

CAUSE NO. DC-12-00891-C

HIGHLAND CDO OPPORTUNITY	§	IN THE DISTRICT COURT OF
MASTER FUND L.P.,	§	
HFP CDO CONSTRUCTION CORP., and	§	
HIGHLAND FINANCIAL PARTNERS,	§	
L.P.,	§	
	§	
Plaintiffs,	§	
	§	
v.	§	DALLAS COUNTY, TEXAS
	§	
ORRICK, HERRINGTON & SUTCLIFFE	§	
LLP and ORRICK, HERRINGTON &	§	
SUTCLIFFE (EUROPE) LLP,	§	
	§	
Defendants.	§	<u>68TH</u> JUDICIAL DISTRICT

PLAINTIFFS' ORIGINAL PETITION

TO THE HONORABLE JUDGE OF SAID COURT:

Plaintiffs Highland CDO Opportunity Master Fund, L.P. (the "CDO Fund"), HFP CDO Construction Corp. ("HCC"), and Highland Financial Partners, L.P. ("Highland Financial") (collectively, "Plaintiffs" or "Highland") hereby file this original petition (the "Petition") seeking damages arising from the legal malpractice of Defendants Orrick, Herrington & Sutcliffe LLP and Orrick, Herrington & Sutcliffe (Europe) LLP (collectively, "Defendants" or "Orrick").

I. SUMMARY OF THIS ACTION

1. This case arises from Orrick's negligence in connection with a proposed multimillion-dollar collateralized debt obligation ("CDO") transaction between Highland as borrower and Royal Bank of Scotland plc ("RBS") as lender. During 2007 and 2008, Highland hired Orrick to review two amendments (collectively, the "Amendments") that were supposed to extend the deadline to close the CDO transaction. Orrick knew that Highland paid RBS more than \$65 million for the purported extensions but committed a critical error when it failed to

advise Highland that the Amendments did not remove a provision in the original agreements that permitted RBS to terminate the CDO transaction at will. As a result, Highland paid RBS tens of millions of dollars for meaningless extensions.

2. RBS capitalized on Orrick's negligence and prematurely terminated the transaction in October 2008 to take advantage of certain changes to the international accounting standards. Specifically, the new accounting standard enabled RBS to report a \$30 million windfall "profit" when it foreclosed on the underlying assets in November 2008 (at the height of the financial meltdown). As a result of Orrick's failure to close the loophole in the Amendments that permitted RBS to terminate the transaction at will, Highland lost the \$65 million that it paid to RBS and is now faced with an approximately \$30 million alleged deficiency.

3. Orrick touted itself as a "leading law firm" in structured finance with substantial experience advising clients on CDO transactions both in the United States and Europe. Orrick served as Highland's counsel in all of its CDO transactions until the failed RBS deal. Over the span of more than a decade, Orrick represented Highland in more than 20 similar CDO transactions. As Highland's longtime and exclusive counsel on these matters, Orrick was intimately familiar with the standard deal structure and provisions — in fact, Orrick had drafted, reviewed, and revised tens of these agreements for Highland (including extensions) by the time of the Amendments.

4. When Highland retained Orrick to review the Amendments, it was well understood that Highland paid more than \$65 million in exchange for an extension of the transaction that would allow the parties sufficient time to close the deal. Yet, despite Highland's express directives, Orrick's extensive experience with Highland, and Orrick's industry-leading knowledge of these transactions, Orrick negligently failed to advise Highland that the

Amendments permitted RBS to *unilaterally* terminate the deal *at any time* — directly contrary to Highland’s intended objective.

5. Had Orrick acted as reasonably prudent counsel and properly advised Highland that the Amendments permitted RBS to terminate the transaction at any time, Highland would not have entered into the Amendments or paid the accompanying \$65 million in consideration. Moreover, absent the Amendments, the CDO collateral would have been liquidated at a much earlier point in time and reduced any deficiency owed by Highland. Accordingly, as a direct and proximate result of Orrick’s negligence, Highland has suffered and now seeks to recover damages of approximately \$95 million.

II. DISCOVERY CONTROL PLAN

6. In accordance with Rule 190 of the Texas Rules of Civil Procedure, Plaintiffs intend to conduct discovery under a Level 2 Discovery Control Plan.

III. PARTIES

7. Plaintiff CDO Fund is a Bermuda limited partnership with its principal office at 13455 Noel Road, Suite 800, Dallas, TX 75240.

8. Plaintiff HCC is a Cayman company with its principal office at 13455 Noel Road, Suite 800, Dallas, TX 75240.

9. Plaintiff Highland Financial is a Delaware limited partnership with its principal office at 13455 Noel Road, Suite 800, Dallas, TX 75240. Highland Financial has partners who reside in and are citizens of, among other states, Texas, California, and New York.

10. Defendant Orrick, Herrington & Sutcliffe LLP is a California limited liability partnership with offices at 777 South Figueroa Street, Suite 3200, Los Angeles, CA 90017-5855.

Defendant Orrick, Herrington & Sutcliffe LLP has partners who reside in and are citizens of, among other states, California and New York.

11. Defendant Orrick, Herrington & Sutcliffe (Europe) LLP is a limited liability partnership registered in England and Wales with offices at 107 Cheapside, London EC2V 6DN, United Kingdom.

IV. JURISDICTION AND VENUE

12. Venue is proper in Dallas County, Texas, pursuant to Section 15.002(a)(1) of the Texas Civil Practice and Remedies Code. A substantial part of the events and omissions giving rise to this claim, in whole or in part, occurred in Dallas County. Plaintiffs are managed, through various general partnerships and entities, by Highland Capital Management, L.P. (“HCM”), a SEC-registered investment advisor based in Dallas, Texas.

13. Orrick is subject to specific and general jurisdiction in Texas. HCM engaged Orrick to provide legal representation to Plaintiffs in connection with the proposed CDO transaction with RBS, and Orrick rendered and directed professional services and attorney-client communications to HCM in Dallas on this matter. All invoices for Orrick’s work on the proposed CDO transaction with RBS — including work performed by Orrick’s attorneys in England — were sent to HCM in Dallas, Texas. Orrick also directed promotional and marketing materials to HCM employees in Texas in which Orrick touted its expertise in CDO transactions. In addition, Orrick, Herrington & Sutcliffe LLP represents clients in various Texas proceedings and has several attorneys who are admitted to practice in Texas state and federal courts.

14. Plaintiffs seek damages in excess of the minimum jurisdictional limits of this Court.

V. STATEMENT OF FACTS

A. ORRICK'S REPRESENTATION OF HIGHLAND

15. Orrick and HCM had an extensive and longstanding relationship. In 1993, Orrick executed an engagement letter to provide transactional legal services to HCM and its affiliated funds (collectively, the "HCM Companies"). From that point forward, Orrick exclusively represented the HCM Companies in every one of its CDO transactions. In fact, Orrick served as counsel to the HCM Companies in 25 such transactions in the United States and 4 others in Europe from approximately 1996 to 2008.

16. The deal structure was similar among the various CDO transactions. Specifically, the HCM Companies (usually through a special purpose vehicle) would borrow funds from a large investment bank (such as RBS, UBS, or Citigroup) to acquire loan and other debt assets that would serve as collateral for the issuance of securities. In each instance, the HCM Companies retained Orrick to provide legal advice in connection with the documentation of the CDO transactions, which entailed reviewing and revising the relevant transaction agreements. The HCM Companies specifically hired Orrick because they needed sophisticated and internationally-renowned counsel who could competently represent the HCM Companies in what were cutting-edge and complex deals with the largest banks in the world.

17. Orrick's Los Angeles office handled all of the U.S.-based CDO transactions and coordinated with Orrick's London office on the European deals. Orrick's Martin Howard ("Howard") was the relationship partner responsible for the CDO transactions, including the one with RBS. Howard served in Orrick's Structured Finance Group and was intimately familiar with CDO transactions and the CDO market. Notably, Howard walked the HCM Companies

through their first CDO transaction in approximately 1996, which provided the pioneering blueprint for every subsequent deal.

18. Moreover, Orrick boasted its expertise in CDO transactions in various marketing materials and legal articles that they provided to the HCM Companies. For instance, in one such marketing brochure, Orrick stated:

Orrick is one of the world's leading law firms in the structured finance sector and has been an active adviser to participants in this market since its inception. We represent significant banking and financial institutions active in the financing, purchase and securitization of financial assets. Our lawyers advise many types of market participants, including issuers, underwriters, arrangers, collateral managers, originators, investors, liquidity providers, derivatives counterparties, lenders and conduits, in the United States and throughout Europe and Asia.

....

The CDO Group at Orrick regularly ranks as one of the most active legal advisers in collateralized debt obligations (CDOs), collateralized bond obligations (CBOs) and collateralized loan obligations (CLOs) in Europe and the U.S. We have extensive experience in a wide range of CDO structures including cash flow, market value, arbitrage, balance sheet and synthetic structures. We have advised major players in this market since its inception in the late 1980s and are a recognized leader, having closed many billions of dollars in transactions in the last few years alone. (Emphasis added.)

Orrick also periodically sent the HCM Companies updates on the CDO market, including articles on current legal and financial trends in the industry. In sum, Orrick (and particularly Howard) was very familiar with the CDO transactions, the CDO market, and the HCM Companies' corresponding business objectives and risks.

19. Despite its purported expertise as "one of the most active legal advisers" in CDOs, Orrick neglected to properly review the Amendments and therefore, failed to advise Highland about the loophole that permitted RBS to unilaterally terminate the transaction to Highland's substantial detriment, as explained below.

B. OVERVIEW OF THE PROPOSED CDO TRANSACTION WITH RBS

(1) The Relevant Transaction Documents

20. In 2006, HCM hired Orrick to represent Highland Capital Management Europe, Limited (“HCM Europe”), HCC, the CDO Fund, and Highland Financial in the CDO transaction with RBS. As it had done many times before, HCM asked Orrick to represent and advise Plaintiffs on the CDO transactional documents.

21. Orrick attorneys — in particular, Howard and London-based Karin Artmann (“Artmann”) — spent considerable time reviewing and revising these documents, most of which were originally drafted by RBS’s counsel in England, Ashurst LLP. As was typical in these deals, Orrick reviewed drafts and provided suggested revisions to HCM’s Philip Braner (“Braner”), who would then communicate and negotiate the points with RBS. After several rounds of changes, the parties executed the original deal documents between December 2006 and April 2007.

22. Specifically, on December 18, 2006, RBS and HCM Europe entered into a letter agreement (the “Mandate Letter”) that set forth the overarching framework for the transaction. Pursuant to the Mandate Letter, HCM Europe engaged RBS as a sponsor and financial arranger for a proposed CDO “transaction with an anticipated aggregate issuance size of approximately €500 million [\$653 million] in securities.” Orrick drafted the Mandate Letter and provided legal counsel to HCM Europe throughout its negotiations with RBS on the anticipated deal structure. Orrick then reviewed and revised all of the transaction documents (including the later Amendments), which were drafted by RBS’s counsel in England.

23. As a general matter, pursuant to the transaction documents, RBS agreed to extend financing to a special purpose vehicle (the “Issuer”) to purchase an investment portfolio

primarily comprised of European senior secured loans (collectively, the “Loans”) that would serve as collateral for the transaction. The parties agreed that the Issuer would acquire a significant portion of Loans prior to the issuance of securities through a warehouse facility (the “Warehouse”). The Issuer would then repay RBS when the transaction closed and securities were issued to entities affiliated with HCC and the CDO Fund, as well as to third-party investors. HCC and the CDO Fund agreed to guarantee the Issuer’s debt to RBS such that they would be liable for a deficiency if RBS was not fully repaid.

24. This original deal structure was essentially set forth in two April 5, 2007 agreements: (1) a Variable Funding Note Purchase Agreement (the “Funding Agreement”) executed by RBS and the Issuer; and (2) an Interim Servicing Deed (the “ISD”) executed by RBS, the Issuer, HCM Europe, HCC, and the CDO Fund. Pursuant to the Funding Agreement, RBS agreed to make available to the Issuer a facility of up to \$537 million (€400 million) for the acquisition of Loans during the Warehouse period (the “Warehouse Period”), which initially expired on September 30, 2007. As set forth in the ISD, the Issuer appointed HCM Europe as the “Interim Servicer” to act on the Issuer’s behalf in selecting and servicing Loans acquired before the anticipated issuance of securities closed.

25. Subsequent to the execution of the original deal documents, the parties entered into two Amendments on October 31, 2007 (the “October 2007 Amendment”) and April 1, 2008 (the “April 2008 Amendment”), respectively, as well as a First Loss Deposit Facility Deed (the “First Loss Deed”) in October 2007. As explained further below, under both Amendments, HCC and the CDO agreed to pay RBS millions of dollars for purported extensions of the transaction. And pursuant to the First Loss Deed, Highland Financial agreed to guarantee HCC’s obligations to RBS.

(2) **Provisions Concerning Termination of the Transaction**

26. As Highland's transactional counsel on the deal, Orrick knew that the ISD provided that the transaction would terminate in certain circumstances, which were set out under the definition of "Termination Date" in the ISD. The transaction would automatically terminate at closing (*i.e.*, issuance of the securities) or the expiration of the Warehouse Period, but the parties could also terminate the transaction *before* closing or expiration of the Warehouse Period upon the occurrence of specified events of default (collectively, the "Events of Default").

27. For instance, one of the Events of Defaults provided RBS with the right to terminate the transaction if the market value of the Loans, which were marked to market ("MTM"), declined by more than 2% during the Warehouse Period (the "MTM Trigger"). As explained further below, as part of the amendment process whereby Highland agreed to pay RBS tens of millions of dollars for purported extensions, Highland negotiated with RBS to first amend (in October 2007) and then ultimately remove (in April 2008) the MTM Trigger as an Event of Default. Orrick knew that Highland could not achieve a meaningful extension of the transaction without removing the MTM Trigger as an Event of Default because there was a substantial likelihood that the MTM Trigger would be invoked prior to January 31, 2009, the end of the Warehouse Period under the April 2008 Amendment.

28. The ISD also provided that RBS or the Interim Servicer could terminate the transaction by terminating the Mandate Letter, which, in turn, stated that "either party hereto may terminate [RBS]'s engagement hereunder *at any time* upon written notice to the other party (emphasis added)." Having reviewed and negotiated the original deal documents, Orrick knew that the ISD contained this "backdoor" means for terminating the entire transaction (the "Backdoor Termination Provision").

29. Importantly, as stated above, the ISD provided that if the transaction was terminated before closing, RBS had the right to direct the Issuer to sell the Loans in the Warehouse and then seek any resulting deficiency from HCC and the CDO Fund. Thus, HCC and the CDO Fund were liable to RBS if a sale of the Loans was insufficient to repay RBS's loan to the Issuer under the Funding Agreement.

30. Accordingly, Orrick knew that Highland's principal risk in the transaction was RBS's ability to seek a deficiency from HCC and the CDO Fund in the event of early termination. Given its knowledge of the CDO market and the deal terms that it helped to draft and negotiate, along with its discussions with Highland regarding the Amendments, Orrick also understood that Highland's risk increased when the value of the Loan Portfolio began to decline in the second half of 2007. Yet, as explained below, Orrick failed to advise Highland that the supposed extensions under the Amendments were meaningless because RBS retained the right to terminate the transaction *at any time* under the Backdoor Termination Provision and then sue Highland for any resulting deficiency.

C. ORRICK NEGLIGENTLY FAILS TO ADVISE HIGHLAND THAT RBS COULD UNILATERALLY TERMINATE THE TRANSACTION AT ANY TIME

31. Highland and RBS were unable to complete the CDO transaction within the original Warehouse Period due, in part, to the deteriorating CDO market. As a result, the parties entered into negotiations to purportedly extend the transaction and ultimately agreed to two separate Amendments to document these extensions, in October 2007 and April 2008, respectively.

32. With both Amendments, RBS demanded that Highland pay substantial cash sums to extend the transaction. Although extensions were relatively commonplace, it was *highly unusual* for Highland to agree to post any cash collateral (much less tens of millions of dollars)

for any such extension. Highland entered into the Amendments and paid these large amounts because it believed that RBS could only terminate the deal prior to the end of the Warehouse Period in the event that Highland defaulted under the terms of the ISD or Funding Agreement by, for instance, failing to perform one of its material obligations under the Mandate Letter. In fact, as stated above, Orrick knew that as part of Highland's agreement to pay RBS for the extensions, Highland negotiated with RBS to amend and ultimately remove the MTM Trigger from the agreements because it was the only Event of Default that was likely to occur and not within Highland's control.

33. At bottom, Orrick understood that Highland's primary objective in entering into the Amendments was to secure an extension that would allow sufficient time for the parties to close the transaction or reach another business resolution. Orrick knew that Highland only agreed to pay RBS in order to obtain a concrete extension of the deal and would not have done so if it knew that RBS could terminate the transaction at will. Notwithstanding this straightforward task, Orrick never advised Highland that RBS could cancel the transaction at any time under the Backdoor Termination Provision and that Highland was paying RBS tens of millions of dollars in exchange for a futile extension.

(1) **The October 2007 Amendment Deed**

34. In approximately August 2007, Highland and RBS entered into discussions to extend the transaction. In exchange for this purported extension, RBS required Highland — specifically, HCC and the CDO Fund — to pay \$10.8 million (€7.5 million), and additionally demanded that Highland Financial guarantee the payment obligations of HCC. Highland agreed to pay this hefty sum because it knew it was seeking to obtain a non-standard extension, *i.e.*, one

that would not allow the lender to terminate the transaction at will. To codify this agreement, Highland and RBS entered into the October 2007 Amendment and First Loss Deed.

35. The October 2007 Amendment and First Loss Deed, both initially drafted by RBS's counsel, were relatively short and uncomplicated agreements — each only several pages in length and containing only a few changes to the original documents. As was routine, Braner contacted Orrick to review the documents and advise Highland. In particular, Braner told Orrick attorneys Howard and Artmann that Highland had agreed to pay \$10.8 million to RBS in order to secure more time to complete the CDO transaction.

36. Based on its discussion with Braner and its prior representation of Highland in numerous similar CDO transactions, Orrick knew that Highland would not have agreed to post \$10.8 million in collateral to secure an extension if RBS could terminate the deal at any time. Nevertheless, when Orrick reviewed the October 2007 Amendment and First Loss Deed, it failed to advise Highland that RBS's counsel had not removed the Backdoor Termination Provision, which was contained in the same paragraph as the other termination clauses that were being amended. As described below, this would prove to be a critical and costly error.

(2) The April 2008 Amendment Deed

37. In the months following the October 2007 Amendment, the market value of the Loans continued to decline. When the CDO transaction failed to close by February 2008, Highland and RBS entered into further discussions to purportedly extend the transaction and ultimately agreed to the April 2008 Amendment. Once again, in exchange for the extension, RBS demanded that Highland pay significant cash sums.

38. As set forth in the April 2008 Amendment, Highland agreed that HCC and the CDO Fund would provide RBS with an additional \$54 million (€35 million), in tranches, to

extend the transaction to January 31, 2009. Specifically, HCC and the CDO Fund agreed to pay RBS in five equal installments on February 29, March 31, April 30, May 30, and June 30, 2008. Except for the February 2008 payment, which Highland made prior to the April 2008 Amendment, each payment purportedly served to extend the transaction by a month, and the parties agreed that the transaction would terminate at the end of each month if HCC and the CDO Fund failed to make a payment.¹ If Highland made all of the payments, the transaction supposedly was extended to January 31, 2009.

39. As before, Braner contacted Orrick to advise Highland on the April 2008 Amendment. From late February to end of April 2008, Orrick was involved in the negotiation and amendment process. As with the prior amendment, Orrick understood that the April 2008 Amendment was not a typical extension agreement. Orrick knew that Highland only agreed to post cash collateral in order to obtain more time to complete the CDO transaction or reach another business agreement with RBS. Likewise, Orrick knew that Highland specifically was negotiating an extension of the transaction whereby RBS could not unilaterally terminate at any time, which was supposed to be codified in the April 2008 Amendment.

40. Specifically, Orrick understood that Highland's objective was to secure an extension that was subject to early termination only upon the occurrence of extraordinary and unlikely Events of Default. In fact, by the time of the April 2008 Amendment, Highland was sufficiently concerned about the value of the Loans that it negotiated to remove RBS's ability to declare a default based on the MTM Trigger. The ISD, as amended by the October 2007 Amendment, provided that an Event of Default occurred if the market value of the Loans

¹HCC and the CDO Fund timely paid the March 31, April 30, and May 30, 2008 installments. In late June 2008, Highland notified RBS that HCC and the CDO Fund needed an additional month to make the final payment. RBS agreed to provide Highland until August 4, 2008 to make the final payment, which was documented in another amendment on July 10, 2008.

declined more than €2 million. Given the market conditions, Highland recognized that it was becoming increasingly likely that a decline in the Loans' value might trigger default and termination, which would effectively thwart Highland's attempt to obtain an extension through January 31, 2009.

41. Highland communicated its objective to Orrick on numerous occasions. For example, on March 14, 2008, Braner sent an email to Howard stating that the amendment should include "a monthly extension with us posting 7mm euro at the end of each month, then at the end of June, we get an extension through 1/31/2009 (emphasis added)." Braner also emphasized that the April 2008 Amendment must include "a clause getting rid of the concept of posting additional money subject to a 2mm euro drop in mv [market value]."

42. Orrick knew that Highland negotiated to remove the MTM Trigger because it effectively wanted to guarantee that the transaction would be extended until January 31, 2009. Orrick also knew that the Backdoor Termination Provision was entirely inconsistent with Highland's stated purpose for agreeing to the April 2008 Amendment. In fact, during the same time that Orrick was advising Highland on the RBS deal, Orrick also was revising warehouse documents for Highland in another CDO transaction. In that other transaction, Orrick specifically recognized that in order for Highland to secure a concrete extension, the revised agreements needed to remove the counterparty's ability to terminate the transaction at will.

43. Notably, on February 29, 2008, Braner emailed Howard stating that the revised agreements for the other CDO transaction "need[ed] to make sure" that the counterparty could not terminate the transaction due to a "material/adverse change in the operations" of the HCM Companies involved. Howard responded that the current draft of the revised warehouse agreements permitted the counterparty to declare a default, among other things, upon the

occurrence of a material adverse change” in the condition of the HCM Companies that were parties to the deal. Howard then added: “More troubling, note that either party can terminate the warehouse agreement open [sic] five business days notice (emphasis added).”

44. On the same day, Howard sent another email to Highland’s internal counsel, notifying him that the original warehouse documents also permitted either party to terminate the transaction by merely terminating the engagement letter (which was substantially similar to the Mandate Letter in the RBS transaction), explaining:

The warehouse would cease upon the termination of the engagement letter:

This Agreement shall continue in full force and effect and shall be irrevocable by any party hereto until the earlier of the Termination Date occurring and the Transaction being abandoned pursuant to the Engagement Letter; provided, however, that Sections 4, 5, 6 12, 13 and 14 shall survive the termination of this Agreement. (Emphasis added but underlining in original.)

Highland’s internal counsel responded that Orrick “need[ed] to remove[] the underlined” provision from the warehouse agreements. Orrick redrafted the appropriate sections of the warehouse agreements to remove the ability of the counterparty to terminate the transaction at will.

45. In sum, in the other CDO transaction, Howard recognized and properly advised Highland that the HCM Companies would not achieve their objective of securing an extension of the transaction if the counterparty could unilaterally terminate the deal at any time. Upon learning this critical information, Highland demanded the removal of the at-will termination provisions.

46. The April 2008 Amendment was considerably more straightforward than the revised agreements that the HCM Companies were negotiating in the other CDO transaction. Unfortunately, it appears that Orrick only gave the April 2008 Amendment a very cursory

review. As a result of Orrick's inattention, the April 2008 Amendment was not only poorly drafted but also failed to accomplish Highland's stated objective to extend the transaction until January 31, 2009.

47. In particular, although Orrick knew that the purpose of the April 2008 Amendment was to extend the transaction, the amendment not only failed to remove the Backdoor Termination Provision but also failed to amend several other relevant termination provisions in the agreements. For example, the April 2008 Amendment completely failed to amend the definition of Termination Date in the ISD, even though it was the primary provision that governed the parties' termination rights. Accordingly, the ISD, as amended by the October 2007 Amendment, continued to provide that the transaction technically terminated on February 28, 2008. Similarly, Orrick failed to notice that the April 2008 Amendment also did not revise the definition of "Termination Date" in the First Loss Deed, such that the First Loss Deed also continued to provide that the Termination Date occurred on February 28, 2008.

48. The only definition of "Termination Date" that the April 2008 Amendment did amend was the one in the Funding Agreement, which was deleted and replaced with the following:

"Termination Date" means the earlier of (i) the next Scheduled Payment Date following the payment of the relevant Collateral Amounts by HCC and CDO Fund and received by [RBS] on the previous Scheduled Payment Date as set out in Schedule 2 [e.g., March 31, April 30, May 30, and June 30, 2008]; (ii) 31 January 2009 subject to the payment in full of all Collateral Amounts on each of the Scheduled Payment Dates as specified in Schedule 2 of the First Loss Deposit Facility Deed or (iii) at any date notified by [RBS] following an Event of Default.

This amended definition of "Termination Date" in the Funding Agreement effectively set forth Highland's understanding at the time that the April 2008 Amendment extended the transaction to

January 31, 2009, unless Highland failed to make a collateral payment or an Event of Default occurred.

49. Moreover, although the April 2008 Amendment did not amend the First Loss Deed's definition of "Termination Date," the amendment added the following paragraph to that agreement:

Provided payment of the relevant Collateral Amounts set out in Schedule 2 have been made by HCC and CDO Fund and received by [RBS] on the applicable Scheduled Payment Date as set out in Schedule 2, [RBS] will extend the Note Purchase Facility until the following Scheduled Payment Date and subject to the payment and receipt of all due Collateral Amounts on or prior to each relevant Scheduled Payment Date, will continue to extend the Note Purchase Facility until the last Scheduled Payment Date on 30 June 2008 at which time, provided all payments of the Collateral Amounts have been made in accordance with Schedule 2 and received by [RBS], [RBS] will extend the Note Purchase Facility for a further period of seven months to expire on 31 January 2009.

Along with and similar to the amended definition of "Termination Date" in the Funding Agreement, this paragraph further evidenced Highland's belief at the time that the April 2008 Amendment Deed extended the transaction until January 31, 2009, subject to Highland making the required monthly payments and not otherwise defaulting under the terms of the agreements. Orrick knew that Highland wanted the April 2008 Amendment to make the final sentence of the above paragraph airtight — so that the transaction was extended for a *period of seven months to expire on 31 January 2009*.

50. Instead, as a result of Orrick's negligence, Highland was unaware of the loophole in the Amendments that permitted RBS to terminate the transaction at will. Highland had relied on its longtime transactional counsel, a self-advertised leader in the CDO-transaction industry, to notice and advise them of such a grave error. For many years, Orrick had guided Highland through some of the most complex CDO transactions in the world. Ironically, however, Orrick botched two seemingly simple Amendments that cost Highland tens of millions of dollars. Had

Orrick properly reviewed the April 2008 Amendment alongside the original ISD and October 2007 Amendment, it would have noticed that the “Termination Date” definition in the ISD — which was completely untouched by the April 2008 Amendment — enabled RBS to terminate the transaction at will by terminating the Mandate Letter. Had Orrick done more than merely spend a few hours doing a cursory review of the April 2008 Amendment, it would have noticed the same “troubling” fact that it recognized in the other CDO transaction — that the Amendments failed to remove RBS’s right to terminate the transaction at will.

51. In sum, Orrick knew that Highland only agreed to pay RBS tens of millions of dollars to obtain a meaningful extension of the transaction. Nevertheless, as a result of Orrick’s negligence and utter inattention to the proper drafting of the Amendments, Orrick never advised Highland that RBS could unilaterally terminate the transaction at any time. If properly advised, Highland would not have entered into the Amendments or paid \$65 million to RBS in exchange for worthless extensions. Had the transaction terminated in October 2007 or February 2008, and the Loans been sold in a commercially reasonable manner, Highland’s alleged deficiency would either have been eliminated altogether or drastically reduced.

D. RBS PREMATURELY TERMINATES THE TRANSACTION

52. In mid-October 2008, certain amendments to International Accounting Standard 39 (the “IAS 39 Amendment”) incentivized RBS to prematurely terminate the transaction, foreclose on the collateral, and then sue Highland for the resulting deficiency. The IAS 39 Amendment allowed RBS to reclassify the Loans, which were marked to market on RBS’s trading books, to long-term investments on its banking books, and then retroactively value the Loans as of June 30, 2008, instead of having to recognize the substantially diminished marked-to-market value of these assets as of October 2008. Importantly, to take advantage of this

reclassification, RBS needed to transfer the Loans to its banking books prior to October 31, 2008. But in order to reclassify the Loans to its banking book, RBS needed to own the Loans, which required RBS to terminate the transaction and foreclose on the collateral.

53. Thus, without the Backdoor Termination Provision, RBS would not have been able to utilize the IAS 39 Amendment to report what effectively amounted to a windfall “profit.” If RBS had not been able to terminate the transaction at will to take advantage of this limited window of opportunity, RBS would have had no reason to realize its losses in 2008 or at any later point in time.

54. On or around October 20, 2008, RBS informed Highland that it was considering terminating the transaction, but it concealed from Highland its true motivations for termination. Highland believed that RBS had no contractual basis to terminate the transaction because it had paid RBS approximately \$65 million to receive two extensions and was not in default under the terms of the ISD, Funding Agreement, First Loss Deed, or any of the amendments thereto. Nonetheless, Braner asked Highland’s Nina Tripathy (“Tripathy”) to check with Orrick regarding “RBS’ ability to terminate the warehouse prior to the termination date.” On October 20, 2008, Tripathy sent an email to Artmann, requesting that she look into “any way that RBS can terminate other than the language that is under the Servicer event [of default].”

55. Shortly thereafter, Orrick apparently realized that the ISD contained the Backdoor Termination Provision and, more importantly, that neither of the Amendments modified the ISD’s “Termination Date” definition to eliminate RBS’s right to unconditionally terminate the transaction. On October 21, 2008, Tripathy emailed Braner the list of ways that RBS could terminate the transaction according to Artmann, noting that RBS could terminate the transaction at will by terminating the Mandate Letter. Understandably shocked by this answer, Braner

responded to Tripathy and Artmann: “This isn’t the right answer . . . need to find an argument against termination of the facility (emphasis added).” He then immediately sent an email to Howard telling him that he needed to get involved.

56. The following day, Tripathy asked Artmann whether she and Howard had found a way to argue against termination of the transaction. Having recognized Orrick’s colossal and ill-fated mistake, Artmann merely responded to Tripathy’s question: “Still looking,” while Howard provided no further response by email. Instead, and in direct contravention to its ethical duty to provide a truthful answer to its client, Orrick assured Highland that RBS’s termination of the transaction was improper and RBS did not have any lawful basis for termination.

57. On October 30, 2008, RBS notified Highland that it would exercise the Backdoor Termination Provision on October 31, 2008, thereby terminating the entire transaction. Orrick continued to advise Highland on the matter, and Orrick drafted Highland’s response letter to RBS. Notably, in this response, Orrick acknowledged that Highland believed that the Termination Date would not occur prior to January 31, 2009, based upon the Amendments:

[W]hile the Mandate Letter purports to give RBS a right to unilateral termination of the Mandate Letter, we do not consider that RBS has any lawful basis for exercising such a right given that as a result of the three extensions of the warehouse, we have been led to believe and reasonably relied upon the fact that the Termination Date would not occur prior to 31 January 2009. (Emphasis added.)

58. In early November 2008, RBS foreclosed on the Warehouse. RBS contacted Highland to see if it wanted to bid on any of the Loans in the Warehouse. Highland sought Orrick’s advice on whether it should respond to RBS. A partner from Orrick’s London office responded:

There is no need to respond, and I think you should not: you have the right to bid, but there is nothing to say you must say if you do or not, and we certainly do not want to give the impression we are under any implied obligation, or assume any obligation. Our

position is that the sale is improper under the contract, so apart from protesting our position (which we have done) we should avoid responding on mechanical issues over the sale. (Emphasis added.)

59. Highland did not bid on any of the Loans. RBS transferred a portion of Loans to its banking books to take advantage of the IAS 39 Amendment, which ultimately allowed RBS to report an approximately \$30 million accounting windfall. RBS then sold the remaining Loans through a commercially unreasonable sale process that resulted in significantly depressed sale values. In sum, RBS's premature termination of the transaction allowed RBS to garner a substantial profit while Highland suffered a huge and overstated deficiency.

E. ORRICK CONTINUES TO REPRESENT HIGHLAND WHILE CONCEALING ITS OWN MALPRACTICE

60. Following its termination of the transaction and commercially unreasonable sale of the Loans, RBS claimed that it lost more than \$100 million on the Loan portfolio. RBS sent a demand letter to Highland in March 2009. As before, Orrick assisted Highland in drafting a response to RBS's demand in which Highland reiterated that it reasonably believed that RBS wrongfully purported to terminate the transaction:

In response to your letters dated March 16, 2009 and March 18, 2009, we reject your demand for payment and reject all your claims supporting such demand. *RBS wrongfully purported to cancel the amended agreements in October, 2008*. In addition, RBS used incorrect "marks" in liquidating the collateral and, consequently, we do not accept your determination of any loss amount. (Emphasis added.)

61. Based on Orrick's advice and representations, Highland reasonably continued to believe that RBS wrongfully terminated the agreements. Notwithstanding its fiduciary duties to Highland, Orrick never disclosed to Highland that RBS properly terminated the agreements or that Orrick was at fault for failing to notice the Backdoor Termination Provision. Orrick concealed its malpractice from Highland to avoid being sued and, as explained below, to possibly represent Highland in any resulting litigation with RBS.

62. In May 2009, RBS brought suit against Highland in England to recover an alleged \$52 million (€35 million) deficiency, after providing Highland credit for the approximately \$65 million (€42.5 million) that Highland had previously advanced to RBS as consideration for the purported extensions.

63. Orrick sought to represent Highland in the litigation with RBS but was conflicted out of the representation. Highland, therefore, retained separate English counsel to represent it in the English proceedings.

64. Although Orrick could not list itself as counsel to Highland in the English proceeding, it continued to represent Highland in relation to the dispute with RBS until August 2009. In fact, Orrick billed several thousand dollars to this matter between October 2008 and August 2009.

65. As informed by Orrick, Highland defended RBS's lawsuit in England on a number of grounds, including on the basis that RBS was not permitted to unilaterally terminate the transaction at will under the agreements. Based on this notion of improper termination, Highland also brought a counterclaim for return of the cash collateral paid to RBS.

F. HIGHLAND'S DAMAGES

66. On February 10, 2010, the English court ruled that RBS's termination was proper because RBS had the right to terminate the transaction by terminating the Mandate Letter. Following a damages trial, the English court issued a judgment in favor of RBS and ordered Highland to pay approximately \$30 million. Accordingly, as a direct consequence of Orrick's negligent legal counsel, Highland not only paid RBS more than \$65 million to purportedly extend the transaction, but also is now faced with an approximately \$30 million judgment against it. But for Orrick's failure to advise Highland that RBS could terminate the transaction at any

time, Highland would not have agreed to enter into the Amendments with RBS, thereby saving it from approximately \$95 million in damages.

67. That is, had Orrick provided reasonable legal advice to Highland and explained to Highland that the ISD permitted RBS to unilaterally terminate the transaction, Highland would not have entered into the Amendments and paid RBS tens of millions of dollars to purportedly extend the transaction. Likewise, RBS would not have agreed to the Amendments absent the Backdoor Termination Provision because RBS viewed it as “a key ‘risk mitigant,’” and it was “important for RBS” to have the ability to “trigger the liquidation of the warehoused Loans, at any time and without cause.” Had the transaction terminated in October 2007 or February 2008 and the Loans been sold at either of these times, the sales prices would have been considerably higher than they were in October 2008, thereby saving Highland from an alleged multimillion-dollar deficiency.

68. Alternatively, even if RBS had agreed to remove the Backdoor Termination Provision from the ISD — a highly unlikely outcome — then RBS would not have been able to terminate the transaction in late October 2008. RBS, on information and belief, also would not have terminated the transaction on January 31, 2009, at the bottom of the market, because there was no advantage to RBS to terminate at that time and thereby realize its losses. Rather, on information and belief, Highland and RBS would have agreed to extend the transaction until a later point in time when the Loans had regained much of their value.

69. In short, it would have been beneficial to both RBS and Highland to liquidate the Warehouse at a time when the Loans would have received a higher price in a commercially reasonable sale. Had Highland and RBS agreed to sell the Loans in 2010, it is possible that RBS would have been repaid in full. At the very least, had the liquidation occurred in 2010, any

resulting deficiency would have been significantly less than the deficiency claimed by RBS following its November 2008 sale of the Loans, thereby saving Highland from tens of millions of dollars in damages.

VI. CAUSES OF ACTION

LEGAL MALPRACTICE / NEGLIGENCE

70. Plaintiffs repeat and reallege the allegations set forth in all preceding paragraphs of this Petition as if fully set forth herein.

71. Orrick had an attorney–client relationship with Highland. As counsel to Highland, Orrick owed Highland a duty to exercise reasonable and professional care consistent with the standard of care that is expected to be exercised by a reasonably prudent attorney in providing legal services.

72. Orrick, however, failed to exercise reasonable and professional care in providing services to Orrick. To summarize, Orrick knew that the agreements governing the proposed CDO transaction permitted RBS to terminate the transaction at will. Orrick also knew that Highland would not have entered into the Amendments had Highland known these amendments did not eliminate RBS’s right to unilaterally terminate the transaction.

73. Accordingly, Orrick should have advised Highland before Highland entered into the Amendments that the documents did not properly codify Highland’s understanding of the parties’ agreement, but instead contained the Backdoor Termination Provision whereby RBS could unilaterally terminate the transaction at any time.

74. As a direct and proximate result of Orrick’s legal malpractice and professional negligence, Highland suffered considerable damages in an exact amount to be proven at trial. Specifically, but for Orrick’s negligence, Highland would not have entered into Amendments,

thereby saving it from paying \$65 million in consideration to RBS and another \$30 million alleged deficiency owed to RBS.

VII. DEMAND FOR JURY

75. Plaintiffs demand a jury trial and tender the required fee with this Petition.

VIII. REQUEST FOR RELIEF


THEREFORE, Plaintiffs respectfully request that Defendants be cited to appear, and that Plaintiffs have judgment against Defendants for all of the following:

- a. Compensatory, consequential, and/or monetary damages in an amount to be determined by a jury;
- b. Pre-judgment and post-judgment interest at the highest rates allowed by law or equity; and
- c. Such other and further relief, at law or in equity, as this Court deems just and proper.

Dated: January 25, 2012

Respectfully submitted,

REID COLLINS & TSAI LLP
4301 Westbank Drive
Building B, Suite 230
Austin, Texas 78746
Telephone: (512) 647-6100
Telecopier: (512) 647-6129

By:  _____

William T. Reid IV

◆ Texas Bar No. 00788817

◆ wreid@rctlegal.com

Lisa S. Tsai

◆ Texas Bar No. 24046999

◆ lsai@rctlegal.com

Joshua J. Bruckerhoff

◆ Texas Bar No. 24059504

◆ jbruckerhoff@rctlegal.com

Craig A. Boneau

◆ Texas Bar No. 24064922

◆ cboneau@rctlegal.com

Attorneys for Plaintiffs