

Beware of HSR Filing Requirements for Option Exercises or Vesting of Restricted Stock

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This week the Federal Trade Commission obtained a \$250,000 civil penalty against James Dondero, the operator of the Highland Capital hedge fund and a director of Motient Corporation, for making a late Hart-Scott-Rodino Act filing in connection with his 2005 exercise of options to acquire 10,000 Motient shares. The acquired shares had a value at the time of less than \$300,000. Two factors led to the FTC action, both of which are instructive.

First, between 2002 and 2004, Highland Capital (which Dondero controlled) acquired a total of 3.5 million shares of Motient, which at the time had a total value below the then-applicable \$50 million HSR threshold so no filing was necessary. But the value of those shares subsequently appreciated significantly to the point that, at the time of Dondero's option exercise, his cumulative direct and indirect holdings—which is the relevant measure for HSR, **not** simply the current transaction—significantly exceeded \$50 million. Given the appreciation, any acquisition by Dondero would trigger the need to file.

Second, this was Dondero's second offense. Dondero failed to make timely HSR filings in connection with Highland's acquisition of shares of another company in 2003 and 2004. While no penalty was assessed, Dondero had to outline the steps Highland would take to ensure such violations did not occur in the future. As Bill Gates also learned in connection with a missed filing in 2002 after having failed to make a timely filing for an earlier unrelated transaction, the FTC rarely if ever allows a second bite. Significantly, Dondero was fined despite the fact that, due to changes in IRS regulations, Dondero's options, which originally had a 10-year expiration, were later amended to expire one day after vesting, effectively forcing Dondero to exercise when he did, without time to file and observe the HSR waiting period.

While some large shareholders who are otherwise unaffiliated with a company can take advantage of the "solely for purposes of investment" exemption to avoid a filing, officers or directors who directly or indirectly acquire stock in their companies must observe HSR filing requirements if the cumulative value of the officer's or director's shares exceeds the then-applicable HSR threshold (currently \$59.8 million). This is the case regardless of when the 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. Importantly, an option exercise will not be deemed an acquisition **if** (i) the officer 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** (ii) the sale is the same day as the exercise. Otherwise, a filing must be made and the waiting period observed before **any** new stock can be acquired.

A filing can be made well in advance of the actual acquisition, but there must be evidence of an intention to acquire the stock before a filing can be made, such as a vesting schedule and a declaration by the officer of his/her intent. The filing is effective for a year after the waiting period is terminated. For example, if an officer were to file June 1 to acquire stock that would result in total holdings of more than \$59.8 million, and the waiting period terminated on July 1, then he or she would have until June 30 of the following year to acquire enough shares to exceed that amount (*e.g.*, if current holdings are \$50 million, then at least \$9.81 million). If not enough shares were acquired during that period, a new filing would have to be made before any new acquisition that would exceed the threshold. Assuming the acquisition did meet the threshold, the HSR rules provide a five-year period during which the officer can acquire more stock up to the next HSR threshold (currently \$119.6 million) without having to refile.

A final note: while the filing itself usually can be prepared quickly and efficiently, the FTC filing fee for holdings between \$59.8 million and \$119.6 million is \$45,000, which the officer, as the acquiring person, is obligated to pay (although both the officer and the company have to make filings). If holdings will exceed \$119.6 million, the fee is \$125,000.

For any questions relating to the above or to HSR requirements generally, please contact Mark S. Ostrau, Co-Chair, Antitrust and Unfair Competition Group, mostrau@fenwick.com, 650.335.7269 or any other member of the Antitrust Group.

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