Chapter 1

The Modern Deal

I begin with a short deal story.

In 1868, Cornelius Vanderbilt, the railroad baron, went to war against the Erie Gang—Jay Gould, Daniel Drew, and James Fisk. The dispute's genesis was the rather reprehensible conduct of the Erie Gang with respect to the hapless New York & Erie Railroad. The three men had acquired a majority interest in the company, treating it as their personal piggy bank. Not content with the millions in profit reaped through outright theft, the gang further took advantage of Erie's public shareholders by manipulating Erie's stock to their benefit. The gang's machinations so financially weakened the Erie that it defaulted on its debt payments.

Meanwhile, Vanderbilt coveted the Erie railroad for its railroad line out of New York and to Lake Erie. The combination of the line with his routes would provide Vanderbilt with a stranglehold over much of the railroad traffic out of New York. Vanderbilt began to build a position in Erie by purchasing the stock sold by the Erie Gang. When the Erie Gang discovered this activity, they quickly acted to their own advantage. The gang arranged for Erie to issue out bonds convertible into Erie stock to sell to Vanderbilt, thereby diluting Vanderbilt's position.

Vanderbilt soon became aware of the stock issuance and arranged for his lawyers to obtain a court injunction halting them. This was easy for Vanderbilt's counsel as the judge issuing the injunction was on Vanderbilt's retainer. The Erie Gang responded by arranging to have their own kept judge issue a competing injunction restraining Vanderbilt's conduct. Meanwhile, Vanderbilt kept buying, and the Erie Gang circumvented the injunction by arranging for third parties to sell stock to the unknowing Vanderbilt. Fisk purportedly said at the time that "if this printing press don't break down, I'll be damned if I don't give the old hog all he wants of Erie."[1]

Vanderbilt then upped the ante and arranged for an arrest warrant to be issued for all three of the Erie Gang, who promptly fled from New York to New Jersey. They smartly, but illegally, took over $7 million of Erie's funds and yet more unissued Erie stock. The fight then became physical as Vanderbilt sent armed goons to attack the Erie Gang. Vanderbilt's henchmen were repelled by the gang's own hired men, and Fisk even went so far as to have 12-pound cannons mounted on the docks outside Erie's New Jersey refugee headquarters. Ultimately, the war was resolved when the Erie Gang succeeded in bribing the New York legislature to enact legislation validating the trio's actions. Vanderbilt was forced to cut his losses and settle, leaving the Erie Gang in control of the Erie Railroad, now forever known as the Scarlet Woman of Wall Street, and Vanderbilt was out an amount alleged to be over $1 million.[2]

A modern-day observer of corporate America may dismiss this well-known story as an interesting and well-cited relic of long-ago battles from a wilder age. The rule of law has grown stronger since the Gilded Age, and machinations like those of the Erie Gang and Vanderbilt are no longer a part of battles for corporate control. But before you agree, compare the war over Erie with a thoroughly modern dispute.

In August 2004, eBay Inc. acquired 28.5 percent of craigslist. The facts surrounding eBay's acquisition are a bit hazy, but it appears to have occurred due to a break among the prior owners of craigslist, Craig Newmark, James Buckmaster, and Phillip Knowlton. But for whatever reason, and no doubt in pursuit of money, Knowlton arranged to sell his interest to eBay for a rumored $16 million.[3] The sale placed Newmark and Buckmaster in an awkward position. Adamantly proclaimed anticorporatists, the two assert craigslist to be a community service and have publicly rejected the idea of selling any part of craigslist to the public or a third party. Nonetheless, perhaps because Newmark and Buckmaster had no choice, they acquiesced in eBay's purchase. At the time, the reason cited by the two for accepting the sale was that they believed that eBay would not interfere in the core mission of craigslist. "They have no interest in asking us to change that in anyway," Buckmaster stated. "They're happy with us having our full autonomy. They recognize us as experts at what we do."[4]

The parties' honeymoon was short. A dispute among them soon arose over eBay's decision to launch its own free classifieds service, Kijiji. Apparently, eBay didn't think the craigslist people were as expert as they thought. The business competed with craigslist and therefore triggered certain provisions in the shareholders agreement among eBay and the other two craigslist shareholders. Specifically, eBay lost its right of first refusal to purchase equity securities sold or issued by craigslist or to purchase Newmark's or Buckmaster's shares, should either attempt to sell them.

Newmark apparently thought this prenegotiated penalty was insufficient. He e-mailed Meg Whitman, eBay's CEO at the time, and stated that he no longer desired eBay as a craigslist shareholder. Whitman responded with a polite no, instead expressing eBay's own interest in buying craigslist. Clearly there was a communication gap among the parties. Newmark and Buckmaster, both directors of craigslist, responded by adopting (1) a share issuance plan under which any craigslist shareholder who granted craigslist a right of first refusal on their shares received a share issuance and (2) a poison pill preventing any current shareholder from transferring their shares other than to family members or heirs.

The poison pill effectively prevented eBay from transferring its shares, except in discrete blocks below a 15 percent threshold, to any single person. Moreover, Newmark and Buckmaster agreed to the right of first refusal and received the authorized share issuance; eBay did not, probably because it wanted to reserve the right to freely sell its position.

The result was to dilute eBay's ownership of craigslist to 24.85 percent. This action was important, because under the parties' shareholder agreement if eBay falls below the 25 percent ownership threshold, craigslist's charter can be amended to eliminate cumulative voting.

Cumulative voting provides minority shareholders the ability to concentrate their votes by allowing them to cast all of their board-of-director votes for a single candidate rather than one vote per candidate. So if, for example, there are three directors up for election, eBay would have three votes and could cast all of them for one candidate. In the case of craigslist, this right had enabled eBay to elect one director to the three-member craigslist board. But Newmark and Buckmaster now acted to amend craigslist's charter to eliminate this right, and eBay thus lost its board seat. Moreover, the poison pill effectively prevented eBay from selling its shares. Who would want to buy a minority position in a company where the other shareholders did not want you and you were effectively without any control rights? The amendment and the poison pill thus combined to lock eBay into a voiceless minority position.

So eBay sued craigslist, Newmark, and Buckmaster in Delaware, the place of craigslist's incorporation, for breach of fiduciary duty and to have their actions nullified. Meanwhile, craigslist countersued eBay in California State Court for false advertising and unfair and unlawful competition. The parties remain in litigation at the time of this writing, with the two craigslist directors still firmly in control of the company.[5] Given the tremendous dollar amounts at stake, whether the craigslist founders will succeed or desire to keep their grip remains to be seen.

Approximately 140 years separate these two events, but the story of craigslist and eBay shows that in deals, companies and the people running them are still not above fighting to the figurative death, employing every available tactic. The big difference is that these fights largely play out in the courts, the regulatory agencies, or the plains of shareholder and public opinion rather than as brawls in the street or bribery. Microsoft Corporation and Google Inc. will battle over relevant acquisitions in the halls of their antitrust regulator, the Federal Trade Commission, or in the marketplace. The CEO of Google Inc., Eric Schmidt, is hopefully not about to attempt to send armed men to assault

Steve Ballmer, Microsoft Corp.'s current CEO. They both will work within the rules, perhaps even stretching them, to fulfill their goals.

The strengthening of the rule of law and the immense economic and social changes of the past century and a half have placed lawyers in a primary role. The structure and manner of takeovers has not remained static over the years. Nonetheless, as illustrated in these two stories, central tenets of deal-making have emerged and remained. Deals are still in large part about money, earning a return on invested capital commensurate with the risk, but like so many things in life, it is not all about the money. Other factors come into play and skew the process. These include:

- The personality element—individuals often determine the outcome of deals, sometimes by acting outside their company's and shareholders' economic interests. In doing so, these individuals act in their own self-interest and with their own psychological biases to affect deals, sometimes acting to overtly enrich themselves or more subtly aggrandize themselves and build empires.
- The political and regulatory element—Congress, state legislatures, and other political bodies can take direct and indirect action to determine the course of deals, particularly takeovers. Meanwhile, deals have steadily become more regulated and impacted by regulation, whether by the federal securities laws or antitrust or national security regulation.
- The public element—popular opinion and the constituencies that are affected by deals increasingly matter.
- The adviser element—deals have become an institutionalized industry; advisers and the implementation of their strategic, legal, and other advice now affect the course of transactions.
- The game theory element—tactics and strategy continue to matter in deals and deal-making, as these disputes show. As I discuss in Chapters 8 and 9, structuring deals within (and sometimes) outside the law and the tactics and strategy used to implement that plan can define the success or failure of a deal outside of economic drivers.

But of these five noneconomic factors I would argue that personality, the psychological biases and foundation of individuals, has historically been the most underestimated deal-making force.

The Import of Personality

The Erie story was as much about culture as it was about economics. Vanderbilt was self-made but also established money. He represented the period's dominant economic interests. The Erie group, and particularly Jay Gould, could best be characterized as new money, taking advantage of the emergent U.S. capital market to extract their own benefits. The intensity and length of the parties' dispute was no doubt enhanced by this cultural gap, which made each party want to win despite the benefits of compromise. Vanderbilt contemplated settling with these hooligans only when the New York legislature acted and he was left with no choice. The eBay-craigslist story is similarly one of stubborn will and cultural difference. The craigslist controlling shareholders have proclaimed that their opposition to eBay is moral. It is a desire to maintain an environment free from corporate influence in contrast to ex-eBay CEO Meg Whitman's seeming disbelief in Newmark and Buckmaster's expressed intentions and her and her successor's wish to exploit a very exploitable economic asset.

The cultural aspect to these disputes is not unique. Like many facets of our society, deals and takeovers in particular are often driven by culture, as well as other extrinsic factors such as morality, class, ideology, cognitive bias, and historical background. These affect not only whether deals succeed after they are completed but also whether they even occur. The epic battle for Revlon Inc. in the 1980s was likely as contentious as it was because of then Revlon Inc. CEO Michel Bergerac's deep hatred for Ronald O. Perelman, the hostile raider who controlled Pantry Pride Inc., the company that made a hostile bid for Revlon in competition against Teddy Fortsmann's Forstmann Little & Co. Perelman was described as an upstart Jew from Philadelphia, a corporate raider with a penchant for gruff manners and cigars. He was the antithesis of Bergerac's world; Bergerac could not see his prized company going to such a man and often referred to Perelman's bidding company as "Panty Pride."[6] Bergerac's hostile reaction lost him not only his company but also the $100 million pay package Perelman had initially offered Bergerac to induce him to support the takeover.

Similarly, the battle over Paramount Pictures Corp. between Viacom Inc. and QVC, Inc. in the 1990s was as much about Barry Diller, the CEO of QVC, needing to prove that he had escaped the grasp of

Martin Davis, CEO of Paramount, as much as it was about building an integrated media empire. Davis had previously been Diller's boss when Diller had been the head of Paramount. Diller had left the company after repeatedly clashing with Davis. The takeover of Paramount was his payback.[7]

The reason for this bias is in part that takeovers are a decision-driven process helmed by men (and they have been almost uniformly men) who make these choices about when and what to pay or otherwise sell for assets. It was, after all, J. P. Morgan who singlehandedly decided to purchase U.S. Steel and consolidate the steel industry in order to rein in price competition. As such, these are people driven by their own psychological considerations and backgrounds. It's not just about business. These biases can distort the deal process, most prominently injecting uneconomic or economically self-interested factors into takeover decisions. This has tended to be exacerbated by the increasing tendency of the media to personify corporations through the personality of their CEO: Microsoft becomes Bill Gates and then Steve Ballmer, Viacom becomes Sumner Redstone, JPMorgan Chase & Co. becomes Jamie Dimon, and so on.

The result has not been just a centrality in CEO decision making but the encouragement of CEO and individual hubris. In the 1960s, deal-making was about conglomerates—the idea was that management was a deployable resource and a company in diverse industries could resist a downturn in any single sector. But again it was about the individual who could ultimately control these empires. People like Charles Bluhdorn at Gulf + Western Inc., nicknamed Engulf and Devour for its acquisition practices, and James Joseph Ling at Ling-Temco-Vought were headline-making actors and stars of the business media. In the wake of the conglomerates, acquisition activity sharply rose from 1,361 acquisitions in 1963 to 6,107 in 1969.[8] It created an atmosphere ripe for investment in these conglomerates, but it also set up spectacular failures, as many of these companies were built on the idea of an individual CEO's capability without sound financial underpinning.

Conglomerates have largely been buried by Wall Street, but hubris often masked by labels such as "vision" still persist: Perhaps the most spectacular failure and example of the later age is the merger of America Online, Inc. (AOL) and Time Warner Inc. orchestrated by

Time Warner CEO Jerry Levin and AOL co-founder Stephen Case. The deal is cited as one of the worst bargains in history and has resulted in the destruction of up to $220 billion in value for Time Warner shareholders.[9] Moreover, in the deal-making arena, the market constantly proclaims winners and losers based on the outcome of takeover and other contests, rather than on pure economics. Whether it is the clash of wills in Yahoo! and Microsoft—will Steve Ballmer prove his mettle as the newly anointed CEO of Microsoft—or another Stephen, Stephen Schwarzman of Blackstone, out to crown himself the king of private equity, the need for perceived success and the psychology of the actors drive deals.

This latter phenomenon has a name in economics: the winner's curse. Auction theory predicts that winning bidders in any auction will tend to overpay because of a psychological bias toward winning. In takeovers, this has a documented effect that has caused many to overpay for assets, caught up in the dynamics of a given takeover contest.[10] A notorious example again comes from the 1980s, when KKR entered into a bidding war for RJR Nabisco, Inc. against CEO F. Ross Johnson's management-led buy-out team. In frenzied bidding, KKR ultimately won RJR but was forced in the 1990s into a refinancing of the company and an ultimate loss of $958 million.[11] In that time, this philosophy was personified by Bruce Wasserstein, the legendary investment banker sometimes labeled "bid 'em up Bruce." Wasserstein was allegedly notorious for his dare-to-be-great speeches, which egged on his clients to pay higher prices to win a deal. Some of these deals worked out perfectly fine, but others, such as the RJR Nabisco deal on which he advised KKR, didn't fare as well. Wasserstein, by the way, has also authored a book on takeovers, entitled *Big Deals*.[12] Notably, private equity is now suffering the same hangover during this downturn as it struggles with portfolio companies for which in hindsight it overpaid during the headier time of 2004–2007. The recent bankruptcies of such notable private equity acquisitions as Chrylser, LLC, Linens 'n Things and Mervyn's are examples.

This CEO hubris has been reinforced by the institutionalization of deal-making. The deal-making industry is now vast. It involves the investment banks who provide financial advice and debt financing, the law firms who structure and document these deals, the consultants who work on strategic issues, and the media that cover it all. The deal machine provides its own force toward deal-making and completion. In many circumstances, the vast proportion of the fees of these ancillary actors are based on the success of the transaction. If a deal is not completed, they are paid little. But if a deal does succeed, the deal machine reaps tens of millions, too often with little accountability for the future of the combined company. The result is that the voice heard by corporate executives is too often one that pushes their own biases toward completing and winning takeovers.[13]

If deal-making is an industry of individuals, noticeably absent from much of its history has been the board of directors, the entity with primary responsibility for running the corporation. Until the 1980s, deals and particularly takeovers were almost wholly an individual's decision, typically the CEO's. That changed in the 1980s, as a series of decisions in the Delaware courts starting with *Smith v. Van Gorkom* in 1985 placed seemingly heightened strictures on boards to exercise due care and oversight of the takeover process.[14] Since this time, the Delaware courts have tended to place the board as the ultimate decision maker in the sale of the company. This is perhaps the greatest lasting impact of the controversial *Van Gorkom* decision. And although the CEO maintains his or her ability to negotiate and influence the process, the Delaware courts have not hesitated to overrule sale decisions where the CEO has overcontrolled or overtly skewed the process.[15] The result is that today's board is significantly more involved in the sale decision, though boards still too often rubber-stamp CEO wishes.

The regulation of the takeover decision has also largely focused on the sell side. In the past 20 years, Delaware has erected an elaborate skein to govern the standard by which board decisions to sell—or not to sell—are measured. This is a framework we explore further and in more detail later in this book. But the Delaware courts have placed significantly fewer strictures on the buy side, and absent a conflict of interest, the Delaware courts review these decisions under the lower business judgment standard. Courts reviewing a decision under the business judgment rule will not second-guess the acquisition decision unless it is grossly negligent or irrational—a test almost impossible to fail. The result is that the CEO of a company still has fair leeway to negotiate a takeover and to initiate strategy. Take, for example, Bank of

America Corporation's 2008 acquisitions of Countrywide Financial Corporation and Merrill Lynch & Co, Inc. There a headstrong CEO, Kenneth D. Lewis, appeared to drive two quite risky and hasty acquisitions. These decisions ultimately bit the company hard when it was forced to seek a multibillion-dollar government bail-out in light of a $15.3 billion quarterly loss at Merrill Lynch.[16] Though but one example, the "deal from hell" phenomenon—buyer acquisitions that have gone stunningly bad as a result of individualized, bad decisions—has been a feature of deal-making throughout its history.

The result has been that the personality-driven model of deal-making has persisted, driven by the individuals who make the decision to buy rather than sell. In the first year of the financial crisis, this was on display as Treasury Secretary Henry J. Paulson Jr. turned into the market arbiter. During this time, it was Paulson who apparently decided which companies died and which lived and were acquired or bailed out. His choices dictated that Bear, Stearns & Co. should live but left Lehman Brothers to fall into bankruptcy. In the process, Paulson demanded, at least initially, that government-facilitated takeovers be structured in a manner that punished shareholders but did not specifically target officers or directors. Secretary Paulson, a veteran deal-maker and ex-CEO of the Goldman Sachs Group Inc., may have been bowing to political and legal reality in his decision-making. But his approach aligned with his deal-making experience: The bail-out can be viewed as a series of deals where the shareholders bore the costs over management.

The role of personality will be seen in the deals examined in this book and is the reason for its title: Failing to ignore the personality element in deals and deal-making is to ignore one of its central determinants. But if deal-making is to truly succeed, this personal element must be restrained. As will be seen, modern deal-making is often a fight to restrain this element for more rational, economic decision making.

The Evolution of the Takeover

While themes emerged and stayed through the past century and a half, change does come to deals and takeovers. The takeover market is a cyclical one. It has evolved over the past century principally through six boom-bust waves. Each of these cycles has had its own unique character and engendered its own differing and sometimes world-redefining change. This change has typically brought a new regulatory response as each wave alters the playing field for takeovers. The result has been that regulation of takeovers has largely been responsive to the prior or current wave. It has failed to anticipate or account for future possible change, instead regulating backward and shaping the course of the next waves. The regulation of deal-making through history has thus been one of catch-up and circumstance, leaving us with the piecemeal system that we have today, where takeovers are a matter of joint supervision by the Delaware courts and the Securities and Exchange Commission (SEC). Moreover, the regulatory response over the years has revealed another increasingly prominent noneconomic force on the deal market, government, and regulation.

The first true wave and movement for regulation of takeovers occurred during the period of 1890 through 1907 and in the wake of the American Industrial Revolution. This was the time of the trusts—large corporate entities combining diverse enterprises in a single industry with the purpose to control production and, more important, pricing. John Moody, the founder of Moody's Investor Service, calculated that during this first wave, approximately 5,300 industrial sites were consolidated into just 318 industrial trusts.[17] The wave marked the emergence of the modern industrial corporation as much as it was about the creation of monopoly. During this period, Standard Oil of New Jersey, the United Fruit Company, and the first billion-dollar corporation, U.S. Steel, were all created.[18]

The first wave also spurred the first real regulation of corporate combinations, regulation focused on stemming the monopoly power of these new corporate behemoths. Between 1881 and 1901, Congress introduced 45 different antitrust legislative acts intended to regulate the trusts.[19] Antitrust regulation did indeed come in the form of the Sherman Antitrust Act, the Clayton Antitrust Act, the creation of the Federal Trade Commission, and increased regulation of railroads through the Interstate Commerce Act, among other regulatory acts.[20] Moreover, the first corporate regulators were formed by Congress during this time. In 1898, the U.S. Industrial Commission was formed to investigate these new large businesses, and in 1903, the United States Bureau of Corporations was formed to further investigate antitrust violations.[21] But this regulation was focused on the perceived menace of the times—the anticompetitive effects of the trusts—rather than on corporations or takeovers themselves. There were scattered attempts in Congress to adopt a federal incorporation act and to implement a scheme of securities regulation. These attempts failed, and the takeover process was still largely unregulated at the end of this first wave.

The first takeover wave collapsed in the panic of 1907, but a second wave of merger activity occurred from 1916 to 1929. The trigger for this wave was World War I and a new industrial boom within the United States. This second wave was shaped by the regulation adopted in the prior age and the heightened antitrust enforcement of the time, which provided the government the ability to stall anticompetitive, horizontal takeovers. This second wave avoided horizontal mergers, or mergers of competitors, instead producing oligopolies consisting of vertically integrated industrials.[22] But like the prior wave, this takeover cycle did not produce regulation aimed at the takeover process. Rather, the regulatory response to this wave was shaped by the subsequent Great Depression and the general controversy over the collapse of the securities market and the perceived stock-trading abuses of the 1920s. The SEC was formed, and the Exchange Act and Securities Act were enacted to regulate the offering and trading of securities. Although specific regulation of takeovers was forgone, like the first wave of regulation, Congress' actions would shape the next wave of takeover regulation by providing an apparatus to add on future legislation and rules.

This third wave of U.S. merger activity transpired during the period 1960–1971 and was largely caused by that generation's bubble, the conglomerate acquisition craze.[23] At the wave's height, from 1967 to 1969, more than 10,000 companies were acquired, with approximately 25,000 acquisition transactions throughout the entire period.[24] It was in response to this flurry of activity and the consequent emergence of the cash tender offer that modern-day federal takeover regulation originated. In the post–World War II era, takeovers had been staid events conducted primarily through proxy solicitations regulated by both state and federal proxy law. These contests required that the target company approve the transaction and that the target's shareholders vote to approve or disapprove it. In the mid-1960s, however, at the crest of this third wave, there was a sharp comparative rise in unsolicited or hostile takeover attempts. These unsolicited bidders typically preferred to evade the federal and state regulatory apparatus applicable to proxy contests and, instead, often made their takeover attempts via cash tender offer, a vehicle that allowed them to purchase target shares directly without the approval of the target.[25]

These early tender offers were largely unregulated affairs, and bidder conduct was often egregious. The "Saturday night special" was a favorite. In one form, a bidder would embark on a preoffer buying raid to establish a substantial beachhead of ownership at a reduced price. This would be followed by a short period of a first-come, first-serve public tender offer. Stockholders would rush to tender, afraid that they would be left in a minority position in the company or that their shares would otherwise be purchased subsequently for less money. In the wake of these new and unfamiliar tactics, stockholders and target corporations were relatively helpless. Takeover defenses at the time were virtually nonexistent. Indeed, surveying takeover manuals published during this time period, one marvels at the breadth of subsequent developments.[26]

In light of the states' failure to respond, the SEC, the agency created at the end of the second wave, became the principal governmental actor in the drive to regulate cash tender offers. In 1968, Congress passed the tender offer regulation bill introduced by Senator Harrison A. Williams.[27] The Williams Act was almost entirely in the form recommended by the SEC. The act both substantively and procedurally regulated tender offers, and its terms were keyed specifically to respond to the perceived abuses of the time. It enacted a scheme of regulation of tender offers that included disclosure requirements as well as substantive requirements regulating how tender offers were made and prosecuted.

The third wave of merger activity subsided in the early 1970s with the popping of the conglomerate stock bubble and repeated U.S. economic recession. These two events combined to birth the next major issue of takeover regulation: the abusive going-private. These were largely take 'em public high, then buy 'em out low affairs: Majority owners of corporations who had only recently engaged in initial public offerings when stock market prices were substantially higher offered to buy out their own minority publicly held stock at markedly lower prices. Because there was an inherently coercive element in these transactions—the vote was a foregone conclusion since the parent had a controlling interest and the opportune timing was at the parent's discretion—these purchases engendered cries of fraud and unjust enrichment.[28]

In 1975, the SEC launched a fact-finding investigation and simultaneously proposed rules to govern going-private transactions. One form of the proposed rule would have required that a price paid in such a transaction be no lower than "that recommended jointly by two qualified independent persons."[29] Adoption of this rule was delayed, largely because of allegations that the SEC lacked rule-making authority under the Williams Act. Then, in 1977, the Supreme Court in *Green v. Sante Fe Industries, Inc.* overruled the Second Circuit's holding that the antifraud provisions of the Exchange Act embodied in Rule 10b-5 constituted a basis to challenge a going-private decision on substantive grounds.[30] This decision, as well as continued dissatisfaction with state regulation of going-privates, led the SEC to repropose rules. These rules were finally adopted by the SEC in 1979 and, although not as far-reaching as originally proposed, established a new disclosure-based regime for going-privates. The rules now obligate corporations in going-private transactions to express an opinion as to the fairness of the transaction to unaffiliated stockholders.[31] Most notably, the SEC action here marked the first significant regulation not in a takeover wave; takeover regulation had become a full-time affair.

The fourth wave of takeover activity commenced in the late 1970s and early 1980s and ended in 1989 in the wake of the collapse of the high-yield bond market and the S&L scandal. The heightened activity was again quantitatively marked: The annual value of domestic acquisition transactions rose from $43.5 billion in 1979 to a peak of $246.9 billion in 1988 before bottoming out at $71 billion in 1991.[32] Unsolicited takeover activity, mainly cash tender offers, also sharply and fiercely increased from 12 contested tender offers in 1980 to 46 such offers in 1988; the increase was juiced by cheap financing in the form of high-yield or junk bonds.[33] This was the time of the corporate raiders, men of brash personalities like T. Boone Pickens, who would launch hostile bids with a goal to break up or restructure the corporate target. Pickens, in fact, was labeled by *Fortune* magazine as "the most hated man in corporate America" because of his hostile offers for Gulf Oil, Phillips Petroleum, and Unocal Corp., among others.[34]

The fourth wave was different in one significant respect: This time, targets were equipped for defense. The fourth wave was notable for the widespread use of takeover defenses, including poison pills, shark repellents, Pac-Mans, golden parachutes, greenmail, and other defenses discussed more thoroughly in Chapter 8.[35] The renewed vigor of targets, as well as revised bidder tactics, spurred a revolution in takeover methods, resulted in more extended public takeover battles, and led state courts and legislatures, Congress, and the federal courts, as well as the SEC, to confront this phenomenon.

In this cauldron, much of the legal doctrine of takeovers was forged, as well as the structure of today's modern takeover. But to the extent this structure and mode was law-driven, the primary regulator of this period was no longer the SEC and the federal government, but the courts of the state of Delaware. During this time, the Delaware courts promulgated new rules governing the sale or change of control of a company, the appropriate defensive measures a company could use, the applicable standard of review for a going-private transaction, and the validity of the poison pill. The last act was perhaps the most controversial of the court and was opposed by the SEC, which battled and lost in the 1980s to limit takeover defenses. When the takeover market came to a screeching halt in 1989 with the collapse of the high-yield market, deal-making was a much more regulated affair. The Delaware courts had not only trumped the SEC as the primary regulator of these affairs but also erected a set process for takeovers interlaid with the federal one. It was a regulatory scheme that allowed companies to defend the corporate bastion against hostile raiders and activist shareholders with an array of takeover defenses, the most important and prominent of which was the poison pill.

The fifth and sixth waves of takeovers are recent history. The fifth coincided with the tech bubble and was marked by strategic transactions using inflated equity securities and breathtaking valuations. Who could forget the $4.66 billion paid by Yahoo in January 1999 for GeoCities, a company with only $18 million in revenues? Yahoo made the acquisition only months after the Disney–Infoseek, AOL–Netscape, @Home–Excite and USA Networks–Lycos deals—and thereby set off the Internet deal-making craze.[36] During this period, debt was less commonplace as a financing tool, and longer term business considerations dominated acquisition decisions. This wave was less beset by new takeover regulation, largely because any excesses were written off as merely a heady response to the tech bubble. The collapse of Enron Corporation and Worldcom Inc. also directed the typical postbubble regulatory impulses toward corporate governance rather than deal-making.

The downturn was short, and takeovers quickly entered into a sixth wave—the era of private equity and cross-border and global transactions.

This wave was boosted by its own bubble, an unprecedented wave of liquidity and cheap credit brought on by inordinately low interest rates and savings imbalances across the world. The twilight of the sixth wave and the financial crisis is the subject of this book. It covers the changing nature of deals and deal-making in these times and the consequences of the economic crisis we are still witnessing. And while we are currently in a postwave period, the truth is that these waves are coming faster and turning deal-making into a constant affair. Even in the terrible down year of 2008, takeovers globally still accounted for $2.9 trillion in value, and in 2009 takeovers are still likely to exceed $2 trillion in value.[37] Deals are continuing and, as we emerge from this current down cycle, will enter into new and uncharted territory, territory that will be marked by the response to recent events (see Figure 1.1).

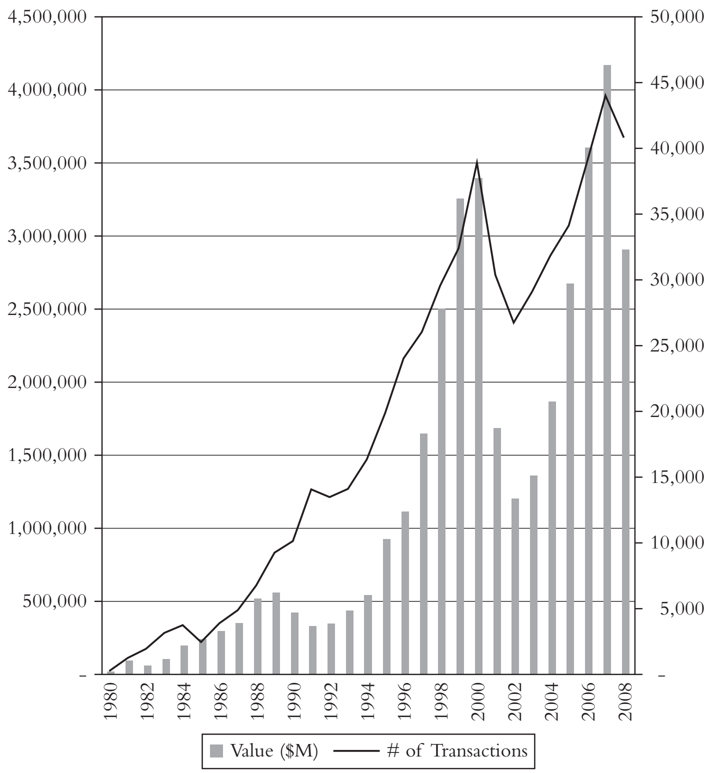

Figure 1.1 Global Takeover Volume 1980–2008
SOURCE: Thomson Reuters

The Takeover Revolution

Deal-making has evolved and moved past the day when Vanderbilt sent armed goons to assault the Erie Gang. Even then the law remained an important guidepost in deciding takeover battles. This was true despite the corrupt malleability of the judges and legislatures enacting these rules. It was, after all, the tainted law enacted by the New York legislature that finally brought the parties to settlement. Since that time, the role of law in deciding and regulating deals, particularly takeovers, has grown increasingly important.

The real shift in takeovers began in the 1960s. Prior to that time, the thuggery and bribery of Vanderbilt's era had gradually faded away into a stronger rule of law. But up until the 1960s, there was little law regulating what companies could and could not do in response to and in making takeovers. The change began only when a more active takeover market began to arise in the 1960s. The skein of law imposed created varying takeover standards. The result is that takeovers are now a regulated industry subject to and shaped by the rule of law. This made the industry the playground of lawyers. It also created a more organized, systematic approach to deal-making.

This latter aspect is reflected in the deal machine. Takeovers today are about party planning—putting together legal, financial, strategic, investor relations, and publicity considerations into one mix. And each of these elements has its own group of key advisers that one retains. So, for example, you see a handful of public relations firms on almost every large deal. Each has its own personality, depending upon the founder. Brunswick Group LLP, spearheaded in the United States by ex-*Wall Street Journal* reporter Stephen Lipin, is more staid and corporate; Joele Frank, Wilkinson Brimmer Katcher, led by the energetic Joele Frank, is perhaps more aggressive. The deal machine has become vast and organized.

In this regard, while central themes have emerged over the years, takeover tactics and strategy have shifted in light of these developments and with each wave. Moreover, as deal-making has evolved, each wave has brought its own mini-revolution, whereby new tactics and strategy bring further regulation in response. The first wave brought antitrust regulation; the third and fourth brought substantive regulation of the takeover process. The fifth wave was the first not to produce significant revolutionary tactics but also the first to fail to produce substantive regulatory change. Yet, this regulation has largely been adopted piecemeal without any holistic view. The result is that the regulation of takeovers today is a hodgepodge of state and federal regulation that both underregulates and overregulates.

The public and political elements of deal-making have become increasingly important over the years. The public here includes not just legislators but the executive bodies of the states and federal government; regulators on a broad-based level including the SEC, the Federal Trade Commission, and the Federal Reserve, as well as those with a particular industry focus; unions and employment bodies; media; lobbying groups; and the public generally. Many of the deals described in this book such as InBev N.V./S.A.'s hostile takeover of Anheuser-Busch, Dubai Ports World's failed acquisition of a number of U.S. ports, and a private equity consortium's successful acquisition of Texas utility TXU, Inc. were more public successes than anything else.

Thus, going into the sixth wave, deals had become a complex affair—mixing economics, politics and interest groups, regulation, public relations, and personality. But the sixth wave brought about its own revolution, which threatens to upset this mix. The events of the past few years have changed deal-making as the quickening pace of financial innovation and extraordinary growth in the global capital markets have changed the way takeovers are structured and implemented. During the sixth wave, from 2004 to 2008:

- Deal-making became a truly global business.
- Sovereign wealth funds first appeared.
- Private equity dominated takeovers and then simply disappeared.
- Hedge funds became ubiquitous, driving shareholder activism and takeovers.
- Derivatives became increasingly complex and a controversial, frequent tool of activist hedge funds.
- The structure of strategic transactions changed in light of the credit bubble, the ensuing crisis, and the drying up of cash financing.
- Private markets became an increasingly important source of capital.
- The public became an increasingly important element of transactions.
- A series of strategic hostile takeovers transformed the playing field for these unfriendly bids.

In particular, shareholders led by activist hedge funds have become more active than ever before. Together with the good corporate governance movement led by the corporate governance proxy advisory services, they are driving a more disciplined approach to deal-making and corporate conduct. These are new actors and new weapons that are unlike anything ever before seen.

The changes fostered by these developments have been skewed by the financial crisis and the massive market panic that occurred beginning in September 2008. The crisis has been a crucible through which the recent changes in deal-making have crystallized and become self-apparent. The stresses brought upon the market created their own magnifying lens, exposing the flaws in the deal system but also shaping its future. It has exploded the old investment banking model and caused actors to reassess the role of financing, particularly debt, in deal-making.

The result is a transformed marketplace but also a regulatory system and an approach to deal-making that is a step behind. The deals that follow are about the past years of frantic change and crisis, the future of deals and deal-making, and the appropriate response of dealmakers and regulators. It is about the glory and failures of deal-making and the role of dealmakers. It is about the transformative transactions in the new millennium and a history of deal-making in a soaring and perilous time. It is about how deals will be done, and perhaps regulated, in the future.

But to understand deal-making today, it is first necessary to take a step back and explore its driving transformational force in the sixth wave—private equity.