UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

REDEEMER COMMITTEE OF HIGHLAND CREDIT STRATEGIES FUNDS,

Petitioner,

-v-

HIGHLAND CAPITAL MANAGEMENT, L.P.,

Respondent.

16 Civ. 2668

MEMORANDUM ORDER

JED S. RAKOFF, U.S.D.J.

On April 6, 2016, a three-member arbitration panel rendered an award ordering Highland Capital Management, L.P. ("Highland") to distribute approximately $31 million to investors represented by the Redeemer Committee of Highland Credit Strategies Funds ("the Committee"). See Declaration of Stuart Sarnoff, Esq. Exhibit B, Dkt. 22 ("Final Award") at ¶ 156A. On April 11, 2016, the Committee filed a petition to confirm the arbitration award. See Petition to Confirm Arbitration Award, Dkt. 10.

On May 4, 2016, Highland filed a motion opposing the Committee's petition to confirm and seeking vacatur of the award. The motion was briefed by both sides. See Memorandum in Opposition to Motion to Confirm and in Support of Motion to Vacate Arbitration Award ("Highland Opp. Mem."), Dkt. 2; Reply Memorandum of Law in Support of the Redeemer Committee's Petition to Confirm Arbitration Award and in Opposition to

Highland's Motion to Vacate Arbitration Award ("Committee Reply Mem."), Dkt. 30; Highland Reply Memorandum of Law in Opposition to Motion to Confirm and in Support of Motion to Vacate Arbitration Award ("Highland Reply Mem."), Dkt. 39. The Court heard oral argument on June 7, 2016, and thereafter received supplemental briefings from the parties on the cross-motions to confirm and vacate the award. See Supplemental Memorandum of Law in Support of the Redeemer Committee's Petition to Confirm Arbitration Award and in Opposition to Highland's Motion to Vacate Arbitration Award ("Committee Suppl. Mem."), Dkt. 41; Highland's Response to the Redeemer Committee's Supplemental Memorandum in Support of Motion to Confirm and in Opposition to Motion to Vacate Arbitration Award ("Highland Suppl. Mem."), Dkt. 42. Having fully considered the parties' submissions and arguments, the Court hereby grants the Committee's petition to confirm the award and denies Highland's motion to vacate.

By way of background, respondent Highland Capital Management manages the Highland Credit Strategies Master Fund, L.P. (the "Fund"). On October 15, 2008, Highland contacted investors in the Fund, announcing Highland's intent to liquidate and redeem all interests. In April 2011, Highland came to an agreement with the Fund's investors on a method for liquidating the Fund's assets and distributing the proceeds, which was

memorialized in a "Joint Plan of Distribution of Credit Strategies Funds" (the "Joint Plan"). Highland Opp. Mem. at 4; Final Award at ¶¶ 8-9.

The Joint Plan provided for the formation of a "Redeemer Committee" (i.e., the Committee bringing the instant motion to vacate) to represent investors' interests in the Fund. See Final Award at Art. 2. After several years of increasingly contentious negotiations over the liquidation of the Fund's assets, the Committee, on June 25, 2014, invoked the Joint Plan's arbitration clause, which provided for private dispute resolution administered by the American Arbitration Association ("AAA").

In the proceedings before the arbitration panel, the Committee alleged that Highland had breached its common law and contractual duties by, among other things, secretly marketing and selling at too low a price the Fund's stake in Cornerstone, a health care company wholly owned by Highland. See id. at ¶¶ 23-27. On April 6, 2016, after eight days of hearings, the arbitration panel rendered its Final Award. With regard to the Cornerstone allegations, the panel found that Highland had breached its obligations under the Joint Plan and engaged in "willful misconduct." Id. at ¶ 82. The Final Award ordered Highland to distribute the $24 million that the Fund received

from the sale of Cornerstone, as well as $7,050,000 in damages, the latter figure reflecting the difference between the sum that the Fund received from the sale of Cornerstone and the sum that the panel found the Fund would likely have received absent Highland's misconduct. Id. at ¶ 156A. The arbitrators also ordered Highland to pay five percent interest on the sum of the $24,000,000 and $7,050,000, beginning from the date of the Cornerstone sale in September 2013. Finally, the panel ordered Highland to reimburse the Fund for any money it withdrew from the Fund in order to contest the arbitration. Id. at ¶ 156C.

The Federal Arbitration Act ("FAA"), 9 U.S.C. § 10, provides that "at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected . . . ." Here, as its initial challenge to confirmation, Highland contends that the panel was never authorized to decide disputes between Highland and the Committee because the Committee was not properly constituted. The Joint Plan defines the Redeemer Committee as follows: "A five-person committee composed of representatives of four Consenting Prior Redeemers . . . and a representative of one Consenting Compulsory Redeemer . . . which will represent all Consenting

Redeemers with respect to those matters specified in Article 2 hereof." Highland argues that, contrary to these requirements, the Committee contained three members rather than five, one of its three members was not a valid representative, and no member of the committee represented a Consenting Compulsory Redeemer. See Highland Opp. Mem. at 13-16, citing Joint Plan at Art. 1.

This challenge also raises the question of who is to determine whether the Committee was properly constituted — the Court or the arbitration panel? This kind of question is generally referred to as a dispute about "arbitrability." Although that term is not without ambiguity, it has become so embedded in the case law that the Court will use it here to refer to the initial dispute over who gets to decide if the Committee was properly constituted.

"The question whether the parties have submitted a particular dispute to arbitration . . . is an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise." Schneider v. Kingdom of Thailand, 688 F.3d 68, 71 (2d Cir. 2012) (internal quotation marks omitted). However, the presumption in favor of judicial resolution of disputes about arbitrability may be overcome by "clea[r] and unmistakabl[e] evidence" that the parties intended for the issue in question to be addressed by the arbitrator in the first

instance. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995) (internal citations and quotation marks omitted).

In the instant case, the Joint Plan's arbitration clause provides, in relevant part: "Any dispute related to or arising out of this Plan, which is not covered by or cannot be resolved through mediation referenced in Sections 2.04 or 5.05 above, shall be subject to and decided by arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules." Joint Plan at § 8.04. Rule 7(a) of the AAA Commercial Arbitration Rules, in turn, specifies that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim." (emphasis added). However, this AAA exception to the general presumption that questions of arbitrability are for courts to decide has itself at least one exception. See Highland Suppl. Mem. at 2-3. Specifically, as the Second Circuit found in NASDAQ OMX Grp., Inc. v. UBS Sec., LLC, 770 F.3d 1010, 1031 (2d Cir. 2014), if the assignment of decision-making authority to the arbitrator is subject to a "qualifying provision that at least arguably covers the present dispute," then decisions over arbitrability remain

with a court.

Highland contends that the clause in Section 8.04 of the Joint Plan providing for mediation — i.e., the clause stating "which is not covered by or cannot be resolved through mediation referenced in Sections 2.04 or 5.05 above" — is just such a "qualifying provision." Therefore, Highland concludes, the parties did not "clearly and unmistakably" authorize the arbitrators to determine arbitrability. Highland Opp. Mem. at 12-13; Highland Suppl. Mem. at 2-3. However, unlike the general exclusions from arbitration that were at issue in NASDAQ and in the other two cases on which Highland principally relies, namely, Katz v. Feinberg, 290 F.3d 95 (2d Cir. 2002), and Virk v. Maple-Gate Anesthesiologists, P.C., 80 F. Supp. 3d 469 (W.D.N.Y. 2015), the mediation provision here does not exclude any claims from arbitration.[1] Instead, the mediation clause in the Joint Plan allows all claims to ultimately proceed to arbitration.

Specifically, section 8.04 of the Joint Plan states, in relevant part, that "[a]ny dispute . . . which is not covered by

[1] For example, the arbitration clause at issue in NASDAQ stated: "Except as may be provided in the NASDAQ OMX Requirements, all claims, disputes, controversies and other matters in question between the Parties to this Agreement . . . shall be settled by final and binding arbitration." 770 F.3d at 1031. There, unlike here, the arbitration clause excluded a specific set of claims from arbitration — namely, anything provided for in the NASDAQ OMX Requirements. The mediation clause in the Joint Plan makes no such exclusion.

or cannot be resolved through mediation referenced in Section 2.04 or 5.05 above, shall be subject to and decided by arbitration . . . ." Section 5.05 is not at issue in these proceedings, since it addresses potential disputes between a "Contribution Committee" and Highland over distributions to a trust account. Joint Plan at Art. 1; § 5.05. Section 2.04, the other provision cited in the mediation clause of the Joint Plan, provides that "[i]n the event of a dispute between the Redeemer Committee and the Investment Manager, the General Partner or the Board relating to the matters in the preceding section, the applicable parties' representatives shall confer in good faith in an attempt to resolve the issue within 48 hours of a request by either side. If they cannot reach a resolution through such good-faith effort, either side may engage Layn Phillips at the expense of the Fund or, if he is unavailable, another mutually agreeable third party to mediate the dispute."

In other words, Highland and the Committee "may," but are not required to, "mediate the dispute." The mediation clause therefore does not exclude any claims from arbitration, as did the clauses found to be qualifying provisions in NASDAQ, 770 F.3d at 1031; Katz, 290 F.3d at 97; and Virk, 80 F. Supp. 3d at 475.

Highland counters that the mediation clause is not

permissive, but is instead a "condition precedent" for arbitration. Highland Suppl. Mem. at 1. In Highland's view, the "may" in the mediation clause gives either party the right to unilaterally engage a mediator, and thereby compel the other party to undertake mediation prior to arbitrating their disputes. Id. at 1-2. Yet even if the mediation clause is a condition precedent, as Highland claims, the arbitrator is still empowered to decide any disputes arising out of the Joint Plan, provided that mediation does not resolve them.

Consequently, the Court finds that the Joint Plan "clearly and unmistakably" committed questions of arbitrability, including the issue of whether the Committee was properly constituted, to the arbitration panel.[2] That panel, in turn, did address the issue, and determined that the Redeemer Committee was properly constituted and was entitled to assert claims against Highland in the arbitration.

The Court will enforce the panel's decision so long as the arbitrators' decision has a "barely colorable" justification. See Landy Michaels Realty Corp. v. Local 32B-32J, Serv. Employees Int'l Union, AFL-CIO, 954 F.2d 794, 797 (2d Cir.

[2] It should be noted, moreover, that if the Court were called upon to decide if the Committee was duly constituted, the Court would hold that it was, for the reasons set forth below.

1992). Here, the justification is ample.

As noted, the Joint Plan defines the "Redeemer Committee" as a "five-person committee composed of representatives of four Consenting Prior Redeemers . . . and a representative of one Consenting Compulsory Redeemer . . . which will represent all Consenting Redeemers with respect to those matters specified in Article 2 hereof." Joint Plan at Art. 1. In practice, however, the Committee with which Highland negotiated included only three individuals: Ruth Eliel, Stuart Robinson, and Brant Behr. In challenging the Committee's bona fides, Highland first argued that the Joint Plan plainly called for a committee of five individuals, and so the three-member body party was not the Redeemer Committee empowered by the Joint Plan to raise claims in arbitration. Highland Opp. Mem. at 1.

The arbitration panel rejected this claim primarily on the basis of waiver, because of the longstanding interaction between Highland and the Committee. Whatever the Committee's deficiencies, the panel noted, these "[have] been ignored for the past three years. Indeed . . . Highland only objected when the Committee instituted the instant arbitration." Interim Award at 5. For example, despite Highland's belated argument that a three-member Committee did not constitute a quorum, the minutes of several meetings between the parties indicate that Highland

consistently affirmed the adequacy of the Committee. See, e.g., Ex. J-44 ("We only have 3 [Committee Members] . . . We have a quorum.")

The finding of waiver therefore provides at least a "barely colorable" justification for the panel's conclusion that the Committee was properly constituted even if it consisted of only three members. See Interim Award at 5. Indeed, if the issue of waiver were a matter for the Court to decide on the merits, it would reach the same conclusion as the arbitration panel.

Highland further claimed, however, that even if, as a general matter, the Committee could be validly constituted with three members, testimony during the arbitration indicated that Brant Behr was never a legitimate member of the Committee. Highland Opp. Mem. at 6-9. In particular, the testimony indicated that Behr, an employee of Concord Management, served on the Committee as an agent for two investors in the Fund (Bradfield and Netherfield), and neither Concord nor Behr held any stake in the Fund. See 492:18-493:15(Ex. A-18); 1695:8-15; 1702:19-21(Ex. A-18). Following this testimony, Highland renewed its claim before the arbitration panel that the Committee was improperly constituted, alleging that the Committee in fact had two rather than the mandatory five, or at least three, members. See Highland Opp. Mem. at 15-16. Highland now argues that the

arbitrators' rejection of this claim justifies vacatur.

The arbitration panel rejected Highland's contention on the basis, inter alia, that the Joint Plan permits investors to appoint "representatives" for membership of the Committee. Joint Plan at Art. 1. The panel found that while in testimony Concord was described as an "advisor," Behr, as a Concord employee acting on behalf of investors in the Fund, satisfied the Plan's "representative" requirement. Final Award at ¶ 39. The panel's decision also relied on an affidavit from Gotcha Djabidze, a director of one of the investors for whom Behr acted as an agent. The affidavit confirmed that Behr was "at all times authorized to represent" investor Bradfield[3] as a member of the Redeemer Committee. Ex. A-7.[4]

The Court finds these justifications at least "barely colorable." Gottdiener, 462 F.3d at 110. Indeed, once again, if the Court had the matter before it on the merits, it would reach

[3] Investor Netherfield was consolidated into Bradfield prior to the arbitration proceedings. Ex. A-4.

[4] Highland argues that the affidavit should not have been considered by the panel because it lacked an oath or other statement that it was made under penalty of perjury. Highland Opp. Mem. at 8-9. The panel had ample discretion to ignore this supposed defect. Indeed, under AAA rules, it was free to consider even rank hearsay. See LJL 33rd St. Associates, LLC v. Pitcairn Properties Inc., 725 F.3d 184, 194 (2d Cir. 2013); see also AAA Rule 34(a): "The parties may offer such evidence as is relevant and material to the dispute . . . . Conformity to legal rules of evidence shall not be necessary."

the same conclusion as the panel. Consequently, the Court upholds the panel's decision that Behr was a valid member of the Committee, and that the Committee had the authority to arbitrate disputes with Highland.

Highland also challenges the award on the basis of alleged panel misconduct. See FAA §10(a)(3). Specifically, Highland objects to the panel's refusal to entertain further testimony regarding Behr, Concord, and the investors they represented. This testimony, Highland claims, was essential to Highland's ability to challenge whether the Committee was properly constituted, and so the panel's refusal to hear such testimony deprived Highland of a "fundamentally fair arbitration." Highland Opp. Mem. at 19-20. This in turn means, according to Highland, that the arbitrators "were guilty of misconduct . . . in refusing to hear evidence pertinent and material to the controversy." 9 U.S.C. §10(a)(3).

As a general matter, however, "[i]t is well settled that procedural questions that arise during arbitration, such as which witnesses to hear and which evidence to receive or exclude, are left to the sound discretion of the arbitrator and should not be second-guessed by the courts." Nat'l Football League Mgmt. Council v. Nat'l Football League Players Ass'n, 2016 WL 1619883, at *14 (2d Cir. Apr. 25, 2016). Here, the panel

had already addressed Highland's two prior challenges to the Committee's composition, and after Behr's testimony, the panel permitted Highland to re-call Heath Kihn, another Concord employee, to examine him concerning Concord's status on the Committee. See 1694:23-1694:25 (Ex. A-4). Highland's demand for more, was, moreover, prejudicially tardy. It appears that Highland had received notice regarding Concord's status as an agent for the two Fund investors as early as March 2006, see Ex. C-414 at 1, and once more during the formation of the Committee in 2011. See Ex. R-808. Against this background, the panel's decision to exclude further belated testimony was well within its discretion.

Highland further challenges the arbitrators' order requiring Highland to pay five percent interest on the $24 million that Highland received from the sale of Cornerstone. Highland contends that because neither party requested precisely this relief, the arbitrators exceeded their authority in awarding it, and the Court should therefore vacate the award under Section 10(a)(4) of the FAA. Highland Opp. Mem. at 23. Highland, however, elides the distinction between issues and remedies. The question is not "whether a potential remedy was presented to the arbitrators," but "whether an issue was presented to the arbitrators." Harper Ins. Ltd. v. Century

Indem. Co., 819 F. Supp. 2d 270, 277 (S.D.N.Y. 2011). While the Committee did not specifically request interest on the $24,000,000, the Committee did request damages relating to the sale of Cornerstone. Committee Reply Mem. at 22. The relevant issue was therefore presented to the arbitrators.

Furthermore, AAA Rule 47(a) states that "[t]he arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties." The sale of the Fund's stake in Cornerstone was clearly "within the scope of the agreement of the parties." Incorporating the sale of that stake into an interest calculation thus fell within the arbitrators' discretion to devise what it deemed a "just and equitable" award. The Court therefore finds no grounds for vacatur under 9 U.S.C. 10(a)(4), and it upholds the arbitrator's decision to award five percent interest on the $24 million figure.

Along with confirmation of the Final Award, the Committee seeks an order requiring Highland to reimburse the Fund for any money it withdrew to challenge these confirmation proceedings. See Committee Reply Mem. at 23. Though 28 U.S.C. § 1927 authorizes a court to award "costs, expenses, and attorneys' fees" against a party who "multiplies the proceedings in any case unreasonably and vexatiously," an award "under § 1927 is

proper only when there is a finding of conduct constituting or akin to bad faith." Zurich Am. Ins. Co. v. Team Tankers A.S., 811 F.3d 584, 591 (2d Cir. 2016) (internal quotation marks omitted). The Court finds no such conduct on Highland's part in the instant proceedings. Though the Court rejects Highland's challenges, they were at least colorable. The Court thus declines to order Highland to reimburse the Fund for expenses incurred in connection with these proceedings.

For the foregoing reasons, the Court hereby grants the Committee's motion to confirm the arbitration award and denies Highland's motion to vacate the award. The Clerk of the Court is ordered to enter judgment and to close docket entry 32.

SO ORDERED.

Dated: New York, NY
July 12, 2016

JED S. RAKOFF, U.S.D.J.