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Highland LP's bankruptcy could trigger power grab, as hunt for assets begins

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Creditors facing up to the bankruptcy protection filing of Highland Capital Management's limited partner subsidiary (HCMLP) are clamouring for the removal of James Dondero, the Texas-based asset management firm's co-founder and president.

"If necessary, I have organised a management team consisting of former Highland partners and employees to operate Highland on a post-emergence basis," said Patrick Daugherty, a former partner at Highland and HCMLP's second largest unsecured creditor. Daugherty is president and chief investment officer of Glacier Lake Capital Advisors. "I believe we can work collaboratively with existing creditors to accomplish a full recovery for all."

Daugherty's \$11.7 million litigation claim stems from his lawsuit against HCMLP, as well as other Highland subsidiaries. HCMLP's largest creditor is the Redeemer Committee of the Highland Crusader Fund, which won a \$189 million arbitration award earlier this year. The Redeemer Committee attempted to collect the award by pursuing a judgment in Delaware Chancery Court.

Hearings early last week for both cases in the Delaware Chancery Court triggered HCMLP's Wednesday morning bankruptcy protection filing. In the US, a bankruptcy proceeding occurs in a federal court, which supersedes and often stays state-level court actions.

Acis Capital Management, Highland's former CLO platform, called for Dondero's removal during HCMLP's hearing of first day motions on Friday, according to *Creditflux* sister publication, *Debtwire*.

"We will likely seek the appointment of a chapter 11 trustee," said Acis bankruptcy counsel Rakhee Patel of Winstead PC during the hearing. "This will not come as a surprise to Mr Dondero or the debtors counsel."

In response, HCMLP expressed confidence in its restructuring strategy.

"We believe the concerns and allegations expressed by certain creditors at the first-day hearing are without merit," said a company spokesperson in a written statement to *Creditflux*. "HCMLP's goal is to conduct this reorganisation in an orderly manner that creates value for all constituents, and we trust the court to direct the process toward that outcome. With all initial debtor motions approved, we are glad to see this process moving forward in the most efficient manner possible. Our investment platform has continued to operate without disruption, and the initial approvals extend that same stability to HCMLP's business activities."

HCMLP is the only investment advisor on the Highland Capital Management platform seeking bankruptcy protection. It filed for bankruptcy because it does not have enough assets to pay for the litigation and arbitration awards against it,

according to a Highland press release.

This creates a situation wherein the bankruptcy could affect non-debtor subsidiaries. To enhance HCMLP's liquidity, HCMLP might sell non-debtor subsidiary assets and distribute the proceeds, according to the first-day declaration from HCMLP chief financial officer Frank Waterhouse.

"I imagine the assets of the estate are the LP interests in various Highland managed funds, as well as management contracts and sub advisory contracts," said Daugherty. "I would expect that the estate will look at every transfer or novation over the last 10 years to see if they were in the best interest of the estate and evaluate them for claw-back."

A hunt for assets and a change in leadership at HCMLP foreshadow a potentially lengthy, litigious restructuring. On one hand, the debtor believes it lacks the assets to pay creditors in full. Yet at the same time, it must convince creditors to have confidence in Dondero to generate the returns necessary to satisfy creditors.

"One of the cardinal rules of bankruptcy is you don't want to dissipate your assets by litigating all over the place," said a source close to the situation. "You get a centralised forum in the bankruptcy court. The idea would be, there has been a variable strategy here, they've made some money. It will depend on whether the fund has confidence."

The Redeemer Committee declined to comment on HCMLP's leadership. But it is confident that it will recover the full amount of its claim through the bankruptcy process, said a spokesperson for the committee in a written statement.

In 2016, the Redeemer Committee "initiated legal proceedings to make the Crusader investors whole for damages caused by Highland's willful misconduct in the course of its management of the liquidation of the Crusader Funds," according to Redeemer Committee's written statement.

HCMLP generated \$50 million in revenue in 2018, primarily from fees for its management and advisory services regarding about \$2.5 billion in assets under management, according to court documents.

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