

## Justice Department Charges Hedge Fund Manager with HSR Violation

On May 21, 2007, the Department of Justice filed in federal court in Washington DC, a complaint and proposed final judgment against hedge fund manager James Dondero. The complaint, filed on behalf of the Federal Trade Commission, alleged that Dondero violated the premerger requirements of the Hart-Scott-Rodino (HSR) Act when he exercised stock options without first filing notification under the HSR Act. The complaint further alleged that Dondero violated the HSR Act by failing to observe the mandatory 30-day waiting period.

According to the DOJ's complaint, Dondero is the director and ultimate parent of Highland Capital Management LP, a limited partnership located in Dallas, Texas. In April 2002, Highland acquired more than 1 million shares of Motient Corporation, a wireless data provider located in Reston, Virginia. Shortly thereafter, in July 2002, Dondero was appointed to Motient's board of directors. Highland made additional acquisitions of Motient shares between April 2004 and November 2004, bringing Highland's total holdings of Motient to about 3.5 million shares, worth approximately \$33 million.

The violation charged in the DOJ's complaint concerned Dondero's exercise of stock options that were granted in December 2004, while he was a member of Motient's board. On February 28, 2005, Dondero exercised his options on 10,000 shares of Motient stock without first filing a report and notification form with the DOJ and FTC. Dondero also failed to wait the requisite 30 days before concluding the transaction. When combined with the 3.5 million Motient shares that Dondero already held by virtue of his ownership of Highland, which the DOJ alleged had appreciated in value since the time Dondero had first acquired them, Dondero's exercise of his options resulted in his holding roughly \$94 million of Motient voting securities.

At the time of the transaction, the HSR Act required parties engaging in stock acquisitions in excess of \$50 million to report the intended transaction to the DOJ and FTC prior to consummation of the transaction. (The HSR threshold is currently \$59.8 million and is adjusted each year to reflect changes in gross domestic product.) The exercise of stock options constitutes an acquisition for purposes of the HSR Act.

According to the DOJ, Dondero did not make a notification under the HSR Act until April 23, 2005, almost two months after exercising his options. The 30-day waiting period expired on May 28, 2005, which meant that Dondero was in continuous violation of the HSR Act for three months. A party found in violation of the HSR Act can receive fines of up to \$11,000 per day. Dondero agreed to pay a fine of \$250,000 in settlement of the charges.

*If you have any questions about these developments, please feel free to contact the following:*

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Significantly, this was not Dondero's first HSR Act violation. Dondero had previously failed to make an HSR filing for his acquisition of shares in Neighborcare, Inc., in 2003. No fines were levied then, however, as Dondero made a corrective filing and committed to a plan outlining steps that he and his company would take to prevent such violations from occurring in the future.

This latest case illustrates several interesting aspects of the HSR Act reporting requirements:

- First, when determining the value of voting securities that will be held as a result of an acquisition, count not only the securities to be acquired by the filing person (in this case, Dondero), but also the securities already held by that person and all entities controlled by that person (i.e., Highland).
- Second, the acquisition of options does not require an HSR filing, but the exercise of those options may require prior notification if, as a result of the acquisition, the acquiring party will hold voting securities in excess of the prevailing HSR threshold.
- Third, appreciation in the value of stock cannot trigger an HSR filing, but before you can acquire additional shares, you may first have to file under the HSR Act and observe the 30-day waiting period.

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