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CAUSE NO. CC-06-15900-C FILED

MARSHALL HESS and STUART SMITH,  
Plaintiffs,

IN THE COUNTY COURT OF

2006 NOV -2 PM 12:55  
COUNTY CLERK  
DALLAS COUNTY

v.

HIGHLAND CAPITAL MANAGEMENT,  
L.P., DAVIS DEADMAN, JAMES  
DONDERO, and NEXBANK  
SECURITIES, INC.

DALLAS COUNTY, TEXAS

Defendants.

COUNTY COURT AT LAW NO. 3

**PLAINTIFFS' ORIGINAL PETITION**

Plaintiffs Marshall Hess and Stuart Smith (collectively, Plaintiffs) submit this Original Petition, complaining of Defendants Highland Capital Management, L.P., Davis Deadman, James Dondero, and NexBank Securities, Inc., and would show as follows:

**I.  
DISCOVERY CONTROL PLAN**

1. Discovery is intended to be conducted under Level 3 of Tex. R. Civ. P. 190.

**II.  
PARTIES AND VENUE**

2. Plaintiffs Marshall Hess and Stuart Smith are individuals who reside in Dallas County, Texas.

3. Defendant Highland Capital Management, L.P. is, on information and belief, a Delaware limited partnership with a principal place of business in Dallas County, Texas. It may be served with process by delivering a citation and a copy of this Petition to

James Dondero, as registered agent for  
Strand Advisors, Inc., the general partner of  
Highland Capital Management, L.P.  
13455 Noel Road, Suite 800  
Dallas, Texas 75240

4. Defendant Dondero is an individual who, on information and belief, resides in Dallas County, Texas. He may be served with process by delivering a citation and a copy of this Petition to

James Dondero  
Highland Capital Management, L.P.  
13455 Noel Road, Suite 800  
Dallas, Texas 75240

5. Defendant Deadman is an individual who, on information and belief, resides in Dallas County, Texas. He may be served with process by delivering a citation and a copy of this Petition to

Davis Deadman  
NexBank  
13455 Noel Road, Suite 2200  
Dallas, Texas 75240

6. Defendant NexBank Securities, Inc. is a Delaware corporation with a principal place of business in Dallas County, Texas. It may be served with process by delivering a citation and a copy of this Petition to its registered agent at

NexBank Capital, Inc.  
13455 Noel Road, Suite 2220  
Dallas, Texas 75240

7. Venue of this action is proper in Dallas County, Texas because a substantial part of the acts and omissions giving rise to Plaintiffs' claims occurred here.

### **III. FACTUAL BACKGROUND**

8. Plaintiffs are experienced real estate and investment professionals. For years, they have been in the business of identifying attractive real estate development opportunities and assembling groups of investors who might be interested in taking advantage of these opportunities.

9. Highland Capital Management, L.P. (“Highland Capital”) is a high-profile “hedge fund” operated out of Dallas, Texas. Defendant Dondero runs Highland Capital. His fingerprints can be found on every substantial decision made and every substantial action taken at Highland Capital.

10. Defendant Deadman is one of Dondero’s lieutenants. When Dondero wanted to expand Highland Capital’s operations into real estate, Dondero put Deadman in charge of assembling a qualified team of professionals to get Highland Capital’s real estate operation up and running.

11. Dondero and Deadman wanted to form a new real estate unit who would be able to earn a profit with a minimum of time needed to ramp up the operation. Neither Dondero, Deadman, nor anyone else at Highland Capital had the interest or the ability to teach existing Highland Capital employees how to do the work. Nor would it have been feasible to bring in *inexperienced* real estate professionals to start up the operation.

12. Their only option was to hire well-qualified, experienced professionals who could create a real estate operation from scratch, without any training or guidance from existing Highland Capital personnel.

13. Dondero and Deadman got lucky. When they went looking for an experienced team that they could put in place, they found the Plaintiffs. In particular, the Plaintiffs worked together with a team which possessed widespread experience in handling high-value commercial real estate transactions. They had an established client base of potential investors. They had hands-on experience finding, negotiating, and closing the transactions. They had all of the tools necessary to organize and implement a functioning real-estate investment team.

14. To lure Plaintiffs' team to join Highland Capital, Defendants promised them a specific share (45%) of the "net cash flow" that the new Real Estate Group generated. "Net cash flow" was defined as the fees generated by the Real Estate Group after repaying the capital investment and cash advances made by Highland Capital. Defendants further promised them another share (47.5%) of the "returns" that these investments generated upon selling the real estate which was to be acquired. These compensation agreements were specifically discussed as a performance-based means of compensation.

15. When these agreements were reduced to writing, Plaintiffs' compensation was structured as a bonus payment. Still, however, the 55/45 and 52.5/47.5 splits between Highland Capital and the Plaintiffs remained explicit.

16. Highland Capital also proposed a clause which would allow Highland Capital to reduce the bonus in certain circumstances. Plaintiffs directly asked Deadman to explain this proposal and how it would work in practice. Deadman replied that Highland Capital needed to have flexibility to reduce bonus payments in the event that the real estate unit did not perform up to expectations and could not show a profit. Because this answer conformed to the parties' previous discussions in which Plaintiffs agreed that their compensation would be dependent on their positive performance, Plaintiffs accepted this term. Essential to Plaintiffs' acceptance, however, was their reliance on Deadman's representation that the bonus payments would only be reduced if the Real Estate Group could not show a profit.

17. Employment agreements were signed in August 2005, and Plaintiffs quickly w  
to work on behalf of Highland Capital.

18. Their performance was outstanding. Not only did they show a profit, bu'  
clearly *exceeded* their business plan and Highland Capital's own expectations. They completed

twenty-three deals which, in turn, generated over \$5 million in fees by acquiring properties for investors. These deals will also generate many millions of additional dollars in “back end fees” when the properties are later sold.

19. As it later turned out, Plaintiffs’ team was not only successful, but, in fact, they proved to be *too successful*.

20. Jim Dondero has an unwritten rule. Even though he makes millions of dollars a year on average, the compensation of employees like Plaintiffs is regularly capped at approximately \$500,000 per year. Plaintiffs never learned of this unwritten rule until after their fantastic first-year performance with Highland Capital.

21. In August 2006, Deadman approached Plaintiffs and informed them that, even though they had earned millions of dollars in bonuses through their outstanding performance, Highland Capital was not going to pay them those bonuses. Highland Capital was simply going to renege on its promises to Plaintiffs. Deadman told Plaintiffs that they had no choice but to accept Highland Capital’s ultimatum or they would be fired (and, again, would still be denied their compensation).

22. Highland Capital sought, after-the-fact, to rewrite the terms of Plaintiffs’ compensation and to deny them bonuses that had already been earned. Indeed, Highland Capital never intended to allow Plaintiffs to reap the full benefits of the compensation plan that was used to induce Plaintiffs to join Highland Capital. Instead, unbeknownst to Plaintiffs, Highland Capital had a separate system for calculating bonuses that did not match up with the contractual language offered to Plaintiffs. When Plaintiffs earned millions, Highland Capital argued that they simply did not have to live up to their promises.

**IV.  
CAUSES OF ACTION**

**First Cause of Action –  
Breach of Contract**

23. Highland Capital and NexBank agreed to pay Plaintiffs their share of a cash bonus equivalent to 45% of the “net cash flow” generated by Plaintiffs and 47.5% of the “back-end” return obtained on investments.

24. Nevertheless, Highland Capital and NexBank reneged on their promise in breach of their contractual obligations.

25. As a reasonably foreseeable result, Plaintiffs have suffered injuries in excess of the minimum jurisdictional limits of this court, for which they seek recovery.

**Second Cause of Action –  
Tortious Interference**

26. Plaintiffs had existing contractual expectations to a bonus equivalent to their share of 45% of the “net cash flow” that they generated and 47.5% of the “back-end” return they obtained. Jim Dondero and Davis Deadman tortiously interfered with those expectations by retroactively changing the terms of Plaintiffs’ bonus plan to Plaintiffs’ detriment. The interference was malicious and unjustified.

27. As a proximate result of Defendants’ interference, Plaintiffs have suffered injuries in an amount in excess of the minimum jurisdictional limits of this court, for which they seek recovery.

**Third Cause of Action –  
Plaintiffs are entitled to an equitable, quasi-contractual recovery  
under the principles of quantum meruit, estoppel, and unjust enrichment**

28. Plaintiffs performed professional real estate investment services for the benefit of Highland Capital and NexBank. The latter were aware that Plaintiff intended to be compensated

for their work with their share of a cash bonus equivalent to 45% of the “net cash flow” generated by Plaintiffs and 47.5% of the “back-end” return obtained on investments.

29. By failing to pay those amounts (and, instead, keeping those amounts for themselves), Highland Capital and NexBank have been unjustly enriched in an amount in excess of the minimum jurisdictional limits of this court, for which Plaintiffs seek recovery.

30. Furthermore, Defendants are estopped to deny Plaintiffs the compensation that Plaintiffs had earned. Defendants falsely represented that Plaintiffs would receive their share of cash bonuses equal to 45% of the “net cash flow” generated by the Real Estate Group and 47.5% of the “back-end” return obtained on investments as long as the group was profitable. They concealed the fact that they would not allow Plaintiffs to recoup this compensation if Plaintiffs actually met or exceeded their performance targets. The false representations and concealment of other facts was made with knowledge of the true facts, with the intention that Plaintiffs rely on the false impression that was conveyed.

31. Because Plaintiffs lacked knowledge of the true facts and lacked the means to obtain such knowledge, they relied to their detriment on the false impression that Defendants conveyed.

32. As a result, Defendants were able to secure for themselves the benefits of Plaintiffs’ hard work. Defendants gladly accepted the benefits of Plaintiffs’ performance, but then refused to provide the corresponding benefits that Plaintiffs had earned. Allowing Defendants to profit themselves through such misconduct would be unconscionable.

33. As a proximate result of Defendants’ misconduct, Plaintiffs have suffered injuries in excess of the minimum jurisdictional limits of this court, for which they seek recovery. Indeed, Defendants have been unjustly enriched by the amount of the compensation that should

have been paid to Plaintiffs but which was wrongly withheld by the Defendants. Plaintiffs seek to recover such amounts through this action.

**Fourth Cause of Action –  
Fraud**

34. Defendant Deadman, acting as an agent for Highland Capital, Jim Dondero, and NexBank, promised Plaintiffs that any discretion afforded to Highland Capital and/or NexBank related to restricting the payment of bonuses to Plaintiffs would only be exercised in the event that the Real Estate Group was unable to achieve a profit. This representation was false and was made with the intent that Plaintiffs rely on it in order to go to work for Highland Capital. Deadman knew it was false.

35. Defendants also represented that they would pay to Plaintiffs their share of 45% of the “net cash flow” achieved by the Real Estate Group and 47.5% of the “back-end” return obtained on investments. Again, Defendants made this representation with the intent that Plaintiffs rely on it. At the times that this representation was made, Defendants had no intention of fulfilling such a promise, knowing that Dondero would instead disregard the contractual terms and arrive, unilaterally, at his own determination of Plaintiffs’ “appropriate” compensation. The discussion of the 55/45 and 52.5/47.5 splits was merely a charade designed to induce Plaintiffs to come to work for Highland Capital.

36. Plaintiffs relied on the representations by going to work for Highland Capital. As a proximate result of Defendants’ fraud, Plaintiffs have suffered injuries in an amount in excess of the minimum jurisdictional limits of this court, for which they seek recovery.

**Fifth Cause of Action –  
Conspiracy**

37. Defendants conspired by agreeing to induce Plaintiffs to join Highland Capital based on representations about their entitlement to their share of 45% of the “net cash flow”



generated by the Real Estate Group and 47.5% of the “back-end” return obtained on investments, despite knowing that Highland Capital and NexBank would never live up to such a contractual obligation if Plaintiffs performed as successfully as they did.

38. Defendants took affirmative steps in furtherance of the conspiracy by making affirmative representations to fraudulently induce Plaintiffs to work for Highland Capital.

39. As a proximate result of Defendants’ conspiracy, Plaintiffs have suffered injuries in an amount in excess of the minimum jurisdictional limits of this court, for which they seek recovery.

**Sixth Cause of Action –  
Request for Declaratory Relief**

40. Plaintiffs’ employment agreements contained purported “non-competition” covenants. Despite having forced Plaintiffs out, Highland Capital has now threatened to enforce those non-competition covenants against Plaintiffs, preventing Plaintiffs from carrying on in their long-standing professions in the real estate business.

41. Pursuant to Chapter 37 of the Texas Civil Practice & Remedies Code, Plaintiffs therefore seek a declaration that:

- a. The non-competition covenants in Plaintiffs’ employment agreements are invalid;
- b. Those non-competition covenants are not supported by sufficient consideration under Texas law;
- c. Those non-competition covenants are not necessary to protect any legitimate business interests of Highland Capital or NexBank;
- d. Defendants did not provide Plaintiffs with any confidential or proprietary information which would justify restricting Plaintiffs’ competition;

- e. The geographic, scope of activity, and time restrictions of those non-competition covenants are not reasonably limited to what is necessary to protect any legitimate business interests of Highland Capital or NexBank;
- f. Those non-competition covenants are unenforceable due to Defendants' tortious conduct;
- g. Those non-competition covenants are unenforceable due to Defendants' breaches of contract; and
- h. Those non-competition covenants are unenforceable due to Defendants' actions which actually or constructively terminated Plaintiffs' employment.

#### **Attorney's Fees**

42. As a result of Defendants' conduct, Plaintiffs have been compelled to retain counsel in order to protect their rights. Accordingly, Plaintiffs seek to recover their attorney's fees as allowed under Tex. Civ. Prac. & Rem. Code §§ 37.009 and 38.001.

#### **Punitive Damages**

43. Defendants' tortious conduct, as described above, was undertaken with that level of mental culpability for which Texas law allows the imposition of punitive damages, which Plaintiffs seek.

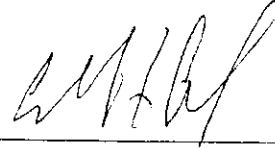
#### **Discovery**

44. Plaintiffs have served requests for disclosures and requests for production of documents contemporaneously with this petition.

WHEREFORE, Plaintiffs pray that the Defendants be cited to appear and that, upon a final trial on the merits, Plaintiffs recover their actual damages, punitive damages, attorney's fees, pre- and post-judgment interest, and costs of court and that they receive such other relief to which they may be entitled.

Respectfully submitted,

The Law Offices of Frank L. Branson P.C.



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