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Hedge Fund Manager Fined for Violating HSR Act By Exercising Stock Options

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On May 21, 2007, the Justice Department (following a request by the Federal Trade Commission) charged a hedge fund manager with failing to comply with the Hart-Scott-Rodino (HSR) Act notification and waiting period requirements before exercising options to acquire stock in Motient Corp.

Key Implications

As we previously highlighted in a November 2006 Legal Update, the U.S. antitrust agencies are increasingly scrutinizing whether financial investors, including hedge funds, are complying with the HSR rules.^[1] In particular, the agencies are closely examining whether hedge funds and other private equity firms are improperly relying on the “investment-only” exemption to the HSR reporting requirements. Thus, it is important for financial investors, including wealthy individuals with significant stock holdings, to consult with antitrust counsel to determine whether their proposed investments, including the exercise of stock options, could trigger HSR reporting obligations. This is true even when they are not seeking to own all, or ultimately to control all, of the company whose securities are being acquired.

Case Background

According to DOJ’s complaint, Highland Capital Management L.P., a hedge fund that specializes in senior bank loans and is controlled by James Dondero, had previously acquired stock in Motient on various occasions between 2002-2004, and as of November 10, 2004, this stock had a value of approximately \$33 million. In February 2005, Mr. Dondero, a member of Motient’s board of directors, exercised an option to purchase an additional 10,000 shares of Motient stock. Due to the appreciation of Highland’s existing stock holdings, Mr. Dondero (together with Highland) now held, as a result of exercising this option, Motient stock valued at approximately \$94 million.

The Justice Department alleged that Mr. Dondero was required to submit an HSR notification form and observe the mandatory waiting period before exercising this option. Yet, Mr. Dondero did not make an HSR filing with the Commission until April 25 - two months after exercising the option and acquiring the Motient stock. In addition, according to DOJ’s complaint, Highland had previously made a late HSR filing after closing a prior transaction, and had promised to implement procedures to prevent future failures to make timely HSR filings and comply with the mandatory HSR waiting periods. As a result, DOJ charged Mr. Dondero with a civil violation of the HSR Act, and Mr. Dondero agreed to pay a penalty of \$250,000 to settle the charges.

[1] See <http://www.mofo.com/news/updates/files/update02264.html>.