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Recent Civil Penalty for Failure to Comply With Hart-Scott-Rodino Act Highlights Need to Be Vigilant Regarding Reporting Thresholds

On May 21, 2007, the Federal Trade Commission (FTC) announced a $250,000 civil penalty against James D. Dondero, the ultimate parent of hedge fund Highland Capital Management, L.P. (Highland) for violating the Hart-Scott-Rodino Antitrust Improvements Act of 1976 as amended (HSR Act). Mr. Dondero failed to file a timely pre-merger notification form in connection with the exercise of options to purchase additional shares of Motient Corporation (Motient). See http://www.ftc.gov/opa/2007/05/dondero.shtm. The civil penalty was imposed pursuant to a court order settling a complaint filed by the United States Department of Justice at the FTC's request. This incident involved the second corrective HSR filing by Mr. Dondero within a year.

Factual Background for Enforcement Action

Mr. Dondero's first corrective HSR filing arose out of acquisitions by Highland of voting securities of Neighborcare, Inc. made in 2003 and 2004 that resulted in Highland — and Mr. Dondero as Highland's ultimate parent — holding voting securities in that company valued above the then $50 million HSR size of the transaction threshold without first complying with the HSR Act. Mr. Dondero submitted a corrective filing in April 2004 for these acquisitions and, as part of the corrective filing, outlined steps that Highland would take to ensure against future HSR Act violations. No enforcement action was taken for this initial HSR Act violation.

The second corrective filing was made in 2005 with regard to an investment by Mr. Dondero and Highland in Motient. In February 2005, Mr. Dondero exercised options to acquire 10,000 shares in Motient, a company in which Highland already held some shares. The prior acquisitions by Highland of this stock had not been HSR-reportable and had not given Highland a controlling amount of the voting securities of Motient. Including shares Highland already owned, the value of which had appreciated, Mr. Dondero held after the exercise of the options Motient stock valued in excess of $90 million, well above the HSR reporting threshold.

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Mr. Dondero failed to file under the HSR Act as required prior to the exercise of the options, but made a corrective filing in April 2005.

Important Reminders Regarding HSR Act Compliance

This enforcement action serves as an important reminder of the need for strict adherence to obligations under the HSR Act. Other important reminders regarding HSR compliance from this matter include:

- The penalties under the HSR Act can be significant. Any entity or individual who fails to comply with the HSR Act may be subject to a civil penalty of up to $11,000 a day for each day in violation of the HSR Act. This can result in a large penalty over time, particularly for a violation that is not discovered for several years.
- If you believe that you may have violated the HSR Act, you should consult with counsel immediately. The FTC has procedures for making a post-consummation filing. Persons who discover that they have closed a reportable transaction without filing should immediately notify the FTC and make a filing as soon as possible.
- The value of an acquisition for HSR purposes may require aggregating the value of the current transaction with the value of a prior acquisition. For example, if a person previously acquired a non-reportable and non-controlling amount of voting securities in a company, the value of those previously acquired shares will need to be aggregated with the value of any additional voting securities being acquired to determine if the HSR Act is triggered. Further, when aggregation is required, the acquiring person cannot rely on an original acquisition price in valuing the interests it already holds but must use the current market value. As with other HSR analyses, the holdings of the parent generally must be aggregated with those of all other entities the parent directly or indirectly controls.
- For any transaction, including acquisitions of voting shares that do not yield control, parties should carefully determine if a reporting threshold is met, given that the process can be very complex and the rules are highly technical.