GODS AT WAR

SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLOSION

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Preface

I wrote this book for two reasons. First, readers of my *New York Times* DealBook column often ask me if there is a book explaining the mechanics of the deal and takeover markets. Prior to this time, there was nothing that quite fit. I hope this book fills this gap and provides even the most inexperienced reader and student an inside look into the intricacies, legal and otherwise, of deals and deal-making.

Second, recent catastrophic events in our capital markets have left many baffled, unable to understand what occurred and what it means for the future. This book is an attempt to order and make sense of the events leading up to and through the financial crisis. *Gods at War* is therefore the story of deal-making in the sixth takeover wave and through this crisis. It is about the private equity boom and its implosion, the return of the strategic transaction and hostile takeover, the failure of the investment banking model, the government's deal-making during the financial crisis, and the changes occurring in the capital markets during this time.

This book is ordered chronologically. I begin in Chapter 1 with a brief history of takeovers and a discussion of the key elements driving deals in today's capital markets. In Chapter 2, I trace the origins of private equity through a history of its creator, Kohlberg Kravis & Roberts Co. This detour is necessary because private equity is a key force driving the changes in today's deal market.

In Chapters 3 and 4, I move to fall 2007 and spring 2008. In these two chapters, I discuss the multiple implosions of private equity and other transactions and what it means for the future of deal-making, as well as private equity itself. I do so by first discussing in Chapter 3 the initial material adverse change disputes in the fall of 2007 and the key battles during this time, particularly that of Accredited Home Lenders, the mortgage originator, versus Lone Star Funds, the private equity firm. In Chapter 4, I discuss the second wave of deal disputes, which began in November 2007 with Cerberus's successful attempt to terminate its acquisition of United Rentals, the equipment rental company. This second wave of disputes would be driven by private equity's repeated attempts to terminate deals agreed to prior to the financial crisis and would be shaped by the material adverse change disputes earlier in the fall.

In Chapter 5, I discuss the sovereign wealth fund phenomenon. I use Temasek Holding's investment in Merrill Lynch as a launching board to discuss the nature of these investments during the initial phase of the financial crisis. Sovereign wealth funds may have had a brief heyday, but these investments tell us much about the regulation and importance of foreign capital. In Chapter 6, I move to the next phase of the book, discussing the fall of Bear Stearns. Much has already been written on this event, but my focus is new. In this chapter, I principally examine the innovative deal structures created and the deal's significance for later deal-making and government action.

In Chapters 7, 8, and 9, I turn to the time after Bear Stearns's fall. In Chapter 7, I discuss the rise of the hedge fund activist investor and its potential for transforming change in the deal market. I do so by detailing two significant shareholder activist battles in the spring of 2008: Jana Partners' targeting of CNET Networks, Inc., the Internet media company, and Children's Investment Fund's and 3G Capital Partner's targeting of CSX Corp., the railroad operator.

In Chapter 8, I discuss the increasing role of hostile takeovers in deal-making through the lens of Microsoft Co.'s hostile bid for Yahoo! Inc. and InBev NV/SA's hostile bid for the Anheuser-Busch

Companies Inc. I connect the rise in shareholder activism detailed in Chapter 7 with the increased rate of hostile activity in recent years.

Chapter 9 discusses the changing nature of strategic transactions through and beyond the financial crisis. I examine the innovation that has recently occurred in the strategic deal market, in particular the deal structures used in the acquisitions of Wm. Wrigley Jr. Co. by Mars Inc. and Wyeth by Pfizer Inc. Both transactions borrowed heavily from the private equity model and were engineered to address the issues raised by the serial implosion of private equity deals in 2007 and 2008, discussed in earlier chapters.

I conclude with Chapters 10, 11, and 12. Chapter 10 discusses the government as dealmaker in the serial bailouts of AIG, Bank of America, Citigroup, and others and the implications of "government by deal" for our economy and for deal-making specifically. The last two chapters look to the future. In Chapter 11, I discuss potential reform of the nation's takeover law. In the final chapter, Chapter 12, I draw on the conclusions of the prior 11 chapters to sketch the future of deal-making in a crisis age and beyond. In this final chapter, I also discuss whether deals and deal-making add value to our economy and examine the related question of the role of deals and deal-making in precipitating the global financial crisis.

We live in a time where many corporate veterans wonder whether a long 50-year cycle of deal-making that began with the go-go 1960s has come to an end, an end driven by a massive deleveraging of the financial system. But I am more hopeful believing that deals and deal-making will continue to be an integral, substantial, and necessary part of our capital markets. Either way, the events covered in this book are likely to set the course for deals and deal-making for the foreseeable future.

Ultimately, *Gods at War* is about the factors that drive and sustain deal-making. It is a legal-oriented history of the recent events that will alter and strongly influence the future of deal-making. It is also the story of the deal machine, the organizations built up to foster deal-making as well as the increasingly important role of shareholders themselves. In the midst of these forces sit the corporate executives and their advisers who decide whether to deal or not. Their own individual personalities and ego-driven decisions further shape and drive deal-making. It is here where I draw the title for this book. These individuals, like gods, can determine the future of companies and our economy.

Author's Note

Portions of this book cover topics first written about in the *New York Times* "DealBook" and the M&A Law Prof Blog. In addition, parts of this book were taken or based on my following prior writings: "Regulation by Deal: The Government's Response to the Financial Crisis" *Administrative Law Review* (forthcoming) (with David Zaring); "The Failure of Private Equity," 82 *Southern California Law Review* 481 (2009); "Black Market Capital," 2008 *Columbia Business Law Review* 172; "The SEC and the Failure of Federal Takeover Regulation," 34 *Florida State University Law Review* 211 (2007); and "*Accredited Home Lenders v. Lone Star Funds:* A MAC Case Study" (February 11, 2008) (with Kristen Baiardi).

Prologue

The social caste of New York is still set by money and the power to control it. Money provides an entrée into New York society, but the power quotient—your position in the financial industry—ranks you among your peers. It was thus no coincidence that the New York social event of 2007 was the 60th birthday party of Stephen Schwarzman, chief executive officer (CEO) and co-founder of the private equity firm the Blackstone Group.

The $3 million Valentine's Day–themed gala was held on February 13 at the Seventh Regiment Armory on Park Avenue. Amid the bomb-sniffing dogs and paparazzi, a who's who of finance, government, and media attended. These included John Thain, now the embattled former CEO of Merrill Lynch & Co., Inc.; Sir Howard Stringer, chairman of Sony Corp. of America; Leonard A. Lauder, chairman of the board of Estée Lauder Inc.; former Secretary of State Colin L. Powell; and Maria Bartiromo, the proclaimed money honey of CNBC. Rod Stewart and Patti LaBelle serenaded the guests, and the party ended at a punctual midnight, sufficiently early to allow everyone to return to work the next day.[1]

The media publicity and attendance were not just because it was an expensive birthday party thrown for a billionaire. Rather, this was the unofficial coronation of Schwarzman as the new king of private equity. Henry Kravis, along with Jerome Kohlberg Jr. and George R. Roberts, founded the private equity industry back in the 1970s and 1980s. Their firm, Kohlberg Kravis Roberts & Co., known as KKR, had dominated the field until the 1990s. Schwarzman's Blackstone had recently surpassed KKR as the largest of the private equity shops with assets under management of $78.7 billion.[2] This was Schwarzman's coming out party. Henry Kravis, still co-CEO of KKR, did not attend, and would not even publicly state whether he was invited.

And so what if the press coverage in the *New York Times*, the *Wall Street Journal*, and elsewhere was less than favorable, describing Schwarzman as "controlling" and nouveau riche, a man who would complain about his staff's squeaky sneakers and who regularly feasted on $400 apiece stone crabs.[3] Schwarzman, Blackstone, and the entire private equity industry were on top of the capital markets. In 2006, private equity would be responsible for 25.4 percent of all announced takeovers in the United States.[4] The year 2007 was shaping up to be even better. In the prior year, private equity had globally raised $229 billion in new funds to invest.[5] Given the availability of easy credit, these funds provided private equity with the ability to make more than a trillion dollars in new acquisitions. No company seemed immune from takeover.

Blackstone had proved this only a few days before. On February 9, Blackstone had completed the $39 billion leveraged buy-out of real estate company Equity Office Properties Trust. The buy-out was the largest private equity acquisition ever, even bigger than KKR's historic RJR/Nabisco acquisition. Blackstone had beaten out Steven Roth's Vornado Realty Trust in an epic takeover battle begun by an e-mail sent to Roth by Equity Office's founder, the cantankerous Samuel Zell. The e-mail had simply stated: "Roses are red, violets are blue; I hear a rumor, is it true?" Roth's reply: "Roses are red, violets are blue. I love you Sam, our bid is 52."[6] Schwartzman's Blackstone had trumped Vornado's love offer with a bid of $55 a share.

Schwartzman's party was thus not just for him, but for private equity. In a few short years, Schwarzman and his cohorts had revolutionized the takeover market. It was not just Schwarzman and private equity. The period from 2004 through 2008, a time of extraordinary growth and near financial calamity, transformed the U.S. capital markets. The financial revolution, globalization, and the financial crisis permanently changed deal-making, creating perils and opportunities for dealmakers and regulators. It is a pace of change and innovation so fast that regulators have yet to account for the new takeover scene and its systemic risks, a failure ably on display in recent years.

But Schwarzman's party not only marked this new paradigm but also was symbolic in the way of prior lavish Wall Street social events such as the Roman Empire–themed party Tyco International Ltd. CEO L. Dennis Kozlowski threw for his wife on the island of Sardinia or Saul Steinberg's 1988 party for his daughter's wedding in the Temple of Dendur at the Metropolitan Museum of Art. These parties not only heralded a new king but also ominously foreshadowed the perils of hubris and coming market disruption.[7]

In the years after Schwarzman's celebration, the federal government would implement the largest capital markets bailout in history; Blackstone would trade as low as a fifth of its initial public offering price; the stock market would viciously decline; the private equity market would evaporate; distressed acquisitions would overshadow a chastened and diminished takeover market; Bear, Stearns & Co., Inc. and Lehman Brothers Holdings, Inc. would implode; the credit markets would dry up; sovereign wealth funds would invest billions in ailing U.S. financial institutions; and both Anheuser-Busch Companies, Inc. and Yahoo! Inc. would be the subject of historic hostile offers. But all of this would be the future. Instead, on that night, February 13, 2007, Schwarzman was the symbol of private equity's wealth and dominance and the enduring nature of money in the city of New York. He was the epitome of the revolution occurring in the capital markets.

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