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Highland Capital Used False Pretexts in Ousting of Portfolio Manager, Panel Finds

Firm made false accusations of self-dealing and sexual relationship to justify termination: panel

Highland Capital founder James Dondero, above, 'was simply angry and realized Terry was not a 'yes man' willing to let Dondero have his wrongheaded way,' the panel found. Photo: Brent Humphreys

By

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An arbitration panel found that fund management company Highland Capital Management used pretexts and false allegations of a sexual relationship with a coworker to fire a portfolio manager without paying millions of dollars it owed him.

The finding is one of several legal reversals over the past several years for the Dallas-based firm, which has been fighting in court with former investors, former employees and trading partners since the financial crisis.

Highland's founder, James Dondero, fired the firm's most productive portfolio manager, Josh Terry, in June 2016 after Mr. Terry opposed a plan by Mr. Dondero to transfer funds between Highland investment vehicles and to delay repaying money owed to Highland investors, the Dallas arbitration panel determined in October. Mr. Terry believed the plan was a breach of his fiduciary duty to Highland clients and an external lawyer hired by the firm sided with him against Mr. Dondero, according to the panel.

"Dondero was simply angry and realized Terry was not a 'yes man' willing to let Dondero have his wrongheaded way," the panel found in its ruling. "So Dondero fired Terry on the spot and later sought to characterize Terry's termination of employment 'for cause'."

The panel also found Mr. Terry "did not prove that the sole reason for his termination was his refusal to commit an illegal act." The panel didn't rule on whether Mr. Dondero's plan would constitute a breach of fiduciary duty.

Three months after it fired him, Highland sued Mr. Terry, who had been trying to collect retirement investments from his former employer. Highland alleged Mr. Terry had acted against the interests of investors in a fund he managed and that he had sexual relationships with several subordinates. The court ordered the two parties to arbitration.

Mr. Terry never caused damage or loss to the fund Highland alleged he mismanaged, according to the arbitration ruling. The arbitration panel, made up of three former Texas district court judges, also determined that Highland's accusation that Mr. Terry had sex with a junior lawyer at the firm and involved her in alleged financial improprieties was "offensive."

The relationship never happened and "this allegation was based solely on someone's fantasy related to costumes they wore to an office Halloween party," the panel stated. Two other sexual relationships Highland alleged Mr. Terry had with coworkers were insignificant in one case and unproven in the other, according to the arbitrators.

The panel said Mr. Dondero retrospectively constructed a pretext for the firing to justify not paying Mr. Terry $5.7 million he was owed by Highland. Arbitrators awarded Mr. Terry $7.9 million in damages and interest.

"The arbitration award speaks for itself," said Rogge Dunn, Mr. Terry's attorney.

The decision was made public last week in a lawsuit filed by Mr. Terry in Dallas County District Court to recover the award, as the money can't be automatically collected with just an arbitration ruling. The two sides are expected to continue their battle in the district court.

A Highland spokeswoman said in a statement: “In this ongoing compensation dispute, Highland’s remaining claims regarding Josh Terry’s misconduct, including over a year of malicious taping of co-workers and counter-parties, will dwarf the arbitration award.” The arbitration panel found that Mr. Terry was entitled to keep all the recordings he had made of his conversations with Highland employees.

Highland specializes in trading distressed debt and secured loans of companies with junk credit ratings and managed about $39 billion at its peak in 2007. The firm took heavy losses in the financial crisis, leading to the liquidation of several of its hedge funds and to multiple lawsuits. Its assets under management have shrunk to $13.5 billion, according to a company website.

Highland also lost an arbitration in 2016 against investors in one of its hedge funds who alleged they had been cheated out of millions of dollars. The firm subsequently reached an agreement with the investors. Separately, a New York State Supreme Court judge in April dismissed a lawsuit by the firm accusing an investor of libel, a ruling Highland is appealing.

Highland also is still fighting in court against another former fund manager, Patrick Daugherty. The firm sued Mr. Daugherty in 2012, alleging he defamed Highland and publicized confidential information after leaving in 2011. Mr. Daugherty countersued, alleging he had been forced out of the firm for refusing to approve asset transfers ordered by Mr. Dondero. A jury found in favor of each of the sides on different issues in 2014 and both Highland and Mr. Daugherty have since been litigating to collect the amounts the jury awarded them.

Highland has subpoenaed The Wall Street Journal related to the litigation between the firm and Mr. Daugherty. Dow Jones has challenged the subpoena and the matter is pending before the Dallas Court of Appeals. Mr. Daugherty was found in contempt of court in that case in August and was sentenced to 38 days in jail, a ruling he is now appealing.

Mr. Terry was in good standing at Highland, managing more than $10 billion of the firm’s assets under management, until his abrupt firing, according to the ruling. The conflict started in 2016 when Mr. Dondero instructed Mr. Terry to lend $17 million from an investment fund Mr. Terry managed to another Highland fund to pay for the acquisition of a Brazilian latex manufacturer, according to the ruling. Mr. Dondero also planned to postpone a $56 million payment owed in May 2016 to investors in other Highland funds, the panel found.

Mr. Terry opposed the plan to delay repaying money owed to clients. In early June 2016, an internal Highland committee approved the Brazilian acquisition but required the $56 million obligation be paid without further delay.

That left Mr. Dondero with less money to fund his plan and he promptly fired Mr. Terry, the panel determined.

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