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KINDER MORGAN: WHEN MANAGEMENT CONCEALS A BUYOUT FROM THE BOARD OF DIRECTORS

Jonathan Tiegerman*

Chief management officials at Kinder Morgan, Inc. considered the prospect of a leveraged buyout for months before letting the oil-and-gas pipeline company’s Board of Directors in on the deal. The actions of management, keeping the Board in the dark about the developing private equity buyout, which marks one of the largest of its kind ($14.8 billion), illustrates the divergent interests of top management and directorial boards in today’s public companies.

The wedge driven between a company’s Board of Directors and its managerial foremen, often in the form of handsome compensation packages promised to management by private equity buyers, highlights an old concern for public investors but with a new twist: In private equity deals, investment banks are now seeking to concurrently don multiple hats as both advisor to the target company and as investor in the target. This is precisely the scenario that has unwound in the Kinder Morgan buyout whereby Goldman Sachs Group Inc. initially acting as financial advisor to Kinder Morgan later became a principal investor in the public-to-private buyout of its client.

The story begins in February of 2006 when Kinder Morgan president C. Park Shaper enlisted Goldman Sachs to propose strategies in order to augment the gas-and-oil pipeline company’s shareholder value. The alternative of a leveraged buyout was not suggested until March. In April, president Shaper was joined by Rich Kinder, founder of Kinder Morgan and 18% owner of the company at the time, who was to lead a potential buyout group. The private equity arm of the world’s foremost investment bank, Goldman Sachs Capital Partners had negotiated a not-so-shabby arrangement with the Kinder Morgan management buyout group to serve as the leveraged buyout’s principal investor.

In the subsequent months, the terms of the buyout were negotiated (although negotiations imply a degree of contentiousness which I surmise was lacking here) with Goldman Sachs Group on one side of the negotiation table.

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1 See Berman, Dennis and Henny Sender, In Kinder LBO, Board Was Left in Dark For Over 2 Months as Deal Percolated, WALL STREET JOURNAL, Sept. 29 2006 at C1.

2 See id.
advocating the interests of Kinder Morgan shareholders opposite Goldman Sachs Capital Partners, representing the investment bank’s proprietary interests. News of these ongoing developments did not reach Kinder Morgan’s Board until May 13. Already in place at that time were the armies of lawyers, from Weil, Gotshal & Manges LLP, and Wachtell, Lipton, Rosen & Katz, hired to advise the management buyout group in the public-to-private transaction.

REVLOn: DUTY TO AUCTION THE CONCERN TO THE HIGHEST BIDDER

In this situation, the Board and management possess conflicting interests. Consequently, the amount of time the Board is given before shareholders vote on the buyout may significantly weigh upon the success of the buyer’s bid. The Board of Directors, upon learning of the potential sale of the company, will attempt to control the process and the terms of the sale in a manner most favorable to the company’s shareholders. This reflects the edict handed down by the Revlon case adjudicated during the leveraged buyout boom of the 1980s. In Revlon, the court opined that the directors’ fiduciary duty to maximize shareholder profits could only be accomplished by obtaining the highest price for the benefit of the stockholders.

Application of a Revlon duty depends upon the effect the corporate combination will have on stockholders’ meaningful participation in corporate governance. Thus, the demarcation between Revlon and non-Revlon deals hinges upon a change of corporate control. If there is a change in corporate control, as in a leveraged buyout, wherein shareholders will no longer participate in corporate governance because they are “cashed out”, a Revlon duty is triggered. This is in contrast to a stock-for-stock merger, for instance, wherein shareholders will retain their voting rights via newly issued stock in the surviving company: this transaction is entitled to business judgment deference. This result is equitable since the shareholder who receives stock in the surviving corporation has preserved her right to enjoy the future maximization of wealth and has presumably lost nothing.

The significance of a change in corporate control is deserving of a Revlon duty to protect shareholder interests: “there are few events that have a

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3 See id.
5 Id; see also Smith v. Van Gorkom
7 Id.
8 See In re Santa Fe Pacific Corp. Shareholder Litigation, 669 A.2d 59 (Del. 1995).
more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise.9 Revlon reaches a logical result since a holder of equity who is pushed out of the company is denied participation in the future profits of the company. That shareholder has a compelling right to enjoy a maximization of profits today since there is no pot of gold at the end of the rainbow.10

Faced with a buyout which would effectuate an immediate divestiture of the shareholders’ present and future interests in Kinder Morgan, Inc., the Board of Directors owed a Revlon fiduciary duty to put the company up for auction in order to fulfill its obligation to shareholders to obtain the richest purchase price. The competing financial interests of the management buyout group to see the private equity bid succeed were furthered by CEO Rich Kinder’s evasive tactics. As aforementioned, the Board of Directors only became aware of Goldman’s buyout proposal two months after the advisory firm initiated discussion of the transaction due to management’s careful concealment of the matter. Mr. Kinder and his constituents appeared to entrench the company from competing offers agreeing, at the behest of Goldman’s private equity arm, not to negotiate competing bids with third parties for 90 days.11 Such maneuvers suggest that the rights of Kinder Morgan shareholders to enjoy a present maximization of wealth may have been pretermitted.

THE ROLE OF THE BANKER

Investment banks are generally responsible for pricing and structuring transactions that satisfy the needs of market participants. By distributing products and making markets, investment banks provide a forum for buying and selling in the context of business combinations (M&A) and underwriting (capital formation). More simply, investment banks lead clients who are mired in some quandary to firmer ground by advising clients on creating frameworks for internal capabilities and proposing external opportunities. Financial advice may take the form of negotiating the terms of a deal, analyzing financial, commercial operational, and strategic assumptions of a business, rendering valuation assessments of a business combination’s price risk, implementing a stock price performance analysis, a discounted cash flow analysis of a target

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10 See supra note 6 (explaining that “public shareholders cannot participate in the long-term strategic value of the [merger].”)
11 See Berman, Dennis and Henny Sender, In Kinder LBO, Board Was Left in Dark For Over 2 Months as Deal Percolated, WALL STREET JOURNAL, Sept. 29 2006 at C1.
company’s earnings and estimated future earnings, or various other services.

The horizontal design of investment banks and pedigree personnel provide the heavy firepower that clients desire in devising and executing business strategies in short periods of time. Because of the technical nature and exclusivity of the complex solutions engineered by investment bankers, a kind of trustee-client relationship naturally follows.

Of considerable controversy are the fairness opinions issued by investment banking institutions. The opinion is supposed to provide assurance that a deal is fair from a financial standpoint. Because the fairness opinion insulates a company’s officers and directorial Board from legal liability to company shareholders’, companies are willing to pay hefty sums for this flimsy document. Moreover, the subjective nature of the determination that a deal is fair makes the opinion nearly immune from challenge and of minimal value to shareholders in deciding whether to support or vote against a deal.

CONFLICTS OF INTERESTS: BANKERS CAN DO WHAT LAWYERS CANNOT

The relationship existing between investment bankers and their clients during the rendition of advisory services is not substantially unlike the attorney-client relationship. From the perspective of the client, the advisor (whether a law firm or an investment bank) is expected to remain loyal to the client’s interests for which the advisor has been employed. On the basis of this expectation of loyalty, investment bankers will be privy to confidences and secrets that the client would not otherwise reveal. Thus, analyzing the potential conflicts of interest that may eventuate in the analogous attorney-client relationship, according to the ethical boundaries of legal standards, may provide some insight into the potential means by which banker-client conflicts should be addressed.

The “conflicts of interest” issue is one that lawyers have struggled with for many years in determining when an attorney is not fit to represent a client because of a conflict of interest. The conflict of interest embodies the age-old premise that “no man can serve two masters.” As admitted by Roy Simon, preeminent professor in the field of lawyers’ ethics, conflicts of interests remain thorny matters to evaluate because of the corresponding “complexities of even

12 See e.g. Weinberger v. UOP, Inc., 517 A.2d 653 (Del. 1986).
13 See e.g. Daimler-Chrysler Merger Agreement (substantiating the $55 million that the Chrysler Board paid Credit Suisse First Boston for its opinion that the terms of the merger of equals with Daimler Benz were fair.).
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garden variety conflicts questions."15 The analysis begins with a discussion of concurrent conflicts. Under the New York Code of Professional Responsibility and the equivalent ABA Model Rule, a lawyer is prohibited from accepting or continuing representation of a client where doing so would be directly adverse to the interests of another client; i.e. advocating the interests of one client directly harms the interests of another current client. This was the holding of the Second Circuit16, thereafter enacted in the New York Code of Professional Responsibility (DR § 5-105(a)):

A lawyer shall decline proffered employment if the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve the lawyer in representing differing interests, except to the extent permitted under subdivision (c) of this section.17

Subsection (c) elaborates on the former providing that independent professional judgment is not deemed to be adversely affected "if a disinterested lawyer would believe that the lawyer can competently represent the interest of each and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved."18 Therefore, notwithstanding a concurrent conflict, a lawyer may accept or continue representation of directly adverse clients if each client gives informed consent (preferably confirmed in writing) and if the lawyer meets the "disinterested lawyer" standard defined in DR § 5-105(c). This standard is an objective one: if Jiminy Cricket believes the lawyer will be able to provide competent and diligent legal representation, then the attorney's independent professional judgment is deemed in tact and the representation is free to commence or continue.

Another kind of conflict involves the situation where the lawyer

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16 Cinema 5 v. Cinerama, Inc., 528 F.2d 1384 (2d Cir. 1976).
17 Stephen Gillers & Roy D. Simon, Regulation of Lawyers: Statutes and Standards, NEW YORK DISCIPLINARY RULE § 5-105 (2006); see also e.g. NY DR § 5-101 (2004)(stating that "a lawyer shall not accept or continue employment if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property or personal interests, unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby and the client consents to the representation after full disclosure of the implications of the lawyer's interest.").
18 NY DR § 5-105(c) (2006).
obtains a financial interest that is potentially adverse to the interests of his/her client. Ethical Consideration 5-4 of the New York Code of Professional Responsibility illustrates the drafters’ concerns in one instance where during the course of an attorney-client representation, a client under criminal prosecution agrees in place of a fee (either in whole or in part) to grant the lawyer a beneficial ownership in literary rights relating to the subject matter of the legal representation. Here, there is a risk that the lawyer “may be tempted to subordinate the interests of the client to the lawyer’s own anticipated gain. For example, a lawyer in a criminal case who obtains from the client television... rights with respect to the case may be influenced, consciously or unconsciously, to a course of conduct that will enhance the value of the [television] right to the prejudice of the client.”19 This conflict can also be cured by informed consent so long as the attorney’s independent professional judgment is uncompromised.

Several policy arguments underlie the legal profession’s cynicism toward legal practitioners engaging in representations, which pose potentially significant risks of concurrent conflicts. Specific to lawyers alone, the attorney client relationship binds the attorney with a duty of confidentiality.20 Hence, there is concern where a concurrent conflict exists, an attorney possessing confidential information about Client A in an earlier or present matter would be tempted to use such confidential information when later representing Client B against Client A to the disadvantage of Client A.

The other policy reason against concurrent conflict representations stems from the client’s expectation of loyalty from his trusted advisor. The sacrament that is the expectation of loyalty was best illustrated by a Connecticut state court:

When a client engages the services of a lawyer in a given piece of business he is entitled to feel that, until that business is finally disposed of in some manner, he has the undivided loyalty of the one upon whom he looks as his advocate and his champion. If as in this case, he is sued and his home attached by his own attorney who is representing him in another matter, all feeling of loyalty is necessarily destroyed, and the profession is exposed to the charge that it is interested only in money.21

21 Grievance Committee v. Rottner, 203 A.2d 82 (Conn. 1964).

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While this duty is legally binding betwixt lawyers and their clients, the expectation of loyalty is not exclusive to the legal profession. The legal seal stamped upon the attorney-client relationship is largely a consequence of the sacred regard with which we behold the relationship due to its historical significance and longevity in Western society. Our protection of the former relationship is also the result of longstanding concern that the erosion of the attorney-client relationship, and consequently the fiduciary’s violation of this confidence, poses catastrophic damages to the client’s interests.

Substituting a single law firm for Goldman Sachs in the Kinder Morgan scenario and applying the aforementioned ethical standards, we reach the undeniable conclusion that concurrent representation of both the leverage buyout group (headed by CEO Rich Kinder) and Kinder Morgan, Inc. in this public-to-private transaction would certainly lie outside the realm of ethical standards maintained by any of the 50 States. 22

SARBANES OXLEY, ENRON, AND THE VOID LEFT FOR SELF-DEALING IN PRIVATE EQUITY BUYOUTS

The scandalous accounting practices that unwound beginning with the fall of Enron embodied the many shortcomings of the safeguards that were put in place to prevent the cloth from being pulled over the eyes of corporate shareholders, regulators, the media, and the investing public. 23 Many were to blame: Arthur Andersen, Enron, the investment banks, the convoluted network of partnerships through which Enron masked its true colors, etc. . . The writing was on the wall: ‘‘[o]ne can violate the SEC laws and still comply with’ generally accepted accounting principles.” 24 The sacrificial lambs remained the lowly public, standing on the outside and bearing the expense of wrongdoing by corporate insiders. In the 2000 fiscal year, shareholders who had invested in companies which restated their earnings suffered losses of $31.2 billion. 25

22 See e.g. ABA MODEL RULE § 1.10(a) (2006)(prohibiting two lawyers, in the same law firm, from representing directly adverse parties in the same matter. Rules of imputation therefore treat a law firm as one lawyer.); see also RESTATMENT THIRD, THE LAW GOVERNING LAWYERS § 122(2); see also ABA MODEL RULE 1.7(b) (2006)(prohibiting the representation of two clients in the same litigation where one client will assert a claim against the other.).

23 See Accountability Issues: Lessons Learned From Enron’s Fall, United States Senate Committee on the Judiciary, 107th Cong. (Feb. 6, 2002) (Statement of Susan P. Koniak, Professor of Law, Boston University School of Law).


Enron Chief Financial Officer, Andy Fastow, demonstrated the potential damage that can be done to shareholder value as a result of insider wrongdoing, specifically executive self-dealing. The convoluted network of Enron partnerships was instrumental in the energy giant’s concealment and perpetuation of corporate frauds. The partnerships purchased and sold assets to Enron of an estimated value in the hundreds of millions of dollars. In some cases, in order to meet earnings expectations, “these executive-run partnerships were used to keep debt and losing ventures off Enron’s books.” In another instance, partnership LJM2 renegotiated a deal that saved it millions of dollars at the expense of parent company Enron. These transactions beg the question, where do management’s loyalties lie? Were the executives of this company seeking to maximize the wealth of the firm and derivatively the shareholders of the firm to whom they owed a duty of loyalty? Or, rather were the terms of negotiation with parent company Enron intended to maximize the wealth of the partnership in which the executives held a proprietary interest?

Consequently, the billions in losses shouldered by public voters marked one of the rare instances where partisans stood on the same side of an issue. Democratic Senator Paul Sarbanes and Republican Representative Michael Oxley bore the sweeping legislation aimed at prosecuting the fraudulent accounting practices that infected what had previously been deemed the model firms of Corporate America. Among other things, the Sarbanes Oxley Act of 2002 set higher procedural standards for the auditors of public companies. SOX regulations blew the doors off of corporate compliance requirements in place at the turn of the century.

A law’s effectiveness in deterring future corporate wrongdoing in response to prominent scandal of the recent past necessarily hinges upon legislators’ skillful definition of the underlying problem in the present. Characterizing the shortcomings of regulations appurtenant to the enactment of Sarbanes Oxley in 2002, the independence of executives in the context of deal-making remains a sparsely regulated matter as implicated by federal law. Where private equity funds express interest in a target company for a buyout, corporate executives are crucial players in advising their constituents and shareholders in the public-to-private transaction. Yet, their fiduciary role in maximizing shareholder wealth appears to be under attack by private equity firms showering the executives with promises of stock options, bonuses, and golden parachutes upon the consummation of the leveraged buyout. Such

27 Id.
28 See id.
incentives weaken the expectation that executives and managers will be able to render objective advice (with absolute loyalty) in the best interests of shareholders when management stands to benefit so handsomely from the public-to-private bid. The extravagant riches promised to executives are exemplified by the purchase of German chemical company, Celanese, by private equity concern Blackstone Group. Blackstone, in December 2003, paid a 13% premium above market capitalization for a total deal value of $4 billion. For its success in buying out the German concern, and a subsequent initial public offering, the private equity group rewarded Celanese's executives with a $13 million bonus to be split up among them. Options on 7.8 million shares of common stock were granted to the executives with an additional 1.6 million shares offered at a steeply discounted price. At the end of the rainbow, Celanese executives ultimately shared a pot of gold valued at greater than $65 million.

The duty of loyalty (by legal standards) requires that corporate officers exercise institutional power over corporate process in a good faith-effort to advance the interests of the company. Executives, when transacting with the corporation, have a duty to fully disclose all material facts to the corporation’s disinterested representatives and to deal with the corporation on terms that are intrinsically fair. Officers of the corporation cannot deal with the corporation in any way that benefits them at the corporation’s expense. The fiduciary duty owed by corporate management and directorial boards has been held by Courts to extend far beyond the more blatant instances of executive disloyalty. In *Dodge v. Ford Motor*, Ford Motor Company’s operations had sustained an extended period of profitability. With these profits, CEO Henry Ford decided to raise employee wages, reinvest in the company, and cut prices to consumers. Shareholders brought suit in Delaware courts. The Delaware Court presiding opined that Ford Motor Company had a duty to pay dividends to its shareholders, who behold a primacy interest in the company. While the outcome of this case would fall presently under business judgment deference, Delaware continues to hold that the duty of loyalty is owed strictly to shareholders.

30 See id.
31 See id.
32 See id.
33 See id.
If the duty of loyalty owed solely to the corporation’s shareholders proscribed (under certain circumstances) a company from paying increased wages to workers, lowering prices to customers, and plowing back earnings into the going concern prior to distributing dividends to shareholders, how can this duty be deemed sufficed when corporate officers welcome the same bankers who are advising the company in the sale of itself to be the primary purchasers of the company thereby ensuring that the going concern will not be sold for the highest possible price? After all, a purchaser wouldn’t spend $18 billion on an asset unless it believed it stood to earn substantial returns on its investment which were not accounted for in the purchase price (otherwise, it would realize no gain on the purchase).

Similarly, how can the independence of Goldman Sachs Group, Inc. be found unquestionably in tact in advising Kinder Morgan with the objective of obtaining the optimal price for Kinder’s shareholders in the sale of the company when the advisory branch’s coworkers and compatriots in Goldman Sachs Capital are sitting across the table bargaining for the cheapest purchase price it can negotiate? Furthermore, what assurances do a target company’s shareholders have that the investment bank advising the target in a leveraged buyout won’t hold back or pull its punches at the negotiating table when the bank is also acting as a principal investor in the purchase of the target? Investment banks risk only their reputations in rendering quality services to their clients; banks are not bound by a legal duty short of a general obligation not to defraud their clients. When comparing the loyalty a client expects from his/her banking advisor versus the legally binding duties owed by lawyer-to-client and corporate officer-to-shareholder, bankers seem to have little to fear in the way of legal consequence or discipline. Law firms on the other hand appear to be looking down the barrel of a loaded gun: the firm’s license to practice law is at stake, the State Bar is vested with the authority to slap lawyers with heavy disciplinary fines, and the firm risks substantial monetary damages for malpractice lawsuits should the firm breach ethical standards by accepting or continuing representation involving an unwaived or unconsentable conflict of interest. Nor do corporate officers have it as easy as bankers: management and board members may be held personally liable for breaches of their fiduciary duties through shareholders’ derivative lawsuits.

Investment bankers are free to engage in ethically compromised conduct because the business practice operates without the constraints of a binding code of conduct. Consider the recent adjudication of four Merrill Lynch bankers in the notorious “barge deal.” This deal involved an equity interest in several power-generating barges on the coast of Africa. The four bankers agreed that its employer Merrill Lynch would purchase and retain the equity interest from Enron for a six month period after which Enron executives
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(including Andy Fastow) promised the energy giant or one of its affiliates would buyback the equity interest. To Enron, temporarily removing the asset from its book for the purpose of reporting year end earnings and meeting analyst forecasts was worth a flat fee of $250,000 and a guaranteed 15% annual rate of return over the six-month period that Merrill retained its equity interest in the barges. The deal allowed Enron to record an additional $12 million in earnings thereby defrauding public investors as to the true state of the company. For allowing Enron to park its assets on Merrill Lynch’s books, the investment bank earned $775,000 on the barge deal. Prosecutors averred, rightfully so, that the transaction was a lease in substance and therefore Merrill bankers and Enron officials had conspired to defraud Enron and its shareholders.

The Merrill four were initially convicted by the trial court. The conviction was reversed on the appellate level. According to Dr. Barbara Jennings, the appellate court sympathized with the bankers’ Nuremberg defense: “Fraud requires proof of intent to defraud someone, and where a company is so fraught with fraud that fraud becomes its business those on the outside doing transactions cannot be expected to ferret through the smoke screens. Such a requirement would set a dangerous legal precedent with its imposition of duties on bankers.” From this outcome, what dangerous legal precedent have we avoided now that the letter of the law condones bankers to aid and abet fraud so long as this is the wish of the client? This result enables the moral turpitude of financial advisors despite the so called reputational risks faced by investment bankers. No doubt finance professionals will weigh the benefits of aiding client fraud against reputational risk and choose the more lucrative of the two. And since courts refuse to attach penalties to the unethical practices of investment bankers, the scale seems heavily tipped in favor of the economic benefits to stem from abetting client manipulations and wrongdoings.

Certainly, the system would be better off if advisor (i.e. Goldman Sachs Group, Inc.), upon perceiving unrealized profit potential bound up within its client, was legally compelled to advise its client on actualize such profits and legally prohibited from reaping such gains for itself (i.e. Goldman’s private equity arm) at a bargain price. There can be no doubt that Kinder management has enabled its future employer and owner (Goldman Sachs Capital Partners) to deal with the corporation in a way that benefits the buyers at the corporation’s expense. “[T]hese arrangements present the possibility for conflicts of interest, as clients become wary that the strategic advice is tilted in a way that favors the

35 See Dr. Barbara Jennings, Ethics in Finance, FINANCIAL ENGINEERING NEWS, Nov. 06, 2006.
36 Id.
adviser’s own investing role.”  

A less than zealous effort on the part of the advisory firm to represent the interests of the shareholders in the sale of the target company engenders a resulting sale that falls short of satisfying the company’s Revlon duty. The essence of an auction is that the highest bidder wins the bidding. It is difficult to imagine that the company has really been sold for the highest price it would otherwise have been purchased for where the investment bank plays the part of both auctioneer and bidder while locking competitive bidders out of the auction hall. The result is that the shareholders of Kinder Morgan have sold their securitized right to participate in corporate governance and the future profits of company at a discounted price.

The new regulations under Sarbanes Oxley serve as a solution to a specific problem: material misrepresentations and fraud in public companies’ accounting statements filed with the S.E.C. The 2002 legislation fell short of regulating management’s self dealing in private equity buyouts despite reports that Andy Fastow, for his self dealing, defrauded Enron shareholders to the tune of $30 million. This is likely the case since regulations sought to deter frauds committed primarily in the accounting statements of public companies, which is outside the scope of mergers and acquisitions. Additionally, fraud-doers may be subject to criminal prosecution in contrast to the less reprehensible civil offence of self-dealing; arguably, the magnitude of the monetary loss suffered by Kinder Morgan’s shareholders cashed out at a discounted price is greater than some of the losses induced by the corporate frauds that Sarbanes Oxley was purported to address. Shareholders remain exposed in private equity transactions to the conflicting financial interests of management and the proprietary interests of the corporation’s bankers.

RESOLVING THE CONFLICTS

In order to protect the shareholder from the conflicts of interest born by managerial officials and investment bankers, a number of resolutions should be considered. Centralizing authority in a regulatory body with a heightened purpose toward overseeing the conduct of investment advisors and corporate executives in private equity deals is a first step. Public investors are ill-equipped to monitor the conduct of corporate insiders and their bankers. This is especially the case where, as in the current predicament, even the Board of Directors is kept in the dark as to management’s clandestine plotting to ensure a

37 Berman, Dennis and Henny Sender, In Kinder LBO, Board Was Left in Dark For Over 2 Months as Deal Percolated. WALL STREET JOURNAL, Sept. 29 2006 at C1.
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The government must expand its role as advocate for the lowly shareholder whose final opportunity to enjoy a wealth maximization event is outmatched by the power and influence of corporate officers to manipulate the terms of the prospective sale. Another strategy to deter management’s subordination of shareholder interests in favor of personal gain would be legislation vesting in shareholders and corporations a cause of action to sue the corporation’s officers. Currently, certain kinds of expropriation by corporate officials do not rise to the threshold of illegality. Legal reforms would go a long way to protecting minority shareholders from corporate insiders by discouraging the self-dealing of management which accentuates the conflict of interest. In doing so, the U.S. stock market as a whole would appreciate in value where laws are protective of outside investors and well enforced, investors are willing to finance firms, and financial markets are both broader and more valuable.

This hypothesis was substantiated by the findings of a recent study. As a significant component of the study, academic scholars and financial theorists analyzed how firms’ valuations were related to the legal protections afforded to minority shareholders by the respective countries in which the firms engaged in regular business. Data was compiled by sampling 539 large firms from 27 international economies of wealth. The researchers closely monitored the relationship between investor protection and corporate valuation throughout the 27 countries. The findings were conclusive:

When [shareholders’] rights are better protected by the law, outside investors are willing to pay more for financial assets such as equity and debt. They pay more because they recognize that, with better legal protection, more of the firm’s profits would come back to them as interest or dividends as opposed to being expropriated by the entrepreneur who controls the firm. By limiting expropriation, the law raises the price that securities fetch in the marketplace. In turn, this enables more entrepreneurs to finance their investments.

39 See e.g. Claessens, Stijn et al., Disentangling the Incentive and Entrenchment Effects of Large Shareholdings, 57 JOURNAL OF FINANCE 2741-2770 (Dec. 2002); see also La Porta, Rafael et al., Corporate Ownership around the World, 54 JOURNAL OF FINANCE 471-517 (Apr., 1999).
40 La Porta, Rafael et al., Investor Protection and Corporate Valuation, 57 JOURNAL OF FINANCE 1147 (Jun., 2002).
41 La Porta, Rafael et al., Investor Protection and Corporate Valuation, 57 JOURNAL OF FINANCE 1147-1169 (Jun., 2002).
externally, leading to the expansion of financial markets.\textsuperscript{42}

Vis-à-vis strong evidentiary support that poor legal protection of shareholders diminishes firm value and derivatively lowers the values of a nation’s debt and equity markets, there is strong economic incentive to impress more pronounced legal protections. In a related study of the consequences of entrenched controlling shareholders on firm valuation, a consistent conclusion was reached.\textsuperscript{43} The authors of the study found a significant propensity for large investors to represent their personal proprietary interests which were often at odds with the interests of the firm and its investors.\textsuperscript{44} A further revelation was an “inverse U-shaped relationship between managerial equity ownership and firm valuation for a sample of U.S. firms,”\textsuperscript{45} confirming the notion that firm value is negatively effected by the entrenchment of managements and controlling shareholders. Responding to the leveraged buyout boom of the 1980s, Shleifer and Vishny were interested in qualifying and quantifying the costs to a target corporation of entrenched manager ownership in blocking value-enhancing turnovers. Somewhat ironically, the findings of Shleifer and Vishny appear equally applicable to the situation where management attempts to expropriate or diminish shareholder wealth by facilitating a buyout while minimizing the number of competing bidders participating in the purchase of the company. The buyout firm has conceivably saved hundreds of millions of dollars by paying a sliver of its cost savings over to management in the way of weighty golden parachutes in exchange for management’s complicity, shutting the auction house doors closed in order to exclude competing bidders. In both the entrenched controlling shareholder scenario and the situation involving managerial efforts to entrench a buyout bid, the risk is the same – the risk of expropriation by an authority bearing substantial control over corporate affairs. Increased legal protection for minority shareholders could be achieved by enacting a statutory right of shareholders to force the corporation to sue itself for managerial expropriation. This would relieve some of the conflicting interests between management and investors in the course of a buyout, as well as furnish the United States’ securities markets with economic enrichment.

Finally, the fairness opinion is far from an affirmation that shareholder

\textsuperscript{42} Id. at 1147.
\textsuperscript{43} Claessens, Stijn et al., Disentangling the Incentive and Entrenchment Effects of Large Shareholdings, 57 JOURNAL OF FINANCE 2742 (Dec. 2002).
\textsuperscript{44} Id. (quoting Shleifer, Andrei, and Robert Vishny, A Survey of Corporate Governance, 57 JOURNAL OF FINANCE 758 (1997)).
\textsuperscript{45} Id. (citing Morck, Randall, Shleifer, Andrei, and Robert Vishny, Management Ownership and Market Valuation: An Empirical Analysis, 20 JOURNAL OF FINANCIAL ECONOMICS 293-315 (1988)).
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wealth has been maximized via the private equity buyout (especially when the advisors are regularly stamping each others’ deals as fair and will thus be weary of declining another bank’s deal with the possible consequence of a backlash in obtaining fairness opinions for its own deals and the forbearance of hefty revenues). Additionally, the conflicting interests of management in leveraged buyouts are inadequately addressed by fiduciary duties imposed by corporate governance laws. Rather than waiting for a bright line case to reach the courts (i.e. a private equity firm enlisting management in facilitating the purchase of a controlling equity interest in a company for peanuts), shareholder losses and litigation expenditures could be avoided by imposing “disinterested banker” and “disinterested executive” standards similar to that used by lawyers’ ethics oversight bodies in regulating the representations of conflicted lawyers. By analogizing to the objective standard requiring lawyers to maintain independent professional judgment in representing clients’ interests, a disinterested banker standard would condemn unethical relationships wherein banking advisors might be tempted to subordinate the interests of clients to the banker’s own anticipated gain. It does not take a lawyer to perceive the risk of economic immorality posed by sell-side bankers taking money out of the pockets of shareholders and placing it directly into the pockets of the bankers’ buy-side coworkers. Centralizing authority in an oversight committee empowered to regulate the dealings of investment bankers and private equity funds in ethically questionable dealings protects the unsophisticated investor from self-dealing by corporate insiders and conflicted advisors. As for management, where a potential conflict exists, imposing upon corporate officials a disclose-or-abstain requirement might remedy some of the conflicts that are likely to arise in the context of a buyout. Executives, during a buyout, would owe a legal duty to timely report any personal knowledge of any offer to buyout the company with a failure to do so creating the possibility of legal liability. Alternatively, the executive would be legally obligated to abstain from any preliminary negotiations with outside bidders. This prescription would certainly prevent any further instances of clandestine scheming on the part of overzealous managerial officials.

46 See supra note 13 (Chrysler's Board paid $55 million for a fairness opinion as to its combination with Daimler Benz.).