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INVESTMENT FUNDS GROUP

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Hedge Fund Manager Pays $250,000 to Settle Charges That He Violated Hart-Scott-Rodino Reporting Requirements on Exercise of Stock Options

On May 21, 2007, hedge fund operator James D. Dondero agreed to pay a $250,000 civil penalty to settle charges that he violated reporting requirements of the Hart-Scott-Rodino Act. This penalty was imposed because Dondero, as the "ultimate parent entity" of hedge fund Highland Capital Management, L.P., had exercised options in February 2005 to acquire shares in Motient Corporation without first filing required pre-merger notification forms with the U.S. Federal Trade Commission and the Department of Justice and observing a 30-day waiting period. The case is an important reminder that, under appropriate circumstances, officers and directors may be required to make HSR filings, *even when exercising options to acquire stock in their own companies*.

As the ultimate parent entity of Highland Capital, Dondero acquired a total of 3.5 million shares of Motient Corporation between 2002–2004 and became a Director of the company. Dondero's initial holdings in Motient, both directly and through Highland, were below the then-applicable $50 million threshold for HSR filing. The company's shares later appreciated significantly, however, so that when he exercised stock options in February 2005, his cumulative holdings exceeded the $50 million HSR filing threshold then in effect. As a result, Dondero was required to have filed HSR notification forms with the U.S. government and waited 30 days before exercising options that would have the effect of increasing his holdings.

Instead, Dondero made an HSR filing in April 2005, approximately two months after he had exercised his options. According to the Department of Justice complaint, the 30-day waiting period for Dondero's filing expired on May 28, 2005, and Dondero was therefore in continuous violation of the HSR Act for three months. Fines for HSR Act violations are $11,000 per day. Dondero agreed to pay $250,000 in settlement.

This latest case raises two important points:

- The government will vigorously enforce HSR filing requirements, even where the transaction raises no potential anticompetitive results. The government did not allege that Dondero's stock acquisitions would adversely affect competition in any market. It alleged only that the required filing was not made in a timely manner, *i.e.*, at least 30 days before the acquisition of stock, and

- Although *acquiring* stock options does not raise HSR reporting obligations, *exercising* those options may do so. Stockholders who exercise options may be required to file HSR reports and observe a waiting period if, upon exercising their options, they hold voting securities with a total value greater than HSR reporting thresholds (currently $59.8 million, adjusted annually).

Some large shareholders may take advantage of an exception to HSR reporting requirements if they are acquiring shares "solely for purposes of investment." This exception, however, is quite limited, and officers, directors and stockholders with board representation generally do not qualify.

Regardless of when stock already held was acquired and regardless of whether the new stock is acquired by direct purchase, as a result of an option exercise, or through vesting of restricted stock, an HSR filing and observance of a 30-day waiting period may be required. A limited exception to this filing requirement exists for an officer who sells all the shares acquired through the option exercise (or sells other shares in an amount not less than the number of shares acquired through the option exercise) and makes that sale on the same day as exercising the option.

Because the HSR Act and its regulations include numerous highly technical provisions, clients are well-advised to seek legal advice before acquiring stock whenever their current holdings in a company exceed a value of $59 million.

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