

DOJ IMPOSES FINE ON HEDGE FUND MANAGER FOR FAILURE TO FILE HSR

The Antitrust Division of the United States Department of Justice (“DOJ”) has announced the settlement of another complaint alleging that a hedge fund manager violated the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the “HSR Act”), again highlighting the need for hedge fund managers to pay close attention to this statute. The complaint alleged that the hedge fund manager failed to submit required notification to DOJ and the Federal Trade Commission (the “FTC”) and observe a waiting period before acquiring voting securities of Motient Corporation (“Motient”) which caused the acquirer to hold securities valued in excess of the HSR Act’s minimum notification threshold (currently, \$59.8 million). James D. Dondero, a hedge fund manager and controlling partner in Highland Capital Management L.P. (“Highland”) -- and a repeat offender of the HSR Act -- has agreed to pay a \$250,000 fine to settle the complaint. An FTC press release is available at <http://www.ftc.gov/opa/2007/05/dondero.shtm>.

According to DOJ’s allegations, as a director of the company, Mr. Dondero received options to acquire 10,000 shares of Motient voting securities. When Dondero exercised those options on February 28, 2005 and acquired additional shares,¹ that exercise resulted in his holding Motient voting securities valued in excess of the HSR Act’s minimum notification threshold then in effect.

This recent DOJ action and settlement highlights several important elements of the enforcement policy of the antitrust enforcement agencies concerning the HSR Act. First, while the agencies will typically show leniency the first time an acquirer inadvertently fails to file under the HSR Act, an acquirer’s second HSR violation will likely trigger an enforcement action seeking the imposition of fines, even where the acquirer holds a relatively small position in the issuer. Second, this action is yet another example of the agencies’ close scrutiny of the activities of hedge funds, even where the acquirer’s holdings are relatively modest. Finally, it illustrates the importance of considering HSR issues when making non-traditional acquisitions, such as when one acquires stock through exercising options, and of understanding how the HSR Act “values” shares held prior to the subject acquisition.

Mr. Dondero had previously acquired voting securities of another company -- Neighborcare, Inc. (then known as Genesis Health Ventures) -- but failed to file notification under the HSR Act. Dondero continued to acquire Neighborcare voting securities and remained in violation of the HSR Act for over six months. Upon discovering that he was required to file notification under the HSR Act, Dondero made a corrective post-acquisition filing with respect to his holdings in Neighborcare. Consistent with general policy (and assuming Dondero’s failure to file HSR

¹ Under the HSR rules, the acquisition of an option is not an event that would typically trigger notification obligations. However, the exercise of an option is an acquisition that may trigger HSR notification unless the acquirer sells the shares acquired pursuant to the exercise on the same trading day.

notification was not intentional), neither the FTC nor DOJ initiated an enforcement action seeking fines with respect to that violation. However, at the agencies' insistence, Dondero's corrective filing outlined procedures that Dondero would implement to ensure that future violations under the HSR Act would not occur. Despite his purported HSR compliance program, according to the DOJ complaint, Dondero made an acquisition of Motient securities in violation of the HSR Act less than one year after the Neighborcare corrective filing. This time, the agencies proved to be less accommodating and initiated the investigation that resulted in the subject settlement.²

The Dondero settlement illustrates the important point that an acquirer need not hold a dominant or controlling position, or make a particularly substantial acquisition, in order to invite an HSR enforcement action, particularly where that acquirer has a prior history of HSR violations. Here, Dondero's position was nowhere near sufficient to allow Dondero or Highland to assert any meaningful control over Motient. Moreover, the acquisition that triggered the FTC's investigation was only 10,000 shares, for which he paid \$85,700 (and that had a "market value" (described below) of less than \$270,000). Nevertheless, the agencies saw fit to proceed with an enforcement action.

This enforcement action is another example of the agencies' careful scrutiny of the activities of a hedge fund or its controlling partner. A recent HSR enforcement action prior to this one involved a failure to file notification by a hedge fund (Durus Life Sciences Master Fund) and its controlling interest holder (Scott Sacane) (see <http://www.ftc.gov/opa/2005/09/durus.shtm>).

Finally, this matter illustrates the importance of understanding how the HSR Act determines the value of securities held prior to an acquisition. As of November 2004 (the time of Dondero's last acquisition prior to exercising his options), Dondero held Motient voting securities valued at only \$33 million, based on their "market price" (defined by 16 C.F.R. § 801.10(c)(1) as the lowest closing price within the 45 calendar days prior to (i) a relevant HSR notice provided to the target issuer, where HSR notification is required or (ii) consummation of the acquisition, if HSR notification is not required). The price that Dondero actually paid for those shares is irrelevant to their "value." Since the value of shares held in inventory is a direct function of the fluctuation of the public market, by the time Dondero exercised his options on February 28, 2005, those same shares held by Dondero had appreciated to a value well above the minimum notification threshold under the HSR Act (applying the lowest closing price for the 45 days prior to February 28, 2005). Thus, any additional acquisition by Dondero -- even of a single share -- would have triggered HSR notification obligations, whether he acquired the shares by exercising an option or otherwise.

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² Bill Gates is another example of an acquiring person who violated the HSR Act once without penalty, but was fined when the agencies discovered a subsequent violation (see <http://www.ftc.gov/opa/2004/05/gates.shtm>).

If you have any questions about the Dondero settlement, or the HSR Act generally, please contact William H. Rooney (212-728-8259, wrooney@willkie.com), Bernard A. Nigro, Jr. (202-303-1125, bnigro@willkie.com), Theodore C. Whitehouse (202-303-1118, twhitehouse@willkie.com), Barry P. Barbash (202-303-1201, bbarbash@willkie.com), Jonathan J. Konoff (212-728-8627, jkonoff@willkie.com), or the attorney with whom you regularly work.

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