IRRECONCILABLE DIFFERENCES: DIRECTOR, MANAGER AND SHAREHOLDER CONFLICTS IN TAKEOVER TRANSACTIONS

INTRODUCTION

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2:55 – 3:10 pm

Robert Kindler: It's good being here. I have been pretty lucky in my career because in the twenty years I was at Cravath and eleven years as a banker, I have actually been involved in lot of the cases that you are all studying. I did the original *Time Warner* defense way back when and was involved in things like *Grand Metropolitan-Pillsbury*, the *Interco* decision where Chancellor Allen talked about the pill, and even just in the last year I was involved in *Barnes & Noble*, *Crown Media* where I got to testify in front of Chancellor Chandler, *Dollar Thrifty*, and lots of others. So I think I have a pretty unique view of law and the facts around it. I actually spent this weekend at New York Stock Exchange and putting out the announcement that we put out this morning. I am going to talk about that in the context of what you are all studying.

The interesting thing about my profession as a banker is that the law guides a lot of what you do. You spend an enormous amount of time at these board meetings talking about what the law is and making sure that you guide your conduct in accordance with all of this case law. Couple of things, as Professor [Davidoff] noted, I did come up with the matching rights back in early 1990 but I am not at all proud of that, and it actually is a demonstration of what happens in M&A. Back in the early '90s we were advising Chris-Craft who was buying Pinelands and for very technical reasons because of a preexisting agreement with Disney, Pinelands was unable to give a breakup fee. They actually had an agreement that said, "you can go out and sell Pinelands but don't you give a breakup fee to a third party." So the only thing I could come up with was saying, "fine, as long as we give a last look in matching rights, we would do that." So we entered into the agreement with Chris-Craft, got these matching rights. But of course, what happens with M&A is that once anyone puts matching rights in, everyone puts matching rights in regardless of what the facts are. I actually think the

*The views expressed in this introduction are his own and do not reflect the views of Morgan Stanley, nor do his views constitute legal advice matching rights are something that certainly in the private equity arena you want to avoid. In the strategic world, it doesn't really matter very much, it doesn't really stop people from bidding but when you have private equity bidders, the odds of people showing up with matching rights are very, very small.

The other thing I note is I heard a discussion before on majority of the minority, and the importance of having it or not having it in special committees, and I think that a lot of this theoretical thinking about majority of the minority would be well informed if people saw what happened in the reality of deals. So I will just give you an example. I was advising the special committee of Hearst-Argyle, which was controlled by Hearst. Hearst made a bid to buy out the minority of Hearst-Argyle, this was couple of years ago. And Hearst itself—this was the majority shareholder—proposed a majority of the minority condition because their lawyer said "this would be a very good thing to have; why not have a majority of the minority condition?" It would just give you extra protection in Delaware. I saw this representing the committee and realized that there was one shareholder that was out there that controlled a lot of the public flow. So what they were basically doing is giving a veto to the shareholder out there. I said "you guys have got to be kidding. Why would you do that?" They said, "well our lawyers tell us." Okay. So we went down the path and there was a price of $28 a share that we thought would work. The controlling shareholder said, "no way am I selling below $30," and the special committee actually went to Hearst and said "we will waive the majority/minority, we special committee don't want the majority of the minority, we want to do a $28 dollar deal," and they refused. Post script, the company sold for $3 a share about 18 months later. So be careful what you wish for, and I think people just think about these things and they don't think about the practical aspects of them. I think the majority of the minority makes no sense. It means the special committee, when the special committee is negotiating with the controlling shareholder, if the controlling shareholder knows there is a majority of the minority, there is no reason that they would ever put their best price on the table because they figure this is just the first step of their negotiations. The controlling shareholder thinks "we will do this, then we will have to negotiate with the majority of the minority and we will have to negotiate with strike-suit lawyers." It doesn't make a lot of sense to me.

Another thing that I find quite interesting are go-shops, which technically are a joke. Go-shops have never and will never result in anyone showing up. What's critically important in go-shops is that you tell the board no one is showing up. Don't create the illusion that by having a go-shop you have done your job under *Revlon* to get the best price available. So when I was in front of the Burger King board, I said look, "we will get a go-shop; it's interesting but don't for a second think that that satisfies your duties as a board member. You had better be sure you are getting the best price now because no one is showing up at this party." I think what unfortunately happened in *J. Crew* is that the board somehow believed that they were sanitizing their actions by having a go-shop so that they can go with this totally flawed process where management ran off without any knowledge of the board and provided confidential information, everything gets fixed by a go-shop. Well of course that was ridiculous. No one was ever going to show up. What was even more ridiculous was that a big part of the settlement with the plaintiffs' lawyers was extending a meeting with go-shop, and that's exactly what happened. So after they did the Go-shop, which by the way was during the Christmas season—a very good time to try to shop—the buyers of retail companies, after they did that meaningless Go-shop, they settled by extending it for two more weeks.

But there are a lot of lessons from *J. Crew*, and I am going to talk a bit about *Del Monte*, and I am going to talk also about New York Stock Exchange/Euronext. The lesson from *J. Crew* is that none of this had to happen. If the CEO had just gone to the board and said "you know what, I think it might be a good opportunity to do a private equity deal here, do you mind if I go talk to third parties?" What was the board going to say? You had a pretty dominating CEO, the board probably would have said, "fine, go have those conversations and then we will take control of the process." It was totally unnecessary.

The other thing in *J. Crew* that people have totally missed is what the conflicts were at J. Crew and the fact—and I am going to get to *Del Monte* in a moment—but the boutique investment banking firms have made a lot of *Del Monte* and why it is you need to have these boutique firms involved in these transactions. In fact, *J. Crew* was the opposite. *J. Crew* is an example of why boutique firms can't possibly provide the advice that boards need because the most important question for the J. Crew board, knowing that a go-shop was never going to go anywhere was: Were they getting the best price achievable at that moment? The only way they could have known that is if they had a banker who could have told them that they were levering up the company the most they could lever it up. They had a very good boutique firm, they had Perella Weinberg which is a great firm but they can't possibly provide the most important advice that the board needed. There were also other bad facts in that the way Perella Weinberg got picked. Remember, the fact here was that Goldman Sachs went out with no authority and provided confidential information to third parties. One of the board members of J. Crew was a former Goldman Sachs partner. That board member went out and picked the boutique firm, which was Perella Weinberg, which was Peter Weinberg, a former Goldman Sachs partner. You couldn't have had worse facts, and yet with the worst possible facts you have they didn't go out and hire a full service bank that could have told them what the actual leverage would have been for that deal. Jim Walter Reed heard me on CNBC a couple of weeks ago, and I think this concept of boutique firms—which do have a very valuable role, by the way—that somehow they can provide the full service and that they are conflict free is kind of ridiculous which brings us to *Del Monte* which I know you spent a lot of time. I don't refer to it as *Del Monte*, I refer to it as the Barclays case.

But *Del Monte* in my mind is a pretty classic example of how in our business—either as lawyers or bankers—is not a complicated business. Your job is to do what is right for the client, not what is right for the bank or the law firm. It's actually not very complicated. What the judge decided in there was absolutely right. There was no reason why the board allowed Barclays to go and finance a bidder. There was just no reason because they couldn't articulate why that is a good thing for Del Monte and its shareholders. And by the way, there is nothing new about this. A couple of years ago in the *Toys "R" Us* case, Credit Suisse got slammed for even asking to finance a bidder after the special committee had said no. So our practice—it's not just Morgan Stanley's practice —but our practice has been, since the *Toys "R" Us* case, is that we will only provide financing to a bidder when we are advising a special committee if we are specifically asked by the special committee to do it. Meaning that the special committee has to make the request after they are advised to why this is a good thing to do—a good thing for the company, not for Morgan Stanley. And by the way, there are circumstances where that's the case. Last year, again very public, Seagate decided to go out and see whether or not they could do a go-private deal. Seagate is a disc manufacturer that traded in a very low multiple. Seagate went out and decided with a very careful process by the board that they wanted Morgan Stanley to provide financing to bidders to keep it confidential. But from the very first day, we had a boutique investment banking firm alongside us and it was agreed that at the end of the process we would let other financing sources in and that we wouldn't lead any financing. It was basically all done to keep the process confidential and demonstrably at the request of the company. By the way, what happened was at the end of the process we brought other financing sources in, it leaked within 24 hours which of course is always the case. In any event, the lesson from *Del Monte* is that it's all about the client, it's not all about the investment bank or the law firm. You wouldn't think that was complicated but it seems to be.

Then back to NYSE Euronext. This was really interesting because everything that we have learned kind of over time, all the lessons from *Time Warner* will really come to bear here. Here, the New York Stock Exchange and Euronext after literally years of studying decided to do a strategic merger. Clearly, not in the *Revlon* mode, they decided that scale mattered, global presence mattered, etc., and they signed up the deal. Then NASDAQ and ICE come in with a proposal, and what is the board supposed to do? Is the board in the *Revlon* mode? Is the board not in a *Revlon* mode? Now interestingly, even if the board was in a *Revlon* mode, which it wasn't, what was proposed was kind of ridiculous. Aside from all the regulatory issues which are extreme, the regulatory issues are extreme for that deal not only in the U.S. but in Europe. But even forgetting that, everyone acknowledges that New York Stock Exchange would probably be trading in the high $30s, certainly over $35 a share if there was never any deal, and these guys proposed $42 a share. Well who would ever sell a company for $42 a share if you are trading at $36 a share? It's nothing to even talk about. Now having said that, they were not in *Revlon* mode and they were in the mode of basically saying that "we are continuing with our strategic deal," and I thought it was pretty interesting how much time was spent at the board meeting talking about *Time Warner*, talking about strategic mergers, talking about all the things that people talk about in your life and the school here.

Then there is the whole thing about poison pills. First of all, poison pills are affirmatively a good thing notwithstanding what ISS says. And by the way, ISS kind of has recognized that they are a good thing. They say "fine, you can put them in for limited purposes with limited duration, but I am not sure about the threshold levels." But they kind of conceded that. But to kind of go back with the story with *Time Warner*, we successfully defended Time against the Paramount bid in the early '90s to create Time Warner. We agreed—we, Time Warner—agreed that we would not have a poison pill in place, as a matter of policy that we would not have a poison pill in place. And then Edgar Bronfman and Seagram started acquiring stock in Time Warner and they went to 9% and then 10% and 13% and every institution called up Time Warner and asked them why they didn't have a pill. It was like, "how could you guys let these guys buy control in the market?" Well, obviously they put the poison pill in. I think poison pills have a very, very good use in stopping creeping acquisitions and giving some control to the board. I happen to agree with Chancellor [Chandler] that the [Delaware] Supreme Court is probably wrong that you can keep a poison pill in forever and that it is preclusive having a staggered board and a pill, but that is the law in Delaware. I don't think it made a difference in the Airgas-Air Products deal at a lowball bid by Air Products. But I think the general concept that poison pills are not good for stockholders is just misguided. So with that, I am going to sit over there.