors in  
4 our funds.

5 So we have separate administration agreements with SCI  
6 for example. They actually do fund accounting. Our  
7 advisory contract with the advisor, their primary role is  
8 investment selection. They need support staff in order to  
9 help facilitate that. So we really looked to the advisor to  
10 assess what they needed and whether or not they were getting  
11 from HCMLP all of the, you know, various back office and  
12 mid-office support services that they needed to order to  
13 perform their primary function.

14 Q So we'll break that down just a little bit. So first  
15 of all, let's give the judge an order -- an idea of the  
16 order of magnitude of the assets under management that the  
17 funds have that the advisors are advising for --

18 A For these?

19 Q Yes.

20 A 3 billion we'll call it.

21 Q How much?

22 A 3 billion.

23 Q 3 billion with a B?

24 A Uh-huh.

25 Q And you mentioned back-office services, you described

1 those -- you mentioned mid-office services, can you give a  
2 generalized description of your understanding of middle  
3 office service?

4 A Sure. Middle office would be trade settlement, trade  
5 reconciliation, performing some of the fund analysis and  
6 portfolio compensation analysis. Back office would be more  
7 accounting and audit support services.

8 Q Have you also heard of the phrase front office  
9 services?

10 A I have.

11 Q What's your understanding of that phrase?

12 A Front office is the primary investment selection and  
13 monitoring decisions.

14 Q And I think you mentioned that's what the advisors did.

15 A Yes, correct.

16 Q Okay. Did you understand that that -- did you  
17 understand that shared services, those contracts did not  
18 include front office services?

19 A I did.

20 Q Okay. Have you heard of payroll reimbursement  
21 agreements between the advisors and Highland?

22 A I believe so, yes.

23 Q And we'll go through those in some details. Are these  
24 board meetings that counsel took you through, who actually  
25 prepared those meetings?

1 A That would be SCI's regulatory administration group.

2 Q Okay. Did Ms. Bedford have a -- I can't pronounce her  
3 name I apologize, I'm a foreigner, did Ms. Fedford have a  
4 role in that?

5 A You did a good job on that. She would have, yeah.

6 Q Okay. Was she primarily the one that put it together?

7 A She would have been the primary review party from the  
8 advisors.

9 Q Do you have an understanding with whose employee she  
10 was?

11 A She was I believe HCMLPs, but it's also important to  
12 note that lots of people had multiple hats and were employed  
13 by multiple different entities.

14 Q And you mentioned multiple times or at least twice when  
15 counsel was asking you about services being provided by  
16 HCMLP, which we also call the debtor here, which is why.

17 A Uh-huh.

18 Q And you mentioned that what was interest -- of interest  
19 to you was the services being provided by both the advisors  
20 and the debtors. Do you remember testifying?

21 A Yes.

22 MS. WINOGRAD: Objection, leading.

23 MR. RUKAVINA: Well, I'm phrasing my next  
24 question. I'm just phrasing -- it's a predicate to my next  
25 question.

1 THE COURT: Overruled.

2 BY MR. RUKAVINA:

3 Q What did you mean by that when you said that for both  
4 the advisors and HCMLP?

5 A So, yeah, our contract is primarily with the advisors  
6 period. What they choose to do with what's called their  
7 bona fide profits, which is their management fee is really  
8 up to them, right.

9 A lot of fund complexes don't have multiple advisory  
10 entities and it's just a single advisor without any sort of  
11 shared services arrangement in and amongst the various  
12 entities.

13 So we really just looked at the advisor to make sure  
14 that first and foremost that the financial outcomes for our  
15 investors were what we set out to provide them, right, and  
16 that was front office.

17 To the extent that the front office function was using  
18 HCMLP to support them it was somewhat ancillary because, you  
19 know, as long as they had what they needed to perform their  
20 job and the performance results were as intended, how they  
21 got there and how they used the management fee that the  
22 funds paid them was really up to them.

23 Q Did you have an understanding during what was described  
24 as the relevant period as to whether the advisors had their  
25 own employees?

1 A Yes.

2 Q Okay. What was your understanding as to the advisors'  
3 own employees?

4 A That the advisors' employees that were, you know, very  
5 experienced, capable financial professionals, capable of  
6 stepping in as needed in the event that there was any, you  
7 know, misstep from a shared services perspective.

8 Q And what was your understanding as to what services the  
9 advisors own employees were providing during the relevant  
10 period to the funds?

11 A In any --

12 Q You mentioned front office, middle office and back  
13 office.

14 A Right.

15 Q Can you kind of put them into one or more of those  
16 buckets?

17 A Oh, they were front office primarily, yeah.

18 Q And during this relevant period, were you concerned or  
19 to your knowledge was the board concerned about Highland  
20 employees leaving en masse?

21 A Yes.

22 Q Was that discussed internally?

23 A Yes.

24 Q Was that discussed with Mr. Seery?

25 A Yes, I imagine it was.

1 Q What was the concern, why were -- why was the board  
2 concerned?

3 A Again, (indiscernible - 10:04:36) services you're  
4 talking about a pretty public bankruptcy, it's a competitive  
5 job market, you know, Highland has a pretty complex and  
6 nuanced investment philosophy and strategy. So finding and  
7 retaining quality candidates in any one of those three  
8 buckets you outlined, you know, in that environment might be  
9 difficult.

10 Q And you also mentioned that these meetings were present  
11 the conclusions reached and you mentioned that the meeting  
12 sometimes took a long time.

13 A Correct.

14 Q Can you help us understand some more the relationship  
15 between the meetings and what was actually discussed during  
16 these sometimes lengthy meetings?

17 A As it relates to the meeting minutes or?

18 Q Yes, sir.

19 A Right. So like I said the idea isn't that the meeting  
20 minutes aren't a transcript because that would be cumbersome  
21 and not productive. You know, at least on a quarterly basis  
22 we would have two-day meetings. We, during the period, had  
23 I don't even know how many meetings, but many, many  
24 meetings.

25 And the idea of the meeting minutes was really to

1 memorialize the conclusions reached, material questions  
2 asked and answered. And any supporting documentation that  
3 may be relevant to reach those conclusions.

4 Q Could it be that things were discussed at those  
5 meetings that did not end up in the minutes?

6 A Yes, absolutely.

7 Q Do you recall whether there was ever discussed with the  
8 advisors that various employees at Highland pursuant to  
9 certain payroll reimbursement agreements were no longer  
10 there, were no longer providing services?

11 A At some point we did hear about that, yes.

12 Q And I asked you whether you'd heard of the payroll  
13 reimbursement agreements.

14 A Uh-huh.

15 Q What is your understanding of the payroll reimbursement  
16 agreements between the advisors and Highland?

17 A That part of the compensation under the shared services  
18 agreement was to share in some of the costs of the actual  
19 labor resources at HCMLP.

20 Q Did you understand the payroll reimbursement agreements  
21 were separate from the shared service agreements or did you  
22 just kind of think that they were one in the same?

23 A Yeah, they were one in the same as far as we were  
24 concerned.

25 Q What -- the concern to you was that you were getting

1 the services that you needed and how they were contractually  
2 done didn't necessarily matter.

3 A That's right. We did not dive into that and we did not  
4 dive into the bankruptcy.

5 Q Do you recall ever at these meetings specifically  
6 discussing the payroll reimbursement agreements themselves?

7 A Not in detail.

8 Q What is your best recollection about the discussion  
9 that you said you do remember at some point in time about  
10 Highland employees leaving and no longer being available to  
11 the advisors? What do you remember?

12 A That there was some attrition and we really always come  
13 back to how is the attrition impacting our investors. And,  
14 you know, some of the quotes in the meeting minutes include  
15 the assessment that, you know, as it relates to our  
16 investors, either HCMLP debtor employees were picking up or  
17 the advisors' employees were stepping in and performing  
18 services.

19 Q Did you have an understanding that the advisors  
20 actually hired a number of their own employees to provide  
21 front office service?

22 A Yes.

23 Q Okay. Also briefly do you have an understanding --  
24 well, strike that. I won't burden you with that.

25 Let's go through some of these same exhibits, please,



1 that counsel took you through. Please start with Exhibit  
2 No. 57.

3 A 57.

4 Q Yeah.

5 A Okay.

6 Q Okay. So let's look at page 3 please, the bottom  
7 paragraph. Are you there, sir?

8 A I am.

9 Q Okay. Mr. Norris discussed the shared services  
10 arrangements that each advisor is a party to with HCMLP.  
11 Did I read that correctly?

12 A You did.

13 Q Okay. Is there any mention of payroll reimbursement  
14 agreements there?

15 A There is not.

16 Q Okay. And he concludes or he discusses further on that  
17 the advisors may use employees from HCMLP for the provision  
18 of various services such as human resources, accounting,  
19 valuation, information technology services, compliance and  
20 legal. Did I read that correctly?

21 A You did.

22 Q Please put those services into one or more of your  
23 three buckets that you mentioned earlier.

24 A Okay. All right.

25 I'll go with human resources as back office, as with

1 accounting, information technology services and compliance  
2 and legal. Valuation would be more of a mid-office  
3 function.

4 Q None of those front office functions, are they?

5 A None of those are front office.

6 Q Okay. And let's go to Exhibit 58, please.

7 A Okay.

8 Q And, sir, if you'll back to page 20, the same one that  
9 Ms. Winograd asked you about.

10 A Okay.

11 Q And it starts by Mr. Post also discussed the quality  
12 and continuity of services provided to the funds by HCMLP,  
13 pursuant to shared services agreements with the advisors.  
14 Did I read that correctly?

15 A You did.

16 Q Anything in there about payroll reimbursement  
17 agreements?

18 A There is not.

19 Q And Exhibit 59, we're going to burn through these. I'm  
20 going to have the same question for every one.

21 A Okay.

22 Q Exhibit 59, page 6 please. Okay. Page 11 please. The  
23 larger bottom paragraph it starts with Mr. Seery then  
24 pointed out to the board a potential conflict of interest.  
25 Do you recall what Mr. Seery was discussing? Please read

1 that to refresh your memory.

2 A Sure, yeah.

3 Q Do you have a memory of what was being discussed?

4 A I do.

5 Q What is it?

6 A We held a position in our funds that were also held as  
7 debtor collateral in the bankruptcy and we had collectively  
8 a large position and debtor was going to liquidate their  
9 position and was interested in us joining the liquidation  
10 and we were not.

11 Q So that's the complex that was created?

12 A Correct, yeah.

13 Q Do you know who Jason Post is?

14 A I do.

15 Q What was Jason Post's role during the relevant period  
16 vis-a-vis the funds?

17 A He was the chief compliance officer.

18 Q Okay. Do you understand whether at some point in time  
19 Mr. Post left HCMLP to join the advisors?

20 A I do.

21 Q Okay. Do you have an understanding as to why that  
22 happened? Well, let me ask it this way. Did it have  
23 anything to do with this conflict of interest?

24 A Not directly, but yeah, it was definitely a considering  
25 factor.

1 Q This conflict of interest was identified, was it a  
2 concern that there might be future ones?

3 A Yep, yes.

4 Q So was Mr. Post's reason, to your understanding, for  
5 changing from HCMLP to the advisors to, in effect, remove  
6 these potential conflicts?

7 A That's right.

8 Q Do you have an understanding as to whether Mr. Seery  
9 approved Mr. Post leaving HCMLP to work for the advisors  
10 directly?

11 A I believe he did, yes.

12 Q If we continue with these exhibits, Mr. Powell, Exhibit  
13 60 please. And it's going to page 7 and it's the big full  
14 paragraph, it's too long for me to read, but you see that it  
15 talks about Mr. Seery discussing the shared services  
16 agreements and services under the shared services  
17 agreements. Do you see that, sir?

18 A Yes, I do.

19 Q Any mention in here of payroll reimbursement  
20 agreements?

21 A Oh, boy, give me a second.

22 No.

23 Q Okay. And if we go to -- your answer was no, correct?

24 A No, that's correct.

25 Q And if you flip to the next exhibit, please which is

1 60, or I'm sorry, we're still on 60, aren't we?

2 A Yeah, we're on 60.

3 Q Go to page 12, review of the 15-C materials.

4 A All right.

5 Q And it talks about in there that Mr. Surgent, who did  
6 you understand Mr. Surgent to be?

7 A Thomas Surgent, complex CCO.

8 Q Okay. CCO. And it talks about he provided the board  
9 with a status update on the HCMLP bankruptcy and discussed  
10 the impact of the HCMLP bankruptcy and the shared services  
11 arrangements with the funds noting he does not expect that  
12 the level and quality of services would change in the  
13 immediate term. Did I read that correctly?

14 A You did.

15 Q Any discussion there about the payroll reimbursement  
16 agreements?

17 A There's not.

18 Q Okay. Exhibit 61, please, sir.

19 A All right.

20 Q And if you'll flip to page 3.

21 A Okay.

22 Q And take as much time as you need to read, but it talks  
23 about Mr. Sauder. Who did you understand Mr. Sauder to be?

24 A D.C. Sauder, one of the counsel for the advisor.

25 Q Mr. Sauder also discussed the status of the shared

1 services agreements, et cetera, et cetera. Any mention in  
2 there about payroll reimbursement agreements?

3 A There is not.

4 Q And I'll spare the Court, we're going through the next  
5 10 of these and I'll address them during closing, but do you  
6 remember the advisors ever telling you that everything was  
7 fine under the payroll reimbursement agreements, as opposed  
8 to the shared services agreements?

9 A Yeah, we would have just said is everything fine  
10 relative to the shared services.

11 Q The shared services.

12 A Yeah.

13 Q Okay. And let's look at Exhibit 22 real briefly before  
14 we conclude. You looked at that earlier.

15 A Yeah. Okay.

16 Q So are you there, sir?

17 A I am.

18 Q "A-1, please provide to the extent practical the  
19 contingency plans with respect to the services provided  
20 under the shared services agreements." Did I read that  
21 correctly?

22 A You did.

23 Q And then there's an answer. Anything in here about  
24 payroll reimbursement agreements?

25 A No.

1 Q And then in number 2 at the end of the response, the  
2 advisors respond to you, all amounts owed by each of  
3 NexPoint and HCMFA pursuant to the shared services agreement  
4 with HCMLP have been paid as of the date of this letter.

5 Did I read that --

6 MR. MORRIS: One second, please, Your Honor, what  
7 exhibit is that?

8 MR. RUKAVINA: Exhibit 22, the supplemental 15-C.

9 MR. MORRIS: Okay. Can we please read that more  
10 accurately?

11 MR. RUKAVINA: I'm sorry, I need new reading  
12 glasses.

13 MR. MORRIS: Okay.

14 MR. RUKAVINA: I'm trying. It says, all --

15 MR. MORRIS: It doesn't say shared services --

16 MR. RUKAVINA: Arrangement, arrangement.

17 MR. MORRIS: It says shared services --

18 MR. RUKAVINA: Yeah, and I apologize.

19 MR. MORRIS: -- arrangement.

20 MR. RUKAVINA: That's true and I apologize.

21 Again, you'll see that I can't --

22 MR. MORRIS: No problem.

23 MR. RUKAVINA: I'm of that age where I need  
24 reading glasses and I'm too embarrassed to admit it.

25 BY MR. RUKAVINA:

1 Q All amounts owed by each of NexPoint and HCMFA pursuant  
2 to the shared services arrangement with HCMLP had been paid  
3 as of the date of this letter. I apologize for my mistake.  
4 Did I read that correctly now?

5 A You did, yes.

6 Q Any mention about payroll reimbursement agreements?

7 A There is not.

8 MR. RUKAVINA: Okay. Thank you, Mr. Powell, for  
9 your time. Pass the witness, Your Honor.

10 THE COURT: All right. Redirect?

11 REDIRECT EXAMINATION

12 BY MS. WINOGRAD:

13 Q Mr. Powell, you were aware of the payroll reimbursement  
14 agreements; is that right?

15 A Conceptually, yes.

16 Q Did you view them -- did you view the shared services  
17 and the front office services as one in the same?

18 A Shared services and front office?

19 Q Uh-huh.

20 A No, we do not.

21 MS. WINOGRAD: Thank you.

22 THE WITNESS: Okay.

23 THE COURT: Any recross?

24 MR. RUKAVINA: No, Your Honor, thank you.

25 THE COURT: All right. Thank you, Mr. Powell,



1 you're excused now.

2 THE WITNESS: Okay. Thank you.

3 THE COURT: All right. Your next witness?

4 (Witness excused)

5 MR. MORRIS: Good morning, Your Honor, John Morris  
6 from Pachulski Stang Ziehl & Jones for Highland Capital  
7 Management.

8 Highland next calls Mr. James P. Seery, Jr.

9 THE COURT: Mr. Seery.

10 MR. SEERY: Good morning, Your Honor. Off the  
11 record, I've been wearing a mask because I have a cold and  
12 I've been testing, so I'm -- every day, so.

13 THE COURT: Well, you may have noticed I've  
14 been sniffing a lot up here and I'm pretty sure it's  
15 allergies.

16 MR. SEERY: My apologies. If the Court would like  
17 me to wear the mask under testimony, I can do that,  
18 otherwise, I will be a bit raspy.

19 THE COURT: Well, you know, it's up to you. I'd  
20 say whatever makes each individual feel comfortable, so  
21 please raise your right hand.

22 JAMES P. SEERY, WITNESS, SWORN

23 THE COURT: All right. Please be seated.

24 THE WITNESS: Thank you.

25 THE COURT: Okay.

1 DIRECT EXAMINATION

2 BY MR. MORRIS:

3 Q Good morning, Mr. Seery.

4 A Good morning.

5 Q You were appointed in January of 2020; is that right?

6 A As an independent board member, yes.

7 Q Okay. And at the time -- and you were appointed with  
8 two other gentlemen, correct?

9 A Yes, Mr. John Dubell (ph) and Mr. Ruff Snelms (ph).

10 Q After the independent board was appointed on January  
11 1st, 2020 did the independent board meet with Frank  
12 Waterhouse to go after financial information concerning  
13 Highland?

14 A Yes. We met with the whole team. Often individually  
15 including Frank individually for the senior people and then  
16 each group. So with finance and accounting it was Frank and  
17 Dave Klos.

18 Q Okay. And do you recall the topics of discussion  
19 during the early period after the independent board was  
20 appointed that you had with Frank and with Mr. Klos?

21 A Yes.

22 Q Can you describe for the Court what you recall  
23 generally about the substance of those discussions?

24 A These were multiple topics, multiple meetings starting  
25 on the afternoon of the 9th and going forward I was in

1 Dallas most days usually at least Monday to Wednesday or  
2 Thursday, sometimes Tuesday to Friday but most of the days  
3 up until COVID hit. And we had in-depth conversations  
4 regarding each of the funds that Highland managed, each of  
5 the sources of revenue, each of the obligations that  
6 Highland had, the employees, everything that rolled up to  
7 Waterhouse and Klos, which included HR, which rolled up to  
8 Waterhouse. And then we show up -- the investing in a  
9 distressed company we show up in a bankruptcy it's like real  
10 estate, there's three important things, liquidity, liquidity  
11 and liquidity.

12 Q Did the issue of the relationship between Highland and  
13 affiliates who were owned and/or controlled by Mr. Dondero  
14 come up?

15 A Yes. Right out of the gate. So Highland, the way it  
16 was set up --

17 MR. RUKAVINA: Your Honor, excuse me. Your Honor,  
18 he's not allowed to testify narratively, he answered the  
19 question, what do you recall about that topic.

20 THE WITNESS: So right out of the gate one of the  
21 important considerations were what were the contractual  
22 relationships that Highland had, what were the revenues you  
23 could receive from those contractual relationships, what  
24 were the obligations you had to do to manage those  
25 obligations, and what were the risks with respect to those

1 obligations. Did they -- were they ultimately -- were they  
2 worthwhile keeping, were they things you should think about  
3 getting rid of, how to staff them, were there ways to manage  
4 that exposure.

5           And the interrelationship of the Highland entities  
6 was front and center in the case. So even from before the  
7 case got transferred here, one of the big issues for the UCC  
8 which was mentioned at a lunch we had with some of the UCC  
9 members which I don't -- it may have been the day of the  
10 appointment was issues with respect to is Dondero -- is  
11 Dondero or are Dondero entities siphoning value from  
12 Highland to the detriment to the creditors and to the  
13 Highland estate.

14 BY MR. MORRIS:

15 Q       And did that topic continue to be discussed between you  
16 and the independent board and the committee into March?

17 A       These are front and center major issue and the reason,  
18 the reason it was is sort of obvious. But it was not just  
19 ultimate value, but it would have to do with liquidity. So  
20 when we considered the various contractual arrangements what  
21 were the ways that we got revenue and was that revenue  
22 important enough to keep.

23           So we thought about it as the big four in terms of  
24 revenue. You had the 1.0 CLOs and they would pay management  
25 fees based upon the fee stream that they had, which was at

1 that point simply just the management portion of the CLO  
2 fee. And then you had the HCMFA which was paying a  
3 combination of fees, flat fees under the -- about a flat  
4 fee, a flat fee under the payroll reimbursement and a  
5 relatively flat fee although it had a slight fluctuation, I  
6 can go into detail on that, on the shared services. And  
7 their flat fee from NPA on shared services and a flat fee  
8 from NPA on the PRAs.

9 The structure of that, that was the vast majority of  
10 the revenue on a regular basis that you'd get. Everything  
11 else was kind of a rounding error.

12 Q Do you recall having a meeting in which Josh Carey (ph)  
13 participated where the topic of the shared services and sub-  
14 advisory or payroll reimbursement agreements was discussed?

15 A Well, Mr. Terry had a -- yes, and Mr. Terry --

16 Q Do you recall the meeting?

17 A Yeah.

18 Q I just want to satisfy counsel, let me just ask the  
19 questions. Do you recall the meeting?

20 A I recall the meeting, yes.

21 Q Okay. Can you explain to the judge what you recall  
22 about the meeting?

23 A It was actually multiple meetings. So it started at  
24 this lunch which was we stayed at the Jewel the first night  
25 of the first hearing and I think our lunch was there or

1 right in and around there. And Mr. Terry and his counsel  
2 peppered us with information regarding their perspective on  
3 certain things went on at Highland.

4 And Mr. Terry had a unique perspective because he was  
5 part of the ASIS arrangement. So ASIS which managed the CLO  
6 business, which had been Highland's business and then got  
7 put off to ASIS, ASIS had a shared service arrangement.  
8 ASIS had a -- didn't have a -- I don't think it had a PRA,  
9 but it didn't really make a difference. If it did, it might  
10 have been a nominal fee. And ASIS also had a sub-advisory  
11 fee.

12 So ASIS was paying sub-advisory to Highland at a very  
13 low rate. And ASIS was paying shared services amounts at a  
14 very low rate and getting lots of value. How did Mr. Terry  
15 know this? Because he was one of the partners in ASIS that  
16 benefitted from this value transfer.

17 ASIS was getting value from Highland. When the ASIS  
18 bankruptcy happened and it started stripping out assets,  
19 they upped the fees on the management fee from I think five  
20 bips to 25. ASIS was probably making around 40. So he knew  
21 exactly that these arrangements and from his perspective  
22 took value away from Highland for the benefit of these other  
23 entities. That was ASIS and he was focused on HCMFA and NPA  
24 because NPA's completely owned by Dondero through Dougaboy  
25 (ph) and HCMFA had been completely owned by Dondero but then

1 it was owned by Dondero and Okada through entities.

2 Q And after having these conversations and leading up to  
3 these conversations, did you communicate with Mr. Waterhouse  
4 about the economics of the intercompany agreements that you  
5 just described?

6 A Well, right out of the gate that was important, not  
7 only for as I said earlier for Mr. Terry's inquiry, and it  
8 became a larger committee inquiry, but because of the  
9 liquidity issues.

10 So I needed to know what was coming in from each of  
11 these contracts, what were the risks. The 1.0 CLOs while  
12 they had a lot of assets under management, they were lumpy  
13 because some of them didn't have cash. They -- we've talked  
14 about it before, they weren't really CLOs. They're  
15 basically closed in funds because they don't go buy any  
16 assets, they don't have anything that's really income  
17 producing.

18 They own reorganized equity, defaulted debt, so when  
19 those paid off, then one would come in and get paid fees,  
20 otherwise the fees accrued. So that was lumpy. Then you  
21 had direct fees from HCMFA, in the form of the two  
22 agreements, indirect fees from NPA.

23 And I had a very specific conversation with Mr.  
24 Waterhouse and Mr. Klos and I recall it vividly, I'm  
25 burdened by that, and I can picture Mr. Waterhouse on the

1 table telling me, well -- because I looked at the exhibits  
2 and I said how do I know this money's coming in. And they  
3 told me it was a flat fee coming in so we could count on  
4 that.

5 And I asked about the specific schedule at the back of  
6 these agreements and I said, who came up with this, where  
7 Sirhan (ph) is 29 percent for one and 9 percent for another,  
8 how do I know that that's an accurate number. And they said  
9 well -- and it's going to keep coming in every month. They  
10 said, well, that's a fixed number one day, it's just a plug,  
11 it was topped down, don't worry about it, that comes in  
12 every month.

13 And I said, well, HCMFA does that come in every month.  
14 And the answer was, well, it has a variable on the shared  
15 service by it's very small, it's 290 to 300,000 a month.

16 Q I just want to --

17 A So that was the focus on the first time we talked about  
18 the shared service arrangements was liquidity. We didn't  
19 talk about at that point whether Mr. Terry's concern that  
20 value was getting sucked out. It was first how much money I  
21 have to keep the lights on here.

22 Q Okay. And you were actually looking at the exhibits to  
23 the payroll reimbursement agreements --

24 A Yeah.

25 Q -- do I have that right?



1 A Uh-huh.

2 Q All right. I'm not going to take the time to go  
3 through that. Did --

4 A Yeah, you'll see each of them, he's the first guy. And  
5 I remember, I just remember specifically asking 9 percent,  
6 how did you guys come up with that, maybe I'm too simple,  
7 but I think in 5s and 10s if I'm rounding and they laughed  
8 and said it's a plug number, you needed to adjust it to get  
9 the output.

10 Q Okay. Did either Mr. Klos or Mr. Waterhouse tell you  
11 ever that the advisors were overpaying under the payroll  
12 reimbursement agreements?

13 A Absolutely not.

14 Q Okay. You sat here yesterday. You saw the analyses  
15 that Mr. Klos prepared in late 2019 before the independent  
16 board was appointed. Did either Mr. Klos or Mr. Waterhouse  
17 show you either one of the analyses that Mr. Klos prepared  
18 in 2019?

19 A I never saw those until we started preparing for this  
20 trial. And this was a front and center issue. So the  
21 committee was pushing very early for Highland to terminate a  
22 lot of employees. Because as I said, Mr. Terry knew the  
23 arrangements and knew how it worked. And it worked as I  
24 described. And the committee, other members, picked that  
25 up.

1 And so the first meeting, we had a face-to-face meeting  
2 on March 9th in New York City at the Pachulski offices.  
3 What I remember it was the last chopper out of Saigon as  
4 they say, it was the last meeting before COVID really shut  
5 down New York and literally that night it was over. And it  
6 was a very tense meeting for a whole bunch of reasons.  
7 Including UBS issues which were separate, but Mr. Terry was  
8 very focused and I don't recall if he was there, but it was  
9 a packed conference room, so in hindsight felt very  
10 unhealthy.

11 A lot of focus on the value being sucked out by Dondero  
12 entities. And I was ill prepared. I don't show up very  
13 often unprepared and I was not at my best and he was giving  
14 it to me pretty good.

15 And so that became a major focus for us to start  
16 figuring out how -- what are we burning cash on and why are  
17 we burning so much cash and why don't these arrangements,  
18 the big four, CLOs which were fixed, HCMFA, NPA, why don't -  
19 - I forget the fourth, why don't we have enough money  
20 because we knew by then we were burning cash.

21 Q Did you communicate with Scott Ellington (ph) and Isaac  
22 Leviton (ph) during the six months after the appointment  
23 about various matters?

24 A Absolutely.

25 Q Did either Scott Ellington or Isaac Leviton tell you at

1 any time in the history of the world that they had  
2 information from Frank Waterhouse showing that the advisors  
3 were overpaying under the payroll reimbursement agreement?

4 MR. RUKAVINA: Your Honor, that's going to be  
5 hearsay, objection. Those are not our officers, not a party  
6 admission.

7 THE COURT: Okay. Let me think through that.

8 Okay. Not a party opponent because they're  
9 technically Highland employees, so.

10 MR. MORRIS: I want to know what the newly  
11 appointed independent board knew, right, isn't it important  
12 to know based on their entire case -- all right. I'll ask  
13 this question.

14 THE COURT: Okay.

15 BY MR. MORRIS:

16 Q Did anybody in the world, anybody in the whole wide  
17 world ever tell you or any member of the independent board  
18 that Highland was overcharging the advisors under the  
19 payroll reimbursement agreements?

20 A It didn't happen and it couldn't happen and the reason  
21 it couldn't happen was because these arrangements were  
22 massive money losers.

23 So the issue that Mr. Terry raised on the first day and  
24 beat me up on March 9th on didn't stop on March 9th, it  
25 continued. Again, the committee's focus was how do we stop

1 the burn. We did 13-week cash flow meetings every single  
2 week. I am not comfortable with a 13-week cash flow where  
3 the numbers have parenthesis around them. That means  
4 they're negative. And so I don't like looking out five  
5 weeks and see we're running out of cash.

6 So we were continually working to figure out why --  
7 where we were burning cash, where we could offset, at the  
8 same time not going through a wholesale firing of employees  
9 because my view at the time and the board concurred with me  
10 and held the same view, was that we should try to hold the  
11 organization together and get a larger reorganization, which  
12 would have required Mr. Dondero's participation and it  
13 wouldn't have made sense for Mr. Dondero to participate if  
14 the entity had lost all its employment and utility to him  
15 and his companies.

16 Q If the contracts were losing so much money, why didn't  
17 you just immediately move to reject? You were getting this  
18 pressure from Mr. Terry, why didn't you just reject the  
19 contracts?

20 A Well, precisely because we wanted to hold the business  
21 together. So what we did was, we did -- by the time we got  
22 to June-ish, May/June, we had really analyzed these  
23 arrangements. And we found that the arrangement with DAF,  
24 which was one of the big four was profitable, it had a  
25 shared service but I don't think there was a fee under it,

1 but it was a typical 2 and 20 arrangement.

2 So you've got 2 percent of the assets under management  
3 and then you've got 20 percent of the upside and I think it  
4 was annual, I don't think it had an earlier advancement of  
5 the profit up. So that was a good arrangement. You got a  
6 good sense of where that was coming in. That was a  
7 profitable arrangement.

8 The other contracts by the time we had the next meeting  
9 with the committee were in the 8 to \$10 million loser range.  
10 That's what we were burning at Highland ex-restructuring  
11 costs. So not including counsel and committee counsel and  
12 financial advisors.

13 Q Okay. Let's shift gears a little bit to the provision  
14 of services. From your perspective, did Highland perform  
15 the services required under the payroll reimbursement  
16 agreements and the shared services agreements?

17 A Absolutely. That was what the employees did and it was  
18 middle, front and back. And we didn't, to be fair, look and  
19 say, oh, look at this one contract versus this one. They  
20 were arrangements. They were the complete arrangement with  
21 HCMFA.

22 And let's be clear about what we're talking about and  
23 everybody else knows this, HCMFA and NPA aren't real  
24 separate entities, they've now developed.

25 MR. RUKAVINA: Your Honor, I object. Now, this is

1 narrative, this is all kinds of legal conclusions, expert  
2 conclusions that has no relevance to this.

3 THE WITNESS: This is factual.

4 MR. RUKAVINA: To say that my clients are not  
5 separate legal elements -- entities, the man is just  
6 narratively telling you a story that has some tangential  
7 relevance. He should be asked questions and give clear  
8 answers.

9 MR. MORRIS: Okay.

10 THE COURT: All right. Well, there is some  
11 narrative but we've got two days for this trial, you know.  
12 I mean, I'm trying to balance the narrative versus we don't  
13 want this going on four days. So let's just try to keep it  
14 in check.

15 BY MR. MORRIS:

16 Q Mr. Seery, from the date that the independent board was  
17 appointed on January 9th, 2020 until November 30th, 2020  
18 when Highland gave notice of termination under the shared  
19 services agreements, did you -- do you recall receiving any  
20 complaints about Highland's performance of back, middle and  
21 front office services to -- withdrawn. I'm going to start  
22 this differently.

23 Let's call that the relevant period from your  
24 appointment until November 30th, 2020. Okay.

25 I'll start with the advisors. Do you recall receiving

1 any complaints at any time during that period that the  
2 advisors -- that Highland was failing to perform back,  
3 middle, or front office services under the three agreements  
4 -- under the agreements?

5 A From the advisors?

6 Q Yes.

7 A Not at all, never, not once.

8 Q Not once.

9 A Not once.

10 Q Okay. Is there anybody in the world that you recall  
11 complaining about the provision of services by Highland  
12 during the relevant period?

13 A Yes.

14 Q Who made the complaint?

15 A John Holt.

16 Q Who's John Holt?

17 A He's the CEO of NexBank.

18 Q And do you recall the nature of the complaint, just  
19 briefly?

20 A Yes. He thought he was being charged too much for his  
21 various service arrangements and didn't think he was getting  
22 quality service, particularly from the legal department, Mr.  
23 Allenton (ph), Leviton, compliance, et cetera.

24 Q And did you -- what happened as a result of the  
25 complaint that you received?

1 A I investigated it. I talked to Allenton and the rest  
2 of the legal team. They came back with specifics that Mr.  
3 Holt was in their opinion mistaken, that they had been  
4 providing significant services for NexBank and that he may  
5 not have been aware of them as the CEO.

6 They complained that he as paid on an EBITDA basis so  
7 that his incentive was to reduce costs wherever he could and  
8 get services for free. I found Mr. Holt to be a  
9 sophisticated, straight businessman. We had a discussion on  
10 the phone. We agreed to disagree and defer discussion on it  
11 until we could figure out how to best separate the  
12 relationship between Highland Capital Management and  
13 NexBank.

14 Q Do you recall receiving a letter from D.C. Sauder (ph)  
15 in mid-October, 2020?

16 A I believe I got a letter from Mr. Sauder. I'm not sure  
17 if I even knew who he was when I got it. And it was right  
18 after, I believe it was right after things had really gone,  
19 I would say south with Mr. Dondero.

20 Q Do you recall -- when you say it went south, did there  
21 come a time when Mr. Dondero resigned from Highland?

22 A Beginning of October.

23 Q Okay. And your recollection is that you received this  
24 -- give me just one second.

25 A In or around that time.



1 MR. MORRIS: I apologize, but give me just one  
2 second.

3 Q It's Exhibit 148 in your book, if you can get that.

4 THE COURT: I'm sorry, what number?

5 MR. MORRIS: 148.

6 THE COURT: Okay.

7 BY MR. MORRIS:

8 Q And if you could just take a look at that, Mr. Seery.

9 A I thought you said it was from Sauder. This says from  
10 Norris. Did I miss --

11 Q Oh, no. I may just be mistaken, I apologize. This is  
12 a letter from Mr. Norris.

13 A I don't think I knew who he was either.

14 Q Okay. So do you recall receiving this letter then?

15 A I recall getting a letter in or around this time from  
16 NexPoint.

17 Q And can you take a quick look at that letter and see if  
18 you can let the Court know if you recall whether Mr. Norris  
19 put Highland on notice about any failure to provide back,  
20 middle, front office services of any kind?

21 A It looks to me to be a complaint about the OmniMax  
22 issue.

23 Q Is that -- do you understand that that's the issue that  
24 Mr. Powell just testified about?

25 A He -- I heard Mr. Powell's testimony and he mentioned

1 the OmniMax issue. He -- to be clear, I was invited to the  
2 board meetings. I didn't volunteer to go to the retail  
3 board meetings and I said I would do that. And I did raise  
4 the issue around the OmniMax transaction.

5 And what happened was Highland had a big position. The  
6 retail funds had a small position. We thought the  
7 transaction was a good transaction because the company --  
8 this other guy is going to file and the buyer of the company  
9 was willing to take out the whole piece.

10 I had been in discussions with Mr. Dondero. Mr.  
11 Dondero had agreed to a price. When I came back with the  
12 price, he said I never agreed to that price. I said fine,  
13 we're going to trade these because this is a good price.  
14 And the structure of the trade was such that with the buyer,  
15 if need be, would be put into bankruptcy and the hold out  
16 would be crammed down. And we were happy to do that.

17 Mr. Dondero ultimately held out. The funds held out.  
18 They cut a deal with the buyer and then we had to pick part  
19 of it because it was less expensive than filing the company  
20 for bankruptcy.

21 Q And --

22 A So they got bought out at a little bit higher level.

23 Q Is it fair to say that there was simply difference in  
24 investment strategy between you and Mr. Dondero?

25 A Yes, I think that's fair.

1 Q And is that when we talk about conflict is that what  
2 you're talking about?

3 A That's correct.

4 Q Can you think of any other transaction -- oh. Was it  
5 possible that conflicts would arise with respect to other  
6 jointly held assets?

7 A Definitely could be.

8 Q And that's really -- did you understand that's what Mr.  
9 Norris was referring to?

10 A I do.

11 Q In the second paragraph.

12 A That's what it looks like he's referring to. I'm not  
13 remember spending that much time thinking about this letter  
14 frankly.

15 Q Okay. Do you -- I'm -- do you recall receiving other  
16 letters from the advisors and from their lawyers at K&L  
17 Gates?

18 A Definitely lawyer letters, yes.

19 Q Do you recall whether any lawyer -- withdrawn.

20 Do you recall whether any letter because I don't want  
21 to go through all of them, they speak for themselves, so I'm  
22 asking for your recollection; do you recall receiving any  
23 letter sent by the advisors or by their lawyers where they  
24 made any complaint at all about the provision of front, back  
25 or middle office services?

1 A Never received, other than the Holt complaint related  
2 to NexBank, never received a complaint about the amount of  
3 the services or the quality of the services that were being  
4 provided front, middle or back. And it was all three.

5 Q In the administrative claim there's an allegation that  
6 you instructed Highland's employees to stop providing  
7 services in July 2020. Are you familiar with that  
8 allegation?

9 A I'm familiar with the allegation.

10 Q Did you instruct anybody in July 2020 to stop providing  
11 services to anybody?

12 A No, never happened.

13 Q Do you have any understanding or recollection as to  
14 what you said at that time that they might be referring to?

15 A Very distinct recollection, yes.

16 Q Can you explain to Judge Jernigan what your  
17 recollection is as to what you actually said?

18 A There was a discovery dispute between the committee and  
19 Highland at the time. And the discovery dispute was  
20 actually quite surprising to me because I'd instructed the  
21 Pachulski team and the Highland team to produce information  
22 because there was really no point in wasting a lot of time  
23 fighting about discovery.

24 And frankly Mr. Levinson found a different way to deal  
25 with discovery that was less than cooperative. And the

1 committee raised the issue about multiple parties wearing  
2 multiple hats to the Court. And it was a bit Alice in  
3 Wonderland in terms of Mr. Leviton and others saying, well,  
4 I'm the advisor to the -- I'm the counsel to the advisor and  
5 I have a fiduciary duty to them, you're our lawyer, you have  
6 to do what we direct you to do. And it was very  
7 manufactured.

8 And my recollection, and I took it very directly  
9 because I was on video, but I took this as if the Court were  
10 talking to me directly was that you better make sure you  
11 have your house in order regarding people with conflicts  
12 what they are doing, especially lawyers, who claim to be  
13 wearing multiple fiduciary hats and forsaking their duties  
14 to the debtor.

15 I left that hearing really informed and nervous isn't  
16 the right word, but focused, that we needed to make sure  
17 that everyone got the message. So I had a specific call  
18 with the entire legal department. And the legal department  
19 at Highland, it may be a misnomer, because there were a  
20 number of non-lawyers in that department and they did  
21 different things in the Cayman Islands or other places that  
22 didn't have much to do with Highland.

23 And I had very direct discussion and I used the word  
24 and it seems to show up now inimical but any -- taking any  
25 adverse action to the Highland estate and if anybody felt

1 that they had a reason that they couldn't do something for  
2 the Highland estate I better hear about it directly.

3 And it was a very direct discussion. I had then had  
4 the same call with Mr. Waterhouse, Mr. Klos, Ms. Hendricks,  
5 Mr. Darquentin (ph) may have been on it, he may have been  
6 too junior, but very direct. And then a similar discussion  
7 with Brian Collins, head of HR, that we better -- I better  
8 not hear about this again because you do it, you be fired  
9 for cause and we will take action. It was, I took it very,  
10 very seriously.

11 Q So there was no direction to stop performing services?

12 A No, absolutely not. You still had to do your job and  
13 if something raised a conflict, I needed to know about it,  
14 like ultimately the OmniMax transaction which was after this  
15 time, but if you didn't think you could produce documents  
16 because you had some other duty, I needed to know about  
17 that.

18 If you thought that you represented any other entity,  
19 Dougaboy, whomever and that interest was averse to the  
20 estate, I needed to know about it. And I was very clear.  
21 And I think it had the desired effect. We had a larger call  
22 with the team that was not nearly as forceful, but people  
23 needed to know that this is an estate and as employees of  
24 the estate, you have duties to the estate. And as officers  
25 of the estate, you have fiduciary duties to the estate.

1 Q And did you -- going back you mentioned OmniMax, you  
2 mentioned the possibility that there might be other  
3 conflicts that arose as a result of jointly held assets.  
4 Other than OmniMax did, in fact, any other conflict ever  
5 arise prior to the termination of the agreements?

6 A Not that I recall. And just so we're clear, you used  
7 the term jointly held assets. They're not actually jointly  
8 held. Highland owns its own assets. The 1.0 CLO owned  
9 their own assets. HCMFA had their assets in their name.  
10 NPA, et cetera, Dougaboy, et cetera, DUC, DAF (ph).

11 Q So let me restate the question. Were there any other  
12 issues that arose where Highland and another entity  
13 controlled by Mr. Dondero owned assets of the same kind  
14 where investment decisions diverged?

15 A Not that I recall. Certainly not during this period,  
16 not that I recall at all.

17 Q Okay. Did there come a time that Jason Post left the  
18 employ of Highland and became the chief compliance officer  
19 at the advisors?

20 A Yes.

21 Q And when did that happen?

22 A It was right after Mr. Dondero resigned, right in that  
23 time frame.

24 Q So sometime in October?

25 A I believe so.

1 Q So he served in that capacity for six weeks before the  
2 notice of termination was given?

3 A Roughly, I believe.

4 Q And do you have any understanding as to why that move  
5 was made by Mr. Post?

6 A The reason was they requested it. I agreed that it was  
7 a good idea because it was evolving and becoming more and  
8 more likely that there was not going to be a grand bargain  
9 or a settled solution to this case. There wasn't a moment  
10 in time where you knew that, but Mr. Dondero required to --  
11 we had got through mediation, very successful vis-à-vis  
12 settlement with ASIS, productive vis-à-vis UBS, wholly  
13 unproductive for a global settlement. We continued to try  
14 to work on those things, but it became less and less likely.

15 And so by October the plan, I don't know when we filed  
16 it, but it was clear it was going to get filed if we had not  
17 yet filed it. And where we thought that was the crucible to  
18 bring a settlement, it was having the desired effect on the  
19 creditors' side to have them think about compromising their  
20 claims, it wasn't bringing Mr. Dondero and the creditors  
21 close enough together. Although there were efforts, but by  
22 that time it looked like the --

23 MR. RUKAVINA: Your Honor, again, this is just --

24 THE WITNESS: -- the advisors could have the  
25 issue.



1 MR. RUKAVINA: -- just narrative now about  
2 negotiations. The question was why did Post leave. He  
3 answered that question.

4 THE COURT: Sustained.

5 BY MR. MORRIS:

6 Q All right. Let's talk about the payroll reimbursement  
7 agreements. Do you recall that the Court-approved  
8 Highland's disclosure statement in mid-to-late November  
9 2020?

10 A Yes.

11 Q And do you recall that Highland gave notice of the  
12 shared service agreements that it had with the advisors on  
13 November 30th, 2020?

14 A Notice of termination?

15 Q Yes.

16 A Yes.

17 Q Was there a relationship between the Court's approval  
18 of the disclosure statement in mid-to-late November and the  
19 sending of the notices of termination concerning the shared  
20 services agreements on November 30th --

21 A Yes.

22 Q -- 2020?

23 A Yes.

24 Q Can you describe the Court -- for the Court what the  
25 relationship was between those two events?

1 A The relationship was purely timing so that once we knew  
2 we had a disclosure statement approved, then we could set a  
3 confirmation date, and we looked at where that confirmation  
4 date is and we needed to be able to terminate the agreements  
5 before we got to the confirmation date or right at and about  
6 to that time. Then it would, assuming it got confirmed, it  
7 would go to the monetization plan.

8 Q Is it fair to say that the termination of the shared  
9 services agreements was consistent with the plan of  
10 reorganization that Highland was hoping to get approved?

11 A Yes.

12 Q Okay. Did this -- did the debtor ever seek to assume  
13 the payroll reimbursement agreements?

14 A No.

15 Q Did the debtor ever consider assuming the payroll  
16 reimbursement agreements?

17 A No.

18 Q Why not?

19 A The arrangements with HCMFA and NPA, as I said, were  
20 money losers. There was -- I think I was even asked about  
21 it at the confirmation hearing, why not assume these,  
22 because they're money losers. So there was never a plan to  
23 do that. And we weren't going to keep around staff to be  
24 able to work on retail funds. The idea was to focus on  
25 assets that would produce value to the creditors of the

1 estate, not to provide money losing services to third-party  
2 funds.

3 Q Are you familiar with the termination provisions in the  
4 payroll reimbursement agreements?

5 A Generally.

6 Q Can we take a look at them just quickly? Go to Exhibit  
7 6, please.

8 Do you have that in front of you? And we're on the  
9 page ending in Bates Number 622. And I would direct your  
10 attention down to Section 5.02.

11 A Yes.

12 Q If Highland had assumed the payroll reimbursement  
13 agreements, is it your understanding that they have -- would  
14 have had to assume the entirety of the agreement?

15 A I know Counsel doesn't like me talking about the law,  
16 but that is the law.

17 Q Okay. And --

18 A (Indiscernible) as we say.

19 Q And so it would have had to also assume Section 5.02,  
20 right?

21 A That's correct.

22 Q And what does Section 5.02 provide?

23 A It provides that either party can terminate on 60 days'  
24 advance written notice. It -- I think it's the same in most  
25 of the shared service arrangements as well.

1 Q Well, but I'm just focused on the payroll reimbursement  
2 agreements.

3 A Yeah.

4 Q Okay. They could terminate on 60 days' notice. Is it  
5 your understanding based on this agreement that the advisors  
6 needed a reason to terminate?

7 A No, neither party needs a reason.

8 Q And that's -- and where do you get that idea from?

9 A There's no provision in 5.02 that would require a  
10 reason.

11 Q It says, with or without cause, right?

12 A Yeah.

13 Q Just to close this topic, can you go to Exhibit 8,  
14 please, which is the one -- 6, I think, was the next payroll  
15 reimbursement agreement. 8 is the HCMFA payroll  
16 reimbursement agreement. And does it also have the same  
17 Section 5.02 that would have permitted the advisors or HCMFA  
18 to terminate the payroll reimbursement agreement without  
19 cause on 60 days' notice?

20 A Yes. These two agreements are identical say for the  
21 party names and the actual amount paid each month.

22 Q Do you recall -- I'm not going to dig it up. I'm just  
23 going to ask you if you recall that the plan specifically  
24 provided that any contract not specifically assumed would be  
25 deemed rejected?

1 A Yes. That's a pretty standard provision. You only  
2 want to assume the agreements that you intend to assume.  
3 Excuse me.

4 Q Okay. So how come -- are you aware of any -- did  
5 Highland give notice of termination of the payroll  
6 reimbursement agreements?

7 A I frankly don't recall. Mr. Rukavina asked me that at  
8 my deposition. I thought we did with the tiered service  
9 arrangements because they -- we viewed them as one in the  
10 same. But apparently, I've now learned that we didn't, and  
11 they were just rejected as part of the plan.

12 Q During -- were you involved in the discussions  
13 concerning the transition of Highland's employees and assets  
14 to the advisors that took place in early January/February  
15 2020?

16 A Yes.

17 Q During those discussions did Highland make a demand to  
18 keep the employees that were performing front office  
19 investment advisory services?

20 A If I understand your question, did we make a demand to  
21 keep the employees? No. We were going to terminate them.

22 Q Okay. And which employees were you intending to  
23 retain?

24 A At that point I was working on my team, but I was not  
25 going to have more than 10 to 15 employees. I didn't need

1 them.

2 Q And the team that you were constructing, was it a team  
3 that was expected to provide front office investment  
4 advisory services to the advisor's post-confirmation?

5 A No.

6 Q Okay. I just --

7 A I may not be understanding your question. I --

8 Q No, you are.

9 A -- apologize.

10 Q I mean, it's -- but that's -- that was suggested  
11 yesterday.

12 I heard you say, I think, in October, you know, as part  
13 of the Jason Post move you thought that part of the factor  
14 was that negotiations didn't -- weren't bearing fruit with  
15 Mr. Dondero. Is that just generally fair?

16 A Yeah. That's fair. I think it was --

17 Q Okay.

18 A -- just the idea that there was more and more tension  
19 and that even though there had not arisen another conflict,  
20 but OmniMax at that time that there could be one and that it  
21 would be better for the advisors to have their own chief  
22 compliance officer as opposed to -- Jason worked for Thomas  
23 Surgent who provided -- I think Mr. Ethan testified that it  
24 was found that Thomas was the CCO for the complex. He was  
25 Jason's boss. And it just seemed -- they brought it to me.

1 I think -- I don't remember if Jason did or Thomas did. It  
2 just seemed a better way that if another conflict arose,  
3 that Surgent or someone else wouldn't be put in the position  
4 that I had admonished people about in July.

5 Q Nevertheless, do you recall that really through  
6 December up until the confirmation hearing, without  
7 characterizing your views as to the likelihood of success,  
8 did negotiations with Mr. Dondero continue?

9 A Yes.

10 Q Okay.

11 A Not with me directly because he wasn't allowed to talk  
12 to me, which was all fine by me at some point in there, but  
13 through counsel.

14 Q Through counsel. Did Mr. Waterhouse play any role in  
15 those negotiations?

16 A None whatsoever. These are the negotiations with Mr.  
17 Dondero around a larger plan.

18 Q Correct.

19 A Yeah. None whatsoever.

20 Q None. Did you ever ask him to prepare any kind of  
21 analysis of profitability for the inter-company agreements  
22 between the advisors and Highland for use in the  
23 negotiations?

24 A Never.

25 Q You've sat here, you know, for more than a day and

1 you've heard about the allegations about overpayments. Do  
2 you recall when the first time you heard about the issue of  
3 overpayments?

4 A I think the first time I recall hearing about  
5 overpayments was an allegation that Mr. Dondero put in a  
6 January term sheet that was part of negotiations where he  
7 basically said in addition to all the value I'm getting, I'm  
8 going to pick up the \$14 million advisor admin claim. And I  
9 wrote an acronym for something that basically indicates that  
10 I was saying, what does this mean.

11 It was nothing I had ever heard of and it was -- that  
12 was the first time was in January.

13 Q And the first time you heard it was --

14 A That I recall.

15 Q -- in connection with a proposed plan of reorganization  
16 that Mr. --

17 A It was a pot plan.

18 Q Pot plan.

19 A Yeah. And I think at the time it was -- I can't  
20 remember the exact date, but the first couple of weeks of  
21 January. And I believe he and his counsel had filed a plan  
22 under seal right around that time, and this was -- which I  
23 never saw. This was the term sheet for it.

24 Q We can look at them, but I'll test your memory first.

25 So that's the first time. So is it fair to say that



1 you have no recollection of the issue of overpayments being  
2 raised in any of the K&L Gates letters that were sent as  
3 counsel to the advisors to Highland in December 2020?

4 A Not that I recall.

5 Q Do you recall if K&L Gates or any lawyer acting on  
6 behalf of the advisors ever sent any kind of demand for the  
7 return of money that they alleged was overpaid under the  
8 payroll reimbursement agreements?

9 A They never did. And I'll just expand for a second  
10 here. It didn't make sense because we were also negotiating  
11 the transition. And as part of the transition I required --  
12 I wasn't going to keep providing services for free. By this  
13 time it's pretty hot in January and we required NPA and  
14 HCMFA to pay the shared service amount and the PRA amounts  
15 in January and February, and they were doing it by a weekly  
16 basis. And our term sheet demanded that they pay the  
17 November and December amounts that they had failed to pay.

18 And they came back and said, well, we're going to have  
19 trouble with that with Mr. Dondero and they tried to agree  
20 that they could pay it over time, and ultimately I acceded  
21 to that. So the transition services arrangement that was  
22 going to move the employees to either NPA or an affiliate or  
23 an employee-owned entity contemplated that we were going to  
24 get paid back the money from November and December. Nobody  
25 ever said, we don't owe you that money. You've been

1 overpaying us or we've been overpaying you or some such  
2 thing.

3 MR. MORRIS: I have no further questions, Your  
4 Honor.

5 THE COURT: All right. Pass the witness.  
6 Mr. Rukavina.

7 MR. RUKAVINA: Your Honor, may Mr. Morris and I  
8 confer for a moment?

9 THE COURT: Sure.

10 (Pause)

11 MR. RUKAVINA: Your Honor, we've been conferring  
12 about schedules and we've been, I think, very cooperative  
13 with each other. We've told Mr. Dondero to be here at one,  
14 so we have an hour right now and I hate to tell the Court  
15 that we're -- we don't want to use that hour. I would like  
16 to recall Mr. Seery when my case begins.

17 We will get done today.

18 MR. MORRIS: Oh, no. Why aren't you going to  
19 cross-examine him?

20 THE COURT: No. I have to stop -- my presentation  
21 starts at noon. They wanted me to patch in --

22 MR. RUKAVINA: Then I'll cross-examine Mr. --

23 THE COURT: -- 10 or 15 minutes early.

24 MR. RUKAVINA: I'll cross-examine Mr. Seery now.

25 THE COURT: Okay.

1 MR. RUKAVINA: And then --

2 MR. MORRIS: I thought you said you had five  
3 minutes.

4 MR. RUKAVINA: Yeah, I do.

5 And then -- yeah. But I'm just telling the Court  
6 that we're going to give you back some time, but it's  
7 because we had agreed to have Mr. Dondero here at one.

8 THE COURT: Okay. Yeah. But I'll need to stop at  
9 11:45.

10 MR. MORRIS: All right. But I just -- I need to  
11 just clarify, the whole idea is to call witnesses once.  
12 We're not going to --

13 MR. RUKAVINA: Yeah. I'll call --

14 MR. MORRIS: -- recall him in your case --

15 MR. RUKAVINA: Yeah. That's fine.

16 MR. MORRIS: -- later, right?

17 MR. RUKAVINA: That's fine.

18 MR. MORRIS: Okay.

19 THE COURT: Okay.

20 CROSS-EXAMINATION

21 BY MR. RUKAVINA:

22 Q Mr. Seery, good morning.

23 A Good morning.

24 MR. RUKAVINA: Mr. Berghman, if you'll please pull  
25 up Exhibit 10 to Mr. Seery's deposition.

1 Your Honor, this is being printed and will be  
2 couriered to the Court as a paper exhibit prior to 1:00.

3 THE COURT: Okay.

4 MR. RUKAVINA: So we'll just have it  
5 electronically for now.

6 THE COURT: Okay.

7 MR. BERGHMAN: You said Exhibit 10, right?

8 MR. RUKAVINA: Yeah.

9 BY MR. RUKAVINA:

10 Q Mr. Seery, you'll have to scroll down through this, but  
11 do you -- this is a December 11th letter from K&L Gates. Do  
12 you recall having received this letter through your counsel?

13 And please take -- tell my partner just scroll down at  
14 your pace.

15 A Okay.

16 Q Next page.

17 (Pause)

18 A Okay.

19 Q Next page, please.

20 A I'm skimming, just to be clear.

21 Q Well, you tell us when you want the next page, please.

22 A I -- do you want me to read the whole letter?

23 Q I want to ask you just about what's written in here  
24 about PRAs and shared services. But you have the right to  
25 read every word of this if you need to.

1 A Just can you go to the next page?

2 And then take me back to the top.

3 Ask away.

4 Q Do you recall receiving this letter through counsel on  
5 or about December 11th, 2020?

6 A I don't specifically recall this letter. There's  
7 another K&L Gates letter, I believe. I thought there were  
8 multiple, but I may be --

9 Q Would you please pull up --

10 A -- I may be mistaken.

11 Q -- Mr. Seery's deposition transcript. See if I can  
12 refresh your memory.

13 MR. RUKAVINA: Page 42, Thomas.

14 It's not going to be in there, Mr. Seery.

15 MR. MORRIS: What exhibit is this? I apologize.

16 MR. RUKAVINA: It's Exhibit 10 to his deposition.

17 This is an impeachment exhibit that is --

18 MR. MORRIS: Oh, okay.

19 MR. RUKAVINA: -- an exhibit to his deposition.

20 MR. MORRIS: Okay. Thank you. Can I have a copy?

21 MR. RUKAVINA: That's what I told the judge. It's  
22 being couriered. Paper copies are being couriered. They'll  
23 be --

24 MR. MORRIS: Thank you very much.

25 Go ahead.

1 MR. RUKAVINA: -- here before lunch.

2 MR. MORRIS: Go ahead. Yeah.

3 BY MR. RUKAVINA:

4 Q Mr. Seery, you're in the wrong binder, please. It's  
5 not --

6 A Oh, you can do what you like. I got binders. Am I not  
7 allowed --

8 Q But I'm telling you --

9 A -- to look at them?

10 Q I'm telling you this is not in those binders, sir.

11 A That's okay. I'm just thumbing through the binders.

12 Q Okay. No problem. No problem.

13 Mr. Seery, if you'll look, please, I asked you at your  
14 deposition. We marked Exhibit 10. I asked, do you remember  
15 seeing this letter on or about December 11th, 2020 and you  
16 answer, yes. Does that refresh your memory that you did, in  
17 fact, see this letter on or about December 11th, 2020?

18 A Truly I don't recall seeing this letter.

19 Q Okay.

20 A It -- because it deals a lot with the notes. I just  
21 don't recall it. There's another K&L Gates letter that I'm  
22 quite sure that I did get from counsel. They were not  
23 addressed to me. I don't recall seeing this letter. So I  
24 quoted I said, yes. If this is the same letter, I just  
25 don't recall it.

1 MR. RUKAVINA: You can pull down this deposition  
2 transcript, Thomas, and go back to the letter.

3 BY MR. RUKAVINA:

4 Q Would you like to revise your prior testimony, sir,  
5 that at no point in time in the history of the world did  
6 anyone for the advisors or their lawyers ever inform you of  
7 alleged overpayments and alleged failure to provide  
8 services?

9 A No. I wouldn't. I don't recall receiving this letter.  
10 This letter does complain in the one paragraph I did read  
11 about shared services, about some sort of failure of  
12 services. Where's the overpayment section?

13 Q Go back to payroll.

14 And, again, sir, I apologize. We'll have this on paper  
15 momentarily.

16 MR. RUKAVINA: Scroll down, Thomas.

17 MR. BERGHMAN: You want the next page?

18 MR. RUKAVINA: Yes.

19 THE WITNESS: I just don't -- you know, I don't  
20 recall you giving me exhibits, correct? You just put them  
21 on the screen during our deposition, right?

22 MR. RUKAVINA: Sir, I ask the questions, not you.  
23 I did --

24 THE WITNESS: But I'm just --

25 MR. RUKAVINA: I did send them to your counsel

1 prior to the deposition.

2 THE WITNESS: Yeah. I didn't --

3 BY MR. RUKAVINA:

4 Q You see, sir, in --

5 A We looked at them on a screen.

6 Q You see, sir, in there that it talks about -- you can  
7 please read it, but it talks about based on a preliminary  
8 analysis -- this is near the bottom -- next point, HCMFA  
9 believed they have over-reimbursed HCMLP under the payroll  
10 reimbursement agreements of approximately \$5 million.

11 A I see that, yes.

12 Q You have no recollection of having heard about that on  
13 or about December 11th?

14 A No, I don't.

15 Q Then let's go back to your deposition transcript,  
16 please, Page 42. Well, not yet, but do you remember I asked  
17 -- well, let me ask you right now.

18 Sir, do you remember whether in light of this letter  
19 there were any negotiations to try to revise the amounts  
20 under the payroll reimbursement agreements?

21 A There never were, no.

22 Q Okay. And I asked you about that at your deposition  
23 and you said --

24 A Yes.

25 Q -- there never were any.



1 A Correct.

2 Q Okay. So let me ask you again. You don't want to  
3 revise whatever prior testimony you gave that no one from  
4 the advisors, no one at K&L prior to Dondero complaining in  
5 January 2021. You never heard about potential overpayments  
6 under the payroll reimbursement agreements?

7 A I don't recall ever hearing about potential  
8 overpayments. Obviously, this December 11th letter was  
9 received by my counsel. I am certain they gave it to me. I  
10 do not recall it. So when you showed it to me at the  
11 deposition I just missed because there is another K&L Gates  
12 letter that's pretty lengthy in and around this time.

13 Q So when you said you were --

14 A There might be two or three.

15 Q So when you said you read it on or about December 11th  
16 at your deposition, you're now saying that you were  
17 incorrectly testifying at your deposition?

18 A That's correct.

19 Q You --

20 A Yes.

21 Q -- confused it with another K&L letter?

22 A Correct.

23 Q Okay.

24 A I just don't recall seeing this letter.

25 Q Okay. But --

1 A I'm sorry.

2 Q -- would you expect your professional counsel at  
3 Pachulski to forward this to you, this letter --

4 A Absolutely.

5 Q -- or advise you of its substance?

6 A They certainly would have forwarded it to me. I'm --

7 Q Okay.

8 A I suspect they would have talked to me about it. I do  
9 not recall those conversations, not because it's privileged.  
10 I just don't recall having a discussion about this letter.  
11 There were multiple letters at the time.

12 Q Okay. Do you think that the advisors could have  
13 terminated the payroll reimbursement agreements or shared  
14 services agreement post-petition without violating the  
15 automatic stay?

16 A Absolutely.

17 Q Okay. You're a lawyer?

18 A Yeah.

19 Q And you've been a bankruptcy professional for decades?

20 A Yes.

21 Q And you're telling the Court that the automatic stay  
22 does not prevent a counterparty to an unassumed executory  
23 contract from terminating that contract?

24 A That's not what I said and that's not what you asked  
25 me.

1 Q I asked you -- I'll ask it differently.

2 Do you think that had the advisors tried to terminate  
3 these contracts, all four of them, post-petition, that that  
4 would have been a stay violation?

5 A Not if they did it correctly, no.

6 Q And how would they have done it correctly?

7 A They would file a motion to terminate the contract and  
8 set forth why --

9 Q That's a little different --

10 A -- they wanted to term --

11 Q That's a little different.

12 MR. MORRIS: Let him -- please let him finish his  
13 answer.

14 THE WITNESS: Except what -- why?

15 MR. RUKAVINA: That's a little different.

16 THE WITNESS: You can fight with me all you want.  
17 You asked me, could they do this, and the answer is yes.

18 MR. RUKAVINA: Is it --

19 THE WITNESS: You file a motion to terminate the  
20 contract and they set forth their reasons. And even though  
21 it's without cause, the debtor is protected. But that  
22 doesn't give the debtor the right to just receive money and  
23 not get services. That happens all the time. That's what  
24 happens in Bankruptcy Court.

25 MR. RUKAVINA: Word plays, Mr. Seery. Word plays.

1 BY MR. RUKAVINA:

2 Q What about the January --

3 A It's not.

4 Q What about the January 9th injunction prohibiting Mr.  
5 Dondero from causing any related entity from terminating a  
6 contract?

7 A The --

8 Q Do you believe that that order would have prevented the  
9 advisors from terminating these four contracts?

10 A No. They have to come in to the court and file a  
11 motion.

12 Q Okay.

13 A Now I guess you're admitting that Mr. Dondero  
14 completely controls --

15 Q Stop talking, sir.

16 A -- the advisors.

17 Q I've answered -- you've answered my question. I've  
18 asked a question. You've answered it. Okay.

19 A Oh, I'm sorry.

20 Q You're not here to pontificate. You're here to answer  
21 questions.

22 MR. MORRIS: Your Honor, I know Mr. Seery is a  
23 seasoned professional, but there ought to be a limit to the  
24 badgering.

25 THE COURT: Okay. Mr. Rukavina --

1 MR. RUKAVINA: I'm actually done --

2 THE COURT: -- I know you --

3 THE WITNESS: I'm okay.

4 THE COURT: -- can keep it in check here.

5 MR. RUKAVINA: Okay.

6 THE COURT: Okay.

7 BY MR. RUKAVINA:

8 Q And I think you testified that you never instructed  
9 Highland employees not to provide services. Did I get that  
10 correct? You never -- when Mr. Morris was asking you about  
11 whether you ever issued --

12 A No. I never instructed any Highland employees not to  
13 provide services. I did instruct Highland employees not to  
14 take an adverse position to the estate, and if one arose,  
15 they had to come to me.

16 Q Okay. You taught me a word that I never heard before.  
17 It's a cool word. Inimical. Is that --

18 A You've got to expand your vocabulary.

19 Q I agree. You -- did you not issue instructions that if  
20 any Highland employee undertook an action inimical to the  
21 interest of Highland they would be fired?

22 A Yes.

23 Q Thank you.

24 MR. RUKAVINA: I'll pass the witness.

25 THE COURT: Redirect?

1 MR. RUKAVINA: And just so Your Honor knows, we'll  
2 supplement the record with that Exhibit 10 to the deposition  
3 as soon as it comes in.

4 THE COURT: All right.

5 MR. MORRIS: Just one question, Mr. Seery.

6 REDIRECT EXAMINATION

7 BY MR. MORRIS:

8 Q At no time prior to the termination of the shared  
9 services agreements did you ever hear the word -- no. Let  
10 me rephrase.

11 Did you ever hear the word, overpayment, at any time  
12 prior to the date that Highland gave notice of termination  
13 on November 30th, 2020?

14 A No.

15 Q At any time prior to November 30th, 2020 did anybody  
16 ever tell you that Highland was failing to perform back  
17 office middle office or investment advisory services on  
18 behalf of the advisors?

19 A No.

20 MR. MORRIS: No further questions.

21 THE COURT: Any recross?

22 MR. RUKAVINA: Just very briefly.

23 RECROSS-EXAMINATION

24 BY MR. RUKAVINA:

25 Q Mr. Seery, I want to be very respectful, but I heard

1 you say earlier that you're cursed with apparently a very  
2 good memory because you remember exactly how Mr. Waterhouse  
3 was seated opposite of you when you were having that  
4 discussion.

5 A Typically, yes.

6 Q So --

7 A When I tie the verbal to the visual, I actually have a  
8 pretty good memory.

9 Q I'll share that with you.

10 But sitting here today you still don't remember the  
11 December 11th K&L letter raising the overpayments and the  
12 failure to provide services?

13 MR. MORRIS: Objection, Your Honor. Beyond the  
14 scope of redirect. I asked questions going to November  
15 30th, 2020, period, full stop.

16 MR. RUKAVINA: That's fair enough, Your Honor.

17 THE COURT: Okay. Sustained.

18 MR. RUKAVINA: Thank you.

19 THE COURT: All right. Mr. Seery, you're excused  
20 from the witness stand.

21 Thank you.

22 THE WITNESS: Thank you, Your Honor.

23 THE COURT: Okay.

24 MR. MORRIS: So, Your Honor, as discussed with Mr.  
25 Rukavina, respectfully we would like to break now.

1 THE COURT: Okay.

2 MR. MORRIS: What time do you think the Court will  
3 be available to reconvene?

4 MR. MORRIS: I would say five after one.

5 MR. MORRIS: Okay. We'll --

6 THE COURT: I just, the meeting is supposed to --

7 MR. MORRIS: We'll --

8 THE COURT: -- stop at one and --

9 MR. MORRIS: We'll be back at five after one, and  
10 after conferring with Mr. Rukavina, we do remain confident  
11 that we're going to finish today. There are only two more  
12 witnesses. I expect my examination of both Mr. Dondero and  
13 Mr. Norris to be under an hour each --

14 THE COURT: Okay.

15 MR. MORRIS: -- for sure.

16 THE COURT: So we just have Dondero and Norris.

17 MR. MORRIS: Yeah. That's it.

18 THE COURT: All right. Thank you.

19 MR. MORRIS: All right. Thank you, Your Honor.

20 THE COURT: We'll see you at five after one.

21 THE COURT OFFICER: All rise.

22 (Recessed at 11:17 a.m.)

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I N D E X

WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
ETHAN POWELL	4	17	34	
JAMES P. SEERY, JR.	36	69	80	80

R U L I N G S

PAGE

None

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

We, Sheila Orms and Nancy B. Gardelli, Court approved transcriptionists, for Acorn Transcripts, LLC, certify that the foregoing transcript is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter.

FOR ACORN TRANSCRIPTS, LLC

April 14, 2022



SHEILA ORMS



April 14, 2022

Nancy B. Gardelli  
Operating Manager