Docket #4188 Date Filed: 12/16/2024

STINSON LLP
Deborah Deitsch-Perez
Michael P. Aigen
2200 Ross Avenue, Suite 2900
Dallas, Texas 75201
Telephone: (214) 560-2201
Facsimile: (214) 560-2203
Email: deborah.deitschperez@stinson.com
Email: michael.aigen@stinson.com

Counsel for Highland CLO Management, Ltd. and James Dondero

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

In re:	Chapter 11
HIGHLAND CAPITAL MANAGEMENT, L.P.	Case No. 19-34054 (sgj)
Reorganized Debtor.	

HIGHLAND CLO MANAGEMENT, LTD. AND JAMES DONDERO'S RESPONSE TO HIGHLAND CAPITAL MANAGEMENT, L.P.'S MOTION FOR (A) A BAD FAITH FINDING AND (B) AN AWARD OF ATTORNEYS' FEES AGAINST HIGHLAND CLO MANAGEMENT, LTD. AND JAMES DONDERO IN CONNECTION WITH HCLOM CLAIMS 3.65 AND 3.66

1934054241216000000000007

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

Highland CLO Management, Ltd. ("HCLOM") and James Dondero ("Dondero"), by and through their undersigned attorneys, submit this response to *Highland Capital Management, L.P.'s Motion for (A) a Bad Faith Finding and (B) an Award of Attorneys' Fees against Highland CLO Management, Ltd. and James Dondero in Connection with HCLOM Claims 3.65 and 3.66 of Highland CLO Management, Ltd.* [Dkt 4176] ("Motion"). In support of their response, HCLOM and Dondero state the following:

I. INTRODUCTION

1. The Court should reject the Motion for (A) Bad Faith Finding and (B) an Award of Attorneys' Fees against Highland CLO Management, Ltd. and James Dondero in Connection with HCLOM Claims 3.65 and 3.66 (the "Motion"), filed by Highland Capital Management, L.P. ("Highland"). On the eve of the evidentiary hearing at which the validity of HCLOM's claims are to be adjudicated, Highland seeks to foreclose HCLOM from presenting evidence in support of its claims and asks the Court for a finding that HCLOM pursued those claims in bad faith and to award monetary sanctions. This extraordinary relief is wholly unwarranted. As discussed below, this whole proceeding exists, not because HCLOM filed a proof of claim in the bankruptcy, but because *Highland listed the claims at issue, under penalty of perjury, on its own schedules* filed with the Court. Highland did not identify the claims as disputed, contingent, or liquidated. And Highland repeatedly represented to this Court that the liability reflected in the scheduled claims was owed. Under the circumstances, HCLOM's defense of claims that Highland scheduled and repeatedly represented were owed is not bad faith. To the contrary, HCLOM's position is the only defensible one in this proceeding.

2. The truth is that, when Highland learned that the claims were owed to an entity controlled by Mr. Dondero, it decided to invent defenses to their payment. All the theories

currently being argued by Highland are unavailing and could have been asserted long ago—including when Highland filed its bankruptcy schedules, and including when it acknowledged the debt was owed. That Highland regrets its prior position with respect to the debt owed is no basis to find bad faith.

3. In any event, Highland's motion falls well short of supplying "clear and convincing" evidence of bad faith that is required if this Court is to invoke its inherent authority to sanction HCLOM. Indeed, as the Fifth Circuit has repeatedly admonished, this Court may only invoke its inherent authority to sanction a party "to (1) coerce the contemnor into compliance with a court order or (2) compensate another party for the contemnor's violations." *In re Highland Capital Management, L.P.*, 98 F.4th 170, 174 (5th Cir. 2024). Neither circumstance exists here. As set forth above, Highland itself scheduled the claims as uncontested—which is prima facie evidence of their validity and permits the Court to treat the claims as "deemed allowed." 11 U.S.C. § 502(a); *see also* 11 U.S.C. § 1111(a) (no notice of claim is required for scheduled claims. And there can be no serious argument that HCLOM's participation in this proceeding has been wrongful in some way. When Highland decided to object to the claims it scheduled, HCLOM duly responded, participated in discovery, and cooperated to bring the proceeding to a swift closure. Highland never complained that HCLOM's discovery responses were inadequate or violated the rules of procedure and never sought an order compelling better or different responses. Highland's lengthy pleading—while previewing in detail its legal arguments about the enforceability of the Note—fails entirely to marshal the kind of clear and convincing evidence that would justify an award of sanctions.

4. Nor does Highland cite any legal precedent that would justify the sort of sweeping and fatal sanctions it seeks. There is none. Highland, and Highland alone, is the source of the

dispute over the HCLOM Scheduled Claims. Highland, with the benefit of all the relevant records, including those belonging to HCLOM, determined that the Promissory Note at issue was due and owing. Highland's CEO and Chief Restructuring Officer scheduled the related claims (Claims 3.65 and 3.66) and attested to their veracity, both when signing Highland's schedules and when testifying before this Court. And Highland's professionals have repeatedly filed pleadings emphatically insisting that the Note at issue remains due and owing. That HCLOM now actually seeks to be paid on the uncontested, scheduled claims, is not bad faith. The present fight is one of Highland's own making. No bankruptcy court has ever sanctioned a party under the circumstances presented here, and this Court should not be the first. Highland's motion should be denied.

II. RELEVANT FACTUAL BACKGROUND

A. The Debtor Has Already Made Payments and Conceded the Note's Validity and its Own Liability

5. Highland's principal and interest obligations to HCLOM arose under a 2016 Promissory Note in the original principal amount of $12,666,446 with Highland as the maker, and Acis Capital Management, L.P. ("Acis") as the payee.[1] In the Note, Highland promised to pay Acis the principal amount in May of each of the three scheduled payment years.[2] Pursuant to a contemporaneous but separate participation agreement, Acis was to pay Highland fifty percent (50%) of its collateralized loan obligation ("CLO") servicing fees on a quarterly basis ("Servicer Fees").[3]

[1] Promissory Note from Highland Capital Management, L.P. to Acis Capital Management, L.P. in the amount of $12,666,446, dated October 2016, Dkt. 3695-3 in Case No. 19-34054-sgj-11, annexed hereto as Exhibit 3 ("Ex. 3") at App. 0115-0120.

[2] *Id.* at Exhibit A, Amortization Schedule, App.0120.

[3] Agreement for Purchase and Sale of CLO Participation Interests by and between Acis Capital Management, L.P. and Highland Capital Management, L.P., dated October 7, 2016, annexed hereto as Exhibit 4 ("Ex. 4") at App.0122-0135.

6. On January 31, 2017, Hunton & Williams issued an opinion on behalf of Acis that stated, regarding the Note, "The parties to the Transaction believe and intend that the Promissory Note will be paid in accordance with its terms." [Dkt. 4175-28 at 8]

7. And the Debtor was making payments on the Note. The Debtor's schedules show that $9,541,446 25 remains owed on the original Note balance of $12,666,446, reflecting a principal pay down of $3,125,000.[4]

8. The Debtor also satisfied the conditions precedent for the Note to become effective when, *inter alia*, it paid Acis an initial amount of $666,655 under the CLO Participation Agreement.[5] There is no dispute that the Debtor made that payment and that the conditions precedent for the Note to become effective were met.

9. The Note was assigned to HCLOM pursuant to an Assignment and Transfer Agreement between Acis, HCMLP, and HCLOM dated November 3, 2017 ("Note Transfer Agreement").[6] The Note Transfer Agreement contemplated that HCLOM would be appointed successor manager.

10. Shortly before the Acis Bankruptcy Case was commenced, Highland, Acis, and HCLOM entered a Waiver and Acknowledgment Agreement related to Section 1 and Section 2 of the Note Transfer Agreement. [Dkt. 4175-11] Section 1 and 2 of the Note Transfer Agreement contemplated that Acis would appoint HCLOM as Successor Manager of the CLO portfolios.[7] In

[4] Notice of Filing of Debtor's Amended Schedules, dated September 22, 2020, Dkt. 1082, Schedule E/F, §§ 3.65 and 3.66 ("HCLOM Scheduled Claims"), annexed hereto as Exhibit 2 ("Ex. 2") at App. 0105.

[5] Ex. 4 § 1.1, at App.0123.

[6] Agreement for Assignment and Transfer of Promissory Note between Acis Capital Management, L.P. and Highland Capital Management, L.P., dated October 7, 2016, Dkt. 3695-3 in Case No. 19-34054-sgj-11, annexed hereto as Exhibit 5 ("Ex. 5") at App.0137-0142.

[7] *Id.*, at §§ 1-2, App. 0138

the Waiver and Acknowledgment Agreement, the parties agreed to waive enforcement of Sections 1 and 2 of the Note Transfer Agreement – and permit Highland CLO Management, LLC, a Delaware limited liability company, to act as the collateral manager. [Dkt. 4175-11 at 2] The parties expressed their reason for this transaction on the face of the Waiver and Acknowledgment Agreement: "in order to comply with the U.S. Risk Retention Rules, in connection with each such "reset" transaction, each applicable CLO issuer will appoint Highland CLO Management, LLC, a Delaware limited liability company, as the collateral manager of such CLO." [*Id*.] The parties did not agree to alter or waive Section 3 of the Note Transfer Agreement, which assigned the Note to HCLOM Ltd.

11. Following execution of the Note Transfer Agreement, an involuntary bankruptcy petition was filed against Acis in this Court on January 30, 2018, leading to the entry of an order for relief on April 16, 2018 in *In re Acis Capital Management, L.P. and Acis Capital Management GP, LLC*, Case No. 18-30264 ("Acis Bankruptcy Case"). This order was entered before the next scheduled principal pay down payment of $3,125,000 to HCLOM under the Note Transfer Agreement

12. As part of the Acis Bankruptcy Case, the Court entered a temporary restraining order, and then a plan injunction, preventing the CLO notices requesting the appointment of a successor manager from being effectuated.[8] As a result, neither HCLOM nor Highland CLO Management, LLC was ever appointed manager of the CLOs.

[8] *See* Ex Parte Temporary Restraining Order, dated June 21, 2018, Acis Bankruptcy Case, Dkt. 310, annexed hereto as Exhibit 8 ("Ex. 8") at App.0418; Agreed Extension of Temporary Restraining Order, dated June 29, 2018, Acis Bankruptcy Case, Dkt. 354, annexed hereto as Exhibit 9 ("Ex. 9") at App. 0424; Bench Ruling and Memorandum of Law in Support of: (1) Final Approval of Disclosure Statement; and (B) Confirmation of Chapter 11 Trustee's Third Amended Joint Plan, dated January 31, 2019, Acis Bankruptcy Case, Dkt.827, annexed hereto as Exhibit 10 ("Ex. 10") at App. 0430-0476; Findings of Fact, Conclusions of Law, and Order Granting Final Approval of Disclosure Statement and Confirming the Third Amended

13. Instead, Acis continued to serve as manager and continued to be responsible for paying the Servicer Fees due to Highland under the Participation Agreement.[9] The Note Transfer Agreement is clear that only when HCLOM became the successor manager of the CLOs and started to receive fees would HCLOM be obligated to remit a portion of the Servicer Fees to Highland.[10] Because the Acis Bankruptcy Case stymied any appointment of a successor manager, neither HCLOM nor any other entity ever received any of the Servicer Fees as contemplated under the Note Transfer Agreement. Instead, Acis continued to receive those fees.

14. As a result, HCLOM was under no obligation to remit any Servicer Fees to Highland and could not breach the Note Transfer Agreement by failing to do so. Further, as set forth above, Highland agreed that Highland CLO Management, LLC, not HCLOM, would be appointed as Successor Manager and pay any Servicer Fees. And Highland expressly waived any breach of those sections of the Note Transfer Agreement by HCLOM.

15. In any event, any alleged breach of the Note Transfer Agreement cannot excuse Highland's obligation to perform under the Note. Section 3 of the Note Transfer Agreement "immediately" and "irrevocably" transferred the Note from Acis to HCLOM, and nothing in the Waiver unraveled that transfer.[11]

B. Acis Initiates Disputes Relating to the Note, and Highland Repeatedly Reaffirms its Obligations Pursuant to the Note

16. Subsequent events only confirm that Highland was obligated to pay HCLOM under the Note.

Joint Plan for Acis Capital Management, L.P. and Acis Capital Management GP, LLC, as Modified, dated January 31, 2019, Acis Bankruptcy Case, Dkt. 829, annexed hereto as Exhibit 11 ("Ex. 11") at App.0512.

[9] *See* Ex. 5, §3(b), at App.0138..

[10] *Id.*, §3(c), at App.0138.

[11] *See id.*, § 3(a) at App.0138.

17. In the Acis Bankruptcy Case, Acis asserted claims against both Highland and HCLOM for fraudulent transfer with respect to the Note.[12] Highland moved to dismiss Acis's claims. Notably, Highland did not take the position in that motion (or at any point during the Acis Bankruptcy Case) that the Note was invalid or subject to setoff because of a prior material breach.[13]

18. After Highland filed its own petition in bankruptcy, Acis incorporated its claims from the Acis Adversary Proceeding into a proof of claim filed in Highland's case, which was designated as Claim No. 23 in the Claims Register ("Acis POC").[14] In June 2020, Highland objected to the Acis POC ("Acis Claim Objection"), declaring emphatically that Highland "remains liable!" on the Note.[15]

19. Notwithstanding its objection to the Acis POC, Highland ultimately settled with Acis by granting it an allowed claim for a $23 million, which was documented in a settlement agreement ("Acis Settlement Agreement").[16] As part of the settlement, Acis specifically

[12] *See Acis Capital Management, L.P. and Acis Capital Management GP, LLC v. Highland Capital Management, L.P., et al.*, Adversary Proceeding No. 18-03078 ("Acis Adversary Proceeding"), Second Amended Complaint (Including Claim Objections and Objections to Administrative Expense Claim), dated June 20, 2019, Dkt. 157, annexed hereto as Exhibit 12 ("Ex. 12") at App.0708-0815.

[13] Highland Capital's Partial Motion to Dismiss the Second Amended Complaint and Brief in Support, dated July 22, 2019, Acis Adversary Proceeding, Dkt. 171, annexed hereto as Exhibit 13 ("Ex. 13") at App.0817-0849.

[14] Acis Proof of Claim #23 dated December 31, 2019, annexed hereto as Exhibit 14 ("Ex. 14") at App. 0851-0964.

[15] Debtor Objection to Acis Claim, dated June 23, 2020, Dkt. 771 in Case No. 19-34054-sgj-11, annexed hereto as Exhibit 15 ("Ex. 15"), ¶ 58, at App.1001 ("it remains liable!"); *see also id.*, ¶ 58(a) at App.1002 (stating that Highland "indeed remains liable on the Note.").

[16] *See* Order Approving Debtor's Settlement with (A) Acis Capital Management, L.P. and Acis Capital Management GP, LLC (Claim No. 23) (B) Joshua N. Terry and Jennifer G. Terry (Claim No. 156, and (C) Acis Capital management, L.P. (Claim No. 159) and Authorizing Actions Consistent Therewith, dated October 20, 2020, Dkt.1302 in Case No. 19-34054-sgj-11, annexed hereto as Exhibit 16 ("Ex. 16"), p. 6, at App.1037-1044.

disclaimed and released all claims for payment with respect to the Note ("Acis Release").[17] Acis further agreed to withdraw and release its claims against HCLOM, among others.[18]

20. Consistent with the Acis Settlement Agreement, on November 3, 2020, Acis moved to voluntarily dismiss all claims against HCLOM in the Acis Adversary Proceeding—a motion promptly granted by the Court.[19] In obtaining the Court's approval of the Acis Settlement Agreement, Mr. Seery specifically addressed Highland's liability on the Note: "Highland paid on the note. It was actually transferred to an entity that Highland owns and controls . . . .We now believe that, for example, that one, we had very little defense on [the Note] other than a technical defense."[20] Mr. Seery continued, "[i]n addition, as I mentioned, of the total amount, we think that **the note was one that we actually owe**, and we owe it to somebody, but now we owe it to ourselves."[21] This Court relied on his testimony when it approved the settlement and dismissal in the Acis Adversary Proceeding.

21. The lawyers that assisted in negotiating the settlement of the Acis POC and sponsored Mr. Seery's testimony at the Acis Rule 9019 hearing that the Note was a valid obligation of Highland are the same lawyers that later signed an objection to the HCLOM Scheduled Claims—claims scheduled under penalty of perjury by Mr. Seery. And the same lawyers also

---

[17] *Id.,* at App.1046-1055; *see also id.* at App. 1047 (containing the Acis Release which released, among other claims, all debts, liabilities, and obligations against any Highland-controlled party, including HCLOM).

[18] *Id.*, § 2, at App.1049.

[19] Acis Motion to Dismiss Less than All Defendants dated November 3, 2020, Acis Adversary Proceeding, Dkt. 215, annexed hereto as Exhibit 17 ("Ex. 17"), at App.1057-1060; Order Dismissing Less than All Defendants, dated November 6, 2020, Acis Adversary Proceeding, Dkt. 216, annexed hereto as Exhibit 18 ("Ex. 18"), at App.1062-1063.

[20] Transcript of Hearing on Motions to Compromise Controversy with Acis Capital Management [1087] and the Redeemer Committee of the Highland Crusader Fund dated October 20, 2020, annexed hereto as Exhibit 6 ("Ex. 6"), 191:11-17, at App.0334.

[21] *Id.*, 196:25-197:4, at App.0339-0340.

signed Acis Claim Objection in June 2020 that is fundimentally inconsistent with Highland's current position.

22. The underlying facts have not changed. To accept Highland's new—and utterly inconsistent arguments—regarding the Note now being raised, the Court would also have to accept that Highland's management and professionals agreed to a windfall payment to Acis and sponsored incorrect testimony in support of a settlement and dismissal of the Acis POC in this Court. As outlined in HCLOM's response to Highland's objections, this provides a strong basis for judicial estoppel. *See* Dkt. No. 3715 at pp. 8-12.

C. Highland Schedules the Claims at Issue Under Penalty of Perjury but Later Objects to the Claims

23. On December 13, 2019, Highland filed its schedule of liabilities. The schedule included a Claim 3.64 for "Interest payable" in the amount of $599,187.26, and a Claim 3.65 for "Note payable" in the amount of $9,541,446.00. The schedule incorrectly listed the promissory note principal and interest as payable to Highland CLO Holdco.[22]

24. James P. Seery, Jr. was engaged as Chief Executive Office and Chief Restructuring Office ("CEO/CRO") for the Debtor effective as of March 15, 2020. Dkt. 854. Under Mr. Seery's management, Highland filed amended schedules on September 22, 2020 ("Amended Schedules"). Those Amended Schedules contained identical claims—now designated Claims 3.65 and 3.66—for "Interest payable" and "Note payable," but corrected the claimant name to HCLOM, leaving the amounts the same.[23] Mr. Seery, in his role as CEO/CRO for the Debtor, signed the Amended Schedules under penalty of perjury.

---

[22] *See* Official Form 206Sum, dated December 13, 2019 ("Original Schedules"), Dkt. 247, Schedule E/F, §§ 3.64 and 3.65, annexed hereto as Exhibit 1 ("Ex. 1") at App. 0027.

[23] Notice of Filing of Debtor's Amended Schedules, dated September 22, 2020, Dkt. 1082, Schedule E/F, §§ 3.65 and 3.66 ("HCLOM Scheduled Claims"), annexed hereto as Ex. 2 at App. 0105.

25. In the Amended Schedules, Highland did not list the HCLOM Scheduled Claims as disputed, contingent, or unliquidated. As a result, the Amended Schedules constitute prima facie evidence of the validity and amount of the Scheduled Claims pursuant to Federal Rule of Bankruptcy Procedure 3003(b)(1).

26. Although Highland repeatedly reaffirmed the validity of the Scheduled Claims in various proceedings (described above) and in the Amended Schedules, it nonetheless filed an Objection to Scheduled Claims 3.65 and 3.66 of Highland CLO Management, Ltd. ("Objection") in February 2023.[24]

27. HCLOM timely filed its response in April 2023 (Dkt. 3715). Shortly thereafter, the Court stayed litigation on the Objection. Dkt. 3736. On June 11, 2024, the Court lifted the stay and entered its scheduling stipulation. Dkt. 4086.

D. The Proceedings on the Scheduled Claims Have Been Uneventful and Largely Non-Contentious

28. Although past proceedings in this bankruptcy have been contentious, until Highland filed the present Motion, the proceedings regarding the HCLOM Scheduled Claims have not been. The parties have proceeded mostly by agreement. After the Court lift its stay in June 2024, discovery proceeded as contemplated without requiring any involvement from this Court.

29. Highland sought discovery, and HCLOM complied with its requests. Highland served a 30(b)(6) deposition notice on HCLOM on September 3, 2024. HCLOM made Frank Waterhouse available, both individually and as the corporate representative of HCLOM, just a few weeks later on September 24, 2024. Mr. Waterhouse was prepared on all topics noticed and, over the course of the five-plus hour deposition, he gave substantive testimony regarding all topics, with the only objections lodged relating to form.

[24] Dkt. 4175-1.

30. Pursuant to Highland's request, HCLOM also made Mr. Dondero available for a deposition. He did not refuse to answer any questions posed by Highland's counsel. Although Highland complains about his testimony and his recollections, as set forth below, those complaints do not provide a sound basis for a finding of bad faith. Moreover, consistent with Highland's witness list, HCLOM intends to make both Mr. Dondero and Mr. Waterhouse available to testify at the hearing on the Scheduled Claims.

III. LEGAL STANDARDS

31. Under the circumstances of this proceeding, Highland's bad faith motion and related request for sanctions is wildly inappropriate. Highland asks this Court to sanction HCLOM and Mr. Dondero for pursuing a claim *that Highland itself scheduled—under penalty of perjury—among its uncontested, noncontingent liabilities*. Although the Amended Schedules are prima facie evidence that the Scheduled Claims are valid, and although Highland has repeatedly acknowledged its liability under the Note, Highland now asks the Court to preclude HCLOM from presenting evidence at the hearing and to shift all of Highland's costs and fees associated with objecting to its own Scheduled Claims to HCLOM. The Court should reject Highland's invitation and deny its motion.

32. Highland cannot demonstrate that an award of sanctions is appropriate under the circumstances presented. The Fifth Circuit's annunciation of the standard for invoking its inherent power to sanction in a bankruptcy proceeding is clear: "civil contempt sanctions must be calculated either to (1) coerce the contemnor into compliance with a court order or (2) compensate another party for the contemnor's violations." *In re Highland Capital Management, L.P.*, 98 F.4th 170, 174 (5th Cir. 2024). "'Because of their very potency, inherent powers must be exercised with restraint and discretion.'" *Budri v. FirstFleet Inc.*, No. 3:19-CV-0409-N-BH, 2021 WL 849012, at

*6 (N.D. Tex. Feb. 18, 2021), *report and recommendation adopted*, No. 3:19-CV-0409-N-BH, 2021 WL 842123 (N.D. Tex. Mar. 5, 2021) (quoting *Chambers v. NASCO, Inc*., 501 U.S. 32, 50 (1991)). Thus, "'the threshold for the use of inherent power sanctions is high.'" *Id.* (quoting *Chaves v. M/V Medina Star*, 47 F.3d 153, 156 (5th Cir. 1993)). To invoke that power, a bankruptcy court "must make a specific finding of bad faith, which is "not simply bad judgment or negligence" but "the conscious doing of a wrong because of a dishonest purpose or moral obliquity; . . . a state of mind affirmatively operating with furtive design or ill will." *Id.* (internal quotations and citations omitted). Any allegation of "bad faith" must be supported by clear and convincing evidence. *Kreit v. Quinn*, 26 F.4th 285, 292 (5th Cir. 2022). As set forth below in greater detail, Highland's arguments do not come close to justifying a bad faith finding or the requested sanctions.

33. The Fifth Circuit also imposes a higher standard for "litigation-ending sanctions (sometimes called 'death penalty' sanctions)." *Law Funder LLC v. Munoz*, 924 F.3d 753, 758 (5th Cir. 2019). "The district court must make four additional findings to impose a litigation-ending sanction: (1) the discovery violation was committed willfully or in bad faith; (2) the client, rather than counsel, is responsible for the violation; (3) the violation "substantially prejudice[d] the opposing party"; and (4) a lesser sanction would not "substantially achieve the desired deterrent effect."" *Ceats Inc. v. TicketNetwork, Inc.*, 71 F.4th 314, 324-25 (5th Cir. 2023).

IV. ARGUMENT

34. Highland's arguments do not come close to articulating the type of clear and convincing evidence of bad faith that would be required for this Court to exercise its inherent power to sanction HCLOM. Highland does not identify *any* court order that HCLOM or Mr. Dondero has violated—none whatsoever. Instead, emboldened by its successful pursuit of bad faith sanctions in a different proceeding against a different entity under vastly different

circumstances, Highland says even more onerous relief is appropriate in this proceeding, based on two flimsy and legally unavailing arguments. First, Highland argues that, because it can now articulate never-before-advanced defenses to its obligation to pay the Note (including ones not even raised in its Objection), HCLOM's refusal to accept those defenses and simply forego the Scheduled Claims is bad faith. There is no precedent for such a position and the Court should not create bad precedent now. Again, *Highland scheduled the disputed claims* under penalty of perjury and listed those claims as *undisputed.* If anything, the present fight is Highland's fault, not HCLOM's. Second, Highland argues that, because Mr. Dondero did not give satisfactory testimony in his deposition, HCLOM and Mr. Dondero should be punished with potentially case-ending and expensive sanctions. Again, there is no precedent for such sanctions under the circumstances of this case, particularly where, as here, Highland could have filed a timely motion to compel but chose not to do so.

35. Against this backdrop and in view of the very high standards that must be met to justify the Court's invocation of its inherent power to sanction, Highland's bad faith motion can only be described as cavalier. The motion should be denied.

A. HCLOM's Refusal to Accept Highland's Specious Defenses Is not Evidence of Bad Faith

36. Highland's initial argument—that HCLOM has prosecuted its claim in bad faith—is baseless for numerous independent reasons. First, Highland completely ignores that the disputed Scheduled Claims exist because Highland chose to list those claims as a liability in its schedules. Thus, this is not a situation where HCLOM filed proofs of claim and commenced proceedings against Highland to pursue their allowance. As a result, this proceeding stands in stark contrast to the circumstances where this Court previously found "bad faith" sanctions were warranted. *See In re Highland Capital Management, L.P.*, 2024 WL 959335, at *5-6 (Bankr. N.D. Tex. Mar. 5,

2024) (concluding that signing and filing a proof of claim without adequate review constituted an abuse of the judicial process).[25]

37. Second, contrary to Highland's argument, the evidence supporting Highland's obligation to HCLOM is not vague or uncertain. The Note itself, together with the Note Transfer Agreement, plainly and unambiguously establish that Highland owes money to HCLOM. The Note contains no provision conditioning Highland's payment obligations on performance by Acis of its obligations under the Participation Agreement.[26] In fact, the plain language of the Note states the opposite. The "Note embodies the final, entire agreement between Maker [Debtor] and Payee [Acis] with respect to the indebtedness evidenced hereby" and does not incorporate the Participation Agreement by reference, notwithstanding Highland's strained argument that the two agreements are inextricably intertwined.[27]

38. Under applicable Texas law, courts must construe a contract by looking at the plain language of the parties' agreement. *Barrow-Shaver Res. Co. v. Carrizo Oil & Gas Inc.*, 590 S.W. 3d 471, 479 (Tex. 2019). The court must "give effect to the parties' intentions, as expressed in their agreement" unless the "plain, grammatical meaning would clearly defeat the parties' intentions." *Id.* (internal citations omitted). The plain language of the Note makes clear that Highland promised to pay Acis in three annual installments, along with interest. That Note was irrevocably assigned to HCLOM under the Note Transfer Agreement, facially establishing Highland's obligations to make subsequent payments due to HCLOM.

---

[25] This Court's sanction order issued in that case is presently pending on appeal with the U.S. District Court for the Northern District of Texas. The recitation of these principles merely serves to demonstrate the material differences between that case, where the Court granted a motion for sanctions, and this case, where they are far less warranted.

[26] Ex. 3, p. 4, at App.0118.

[27] *Id.*

39. The extrinsic evidence likewise supports, rather than contradicts, a plain-language interpretation of the Note. As set forth above, when Highland and HCLOM entered into the Waiver in January 2018, they explicitly did not amend Section 3 of the Note Transfer Agreement transferring the Note (and Highland's obligations under it) from Acis to HCLOM. Nor does the parties' waiver of enforcement of Sections 1 and 2 of the Note Transfer Agreement somehow change the consideration that existed at the time of the Note's making. As the Waiver makes clear, waiver of Sections 1 and 2 was necessary "to comply with the U.S. Risk Retention Rules." And the change merely replaced HCLOM with a Delaware-based entity, Highland CLO Management, LLC. Where, as here, the parties express the reasons for their agreement in the writing itself, the Court need not—indeed, cannot—look to parol evidence to contradict the express terms of the agreement. *See Jack H. Brown & Co. v. Toys "R" Us, Inc.*, 906 F.2d 169, 175 (5th Cir. 1990) (citing *First Victoria Nat'l Bank v. Briones*, 788 S.W.2d 632 (Tex. App.—Corpus Christi 1990, writ denied)) (holding that parol evidence "cannot vary or contradict those terms of the writing that are complete and unambiguous").

40. Even if Highland had not expressly consented to the assignment of these obligations in the Waiver and Acknowledgment Agreement, nothing in Texas law would have prevented HCLOM from assigning its obligation to become successor manager to a third party, here HCLOM LLC. For a non-assignability clause to prevent assignment, Highland "must have relied upon the personal trust, confidence, skill, character, or credit of another party." *McAleer v. Eastman Kodak Co.*, 2002 WL 31686682 at *4 (Tex. Ct. App. Dec. 2, 2002). As both HCLOM and the Delaware entity were newly-formed entities that Highland controlled at the time of formation, Highland's belated objections to the assignment are unfounded as a matter of Texas law. *Id.* (rejecting application of non-assignability clause where successor "will, in effect, be dealing with the same

group she dealt with before, only …[through] a separate corporation"). And as neither HCLOM nor Highland CLO Management LLC ever received servicing fees under the contract, there can be no breach of the requirement to provide a portion of those fees to Highland by *either* entity.

41. Third, in an effort to avoid the unambiguous terms of the Note, Highland advances a litany of irrelevant attacks against HCLOM, reciting allegations related to a years-old dispute with the Highland's former employee, Mr. Terry, all of which relate to actions that took place years before Highland's September 2020 acknowledgment of the liability on the Note. The enforceability of the Note cannot depend on whether Highland likes or dislikes the Note's beneficial owner. Highland's own judicial admissions in this bankruptcy proceeding relating to its liability on the Note are sufficient to defeat Highland's newly-invented defenses to its own Scheduled Claims and alone defeat any allegation of bad faith on HCLOM's part.

42. Highland also relies on a Cayman Islands case, *Richards v. HEB Enterprises Limited and Bodden, Jr.* (attached to the Motion as Exhibit 5) that has been reversed by the United Kingdom's Privy Council. Because the Cayman Islands is a member of the British Commonwealth of Nations, decisions of the Cayman Islands' highest court are subject to review by the Privy Council, the highest court in the United Kingdom. Highland relies on *Richards* for the principle that, if HCLOM failed to perform a promised obligation under the Note Transfer Agreement, the Note Transfer Agreement fails for lack of consideration. But the Privy Council disagreed with this proposition of law and reversed the decision of the Cayman Islands court—holding instead that the "whole basis for the [agreement]…has not failed because the [party] enjoyed the right[s]…until he repudiated the agreements."[28] Similarly here, HCLOM continued to enjoy rights under the Note and never repudiated the agreements.

[28] *HEB Enterprises LTD v.* Richards ([2023] UKPC 7 (Privy Council Appeal No. 0087 of 2020) at ¶ 67.

43. Fourth, Highland's repeated statements regarding and reliance on the enforceability of the Note—in its First Day filings, in its testimony in support of its settlement with Acis, and in its September 2020 amended schedule of claims—judicially estop Highland from arguing now that the Note is *not* an enforceable obligation. Indeed, judicial estoppel is an independent legal basis, well-established in law, that supports HCLOM's position regarding the Note's enforceability in this proceeding which should itself preclude any finding that HCLOM is acting in bad faith.

44. Highland knew it could not meet its burden to defeat HCLOM's claims on the merits, so seeks instead to escape liability through this ill-conceived pre-hearing sanctions motion. HCLOM's response need not rebut all the legal and factual arguments made by Highland regarding the enforceability of the Note, because, as Highland concedes in the Motion, many of those arguments will turn on determinations of disputed issues related to the enforceability of the Note and wholly unrelated to the allegations of bad faith in this motion.[29]

B. There Is No Basis To Sanction HCLOM or Mr. Dondero as a Result of Discovery

45. Highland also asks the Court to preclude HCLOM and Mr. Dondero from testifying as a sanction for their alleged "bad faith." Again, the Court should reject Highland's request. Bankruptcy courts look to Rule 37 of the Federal Rules of Civil Procedure as a guide in addressing alleged discovery violations. A court may sanction a party under Rule 37(b)(1) only when a deponent fails to appear and be sworn or when a court has already ordered the deponent to answer a question. *See CEATS, Inc. v. TicketNetwork, Inc.*, 71 F.4th 314, 323 n.11 (5th Cir. 2023) (noting that "Rule 37(b)(1) [ ] govern[s] a deponent's failure to be sworn or to answer a question after being directed to do so by the court" (cleaned up)). Neither of those circumstances occurred here.

[29] *See, e.g.*, Motion at 20 ("The Court can assess the credibility of that testimony.")

46. Highland's allegations related to discovery conduct are threadbare and do not warrant sanctions, especially not the litigation-compromising sanctions that it seeks. Indeed, Highland cannot meet any of the requirements for that type of sanction under Fifth Circuit law.

47. First, Highland fails to identify a discovery order of this Court that HCLOM has violated. There has been no such order, because Highland has never initiated any discovery dispute in this Court—much less filed a motion to compel—that would warrant the Court's intervention. The parties cooperated in discovery, exchanged written discovery and documents, and took depositions, all without engaging in any discovery fights. When sanctions are levied, the Court "should impose the least severe sanction that will accomplish the desired result—prompt and full compliance with the court's discovery orders." *United States v. Swanson*, 894 F.3d 677, 684 (5th Cir. 2018). As there were no discovery orders relevant to the Scheduled Claims nor any court order that HCLOM refused to comply with, the motion seeking sanctions for discovery misconduct should be denied without further analysis.

48. But in addition, Highland fails to satisfy any of the four requirements articulated by the Fifth Circuit for the type of sanction Highland seeks . As set forth above, this Court must make four additional findings to impose a sanction precluding HCLOM from presenting evidence in support of its claim. The Court must find (1) the discovery violation was committed willfully or in bad faith; (2) the client, rather than counsel, is responsible for the violation; (3) the violation "substantially prejudice[d] the opposing party;" and (4) a lesser sanction would not "substantially achieve the desired deterrent effect." *Ceats Inc. v. TicketNetwork, Inc.*, 71 F.4th 314 at 324-25. There is no evidence supporting any of these requirements. Highland does not identify any "willful" misconduct on the part of HCLOM. Instead, Highland merely claims that HCLOM's reliance on counsel to develop answers to the interrogatories constitutes misconduct. This

argument is specious at best. Counsel regularly plays a role in the development of interrogatory answers; a client's reliance on that assistance does not convert the company's verification into a willful or bad faith discovery violation. If it were to do so, every well-represented party would be condemned to have violated its duties. That is not the law and does not support a finding of bad faith– much less a finding sufficient to impose the sanctions that Highland is seeking.

49. Moreover, contrary to Highland's arguments, HCLOM did provide relevant testimony regarding HCLOM's intentions in connection with the Note Transfer Agreement. As Mr. Waterhouse testified, the Agreement "was intended to authorize HCLOM Ltd. to take the necessary steps to become Acis' Successor Manager so that it would receive the Servicing Fees and remit them to Highland in exchange for the expected cash streams due under the Note." Dkt 4176 at 17, ¶ 29. Mr. Waterhouse also stated that he was prepared to testify regarding all the topics—but that many of HCLOM's records were in the custody and control of the Debtor: "HCLOM's books and records and all of their – were held at Highland . . . ." Dkt. 4185-1 at 234:11-13]. Given the adversarial relationship between HCLOM and Highland at the time of Mr. Waterhouse's deposition in September 2024, his inability to access all of HCLOM's books and records—which were in Highland's custody and control—cannot reasonably be attributed to bad faith. Under these circumstances, the allegation that HCLOM's corporate representative had limited ability to testify regarding operations of HCLOM is not a basis for finding bad faith conduct, certainly not a showing by clear and convincing evidence.

50. Further, there is another simple fact that easily explains gaps in testimony—something HCLOM could have explained had Highland ever sought to compel better answers to its deposition questions. The Acis involuntary bankruptcy in January 2018 fundamentally changed HCLOM's ability to become the successor manager, as the parties envisioned when they

effectuated the Note Transfer Agreement in late 2017. The Acis bankruptcy prevented that goal from ever being realized, but it did not change the value that HCLOM intended to provide under the agreement as the successor manager. Nor did it change Highland's obligation under the Note—and Highland admitted as much when it scheduled the note as an uncontested liability in 2019 and again in 2020.

51. It is ironic that Highland's assertion of "bad faith" discovery conduct is predicated on a discovery process that Highland initiated by scheduling the disputed claims as a liability and thereafter retracting its sworn statements. That Mr. Waterhouse and Mr. Dondero have limited knowledge or recollection of HCLOM-specific facts on claims that Highland determined were liabilities is not clear and convincing evidence of bad faith discovery conduct.

52. Highland also makes no showing of prejudice from the interrogatory answers or from the deposition testimony. This is because there is none. Highland's prejudice (the cost of pursuing objections to the claims it scheduled) arises from Highland's decision to transfer the Note, its acknowledgment of liability under the Note, its failure to take account of Acis' failure to turn over fess in resolving the Acis POC, and its present refusal to pay. In other words, the only prejudice to Highland is a prejudice of its own making. This is not "undue prejudice," and it does not arise from any conduct of HCLOM. Nor do the costs Highland has forced itself to incur constitute clear and convincing evidence of "the conscious doing of a wrong because of a dishonest purpose or moral obliquity; . . . a state of mind affirmatively operating with furtive design or ill will." *Budri*, 2021 WL 849012, at *6.

53. Although HCLOM denies that its representatives were inadequately prepared for their deposition, to the extent that Highland wanted different answers or better prepared representatives, the proper course was to seek an order compelling the discovery Highland sought,

which would have put the issue before the Court, allowed HCLOM an opportunity to explain any gaps in testimony that existed, and to rectify those gaps if possible. Highland chose not to do so, and so there is no order compelling discovery to vindicate through sanctions. And even had there been some order that HCLOM failed to abide, as the Bankruptcy Court for the Southern District of Texas explained in *In re Lopez* (after authorizing a second corporate deposition at which the corporate representative was allegedly unprepared), "any gaps in knowledge within this context would be best addressed through the process of cross examination on the merits before the trier of fact in this proceeding." *In re Lopez*, 2015 WL 7572097, at *12 (S.D. Tex. Nov. 24,2015).

54. Mr. Waterhouse testified as the representative of HCLOM in September 2024, and Highland had ample time to pursue discovery relief from this Court had it really believed such relief was necessary. Death penalty sanctions are not the answer. Highland's motion in this regard should be denied.

V. CONCLUSION

Highland's motion for bad faith sanctions is utterly without merit and should be denied outright. Highland scheduled the two claims at issue under penalty of perjury. Highland repeatedly reaffirmed its liability under the Note at issue, both in pleadings before this Court and in testimony by the very person who signed the Amended Schedules listing the claims as undisputed. The present motion overreaches and presents no factually or legally tenable basis for the Court to exercise its inherent power to sanction. HCLOM and Dondero respectfully request that this Court enter an Order (i) denying the Debtor's Motion for Sanctions; (ii) allowing the HCLOM Scheduled Claims; and (iii) granting such other and further relief as this Court may deem equitable and proper.

Dated: December 16, 2024

Respectfully submitted,

STINSON LLP

/s/ Deborah Deitsch-Perez

Deborah Deitsch-Perez
Texas Bar No. 24036072
Michael P. Aigen
Texas Bar No. 24012196
2200 Ross Avenue, Suite 2900
Dallas, Texas 75201
Telephone: (214) 560-2201
Facsimile: (214) 560-2203
Email: deborah.deitschperez@stinson.com
Email: michael.aigen@stinson.com

Counsel for Highland CLO Management, Ltd. and James Dondero

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on December 16, 2024, a true and correct copy of this document was served electronically via the Court's CM/ECF system to the parties registered or otherwise entitled to receive electronic notices in this case.

/s/ Deborah Deitsch-Perez
Deborah Deitsch-Perez