No. 22-631

IN THE
Supreme Court of the United States

HIGHLAND CAPITAL MANAGEMENT, L.P.,
Petitioner,
v.
NEXPOINT ADVISORS, L.P., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENTS NEXPOINT ADVISORS, L.P. AND NEXPOINT ASSET MANAGEMENT, L.P.

BENOIT QUARMBY
MOLOLAMKEN LLP
430 Park Ave.
New York, NY 10022

JEFFREY A. LAMKEN
Counsel of Record
ROBERT K. KRY
EUGENE A. SOKOLOFF
MOLOLAMKEN LLP
The Watergate, Suite 500
600 New Hampshire Ave., N.W.
Washington, D.C. 20037
(202) 556-2000
jlamken@mololamken.com

Counsel for Respondents NexPoint Advisors, L.P. and NexPoint Asset Management, L.P.

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D.C. 20002

QUESTION PRESENTED

Section 524(e) of the Bankruptcy Code provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The provision thus limits the effect of a discharge to the debtor itself, expressly excluding other parties. Section 524(g) creates a narrow exception, but only for certain asbestos-related claims. Consistent with those provisions, the Fifth Circuit held below that Section 524(e) generally prohibits a bankruptcy court from exculpating or enjoining claims against third parties who have not themselves declared bankruptcy and thereby subjected themselves to the bankruptcy court's supervision. The question presented is:

Whether Section 524(e) prohibits a bankruptcy court from exculpating or enjoining claims against third parties who have not themselves declared bankruptcy.

CORPORATE DISCLOSURE STATEMENT

Pursuant to this Court's Rule 29.6, respondents state that NexPoint Advisors, L.P.'s majority owner is the Dugaboy Investment Trust, that NexPoint Asset Management, L.P.'s majority owner is Highland Capital Management Services, Inc., and that no publicly held company owns 10% or more of any of those entities' ownership interests.

RELATED PROCEEDINGS

The following proceedings are directly related to this case within the meaning of Rule 14.1(b)(iii):

United States Court of Appeals (5th Cir.):

- *Dondero* v. *Highland Capital Management, L.P.*, No. 21-10219 (dismissed May 18, 2021)
- *NexPoint Advisors, L.P.* v. *Highland Capital Management, L.P.*, No. 21-10449 (judgment entered Aug. 19, 2022)
- *Highland Capital Management Fund Advisors, L.P.* v. *Highland Capital Management, L.P.*, No. 22-10189 (judgment entered Jan. 11, 2023)
- *NexPoint Advisors, L.P.* v. *Pachulski Stang Ziehl & Jones, L.L.P.*, No. 22-10575 (pending)
- *Dugaboy Investment Trust* v. *Highland Capital Management, L.P.*, No. 22-10831 (pending)
- *Dondero* v. *Highland Capital Management, L.P.*, No. 22-10889 (pending)
- *Dugaboy Investment Trust* v. *Highland Capital Management, L.P.*, No. 22-10960 (pending)
- *Dugaboy Investment Trust* v. *Highland Capital Management, L.P.*, No. 22-10983 (pending)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, No. 22-11036 (pending)

United States District Court (N.D. Tex.):

- *Dondero* v. *Highland Capital Management, L.P.*, No. 3:20-cv-03390-X (dismissed Mar. 8, 2022)
- *UBS Securities LLC* v. *Highland Capital Management, L.P.*, No. 3:20-cv-03408-G (dismissed June 14, 2021)

- *Dondero* v. *Highland Capital Management, L.P.*, No. 3:21-cv-00132-E (leave to appeal denied Feb. 11, 2021)
- *Dugaboy Investment Trust* v. *Highland Capital Management, L.P.*, No. 3:21-cv-00261-L (judgment entered Sept. 26, 2022)
- *Highland Capital Management Fund Advisors L.P.* v. *Highland Capital Management L.P.*, Nos. 3:21-cv-00538-N, 3:21-cv-00539-N, 3:21-cv-00546-N, 3:21-cv-00550-N (administratively closed July 12, 2022)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, No. 3:21-cv-00842-B (administratively closed Oct. 18, 2021)
- *Dondero* v. *Jernigan*, No. 3:21-cv-00879-K (dismissed Feb. 9, 2022)
- *Highland Capital Management, L.P.* v. *Highland Capital Management Fund Advisors, L.P.*, Nos. 3:21-cv-881-X, 3:21-cv-880-X, 3:21-cv-1010-X, 3:21-cv-1378-X, 3:21-cv-1379-X, 3:21-cv-03160-X, 3:21-cv-3162-X, 3:21-cv-3179-X, 3:21-cv-3207-X, 3:22-cv-00789-X (pending)
- *Official Committee of Unsecured Creditors* v. *CLO Holdco Ltd.*, No. 3:21-cv-01112-C (pending)
- *PCMG Trading Partners XXIII, L.P.* v. *Highland Capital Management, L.P.*, No. 3:21-cv-01169-N (administratively closed July 6, 2022)
- *Official Committee of Unsecured Creditors* v. *CLO Holdco Ltd.*, No. 3:21-cv-01173-X (dismissed May 6, 2022)
- *Official Committee of Unsecured Creditors* v. *CLO Holdco Ltd.*, No. 3:21-cv-01174-S (pending)

- *Dugaboy Investment Trust* v. *Highland Capital Management, L.P.*, No. 3:21-cv-01295-X (judgment entered Sept. 22, 2022)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, No. 3:21-cv-1585 (administratively closed Oct. 6, 2021)
- *Dondero* v. *Highland Capital Management, L.P.*, No. 3:21-cv-01590-N (judgment entered Aug. 18, 2022)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, No. 3:21-cv-01710-N (administratively closed July 6, 2022)
- *Highland Capital Management Fund Advisors, L.P.* v. *Highland Capital Management, L.P.*, No. 3:21-cv-01895-D (judgment entered Jan. 28, 2022)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, Nos. 3:21-cv-01974-X, 3:21-cv-01979-S (judgment entered Sept. 28, 2022)
- *Dugaboy Investment Trust* v. *Highland Capital Management, L.P.*, No. 3:21-cv-02268-S (dismissed Aug. 8, 2022)
- *NexPoint Advisors, L.P.* v. *Pachulski Stang Ziehl & Jones, L.L.P.*, Nos. 3:21-cv-03086-K, 3:21-cv-3088-K, 3:21-cv-3094-K, 3:21-cv-3096-K, 3:21-cv-3104-K (judgment entered May 9, 2022)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, Nos. 3:21-cv-03129-B, 3:22-cv-00695-B (judgment entered Sept. 2, 2022)
- *Kirschner* v. *Okada*, Nos. 3:22-cv-00203-S, 3:22-cv-229-S, 3:22-cv-253-S, 3:22-cv-367-S, 3:22-cv-369-S, 3:22-cv-370-S (pending)
- *NexPoint Advisors, L.P.* v. *Kirschner*, No. 3:22-cv-00335-L (pending)

- *CLO Holdco Ltd.* v. *Kirschner*, No. 3:22-cv-02051-B (pending)
- *NexPoint Advisors, L.P.* v. *Highland Capital Management, L.P.*, No. 3:22-cv-02170-S (administratively closed Jan. 23, 2023)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, No. 3:22-cv-02280-S (pending)
- *Charitable DAF Fund, L.P.* v. *Highland Capital Management, L.P.*, No. 3:22-cv-02802-S (pending)

United States Bankruptcy Court (N.D. Tex.):

- *In re Highland Capital Management, L.P.*, No. 19-34054 (confirmation order entered Feb. 22, 2021)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

NO. 22-631

HIGHLAND CAPITAL MANAGEMENT, L.P.,

Petitioner,

v.

NEXPOINT ADVISORS, L.P., *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF FOR RESPONDENTS NEXPOINT ADVISORS, L.P. AND NEXPOINT ASSET MANAGEMENT, L.P.

PRELIMINARY STATEMENT

The Fifth Circuit correctly held below that the Bankruptcy Code generally forbids third-party exculpations. That holding follows from the plain text of Section 524(e), which makes clear that the "discharge of a debt of the debtor *does not affect the liability of any other entity* on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e) (emphasis added). It is also buttressed by Section 524(g), which allows bankruptcy courts to exculpate third parties *only* in certain carefully limited circumstances involving asbestos-related claims.

Although the court below reached the right result on that issue, Highland's petition is correct that there is a circuit conflict. The issue is also important: Parties have increasingly used third-party releases to avoid responsibility for everything from the opioid epidemic to sex-abuse scandals, claiming the benefits of a bankruptcy discharge while avoiding all of bankruptcy's burdens. The Court should grant review and restore uniformity among the circuits by putting an end to those abuses.

This case, moreover, is a particularly good vehicle for review because the decision below implicates two related questions that also divide the circuits. First, while the Fifth Circuit correctly struck most of the third-party exculpations, it permitted others. The court upheld provisions that shielded Highland's "Independent Directors" for all misconduct short of gross negligence, invoking an expansive view of the common-law immunity of bankruptcy trustees. That ruling implicates an acknowledged three-way circuit conflict over the standard for common-law immunity: The Fourth, Sixth, Seventh, and Tenth Circuits hold that bankruptcy trustees are immune for all but *willful* violations; the First, Second, Ninth, and Eleventh Circuits allow suits for simple negligence; and the Fifth Circuit requires gross negligence.

Second, the court of appeals upheld provisions that exculpate both Highland and third parties from liabilities arising in the ordinary course of their business operations *after* the bankruptcy discharge. That holding conflicts with the rule in the Seventh, Eighth, Ninth, and Eleventh Circuits. Those courts recognize that, once a debtor emerges from the bankruptcy court's oversight, it leaves behind the bankruptcy court's protections too. The Fifth Circuit's approach has particularly perverse results for registered investment advisers like Highland, seem-

ingly relieving them from liability even for violations of fiduciary duties under federal law.

NexPoint has filed its own petition seeking review of those questions. See No. 22-669. This case thus presents the opportunity to address multiple important questions regarding third-party exculpations—all of which have divided the circuits—in a single proceeding. Review that fails to consider the full range of relevant issues would protract the confusion in the lower courts and undermine the Court's ability to provide clear guidance. A ruling against third-party exculpations, moreover, may have limited practical effect if courts continue to grant broad protections through expansive interpretations of common-law immunity. Highland's own petition therefore underscores why the Court should grant NexPoint's petition as well, so it has the full range of issues before it.

STATEMENT

This case arises out of the Chapter 11 bankruptcy of Highland Capital Management, L.P., a multibillion-dollar investment management firm co-founded by James Dondero. Over the objections of both Mr. Dondero and the U.S. Trustee, the bankruptcy court exculpated a sprawling cast of third parties from liability and purported to immunize both Highland and third parties from ordinary post-bankruptcy business liabilities.

I. THE BANKRUPTCY COURT'S APPROVAL OF A PLAN WITH BROAD EXCULPATORY PROVISIONS

1. During the bankruptcy, Highland initially operated as a debtor-in-possession under Mr. Dondero's control. Pet. App. 49a-50a. Later, the bankruptcy court appointed three "Independent Directors" to manage the company. *Id.* at 58a. Highland ultimately proposed a Fifth Amended

Plan of Reorganization for approval. See Pet. App. in No. 22-669, at 167a-196a ("Plan").

Highland's plan of reorganization provides that, following confirmation of the plan, Highland will "continue to manage funds and conduct its business in the same manner" as before, while gradually paying off creditors and winding down its business. Pet. App. 102a; Plan § IV.C.6-7. "[T]here is no specified time frame by which this process must conclude." Pet. App. 102a. The plan calls for Highland to complete distributions within three years, but permits the court to extend that period indefinitely. Plan § IV.B.14.

The plan includes a sweeping exculpatory provision that extends to "nearly all bankruptcy participants." Pet. App. 8a-9a. The "Exculpated Parties" include "(i) the Debtor and its successors and assigns, (ii) the Employees, (iii) [the Debtor's general partner] Strand, (iv) the Independent Directors, (v) the Committee, (vi) the members of the Committee (in their official capacities), (vii) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (viii) the CEO/CRO; and (ix) the Related Persons of each." Plan § I.B.62. "Related Persons" include all "present, future, or former officers, directors, employees, managers, managing members, members, financial advisors, attorneys, accountants, investment bankers, consultants, professionals, advisors, shareholders, principals, partners, subsidiaries, divisions, management companies, heirs, agents, and other representatives." *Id.* § I.B.112.

The exculpatory provision bars "any claim * * * for conduct occurring on or after the Petition Date in connection with," among other things, "the implementation of the Plan," "the funding or consummation of the Plan," or "the offer, issuance, and Plan Distribution of any secu-

rities issued or to be issued pursuant to the Plan, * * * whether or not such Plan Distributions occur following the Effective Date." Plan § IX.C. Because the plan contemplates that Highland will continue to operate its business for three years or longer, that exculpation sweeps in a broad range of post-discharge conduct. The provision permits claims for "bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct," but not for ordinary negligence. *Ibid.*

The plan also includes a permanent injunction and gatekeeping provision that prohibits bankruptcy participants from asserting claims, without prior court approval, against any "Protected Party"—a category even broader than the list of Exculpated Parties. Plan § IX.F; see *id.* § I.B.56, .105. That provision covers claims relating to, among other things, "the administration of the Plan or property to be distributed under the Plan" or "the wind down of the business of the Debtor." *Id.* § IX.F. Again, because the plan contemplates that Highland will carry on business for multiple years, that provision sweeps in a broad range of post-bankruptcy conduct.

2. The bankruptcy court confirmed the plan. Pet. App. 39a-160a. Citing *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009), the court recognized that the Fifth Circuit had previously rejected third-party exculpations on the ground that "section 524(e) of the Bankruptcy Code 'only releases the debtor, not co-liable third parties.'" Pet. App. 108a. But the court asserted that Mr. Dondero's purported "litigious conduct" justified a different result here. *Id.* at 111a.

II. THE COURT OF APPEALS' OPINION

The Fifth Circuit affirmed in part and reversed in part. Pet. App. 1a-38a.

1. Section 524(e), the court observed, states that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." Pet. App. 28a. The court held that "the exculpation here partly runs afoul of that statutory bar on non-debtor discharge by reaching beyond Highland Capital, the Committee, and the Independent Directors." *Ibid.* The court acknowledged that "there is a circuit split concerning the effect and reach of § 524(e)." Pet. App. 30a. But the court followed its own precedent construing Section 524(e) to prohibit non-debtor exculpations. *Id.* at 31a.

The Fifth Circuit nonetheless upheld the plan's exculpation of the Independent Directors. Citing *In re Smyth*, 207 F.3d 758 (5th Cir. 2000), the court observed that it had "recognized a limited qualified immunity [for] bankruptcy trustees." Pet. App. 32a. *Smyth* acknowledged a "circuit split" over "the proper standard of care to which a trustee should be held." 207 F.3d at 761. Several courts applied an "intentional and deliberate standard," while others permitted claims for "mere negligence." *Ibid.* *Smyth* adopted an "intermediate position" and held that "the proper standard is gross negligence." *Ibid.* Applying that standard, the court below held that the plan's exculpation of the Independent Directors was permissible because it tracked the gross negligence standard that governed their common-law immunity as bankruptcy trustees. Pet. App. 33a.

The court also rejected NexPoint's argument that the plan improperly immunized Highland and third parties for ordinary post-bankruptcy business liabilities. Nex-

Point urged that the plan's post-discharge exculpations amounted to "a perpetual 'get out of jail free' card" for "future, post-confirmation liabilities." NexPoint C.A. Br. 26. In the Fifth Circuit's view, however, "permanency alone is no reason to alter a bankruptcy court's otherwise-lawful injunction on appeal." Pet. App. 35a.

2. The court of appeals granted rehearing and amended its opinion. Pet. App. 2a.[1] Highland and NexPoint then filed two separate petitions seeking this Court's review. See Pet.; Pet. in No. 22-669.

ARGUMENT

The court of appeals correctly held that Section 524(e) ordinarily prohibits bankruptcy courts from exculpating non-debtor third parties. NexPoint agrees with Highland, however, that the court's ruling raises an important and recurring question that has divided the courts of appeals. With alarming frequency, parties have used non-debtor releases to evade responsibility for everything from the opioid crisis to sex-abuse scandals, claiming the benefits of a bankruptcy discharge without enduring bankruptcy's burdens. This is an appropriate case in which to

---

[1] Highland errs in claiming that the Fifth Circuit rejected the argument that "the persons and entities it had struck from the plan's exculpation provision must likewise be left unprotected by the plan's injunction and gatekeeper provisions." Pet. 12. Even in its original opinion, the Fifth Circuit stated that "Appellants' primary contention—that the Plan's injunction 'is broad' by releasing non-debtors in violation of § 524(e)—is resolved by our striking the impermissibly exculpated parties." Pet. App. in No. 22-669, at 61a; Pet. App. 35a. The court then amended its opinion on rehearing to make the point even more clear. Compare Pet. App. in No. 22-669, at 61a, with Pet. App. 35a (deleting the text "[t]he injunction and gatekeeper provisions are, on the other hand, perfectly lawful" and replacing it with "[w]e now turn to the Plan's injunction and gatekeeper provisions").

grant review, restore uniformity to the law, and put an end to those rampant abuses of the bankruptcy system.

This case is a particularly good vehicle for doing so. The case would allow the Court to address two closely related issues that have also divided the lower courts—issues that are presented in NexPoint's own petition from the same judgment. See No. 22-669. There is a wide-ranging and acknowledged circuit conflict over the standard that governs a bankruptcy trustee's common-law immunity. The circuits also disagree over whether a reorganization plan may exculpate parties from ordinary post-bankruptcy business liabilities. The Fifth Circuit's decision takes the wrong side of both of those independently certworthy issues. Granting both parties' petitions would enable the Court to resolve multiple circuit conflicts in a single proceeding and bring clarity to this thorny area of the law.

The issues, moreover, are intertwined. A ruling from this Court that the Bankruptcy Code bars non-debtor exculpations may accomplish little if courts could achieve the same result by inventing expansive common-law principles instead. Granting both petitions would enable the Court to resolve these related issues with a full picture of the relevant principles and how they interact.

I. Third-Party Exculpations Are An Important Issue That Divides The Courts Of Appeals

1. Section 524(e) provides that the "discharge of a debt of the debtor *does not affect the liability of any other entity* on * * * such debt." 11 U.S.C. § 524(e) (emphasis added). That provision limits the effect of a discharge to the debtor itself, expressly excluding other parties from the discharge. Nonetheless, some courts of appeals refuse to enforce that provision as written, resulting in a

circuit conflict and widespread abuse of the bankruptcy process in many parts of the country.

The Fifth and Tenth Circuits read Section 524(e) to mean what it says. That provision "categorically bars third-party exculpations absent express authority in another provision of the Bankruptcy Code." Pet. App. 30a; see also *In re Pac. Lumber Co.*, 584 F.3d 229, 251-253 (5th Cir. 2009); *In re Zale Corp.*, 62 F.3d 746, 760-761 (5th Cir. 1995); *In re W. Real Estate Fund, Inc.*, 922 F.2d 592, 600 (10th Cir. 1990), modified on other grounds, 932 F.2d 898 (10th Cir. 1991). By contrast, the Fourth, Sixth, Seventh, Ninth, and Eleventh Circuits hold that Section 524(e) "does not foreclose a third-party release from a creditor's claims." *In re Airadigm Commc'ns, Inc.*, 519 F.3d 640, 656 (7th Cir. 2008); see also *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015), cert. denied, 577 U.S. 823 (2015); *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002), cert. denied, 537 U.S. 816 (2015); *In re A.H. Robins Co.*, 880 F.2d 694, 702 (4th Cir. 1989), cert. denied, 493 U.S. 959 (1989); cf. *Blixseth* v. *Credit Suisse*, 961 F.3d 1074, 1084 (9th Cir. 2020), cert. denied, 141 S. Ct. 1394 (2021). NexPoint thus agrees with Highland that there is "an acknowledged and substantial circuit split" over this issue. Pet. 13.

2. NexPoint also agrees that the question is important. "Third-party releases are among the most controversial issues in Chapter 11 bankruptcy." Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 Tex. L. Rev. 1079, 1106 (2022). In recent years, parties have used them to avoid liability for everything from the opioid crisis to sex-abuse scandals without actually declaring bankruptcy themselves. Pet. in No. 22-669, at 18. Widespread outrage over those practices has sparked debate over bankruptcy

courts' authority and even proposed legislation in Congress. See, *e.g.*, Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L.J. Forum 960, 967 (2022); Nondebtor Release Prohibition Act of 2021, H.R. 4777, 117th Cong. (July 28, 2021); Nondebtor Release Prohibition Act of 2021, S. 2497, 117th Cong. (July 28, 2021). Highland is therefore also correct that the case presents an "important and recurring issue." Pet. 18.

3. Finally, NexPoint agrees with Highland that this case is a suitable vehicle. The fact that this case involves third-party *exculpations* that limit liability to gross negligence or willful misconduct, rather than third-party *releases* that eliminate liability altogether, does not diminish the importance of the issue or make this case a faulty vehicle. Cf. Pet. 3 n.1, 22.

For one thing, there is no relevant difference between exculpations and releases. An exculpation clause *is* a release with respect to the category of claims that falls within its terms. In this case, for example, the plan purports to eliminate liability for a broad range of third-party claims—all claims short of gross negligence. Whether one labels that provision an "exculpation" or a "release" makes no real difference; the plan purports to eliminate those liabilities. The impact can be very great indeed where, as here, the provision eliminates all liability for ordinary negligence. See *Conway* v. *O'Brien*, 312 U.S. 492, 495 (1941) ("Gross negligence is substantially and appreciably higher in magnitude and more culpable than ordinary negligence.").

Moreover, nothing in the statutory text supports a distinction between exculpations and releases. Section 524(e) states that a bankruptcy discharge shall not "*affect* the liability of any other entity." 11 U.S.C. §524(e) (em-

phasis added). An exculpatory clause clearly "affects" a party's liability: It eliminates liability for a particular category of claims.

Courts thus routinely analyze both exculpations and releases under the same principles. Many courts do not even draw a clear distinction, using the term "release" to embrace exculpations too. See, *e.g.*, *Blixseth*, 961 F.3d at 1081-1082 (describing "Exculpation Clause" as a "liability release" that "releas[ed] the parties from liability * * * [from] negligence claims * * * [but not] willful misconduct or gross negligence"); *In re Dynegy, Inc.*, 770 F.3d 1064, 1066 (2d Cir. 2014) (referring to a "binding release of non-debtor third parties" that "did not cover intentional fraud, willful misconduct, gross negligence, or criminal conduct"); *Seaside*, 780 F.3d at 1081 ("release" did not include "claims arising out of fraud, gross negligence, or willful misconduct"); *Airadigm*, 519 F.3d at 657 ("release" did not include "willful misconduct"); *In re PWS Holding Corp.*, 228 F.3d 224, 247 (3d Cir. 2000) ("release" set forth "applicable standard of liability * * * rather than eliminating it altogether").

The court below thus properly rejected Highland's effort to justify the exculpatory provision in this case on the theory that it merely restricts rather than eliminates liability. Highland urged a "distinction between a concededly unlawful release of all non-debtor liability and the Plan's limited exculpation of non-debtor post-petition liability." Pet. App. 29a. But the Fifth Circuit "rejected th[at] parsing between limited exculpations and full releases," making clear that its interpretation of Section 524(e) applies equally to both types of provisions. *Id.* at 31a. This case thus squarely presents the issue that divides the courts of appeals.

II. This Case Is A Particularly Good Vehicle In Light Of The Issues NexPoint Raises In Its Own Petition

NexPoint has filed its own petition seeking review of the same judgment. See No. 22-669. As that petition explains, the court of appeals' decision implicates two related circuit conflicts that warrant review in their own right. Those questions provide yet another reason this case presents a good vehicle for review.

1. First, the circuits are divided over the standard that governs the common-law immunity of bankruptcy trustees. The First, Second, Ninth, and Eleventh Circuits permit suits for ordinary negligence. See *In re Mailman Steam Carpet Cleaning Corp.*, 196 F.3d 1, 7 (1st Cir. 1999), cert. denied, 530 U.S. 1230 (2000); *In re Gorski*, 766 F.2d 723, 727 (2d Cir. 1985); *Bennett* v. *Williams*, 892 F.2d 822, 823 (9th Cir. 1989); *Red Carpet Corp. of Panama City Beach* v. *Miller*, 708 F.2d 1576, 1578 (11th Cir. 1983). The Fourth, Sixth, Seventh, and Tenth Circuits require intentional misconduct. See *United States* v. *Sapp*, 641 F.2d 182, 184-185 (4th Cir. 1981); *Ford Motor Credit Co.* v. *Weaver*, 680 F.2d 451, 462 (6th Cir. 1982); *In re Chi. Pac. Corp.*, 773 F.2d 909, 915 (7th Cir. 1985); *Sherr* v. *Winkler*, 552 F.2d 1367, 1375 (10th Cir. 1977). The Fifth Circuit takes an "intermediate position" that requires "gross negligence." *In re Smyth*, 207 F.3d 758, 761 (5th Cir. 2000). The court of appeals applied that standard below and upheld the plan's exculpatory provision with respect to the Independent Directors because it tracked that common-law gross negligence standard. Pet. App. 32a-33a.

That conflict is important. The Fifth Circuit's gross negligence standard sharply limits the relief available for trustee misconduct. For that reason, the U.S. Trustee

filed an amicus brief in another Fifth Circuit case urging that court to reconsider its standard. See *In re Schooler*, 725 F.3d 498, 511-512 n.10 (5th Cir. 2013). The Fifth Circuit recognized that "the government has advanced a persuasive argument challenging our holding in *Smyth*," but refused to budge, deeming itself "bound." *Ibid.*

2. The Fifth Circuit's decision below also creates a circuit conflict over whether bankruptcy courts may exculpate debtors from ordinary post-bankruptcy business liabilities. The plan in this case contemplates that Highland will "continue to manage funds and conduct its business in the same manner" as before, while gradually winding down operations. Pet. App. 102a. Yet it broadly exculpates Highland and other parties for their "implementation" of that plan. Plan § IX.C. It also enjoins claims over the "administration" of the plan and "the wind down of the business of the Debtor." *Id.* § IX.F. The plan thus purports to exculpate Highland and third parties for ordinary post-bankruptcy business liabilities.

Other courts of appeals would not permit such provisions. As one circuit explains: "A firm that has emerged from bankruptcy is just like any other defendant" and must defend itself under the "applicable non-bankruptcy law." *Pettibone Corp.* v. *Easley*, 935 F.2d 120, 122 (7th Cir. 1991); see also *In re Fairfield Cmtys., Inc.*, 142 F.3d 1093, 1095 (8th Cir. 1998); *Sw. Marine Inc.* v. *Danzig*, 217 F.3d 1128, 1140 (9th Cir. 2000), cert. denied, 532 U.S. 1007 (2001); *In re Sure-Snap Corp.*, 983 F.2d 1015, 1017 (11th Cir. 1993).

This issue is important too. Under the decision below, debtors can grant themselves indefinite immunity following a bankruptcy so long as their reorganization plan calls for them to continue doing business and exculpates them for "implementing" or "administering" that plan.

The consequences are particularly striking for a registered investment adviser like Highland. Pet. App. 49a-50a. The decision below seemingly exculpates such debtors even from claims over their important fiduciary duties under federal law. See *SEC* v. *Cap. Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 191 (1963).

3. Those two further circuit conflicts underscore this case's suitability for review. By granting both petitions, the Court can settle, in a single case, three related issues that have divided the courts of appeals. That is a far more efficient course than addressing each issue piecemeal. Conversely, review that fails to consider the full range of issues would protract the confusion and undermine the Court's ability to provide clear guidance based on a full understanding of the relevant context.

The close relationship between the issues reinforces the desirability of addressing them all in a single case. The common-law immunity issue is particularly intertwined with the broader question of third-party exculpations. A ruling prohibiting third-party exculpations may do little to settle the disarray in this area if courts continue to grant broad protections to third parties based on expansive views of common-law immunity. Reviewing those issues together is necessary to put an end to third parties' abuse of the bankruptcy system by claiming the benefit of a bankruptcy discharge while avoiding bankruptcy's burdens.

Finally, the questions in NexPoint's petition confirm that the fact pattern here—a case involving exculpations rather than wholesale releases from all liability—is a virtue rather than a defect. Cf. Pet. 3 n.1, 22. A case involving a wholesale release would not permit the Court to address the circuit conflict over the common-law immunity standard. No circuit holds that the common law

provides *complete* immunity, so common-law immunity could never justify a wholesale third-party release. Because this case involves provisions that purport to exculpate third parties only for misconduct short of gross negligence, it squarely presents both the permissibility of third-party exculpations and the scope of the common-law immunity the court of appeals relied on to uphold the provisions for certain third parties.

III. THE FIFTH CIRCUIT'S INTERPRETATION IS CORRECT

While Highland is correct about the circuit conflict and the importance of the issue, it is wrong on the merits. The Fifth Circuit correctly held that Section 524(e) prohibits third-party exculpations.

Section 524 describes the effect of a discharge in bankruptcy. Section 524(a) provides that the discharge bars any effort to collect "a personal liability *of the debtor*." 11 U.S.C. § 524(a) (emphasis added). Section 524(e) then explains that the "discharge of a debt of the debtor *does not affect the liability of any other entity* on, or the property of any other entity for, such debt." *Id.* § 524(e) (emphasis added). That provision makes clear that "Congress did not intend to extend such benefits to third-party bystanders." *W. Real Estate*, 922 F.2d at 600; see also *In re Lowenschuss*, 67 F.3d 1394, 1401 (9th Cir. 1995) (Section 524 "does not * * * provide for the release of *third parties* from liability"), cert. denied, 517 U.S. 1243 (1996).

Section 524(g) erases any doubt. That provision states that a bankruptcy court may issue an injunction that bars an "action directed against a third party" for certain asbestos-related claims "*[n]otwithstanding the provisions of section 524(e)*." 11 U.S.C. § 524(g)(4)(A)(ii) (emphasis added). That provision would make no sense unless Section 524(e) otherwise prohibited such releases. See Jonathan M. Seymour, *Against Bankruptcy Exceptionalism*,

89 U. Chi. L. Rev. 1925, 2008 (2022) (deeming this "the best reading of the statute"). Moreover, where "a general authorization and a more limited, specific authorization exist side-by-side," the "terms of the specific authorization must be complied with." *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 566 U.S. 639, 645 (2012). Section 524(g)'s specific authorization for third-party protections in asbestos cases implies that other generic provisions of the Bankruptcy Code do not already authorize such relief.

Highland contends that Section 524(e) is "merely a 'saving clause' intended to clarify that a debtor's discharge from its debts has no effect on the liability of others on those same debts." Pet. 21. But that is precisely the point. The Bankruptcy Code makes clear that the debtor, and the debtor alone, benefits from the discharge. Bankruptcy courts cannot disregard that fundamental structural feature of the statute by invoking generic authorities to grant discharges to third parties too. Moreover, Highland does not even attempt to square its "saving clause" theory with Section 524(g)'s express authorization for third-party injunctions in asbestos cases "[n]otwithstanding the provisions of section 524(e)." 11 U.S.C. §524(g)(4)(A)(ii). That provision is an insurmountable obstacle for Highland's interpretation.

Highland also urges that Section 1123(b)(6) authorizes Chapter 11 plans to include "any * * * appropriate provision not inconsistent with the applicable provisions of this title." Pet. 21. But the court below explained why that argument begs the question: Section 1123(b)(6) authorizes only provisions that are "*not inconsistent*" with other Code sections. Pet. App. 32a. Third-party exculpations *are* inconsistent with other sections, namely Sections 524(e) and (g)—and if not with their plain text,

then at the very least with their irresistible structural implications. As a result, Section 1123(b)(6) does not authorize such provisions. Highland has no response to that straightforward analysis.

CONCLUSION

The Court should grant both Highland's petition and NexPoint's petition in No. 22-669.

Respectfully submitted.

BENOIT QUARMBY
MOLOLAMKEN LLP
430 Park Ave.
New York, NY 10022

JEFFREY A. LAMKEN
Counsel of Record
ROBERT K. KRY
EUGENE A. SOKOLOFF
MOLOLAMKEN LLP
The Watergate, Suite 500
600 New Hampshire Ave., N.W.
Washington, D.C. 20037
(202) 556-2000
jlamken@mololamken.com

Counsel for Respondents NexPoint Advisors, L.P. and NexPoint Asset Management, L.P.

FEBRUARY 2023