No. _____

In the

Supreme Court of the United States

NEXPOINT REAL ESTATE PARTNERS, L.L.C.,
formerly known as HCRE Partners, L.L.C.,
Petitioner,

v.

HIGHLAND CAPITAL MANAGEMENT, L.P.,
Respondent.

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

PETITION FOR WRIT OF CERTIORARI

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November 18, 2026

QUESTIONS PRESENTED

Petitioner filed a timely, unliquidated proof of claim during a bankruptcy proceeding stating that it "may" have rights against a bankruptcy debtor and that its investigation was "on-going." Experienced bankruptcy counsel, including a former federal bankruptcy judge, prepared the claim for petitioner after an investigation directed by petitioner's vice president and in-house counsel. The Fifth Circuit nonetheless affirmed $825,940.55 in inherent-power sanctions because it found petitioner's manager "likely" knew the claim was false. It also affirmed every fee incurred after petitioner sought to withdraw the proof of claim, even though petitioner offered withdrawal with prejudice, an appeal waiver, and abandonment of all proof-of-claim theories.

The questions presented are:

1. Whether a court may find by clear and convincing evidence that an entity acted in subjective bad faith based on what one officer "likely" knew, without considering the entity's investigation through other officers and counsel, where other circuits hold that even knowingly pursuing a meritless claim does not, without more, establish inherent-power bad faith.

2. Whether *Goodyear Tire & Rubber Co. v. Haeger*, 581 U.S. 101 (2017), permits a court to shift every fee incurred after a procedural event without determining which fees would not have been incurred but for the specific sanctionable conduct.

PARTIES TO THE PROCEEDING

Petitioner NexPoint Real Estate Partners, L.L.C., formerly known as HCRE Partners, L.L.C., was appellant in the court of appeals.

Respondent Highland Capital Management, L.P., was appellee in the court of appeals and debtor in the underlying bankruptcy proceeding.

Petitioners are unaware of any party having a stock ticker symbol.

CORPORATE DISCLOSURE STATEMENT

Petitioner NexPoint Real Estate Partners, L.L.C., is a privately held limited liability company with no parent company. No publicly held company owns 10% or more of its membership interests.

STATEMENT OF RELATED PROCEEDINGS

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

In re Highland Capital Management, L.P., No. 19-34054-sgj11 (Bankr. N.D. Tex.) (sanctions order entered Mar. 5, 2024; reconsideration denied May 21, 2024);

NexPoint Real Estate Partners, L.L.C. v. Highland Capital Management, L.P., No. 3:24-cv-01479-S (N.D. Tex.) (judgment entered Sept. 22, 2025); and

NexPoint Real Estate Partners, L.L.C. v. Highland Capital Management, L.P., No. 25-11185 (5th Cir.) (original opinion issued Aug. 14, 2026; panel rehearing denied and substituted opinion issued Sept. 16, 2026; mandate issued Sept. 16, 2026; petition for rehearing en banc filed Sept. 30, 2026; petition for rehearing en banc deemed untimely and no action taken; motion to recall and stay mandate pending this petition for certiorari denied Oct. 2, 2026).

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PETITION FOR WRIT OF CERTIORARI

Petitioner NexPoint Real Estate Partners, L.L.C., formerly known as HCRE Partners, L.L.C. (collectively, "HCRE"), respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

This case concerns the boundaries of a potent implied power. A federal court may sanction a litigant under its inherent authority, but only upon clear proof of subjective bad faith, and only to compensate for fees the misconduct itself specifically caused. Those limits matter because inherent power is not conferred by statute or rule, and because a fee award imposed without those limits becomes punishment by another name. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 44 (1991) ("Because of their very potency, inherent powers must be exercised with restraint and discretion."); *Goodyear Tire & Rubber Co. v. Haeger*, 581 U.S. 101, 108 (2017) (inherent powers sanctions "must be compensatory rather than punitive in nature").

The published decision below erodes both safeguards. HCRE timely filed a single, unliquidated proof of claim stating merely that it "may" possess rights against Highland and that its investigation into those potential rights was "on-going." Experienced outside bankruptcy counsel, including a former federal bankruptcy judge, prepared the filing. HCRE's vice president reviewed the relevant financial records and agreements, coordinated with in-house counsel, and supplied information to the filing lawyers. Yet the Fifth Circuit treated one manager's inability, years later, to recall personally reviewing particular

documents as clear and convincing proof that the entity itself acted in bad faith. The panel's decisive formulation was telling: that manager "likely" knew the claim was false and thus, the entity must have acted in subjective bad faith. App. 11a.

But one manager "likely" knowing a claim was false is not clear and convincing proof of an entity's subjective bad faith. It is merely a probability inference about one officer that overlooks the investigation performed by the entity through other officers and sophisticated counsel. And the Fifth Circuit's ruling conflicts with sanctions decisions of the Sixth, Ninth, and Eleventh Circuits. The Sixth Circuit holds that even knowingly pursuing a meritless claim is not enough; there must be "something more," such as an independently improper purpose. *See BDT Prods., Inc. v. Lexmark Int'l, Inc.*, 602 F.3d 742, 753–54 (6th Cir. 2010). The Eleventh Circuit likewise reversed inherent-power sanctions where a lawyer's investigation was imperfect but an investigation "nevertheless occurred," because subjective bad faith cannot be replaced by recklessness or hindsight. *Purchasing Power, LLC v. Bluestem Brands, Inc.*, 851 F.3d 1218, 1222–25 (11th Cir. 2017). And the Ninth Circuit requires conduct "more egregious than mere negligence or recklessness" to uphold inherent power sanctions. *Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178, 1196 (9th Cir. 2003). The Fifth Circuit's ruling is in stark conflict with these rulings from its sister circuits, creating a circuit split warranting Supreme Court review.

The particular fee award the Fifth Circuit upheld compounds the problem. During the bankruptcy proceedings, HCRE tried to end the dispute before

trial of its proof of claim. It offered to withdraw its claim with prejudice, waive all rights to appeal, recognize Highland's existing ownership interest in the pertinent entity, and abandon any future challenge based on the pleaded proof-of-claim theories. The parties disagreed only over Highland's demand for language guaranteeing that its ownership percentage could never change under any future circumstance. The bankruptcy court denied withdrawal, compelled discovery and trial, and then charged HCRE approximately $375,000 for the proceedings that followed HCRE's motion to withdraw its claim.

Pursuant to this Court's decision in *Goodyear*, the proper question was not whether the later proceedings occurred after something labeled "bad faith." It was whether Highland would have incurred each category of fees absent the specific misconduct. 581 U.S. at 108–10. That required a counterfactual, but-for analysis of a conditioned, with-prejudice withdrawal embodying HCRE's on-record concessions. Neither lower court performed such counterfactual analysis. The Fifth Circuit instead held that HCRE caused all later fees because it did not accept Highland's preferred withdrawal language. App. 15a–17a. That substitutes a party's refusal to accept demanded dismissal language for *Goodyear* causation.

Both questions are recurring and consequential. Bankruptcy bar dates require creditors to preserve contingent and unliquidated claims before all facts can be known. If an ultimately unsuccessful claim—coupled with an ordinary economic desire to protect assets—permits a court to infer subjective bad faith, prudent creditors will be forced to choose between

forfeiting possible rights and risking uncapped inherent-power sanctions. And if a court may shift an entire procedural phase without identifying the fees the misconduct caused, the causal limit this Court imposed in *Goodyear* does no work.

This case is also an appropriate vehicle for review. Both questions were pressed below and passed upon. Each independently affects an $825,940.55 final sanctions judgment. The Fifth Circuit's published opinion provides rules that will govern future cases in conflict with the rules of the Sixth, Eleventh, and Ninth Circuits. And the record identifies a clean alternative counterfactual for causation because HCRE placed its withdrawal concessions on the record.

This Court has also recently shown interest in cases presenting related questions. Specifically, the Court recently requested a response to a petition for certiorari in *Trump v. Clinton*, Case No. 26-518, which presents a related question about inherent-power sanctions for advocacy of an allegedly substantial and unresolved legal position. *See infra* § III.A. Granting both this petition and the petition in *Trump v. Clinton* would allow the Court to define the metes and bounds of inherent-power sanctions across two distinct factual settings, providing a sound basis for nationwide guidance to federal courts and litigants alike. The Court should thus grant review.

OPINIONS BELOW

The Fifth Circuit's substituted opinion (App. 1a–17a) is reported at ___ F.4th ___ and is available at 2026 WL 2730275. The district court's opinion affirming the sanctions order (App. 34a–43a) is

unreported and available at 2025 WL 2697835. The bankruptcy court's sanctions order (App. 54a–98a) is unreported and available at 2024 WL 959335. The bankruptcy court's order denying reconsideration (App. 44a–53a) is unpublished.

JURISDICTION

The bankruptcy court entered its sanctions order on March 5, 2024, and denied reconsideration on May 21, 2024. The district court had jurisdiction under 28 U.S.C. § 158(a)(1) and affirmed on September 22, 2025. The Fifth Circuit had jurisdiction under 28 U.S.C. § 158(d)(1). It issued a substituted opinion and denied panel rehearing on September 16, 2026. This petition is timely under Supreme Court Rule 13.3. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY AND RULE PROVISIONS INVOLVED

Section 105(a) of the Bankruptcy Code provides in relevant part that a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Code. 11 U.S.C. § 105(a). Federal Rule of Bankruptcy Procedure 3006 governs withdrawal of proofs of claim. The pertinent provisions are reproduced in the appendix. App. 99a–100a.

STATEMENT OF THE CASE

A. The Underlying Transaction and Qualified Proof of Claim

1. In 2018, Highland and HCRE undertook a transaction known as "Project Unicorn," involving the acquisition of 26 multifamily properties. App. 2a–3a.

They formed SE Multifamily Holdings, L.L.C., to hold some of the investments. An amended operating agreement allocated 47.94% of SE Multifamily to HCRE, 46.06% to Highland, and 6% to an unaffiliated investor. App. 3a.

HCRE maintained that those percentages did not fully reflect the parties' relative economic contributions or their expectation that allocations would evolve with the transaction. Highland's October 2019 bankruptcy transferred control of Highland to an independent board and, according to HCRE, impeded contemplated adjustments and distributions. C.A. ROA.1814–18, 14923–25, 14946–47; *see also* App. 85a–86a.[1]

2. Facing the bankruptcy claims bar date, HCRE filed Proof of Claim No. 146 in April 2020. App. 5a. The filing asserted no liquidated sum and no established right to Highland's ownership interest. Instead, it said HCRE "may be entitled" to distributions and "may have a claim" against Highland; that HCRE had requested information needed "to ascertain the exact amount"; and that the inquiry was "on-going." C.A. ROA.1218; App. 68a–69a. Those qualifications reflected the filing's purpose: to preserve a possible claim while the investigation continued.

The filing was not the product of an uninformed manager acting alone. The firm of Bonds Ellis Eppich Schafer Jones, L.L.P.—led by Bankruptcy Judge D. Michael Lynn—prepared the claim and its attachment. HCRE relied on outside counsel's advice that the filing was needed to preserve its interests.

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[1] "C.A. ROA" refers to the consecutively paginated record on appeal in the Fifth Circuit.

C.A. ROA.16815–24. HCRE's vice president and secretary, Matt McGraner, reviewed the "whole gamut" of HCRE's financial records and agreements, coordinated with in-house counsel, and directed the transmission of information to the outside lawyers. C.A. ROA.14919–20.

The Fifth Circuit did not address that entity-level investigation or HCRE's reliance on counsel. Instead, it focused only on James Dondero's testimony that, years after the filing, he could not remember personally reviewing documents or conducting his own due diligence before authorizing the claim. App. 10a. But the claimant was HCRE—not Dondero personally—and organizations investigate and act through multiple officers and counsel. HCRE's reliance on experienced bankruptcy counsel—who no one has suggested acted in an improper or sanctionable manner—is especially relevant to whether the entity intended to abuse the judicial process.

3. Highland objected to HCRE's proof of claim in July 2020 as part of an omnibus objection. App. 5a. Six months after the original filing, newly retained counsel at the firm of Wick Phillips responded and developed possible reformation, rescission, and modification theories based on mutual mistake, lack of consideration, or failure of consideration. C.A. ROA.16644. The response expressly stated that "additional discovery" was needed to evaluate those theories. C.A. ROA.16645.

That chronology matters. The original proof of claim did not assert a completed reformation case. It merely preserved a contingent claim in materially

qualified terms. *See, e.g.*, C.A. ROA.1218 (stating that HCRE "may be entitled" to distributions and "may have a claim" against Highland, and explaining that HCRE had requested information "to ascertain the exact amount" and that "[t]his process is on-going"). The legal theories discussed six months later were not signed by Dondero and amounted to HCRE's counsel's attempt to articulate possible bases for relief as the dispute developed. Trial testimony showing that those later theories failed cannot and did not retroactively establish that HCRE subjectively knew the original, materially qualified filing was false.

4. Discovery proceeded in three rounds. In April 2021, Highland moved to disqualify Wick Phillips based on the firm's alleged prior representation of Highland in connection with Project Unicorn. The parties litigated the issue for six months, and the bankruptcy court ultimately disqualified the firm, though the bankruptcy court declined to impose sanctions for the disqualification dispute. App. 6a, App. 75a–76a, n.40–42.

The Fifth Circuit characterized HCRE's opposition as "classic bad faith." App. 12a. But none of the sanctions awarded were fees caused by HCRE's opposition to disqualification. The bankruptcy court excluded that category from the award. App. 15a n.2. The disqualification dispute therefore cannot supply *Goodyear* causation for the $825,940.55 judgment, much less for the fees incurred after HCRE sought withdrawal.

B. HCRE's Effort to Withdraw the Claim

1. By August 2022, HCRE concluded that the cost and uncertainty of pursuing the proof of claim

outweighed any potential benefit. It thus moved to withdraw under Bankruptcy Rule 3006. C.A. ROA.2204–12. HCRE did so after consultation with outside counsel and expressly cited "the cost and uncertainty of continuing to pursue the Claim in the face of Debtor's objection" as the reason for the requested withdrawal. C.A. ROA.2205.

Highland opposed withdrawal, speculating that HCRE intended to revive the dispute elsewhere. The record dispelled that premise. When asked whether HCRE agreed "to an order denying the proof of claim with prejudice," Dondero answered, "Yes." C.A. ROA.3307–08 at 43:23–44:2. Dondero likewise confirmed that HCRE would "not challenge the estate's ownership or equity interest in SE Multifamily" and would waive "any appeal right" concerning that determination. C.A. ROA.3304 at 40:8–17. HCRE's counsel then made the scope of those concessions explicit: HCRE would not challenge Highland's interest "on the basis of anything asserted in the proof of claim, that being mistake, lack of consideration, or failure of consideration." C.A. ROA.3306 at 42:13–19. As counsel put it, Highland's "46 percent is [its] ownership interest in SE Multifamily and HCRE won't challenge that." *Id.* Thus, HCRE offered to withdraw with prejudice, waive appeal, abandon the proof-of-claim theories in any forum, and recognize Highland's existing 46.06% interest.

The sole remaining disagreement between the parties was narrower. Highland wanted an "ironclad" guarantee that its 46.06% interest would remain fixed regardless of future events under the operating agreement having no relation to the proof of claim.

App. 16a. While HCRE was perfectly willing to abandon its proof-of-claim theories, it could not rewrite the parties' contract to eliminate rights unrelated to those theories, such as the operating agreement's provisions governing how future capital calls or additional investments could affect the members' ownership percentages. C.A. ROA.3305–07. The bankruptcy court invited an agreed order but later acknowledged that all "counsel were unable to reach an agreement on the terms." C.A. ROA.35 n.48.

2. The bankruptcy court denied withdrawal, required the parties to complete discovery, and held a trial in November 2022. It disallowed the claim in April 2023. App. 6a–7a. Highland then sought inherent-power sanctions.

The withdrawal sequence was later portrayed by the Fifth Circuit as evidence of gamesmanship because the motion to withdraw came one day after a 4,000-document production and shortly before two depositions. The panel's original opinion repeatedly said that Highland had just produced those documents to HCRE. App. 23a, 30a. But that was materially wrong. HCRE—not Highland—made the production. On panel rehearing, the court withdrew its opinion and corrected that factual premise. App. 6a, 13a. But the substituted opinion retained the same inference of gamesmanship without confronting how the correction changed it: HCRE had just borne the burden of producing thousands of documents before deciding that the claim was no longer worth pursuing. In other words, the Fifth Circuit panel corrected the factual error, but illogically reached the same conclusion of gamesmanship from the set of facts it had gotten completely backwards.

C. The Sanctions Award and the Decision Below

1. The bankruptcy court awarded Highland $825,940.55 in inherent-power sanctions. App. 97a–98a. The award included approximately $375,000 in fees incurred after HCRE sought to withdraw, i.e., fees for discovery and trial that HCRE had attempted to avoid. C.A. ROA.17–48. The court found that HCRE acted in bad faith in filing, pursuing, and attempting to withdraw the claim. The district court affirmed.

2. The Fifth Circuit affirmed in a published opinion. The panel correctly stated the governing standard: a bad-faith finding must be supported by clear and convincing evidence so "direct and weighty" that it produces a clear conviction "without hesitancy." App. 8a–9a (quoting *Crowe v. Smith*, 261 F.3d 558, 565 (5th Cir. 2001)). The panel also held that it must review the legal sufficiency of the underlying facts "without deference." *Ibid.*

The panel's application departed from that standard. It reasoned that Dondero did not recall personally investigating the claim; that later trial testimony failed to substantiate the reformation theory developed after the filing; and that HCRE wished to protect assets it believed belonged to it. 6a–7a. From those facts, it concluded that Dondero filed the claim "without investigating, likely knowing it was false, and aiming to shield" assets from creditors. App. 10a–11a. That, the panel held, clearly and convincingly established HCRE's bad faith. *Id.*

The opinion did not address McGraner's investigation, HCRE's coordination with in-house counsel, the role of experienced outside bankruptcy

counsel, or the original claim's qualified language. Nor did it identify an improper litigation purpose distinct from HCRE's ordinary economic interest in preserving property it believed was its own.

3. The panel also affirmed the entire fee award under *Goodyear*. It acknowledged HCRE's argument that the bankruptcy court "improperly included costs incurred after it moved to withdraw its claim." App. 15a. But rather than ask what expenses Highland would have incurred absent the specific misconduct, the court asked whether the judgment after trial gave Highland greater security than HCRE's proposed withdrawal. It said the judgment "ironclad[ly]" protected Highland's 46.06% interest, whereas HCRE did not propose language that would have guaranteed that result. App. 16a.

On that basis, the panel concluded that HCRE's conduct caused all post-withdrawal fees. It did not separate fees caused by filing the proof of claim from fees caused by litigating it, opposing disqualification, seeking withdrawal, refusing Highland's preferred language, or complying with the bankruptcy court's order compelling trial. It did not determine what proceedings would have remained under a conditioned dismissal embodying HCRE's actual concessions. And it did not explain why the absence of a newly negotiated permanent ownership guarantee that still does not exist in light of the proceedings below was sanctionable conduct.

4. HCRE timely sought panel rehearing. On September 16, 2026, the panel denied rehearing, withdrew its August 14 opinion, issued the substituted published opinion correcting the 4,000-

document production error referenced above, and issued the mandate—all on the same day. HCRE timely moved to recall and stay the mandate pending this petition for certiorari. Highland opposed on September 30. On October 2—before HCRE could file a reply—the Fifth Circuit summarily denied the requested recall and a stay. HCRE also filed a petition for rehearing en banc on September 30. Despite being filed within 14 days of the Fifth Circuit's September 16 substituted panel opinion as permitted by Fed. R. App. P. 40(d)(1), the petition for rehearing en banc was deemed untimely and no action was taken.

REASONS FOR GRANTING THE PETITION

The decision below warrants review for two independent reasons. First, it conflicts with *Goodyear* by affirming a phase-wide fee award without the required conduct-specific counterfactual. Second, it deepens disagreement among the courts of appeals over what proof separates an unsuccessful claim from subjective bad faith subjecting a party to inherent powers sanctions.

Both questions define the limits of an implied judicial power this Court has repeatedly instructed lower courts to exercise with restraint and raise concerns about the boundaries of lower courts' remedial and discretion-laden authority, which this Court has repeatedly policed in recent terms. *See, e.g.*, *Trump v. CASA, Inc.*, 606 U.S. 831, 841–48 (2025) (holding that universal injunctions likely exceeded federal courts' equitable authority because the injunctions extended beyond the relief necessary to redress the plaintiffs' injuries); *Shoop v. Twyford*, 596 U.S. 811, 819–23 (2022) (reversing an order entered

under the All Writs Act because the Act does not permit courts to circumvent statutory limits or issue relief untethered to their lawful jurisdiction).

I. The Decision Below Conflicts With *Goodyear's* Conduct-Specific Causation Rule.

A. *Goodyear* Permits Only Fees that Would Not Have Been Incurred But For the Misconduct.

Inherent-power sanctions may compensate; they may not punish. *Goodyear*, 581 U.S. at 108. That distinction makes causation indispensable. A compensatory award may include "only the portion of [the opponent's] fees that he would not have paid but for" the bad-faith conduct. *Id.* at 109. The court must establish "a causal link—between the litigant's misbehavior and legal fees paid by the opposing party." *Id.* at 108.

The inquiry is conduct-specific and counterfactual: the court must determine which fees "would not have been incurred in the absence of the sanctioned conduct." *Id.* at 109. Fees that would have been incurred anyway are outside the court's inherent compensatory power, even if the litigation included serious misconduct. *Id.* This is not a matter of loose reasonableness. The causal limitation marks "the difference between compensation and punishment." *Id.* at 108.

Goodyear recognized that a court may sometimes shift all fees incurred "during a discrete phase" of litigation, or even all fees in the case. *Id.* at 109–10. But those are applications of the same but-for rule, not exceptions to it. A phase-wide award is permissible

only if all fees in that phase would have been avoided absent the misconduct—for example, where a party's fabrication "infected" the entire proceeding. *Id.* at 110. The court still must identify the misconduct and make a causal judgment about the fees it generated.

This Court later reinforced the point in *Goodyear* itself: the causal inquiry requires a "do-over" asking what litigation would have occurred without the sanctionable act. *Id.* at 114. A court may use reasonable estimates, but it may not replace the counterfactual with a temporal marker or intuition that the sanctioned party behaved badly. *Id.* at 110–11.

B. The Decision Below Substitutes a Procedural Cutoff for the Required Counterfactual.

The award here cannot be reconciled with the rule set forth in *Goodyear*. HCRE moved to withdraw in August 2022, after it produced 4,000 documents, but before the depositions of its officers and before trial. It offered a with-prejudice disposition, an appeal waiver, recognition of Highland's existing interest, and abandonment of any future challenge based on the proof-of-claim theories. Those concessions supplied the obvious counterfactual: what fees would Highland still have incurred if the court had allowed withdrawal on those conditions?

Neither the bankruptcy court nor the Fifth Circuit posed—much less answered—that question. Instead, the Fifth Circuit panel affirmed every fee incurred after the withdrawal motion because HCRE did not propose language giving Highland an immutable ownership percentage. App. 15a–16a. But

refusing to accept an opponent's preferred language is not the misconduct identified in the sanctions order. And the required causal question is not whether Highland obtained something more valuable after trial. It is which fees would have been incurred absent HCRE's bad-faith conduct.

That distinction is decisive here. HCRE's on-record concessions would have ended the proof-of-claim dispute with prejudice and barred the theories the bankruptcy court later rejected. This is all that Highland obtained after trial on the proof of claim. The parties' disagreement over an "ironclad" 46.06% guarantee concerned potential future events under an operating agreement—not preservation of the withdrawn claim—and Highland does not possess that "ironclad" protection now. For example, future capital calls or additional investments could still alter the members' ownership percentages. C.A. ROA.3307 at 43:2–13; *see also* C.A. ROA.11678 (recognizing that members may make future capital contributions). And if HCRE's concession were not enough, the bankruptcy court could have imposed conditions preventing HCRE from relitigating the claim without rewriting the agreement for all time. Indeed, Bankruptcy Rule 3006 expressly authorizes withdrawal "on terms and conditions" the court deems proper.

The trial did not cure the causal gap. The judgment disallowing the proof of claim merely established that HCRE would take nothing on that claim. But HCRE had already offered that outcome, with prejudice and without appeal. The judgment's supposed additional protection came from the Fifth Circuit's characterization of its consequences, not

from a finding that every discovery and trial expense was necessary to redress a specific act of bad faith.

The Fifth Circuit rule would permit the exception to swallow *Goodyear*. Once a court labels a procedural phase the product of bad faith, it could shift every fee in that phase without comparing the actual litigation to the litigation that would have occurred without the misconduct. That is the precise shortcut *Goodyear* rejected.

C. The Decision Also Conflicts with the Fifth Circuit's Own Prior Application of *Goodyear*.

The tension described above is visible within the Fifth Circuit's own decisions as well. In *The Charitable DAF Fund, L.P. v. Highland Capital Management, L.P.*, 98 F.4th 170 (5th Cir. 2024), the Fifth Circuit vacated portions of an inherent-power fee award because the bankruptcy court had not tied each fee category to conduct that caused it. *Id.* at 175–77. The fact that conduct occurred in the same dispute or after a sanctionable filing did not suffice. *See id.*

Here, by contrast, the panel sustained an entire post-withdrawal phase based on a different premise: HCRE did not accept Highland's proposed language. That is not a finding that all later fees would have disappeared absent the original filing, the continued litigation, or any other identified misconduct. The decision therefore creates an unstable rule in a recurring setting—fee awards based on inherent authority—where clarity about causal limits is particularly important.

Review is warranted under Rule 10(c) because the decision below departs from this Court's

controlling causal standard. At minimum, the judgment should be vacated and the case remanded for a fee-by-fee or category-by-category analysis of the expenses that would have been avoided under the proper counterfactual.

II. The Decision Below Deepens a Conflict Over the Proof Required for Inherent-Power Bad Faith.

A. This Court and Several Circuits Require Subjective Bad Faith Distinct from Merely a Lack of Merit.

Because inherent power is "shielded from direct democratic controls," courts must exercise it "with restraint and discretion." *Chambers*, 501 U.S. at 44. A specific finding of bad faith is required. *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 767 (1980). The finding must concern the sanctioned party's state of mind and conduct; an erroneous or even reckless position does not automatically establish a deliberate abuse of judicial process.

The Sixth Circuit draws that line expressly. In *BDT Products*, the Sixth Circuit reversed an inherent-power sanction against counsel who continued to pursue claims the district court considered meritless. 602 F.3d at 752–54. "[T]he mere fact that an action is without merit does not amount to bad faith." *Id.* at 753. Even knowing pursuit of a meritless claim does not suffice without "something more," such as harassment, delay, disruption, evasion of an order, or another independently improper use of the judicial process. *Id.* at 753–54.

The Eleventh Circuit applies the same subjective limitation. In *Purchasing Power*, counsel failed to

uncover a jurisdictional defect involving an LLC's citizenship. 851 F.3d at 1220–22. The district court imposed $582,385 in inherent-power sanctions because counsel had recklessly failed to investigate. *Id.* at 1222. The Eleventh Circuit reversed. It held that subjective bad faith—not recklessness—is required when the conduct occurs before the court. *Id.* at 1223–25. Particularly relevant here, the court emphasized that counsel had relied on information from the client and conducted some investigation: it "might be lacking, but an investigation nevertheless occurred." *Id.* at 1225.

The Ninth Circuit likewise requires conduct "more egregious than mere negligence or recklessness." *Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178, 1196 (9th Cir. 2003). Those decisions preserve the distinction between a claim that fails—perhaps even one that should not have been brought—and a subjective purpose to misuse the judicial process.

B. The Fifth Circuit's "Likely Knowing" Inference Collapses that Distinction.

The Fifth Circuit panel recited a demanding standard but applied a materially lower one. It said the evidence must produce a clear conviction "without hesitancy." App. 8a (citing *Crowe v. Smith*, 261 F.3d 558, 563 (5th Cir. 2001)). It then held that Dondero "likely" knew the claim was false. App. 11a. "Likely" describes an inference akin to the preponderance of the evidence; it does not explain how the evidence dispelled hesitation, much less how it established HCRE's subjective bad faith.

More fundamentally, the inference omitted the evidence that bore most directly on the entity's state of mind. HCRE's vice president reviewed the "whole gamut" of relevant records and agreements. C.A. ROA.14919. He coordinated with in-house counsel. C.A. ROA.14919–20. Experienced outside bankruptcy counsel prepared the qualified proof of claim and advised that it was needed. C.A. ROA.14919; C.A. ROA.14888. The filing said only that HCRE "may" have a claim and that its investigation remained "on-going." C.A. ROA.1218. The Fifth Circuit did not explain why an entity that examined the underlying records, disclosed its material uncertainty, and relied on sophisticated counsel to investigate and file a proof of claim nevertheless subjectively knew the filing was false.

The later failure of counsel's reformation theory cannot fill that gap. The original proof of claim preceded that theory by six months and did not assert it as an established entitlement. Trial testimony that failed to prove a mutual mistake showed that HCRE ultimately lost. It did not prove that HCRE filed its earlier, contingent claim for an improper purpose.

Nor does HCRE's economic motive distinguish this case from ordinary litigation. The panel reasoned that HCRE sought to protect assets it believed were rightfully its own from Highland's creditors. App. 11a. But nearly every creditor files a proof of claim to protect assets or obtain distributions. An economic motive becomes bad faith only when coupled with a misuse of the judicial process—such as harassment, delay, or an attempt to obtain relief the party knows it has no right to seek. *See, e.g.*, *BDT Prods.*, 602 F.3d at 752–54. The opinion identified no such independent

purpose at filing and the evidence does not support such a finding.

Nor does HCRE's opposition to Wick Phillips's disqualification save the judgment below. Even accepting the panel's characterization of the opposition, the sanctions award excluded fees arising from that dispute. App. 15a n.2. It therefore cannot establish causation for the award under review. And conduct by later-retained counsel cannot retroactively prove HCRE's subjective state of mind when it filed the claim.

C. The Circuit Split is Outcome-Determinative and Warrants Review.

The difference among the circuits is not semantic. Under the Sixth Circuit's approach, for example, the court would have to identify "something more" than even the knowing pursuit of a meritless position. *See BDT Prods.*, 602 F.3d at 753–54. And under the Eleventh Circuit's approach, the undisputed investigation through an officer and counsel would defeat an inference resting on recklessness or hindsight. *See Purchasing Power*, 851 F.3d at 1220–22. But according to the Fifth Circuit, "likely" knowledge by one manager, a failed theory, and a conventional economic motive are enough to establish an entity's subjective bad faith clearly and convincingly.

The decision below also sits uneasily with the Fifth Circuit's own earlier caselaw. For example, *In re Moore* reversed inherent-power sanctions because suspicion and an "odor" of impropriety did not clearly and convincingly establish that the sanctioned party acted in bad faith. 739 F.3d 724, 729–33 (5th Cir.

2014). *Maguire Oil Co. v. City of Houston* likewise vacated sanctions where the record did not show that the party itself willfully abused the judicial process. 143 F.3d 205, 209–12 (5th Cir. 1998). Those decisions require proof about the sanctioned entity, not an inference from one individual's incomplete recollection while ignoring the investigative work done by others acting on behalf of the entity.

But now, a published Fifth Circuit opinion affirming a substantial sanction on a "likely knowing" theory will be invoked well beyond this bankruptcy. Such ruling not only conflicts with other circuits, it will also improperly widen the ability for lower courts to assess inherent authority sanctions that can reach every federal civil proceeding. The Court should thus resolve whether subjective bad faith may be inferred from probable knowledge and lack of merit without the independent improper purpose other circuits require.

III. The Questions are Important, Recurring, and Cleanly Presented.

A. The Questions Fit this Court's Recent Focus on the Boundaries of Lower-Court Authority.

This Court's recent docket reflects an acute interest in policing the boundaries of lower courts' remedial and discretion-laden authority. For example, in *Trump v. CASA, Inc.*, 606 U.S. 831, 841–48 (2025), the Court held that universal injunctions likely exceed the equitable authority Congress granted federal courts, rejecting a remedial practice that lower courts had treated as available for decades. In *Shoop v. Twyford*, 596 U.S. 811, 819–23 (2022), the Court

reversed an order entered under the All Writs Act because that flexible authority remains confined by the court's lawful jurisdiction and governing statutory limits. And in *Starbucks Corp. v. McKinney*, 602 U.S. 339, 345–51 (2024), the Court rejected a diluted test for preliminary injunctive relief and required lower courts to apply the traditional equitable standard.

Those decisions arose in different procedural settings, but they reflect the same institutional concern implicated here: powers described as equitable, discretionary, or inherent do not carry their own limits. Their flexibility makes judicially enforceable boundaries more—not less—important. Inherent-power sanctions are an especially strong candidate for review because the authority is implied, can produce judgments of substantial size, and operates without the procedural safeguards attached to rule- or statute-based sanctions.

The decision below tests both limits this Court has imposed on that power. It permits subjective bad faith to rest on probable knowledge inferred from an unsuccessful position, and it sustains compensatory relief without the conduct-specific causal showing *Goodyear* requires. Review would continue the Court's recent work ensuring that useful judicial tools remain within their lawful bounds.

Further, this Court recently requested a response to a petition for certiorari in *Trump v. Clinton*, Case No. 26-518, which presents the related question of whether inherent power permits monetary sanctions based on advocacy of a legal position alleged to be substantial and unresolved. *See Pet. for Writ of Certiorari* at i, 11-17, *Trump, et al. v. Clinton, et al.*,

No. 26-518 (U.S. Oct. 9, 2026); *see also* Docket, *Trump, et al. v. Clinton, at al.*, No. 26-518 (U.S. Oct. 27, 2026). Granting both this petition and the petition in *Trump v. Clinton* would allow the Court to define the metes and bounds of inherent-power sanctions across two distinct factual settings: constitutional advocacy in civil litigation and a qualified proof of claim in bankruptcy. Review of both settings would provide a sound basis for nationwide guidance to federal courts and litigants.

B. The Decision Below Threatens the Administration of Bankruptcy Claims.

The bad-faith question has particular force in bankruptcy. A creditor who fails to file a proof of claim by the claims bar date forfeits any right to distribution. *See* Fed. R. Bankr. P. 3003(c)(2)–(3) (providing that a creditor who fails to file a required proof of claim "will not be treated as a creditor for that claim"). Bankruptcy Rule 3003(c) therefore contemplates proofs of claim that are contingent or unliquidated. *Id.* ("A creditor or equity security holder whose claim or interest is not scheduled—or is scheduled as disputed, contingent, or unliquidated—must file a proof of claim or interest.") Accordingly, creditors often must act before discovery is complete and before all legal theories can be tested.

The decision below materially changes the risk calculus baked into the Congressionally-approved bankruptcy rules. A creditor that candidly states that a claim "may" exist and that investigation is continuing may still face inherent-power sanctions if the claim later fails and one senior officer cannot remember personally reviewing specific documents. That prospect will deter protective filings the

bankruptcy rules permit, particularly by organizations that necessarily rely on numerous, different officers and counsel to investigate and act.

The causation issue is equally recurring. Fee sanctions often span months or years and involve multiple categories of work. If a court may select a date and shift every later fee without reconstructing what would have occurred absent the misconduct, compensatory authority becomes functionally punitive. Only this Court can ensure that *Goodyear*'s causal boundary is applied consistently and not eroded by circuit authority failing to mind this Court's clear directives.

C. This Case is an Appropriate Vehicle.

Both questions presented were squarely presented and decided. HCRE challenged the sufficiency of the bad-faith evidence and emphasized the investigation by McGraner and counsel. The panel addressed the governing clear-and-convincing standard and nonetheless held the evidence sufficient. App. 8a–11a. HCRE separately argued that post-withdrawal fees failed *Goodyear*'s but-for test. The panel addressed that question and nonetheless affirmed the entire award. App. 15a–17a.

The questions are also outcome-determinative. The $825,940.55 judgment rests entirely on inherent power. A ruling for HCRE on the first question would require vacatur of the sanctions. A ruling on the second would at least require vacatur of the substantial post-withdrawal component and remand for the causal analysis the lower courts omitted.

The record is also unusually concrete. HCRE's proof of claim, the testimony describing HCRE's pre-

filing investigation, and the panel's "likely" formulation are all undisputed features of the record. On causation, HCRE's concessions were stated clearly on the record: withdrawal with prejudice, no appeal, recognition of Highland's existing interest, and no future challenge based on the proof-of-claim theories. *See, e.g.*, C.A. ROA.3304; C.A. ROA.3306; C.A. ROA.3307–08; C.A. ROA.3297–98. The Court need not speculate about the relevant counterfactual.

This case therefore offers a clean opportunity to reinforce two limits that prevent inherent-power sanctions from becoming an open-ended license to punish: subjective bad faith must be proved, not presumed from failure; and compensatory fees must be caused, not merely preceded, by the misconduct.

CONCLUSION

Based on the foregoing, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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November 18, 2026

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UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 25-11185

IN THE MATTER OF HIGHLAND CAPITAL MANAGEMENT, L.P.,

Debtor.

NEXPOINT REAL ESTATE PARTNERS, L.L.C.,

Appellant,

v.

HIGHLAND CAPITAL MANAGEMENT, L.P.,

Appellee.

Filed September 16, 2026

Appeal from the United States District Court
for the Northern District of Texas
USDC No. 3:24-CV-1479

ON PETITION FOR REHEARING

Before STEWART, GRAVES, and WILSON, *Circuit Judges.*

JAMES E. GRAVES, JR., *Circuit Judge*:

Appendix A

IT IS ORDERED that the petition for rehearing is DENIED. We withdraw our previous opinion and substitute the following:

A bankruptcy court holds the inherent power to sanction litigants for bad faith conduct—a critical safeguard to curtail abuse of the bankruptcy process. The bankruptcy court here sanctioned HCRE Partners[1] for just such an abuse. HCRE filed a claim that its officers knew to be baseless, and spent the following years litigating this claim in bad faith. It frivolously opposed a motion to disqualify counsel, and then moved to withdraw its claim to avoid the depositions of its officers, while seeking to preserve the claim's substance for a future forum. Because this is precisely the kind of behavior that warrants an inherent-power sanction, we affirm.

I. Background

A. To execute Project Unicorn, Highland and HCRE created a new LLC and divided its membership between themselves.

In 2018, James Dondero and Matt McGraner embarked on Project Unicorn. *In re Highland Cap. Mgmt., LP* (*Trial Ord.*), No. 19-34054, 2023 WL 3185266, at *6-7 (Bankr. N.D. Tex. Apr. 28, 2023). The project's goal was for several Dondero-affiliated companies, including Highland Capital Management and HCRE, to purchase 26 residential properties for about $1.1 billion. *Id.* at

1. HCRE now goes by NexPoint Real Estate Partners.

*6-7. During Project Unicorn, Dondero controlled both companies, while McGraner was HCRE's vice president and secretary. *Id.* at *1, *6-7.

Highland and HCRE created SE Multifamily Holdings, LLC. The original LLC Agreement governed SE Multifamily. It allocated 49% membership to Highland and 51% to HCRE. SE Multifamily, Highland, HCRE, and other Dondero-controlled entities secured a $550 million loan from Key Bank to finance Project Unicorn. *Id.* at *7.

Before the loan transaction closed, SE Multifamily brought another investor into Project Unicorn, BH Equities, which was unaffiliated with Dondero. *Id.* at *7-8. After BH Equities contributed $21 million, Highland and HCRE amended the LLC Agreement to give BH Equities a 6% membership of SE Multifamily. *Id.* at *8. This diluted Highland's share to 46.06%, and HCRE's share to 47.94%. The Amended LLC Agreement reflected these changes in membership throughout. Dondero signed the agreement on HCRE's and Highland's behalf.

B. When Highland filed for bankruptcy, Dondero challenged its share in SE Multifamily.

"By 2019 . . . myriad unpaid judgments and liabilities forced Highland . . . to file for Chapter 11 Bankruptcy." *In re Highland Cap. Mgmt. LP* (*Highland I*), 48 F.4th 419, 424 (5th Cir. 2022). To avoid appointment of a trustee, Highland, Dondero, and a committee of creditors agreed "to overhaul Highland's governance structure," which led to the appointment of an independent board. *Dondero*

v. Highland Cap. Mgmt., LP (*Highland II*), 105 F.4th 830, 834 (5th Cir. 2024). Almost immediately, Dondero disagreed with the new board about how the bankruptcy should proceed, and the board ousted him. *Id.*

1. Highland filed for bankruptcy, and Dondero interfered.

Dondero has earned at least two sanctions for his interference with Highland's bankruptcy. In December 2020, Highland sought a TRO against Dondero. *Id.* at 835. Although he had left Highland itself, its "organizational structure encompasses up to 2,000 other investment entities" which "share various service agreements with Highland." *Id.* at 834. Dondero exercises "de facto control" over many of these entities. *Id.* (citation modified). The bankruptcy court entered a TRO to prevent Dondero from further interfering with Highland. *Id.* at 835. But by January 2021, Dondero had violated the TRO by "communicating with members of Highland's legal team to coordinate [his] legal strategy against Highland and interfering with Highland's intended [asset] sales." *Id.* For this, Dondero earned a nearly $500,000 sanction, which our court affirmed. *Id.* at 836-41.

Our court also (partially) affirmed a sanction against Dondero for filing vexatious litigation connected to Highland's bankruptcy. *The Charitable DAF Fund, LP v. Highland Cap. Mgmt., LP* (*Highland III*), 98 F.4th 170, 174-77 (5th Cir. 2024). To protect one of the independent directors from vexatious lawsuits, the bankruptcy court adopted an order that gave it "sole jurisdiction"

to adjudicate claims against the director related to his appointment. *Id.* at 172-73. Yet Dondero sued Highland in district court and moved to amend the complaint to add the independent director as a defendant. *Id.* at 172. The bankruptcy court sanctioned him for the motion. *Id.* at 173-74. We affirmed the portion of this sanction that shifted the attorney fees related to defending the motion. *Id.* at 174-77.

2. Dondero and HCRE challenged SE Multifamily's membership allocation in the bankruptcy proceeding.

Dondero filed a Proof of Claim with the bankruptcy court in April 2020 on HCRE's behalf. He averred that HCRE "may be entitled to distributions out of SE Multifamily, but such distributions have not been made because of" Highland's conduct. As a result, HCRE "may have a claim against the Debtor."

Highland objected to the Proof of Claim in July 2020, denying any liability. By October 2020, HCRE hired a new law firm—Wick Phillips—to pursue its claim. *In re Highland Cap. Mgmt.* (*Sanctions Ord.*), No. 19-34054, 2024 WL 959335, at *7 (Bankr. N.D. Tex., Mar. 5, 2024). HCRE, through Wick Phillips, responded to Highland's objection in October 2020. The response clarified HCRE's legal theories to allege that SE Multifamily's organizational documents mistakenly apportioned its membership and asked the bankruptcy court to reform the Amended LLC Agreement.

3. During the first round of discovery, Highland moved to disqualify Wick Phillips.

The first of three rounds of discovery began in December 2020. Initially, this went as planned, and the parties served deposition notices, exchanged discovery demands, and produced voluminous documents. But from this discovery, Highland learned that Wick Phillips may have jointly represented HCRE and Highland for the Project Unicorn transactions. *Id.* So in April 2021, Highland moved to disqualify Wick Phillips. *Id.* After a second round of discovery and six months of litigation, the bankruptcy court disqualified the law firm.

4. During the third round of discovery, HCRE moved to withdraw its claim.

A third round of discovery began in June 2022. During this round, the parties exchanged documents, and HCRE deposed Highland's witnesses. *Id.*

But in August 2022—two days before Dondero's and McGraner's scheduled depositions and one day after HCRE produced 4,000 documents—HCRE moved to withdraw its claim. *Id.* After a hearing, the bankruptcy court denied the motion, finding that Highland would suffer prejudice from the withdrawal. *See Manchester, Inc. v. Lyle* (*In re Manchester*), No. 08-30703-11, 2008 WL 5273289, at *3 (Bankr. N.D. Tex. Dec. 19, 2008) ("[W]ithdrawal of a proof of claim should be permitted unless that withdrawal results in . . . prejudice to [the] nonmoving party." (citation modified)).

5. Once discovery ended, HCRE lost at trial.

After the bankruptcy court denied withdrawal, the parties completed discovery, and the court held a bench trial in November 2022. *Trial Ord.*, 2023 WL 3185266, at *1. HCRE lost. *Id.* at *16. The court found no evidence that the parties to the Amended LLC Agreement arrived at a different understanding of the membership allocation in SE Multifamily than was reflected in the agreement. *Id.* at *13. So the court refused to reform the contract, and disallowed the Proof of Claim. *Id.* at *12-16. At trial, Highland orally moved for sanctions. *Id.* at *16. The bankruptcy court denied the motion without prejudice because HCRE lacked an adequate opportunity to respond. *Id.*

6. After trial, the bankruptcy court sanctioned HCRE.

In June 2023, Highland moved for a bad faith finding and attorney fees. Invoking its inherent power to sanction litigants, the bankruptcy court awarded Highland $825,940.55. *Sanctions Ord.*, 2024 WL 959335, at *12-15. The bankruptcy court denied HCRE's motion for reconsideration. The district court affirmed the bankruptcy appeal. HCRE now appeals to this court.

II. Our Review

Generally, we "review [a] bankruptcy court's legal conclusions de novo and its factual findings for clear error." *Kreit v. Quinn* (*In re Cleveland Imaging & Surgical*

Hosp., LLC), 26 F.4th 285, 292 (5th Cir. 2022). But if a "court sanctions a party using its inherent authority, our review is closer." *Id.* We affirm "only if (1) the bankruptcy court finds that the party acted in bad faith or willfully abused the judicial process" and (2) "clear and convincing evidence" supports this finding. *Id.* (citation omitted). If the bankruptcy court "surmount[s]" this "high threshold" we review the sanction's substance for abuse of discretion. *Cadle Co. v. Moore* (*In re Moore*), 739 F.3d 724, 730 (5th Cir. 2014) (citation omitted).

Highland urges us to adopt a standard that "a bankruptcy court's factual determination that clear and convincing evidence exists to support its finding is, itself, reviewed for clear error." We cannot.

A bad faith finding "must be supported by clear and convincing [evidence]." *Id.* (quoting *Crowe v. Smith* (*Crowe II*), 261 F.3d 558, 563 (5th Cir. 2001)). "[T]he evidence must be so direct and weighty" that it would "enable the fact finder to come to a clear conviction, without hesitancy, of the truth of" the facts that supported the finding. *See Crowe II*, 261 F.3d at 565 (citation omitted). Hence "contradictory testimony" or unclear circumstances cannot sustain a sanction. *See id.* at 566.

Put differently, we must "ensure the legal sufficiency" of "the underlying facts" to "support [the bankruptcy] court's more generalized finding of bad faith." *Crowe v. Smith* (*Crowe I*), 151 F.3d 217, 236 (5th Cir. 1998). We "probe the record in detail" to unearth these underlying facts. *Id.* And we do so "without deference." *Vikas WSP,*

Ltd. v. Econ. Mud Prods. Co., 23 F.4th 442, 455 (5th Cir. 2022). If the evidence is legally insufficient, "the district court abused its discretion." *Crowe II*, 261 F.3d at 566. This standard leaves no room for Highland's attempt to append a clear error standard onto what is, essentially, a de novo review of evidentiary sufficiency.

Highland relies on *In re Carroll* to justify its clear error standard, where our court affirmed a sanction because "the record fully support[ed] the bankruptcy court's determination of bad faith, and Appellants [did] not establish[] that any of [its] findings were clearly erroneous." *Carroll v. Abide* (*In re Carroll*), 850 F.3d 811, 816 (5th Cir. 2017). That panel may have invoked the "clearly erroneous" standard because it considered a prefiling injunction against a vexatious litigant, as well as an inherent-power sanction. *See id.* at 815-16. We review a prefiling injunction under a general abuse of discretion standard, which means we review evidentiary findings for clear error. *Id.* Because the *In re Carroll* panel also reviewed a prefiling injunction, we construe its clear error language to relate to the injunction, not to disturb our well-established standard of review for inherent-power sanctions.

III. Discussion

Applying this standard, we affirm HCRE's sanction. Clear and convincing evidence supports the bankruptcy court's finding that HCRE acted in bad faith. And because HCRE's sanctionable conduct caused the costs Highland incurred—even after the withdrawal motion—the court

did not abuse its discretion in setting the sanction amount.

A. Clear and convincing evidence supports the bankruptcy court's bad faith finding.

HCRE maintains that "no evidence" supports the bankruptcy court's bad faith finding. Quite the contrary. The ample evidence of HCRE's bad faith clearly and convincingly shows that it (1) filed the Proof of Claim in bad faith, and (2) litigated the claim in bad faith. The bankruptcy court thus properly invoked its inherent sanction power.

1. HCRE filed its claim in bad faith.

When Dondero filed the Proof of Claim, he failed to investigate it. He could not recall "personally do[ing] any due diligence . . . before [he] authorized it to be filed." He did not "review any documents." Nor could he recall who provided the information in the claim to their law firm, or what information they gave. Even so, he signed the claim under penalty of perjury, and attested that he had "a reasonable belief that the information" in the claim was "true and correct."

Dondero and McGraner—the two HCRE officers coordinating Project Unicorn—then admitted at trial that they knew the claim was baseless. Dondero testified that SE Multifamily's membership allocation in the Amended LLC Agreement "comport[ed] with [his] expectations when [he] signed [it]." And McGraner could not identify any part of the agreement that did not reflect the parties'

intent. In other words, both officers admitted that there was no reason to reform the agreement.

In fact, the trial revealed that HCRE filed its claim with an ulterior motive. McGraner testified that the real "mistake" was that Dondero filed Highland's bankruptcy, which prevented them from freely amending the organizational documents to dilute Highland's membership. As a result, SE Multifamily's assets—which McGraner and Dondero believed were rightfully HCRE's—were at risk from Highland's creditors. McGraner called this "crazy and unjust."

So Dondero filed the Proof of Claim without investigating, likely knowing it was false, and aiming to shield SE Multifamily's assets from Highland's creditors. This evidence shows us clearly and convincingly that HCRE filed its claim in bad faith.

2. HCRE litigated its claim in bad faith.

The bankruptcy court focused on two aspects of HCRE's litigation conduct: (a) its opposition to the disqualification motion and (b) its attempt to withdraw its claim while trying to preserve its substance for a future forum. *Sanctions Ord.*, 2024 WL 959335, at *8-10. We agree with the bankruptcy court that these actions reflect HCRE's bad faith.

a. HCRE frivolously opposed Wick Phillips's disqualification.

In opposing Wick Phillips's disqualification, HCRE distorted the firm's role in SE Multifamily's formation. The response to Highland's disqualification motion claimed that Wick Phillips's previous representation of Highland "was limited to the negotiation and drafting of the [Key Bank] [l]oan." Yet at trial, McGraner admitted that he "personally knew that Wick Phillips represented both HCRE and Highland jointly in connection with the negotiation [and] drafting of the original LLC agreement, the Key Bank Loan, and the" Amended LLC Agreement. McGraner's admission shows that HCRE misrepresented Wick Phillips's role in the underlying transaction, a misrepresentation that took six months of expensive litigation to disprove. This goes beyond opposing a motion and losing; this is knowingly raising, then standing by, a frivolous argument—classic bad faith.

HCRE protests that because its ethics expert opined that the Wick Phillips conflict did not require disqualification, it cannot have taken a frivolous position. But this expert "assum[ed]" that HCRE's claims in response to the disqualification motion were true, which they were not. Because the expert based his opinion on a faulty assumption, it offers little insight into the merits of the disqualification dispute.

b. HCRE tried to withdraw its claim to avoid discovery obligations, while seeking to preserve the substance for a future forum.

The bankruptcy court found that the motion to withdraw reflected "gamesmanship," calculated to allow HCRE to avoid its discovery obligations while preserving its underlying claims for a future forum. The withdrawal motion's timing was indeed suspicious—two business days before Dondero's and McGraner's depositions, and one day after HCRE produced 4,000 documents. *Sanctions Ord.*, 2024 WL 959335, at *9.

HCRE never offered a cogent explanation for the timing. In the motion, it claimed that it "simply wishe[d] to no longer pursue a claim." It supplied no more insight at the hearing. The bankruptcy court grew concerned that HCRE harbored a tactical motive. *Id.* at *8-9. Especially because HCRE seemed interested in preserving its challenge to SE Multifamily's membership allocation after the withdrawal.

The court gave HCRE a choice: it would deny withdrawal, or HCRE could submit a proposed dismissal order that would prevent it from raising similar claims in another forum. The court ordered HCRE to confer with Highland about the language and report back Highland's position. But HCRE never submitted a proposed order, nor did it notify the court of any discussions with Highland. *Id.* at *9 n.48. So the bankruptcy court's concerns about gamesmanship persisted, and it denied withdrawal. *Id.*

Granted, HCRE assured the court at the motion hearing that it was willing to withdraw its claim with prejudice. But the court was understandably wary of Dondero's inconsistent statements on the scope of a with-prejudice withdrawal, and his refusal to rule out a future challenge to Highland's interest in SE Multifamily. *Id.* The bankruptcy court offered a practical way to allay these concerns, which HCRE ignored. HCRE cannot rely now on its offers to withdraw its claim with prejudice when it squandered its opportunity to address the court's legitimate concerns.

The withdrawal motion's suspicious timing, and HCRE's failure to allay the bankruptcy court's concerns about it, sustain the court's finding that HCRE moved to withdraw its claim in bad faith. And the record also supports the court's finding that HCRE filed its claim in bad faith. Because clear and convincing evidence supports both findings, the bankruptcy court properly found that HCRE acted in bad faith, hence it did not err by invoking its inherent sanction power.

B. The sanction was causally related to HCRE's sanctionable conduct.

HCRE next challenges the sanction amount. We review a sanction's substance for abuse of discretion. *In re Moore*, 739 F.3d at 730. Here, the bankruptcy court issued a "fee-shifting sanction." *Highland III*, 98 F.4th at 175. So there must be "a causal link between [HCRE's] misbehavior and [the] legal fees" awarded. *Id.* (citation modified). Without this link, "the sanction is punitive" and exceeds "the bankruptcy court's statutorily limited powers." *Id.*

HCRE argues that any fees incurred after it moved to withdraw are not causally related to its conduct.[2] Mostly, this repackages its complaints about the bankruptcy court's refusal to allow it to withdraw its claim. But once Highland had objected to the claim, HCRE could not withdraw it without court permission. Fed. R. Bankr. P. 3006(a). The court had good reason to deny permission, since it found that the withdrawal would unfairly prejudice Highland. Besides, HCRE's failure to propose withdrawal language *caused* the denial of its motion to withdraw, so it cannot plausibly claim now that Highland's subsequent costs were not causally related to its conduct.

Nor is Highland in the same position as it would have been by "tak[ing] the win," and not opposing withdrawal. The bankruptcy court's concern when denying withdrawal was not only that HCRE would refile another adversary bankruptcy claim, but that HCRE would challenge Highland's interest in SE Multifamily in another forum. *Sanctions Ord.*, 2024 WL 959335, at *9. If the withdrawal order had merely been with prejudice—without addressing whether that prejudice extended to claims in non-bankruptcy proceedings—HCRE might subsequently argue that its underlying contract reformation claim was left unresolved.

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2. HCRE also suggests that the fees associated with the disqualification dispute were not caused by its sanctionable conduct. But as Highland points out, it did not seek, nor did the bankruptcy court award, fees related to the disqualification motion. *Sanctions Ord.*, 2024 WL 959335, at *8 n.43.

But now, a court has rejected HCRE's claim on the merits. An order resolving a proof of claim is a "final judgment" for claim or issue preclusion purposes. *Lafayette v. Baudoin* (*In re Baudoin*), 981 F.2d 736, 742 (5th Cir. 1993). So HCRE cannot sue based "on the same nucleus of operative facts." *See id.* at 743. Or relitigate any issue necessary to the bankruptcy court's judgment. *Clem v. Tomlinson* (*In re Clem*), 124 F.4th 341, 348 (5th Cir. 2024). So after two years of costly litigation, Highland has what it sought at the withdrawal motion hearing: "an ironclad" guarantee that HCRE cannot challenge its interest in SE Multifamily again; whether in a bankruptcy court, or any other forum. Had HCRE proposed terms that would achieve this, further litigation would have been unnecessary.

Although HCRE claims otherwise, the sanctions our court vacated in *Highland III* have little in common with the sanctions here. 98 F.4th at 172-77. In *Highland III*, we held that the bankruptcy court could not impose fees incurred in litigating a sanctions motion, only fees caused by the sanctionable conduct. *See id.* at 174-76. But here, the bankruptcy court did not shift Highland's fees connected with its sanctions motion. *See Sanctions Ord.*, 2024 WL 959335, at *12. While *Highland III* guides us generally, the bankruptcy court here shifted fees related to the underlying sanctionable conduct, which yields a different result.

Thus, Highland's costs that accrued after HCRE moved to withdraw its claim are still causally related to HCRE's conduct. So the bankruptcy court did not

abuse its discretion when it imposed them. Because the court properly invoked its inherent sanction power and issued sanctions causally related to HCRE's sanctionable conduct, we AFFIRM.[3]

3. HCRE also maintains that the bankruptcy court should have reconsidered the sanctions, and that the district court should not have affirmed them. These arguments merge with HCRE's other challenges to the sanctions order. We reject them for the same reasons that we affirm the sanctions.

Appendix B — Opinion, United States Court of Appeals for the Fifth Circuit, *NexPoint Real Estate Partners, L.L.C. v. Highland Capital Management, L.P.*, No. 25-11185 (Aug. 14, 2026)

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 25-11185

IN THE MATTER OF HIGHLAND CAPITAL MANAGEMENT, L.P.,

Debtor,

NEXPOINT REAL ESTATE PARTNERS, L.L.C.,

Appellant,

v.

HIGHLAND CAPITAL MANAGEMENT, L.P.,

Appellee.

Filed August 14, 2026

Appeal from the United States District Court
for the Northern District of Texas
USDC No. 3:24-CV-1479

Before STEWART, GRAVES, and WILSON, *Circuit Judges.*

JAMES E. GRAVES, JR., *Circuit Judge*:

Appendix B

A bankruptcy court holds the inherent power to sanction litigants for bad faith conduct—a critical safeguard to curtail abuse of the bankruptcy process. The bankruptcy court here sanctioned HCRE Partners[1] for just such an abuse. HCRE filed a claim that its officers knew to be baseless, and spent the following years litigating this claim in bad faith. It frivolously opposed a motion to disqualify counsel, and then moved to withdraw its claim to avoid the depositions of its officers, while seeking to preserve the claim's substance for a future forum. Because this is precisely the kind of behavior that warrants an inherent-power sanction, we affirm.

I. Background

A. To execute Project Unicorn, Highland and HCRE created a new LLC and divided its membership between themselves.

In 2018, James Dondero and Matt McGraner embarked on Project Unicorn. *In re Highland Cap. Mgmt., LP* (*Trial Ord.*), No. 19-34054, 2023 WL 3185266, at *6-7 (Bankr. N.D. Tex. Apr. 28, 2023). The project's goal was for several Dondero-affiliated companies, including Highland Capital Management and HCRE, to purchase 26 residential properties for about $1.1 billion. *Id.* at *6-7. During Project Unicorn, Dondero controlled both companies, while McGraner was HCRE's vice president and secretary. *Id.* at *1, *6-7.

1. HCRE now goes by NexPoint Real Estate Partners.

Highland and HCRE created SE Multifamily Holdings, LLC. The original LLC Agreement governed SE Multifamily. It allocated 49% membership to Highland and 51% to HCRE. SE Multifamily, Highland, HCRE, and other Dondero-controlled entities secured a $550 million loan from Key Bank to finance Project Unicorn. *Id.* at *7.

Before the loan transaction closed, SE Multifamily brought another investor into Project Unicorn, BH Equities, which was unaffiliated with Dondero. *Id.* at *7-8. After BH Equities contributed $21 million, Highland and HCRE amended the LLC Agreement to give BH Equities a 6% membership of SE Multifamily. *Id.* at *8. This diluted Highland's share to 46.06%, and HCRE's share to 47.94%. The Amended LLC Agreement reflected these changes in membership throughout. Dondero signed the agreement on HCRE's and Highland's behalf.

B. When Highland filed for bankruptcy, Dondero challenged its share in SE Multifamily.

"By 2019 . . . myriad unpaid judgments and liabilities forced Highland . . . to file for Chapter 11 Bankruptcy." *In re Highland Cap. Mgmt. LP* (*Highland I*), 48 F.4th 419, 424 (5th Cir. 2022). To avoid appointment of a trustee, Highland, Dondero, and a committee of creditors agreed "to overhaul Highland's governance structure," which led to the appointment of an independent board. *Dondero v. Highland Cap. Mgmt., LP* (*Highland II*), 105 F.4th 830, 834 (5th Cir. 2024). Almost immediately, Dondero disagreed with the new board about how the bankruptcy should proceed, and the board ousted him. *Id.*

Appendix B

1. Highland filed for bankruptcy, and Dondero interfered.

Dondero has earned at least two sanctions for his interference with Highland's bankruptcy. In December 2020, Highland sought a TRO against Dondero. *Id.* at 835. Although he had left Highland itself, its "organizational structure encompasses up to 2,000 other investment entities" which "share various service agreements with Highland." *Id.* at 834. Dondero exercises "de facto control" over many of these entities. *Id.* (citation modified). The bankruptcy court entered a TRO to prevent Dondero from further interfering with Highland. *Id.* at 835. But by January 2021, Dondero had violated the TRO by "communicating with members of Highland's legal team to coordinate [his] legal strategy against Highland and interfering with Highland's intended [asset] sales." *Id.* For this, Dondero earned a nearly $500,000 sanction, which our court affirmed. *Id.* at 836-41.

Our court also (partially) affirmed a sanction against Dondero for filing vexatious litigation connected to Highland's bankruptcy. *The Charitable DAF Fund, LP v. Highland Cap. Mgmt., LP* (*Highland III*), 98 F.4th 170, 174-77 (5th Cir. 2024). To protect one of the independent directors from vexatious lawsuits, the bankruptcy court adopted an order that gave it "sole jurisdiction" to adjudicate claims against the director related to his appointment. *Id.* at 172-73. Yet Dondero sued Highland in district court and moved to amend the complaint to add the independent director as a defendant. *Id.* at 172. The bankruptcy court sanctioned him for the motion. *Id.*

at 173-74. We affirmed the portion of this sanction that shifted the attorney fees related to defending the motion. *Id.* at 174-77.

2. Dondero and HCRE challenged SE Multifamily's membership allocation in the bankruptcy proceeding.

Dondero filed a Proof of Claim with the bankruptcy court in April 2020 on HCRE's behalf. He averred that HCRE "may be entitled to distributions out of SE Multifamily, but such distributions have not been made because of" Highland's conduct. As a result, HCRE "may have a claim against the Debtor."

Highland objected to the Proof of Claim in July 2020, denying any liability. By October 2020, HCRE hired a new law firm—Wick Phillips—to pursue its claim. *In re Highland Cap. Mgmt.* (*Sanctions Ord.*), No. 19-34054, 2024 WL 959335, at *7 (Bankr. N.D. Tex., Mar. 5, 2024). HCRE, through Wick Phillips, responded to Highland's objection in October 2020. The response clarified HCRE's legal theories to allege that SE Multifamily's organizational documents mistakenly apportioned its membership and asked the bankruptcy court to reform the Amended LLC Agreement.

3. During the first round of discovery, Highland moved to disqualify Wick Phillips.

The first of three rounds of discovery began in December 2020. Initially, this went as planned, and the

parties served deposition notices, exchanged discovery demands, and produced voluminous documents. But from this discovery, Highland learned that Wick Phillips may have jointly represented HCRE and Highland for the Project Unicorn transactions. *Id.* So in April 2021, Highland moved to disqualify Wick Phillips. *Id.* After a second round of discovery and six months of litigation, the bankruptcy court disqualified the law firm.

4. During the third round of discovery, HCRE moved to withdraw its claim.

A third round of discovery began in June 2022. During this round, the parties exchanged documents, and HCRE deposed Highland's witnesses. *Id.*

But in August 2022—two days before Dondero's and McGraner's scheduled depositions and one day after Highland produced 4,000 documents—HCRE moved to withdraw its claim. *Id.* After a hearing, the bankruptcy court denied the motion, finding that Highland would suffer prejudice from the withdrawal. *See Manchester, Inc. v. Lyle* (*In re Manchester*), No. 08-30703-11, 2008 WL 5273289, at *3 (Bankr. N.D. Tex. Dec. 19, 2008) ("[W]ithdrawal of a proof of claim should be permitted unless that withdrawal results in . . . prejudice to [the] nonmoving party." (citation modified)).

5. Once discovery ended, HCRE lost at trial.

After the bankruptcy court denied withdrawal, the parties completed discovery, and the court held a bench

trial in November 2022. *Trial Ord.*, 2023 WL 3185266, at *1. HCRE lost. *Id.* at *16. The court found no evidence that the parties to the Amended LLC Agreement arrived at a different understanding of the membership allocation in SE Multifamily than was reflected in the agreement. *Id.* at *13. So the court refused to reform the contract, and disallowed the Proof of Claim. *Id.* at *12-16. At trial, Highland orally moved for sanctions. *Id.* at *16. The bankruptcy court denied the motion without prejudice because HCRE lacked an adequate opportunity to respond. *Id.*

6. After trial, the bankruptcy court sanctioned HCRE.

In June 2023, Highland moved for a bad faith finding and attorney fees. Invoking its inherent power to sanction litigants, the bankruptcy court awarded Highland $825,940.55. *Sanctions Ord.*, 2024 WL 959335, at *12-15. The bankruptcy court denied HCRE's motion for reconsideration. The district court affirmed the bankruptcy appeal. HCRE now appeals to this court.

II. Our Review

Generally, we "review [a] bankruptcy court's legal conclusions de novo and its factual findings for clear error." *Kreit v. Quinn* (*In re Cleveland Imaging & Surgical Hosp., LLC*), 26 F.4th 285, 292 (5th Cir. 2022). But if a "court sanctions a party using its inherent authority, our review is closer." *Id.* We affirm "only if (1) the bankruptcy court finds that the party acted in bad faith or willfully

abused the judicial process" and (2) "clear and convincing evidence" supports this finding. *Id.* (citation omitted). If the bankruptcy court "surmount[s]" this "high threshold" we review the sanction's substance for abuse of discretion. *Cadle Co. v. Moore* (*In re Moore*), 739 F.3d 724, 730 (5th Cir. 2014) (citation omitted).

Highland urges us to adopt a standard that "a bankruptcy court's factual determination that clear and convincing evidence exists to support its finding is, itself, reviewed for clear error." We cannot.

A bad faith finding "must be supported by clear and convincing [evidence]." *Id.* (quoting *Crowe v. Smith* (*Crowe II*), 261 F.3d 558, 563 (5th Cir. 2001)). "[T]he evidence must be so direct and weighty" that it would "enable the fact finder to come to a clear conviction, without hesitancy, of the truth of" the facts that supported the finding. *See Crowe II*, 261 F.3d at 565 (citation omitted). Hence "contradictory testimony" or unclear circumstances cannot sustain a sanction. *See id.* at 566.

Put differently, we must "ensure the legal sufficiency" of "the underlying facts" to "support [the bankruptcy] court's more generalized finding of bad faith." *Crowe v. Smith* (*Crowe I*), 151 F.3d 217, 236 (5th Cir. 1998). We "probe the record in detail" to unearth these underlying facts. *Id.* And we do so "without deference." *Vikas WSP, Ltd. v. Econ. Mud Prods. Co.*, 23 F.4th 442, 455 (5th Cir. 2022). If the evidence is legally insufficient, "the district court abused its discretion." *Crowe II*, 261 F.3d at 566. This standard leaves no room for Highland's attempt to

append a clear error standard onto what is, essentially, a de novo review of evidentiary sufficiency.

Highland relies on *In re Carroll* to justify its clear error standard, where our court affirmed a sanction because "the record fully support[ed] the bankruptcy court's determination of bad faith, and Appellants [did] not establish[] that any of [its] findings were clearly erroneous." *Carroll v. Abide* (*In re Carroll*), 850 F.3d 811, 816 (5th Cir. 2017). That panel may have invoked the "clearly erroneous" standard because it considered a prefiling injunction against a vexatious litigant, as well as an inherent-power sanction. *See id.* at 815-16. We review a prefiling injunction under a general abuse of discretion standard, which means we review evidentiary findings for clear error. *Id.* Because the *In re Carroll* panel also reviewed a prefiling injunction, we construe its clear error language to relate to the injunction, not to disturb our well-established standard of review for inherent-power sanctions.

III. Discussion

Applying this standard, we affirm HCRE's sanction. Clear and convincing evidence supports the bankruptcy court's finding that HCRE acted in bad faith. And because HCRE's sanctionable conduct caused the costs Highland incurred—even after the withdrawal motion—the court did not abuse its discretion in setting the sanction amount.

Appendix B

A. Clear and convincing evidence supports the bankruptcy court's bad faith finding.

HCRE maintains that "no evidence" supports the bankruptcy court's bad faith finding. Quite the contrary. The ample evidence of HCRE's bad faith clearly and convincingly shows that it (1) filed the Proof of Claim in bad faith, and (2) litigated the claim in bad faith. The bankruptcy court thus properly invoked its inherent sanction power.

1. HCRE filed its claim in bad faith.

When Dondero filed the Proof of Claim, he failed to investigate it. He could not recall "personally do[ing] any due diligence . . . before [he] authorized it to be filed." He did not "review any documents." Nor could he recall who provided the information in the claim to their law firm, or what information they gave. Even so, he signed the claim under penalty of perjury, and attested that he had "a reasonable belief that the information" in the claim was "true and correct."

Dondero and McGraner—the two HCRE officers coordinating Project Unicorn—then admitted at trial that they knew the claim was baseless. Dondero testified that SE Multifamily's membership allocation in the Amended LLC Agreement "comport[ed] with [his] expectations when [he] signed [it]." And McGraner could not identify any part of the agreement that did not reflect the parties' intent. In other words, both officers admitted that there was no reason to reform the agreement.

In fact, the trial revealed that HCRE filed its claim with an ulterior motive. McGraner testified that the real "mistake" was that Dondero filed Highland's bankruptcy, which prevented them from freely amending the organizational documents to dilute Highland's membership. As a result, SE Multifamily's assets—which McGraner and Dondero believed were rightfully HCRE's—were at risk from Highland's creditors. McGraner called this "crazy and unjust."

So Dondero filed the Proof of Claim without investigating, likely knowing it was false, and aiming to shield SE Multifamily's assets from Highland's creditors. This evidence shows us clearly and convincingly that HCRE filed its claim in bad faith.

2. HCRE litigated its claim in bad faith.

The bankruptcy court focused on two aspects of HCRE's litigation conduct: (a) its opposition to the disqualification motion and (b) its attempt to withdraw its claim while trying to preserve its substance for a future forum. *Sanctions Ord.*, 2024 WL 959335, at *8-10. We agree with the bankruptcy court that these actions reflect HCRE's bad faith.

a. HCRE frivolously opposed Wick Phillips's disqualification.

In opposing Wick Phillips's disqualification, HCRE distorted the firm's role in SE Multifamily's formation. The response to Highland's disqualification motion

claimed that Wick Phillips's previous representation of Highland "was limited to the negotiation and drafting of the [Key Bank] [l]oan." Yet at trial, McGraner admitted that he "personally knew that Wick Phillips represented both HCRE and Highland jointly in connection with the negotiation [and] drafting of the original LLC agreement, the Key Bank Loan, and the" Amended LLC Agreement. McGraner's admission shows that HCRE misrepresented Wick Phillips's role in the underlying transaction, a misrepresentation that took six months of expensive litigation to disprove. This goes beyond opposing a motion and losing; this is knowingly raising, then standing by, a frivolous argument—classic bad faith.

HCRE protests that because its ethics expert opined that the Wick Phillips conflict did not require disqualification, it cannot have taken a frivolous position. But this expert "assum[ed]" that Highland's claims in response to the disqualification motion were true, which they were not. Because the expert based his opinion on a faulty assumption, it offers little insight into the merits of the disqualification dispute.

b. HCRE tried to withdraw its claim to avoid discovery obligations, while seeking to preserve the substance for a future forum.

The bankruptcy court found that the motion to withdraw reflected "gamesmanship," calculated to allow HCRE to avoid its discovery obligations while preserving its underlying claims for a future forum. The withdrawal

motion's timing was indeed suspicious—two business days before Dondero's and McGraner's depositions, and one day after Highland produced 4,000 documents. *Sanctions Ord.*, 2024 WL 959335, at *9.

HCRE never offered a cogent explanation for the timing. In the motion, it claimed that it "simply wishe[d] to no longer pursue a claim." It supplied no more insight at the hearing. The bankruptcy court grew concerned that HCRE harbored a tactical motive. *Id.* at *8-9. Especially because HCRE seemed interested in preserving its challenge to SE Multifamily's membership allocation after the withdrawal.

The court gave HCRE a choice: it would deny withdrawal, or HCRE could submit a proposed dismissal order that would prevent it from raising similar claims in another forum. The court ordered HCRE to confer with Highland about the language and report back Highland's position. But HCRE never submitted a proposed order, nor did it notify the court of any discussions with Highland. *Id.* at *9 n.48. So the bankruptcy court's concerns about gamesmanship persisted, and it denied withdrawal. *Id.*

Granted, HCRE assured the court at the motion hearing that it was willing to withdraw its claim with prejudice. But the court was understandably wary of Dondero's inconsistent statements on the scope of a with-prejudice withdrawal, and his refusal to rule out a future challenge to Highland's interest in SE Multifamily. *Id.* The bankruptcy court offered a practical way to allay these concerns, which HCRE ignored. HCRE cannot

rely now on its offers to withdraw its claim with prejudice when it squandered its opportunity to address the court's legitimate concerns.

The withdrawal motion's suspicious timing, and HCRE's failure to allay the bankruptcy court's concerns about it, sustain the court's finding that HCRE moved to withdraw its claim in bad faith. And the record also supports the court's finding that HCRE filed its claim in bad faith. Because clear and convincing evidence supports both findings, the bankruptcy court properly found that HCRE acted in bad faith, hence it did not err by invoking its inherent sanction power.

B. The sanction was causally related to HCRE's sanctionable conduct.

HCRE next challenges the sanction amount. We review a sanction's substance for abuse of discretion. *In re Moore*, 739 F.3d at 730. Here, the bankruptcy court issued a "fee-shifting sanction." *Highland III*, 98 F.4th at 175. So there must be "a causal link between [HCRE's] misbehavior and [the] legal fees" awarded. *Id.* (citation modified). Without this link, "the sanction is punitive" and exceeds "the bankruptcy court's statutorily limited powers." *Id.*

HCRE argues that any fees incurred after it moved to withdraw are not causally related to its conduct.[2] Mostly,

2. HCRE also suggests that the fees associated with the disqualification dispute were not caused by its sanctionable conduct. But as Highland points out, it did not seek, nor did the bankruptcy court award, fees related to the disqualification motion. *Sanctions Ord.*, 2024 WL 959335, at *8 n.43.

this repackages its complaints about the bankruptcy court's refusal to allow it to withdraw its claim. But once Highland had objected to the claim, HCRE could not withdraw it without court permission. Fed. R. Bankr. P. 3006(a). The court had good reason to deny permission, since it found that the withdrawal would unfairly prejudice Highland. Besides, HCRE's failure to propose withdrawal language *caused* the denial of its motion to withdraw, so it cannot plausibly claim now that Highland's subsequent costs were not causally related to its conduct.

Nor is Highland in the same position as it would have been by "tak[ing] the win," and not opposing withdrawal. The bankruptcy court's concern when denying withdrawal was not only that HCRE would refile another adversary bankruptcy claim, but that HCRE would challenge Highland's interest in SE Multifamily in another forum. *Sanctions Ord.*, 2024 WL 959335, at *9. If the withdrawal order had merely been with prejudice—without addressing whether that prejudice extended to claims in non-bankruptcy proceedings—HCRE might subsequently argue that its underlying contract reformation claim was left unresolved.

But now, a court has rejected HCRE's claim on the merits. An order resolving a proof of claim is a "final judgment" for claim or issue preclusion purposes. *Lafayette v. Baudoin* (*In re Baudoin*), 981 F.2d 736, 742 (5th Cir. 1993). So HCRE cannot sue based "on the same nucleus of operative facts." *See id.* at 743. Or relitigate any issue necessary to the bankruptcy court's judgment. *Clem v. Tomlinson* (*In re Clem*), 124 F.4th 341, 348 (5th Cir. 2024).

So after two years of costly litigation, Highland has what it sought at the withdrawal motion hearing: "an ironclad" guarantee that HCRE cannot challenge its interest in SE Multifamily again; whether in a bankruptcy court, or any other forum. Had HCRE proposed terms that would achieve this, further litigation would have been unnecessary.

Although HCRE claims otherwise, the sanctions our court vacated in *Highland III* have little in common with the sanctions here. 98 F.4th at 172-77. In *Highland III*, we held that the bankruptcy court could not impose fees incurred in litigating a sanctions motion, only fees caused by the sanctionable conduct. *See id.* at 174-76. But here, the bankruptcy court did not shift Highland's fees connected with its sanctions motion. *See Sanctions Ord.*, 2024 WL 959335, at *12. While *Highland III* guides us generally, the bankruptcy court here shifted fees related to the underlying sanctionable conduct, which yields a different result.

Thus, Highland's costs that accrued after HCRE moved to withdraw its claim are still causally related to HCRE's conduct. So the bankruptcy court did not abuse its discretion when it imposed them. Because the court properly invoked its inherent sanction power and issued sanctions causally related to HCRE's sanctionable conduct, we AFFIRM.[3]

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3. HCRE also maintains that the bankruptcy court should have reconsidered the sanctions, and that the district court should not have affirmed them. These arguments merge with HCRE's other challenges to the sanctions order. We reject them for the same reasons that we affirm the sanctions.

Appendix C — Memorandum Opinion and Order, United States District Court for the Northern District of Texas, *NexPoint Real Estate Partners, L.L.C. v. Highland Capital Management, L.P.*, No. 3:24-cv-01479-S (Sept. 22, 2025)

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

CIVIL ACTION NO. 3:24-CV-1479-S

NEXPOINT REAL ESTATE PARTNERS, LLC

v.

HIGHLAND CAPITAL MANAGEMENT, L.P.

BANKRUPTCY CASE NO. 19-34054-SGJ11

IN RE: HIGHLAND CAPITAL MANAGEMENT, L.P.

Filed September 22, 2025

MEMORANDUM OPINION AND ORDER

Before the Court is an appeal from the Memorandum Opinion and Order Granting Highland Capital Management, L.P.'s Motion for (A) Bad Faith Finding and (B) Attorneys' Fees Against NexPoint Real Estate Partners LLC (f/k/a HCRE Partners, LLC) in Connection with Proof of Claim #146 ("Sanctions Order") and the

Appendix C

Order Denying Motion of NexPoint Real Estate Partners, LLC (f/k/a HCRE Partners, LLC) Seeking Relief from Order Pursuant to Fed. R. of Bankr. P. 9024 and Fed. R. Civ. P. 60(b)(1) & (6) ("Reconsideration Order") entered by the United States Bankruptcy Court for the Northern District of Texas ("Bankruptcy Court") in a dispute between Appellant NexPoint Real Estate Partners, LLC, and Appellee Highland Capital Management, L.P. *See* Second Am. Notice of Appeal [ECF No. 1-1] 1-2. The Court has reviewed and considered Appellant's Opening Brief ("Appellant's Brief) [ECF No. 19], Appellee's Brief [ECF No. 24], the Reply in Support of Appellant's Brief [ECF No. 27], the record on appeal ("Record") [ECF No. 17], and the applicable law. For the following reasons, the Court AFFIRMS the Sanctions Order and Reconsideration Order.

I. BACKGROUND

This appeal stems from the April 8, 2020, proof of claim filed by Appellant NexPoint Real Estate Partners, LLC, in the underlying bankruptcy case. R. 155, 810-14. James Dondero, NexPoint's president and sole manager, signed the proof of claim. *Id.* at 155, 164, 812. In an exhibit to the proof of claim, NexPoint stated that it was a limited partner in SE Multifamily Holdings, LLC. *Id.* at 155, 814. Appellee Highland Capital Management, L.P., was also a limited partner in that entity. *Id.* NexPoint claimed that it "may be entitled to distributions out of SE Multifamily" and that Highland Capital's rights or interests in SE Multifamily "may be the property of [NexPoint]." *Id.* at 814. NexPoint stated that it would update its proof of claim

to provide the exact amount of money owed in the next ninety days, but it never did so. *Id.* at 155, 814. Highland Capital objected to the proof of claim. *Id.* at 155, 802.

NexPoint hired counsel and responded to the objection, arguing that the organizational documents for SE Multifamily improperly allocated the members' ownership percentages due to mutual mistake, lack of consideration, and/or failure of consideration. *Id.* at 806 ¶ 5; Appellant's Br. 8. Highland Capital later moved to disqualify the law firm representing NexPoint because that firm represented Highland Capital in one or more transactions underlying the proof of claim. R. 822-45. The Bankruptcy Court granted the motion to disqualify NexPoint's counsel. *Id.* at 1761-64.

NexPoint engaged new counsel, and the parties thereafter conducted discovery. Appellant's Br. 10. When only two fact depositions—both of NexPoint's witnesses—remained, NexPoint moved to withdraw its proof of claim ("Motion to Withdraw"). *Id.* at 11; R. 1765-73. Highland Capital opposed the Motion to Withdraw and requested, among other things, that any permitted withdrawal either: (1) be with prejudice; or (2) come with the requirement that any refiling of NexPoint's claims must be in the same court. R. 1774-1800.

The Bankruptcy Court held a hearing on the Motion to Withdraw on September 12, 2022. *Id.* at 2793-2853. During the hearing, NexPoint's counsel asked Dondero if NexPoint would agree not to challenge Highland Capital's interest in SE Multifamily. *Id.* at 2835 at 43:3-5.

Dondero responded that Highland Capital's interest in SE Multifamily was subject to the agreement governing the entity. *Id.* at 43:6-13. After the hearing, the Bankruptcy Court denied the Motion to Withdraw. *Id.* at 2853A-53B, 2853C-53D. NexPoint did not appeal this ruling. Appellee's Br. 24.

The parties completed discovery, and the Bankruptcy Court held an evidentiary hearing on NexPoint's proof of claim. R. 10069-270. At the hearing, NexPoint asked the Bankruptcy Court to reallocate the equity in SE Multifamily. *Id.* at 10247-48 at 179:23-180:9. Highland Capital asked the Bankruptcy Court to make a finding of bad faith in connection with the filing of the proof of claim. *Id.* at 10100-01 at 32:23-33:6, 10264 at 196:17-22. The Bankruptcy Court later entered an order disallowing NexPoint's proof of claim and denying without prejudice Highland Capital's request for sanctions based on NexPoint's alleged bad faith. *Id.* at 10726-64.

Highland Capital then filed its Motion for (A) Bad Faith Finding and (B) Attorneys' Fees Against NexPoint in Connection with Proof of Claim 146. *Id.* at 10804-15. In support of the motion, Highland Capital argued that NexPoint filed and prosecuted the proof of claim in bad faith and that Dondero had no reason to believe it was truthful. *See*, *e.g.*, *id.* at 10805 ¶ 2. The Bankruptcy Court held a hearing on the motion. *Id.* at 11308-90.

On March 5, 2024, the Bankruptcy Court entered the Sanctions Order. *Id.* at 154-85. The Bankruptcy Court concluded that NexPoint filed and prosecuted its proof

of claim in bad faith and willfully abused the judicial process. *Id.* at 163-64. Specifically, the court held: (1) Dondero signed and authorized the proof of claim without reading the proof of claim or conducting any due diligence; (2) NexPoint's litigation strategy evidenced bad faith because, among other things, it moved to withdraw the proof of claim just two business days before the depositions of NexPoint's witnesses and repeatedly attempted to preserve its claims for use in the future despite the motion to withdraw; and (3) NexPoint pursued its proof of claim at trial even though its representatives' trial testimony showed that there was no factual or legal basis for its request. *Id.* at 164-76. The Bankruptcy Court ordered NexPoint to reimburse Highland Capital's attorney's fees and costs in the amount of $825,940.55. *Id.* at 178-79, 184. Over NexPoint's objection, the Bankruptcy Court awarded fees incurred after NexPoint tried to withdraw the proof of claim. *Id.* at 179-81.

Approximately one month later, NexPoint moved for reconsideration of the Sanctions Order. *Id.* at 11455-82. The Bankruptcy Court denied that motion. *Id.* at 146-53.

On June 14, 2024, NexPoint's Second Amended Notice of Appeal was filed in this Court. In Appellant's Brief, NexPoint designated the following issues for appeal:

1. On de novo review, is there clear and convincing evidence that NexPoint filed Proof of Claim #146 in bad faith when it is undisputed that NexPoint acted on the advice of counsel in filing the proof of claim, where the proof of claim explicitly

disclosed that it was indefinite and dependent upon discovery, and where there is no evidence that anything in the POC was false or inaccurate at the time of filing?

2. On de novo review, is there clear and convincing evidence that NexPoint pursued the proof of claim in bad faith, even though Highland Capital's sanctions motion did not make that argument and despite NexPoint's indisputably attempting to withdraw the proof of claim with prejudice before the close of discovery and well in advance of any evidentiary hearing on the proof of claim?

3. Did the Bankruptcy Court abuse its discretion under Bankruptcy Code § 105 by awarding Highland Capital the fees it incurred after thwarting NexPoint's request for a with-prejudice withdrawal of the proof of claim on the theory that NexPoint caused those fees?

4. Did the Bankruptcy Court abuse its discretion in denying reconsideration of the Sanctions Order?

Appellant's Br. 3.

II. LEGAL STANDARD

District courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy courts pursuant to 28 U.S.C. § 158(a)(1). When reviewing a bankruptcy court's decision, the "district court functions

as a[n] appellate court and applies the standard of review generally applied in federal court appeals." *Webb v. Rsrv. Life Ins. Co.* (*In re Webb*), 954 F.2d 1102, 1103-04 (5th Cir. 1992) (citation omitted). "[R]eviewing courts—district and courts of appeals alike—must accept the findings of fact of the bankruptcy court unless the findings are clearly erroneous." *Coston v. Bank of Malvern* (*In re Coston*), 987 F.2d 1096, 1098 (5th Cir. 1992) (citation omitted). "A finding of fact is clearly erroneous only if on the entire evidence, the court is left with the definite and firm conviction that a mistake has been committed." *Robertson v. Dennis* (*In re Dennis*), 330 F.3d 696, 701 (5th Cir. 2003) (internal quotation marks and citation omitted). Conclusions of law and mixed questions of law and fact are reviewed de novo. *Lavie v. Ran* (*In re Ran*), 607 F.3d 1017, 1020 (5th Cir. 2010) (citation omitted); *Cowin v. Countrywide Home Loans, Inc.* (*In re Cowin*), 864 F.3d 344, 349 (5th Cir. 2017) (citation omitted).

III. ANALYSIS

A. Bad Faith

NexPoint first argues that the Bankruptcy Court erred in issuing the Sanctions Order because it incorrectly found clear and convincing evidence that NexPoint filed and pursued the proof of claim in bad faith and willfully abused the judicial process. Appellant's Br. 31-40.

District courts "review de novo" bankruptcy courts'"invocation of [their] inherent power" to sanction. *Cadle Co. v. Moore* (*In re Moore*), 739 F.3d 724, 729 (5th

Cir. 2014) (quoting *Positive Software Sols., Inc. v. New Century Mortg. Corp.*, 619 F.3d 458, 460 (5th Cir. 2010)). The decision to impose a sanction requires a finding of clear and convincing proof of "bad faith or willful abuse of the judicial process," which the district court also reviews de novo. *Id.* (citation omitted). The Court, having reviewed de novo the Bankruptcy Court's imposition of sanctions and determinations regarding bad faith and willful abuse of the judicial process, concludes that the Bankruptcy Court's rulings were correct and thus affirms them.

B. Attorney's Fees Award

Second, NexPoint argues that even if the Court agrees with the Bankruptcy Court's decision to award sanctions, a portion of the sanction issued—namely, the amount awarded for fees incurred after denial of NexPoint's Motion to Withdraw—exceeded the Bankruptcy Court's power under 11 U.S.C. § 105. Appellant's Br. 41-45.

District courts review the content of the sanction awarded for abuse of discretion. *In re Moore*, 739 F.3d at 729 (citation omitted). In other words, the reviewing court will affirm a sanctions order "only if clear and convincing evidence supports the court's finding of bad faith or willful abuse of the judicial process. If this high threshold . . . is surmounted, [the court] review[s] the substance of the sanction itself more deferentially, for an abuse of discretion." *Id.* at 730 (footnote and citation omitted). Fee-shifting sanctions are intended to be compensatory, not punitive. *Charitable DAF Fund, L.P. v. Highland Cap. Mgmt., L.P.* (*In re Highland Cap. Mgmt., L.P.*), 98

F.4th 170, 175 (5th Cir. 2024) (citation omitted). When a bankruptcy court issues a fee-shifting sanction, it must "establish a causal link between the litigant's misbehavior and legal fees paid by the opposing party." *Id.* (cleaned up). The court may shift "only those attorney[']s fees incurred because of the misconduct at issue." *Id.* (citation omitted).

Having reviewed the content of the sanction awarded, the Court concludes that the Bankruptcy Court did not abuse its discretion in calculating the attorney's fees to be shifted. For this reason, and for the reasons set forth above, *see supra* § III.A., the Court affirms the Sanctions Order.

C. Motion for Reconsideration

Finally, NexPoint contends that the Bankruptcy Court erred in denying NexPoint's request for reconsideration. Appellant's Br. 45-48. Courts review denials of motions for reconsideration under Federal Rule of Civil Procedure 60(b) for abuse of discretion. *Martin v. Akzo Nobel Polymer Chems. LLC*, 180 F. App'x 519, 520-21 (5th Cir. 2006) (citation omitted). The Court has reviewed the Reconsideration Order and found no abuse of discretion. Therefore, the Court affirms the Reconsideration Order.

IV. CONCLUSION

For the foregoing reasons, the Court **AFFIRMS** the Bankruptcy Court's Memorandum Opinion and Order Granting Highland Capital Management, L.P.'s Motion for (A) Bad Faith Finding and (B) Attorneys' Fees Against

Appendix C

NexPoint Real Estate Partners LLC (f/k/a HCRE Partners, LLC) in Connection with Proof of Claim #146 and Order Denying Motion of NexPoint Real Estate Partners, LLC (f/k/a HCRE Partners, LLC) Seeking Relief from Order Pursuant to Fed. R. of Bankr. P. 9024 and Fed. R. Civ. P. 60(b)(1) & (6).

SO ORDERED.

SIGNED September 22, 2025.

/s/ Karen Gren Scholer
KAREN GREN SCHOLER
UNITED STATES DISTRICT JUDGE

Appendix D — Order Denying Motion of NexPoint Real Estate Partners, LLC (f/k/a HCRE Partners, LLC) Seeking Relief from Order Pursuant to Federal Rule of Bankruptcy Procedure 9024 and Federal Rule of Civil Procedure 60(b)(1) and (6), United States Bankruptcy Court for the Northern District of Texas, *In re Highland Capital Management, L.P.*, No. 19-34054-sgj11 (May 21, 2024)

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

Chapter 11
Case No. 19-34054-sgj-11

IN RE: HIGHLAND CAPITAL MANAGEMENT, L.P.,

Reorganized Debtor.

Filed May 21, 2024

ORDER DENYING MOTION OF NEXPOINT REAL ESTATE PARTNERS, LLC (F/K/A HCRE PARTNERS, LLC) SEEKING RELIEF FROM ORDER PURSUANT TO FED. R. OF BANKR. P. 9024 AND FED. R. CIV. P. 60(B)(1) & (6)

On March 18, 2024, NexPoint Real Estate Partners, LLC (f/k/a HCRE Partners, LLC) ("HCRE µ ÀOHG LWV *Motion for Relief from Order* (hereinafter, the "Rule 60(b) Motion"),[1] seeking reconsideration of and relief from this court's *Memorandum Opinion and Order Granting Highland Capital Management, L.P.'s Motion for (A) Bad Faith Finding and (B) Attorneys' Fees against NexPoint*

1. Bankr. Dkt. No. 4040.

Real Estate Partners, LLC (f/k/a HCRE Partners, LLC) in connection with Proof of Claim # 146 ("HCRE Sanctions Order").[2] The parties stipulated to a briefing schedule and that the parties would seek a setting for a hearing ("Hearing") on the Rule 60(b) Motion. On April 22, 2024, Highland Capital Management, L.P. ("Highland" or "Reorganized Debtor") filed its response ("Response") in opposition to the Rule 60(b) Motion,[3] and HCRE filed its reply ("Reply") thereto on May 1, 2024.[4] The parties presented oral argument at the Hearing that was held on May 16, 2024.

HCRE and its Proof of Claim. By way of background, HCRE is an entity whose sole manager is James D. Dondero, the former Chief Executive Officer of the Reorganized Debtor. HCRE and Highland were essentially friendly business partners prepetition—not terribly surprising, as they each had the same chief executive. In any event, HCRE and Highland were equity owners/members of a limited liability company named SE Multifamily Holdings, LLC ("SE").[5] SE owned valuable real estate. SE was only formed in March 2019 and was governed by an amended LLC Agreement ("SE's LLC Agreement"). After Highland filed its Chapter 11 in October 2019 and became managed by three new independent directors and a new CRO and then new CEO, James Seery, Highland

2. Bankr. Dkt. Nos. 4038 & 4039.

3. Bankr. Dkt. No. 4052.

4. Bankr. Dkt. No. 4055.

5. Note that there was also an unrelated minority owner (6%) in SE called BH Equities, LLC.

and HCRE were no longer amicable business partners. In IDFW +&5(ÀOHG D SURRI RI FODLP LQ +LJKODQG·V case (on April 8, 2020), for an unliquidated sum, which was electronically signed by Mr. Dondero. The proof of claim asserted that HCRE had a claim against Highland to reduce Highland's equity ownership and rights in SE and, further, that it had grounds to reform, rescind, or modify SE's LLC Agreement based on a mutual mistake.[6] 7ZR \HDUV DQG IRXU PRQWKV DIWHU +&5(ÀOHG W FODLP RQ $XJXVW DQG DIWHU VLJQLÀFDQW G and litigation regarding the proof of claim, HCRE moved to withdraw the proof of claim.

HCRE's Motion to Withdraw its Proof of Claim. There's a rule for withdrawing a proof of claim: Fed. R. Bankr. P. 3006. The bankruptcy court set a hearing, on September 12, 2022, as required by this rule, on HCRE's motion to withdraw the proof of claim ("Sept. 12, 2022 Proof of Claim Withdrawal Hearing").[7] After extensive discussion on the record, the bankruptcy court denied HCRE permission to withdraw its proof of claim—primarily because HCRE declined to withdraw the proof of claim with prejudice to any future litigation in any forum pertaining to the issues raised in the proof of claim. In other words, HCRE would not state unequivocally that it would not re-urge in the future its alleged present entitlement to reform or rescind SE's LLC Agreement. To be clear, HCRE expressed that it would withdraw its proof of claim with prejudice to re-asserting it in the

6. Claim No. 146 & Bankr. Dkt. No. 1212.

7. Bankr. Dkt. No. 3519 (Transcript).

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of a bankruptcy court order on same. ***But this type of withdrawal meant little—because the deadline/bar date for filing proofs of claim in the Highland bankruptcy case had passed 16 months earlier anyway***. HCRE would be time-barred from asserting its proof of claim at this late stage in the Highland bankruptcy case. The bankruptcy court was concerned that HCRE was attempting to preserve its present claims against Highland for use in the future in a different forum.[8] If there was going to be litigation over these issues, Highland thought it was time to get on with such litigation. The bankruptcy court was persuaded that, indeed, Highland would be prejudiced if HCRE were allowed to withdraw its proof of claim without clear and unequivocal language in the order that HCRE would not be able to assert its claims and/or theories regarding rescission and/or reformation of the SE LLC Agreement in any future litigation in any court or forum (after all, future litigation is not what a "fresh start" of bankruptcy is about). Thus, the bankruptcy court issued its Order denying withdrawal of the HCRE proof of claim on September 14, 2022 ("Order Denying Withdrawal of HCRE Proof of Claim").[9]

Trial on the HCRE Proof of Claim. Thereafter, the bankruptcy court held a trial on November 1, 2022, on the merits of HCRE's proof of claim and ultimately disallowed

8. At the time, it appeared that litigation might be on the horizon in state court involving these parties and regarding business records production.

9. Bankr. Dkt. No. 3518.

the proof of claim ("Claim Disallowance Order").[10] There was no evidence presented of any sort of mistake, mutual or otherwise, in connection with SE's LLC Agreement or any other basis for reformation or rescission of SE's LLC $JUHHPHQW 0RUHRYHU 0U 'RQGHUR WHVWLÀHG not even read the HCRE proof of claim or conducted any due diligence regarding the HCRE proof of claim before DXWKRUL]LQJ KLV HOHFWURQLF VLJQDWXUH WR HCRE did not appeal the Claim Disallowance Order.

Highland Motion for Sanctions Against HCRE. +LJKODQG WKHUHDIWHU ÀOHG D ZULWWHQ PRWLR pertaining to HCRE conduct surrounding the proof of FODLP³VHHNLQJ D EDG IDLWK ÀQGLQJ DQG UHLP of Highland's attorney's fees caused by HCRE's actions. Several months later (after, among other things, renewed attempts at global mediation of the remaining issues in the Highland bankruptcy case), the bankruptcy court granted Highland's motion for sanctions, after a contested hearing ("Order Imposing Sanctions").[11] The Order Imposing Sanctions (which shifted to HCRE approximately $825,000 of the Reorganized Debtor's attorney's fees and expenses incurred by Highland in connection with the HCRE proof of claim—which was less than the entire amount that the Reorganized Debtor had incurred regarding the HCRE proof of claim during the more than three years since it was ÀOHG[12] the order now subject to HCRE's Rule 60(b) Motion.

10. Bankr. Dkt. No. 3766 & 3767.

11. Bankr. Dkt. No. 4039.

12. Highland sought attorney's fees and expenses incurred relating to the HCRE proof of claim from the time period of

The Rule 60(b) Motion. HCRE argues, primarily, that the bankruptcy court made two core, related "mistakes" in connection with its Order Imposing Sanctions that it should correct pursuant to Rule 60(b)(1). First, the bankruptcy court allegedly made a "mistake" in refusing to permit HCRE to withdraw its proof of claim based on a mistaken belief by the bankruptcy court that HCRE was not willing to withdraw it with prejudice for all purposes. HCRE now stresses that it was, indeed, willing to withdraw the proof of claim with prejudice to any future litigation in any court—not just in the bankruptcy court. Second, HCRE further argues that the bankruptcy court's mistake of fact on this point caused it to erroneously require an unnecessary trial on the proof of claim—the result of which was Highland incurring/billing unnecessary fees relating to the proof of claim. The bankruptcy court then shifted those fees to HCRE in the Order Imposing Sanctions. HCRE asserts that it is incorrect as a matter of law to conclude that these fees would not have been incurred "but for" HCRE's bad faith

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August 1, 2021 through December 31, 2022. The HCRE proof of FODLP ZDV ÀOHG $SULO +LJKODQG QRW RQO\ GLG UHLPEXUVHPHQW IRU DQ\ WLPH DQG H[SHQVH IRU WKH DIWHU +&5(ÀOHG LWV SURRI RI FODLP EXW +LJKODQG not seek (and the bankruptcy court did not allow) any fees that Highland incurred in successfully moving to disqualify HCRE's counsel in this matter, Wick Phillips (note: Wick Phillips was DFWXDOO\ WKH VHFRQG ODZ ÀUP WKDW +&5(UHWDLQHG LWV SURRI RI FODLP D GLIIHUHQW ODZ ÀUP RULJLQDOO proof of claim (Bonds Ellis), followed by Wick Philips, and then the +RJH *DPHUV / / 3 ODZ ÀUP WRRN RYHU DQG QRZ WK of Reichman Jergensen Lehman & Feldberg LLP is representing HCRE in this matter.

conduct. *See Goodyear Tire & Rubber v. Haeger*, 581 U.S. 101, 108 (2017). Therefore, the bankruptcy court should not have shifted them to HCRE as part of the Order Imposing Sanctions.

The court denies the Rule 60(b) Motion. To be sure, this court does not disagree with HCRE that a mistake of fact ***or*** mistake of law can be grounds for granting a Rule 60(b) motion. *See Kemp v. United States*, 596 U.S. 528, 535-36 (2022). The court also does not disagree with HCRE that an award of fees relating to sanctionable conduct must be limited to fees that would not have been incurred "but for" the sanctionable conduct. *Goodyear Tire*, 581 U.S. 101 at 104, 108 (the "causal link" between the sanctionable conduct and the opposing party's attorney's fees must be established through a "but-for" test; the complaining party may only recover the portion of fees that would not have been paid but-for the sanctionable conduct). However, the bankruptcy court does not believe it made a mistake of fact or of law with regard to either of these points.

First, the bankruptcy court does not believe it made a mistake of fact in interpreting what HCRE was and was not willing to do in connection with its motion to withdraw its proof of claim at the Sept. 12, 2022 Proof of Claim Withdrawal Hearing. HCRE used hedging language, to the extent that it appeared to be willfully obtuse on this point. It was not willing to withdraw the proof of claim ***with prejudice to ever litigating the issues raised in the proof of claim***. It was not future conduct and future theories that HCRE was worried about preserving in

future litigation, and the bankruptcy court was certainly not engaging in a mission to ban all future litigation between these parties in perpetuity. The sole concern was about ***claims/theories in the HCRE proof of claim*** being resurrected somewhere else in the future. The transcript of the September 12, 2022 hearing is clear that there was much discussion on this point, and the court even gave the parties a 24-hour break to go talk outside the presence of the court—to hopefully wordsmith an agreed order withdrawing the proof of claim. Apparently, the parties could not reach an agreement on this relatively simple concept. So, the court would not allow withdrawal of the HCRE proof of claim without clarity that the proof of claim issues would not be raised in future litigation somewhere. The court set a trial on the merits of the proof of claim a few weeks later, as the parties were close to being trial-ready. Moreover, a review of the September 12, 2022 7U DQVFULSW UHÁHFWV WKDW WKH EDQNUXSWF\ F multiple factors in disallowing withdrawal of the HCRE proof of claim—the so-called *Manchester* factors—not simply the failure of HCRE to withdraw the proof of claim with prejudice to all future litigation. *Manchester, Inc. v. Lyle (In re Manchester, Inc.)*, 2008 Bankr. LEXIS 3312, *11-12 (Bankr. N.D. Tex. Dec. 19, 2008) (the *Manchester* factors include: (1) the movant's diligence in bringing the motion to withdraw, (2) any "undue vexatiousness" on the part of the movant, (3) the extent to which the suit has progressed, including the effort and expense undertaken by the non-moving party to prepare for trial, (4) the duplicative expense of re-litigation, and (5) the adequacy of the movant's explanation for the need to withdraw the claim). In other words, there were several factors that

caused the bankruptcy court to deny withdrawal of the HCRE proof of claim.

Moreover, even if the court did make a mistake of fact in interpreting what HCRE was and was not willing to do (i.e., in deciphering what "with prejudice" did or did not mean)—and, in relying on this as a basis to deny HCRE permission to withdraw its proof of claim—wouldn't this have been an error of the bankruptcy court in entering its Order Denying Withdrawal of HCRE Proof of Claim? This order—entered September 14, 2023—was not appealed. Nor was the subsequent Order Disallowing Claim. In some ways, the Rule 60(b) Motion smacks of being a collateral attack on the Order Denying Withdrawal of Proof of Claim which was never appealed. Had there been an appeal of it, it would have been apparent that it was a multifaceted decision, based on many factors (i.e., the *Manchester* factors)—not merely the "with prejudice" issues.[13]

Which leads to the last issue—was there a mistake of law in allowing reimbursement of Highland's fees and expense incurred ***after*** the Order Denying Withdrawal of HCRE Proof of Claim? In particular, over $300,000 of fees were incurred by Highland (and shifted by the court in the Order Imposing Sanctions) associated with the preparation for and trial on the HCRE proof of claim. Was this a mistake of law? Only if the bankruptcy court made a mistake in ordering that there would be a trial on the HCRE proof of claim (i.e., only if the bankruptcy court erred in entering its Order Denying Withdrawal of HCRE

13. Bankr. Dkt. No. 3519 (Transcript, pp. 51-55).

"Debtor," or the "Reorganized Debtor").[2] The motion seeks sanctions against NexPoint Real Estate Partners, LLC, f/k/a HCRE Partners, LLC ("NexPoint/HCRE") for its filing, prosecution, and then abrupt attempt to withdraw a meritless proof of claim (after almost three years of protracted litigation).

NexPoint/HCRE filed the subject proof of claim, #146 on the claims register ("Proof of Claim"), on April 8, 2020.[3] The Proof of Claim was signed electronically by James D. Dondero ("Dondero") and was prepared and filed by a law firm that was representing him personally at that time.[4] The Proof of Claim was not in a liquidated amount and was somewhat ambiguous. It stated in an Exhibit A thereto, that NexPoint/HCRE, which was a limited partner, along with Highland, in a limited liability company called SE Multifamily Holdings, LLC ("SE Multifamily")—an entity which owned valuable real estate—"may be entitled to distributions out of SE Multifamily, but such distributions have not been made because of the actions or inactions of the Debtor" and added that Highland's equity interest "may be the property of Claimant. Accordingly, Claimant may have a claim against the Debtor." NexPoint/HCRE

2. Highland is a reorganized debtor under the confirmed *Fifth Amended Pl Defth 00000-1*[illegible]*F*[illegible]

(Fnto)16 tD.004[illegible]

stated that it would update the Proof of Claim to provide the exact amount of it "in the next ninety days" but never did.

Highland objected to the Proof of Claim. Thereafter, NexPoint/HCRE (while still not providing any liquidated amount of its Proof of Claim) refined its position therein to argue that the organizational documents relating to SE Multifamily improperly allocated the ownership percentages of the equity members, due to mutual mistake, lack of consideration, and/or failure of consideration. NexPoint/HCRE essentially sought to reform, rescind, and/or modify the SE Multifamily limited liability company agreement (and possibly other documentation) to give Highland less ownership (or no ownership interest) in SE Multifamily and, accordingly, NexPoint/HCRE would have a larger ownership interest in SE Multifamily. Next, there occurred years of litigation between the parties, including: (a) a skirmish over Highland's motion to disqualify NexPoint/HCRE's newest counsel (*i.e.*, a law firm that had represented both Highland and NexPoint/HCRE in transactions involving SE Multifamily), which was ultimately granted, and (b) an eleventh-hour attempt by NexPoint/HCRE to withdraw its Proof of Claim (by its newest law firm—this one #3 regarding the Proof of Claim), on the eve of depositions of its principals, including Dondero, and just prior to a trial on the merits. Highland objected to the withdrawal. The court held a hearing on that, as required by Bankruptcy Rule 3006. The court declined to allow withdrawal of the Proof of Claim, when the parties could not stipulate to an agreed form of order (*i.e.*, NexPoint/HCRE was unwilling to withdraw the Proof of Claim *with prejudice* to asserting its claims again in any future litigation in any forum).

Painfully, after all this, an evidentiary hearing was held on the merits of the Proof of Claim ("Trial") on November 1, 2022. During the Trial, Highland made an oral motion for a bad faith finding and assessment of attorneys' fees against NexPoint/HCRE in connection with its filing and prosecution of the Proof of Claim ("Oral Sanctions Motion"), which this court took under advisement, along with the consideration of the Proof of Claim as a whole.

On April 28, 2023, this court entered a 39-page memorandum opinion and order[5] sustaining Highland's objection to NexPoint/HCRE's Proof of Claim, but denying Highland's Oral Sanctions Motion, without prejudice, ***as procedurally deficient in that it was made orally and for the first time during the Trial.*** Thus, the Oral Sanctions Motion failed to provide NexPoint/HCRE sufficient notice and an opportunity to respond and, therefore, did not satisfy concerns of due process.

On June 16, 2023, Highland filed the instant Sanctions Motion, setting forth the legal and factual bases for the relief sought. The Sanctions Motion specifically seeks a finding of bad faith against NexPoint/HCRE and reimbursement of Highland's attorneys' fees and costs, as a sanction for NexPoint/HCRE's filing and prosecution of the Proof of Claim.

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5. *See Memorandum Opinion and Order Sustaining Debtor's Objection to, and Disallowing, Proof of Claim Number 146 [Dkt. No. 906]* ("Proof of Claim Disallowance Order"). Dkt. No. 3767.

After due notice to NexPoint/HCRE, and a hearing held January 24, 2024 on the Sanctions Motion ("Sanctions Motion Hearing"), and after consideration of the pleadings filed, evidence in the record, and arguments of counsel, the court finds, for the reasons detailed in the findings of fact and conclusions of law below,[6] that NexPoint/HCRE acted in bad faith and willfully abused the judicial process in filing, prosecuting, and then pursuing an eleventh-hour withdrawal of its Proof of Claim. Accordingly, NexPoint/HCRE will be required, as a sanction, to reimburse Highland's attorneys' fees and costs (totaling **$825,940.55**) incurred in connection with its objection to the Proof of Claim.

II. JURISDICTION

This court has jurisdiction and authority to determine and enter a final order in this matter, pursuant to 28 U.S.C. §§ 157(b)(1) and (b)(2)(A), (B), and (O) and 1334.[7]

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6. To the extent that any of the findings of fact should be construed as a conclusion of law, it shall be construed as such. To the extent that any of the conclusions of law should be construed as a finding of fact, it shall be construed as such.

7. The Fifth Circuit recently confirmed the jurisdiction and authority of bankruptcy courts to issue sanctions orders in connection with bankruptcy cases and proceedings over which they exercise jurisdiction, because they are in the nature of ***civil contempt*** orders—which are considered "part of the underlying case"—"because the bankruptcy court had jurisdiction over the [] bankruptcy case, it had jurisdiction to enter the sanctions order, too." *Kreit v. Quinn (In re Cleveland Imaging and Surgical Hospital, L.L.C.)*, 26 F.4th 285, 294 (5th Cir. 2022) (cleaned up).

Appendix E

III. BACKGROUND, PROCEDURAL HISTORY, AND FINDINGS OF FACT

A. Incorporation Herein of Proof of Claim Disallowance Order

As noted above, this court, on April 28, 2023, issued its 39-page Proof of Claim Disallowance Order, sustaining Highland's objection to NexPoint/HCRE's Proof of Claim following the Trial on same. The Proof of Claim Disallowance Order sets forth extensive procedural history, findings of fact, and conclusions of law pertaining to NexPoint/HCRE's filing and prosecution of its Proof of Claim, which Highland alleges in the instant Sanctions Motion was conducted in bad faith. NexPoint/HCRE did not appeal the Proof of Claim Disallowance Order. Thus, it is a final and non-appealable order.[8] The court hereby incorporates by reference the Proof of Claim Disallowance

8. The Proof of Claim Disallowance Order is one of the few bankruptcy court orders issued in this bankruptcy case that was not appealed by Dondero or a Dondero-controlled entity. Although the court has not counted the exact number of appeals filed by Dondero and/or Dondero-controlled entities in this bankruptcy case and related proceedings, this court takes judicial notice of information contained in a vexatious litigant motion filed by Highland in the district court (before Judge Brantley Starr), reflecting that Dondero and his controlled entities have "filed over 35 total appeals." *See Highland Capital Management, L.P.'s Reply to Objections to Motion to Deem the Dondero Entities Vexatious Litigants and for Related Relief*, 12, at ¶ 24, filed on February 9, 2024. Dkt. No. 189 (NDTX Case No. 3:21-cv-00881-X).

Order (and all of the findings and conclusions therein), as if set forth verbatim herein.[9]

B. Highland Files Sanctions Motion

On June 16, 2023, Highland filed the instant Sanctions Motion. It was supported with a Declaration of John A. Morris in support of the Sanctions Motion ("Morris Declaration")[10] and 431 pages of attached exhibits as set forth in the following table:

Exhibit A	NexPoint/HCRE's Proof of Claim[11]
Exhibit B	Highland's Objection to NexPoint/HCRE's Proof of Claim[12]
Exhibit C	NexPoint/HCRE's Response to Objection to Claim[13]

9. The Proof of Claim Disallowance Order was attached as Exhibit D to the Declaration of John A. Morris, Dkt. No. 3852, which was filed by Highland in connection with, and in support of, the relief requested in the Sanctions Motion.

10. Dkt. No. 3852.

11. Claim No. 146, filed April 8, 2020.

12. *Debtor's First Omnibus Objection to Certain (A) Duplicate Claims; (B) Overstated Claims; (C) Late-Filed Claims; (D) Satisfied Claims; (E) No-Liability Claims; and (F) Insufficient-Documentation Claims* ("Objection to Claim"), filed July 30, 2020. Dkt. No. 906.

13. *NexPoint Real Estate Partners LLC's Response to Debtor's First Omnibus Objection to Certain (A) Duplicate Claims; (B) Overstated Claims; (C) Late-Filed Claims; (D)*

Appendix E

Exhibit D	Exhibit D Proof of Claim Disallowance Order
Exhibit E	Exhibit E Transcript of November 1, 2022 Trial (on NexPoint/HCRE's Proof of Claim)
Exhibit F	Attorneys' Fees of Pachulski Stang Ziehl & Jones LLP ("PSZJ") for the period of August 1, 2021 through December 31, 2022 incurred in connection with the litigation on the NexPoint/HCRE Proof of Claim
Exhibit G	Invoices for court reporting services provided in connection with depositions taken and defended during the course of the Proof of Claim litigation
Exhibit H	Invoice for services rendered by David Agler, who provided specialized tax advice concerning SE Multifamily and other matters related to the Proof of Claim
Exhibit I	Summary of Fees and Expenses Incurred by Highland in Connection with NexPoint/ HCRE's Proof of Claim

The Sanctions Motion (unlike the Oral Sanctions Motion made during the Trial) provided NexPoint/ HCRE with due and appropriate notice of the legal and factual bases for Highland's request for a bad faith finding and reimbursement of attorneys' fees and costs incurred by it in litigating the Proof of Claim. As stated

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Satisfied Claims; (E) No-Liability Claims; and (F) Insufficient-Documentation Claims ("Response to Objection to Claim"), filed October 19, 2020. Dkt. No. 1212.

in the Sanctions Motion, the legal basis for Highland's request for reimbursement of its attorneys' fees as a sanction for NexPoint/HCRE's bad faith filing and prosecution of its Proof of Claim is the bankruptcy court's "inherent authority under section 105 of the Bankruptcy Code to issue sanctions after making a finding of bad faith."[14] Highland referred to specific documentary and testimonial evidence adduced during the Trial that it alleges supports a finding that NexPoint/HCRE filed and prosecuted its Proof of Claim in bad faith, and attached invoices evidencing its attorneys' fees and costs incurred as a direct result of this alleged bad faith.

Before NexPoint/HCRE filed its response to the Sanctions Motion, the matter was stayed on August 2, 2023, pending court-ordered global mediation.[15] The mediation ultimately proved to be unsuccessful.[16] Thereafter, NexPoint/HCRE filed its *Response to Debtor's Motion for (A) Bad Faith Finding and (B) Attorneys' Fees* ("Response")[17] on December 22, 2023. NexPoint/HCRE denies that it filed and prosecuted its Proof of Claim in bad faith and argues it should not be sanctioned at all. It

14. *See* Sanctions Motion, 10, ¶25.

15. *See Order Granting in Part and Denying in Part Motion to Stay and to Compel Mediation.* Dkt. No. 3897. This was not the first time the bankruptcy court has ordered global mediation in the Highland case.

16. *See Joint Notice of Mediation Report* filed on November 7, 2023. Dkt. No. 3995.

17. Dkt. No. 3995.

further argues that, even if the filing and prosecution of the Proof of Claim are found to have been in bad faith, the amount of the fees incurred by Highland in connection with the Proof of Claim litigation is "*per se* excessive for a single proof of claim objection"[18] and "extraordinarily high given that this dispute could have been brought to a swift close many months ago"—if only NexPoint/HCRE had been allowed to withdraw its Proof of Claim in September of 2022.[19] Highland's has sought reimbursement of more than $800,000 in attorneys' fees and more than $16,000 in expenses, identified in Exhibits F through H (and summarized in Exhibit I) of the Morris Declaration as having been incurred by Highland in connection with its litigation of the Proof of Claim.

Highland filed its *Reply in Further Support of Its Motion for (A) Bad Faith Finding and (B) Attorneys' Fees against NexPoint Real Estate Partners LLC (f/k/a HCRE Partners, LLC) in Connection with Proof of Claim 146*[20] on January 19, 2024, and filed an *Amended Reply in*

18. Response, 10, ¶34.

19. Response, 13, ¶45. NexPoint/HCRE argues that, because it had sought to withdraw its Proof of Claim, any fees incurred by Highland after the filing of NexPoint/HCRE's motion to withdraw cannot be attributable to NexPoint/HCRE's alleged bad faith filing and prosecution of its Proof of Claim; rather, such fees were incurred by Highland as a result of Highland's decision to object to NexPoint/HCRE's withdrawal of its Proof of Claim and to proceed with the litigation, including taking depositions, and proceeding to "trial" on the merits instead of "taking a win" with NexPoint/HCRE's withdrawal of its Proof of Claim. See Response, 2.

20. Dkt. No. 4018.

Further Support of Its Motion for (A) Bad Faith Finding and (B) Attorneys' Fees against NexPoint Real Estate Partners LLC (f/k/a HCRE Partners, LLC) in Connection with Proof of Claim 146 ("Reply")[21] on January 23, 2024. Highland argues that "[n]othing in the Response warrants the denial of the [Sanctions] Motion or its requested award of attorneys' fees" and that "the record makes clear" that NexPoint/HCRE and its principals "clearly and convincingly acted in bad faith by (a) knowingly filing and prosecuting a baseless Proof of Claim, . . . ([b]) seeking an unfair litigation advantage by trying to withdraw its Proof of Claim ***after*** taking Highland's depositions but ***before*** subjecting its own witnesses to questioning, and ([c]) trying at all times to preserve for another day the claims it asserted (*i.e.*, to "reform, rescind and/or modify the agreement")."[22]

The court held a hearing on the Sanctions Motion ("Hearing") on January 24, 2024, during which NexPoint/HCRE was given a full opportunity to respond to Highland's allegations of bad faith and request for sanctions.

IV. CONCLUSIONS OF LAW

A. The Sanctions Motion Satisfies Due Process Considerations

In invoking its inherent power to sanction bad faith conduct or a willful abuse of the judicial process, "[a]

21. Dkt. No. 4023.

22. Reply, 2, ¶2.

court must exercise caution . . . , and it must comply with the mandates of due process, both in determining that the requisite bad faith exists and in assessing fees." *In re Correra*, 589 B.R. 76, 125 (Bankr. N.D. Tex. 2018). As noted above, the court entered its Proof of Claim Disallowance Order on April 28, 2023, in which it sustained Highland's objection to, and disallowed, the Proof of Claim but denied, without prejudice, Highland's Oral Sanctions Motion as being procedurally defective because, having been raised for the first time during Trial and not having been made in writing, it had not given NexPoint/HCRE adequate notice and an opportunity to respond to the specific allegations of bad faith being made against it. The court pointed out that it did not address or make any determination regarding the substance of Highland's requests in the Oral Sanctions Motion for a bad faith finding and sanctions against NexPoint/HCRE, subject to Highland's right seek a bad faith finding and sanctions against NexPoint/HCRE upon and after giving it proper notice and an opportunity to respond:

> Here, where the Reorganized Debtor's generic oral request for a finding of bad faith and for "an award costs for a bad faith filing" did not articulate the legal basis for such an award and was raised for the first time during the Trial, HCRE was not given sufficient notice and an opportunity to respond, and, therefore, the court will deny, without prejudice, [Highland's] request for reimbursement of its costs incurred in connection with its objection to HCRE's Proof of Claim.

Proof of Claim Disallowance Order, 38-39 (quoting *In re Emanuel*, 422 B.R. 453, 464 (Bankr. S.D.N.Y. 2010) ("[A] person facing possible sanctions is entitled to due process. . . . At a minimum, the respondent is entitled to notice of the authority for the sanctions, notice of the specific conduct or omission that forms the basis of possible sanctions and the opportunity to respond."); *In re Magari*, 2010 WL 817327 at **2-3 (Bankr. N.D. Tex. Mar. 4, 2010) ("By requesting the sanctions award, the Trustee has raised due process concerns that can only be satisfied by providing to the affected party sufficient notice and opportunity to respond.")).

The court concludes that the instant Sanctions Motion and Hearing have provided NexPoint/HCRE with the due process that was lacking in connection with the Oral Sanctions Motion. NexPoint/HCRE was given adequate notice of the legal authority invoked for sanctions (the bankruptcy court's inherent powers under section 105 of the Bankruptcy Code) and NexPoint/HCRE's specific conduct (the filing and prosecution of its Proof of Claim) that Highland alleges to have been in bad faith, and NexPoint/HCRE was given adequate opportunity to respond through briefing and at the Hearing on the Sanctions Motion.

With due process concerns having been now addressed and satisfied, the court is able to address the substantive questions raised in the instant Sanctions Motion of (1) whether NexPoint/HCRE did, indeed, act in bad faith in the filing and prosecution of its Proof of Claim and (2) if so, whether an award of reimbursement of Highland's

attorneys' fees and costs incurred in connection with its litigation of the Proof of Claim is an appropriate sanction for such bad faith.

B. NexPoint/HCRE Filed and Prosecuted its Proof of Claim in Bad Faith and Willfully Abused the Judicial Process

A bankruptcy court may sanction a litigant for bad faith filing or litigation if the court makes specific findings, based on clear and convincing evidence, of bad faith or willful abuse of the judicial process. *See Cleveland Imaging*, 26 F.4th at 292 (A bankruptcy court may only sanction a party using its inherent authority if "(1) the bankruptcy court finds that the party acted in bad faith or willfully abused the judicial process and (2) its finding is supported by clear and convincing evidence.") (citing *Cadle Co. v. Moore (In re Moore)*, 739 F.3d 724, 729-30 (5th Cir. 2014)). The bankruptcy court's power to sanction bad faith or willful abuse of the judicial process derives from its inherent authority under 11 U.S.C. § 105(a) to issue civil contempt orders. *Id.* at 294, 294 n.14 (quoting the "relevant part" of Bankruptcy Code section 105(a), which provides that bankruptcy courts may "sua sponte, tak[e] any action . . . necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.") (cleaned up).

Having reviewed the record and the evidence adduced at Trial and NexPoint/HCRE's response to the Sanctions Motion (both in its Response and at the hearing on the Sanctions Motion), the court finds and concludes that

there is clear and convincing evidence here that NexPoint/HCRE filed and prosecuted is Proof of Claim in bad faith and that it willfully abused the judicial process.

1. Dondero's Execution and Authorization of the Filing of the Proof of Claim Without First Having Read the Document or Conducting Any Due Diligence Was in Bad Faith and a Willful Abuse of the Judicial Process

As noted in the Proof of Claim Disallowance Order, NexPoint/HCRE filed its Proof of Claim in this Highland bankruptcy case on April 8, 2020, several months after the post-petition "nasty breakup" between Highland and its co-founder and president and chief executive officer, Dondero. NexPoint/HCRE described the basis of its claim in Exhibit A attached to its Proof of Claim:[23]

Exhibit A

> HCRE Partner, LLC ("Claimant") is a limited partner with the Debtor in an entity called SE Multifamily Holdings, LLC ("SE Multifamily"). Claimant may be entitled to distributions out of SE Multifamily, but such distributions have not been made because of the actions or inactions of the Debtor. Additionally, Claimant contends that all or a portion of Debtor's equity, ownership, economic

23. Claim No. 146.

> rights, equitable or beneficial interests in SE Multifamily does [not] belong to the Debtor or may be the property of Claimant. Accordingly, Claimant may have a claim against the Debtor. Claimant has requested information from the Debtor to ascertain the exact amount of its claim. This process is on-going. Additionally, this process has been delayed due to the outbreak of the Coronavirus. Claimant is continuing to work to ascertain the exact amount of its claim and will update its claim in the next ninety days.

NexPoint/HCRE was one of the many non-debtor Dondero-controlled entities affiliated with Highland. Dondero was the president and sole manager of NexPoint/HCRE, and an individual named Matt McGraner ("McGraner") was NexPoint/HCRE's vice president and secretary. NexPoint/HCRE had no employees of its own but instead relied on Highland's employees (and employees of other entities controlled by Dondero) to conduct business on its behalf. Dondero executed the Proof of Claim as the "person who is completing and signing this claim," checking the box that indicates he is "the creditor's attorney or authorized agent" and acknowledging that "I have examined the information in this *Proof of Claim* and have reasonable belief that the information is true and correct" and that "I declare under penalty of perjury that the foregoing is true and correct."[24] The evidence overwhelmingly supports a finding that Dondero signed

24. Proof of Claim, 3.

and authorized the filing of the Proof of Claim (that the court ultimately determined was lacking in any factual or legal support) without having even read it and without conducting any due diligence on, or investigation into, whether the statements made in the Proof of Claim were truthful and accurate, which supports a finding that Dondero's signing and filing of the Proof of Claim on behalf of NexPoint/HCRE was done in bad faith and constituted a willful abuse of the judicial process.

At Trial, Dondero testified that he had authorized his electronic signature to be affixed to the document and to be filed on behalf of NexPoint/HCRE and admitted that he had not reviewed the document before doing so.[25] He further testified that he could not recall "personally [doing] any due diligence of any kind to make sure that Exhibit A was truthful and accurate before [he] authorized it to be filed,"[26] and, more specifically, that he did not, prior to authorizing his law firm (Bonds Ellis) to affix his electronic signature on, and to file, the Proof of Claim, review or provide comments to the Proof of Claim or its Exhibit A, review the SE Multifamily Amended LLC Agreement or any documents,[27] "check with any member of the real estate group to see whether or not they believed [the Proof of Claim] was truthful and accurate before [he] authorized Bonds Ellis to file it," or do "anything . . .

25. Transcript of the November 1, 2022 Trial on Debtor's Objection to HCRE's Proof of Claim ("Trial Tr.")[Dkt. No. 3616] 55:2-22.

26. Trial Tr. 56:20-23.

27. Trial Tr. 55:10-22, 56:15-57:6.

to make sure that this proof of claim was truthful and accurate before [he] authorized [his] electronic signature to be affixed and to have it filed on behalf of HCRE."[28] Moreover, he testified that he did not know whose idea it was to file the Proof of Claim,[29] who at NexPoint/HCRE worked with, or provided information to, Bonds Ellis to enable Bonds Ellis to prepare the Proof of Claim, what information was given to Bonds Ellis that enabled them to formulate the Proof of Claim, or whether "Bonds Ellis ever communicated with anybody in the real estate group regarding [the Proof of Claim]."[30]

Dondero has argued that he had a good faith basis to sign and file the Proof of Claim on behalf of NexPoint/HCRE because "he had a host of responsibilities across a sprawling and sophisticated corporate structure and relied on numerous individuals within that structure to help manage the day-to-day operations of Highland and its subsidiaries and managed funds"[31] and that he "ha[d] to rely on systems and processes[,]" because "[he] can't be directly involved in everything."[32] Dondero further testified that "[he] sign[s] a lot of high-risk documents and [has] to rely on the process and the people and internally and externally as part of the process to sign it without

28. Trial Tr. 57:25-58:16.

29. Trial Tr. 57:7-9.

30. Trial Tr. 56:1-14.

31. Response, 7, ¶16.

32. Trial Tr. 57:25-58:7.

direct validation from or verification from me, and this [Proof of Claim] is another one of those items."[33]

Dondero's "I'm-a-very-busy-person/too-busy-to-be-bothered-to-investigate" excuse is not a defense, as a matter of law, to his bad faith and willful abuse of the judicial process in connection with the filing of the Proof of Claim. Nor is Dondero's claimed reliance on systems and processes in connection with the execution and filing of this Proof of Claim, as a matter of fact, supported by the evidence. The court notes that the Proof of Claim is not a complex, lengthy legal or corporate document; Exhibit A to the Proof of Claim, which set forth the basis for the claim, is only one paragraph long, yet Dondero did not even bother to read it before signing under penalty of perjury that the information contained in the Proof of Claim, including Exhibit A, was truthful and accurate. And, Dondero's own testimony contradicts his assertion that he relied on "systems and processes" and on other people within the "sprawling and sophisticated corporate structure" and his outside counsel to ensure the accuracy of the Proof of Claim. He had no reasonable or justifiable basis to rely on anyone or any "process" that was allegedly in place in connection with his signing of "high risk" documents, because he asked no questions, conducted no due diligence, and made no effort, whatsoever, to verify that the information that he was swearing was accurate under penalty of perjury was, in fact, truthful.

The court finds and concludes that the foregoing admissions by NexPoint/HCRE, through Dondero,

33. Trial Tr. 57:25-59:2.

provide clear and convincing evidence that ***NexPoint/HCRE filed its Proof of Claim*** in bad faith and willfully abused the judicial process.

2. NexPoint/HCRE's Litigation Strategy and Actions in the Prosecution of Its Proof of Claim Are Further Evidence of Its Bad Faith and Willful Abuse of the Judicial Process

Moreover, NexPoint/HCRE's ***litigation strategy and actions*** taken in the course of prosecuting its Proof of Claim over the next two and a half years, after filing it, ***provide further support for a finding that NexPoint/HCRE engaged in bad faith and willfully abused the judicial process.***

As noted in the Proof of Claim Disallowance Order, six months after Dondero signed and filed the Proof of Claim in April 2020, and in response to Highland's objection to its Proof of Claim,[34] NexPoint/HCRE fleshed-out the legal and factual bases for its claim:[35]

> After reviewing what documentation is available to [NexPoint/HCRE] with the Debtor,

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34. On July 30, 2020, Highland filed an objection to the allowance of the Proof of Claim, contending it had no liability under the Proof of Claim. *See Debtor's First Omnibus Objection to Certain (A) Duplicate Claims; (B) Overstated Claims; (C) Late-Filed Claims, (D) Satisfied Claims; (E) No-Liability Claims; and (F) Insufficient-Documentation Claims*, Dkt. No. 906.

35. Response to Objection to Claim, 2-3, ¶¶ 5-6.

> [NexPoint/HCRE] believes the organizational documents relating to SE Multifamily Holdings, LLC (the "SE Multifamily Agreement") improperly allocates the ownership percentages of the members thereto due to mutual mistake, lack of consideration, and/or failure of consideration. As such, [NexPoint/HCRE] has a claim to reform, rescind and/or modify the agreement.
>
> However, [NexPoint/HCRE] requires additional discovery, including, but not limited to, email communications and testimony, to determine what happened in connection with the memorialization of the parties' agreement and improper distribution provisions, evaluate the amount of its claim against the Debtor, and protect its interests under the agreement.

The Response was filed by a new law firm—Wick Phillips Gould & Martin, LLP ("Wick Phillips")—not the law firm of Bonds Ellis, which had handled the filing of the Proof of Claim. In the course of discovery, Highland became aware that Wick Phillips had jointly represented NexPoint/HCRE and Highland in connection with at least some of the underlying transactions that were the subject of the Proof of Claim, and, on April 14, 2021, more than a year after NexPoint/HCRE filed its Proof of Claim, Highland moved to disqualify Wick Phillips.[36]

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36. Dkt. Nos. 2196-2198. On October 1, 2021, Highland filed a supplemental disqualification motion. Dkt. No. 2893.

Notably, Highland's Plan had been confirmed on February 22, 2021, over the objections of Dondero and his related entities (including NexPoint/HCRE).[37] The effective date ("Effective Date") of the Plan occurred on August 11, 2021, and Highland became the Reorganized Debtor under the Plan. Pursuant to the Plan, on or after the Effective Date, all or substantially all of the Debtor's assets vested in the Reorganized Debtor or the claimant trust ("Claimant Trust") created under the terms of the Plan, including Highland's 46.06% membership interest in SE Multifamily.

Meanwhile, NexPoint/HCRE vigorously fought the disqualification of Wick Phillips, filing its opposition to the disqualification motion on May 6, 2021,[38] and initiating a more than six-month period of expensive discovery and side litigation that culminated, after a lengthy hearing on the disqualification motion, with the entry by this court on December 10, 2021, of its *Order Granting in Part and Denying in Part Highland's Supplemental Motion to Disqualify Wick Phillips Gould & Martin, LLP As Counsel to HCRE Partners, LLC and for Related Relief* ("Disqualification Order"),[39] resolving the disqualification motion by, among other things, disqualifying Wick Phillips from representing NexPoint/HCRE in the contested matter concerning the Proof of Claim, but specifically

37. NexPoint/HCRE, represented by Wick Phillips, filed its *Objection to Debtor's Fifth Amended Plan of Reorganization* on January 5, 2021. Dkt. No. 1673.

38. Dkt. Nos. 2278 and 2279.

39. Dkt. No. 3106.

denying Highland's request that NexPoint/HCRE reimburse it all costs and fees incurred in making and prosecuting the disqualification motion.[40]

In the instant Sanctions Motion, Highland acknowledged that the court denied Highland's specific request for sanctions of reimbursement of Highland's costs and fees in making the Disqualification Motion in its December 2021 Disqualification Order.[41] The court notes that the denial was not "with prejudice"[42] to Highland's right to bring a sanctions motion in the future in connection with allegations that NexPoint/HCRE's filing and prosecution of its Proof of Claim, including its vigorous defense of the Disqualification Motion. Notably, while Highland includes a reference in the instant Sanctions Motion to the lengthy and expensive proceedings on the Disqualification Motion in its recitation of evidence in the record that supports Highland's allegations that NexPoint/HCRE engaged in bad faith conduct in the filing and prosecution of its Proof of Claim, it did ***not*** include them as part of the fees and costs for which Highland is seeking to be reimbursed by NexPoint/HCRE as a sanction for NexPoint/HCRE's bad faith filing and prosecution of its Proof of Claim.[43]

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40. Disqualification Order, 4.

41. *See* Sanctions Motion, 4, ¶8.

42. The Disqualification Order stated, in relevant part, "Highland's request that HCRE reimburse it all costs and fees incurred in making and prosecuting the Motion, including reasonable attorneys' fees, is **DENIED**."

43. *See* Morris Declaration, 3-4, at ¶11 (Referencing the

In any event, following the disqualification of Wick Phillips, NexPoint/HCRE hired yet a third law firm, Hoge & Gameros, LLP, in connection with this matter, and the parties engaged in a second round of extensive discovery, which included the exchange of written discovery and document production and the service of various deposition notices and subpoenas. On August 12, 2022, just two business days after NexPoint/HCRE completed the depositions of Highland's witnesses, and a day after NexPoint/HCRE made a supplemental production of more than 4,000 pages of documentation, and two business days before the consensually scheduled depositions of NexPoint/HCRE's witnesses, Dondero and McGraner, were set to occur, NexPoint/HCRE filed a motion to withdraw its Proof of Claim ("Motion to Withdraw").[44] By this point, Highland had spent hundreds of thousands of dollars objecting to the Proof of Claim.

Query why might NexPoint/HCRE have done this? Just six months earlier, Dondero's family trust, The Dugaboy Investment Trust, had represented to the bankruptcy court that Highland's 46.06% interest in SE Multifamily

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court's denial in its Disqualification Order of Highland's previous request for attorneys' fees incurred in connection with the Disqualification Motion, Morris stated "[W]e reviewed the PSZJ Invoices and redacted all entries relating to the Disqualification Motion; thus, for the avoidance of doubt, Highland does not seek any fee award with respect to any work done in connection with the Disqualification Motion.").

44. *See Motion to Withdraw Proof of Claim* [Dkt. No. 3442].

was worth $20 million,[45] and now, NexPoint/HCRE (which presumably also spent substantial sums prosecuting its Proof of Claim during the nearly two and a half years of litigation) appeared willing to walk away from its multi-million dollar challenge to Highland's 46.06% interest in SE Multifamily. Highland objected to NexPoint/HCRE's Motion to Withdraw, and the court held a hearing on September 12, 2022 (as required by Bankruptcy Rule 3006), following which the court entered an order denying NexPoint/HCRE's Motion to Withdraw, for the reasons set forth on the record,[46] and directing the parties to "confer in good faith to complete the depositions" of Dondero, McGraner, and NexPoint/HCRE and otherwise comply with the scheduling order that had been entered by the court on this matter, which included appearing for an evidentiary hearing on November 1, 2022.[47] The court denied NexPoint/HCRE's Motion to Withdraw, in part, because it was concerned that the timing of it all-just two business days ***after*** completing Highland's depositions but two business days ***before*** the consensually-scheduled depositions of NexPoint/HCRE's witnesses were to take

45. *See Motion for Determination of the Value of the Estate and Assets Held by the Claimant Trust* [Docket No. 3382]. As pointed out by Highland in its Response, "[t]here is no dispute that HCRE is the manager of SE Multifamily and therefore—through Mr. Dondero—would be best positioned to opine on the value of Highland's interest in SE Multifamily." Response, 9, at ¶27 n. 4.

46. The court noted in its order denying HCRE's Motion to Withdraw that, under the Bankruptcy Rules, a creditor does not have an absolute right to withdraw a proof of claim.

47. Dkt. No. 3525.

place—reflected gamesmanship on the part of NexPoint/HCRE (*i.e.*, NexPoint/HCRE prosecuted its Proof of Claim for two and a half years, through and including the taking of depositions of Highland's witness, while shielding its own witnesses from testifying). The court was also concerned by NexPoint/HCRE's repeated attempts to preserve its claims against Highland for use against Highland in the future. In fact, the court entered its order denying NexPoint/HCRE's Motion to Withdraw only after: (1) NexPoint/HCRE refused to agree, at the September 12 hearing, to language in an order allowing withdrawal of the Proof of Claim that stated, unequivocally, that NexPoint/HCRE waived the right to relitigate or challenge the issue of Highland's 46.06% ownership interest in SE Multifamily, and (2) counsel were thereafter unable, in the day or two after the hearing, to work out mutually acceptable language in an agreed order that protected both parties.[48] As noted in its order denying NexPoint/HCRE's Motion to Withdraw, the court had expressed concerns, during the hearing on the Motion to Withdraw, relating to the integrity of the bankruptcy system and claims process if it allowed

48. At the end of the September 12 hearing, the court had expressed concerns about gamesmanship, but, at the same time, assured the parties that it was still open to signing an agreed order regarding withdrawal of the Proof of Claim, if counsel could work out mutually acceptable language that protected both parties "without the pressure of the Court hovering over you." See Transcript of Hearing on Motion to Withdraw, Dkt. No. 3519, 50:14-59:14. Apparently, counsel were unable to reach an agreement on the terms of an agreed order, and so the court signed the order at docket number 3525, denying NexPoint/HCRE's Motion to Withdraw.

NexPoint/HCRE to withdraw its Proof of Claim after two and a half years of litigation, and having caused Highland to spend hundreds of thousands of dollars litigating the Proof of Claim, while at the same time allowing NexPoint/HCRE to preserve its challenges to Highland's ownership interest in SE Multifamily to be used against Highland in the future. The court did not, at the time, make any express findings regarding NexPoint/HCRE's bad faith or abuse of the judicial process, only because Highland's mid-hearing Oral Sanctions Motion had not provided NexPoint/HCRE with adequate notice and an opportunity to respond.[49] With the instant Sanctions Motion, those due process concerns have been satisfied.

Having considered the evidence and argument of counsel at both the Trial on NexPoint/HCRE's Proof of Claim and the hearing on the Sanctions Motion, and the pleadings filed in connection with the Sanctions Motion, including NexPoint/HCRE's written Response, and based on the record as a whole, the court expressly finds and concludes that NexPoint/HCRE's ***litigation strategy and actions*** in prosecution of its Proof of Claim (including vigorous opposition to the Disqualification Motion, the timing of the Motion to Withdraw, and its repeated and overt attempts to preserve the very claims upon which its Proof of Claim was based in connection with the Motion to Withdraw) demonstrates bad faith and a willful abuse of the judicial process on the part of NexPoint/HCRE.

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49. As noted below, NexPoint/HCRE persisted to the end in arguing that the disallowance of its Proof of Claim could not bar NexPoint/HCRE from making future challenges to Highland's 46.06% membership interest in SE Multifamily.

3. NexPoint/HCRE's Admissions at Trial Are Further Evidence of its Bad Faith Filing and Willful Abuse of the Judicial Process

Following the denial of NexPoint/HCRE's Motion to Withdraw, the parties complied with the court's order to schedule the depositions of Dondero and McGraner at mutually agreeable times to complete discovery and then appeared at Trial on November 1, 2022. At the conclusion of the Trial, NexPoint/HCRE doubled-down on its request of the court "to grant the proof of claim and reallocate the equity [in SE Multifamily] based on the capital contribution[s]."[50] This was despite admissions by Dondero and McGraner in their Trial testimony that made it clear that NexPoint/HCRE did not, and never did, have a factual or legal basis for its request. Nevertheless, NexPoint/HCRE continued to the end to try to limit any order disallowing its Proof of Claim so as to preserve its right to assert the very claims asserted in its Proof of Claim (for rescission, reformation and/or modification of the SE Multifamily Amended LLC Agreement to reallocate the membership percentages) for use in the future.[51]

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50. Trial Tr. 179:23-25; 180:8-9.

51. Trial Tr. 179:21-24 ("They want you to make findings that we can't raise any of these other issues, rescissions, stays, et cetera, going forward. That's not proper relief on a proof of claim."); 200:8-12 ("If Your Honor's going to deny the proof of claim, I would ask that you simply deny the proof of claim. We don't have an adversary proceeding here. There wasn't one started. Mr. Morris considered that and then didn't follow that path, because all we have here today is a proof of claim.").

Appendix E

The Trial testimony of Dondero and McGraner revealed that NexPoint/HCRE had no factual basis to claim that a mistake was made by any of the parties, much less a mutual mistake of the parties, regarding the allocation of ownership percentages in SE Multifamily in corporate documentation,[52] and, in fact, "the evidence overwhelmingly point[ed] to the conclusion that both Mr. Dondero and Mr. McGraner understood that the allocation

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52. The court concluded, specifically, that

> HCRE did not produce any evidence, much less clear and convincing evidence, that the parties to the Amended LLC Agreement – HCRE, Highland, BH Equities, and Liberty – had come to a specific and understanding, prior to the execution of the Amended LLC Agreement in March 2019, that the allocation of percentage membership interests in SE Multifamily was different from the percentage allocations contained in the Amended LLC Agreement. When asked on cross-examination, Mr. McGraner, HCRE's officer and co-owner who was most involved in the negotiations of the terms of the Amended LLC Agreement, was unable to identify any specific mistake made in the drafting of the Amended LLC Agreement. Neither he nor NexPoint/HCRE's other witness, Mr. Dondero, were able to point to a specific meeting of the minds of the members of SE Multifamily prior to (or after, for that matter) the execution of the Amended LLC Agreement that the parties intended Highland's allocation of SE Multifamily membership interests to be any percentage other than the 46.06% allocation attributed to Highland in the written Amended LLC Agreement.

Proof of Claim Disallowance Order, 30.

of 46.06% membership interest to Highland, and a total capital contribution by Highland of $49,000 in the Amended LLC Agreement, reflected the intent of the parties prior to, and at the time of, the execution of the Amended LLC Agreement."[53] The court specifically noted in the Proof of Claim Disallowance Order that Dondero admitted that he had not read or reviewed the Amended LLC Agreement or any drafts of it before he signed it—apparently the Amended LLC Agreement was one of those important, high-risk documents that Dondero was too busy to read or investigate before signing (like the Proof of Claim)—but he nevertheless testified that "the capital contributions and membership allocations contained in Schedule A of the Amended LLC Agreement comported with his understanding and intent when he signed the Amended LLC Agreement on behalf of HCRE and Highland."[54] NexPoint/HCRE was also unable to produce any evidence at Trial to support its factual allegation that there was a "lack of consideration" or a "failure of consideration" with respect to the Amended LLC Agreement, such that NexPoint/HCRE would be entitled to a reformation,[55]

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53. *Id.*, 30-31.

54. *Id.*, 31 n. 119.

55. After noting that "neither lack of consideration nor failure of consideration are bases for reformation of a contract under Delaware law (which is what NexPoint/HCRE is seeking in its Proof of Claim)," the court concluded that "HCRE is not entitled to reformation of the Amended LLC Agreement to reallocate the members' membership interests as requested based on its allegations of lack of consideration and/or failure of consideration." Proof of Claim Disallowance Order, 32 n. 120.

rescission,[56] or modification of it, to re-allocate the ownership percentages that the parties agreed to at the time of the execution of it.[57]

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56. The court noted in the Proof of Claim Disallowance Order that NexPoint/HCRE had not actually stated a claim for rescission of the Amended LLC Agreement with respect to its Proof of Claim, but that, if it had,

> Mr. Dondero's admission that he did not read the Amended LLC Agreement (or even have the terms explained to him by counsel or anyone else) prior to signing it on behalf of HCRE and Highland would bar any claim by HCRE for rescission of the Amended LLC Agreement. Moreover, even if HCRE's claim for rescission was not barred by Mr. Dondero's failure to read the Amended LLC Agreement prior to signing it, HCRE did not present any evidence of the other elements of a rescission claim: that the parties were mistaken as to a basic assumption on which the Amended LLC Agreement was made and that the mistake had a material effect on the agreed-upon exchange of performances.

Proof of Claim Disallowance Order, 33-34.

57. See Proof of Claim Disallowance Order, 32-33 n. 120 (where the court found that "HCRE has not shown that there was a lack or failure of consideration on behalf of Highland in connection with the Amended LLC Agreement. . . . Under Delaware law, the courts 'limit [their] inquiry into consideration to its existence and not whether it is fair or adequate,'. . . . '[E]ven if the consideration exchanged is grossly unequal or of dubious value, the parties to a contract are free to make their bargain.' (citations omitted). Here, it is undisputed that Highland made a cash capital contribution of $49,000, that Highland was a jointly and severally liable coborrower under the KeyBank Loan, and that SE Multifamily (and HCRE), having no employees of their

In fact, McGraner ultimately admitted in his Trial testimony that the only reason NexPoint/HCRE had for filing its Proof of Claim, which challenged Highland's title to its 46.06% membership interest in SE Multifamily, was, essentially, ***that NexPoint/HCRE was frustrated with the consequences of Dondero's decision in 2019 to seek bankruptcy protection for Highland (notably, the bankruptcy case was filed just a few months after the Amended LLC Agreement was executed), which resulted in Dondero losing control over Highland***, such that, as far as NexPoint/HCRE was concerned, its "partner" [in SE Multifamily] was no longer its "partner." The court noted in the Proof of Claim Disallowance Order that McGraner

> could not point to any provision of the Amended LLC Agreement that was either "wrong" or a "mistake;" rather, he testified that the "mistake" was "when the bankruptcy was filed and we can't amend it" because "[o]ur partners aren't our partners" – "if you have good partners and you're working with partners that are – that are known to you, then you make amendments to reflect the contributions of those partners, whether monetary or otherwise . . . [a]nd my understanding is I can't do that right now."[58]

McGraner testified that "despite Mr. Dondero being in control of both HCRE and Highland prior to the

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own, relied on Highland's employees to conduct business. Thus, HCRE's claim, to the extent it is based on alleged lack and/or failure of consideration fails.").

58. Proof of Claim Disallowance Order, 27 (citing Trial Tr. 114:24-115:16, 118:6-15).

bankruptcy filing, and despite 'all of the fears [he] had [related to Highland's bankruptcy filing],' HCRE made no effort to amend the agreement before the bankruptcy or post-bankruptcy (because 'we didn't think it would be worth it')[][59] [and] 'because [it] hoped that the issues that caused the bankruptcy filing would resolve themselves.'"[60] This is not a good-faith basis for filing and prosecuting the Proof of Claim, and it exhibits a willful abuse of the bankruptcy claims process by NexPoint/HCRE.

In summary, the admissions by Dondero and McGraner in their Trial testimony made clear that NexPoint/HCRE never had a factual or legal basis for the Proof of Claim. NexPoint/HCRE's principals knew, at the time of filing and through its prosecution of the Proof of Claim, that there was no factual basis for its claim of rescission, reformation, and/or modification of the Amended LLC Agreement to dispossess Highland of some or all of its 46.06% membership interest in SE Multifamily. This clearly and convincingly constitutes bad faith by NexPoint/HCRE and a willful abuse of the judicial process.

C. Reimbursement of Attorneys' Fees and Costs Incurred by Highland in the Proof of Claim Litigation Is an Appropriate Sanction for NexPoint/HCRE's Bad Faith

Having found and concluded by clear and convincing evidence that NexPoint/HCRE filed and prosecuted (and

59. *Id.* (citing Trial Tr. 121:24-122:9).

60. *Id.* at 28 (citing Trial Tr. 122:20-125:21).

attempted withdrawal of) its Proof of Claim in bad faith and willfully abused the judicial process, this court may use its inherent powers under Bankruptcy Code section 105(a) to sanction it for such conduct. Reimbursement of the opposing party's fees and costs incurred in responding to a bad faith filing or willful abuse of the judicial process has been upheld as an appropriate form of sanctions. *See Cleveland Imaging*, 26 F.4th at 294 (upholding the bankruptcy court's sanction order that required the parties who were found to have filed bankruptcy petitions in bad faith to reimburse the fees incurred by a post-confirmation litigation trust in responding to the bad faith filing); *Carroll v. Abide (In re Carroll)*, 850 F.3d 811 (5th Cir. 2017) (bankruptcy court did not abuse its discretion in ordering the debtors to "pay $49,432, which represents the amount of attorneys' fees incurred by [the bankruptcy trustee] in responding to certain instances of the [debtors'] bad faith conduct."); *In re Yorkshire, LLC*, 540 F.3d 328, 332 (5th Cir. 2008) (affirming bankruptcy court's use of its inherent powers to issue monetary sanctions for bad faith filing that were, in part, based upon the opposing parties' attorneys' fees and costs "following an extensive hearing in which the bankruptcy court heard testimony from the parties and witnesses and made certain credibility determinations," and "made specific findings that Appellants acted in bad faith."); *In re Paige*, 365 B.R. 632, 637-399 (Bankr. N.D. Tex. 2007) (awarding attorneys' fees against debtor for their "bad faith" conduct during bankruptcy case, noting "[t]he sanction here is derived from the Court's inherent power to sanction" under section 105(a)); *In re Lopez*, 576 B.R. 84, 93 (S.D. Tex. 2017) (same). Any sanction imposed pursuant to a bankruptcy court's

inherent powers for bad faith conduct or willful abuse of the judicial process "must be compensatory rather than punitive in nature." *In re Lopez*, 576 B.R. at 93 (quoting *Goodyear Tire & Rubber Co. v. Haeger*, 581 U.S. 101, 108 (2017) (citing *Mine Workers v. Bagwell*, 512 U.S. 821, 826-30 (1994)). "[A] sanction counts as compensatory only if it is 'calibrate[d] to [the] damages caused by' the bad-faith acts on which it is based[,]" and "[a] fee award is so calibrated if it covers the legal bills that the litigation abuse occasioned." *Goodyear Tire & Rubber*, 581 U.S. at 108 (quoting *Bagwell*, 512 U.S. at 834). The fee award must be "limited to the fees the innocent party incurred solely because of the misconduct—or put another way, to the fees that party would not have incurred but for the bad faith." *Id.* (quoting *Goodyear Tire & Rubber Co. v. Haeger*, 581 U.S. at 104). The "'causal link' between the sanctionable conduct and the opposing party's attorney's fees" must be established "through a 'but-for test:' to wit, the complaining party may only recover the portion of fees that they would not have paid 'but-for' the sanctionable conduct." *Id.* (citing *Goodyear Tire & Rubber*, 581 U.S. at 108-109 (citing *Fox v. Vice*, 563 U.S. 826, 836 (2011)).

Here, as earlier noted, Highland has requested, as a sanction, reimbursement of its attorneys' fees and costs incurred by it in responding to NexPoint/HCRE's filing and prosecution of its Proof of Claim. Specifically, Highland seeks reimbursement of an aggregate amount of **$825,940.55**, consisting of

- **$782,476.50** in attorneys' fees charged by its primary bankruptcy counsel, PSZJ, for the period

August 1, 2021 through December 31, 2022, for work performed in connection with the litigation of the Proof of Claim;[61]

- **$16,164.05** in third-party expenses for court reporting services provided in connection with the Proof of Claim litigation;[62] and,

- **$27,300.00** in attorneys' fees charged by David Agler for providing Highland with specialized tax advice concerning SE Multifamily and other matters related to the Proof of Claim.[63]

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61. *See* Morris Declaration, 3-4, at ¶¶ 8-13, and Ex. F. As stated in the Morris Declaration, the $782,476.50 amount does not include any fees relating to the Disqualification Motion or any fees that PSZJ concluded were inadvertently coded by a timekeeper to the NexPoint/HCRE Claim Objection category "or that were otherwise unrelated to services rendered in connection with the Proof of Claim litigation." *Id.*, 3-4, at ¶¶ 11 and 12. By way of specific example, Morris stated that "in 2022 and 2023 we charged Highland for services rendered in connection with our unsuccessful attempts to obtain SE Multifamily's books and records but excluded those charges here because they do not directly relate to the litigation of HCRE's Proof of Claim; Highland is seeking those fees in the Delaware Chancery Court where Highland was forced to commence an action against HCRE for specific performance (Case No. 2023-0493-LM))." *Id.*, 4, at ¶ 12.

62. *See id.*, 4, at ¶ 14, and Ex. G.

63. *See id.*, 4-5, at ¶¶ 15 and 16, and Ex. H. A summary of the aggregate fees and expenses of which Highland is seeking reimbursement in the Sanctions Motion is attached as Exhibit I to the Morris Declaration. *See id.*, 5, at ¶ 17, and Ex. I.

NexPoint/HCRE challenges Highland's request for reimbursement of its fees on several bases. ***First***, it argues that it cannot be ordered to reimburse the fees and expenses incurred by Highland ***after*** NexPoint/HCRE attempted to withdraw its Proof of Claim because they do not satisfy the "but for" test for establishing a "causal link" between those fees and costs and NexPoint/HCRE's filing and pursuit of its Proof of Claim—that Highland cannot show that "but for" NexPoint/HCRE's filing and prosecution of its Proof of Claim, Highland would not have incurred those fees and costs. NexPoint/HCRE urges the court to adopt its narrative of the proceedings that "instead of taking a win, [Highland] and its lawyers chose to generate fees to get the same result" and thus Highland's attorneys' efforts were "totally unnecessary" and a "waste of time and resources" that was "the fault of [Highland], not [NexPoint/HCRE]."[64] NexPoint/HCRE states in its Response that "[h]ere, ***it is undisputed*** that, had [Highland] agreed to the withdrawal of the Proof of Claim many months ago – before engaging in costly additional discovery and preparing for and attending a trial on the merits of the claim – [Highland] would have been exactly in the same position that it is in now, but at far less expense" and further that "[t]he real, practical difference between refusing to consent to the withdrawal of [NexPoint/HCRE]'s Proof of Claim and instead prosecuting the Objection to its end is several hundred thousand dollars in attorneys' fees" and, thus, "[t]he Motion abjectly fails any 'but-for' analysis."[65]

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64. Response, 2.

65. Response, 20, at ¶60 (emphasis added).

Appendix E

The court disagrees with NexPoint/HCRE's "narrative" and its view of the evidence established at Trial. Highland ***does*** dispute NexPoint/HCRE's contention that, if only it had allowed it to withdraw its Proof of Claim and accepted a "win," that Highland would have been "exactly in the same position that it is in now [after a Trial and ruling on the merits of the Proof of Claim], but at far less expense." The court does as well. As Highland has argued, NexPoint/HCRE's Motion to Withdraw was itself filed in bad faith. Highland was forced to oppose the withdrawal of the Proof of Claim because NexPoint/HCRE would not agree to a withdrawal, with prejudice, to NexPoint/HCRE's right to challenge Highland's title to its 46.06% membership interest in SE Multifamily in the future.[66] The evidence clearly and convincingly established that any "win" or "victory" that Highland would have obtained through the withdrawal of the Proof of Claim[67]

> would have been pyrrhic because ***HCRE—in a clear act of bad faith—tried to withdraw its Proof of Claim while preserving the substance of it claims for another day***. Had HCRE's duplicitous strategy been successful, Highland's interest in SE Multifamily would have remained subject to challenge—an untenable result for anyone, let alone a post-confirmation entity seeking to implement a court-approved asset monetization plan.

66. *See supra* note 45 and accompanying text.

67. Response, 5, at ¶18.

The court finds and concludes, as argued by Highland, that there is clear and convincing evidence here that the fees and costs incurred by it, after NexPoint/HCRE sought to withdraw its Proof of Claim (*i.e.*, to prepare for the Trial and prosecute its objection to the Proof of Claim through a trial and ruling on the merits), would not have been incurred "but for" NexPoint/HCRE's bad faith. As pointed out by Highland and as noted above,[68] the court did not enter the Proof of Claim Disallowance Order in December 2022 in a vacuum. Rather, the court denied NexPoint/HCRE's Motion to Withdraw only ***after:*** (1) the court had expressed concerns that the timing and context of its filing of its Motion to Withdraw suggested gamesmanship on its part, and that the integrity of the bankruptcy system and claims process would be in jeopardy if the court were to simply allow withdrawal, without protecting Highland from future challenges to its membership interest in SE Multifamily (particularly, after Highland had spent hundreds of thousands of dollars to that point in objecting to the Proof of Claim); and (2) NexPoint/HCRE refused to agree to language in an order that would alleviate these expressed concerns. The court—having now made an express finding that NexPoint/HCRE's filing of its Motion to Withdraw was in bad faith and part of its willful abuse of the bankruptcy claims process that began with the filing of its Proof of Claim in April 2020—now expressly finds that the fees and costs incurred by Highland after NexPoint/HCRE filed its Motion to Withdraw were necessary for Highland to protect its interests and would not have been incurred

68. *See supra* at pages 16-17.

"but for" NexPoint/HCRE's bad faith conduct and willful abuse of the judicial process.

Second, NexPoint/HCRE objects to Highland's fees ($809,776.50) and expenses ($16,164.05) as being "*per se* excessive for a single proof of claim objection."[69] Highland argues that "[s]pending less than 5% of the value of an asset (according to Mr. Dondero's family trust) to obtain good, clear title is economically rational and consistent with the Claimant Trust's duty to maximize value for the benefit of the Claimant Trust's beneficiaries." Per the Morris Declaration, Highland only seeks reimbursement of expenses and fees charged to Highland for expenses incurred and work performed in litigating the Proof of Claim (but—as noted earlier—specifically excluding any fees charged relating to the Disqualification Motion). The court agrees with Highland and finds that the fees and expenses incurred by it in objecting to the Proof of Claim, including the fees incurred ***after*** NexPoint/HCRE sought to withdraw its Proof of Claim, were reasonable and necessary for Highland to protect a valuable asset—it's 46.06% interest in SE Multifamily—and, thus, they are not excessive.

Third, NexPoint/HCRE complains, in its Response, that the fees charged by PSZJ were unreasonable and excessive because the PSZJ invoices show that it was seeking reimbursement for fees charged by "layers of timekeepers whose identities and roles have not

69. Response, 10, ¶34.

been disclosed."[70] NexPoint/HCRE points out three professionals (two of whom billed one hour or less) who were identified in PSZJ's invoices only by their initials.[71] In its Reply, Highland identified the timekeepers by name—as a litigator who billed one hour of time; a bankruptcy attorney who billed 0.6 hours of time; and a bankruptcy partner who billed 15.1 hours of time—all of whom were "called upon to provide discrete support."[72] Collectively, the three previously "unidentified" attorneys charged just 0.023% of the total fee request.[73] PSZJ's identification of the "unidentified timekeepers" and explanation of the work performed by them satisfies the court that these fees were reasonable and necessary fees incurred as a direct result of NexPoint/HCRE's bad faith filing and prosecution of its Proof of Claim. The court rejects NexPoint/HCRE's suggestion that PSZJ overstaffed and overbilled the file because there were "layers of timekeepers." As pointed out in Highland's Reply, "over 82% of the charges related to one litigation partner . . . , one litigation associate . . . , and one paralegal" and "[t]wo other lawyers who have been on the Pachulski team since the inception of this engagement . . . billed relatively modest amounts of time over the course of this prolonged litigation."[74] There is simply no factual basis to support a conclusion that the matter was overstaffed.

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70. *Id.*, 13, ¶45.

71. *Id.*, 12, ¶38.

72. Reply, 9, ¶28.

73. *Id.*

74. *Id.*, 9, ¶28 n. 5.

Fourth, NexPoint/HCRE objects to $9,840 charged by two attorneys for travel time,[75] while acknowledging that those attorneys' non-working travel time was billed at half of the attorneys' regular hourly rate.[76] As pointed out by Highland in its Reply, Highland agreed to pay for travel time in its pre-petition engagement letter, so those "charges cannot come as a surprise to Mr. Dondero."[77] The court takes judicial notice of the fact that attorneys charging half of their hourly rates for non-working travel time, as PSZJ did here, pursuant to its engagement letter with Highland that was approved when the court authorized the retention of PSZJ as counsel for the Debtor, is common practice and is a commonly approved term of engagement of professionals in bankruptcy cases. The $9,840 charged by two attorneys for travel time in this matter was a reasonable and necessary expense incurred by Highland in responding to NexPoint/HCRE's bad faith filing and prosecution of its Proof of Claim.

Fifth, and finally, NexPoint/HCRE objects to the fees charged by David Agler (39 hours of work performed at $700 per hour) for providing Highland with tax advice in August 2022, on the basis that the invoice attached as Exhibit H to the Morris Declaration "indicated that it was 'unbilled' work" and that "[w]hatever work he did, it did not manifest itself in the proceedings."[78] Highland pointed

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75. Response, 12, ¶37.

76. *Id.*, 11, ¶36 (Table 1).

77. Reply, 9-10, ¶29.

78. Response, 12, ¶42.

out that it ***had*** explained, in the Morris Declaration, that Mr. Agler provided "specialized tax advice concerning SE Multifamily and other matters related to the Proof of Claim."[79] Highland provided a more detailed description of the services provided by Mr. Agler and why those services were necessary in its Reply: "Mr. Agler provided his services in August 2022 in conjunction with Highlands's deposition preparation, including the deposition of SE Multifamily's accountant. These services were necessary because—as Mr. Dondero and Mr. McGraner admitted and as the evidence showed—Highland's participation in SE Multifamily was expected to provide substantial tax benefits."[80] The court finds that the fees charged by David Agler for work performed for Highland that are set forth in Exhibit H to the Morris Declaration were reasonable and necessary expenses incurred by Highland in responding to HCRE's bad faith conduct and that they would not have been incurred "but for" NexPoint/HCRE's bad faith conduct and willful abuse of the judicial process.

The court has determined that the full amount of fees – $809,776.50 – and costs – $16,164.05 – that are set forth in detail in Exhibits F through H (and summarized on Exhibit I) of the Morris Declaration were reasonable and necessary for Highland to respond to, and would not have been incurred "but for," NexPoint/HCRE's bad faith filing and prosecution of its Proof of Claim, which the court has

79. Reply, 10, ¶30 (citing Morris Declaration, ¶15).

80. *See id.* (citing Morris Declaration, Ex. [E] (Trial Transcript) 43:2-14; 83:17-84:2; 191:23-193:21 (citing to testimony and tax returns that were admitted into evidence)).

found to have been a willful abuse by NexPoit/HCRE of the judicial process. Under Fifth Circuit precedent, it is appropriate for the court, in the use of its inherent power under Bankruptcy Code § 105(a), to order NexPoint/HCRE, as a compensatory sanction for its bad faith conduct and willful abuse of the judicial process, to reimburse Highland the full amount of fees and costs requested by Highland, which, in the aggregate, total $825,940.55. NexPoint/HCRE's objections to such amounts as excessive, unnecessary, unreasonable, or unrelated to NexPoint/HCRE's bad faith conduct, are overruled.

V. CONCLUSION AND ORDER

In summary, the court has determined that NexPoint/HCRE was given adequate notice and an opportunity to respond to the Sanctions Motion and that there is clear and convincing evidence that it filed and prosecuted its Proof of Claim, including its eleventh-hour attempt to withdraw its Proof of Claim, in bad faith and that it willfully abused the judicial process. Such conduct directly caused Highland to incur $825,940.55 in fees and expenses. In the exercise of its inherent power under Bankruptcy Code § 105(a), the court will grant Highland's Sanctions Motion and order NexPoint/HCRE to reimburse Highland for those fees and expenses as an appropriate sanction for NexPoint/HCRE's bad faith or willful abuse of the judicial process.

Accordingly, and based on the foregoing findings of fact and conclusions of law, including those findings and conclusions in this court's Proof of Claim Disallowance Order, which has been incorporated herein by reference,

IT IS ORDERED that the Sanctions Motion [Dkt. No. 3851] be, and hereby is **GRANTED**;

IT IS FURTHER ORDERED that, in order to compensate Highland for loss and expense resulting from NexPoint/HCRE's bad faith and willful abuse of the judicial process, in filing and prosecuting its Proof of Claim, NexPoint/HCRE is hereby directed to pay Highland the compensatory sum of **$825,940.55**.

###End of Memorandum Opinion and Order###

Appendix F —
Pertinent statutory and rule provisions

11 U.S.C. §105. Power of court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

* * *

Appendix F

Rule 3006. Withdrawing a Proof of Claim; Effect on a Plan

(a) NOTICE OF WITHDRAWAL; LIMITATIONS. A creditor may withdraw a proof of claim by filing a notice of withdrawal. But unless the court orders otherwise after notice and a hearing, a creditor may not withdraw a proof of claim if:

(1) an objection to it has been filed;

(2) a complaint has been filed against the creditor in an adversary proceeding; or

(3) the creditor has accepted or rejected the plan or has participated significantly in the case.

(b) NOTICE OF THE HEARING; ORDER PERMITTING WITHDRAWAL. Notice of the hearing must be served on:

- the trustee or debtor in possession; and
- any creditors' committee elected under § 705(a) or appointed under § 1102.

The court's order permitting a creditor to withdraw a proof of claim may contain any terms and conditions the court considers proper.

(c) EFFECT OF WITHDRAWING A PROOF OF CLAIM. Unless the court orders otherwise, an authorized withdrawal constitutes withdrawal of any related acceptance or rejection of a plan.