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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE EL PASO CORPORATION SHAREHOLDER LITIGATION	Consolidated C.A. No. 6949-CS
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BRIEF IN SUPPORT OF PLAINTIFFS' MOTION FOR A PRELIMINARY INJUNCTION (CORRECTED VERSION)

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PRELIMINARY STATEMENT[1]

During the fall of 2011, the board of directors (the "Board") of El Paso Corporation ("El Paso" or the "Company") was faced with a decision that would fundamentally alter the future of the Company. The Board had to select between three alternatives – (1) completing a previously announced spin-off (the "Spin") of El Paso's exploration and production ("E&P") business and continuing to operate the Company's pipeline segment, (2) selling the entire company to Kinder Morgan Inc. ("KMI"), and (3) breaking up the Company and allowing third parties to bid for its component parts.

The entire process by which the Board decided El Paso's future was inherently tainted because of the Board's reliance on conflicted advisors and management. Goldman, Sachs & Co. ("Goldman"), the Company's long-time financial advisor, could not provide impartial advice about anything due to its 19% ownership stake in KMI, yet the Board allowed Goldman to play a pivotal role in the process. Goldman, in turn, made sure that its purportedly independent co-advisor, Morgan Stanley, had financial incentives that favored a deal with KMI alone. Meanwhile, El Paso's senior management saw an opportunity to profit for themselves by purchasing the E&P business from KMI in their own management buyout, which caused them to take actions not geared toward maximizing value for El Paso's shareholders.

In the end, with its financial advisors and management favoring a deal with KMI based on their own self-interests, the Board failed to even consider the most obvious way to maximize value – selling El Paso in parts – even after being told that KMI would face no competition for El Paso if the only alternative explored was a sale of the whole Company. As a result, KMI's highest bid (and the deal price) is still less than the Board's self-established "floor," but El Paso management and the Company's conflicted advisors have persuaded the Board to accept it anyway.

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[1] All exhibits cited herein are compiled in the accompanying Appendix.

In 2006, Rich Kinder ("Kinder") partnered with Goldman and others to purchase KMI in the largest private equity buyout in history. In September 2010, Kinder planted the seed for a transaction between KMI and El Paso, proposing to Douglas Foshee ("Foshee"), the Chairman and Chief Executive Officer ("CEO") of El Paso, that the Company spin off its E&P business – which Kinder had no interest in owning – and sell to KMI the remaining El Paso pipeline and midstream businesses in exchange for cash and "I-shares" in a KMI affiliate. Foshee recognized that Kinder needed a major acquisition to grow his business because of KMI's limited ability to grow organically. El Paso rejected the offer, in part because the I-shares – which were not publicly traded – were an unacceptable acquisition currency.

A few months later, Foshee began pursuing the Spin, a course of action that the El Paso Board approved in May 2011 after receiving advice and presentations from Goldman and Morgan Stanley, among others. Meanwhile, Kinder solved the acquisition currency issue by taking KMI public in the largest private equity-backed initial public offering ("IPO") in history, with Goldman serving as a lead underwriter and maintaining a 19% stake and two directorships in KMI.

On August 30, 2011, with the Spin preparation well underway, Kinder met with Foshee and proposed buying El Paso for $25.50 per share, consisting of 60% cash and 40% KMI stock. El Paso's senior management immediately contacted Goldman managing director Steve Daniel ("Daniel") to advise the Board. Goldman's staggering conflict of interest was obvious from the outset: with a stake in KMI worth over $4 billion, every dollar shaved off the buyout price represented approximately $150 million of savings for Goldman.[2] Less obvious (because the Board never asked), but still significant, was the fact that Daniel personally held an ownership stake in KMI and thus had his own conflict of interest.

[2] El Paso has about 778 million shares outstanding, so every $1 per share reduction in the Merger price saves KMI about $778 million. Goldman owns 19% of KMI, and thus enjoys 19% of those cost savings, or close to $150 million.

Foshee inexplicably invited Daniel to participate in the September 5 El Paso Board meeting to discuss the KMI proposal. Foshee, who as Chairman sets the agenda for Board meetings, decided to let Goldman present its full assessment of KMI's offer ***before*** any Board-level discussions about Goldman's conflict took place. Among other things, in its September 5 presentation to the El Paso Board, Goldman reduced its prior E&P valuation (rendered a few months before the KMI offer) by [REDACTED] from a range of [REDACTED] to a range of [REDACTED] Goldman's analysis was based purely on short-term market volatility, rather than on the long-term prospects of the E&P business, and therefore underestimated its value. The Board failed to question Goldman about this obvious error.

The Board could have mitigated the prejudicial impact of Goldman's initial KMI-related discussions by kicking Goldman out of the process entirely. Instead, at management's suggestion, the Board inexplicably let Goldman continue in its role as exclusive advisor for the Spin, which Goldman now had a powerful incentive to kill, and even retained Goldman as a "co-advisor" for the KMI offer. The absurdity of asking the owner of 19% of KMI to advise the El Paso Board regarding KMI's buyout offer is summarized in the following email by Morgan Stanley's Steve Munger:

> ***Over Wachtell's objection***, GS got a letter signed which engaged them as an advisor in the sale of the company … Between that fact and the enormous conflict as a 22% shareholder of Kinder … ***this is GS at its most shameless***.[3] (Emphasis added).

Making matters worse, El Paso's Board approved a banker compensation structure that exacerbated, rather than mitigated, the conflict. Unlike a board simply weighing a takeover offer versus staying the course, the El Paso Board was clearly at a fork in the road: it would either pursue the Spin or the Merger (or choose another alternative such as selling the Company in pieces), and it needed outside financial advice to adequately assess its options. While El Paso

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[3] MS00008953 (Ex. 42).

senior management offered Goldman roughly the same amount of fees whether the Board pursued the Spin or the Merger, Morgan Stanley did not get the same deal. Rather, although Morgan Stanley advocated for a fee arrangement under which it would have been paid regardless of whether the Board proceeded with the Spin or the Merger, the fee arrangement ultimately agreed to provide that Morgan Stanley was only to be paid if the Merger was consummated. This arrangement provided Morgan Stanley with an economic incentive to push for the Merger – exactly what Goldman and Foshee wanted. Tellingly, when Morgan Stanley believed it could be paid regardless of which path the Board chose, it advised the Board that KMI's $25.50 offer was patently insufficient, that the Spin was clearly superior, and that KMI would not face any competitive bidding unless the Company was split and sold in pieces. When it realized that its fees hung in the balance of the Merger, however, Morgan Stanley changed its tune and opined that the Merger was fair. In doing so, Morgan Stanley presented analyses to the Board that substantially undervalued El Paso and overvalued KMI, making errors that any reasonably attentive and financially competent El Paso director should have seen. This shift in perspective will allow Morgan Stanley to collect a hefty fee.

The inadequacy of KMI's $25.50 offer was immediately recognized by El Paso's Board. One of its more candid members – before being reprimanded by Foshee to stop putting his views in writing – wrote:

> I would like to be clear that, 1) ***the price is inadequate,*** and 2) I have looked at their values on and off for a long time, and ***I would not take their stock in payment for a box of stale saltines, let alone real value like El Paso***.[4] (Emphasis added).

The Board initially instructed Foshee to reject the offer outright, giving KMI neither a counteroffer nor an opportunity to conduct due diligence. However, Goldman and El Paso management undermined the Board's willingness to hold out for the best deal. When KMI

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[4] EP00022792 (Ex. 23).

refused to raise its price and instead threatened to take the offer public, Goldman encouraged the Board to permit KMI to conduct due diligence. This struck the Board as odd given the inadequacy of the offer, and caused them to question Goldman's motives. Yet, even faced with this evidence of Goldman's conflict influencing its advice, the Board still did not exclude Goldman from the process. Instead, it simply carved Goldman out of "tactical" discussions – *i.e.*, discussions about specific negotiating tactics – while permitting Goldman to continue providing analyses and advice that would influence the Board's ultimate decision.

Following further substantive input from Goldman, Foshee recommended, and the Board agreed, that El Paso would counter at $28 per share, less than 10% above the $25.50 offer which Foshee and the Board had deemed "significantly" low and not compelling. With such a modest counter, a deal became inevitable. KMI promptly agreed to pay $27.55 in cash and stock, although it soon reneged on that offer under the guise of an "error" in its valuation model. KMI then tried to lower the cash and stock component of the proposed consideration by offering a warrant to make up the difference. The Board balked at the warrant and "re-iterated that the floor value for the cash and stock consideration was $26.50."[5] Foshee urged the Board to accept warrant consideration until they ultimately agreed to a merger between KMI and El Paso (the "Merger") at a cash and stock price below their $26.50 floor, taking $25.91 in cash and stock, plus a warrant with an "assumed value" of $0.96.[6] As the Proxy concedes, "the warrants may have limited or no value."[7]

Why did El Paso's senior management work so hard to get a deal done with KMI even if they knew the price was not the best they could get? Discovery has revealed that El Paso

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[5] Preliminary Information Statement/Proxy Statement/Prospectus of Kinder Morgan Inc. and El Paso Corporation, filed with the SEC as part of a Form S-4/A dated January 3, 2012 ("Proxy"), at 105 (Ex. 5).

[6] EP00000549 (Ex. 43).

[7] Proxy at 51 (Ex. 5).

management knew from the outset that KMI had no interest in El Paso's E&P assets, and during the course of the negotiations they learned that KMI not only intended to sell the E&P assets immediately upon closing, but was targeting [8] The bargain available at this price is highlighted by the following email from Morgan Stanley banker Jonathon Cox:

> (Emphasis added).

Foshee and two of his fellow El Paso executives began formulating plans to buy those assets from KMI following the Merger – *i.e.*, when they were no longer fiduciaries and could avoid the legal scrutiny that would come with a proposed management buyout of a public corporation. According to an October 11, 2011 email exchange between El Paso's Chief Financial Officer ("CFO"), J.R. Sult ("Sult"), and the head of El Paso's E&P business, Brent Smolik ("Smolik"), "the bogey [was] becoming clear" for a potential purchase of the E&P assets by El Paso management, but Foshee wanted to wait "as late as possible" to discuss the possibility with KMI.[10] Thus, like Goldman, El Paso's senior management had a direct financial interest in pushing for a sale at a lower price: the less KMI paid El Paso for the entire Company, the lower the price KMI would require for the E&P business. A few weeks after signing the merger agreement at a price well below the Board's prior bottom line, Foshee told Kinder that El Paso management was interested in bidding on the E&P business. The Board, conveniently, was not informed of Foshee's buyout aspiration before voting to approve the Merger.[11]

This case presents a rare combination of deliberate indifference to an advisor's flagrant conflicts with the soft but powerful harm from undisclosed management conflicts. Injunctive

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[8] EP00005407 (September 28, 2011 sources & uses chart) (Ex. 33).

[9] EP00026479 (Ex. 35).

[10] EP00033390 (Ex. 41).

[11] EP00000547-564 (October 16, 2011 Board Minutes) (Ex. 43).

relief is appropriate here because the evidentiary record demonstrates serious breaches of fiduciary duty, leading to a transaction that does not maximize shareholder value and that will cause El Paso's shareholders irreparable harm if the deal is allowed to proceed. The shareholder vote and the enforcement of the deal protection provisions should be preliminary enjoined so the Board can retain an independent financial advisor and pursue alternative transactions, including separate sales of the E&P assets and pipeline business.

FACTUAL BACKGROUND

A. Overview of El Paso

El Paso is an energy company that operates in two principal segments: (i) the Pipeline segment, and (ii) the E&P segment.[12] The Pipeline segment includes the Company's interstate natural gas transmission systems and related operations.[13] The E&P business focuses on the exploration for and the acquisition, development and production of natural gas and oil in the United States, Brazil and Egypt.[14]

B. Overview of KMI

KMI is an energy holding company that derives most of its revenue from its general partnership interest in Kinder Morgan Energy Partners, L.P. ("KMP").[15] KMI also owns an 11% limited partner interest in KMP through a combination of KMP units and I-units ("I-shares").[16] The I-shares are a class of KMP's limited partner interests issued by Kinder Morgan Management, LLC ("KMR") that receive distributions in the form of additional I-shares instead of cash.[17] KMR has at least a 50% economic interest in KMP.

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[12] Proxy at 81 (Ex. 5).

[13] *Id.*; *see also* Foshee Tr. at 37:19-38:4 (Ex. 12).

[14] Proxy at 81 (Ex. 5); *see also* Foshee Tr. at 38:8-13 (Ex. 12).

[15] Kinder Tr. at 9:8-10 (Ex. 6).

[16] Proxy at 79 (Ex. 5).

[17] *Id.*

C. Goldman Partners With Rich Kinder To Take KMI Private

In 2006, a senior banker in Goldman's Houston office pitched Rich Kinder the idea of a management-led buyout ("MBO") of KMI.[18] Goldman then partnered with Kinder in the $22 billion MBO.[19] Goldman also served as financial advisor to Kinder and helped arrange roughly $7 billion in financing for the buyout.[20] Goldman was awarded two seats on KMI's board of directors, and installed by two of its managing directors, who still serve in such roles today.[21]

Subsequently, Goldman maintained a substantial equity interest in KMI, and currently is part of KMI's controlling shareholder group along with Kinder himself.[22] Currently, Goldman's 19% stake in KMI is worth more than $4 billion.[23]

D. KMI Approaches El Paso Regarding A Business Combination In 2010

KMP's partnership agreement requires KMP to pay more than 50% of available distributions to KMI, an allocation well higher than KMI's peers obtain for their general partner interests, and an amount so high that it inhibits KMI's prospects for organic growth.[24]

An acquisition of El Paso would serve two objectives for KMI: (i) it would solve the problems KMI's high distribution split poses to its ability to grow dividends to its limited

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[18] "Rich Kinder's bigger slice," CNNMoney, June 12, 2007 (http://money.cnn.com/magazines/fortune/fortune_archive/2007/05/28/100034252/index2.htm) (Ex. 1).

[19] Kinder Tr. at 7:16 - 8:3 (Ex. 6).

[20] Kinder Tr. at 8:4-10 (Ex. 6).

[21] Daniel Tr. at 16:18 – 17:3 (Ex. 10).

[22] Proxy at 69 ("Kinder Morgan believes that it is a 'controlled company' since … the Sponsor Investors [including Goldman] and Richard D. Kinder collectively hold approximately 78.4% of the voting power of Kinder Morgan's outstanding capital stock entitled to vote on the election of directors, and they have agreed to vote together on certain matters pursuant to Kinder Morgan's shareholders agreement, including on the election of our directors.") (Ex. 5).

[23] Kinder Tr. at 202:11-20 (Ex. 6); Daniel Tr. at 22:24 – 23:8 (Ex. 10).

[24] *See* Sult Tr. at 165:4-17 (Ex. 9).

partners[25] and (ii) the acquisition of El Paso's Pipeline business would materially enhance KMI's pipeline operations. Accordingly, KMI viewed El Paso as an acquisition target for years.[26] In September 2010, Kinder approached Foshee and proposed that El Paso conduct a spin-off of its E&P business (which KMI had no interest in acquiring because KMI itself had no E&P operations[27]) and then sell its Pipeline business to KMI.[28]

Upon receiving KMI's preliminary indication of interest, El Paso management requested that Goldman, the Company's long-time financial advisor[29] but also one of the principal shareholders in KMI, prepare an analysis of the offer.[30] The core problem with KMI's 2010 offer was, from El Paso's perspective, that KMI did not have any publicly-traded shares to use as acquisition currency.[31] In February 2011, KMI remedied this issue by going public again, in the largest private equity-backed IPO in U.S. history.[32] Goldman served as a lead underwriter[33] and, following the IPO, Goldman retained its two KMI board seats and a 19% stake in KMI, currently valued at around $4 billion.[34]

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[25] *See also* EP00000392 at 394 (El Paso's September 15, 2011 Board minutes) (Ex. 29)

[26] Kinder Tr. at 10:9-11:4 (Ex. 6); Sult Tr. at 161:6-10 (Ex. 9).

[27] *See* EP00003435-00003473, at 443 (Ex. 14); Foshee Tr. at 76:19-22 ("That's consistent with my understanding that KMI is not in the E&P business and really doesn't want to be in the E&P business.") (Ex. 12).

[28] Proxy at 97 (Ex. 5); EP00003435-00003473 at 453 (October 8, 2010 Goldman Sachs Discussion Materials, reflecting structure of proposed KMI transaction) (Ex. 14).

[29] *See* GS-ELP00018601 (February 8, 2006 engagement letter between Goldman and El Paso) (Ex. 13).

[30] Sult Tr. at 36:25 – 37:6, 45:25 – 46:4 (Ex. 9).

[31] Foshee Tr. at 63:2-4 ("They were outlining a deal with El Paso that would involve our shareholders getting a, getting KMR equity [*i.e.*, I-shares].") (Ex. 12).

[32] Kinder Tr. at 8:16-20, 9:21-25, 10:2-5 (Kinder affirms that one benefit of going public is the ability to use its publicly-traded stock as acquisition currency) (Ex. 6).

[33] Daniel Tr. at 21:11-19 (Ex. 10).

[34] *See, e.g.*, Kinder Tr. at 202:7-202:20 (Ex. 6); Daniel Tr. at 22:24-23:8 (Ex. 10).

E. El Paso Decides To Spin Its E&P Business

Around the same time that Goldman was helping KMI go public, El Paso CEO Doug Foshee began advocating for a Spin of the Company's E&P business.[35] Foshee projected "substantial value uplift" for El Paso from the $15 range in which El Paso stock traded in January 2011, to $25 to $30 per share.[36]

At the El Paso Board retreat in late March 2011, a handful of investment banks – including Goldman, Morgan Stanley, and Barclays (which would later advise KMI on the Merger) – made presentations on the Company's strategic alternatives.[37] Goldman's presentation conservatively valued El Paso's E&P business at [REDACTED][38]

In May 2011, the Board reached the unanimous conclusion that the Spin was in the best interest of the Company's shareholders,[39] and announced this transaction publicly on May 24, 2011.[40] Rich Kinder wrote to congratulate Foshee on the Spin shortly after the announcement.[41] Wall Street analysts covering El Paso responded favorably[42] and the Company's stock price increased post-announcement.[43] The Board and management anticipated future gains in the

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[35] *See* GS-ELP00019809-00019821 (Foshee's handwritten notes) (Ex. 15).

[36] *Id*. at 00019821.

[37] EP00011705-00011706 (agenda for March 29 – March 31, 2011 El Paso Board meeting) (Ex. 16).

[38] EP00000027 (Hypothetical Net Asset Value slide from March 30, 2011 Goldman discussion materials) (Ex. 17).

[39] Vagt Tr. at 68:23 - 69:14 (Ex. 7).

[40] Proxy at 98 (Ex. 5).

[41] KMI-EP021492 (May 30, 2011 email from Kinder to Foshee) ("Doug – Just want to congratulate you on your plan to spin off the E&P assets. I think it makes a lot of sense and, much more importantly, the investment community seems to agree.") (Ex. 18).

[42] *See, e.g.*, May 25, 2011 Susquehanna Financial Group LLP research note ("[W]e think [El Paso] management is correct in assuming that its E&P segment is undervalued in [El Paso] shares.") (Ex. 4).

[43] Foshee Tr. at 98:18-99:6 ("Q: And the market did respond favorably to the announcement of the spin; right? A: It did. Q: . . . Did you as the CEO of El Paso, think that the market fully incorporated the value of the spin with whatever stock price increase you got on the

Company's stock price once the Spin was complete,[44] and proceeded towards consummation expected to occur by the end of 2011.[45]

On August 25, 2011, Goldman and El Paso finally executed an engagement letter that appointed Goldman as the Company's exclusive financial advisor in connection with the Spin and provided for Goldman to receive (i) a $5 million fee upon announcement of the Spin (which had already occurred), and (ii) an additional $25 million upon consummation of the Spin.[46]

F. KMI Expresses Renewed Interest In Acquiring El Paso

Recognizing that the market was still undervaluing El Paso even after announcement of the Spin, on August 30, 2011, KMI offered to buy all outstanding shares of El Paso for $25.50 per share (60% in cash and 40% in KMI stock).[47] Despite knowledge of Goldman's clear conflict of interest as a 19% owner of KMI,[48] Foshee immediately instructed El Paso CFO Sult to reach out to El Paso's "go to" banker, Goldman's Steve Daniel.[49] Sult invited Daniel to attend the initial Board meeting to discuss the offer,[50] and Daniel readily agreed. Amazingly, neither Foshee nor the El Paso Board bothered to ask whether Daniel had a personal conflict. Nor did Daniel disclose that he personally owns roughly [redacted] dollars worth of KMI stock, and has a [redacted] stake in at least one of the Goldman private equity funds that own KMI shares (in addition to Daniels owning a [redacted] number of Goldman shares whose value would be

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announcement of the spin? A: No, I did not. Q: You thought there was more value to be had, right? A: Yes, I did.") (Ex. 12); Vagt Tr. at 76:8 – 77:4 (he expected El Paso's stock price to rise above $25 per share as the E&P business continued to execute on its business plan after the Spin) (Ex. 7).

[44] *See id*.

[45] Proxy at 99-100 (Ex. 5).

[46] GS-ELP00021501-00021508 (Ex. 19).

[47] GS-ELP00005893-00005897 (August 30 offer letter) (Ex. 20).

[48] *See* Foshee Tr. at 154:16-18 (Ex. 12).

[49] EP00033969 (August 31, 2011 email from Sult requesting that Daniels come to the El Paso Board meeting to discuss KMI's offer) (Ex. 22).

[50] *See id*.

directly affected by a KMI acquisition of El Paso).[51] While Foshee was willing to overlook Goldman's multi-billion dollar institutional investment in KMI, he admitted that knowledge of Daniel's personal investment in KMI would have been [redacted] in the decision to allow Goldman to advise on the KMI proposal.[52]

El Paso's General Counsel alerted the El Paso Board to KMI's $25.50 offer,[53] but the Board was not impressed. As El Paso director Robert Vagt bluntly observed:

> I would like to be clear that, 1) ***the price is inadequate,*** and 2), I have looked at their values on and off for a long time, and ***I would not take their stock in payment for a box of stale saltines, let alone real value like El Paso***.[54] (Emphasis added)

After receiving Vagt's candid assessment, Foshee warned him to stop using email to express his views.[55]

The Board met on September 5, 2011 to discuss the $25.50 offer.[56] Goldman, which now had a direct interest in steering the Board away from the Spin and towards a deal with KMI, presented both an updated Spin analysis and an analysis of KMI's offer.[57] Since a sale to KMI at a low price would better serve Goldman's economic interests (because each $1 per share saved on the purchase price translates into a ***$150 million gain for Goldman***[58]), the conflicted bank took steps to make the Spin appear less attractive than the new KMI offer. Among other things,

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[51] See Daniel at Tr. at 10:15-11:11, 13:20-16:13, 205:22-206:19, 208:11-18 (Ex. 10).

[52] Foshee Tr. at 159:22 – 160:21 (explaining that Daniel's personal financial interest would be relevant because "[t]hat [conflict] is not between two divisions but within one person's brain.") (Ex. 12).

[53] EP00022802-00022804 (Ex. 21).

[54] EP00022792 (August 31, 2011 email from Vagt to Foshee) (Ex. 23).

[55] EP00022792 (August 31, 2011 email from Foshee to Vagt) ("I think its best from here on out for us to have conversations about valuation issues via the telephone, so please feel free to call when you get back in country.") (Ex. 23).

[56] EP00000382-00000390 (El Paso September 5, 2011 Board minutes) (Ex. 24).

[57] *Id*.

[58] Foshee Tr. at 155:4-10 (Ex. 12).

Goldman's September 5 presentation valued El Paso's E&P business at [redacted] – a full [redacted] than in the bank's previous Board presentation in May 2011.[59] This dramatic drop was solely due to a reduction in the peer company EBITDA multiples that Goldman used, at a time when peer trading prices were at temporarily depressed levels – a short-term phenomenon that said nothing about the long-term value of the E&P business. The Board, rather than focus on the long-term prospects of that division, did not bat an eye at this [redacted] drop in Goldman's E&P valuation,[60] and Goldman inappropriately made no effort to emphasize to the Board its likely short-term nature.[61]

Inexplicably, Foshee waited to discuss Goldman's conflict with the Board until ***after*** Goldman had presented its advice regarding KMI's offer.[62] Foshee considered it inconceivable that the Board members would have declined to hear Goldman's advice, even if they were aware of the conflict.[63] Indeed, upon being told of Goldman's conflicting interests, the Board did not tell Goldman its services were no longer needed, but instead simply hired Morgan Stanley to serve as a co-advisor. The Board then compromised Morgan Stanley's independence by tasking Goldman with getting Morgan Stanley "up to speed" on the Company, the Spin, and KMI's

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[59] EP00000259 (September 5 Goldman board presentation – Slide entitled "E&PCo. Analysis at Various Prices" – reducing range of E&P enterprise values from [redacted] (Ex. 26); EP00000383 ("[Daniel] indicated that the relative valuations of most other exploration and production companies had declined since May of 2011 in light of various challenges in the global economy and that the valuation of the Company's E&P segment had probably declined approximately [redacted] since May of 2011 based on the general market decline.") (Ex. 24)

[60] *See* Vagt Tr. at 109:12-20 ("Q: Do you recall anyone on the board expressing concern over this [redacted] A: … I do not recall that there was any conversation of the [redacted]) (Ex. 7); Daniel Tr. at 149:25 – 150:25 (Ex. 10).

[61] *See id*. *See also* Declaration of David G. Clarke ("Clarke Decl.") at 26-27.

[62] EP00000388 (El Paso's September 5, 2011 Board minutes) (Ex. 24).

[63] Foshee Tr. at 144:14-21 (Ex. 12).

offer[64] – a task which, in Foshee's mind, entitled Goldman to a substantial additional fee in the event the Spin fell through.[65]

While Foshee was indifferent to Goldman's conflict, Goldman's eagerness to score a fee despite its conflict rose all the way to the top of the investment bank. On September 7, Goldman CEO Lloyd Blankfein reached out to Foshee for the first time in years,[66] to thank Foshee for engaging Goldman on the deal and to tell El Paso's CEO that the conflict was manageable.[67]

Even with Goldman's conflicted advice, the Board determined that KMI's $25.50 offer was so inadequate that they would not even allow KMI to conduct due diligence,[68] and they instructed Foshee to reject Kinder's offer.[69] Moreover, the Board instructed Foshee not to submit a counteroffer.[70] Foshee delivered the news to Rich Kinder personally at Kinder's home.[71]

G. Goldman's Conflict Rears Its Head And The Board Turns A Blind Eye

Nearly a week after Goldman started advising El Paso regarding a potential sale to KMI (and a year after Goldman provided advice in connection with KMI's September 2010 approach), Goldman formally set up a "Chinese Wall" between the team advising El Paso and the Goldman representatives responsible for the firm's 19% ownership stake in KMI.[72] This effort was simply too little too late, because Goldman's conflict had already infected the sales process.

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[64] Daniel Tr. at 122:12-16 (Ex. 10); Foshee Tr. 200:14-18 (Ex. 12).

[65] *See* Foshee Tr. at 198:12-201:8 (Ex. 12).

[66] Foshee Tr. at 172:20-23 (Ex. 12).

[67] Foshee Tr. at 174:11-22 (Ex. 12).

[68] Sult Tr. at 203:22-24 (Ex. 9).

[69] EP00000390 (September 5, 2011 Board minutes) (Ex. 24).

[70] Vagt Tr. at 127:18-24 (Ex. 7); Foshee Tr. at 180:15-24, 209:17-210:19 (Ex. 12).

[71] Foshee Tr. at 168:10-17 (Ex. 12).

[72] GS-ELP00021426 (Ex. 44); GS-ELP00017624 (Ex. 45).

After Foshee rejected KMI's offer, Kinder threatened to go public with his lowball offer.[73] At that point, Daniel and his team at Goldman inexplicably suggested to El Paso that it should invite KMI to conduct due diligence – even though the Board had just unanimously rejected the $25.50 offer as too low to even warrant diligence.[74] Goldman's advice widely differed from that of Morgan Stanley, causing Foshee "concerns"[75] and leading him to suspect that Daniel was being pressured by Goldman's private equity team to get a deal with KMI done.[76] The Board was informed on September 15 that El Paso management believed Goldman's bankers were being pressured by others at Goldman to discourage a public bidding war.[77] Remarkably, the Board allowed Goldman to continue as an advisor on the merits of both the Spin and the KMI proposal, including during the September 15 Board meeting where Goldman discussed KMI's offer and presented a DCF analysis of El Paso's E&P and Pipeline segments.[78] The only restriction the Board ever placed on Goldman was to bar its post-September 15 participation in "tactical" discussions – *i.e.* discussions about how to respond to particular KMI offers.[79]

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[73] EP00004440 (Ex. 27).

[74] Sult Tr. at 216:5 – 217:17 (Ex. 9).

[75] Foshee Tr. at 184:7-186:11 (Ex. 12).

[76] Foshee Tr. at 187:14-187:21 (Ex. 12).

[77] EP00000392 (Foshee "noted that … some of the advice that was received from the Houston team of Goldman Sachs recently raised management's concerns that they were receiving pressure from other parts of Goldman Sachs to avoid a strategy that might result in KMI going public and making a hostile approach on the Company") (Ex. 29).

[78] Foshee Tr. at 206:3-20 (Daniel discussed KMI's offer during the September 15 Board meeting) (Ex. 12); Daniel Tr. at 162:2-5, 163:6-19 (Goldman's September 15 Board presentation included a DCF analysis of El Paso's E&P and Pipeline businesses, and of the Company as a whole) (Ex. 10). As discussed *infra*, Goldman's DCF analysis contained significant errors that reasonably attentive members of El Paso's board should have recognized and that resulted in a materially reduced value of El Paso. *See also* Clarke Decl. at 25-28.

[79] EP00000392 (El Paso's September 15, 2011 Board minutes) ("In light of the potential conflict, Mr. Foshee indicated that … any discussions on tactical issues would be reserved for the discussions with Morgan Stanley.") (Ex. 29); Daniel Tr. at 104:24-107:12, 109:9-110:4 (Ex. 10).

H. KMI Convinces El Paso To Sell For The Bargain Price Of $27.55 And Then Quickly Reneges

Despite having previously instructed Foshee to reject KMI's $25.50 offer with no counteroffer, during the September 15 meeting the Board acceded to Foshee's recommendation that El Paso counter at $28 per share – less than 10% above the roundly rejected $25.50 offer.[80] Countering at a price so close to the already rejected price is so inconsistent with normal logic that it suggests the management team was pushing the Board to soften its position.

On September 18, Foshee and Kinder, left alone to negotiate the terms of a transaction, preliminarily agreed to a deal at $27.55 per share in cash and KMI stock, subject to due diligence.[81] However, having now lowered El Paso's ceiling to $27.55, Kinder used due diligence as a pretext to revise the agreed price downward. Shortly after beginning its diligence, KMI claimed that it needed to renegotiate the price downward due to a newly-discovered [redacted] error in its model.[82] Even if the Board were inclined to accept KMI's representation that it had made an error warranting renegotiation of the price, ***El Paso was never able to independently verify the error***,[83] and El Paso was suspicious that KMI was just using it as a ruse to renegotiate.[84]

To fill the value "bust" resulting from the alleged error, KMI proposed on September 28 to decrease the amount of cash and stock consideration to a total of $25.50, and to provide in

[80] Proxy at 104 (Ex. 5).

[81] Proxy at 105 (Ex. 5); KMI-EP017568 (September 18, 2011 Rich Kinder email) ("We have a deal subject to due diligence etc. at $27.55.") (Ex. 30); Foshee Tr. at 231:20-21 ("A: ... We agreed on 27.55 as a nominal number, but it was all subject to due diligence.") (Ex. 12).

[82] EP00000413-00000416 (Ex. 34); Sult Tr. at 249:15-22 ("A: KMI communicated to us that they had relied upon public sell side information to develop their models for ultimately getting comfortable with the price. Following some degree of due diligence, it came to their attention that the public sell side information that they relied upon was grossly above that that we shared with them during due diligence.") (Ex. 9).

[83] Sult Tr. at 250:13-18 (Ex. 9).

[84] Sult Tr. at 253:21-23 (Ex. 9).

addition 0.577 warrants on KMI's stock per El Paso share, which warrants KMI valued at $2.05 per El Paso share (bringing the total offer back to $27.55 per share). This offer was formally conveyed in a letter dated September 30, 2011.[85] The warrants, which cost KMI nothing out of pocket, carried an exercise price of $40 and a five-year expiration,[86] meaning that they would never be worth anything unless KMI's stock rose to $40 during the next five years.[87] During a September 30 meeting, the Board decided to reject the counterproposal and "re-iterated" an absolute floor of $26.50 for the cash and stock component of the merger consideration.[88] Nonetheless, Foshee told Kinder that same day that El Paso would accept a cash/stock component of $26.00 – in clear contravention of the Board's instructions – plus only 10% more warrants.[89]

On October 5, KMI responded with an offer of $14.64 in cash, 0.4817 in KMI stock, and 0.640 of a warrant, with a total cash/stock value of $25.78 (excluding the warrants).[90] This offer was on "substantially the [same] terms" as the rejected September 30 offer,[91] with the only difference being a "marginal" increase in the number of warrants to be paid per El Paso share, from 0.577 to 0.640.[92] Despite only marginal improvement and the cash and stock consideration still being below the Board's $26.50 floor (and below Foshee's demand of $26), Foshee recommended KMI's October 5 offer. The Board then accepted the offer after Goldman's October 6 presentation indicated that the E&P segment's value had declined

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[85] EP0000011141-11142 (Ex. 48).

[86] Foshee Tr. at 237:2-7 (Ex. 12); Proxy at 107 (Ex. 5).

[87] KMI-EP 009357 (Ex. 36); Vagt Tr. at 176:21 – 177:4 (Ex. 7).

[88] Proxy at 107-108 (Ex. 5).

[89] *See* EP00000413 (Ex. 34); KMI-EP009378 (Ex. 49).

[90] Proxy at 108 (Ex. 5).

[91] *See* KMI-EP009357 ("[El Paso] has now orally agreed to substantially the terms set forth in my letter of September 30.") (Ex. 36).

[92] *Id.*

since September 5,[93] and was *less* than Goldman's estimates pre-dating KMI's proposal.[94] As the Board was deciding between the Spin and the Merger, Goldman's Spin analysis – which, again, was skewed by short-term market volatility[95] – was "integral" to the Board's decision.[96]

The Company has stated that the warrants have an "assumed value" of $0.96 per El Paso share. However, the Proxy acknowledges that this value is speculative, [97] and the Board had no basis to conclude the warrants would ever be "in the money." Neither the Board's advisors nor Evercore – KMI's financial advisor and the originator of the warrant concept –provided any analysis of the likelihood of the warrants hitting the $40 strike price during their term,[98] and KMI did not have any internal projections suggesting that this would occur.[99] Under these circumstances, the Board could not have reasonably concluded that the warrants had any value – let alone value sufficient to bring the revised deal up to the level of the previously-agreed $27.55.

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[93] Daniel Tr. at 152:11-25 (Goldman reduced post-Spin value of E&P business from on September 5 to on October 6) (Ex. 10).

[94] *See, e.g.,* EP00000488 (October 6, 2011 El Paso Board minutes) (Ex. 39); Daniel Ex. 10 at 11 (listing enterprise values of the E&P business in a range of (Ex. 37).

[95] In his deposition, Goldman's lead banker acknowledged the limited value and short-term nature of these substantially reduced E&P valuations. *See* Daniel Tr. at 156:10-157:12 ("But I mean, the trading multiples are the trading multiples, and the stocks did what they did, and again, this just meant to be a depiction of an estimate of the range based on then-market conditions, and again, assuming that the company was already out freely trading on its own. So not to say that, you know, in two more months, you know, the investors like these stocks better and they rise again. This is just a current at that time fixture of what it looked like.") (Ex. 10).

[96] Foshee Tr. at 196:10-24 (Ex. 12).

[97] Proxy at 7, 20, 94 (Ex. 5).

[98] Pacha Tr. at 184:4-184:11; 186:17-189:8 (Ex. 11); Daniel Tr. at 198:15-19 ("Q: Has Goldman Sachs at any point in time done any valuation of the warrants . . . ? A: I don't believe so.") (Ex. 10).

[99] Pacha Tr. at 185:10-18 (Ex. 11).

I. El Paso Learns That KMI Intends To Flip The E&P Business

Kinder had told Foshee that El Paso made more sense as two standalone entities, and personally applauded the Company's initial announcement of the Spin.[100] On September 20, before KMI even started its due diligence, Kinder revealed that he intended to sell the E&P business right after buying El Paso, and that he wanted El Paso's cooperation in consummating the E&P sale.[101] KMI's intention to flip the E&P assets should have been a "red flag" for Foshee and the Board that KMI believed it could earn an immediate profit – *i.e.*, it was buying the E&P business below market value.

Learning that KMI intended to flip the E&P business should also have led the Board to consider whether they could maximize shareholder value by completing the Spin (or selling the E&P business) and then selling the Pipeline business separately. However, management never asked the Company's advisors to analyze a possible sale of the E&P business, so the Board was never presented with the idea.[102] The Board's failure to recognize the value in selling its businesses separately was particularly damning given the landscape of prospective buyers. While the prospect of competitive bidding existed for the E&P business and the Pipeline business on a standalone basis, Morgan Stanley advised the Board that a similar auction was unlikely to unfold for the entire Company.[103]

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[100] KMI-EP021492 (May 25, 2011 Kinder email to Foshee) (Ex. 18).

[101] *See* MS00009628 (September 20 draft term sheet) (Ex. 31).

[102] Daniel Tr. at 140:24 – 141:5 ("Q: … Upon learning that Kinder Morgan intended to sell the E&P assets, was there any discussion between Goldman and El Paso about whether El Paso should sell the E&P assets? A: No.") (Ex. 10); Vagt Tr. at 150:14-24 ("Q: At some point did you learn that Kinder Morgan's plan, were they to acquire El Paso, was to subsequently sell off the E&P assets? A: Yes . . . . Q: And did that affect your opinion at all about whether to pursue the spin versus continuing negotiations with KMI? A: That fact in and of itself, no.") (Ex. 7).

[103] Foshee Tr. at 166:17-24 ("Q: And in those discussions, did Morgan Stanley's representatives explain that there was not a, not a high likelihood that there was any company that would compete with Kinder Morgan for bidding for all of El Paso? A: I think Morgan Stanley may have done that. I think that was the general consensus of the group.") (Ex. 12).

Management's motivation for helping KMI "flip" the E&P assets is clear: Foshee, Sult and Brent Smolik, the head of the E&P business, were and remain interested in buying the assets from KMI themselves and have breached their duty of loyalty in the interest of acquiring these assets at the lowest possible price. From KMI's "sources and uses" chart,[104] El Paso's executives learned that KMI was looking to earn [redacted] from a sale of the E&P business, and management believes this "bogey" represents an attractive buyout opportunity, as discussed in an email between Sult and Smolik:

> Sult: Any thought of a management buyout strategy? If you could get the financial backing, might be very attractive to [KMI] to sell to a single buyer at close. [redacted] I would be willing to invest some after hour time exploring the possibilities.
>
> Smolik: I have only discussed with Doug [Foshee]. He wants to hold the discussion as late as possible, but is willing (maybe even desires) to have the conversation with [KMI]. Seems the bogey is becoming clear. I like the possibility. Let's discuss in the morning.
>
> Sult: I should have suspected you two have discussed. Could be a real win win. Discussion can wait for the morning.[105]

Foshee admits this course of action could be hugely profitable for management,[106] and that the lower the price KMI paid for all of El Paso, the lower the price KMI would seek for the E&P business, thus lowering the risk of an E&P buyout for El Paso's executives.[107] A few weeks after signing the Merger Agreement, Foshee told Kinder that El Paso management wanted to bid on the E&P business, but that they would wait until KMI obtained "price discovery" on what

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[104] EP00005407 (September 28, 2011 sources & uses chart) (Ex. 33).

[105] EP00033390 (Ex. 41).

[106] Foshee Tr. at 276:5-16 ("Q: And it, if you ran the E&P business as well, it could be a very profitable thing for the management team; right? … A: Right. Q: It could be very profitable for the management team that bought the E&P – A: It could.") (Ex. 12).

[107] Foshee Tr. at 276:20-24 ("Q: And so, and the lower the price that the management team could get the E&P assets at, the less risk there is in acquiring it; right? A: True.") (Ex. 12).

third parties would be willing to pay.[108] Foshee told Kinder that if KMI "ever got to a point in [the] process where they wanted another bidder or wanted to sit down, then management would have some interest in that."[109] Foshee believes KMI may receive bids

.[111]

El Paso's management undoubtedly knew that buying the E&P assets from KMI instead of buying them from the Company would eliminate the prospect of El Paso shareholders challenging the buyout as a related-party transaction. Further, by permitting KMI's

these conflicted insiders will not have to show their hand, giving themselves an advantage over other bidders.[112]

J. Morgan Stanley Becomes Biased Toward A Sale To KMI, Which <u>Is The Only Transaction On Which It Can Receive A Fee</u>

Pursuant to its engagement as co-advisor to the Board on the KMI proposal, Morgan Stanley stood to receive fees totaling $38 million if the Merger was consummated. In order to structure Morgan Stanley's compensation in a way that would foster its impartiality as between the Merger and the Spin, the Company needed the ability to pay some fee to Morgan Stanley in the event the Spin was pursued. Fostering Morgan Stanley's impartiality was particularly crucial given the Board's knowledge of Goldman's strong financial interest in skewing its advice in favor

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[108] *See* Foshee Tr. at 271:5-274:15; 276:5-24; 278:12-16; 278:20-279:14 (Ex. 12).

[109] Foshee Tr. at 279:11-14 (Ex. 12).

[110] Foshee Tr. at 284:5-11 ("Q: But you having been the CEO of the company that owned this E&P business, you think that would be a very reasonable outcome that someone could bid over for it; right? A: I think that is in the range of possibilities.") (Ex. 12).

[111] GS-ELP00002793, at GS-ELP00002808 (valuing E&P business at (Ex. 37); Cox Tr. at 165:23 – 166:6 (Morgan Stanley placed aggregate value on the E&P assets of (Ex. 8).

[112] Foshee Tr. at 277:2-279:14 (Ex. 12).

of the Merger. Incredibly, however, the Board stood idly by while Goldman derailed any prospect of Morgan Stanley having balanced incentives.

Goldman's retention letter for the Spin provided it with exclusivity on that engagement.[113] When El Paso asked to renegotiate that agreement to permit Morgan Stanley to receive a fee if the Spin was consummated, Goldman flatly refused.[114] Goldman knew that by keeping Morgan Stanley's fee completely contingent on consummation of a sale to KMI – the outcome most favorable to Goldman's bottom line – Morgan Stanley would be inclined to embrace that transaction.[115] El Paso exerted no pressure on Goldman to reconsider its position,[116] and Goldman's conduct had precisely its intended effect.

Initially, when Morgan Stanley believed it might have been able to obtain an agreement entitling it to a fee regardless of whether the Board pursued the Merger or the Spin, Morgan Stanley was clear that KMI's offer of $25.50 in cash and stock was less attractive than the Spin, and that unless the Board solicited bids for El Paso's component parts, a competing bid to force KMI to pay fair value for El Paso was unlikely.[117] However, as it became apparent to Morgan Stanley during the coming weeks that Goldman would not allow it to receive any fee if it recommended the Spin, and thus facing the prospect of either receiving a $38 million advisory fee

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[113] *Id.*

[114] Sult Tr. at 137:10 – 138:21 (Ex. 9); Cox Tr. at 43:17 – 44:11 (Ex. 8); Daniel Tr. at 194:23 – 195:10 (Ex. 10).

[115] EP00009006 (October 6, 2011 Morgan Stanley engagement letter; Morgan Stanley will receive $7 million upon the announcement of a deal and $35 million if a sale of the Company is consummated) (Ex. 46).

[116] Daniel Tr. at 195:7-19 ("Q. And Goldman didn't agree to let Morgan Stanley be a co-advisor on the spin; correct? A. Right… I don't recall it as a – a difficult conversation. It was more like – I think it was J.R. [Sult] – more like they had asked – so he was asking but he was going to be okay with wherever we went with it.") (Ex. 10).

[117] EP00000384 (Ex. 24); Cox Tr. at 53:25 – 54:20, 79:16-22; 80:23 – 81:25, 195:23 – 197:4 (Ex. 8).

on the Merger or nothing, Morgan Stanley presented valuation analyses to the Board that materially undervalued El Paso and overvalued the consideration being offered by KMI.

As set forth in more detail in the accompanying Expert Declaration of David G. Clarke ("Clarke Declaration"), Morgan Stanley's valuation methodology implied a perpetuity growth rate of El Paso's Pipeline business of only 0.7% – less than the projected inflation rate and less than one-fourth the projected perpetuity growth rate for KMI, which is in the same business. This discrepancy is glaring given that Foshee testified that El Paso would be growing in the future, while KMI would face challenges growing its earnings.[118] The result of this implausible assumption was a significant undervaluation of El Paso.[119]

Morgan Stanley also overvalued the stock portion of the deal consideration by applying an unreasonably low cost of equity to its discounted cash flow analysis of KMI. The rate it used was significantly below [redacted] and what Morgan Stanley itself calculated as part of another aspect of its analysis.[120] These significant errors should have been apparent to El Paso's Board.[121]

K. El Paso Rewards Goldman With An Unwarranted $20 Million Advisory Fee

While Goldman refused El Paso's request to modify its Spin engagement letter to permit Morgan Stanley to receive a fee on the Spin, Goldman demanded that El Paso sign a new engagement letter so Goldman could earn a fee upon a sale to KMI.[122] In light of the fact that Goldman not only had a conflict of interest but actually gave the Board self-interested advice,

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[118] Foshee Tr. at 43:11 - 46:19 (Ex. 12).

[119] *See* Clarke Decl. at 10-13.

[120] *See* Clarke Decl. at 19-22.

[121] *See* Clarke Decl. at 13, 22.

[122] Daniel Tr. at 186:3 - 188:4, 190:3-23 (El Paso signed an engagement letter with Goldman on October 6, 2011 agreeing to pay Goldman $20 million if the merger closes) (Ex. 10).

Goldman's fee request was truly offensive. El Paso nonetheless capitulated, and agreed on October 6 to pay Goldman $20 million if the KMI deal closed.

L. El Paso And KMI Agree To The Merger

Despite articulating that KMI's offer in early September was inadequate,[123] on October 16, 2011, Morgan Stanley – with the entirety of its $38 million fee hanging in the balance – provided the El Paso Board with a fairness opinion on a reduced KMI offer.

That same day, El Paso and KMI executed the Merger Agreement.[124] Not only was the final deal price lower than the $27.55 outlined in the parties' September 21 draft term sheet,[125] the consideration included KMI warrants that were not initially contemplated[126] and were of questionable value.[127] All of the substantive deal protections outlined in the initial term sheet, including the "no-shop" provision, also survived the entirety of the negotiations[128] despite the absence of a legitimate pre-signing market check.[129] The Board also failed to negotiate for a collar to protect El Paso's shareholders in the event of unfavorable movements in KMI's stock price.

Also problematic was the Board's failure to structure a "fiduciary out" in the Merger Agreement that would allow the Board to abandon the Merger in order to pursue a sale of the E&P assets, regardless of any offer El Paso might receive for that business. The Company cannot

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[123] EP00000282 at 294 (Ex. 47); EP00000382 (El Paso's September 5, 2011 Board minutes) (Ex. 24).

[124] Proxy at 111 (Ex. 5).

[125] KMI-EP016513 (Ex. 32).

[126] *Id.*

[127] Proxy at 94 ("The value of the warrants . . . is uncertain, and the warrants my have limited or no value.") (Ex. 5).

[128] KMI-EP016513 (Draft term sheet contained no-shop provision, information rights and matching rights for KMI) (Ex. 32).

[129] Cox Tr. at 90:14-20 ("A: Okay. It was the board's decision not to shop the company. Q: Did Morgan Stanley make a request of the board to shop the company? A: No. We made a recommendation that the company not shop itself.") (Ex. 8).

enter into discussions with any alternative bidder unless that bidder makes a "Superior Proposal," defined as "a *bona fide* written offer … to acquire, directly or indirectly … more than 50% of the equity securities of the Company or assets of the Company and its Subsidiaries on a consolidated basis …"[130] Because the E&P assets constitute less than 50% of the Company's consolidated assets,[131] this narrow construct prevents the Board from considering (or changing its recommendation in response to) even an outsized offer for the E&P business that would present a more favorable alternative for El Paso shareholders than the Merger.

Although the "fiduciary out" does not bar the Board from considering a superior bid for the Pipeline business (which constitutes more than 50% of El Paso's assets), the Board also agreed to a $650 million termination fee payable to KMI in the event the Board terminates the Merger Agreement to accept a "Superior Proposal."[132] This termination fee is so large as to preclude any alternative bids for the Pipeline assets, since such a bidder would purchase only a portion of the Company but would bear the full brunt of the breakup fee.

The obstacles imposed by the narrow "fiduciary out" and the termination fee are particularly problematic in light of the fact that there was a high likelihood of competitive bidding for the E&P or Pipeline assets on a standalone basis, but KMI was the only logical buyer of the entirety of El Paso. Thus, the deal protections collectively ensured that there would be no market check on the deal as "pure play" energy companies would be unable to make a bid for only one of El Paso's component businesses.

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[130] *See* Merger Agreement § 5.3 (Ex. 3).

[131] *See* El Paso Form 10-Q filed on Nov. 7, 2011, at 24 (El Paso had $24.078 billion total consolidated assets as of September 30, 2011, of which $4.724 billion were E&P assets) (Ex. 4).

[132] *See* Merger Agreement § 7.3(b) (Ex. 3).

ARGUMENT

Plaintiffs assert claims against El Paso's directors for breach of fiduciary duty in connection with their approval of the Merger, and against Goldman and KMI for aiding and abetting these breaches. To prevent irreparable harm to El Paso's shareholders, the Court should enjoin the shareholder vote on the Merger and enforcement of the Merger Agreement's deal protection devices so the Board can evaluate the alternative transactions that are before it (*e.g.*, the Spin, a sale of El Paso in parts, and the KMI Merger) in an effort to maximize shareholder value, guided by a truly independent financial advisor.

Injunctive relief should be granted because: (1) Plaintiffs have a reasonable probability of success on the merits of their claims; (2) El Paso's shareholders face a threat of imminent, irreparable harm; and (3) the balance of equities favors an injunction. *See In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 191-92 (Del. Ch. 2007).

I. PLAINTIFFS HAVE DEMONSTRATED A REASONABLE PROBABILITY OF SUCCESS ON THE MERITS

Because the Merger involves a change of control, El Paso's Board must convince the Court that it undertook a fair process, reasonably designed to maximize shareholder value, and that it did not favor one transaction over another for reasons other than their economic merit. Here, however, the conflicting interests of El Paso's senior management and advisors permeated the sales process, resulting in decisions that were based on self-interest rather than whether they were fair and in the best interests of the Company's shareholders. Moreover, the Board has precluded the market from rectifying their breaches of fiduciary duty by agreeing to deal protection provisions that: (i) prevent the Board from evaluating or accepting a bid for the E&P business alone, even at a very high price; and (ii) effectively preclude any competing bids for the Pipeline business.

A. The Entire Fairness Standard Of Review Applies

The entire fairness standard governs this Court's review of Defendants' approval of the Merger. The Delaware Supreme Court's decision in *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1989) is directly on point. In *Mills*, conflicted directors/managers were bidders in an auction by which control of Macmillan would be sold. Macmillan received competing bids, including a proposal for a management-sponsored buyout of the company by KKR. *Id.* at 1272. Senior management, who would receive a significant ownership interest in the new company if KKR emerged as the successful bidder, essentially rigged the bidding process by, *inter alia*, installing their financial advisor to conduct the "auction" and clandestinely passing competitive bidding information to KKR. *Id.* at 1275. Macmillan's board, while purportedly independent, failed to adequately oversee the auction process, thus creating the circumstances that enabled management to exploit the situation to favor their interests. *See id.* at 1280, 1281, 1284 n.32. Under these circumstances, the Court applied the entire fairness standard of review, noting:

> [T]his judicial reluctance to assess the merits of a business decision ends in the face of illicit manipulation of a board's deliberative processes by self-interested corporate fiduciaries. Here, not only was there such deception, but the board's own lack of oversight in structuring and directing the auction afforded management the opportunity to indulge in the misconduct which occurred. In such a context, the challenged transaction must withstand rigorous judicial scrutiny under the exacting standards of entire fairness.

559 A.2d at 1279 (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983)). The Supreme Court found the breaches of duty at issue in *Mills* so egregious that it reversed the Chancery Court's denial of injunctive relief.

Here, as in *Mills*, self-interested corporate fiduciaries manipulated the sales process to their advantage: (a) Goldman steered the Board towards a sale to KMI to secure a windfall on its $4 billion equity stake in KMI, (b) Morgan Stanley's advice was tainted by its sharing of information with Goldman and its own financial incentive to favor a KMI transaction, and (c) Foshee prevailed upon the Board to accept a price below its $26.50 cash and stock "floor" to advance his own buyout aspirations and secure a $90 million payday. As a result of this rampant

manipulation of the sales process by those in a fiduciary relationship with El Paso's shareholders, the Merger must satisfy the exacting entire fairness standard.

B. Alternatively, The Board Must Demonstrate Its Compliance With *Revlon*

Even if the Court were to find the entire standard fairness inapplicable to the case at bar, the Board's conduct must be measured under the heightened standards set forth in *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) and its progeny, because the Merger is a change of control transaction. *See, e.g., QVC Network, Inc. v. Paramount Commc'ns Inc.*, 635 A.2d 1245, 1265 (Del. Ch. 1993).

Upon closing of the Merger, El Paso's current shareholders will collectively have a minority 32% interest in the combined company, while Rich Kinder, Goldman and the other "Sponsor Investors" will hold a majority (53.7%) of the voting power.[133] The Proxy makes clear that the control Kinder and the Sponsor Investors currently wield over KMI will continue after consummation of the Merger, not only because of their ownership stakes but also by virtue of shareholder agreements and bylaws that enable them to elect the majority of the combined company's board and to veto board actions.[134]

In a change of control transaction such as this, *Revlon* requires corporate directors to "'undertak[e] a sound process to get the best deal available.'" *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 595 (Del. Ch. 2010) (citation omitted). The directors must prove their

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[133] *See* Proxy at 69 ("The 'Sponsor Investors' are investment funds advised by or affiliated with Goldman, Highstar Capital LP, The Carlyle Group and Riverstone Holdings LLC. The Sponsor Investors, together with Rich Kinder, owned 100% of KMI prior to the company's IPO in February 2011, and own approximately 78% of KMI today.") (Ex. 5).

[134] Proxy at 73 (noting, *inter alia*, that "the Sponsor Investors and Mr. Kinder have not only the right to nominate eleven of [KMI's] directors, but also the voting power to elect all of its directors," and that KMI's bylaws "require that substantially all actions brought before [KMI's] board … require supermajority board approval" and that KMI's board "will be unable to approve of any action by supermajority board approval if all of the directors nominated by the Sponsor Investors vote against such action"). (Ex. 5).

reasonableness,[135] and in evaluating whether they have met that burden the courts apply a "heightened standard of reasonableness review" with two "key features":

> (a) a judicial determination regarding the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision; and
>
> (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing.

In re Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975, 1000 (Del. Ch. 2005) (citing *QVC*, 637 A.2d at 45). El Paso's board fails on both counts, having allowed conflicted corporate fiduciaries to corrupt the decision-making process, and having made decisions based on self-interest rather than maximization of shareholder value.

C. Regardless Of What Standard Applies, The Board's Conduct Falls Short

The conduct at issue here cannot pass muster, whether reviewed under the entire fairness standard or *Revlon's* heightened reasonableness standard, because the Board failed to implement the sound decision-making process needed to obtain a value-maximizing price for El Paso's shareholders.

1. The Board's Reliance On Conflicted Financial Advisors And Conflicted El Paso Insiders Corrupted The Decision-Making Process

The Board had at least three choices when it came to selling El Paso: (1) the KMI deal; (2) the Spin; and (3) selling the Company in its component parts. Faced with these multiple options, the Board had "the obligation: (a) to be diligent and vigilant in examining critically the [alternatives]; (b) to act in good faith; (c) to obtain, and act with due care on, all material information reasonably available . . . to determine which of these transactions, or an alternative course of action, would provide the best value reasonably available….; and (d) to negotiate actively and in good faith with [the proponents of the alternative transactions]." *Paramount*

[135] *Forgo v. Health Grades, Inc.*, C.A. No. 5716-VCS, at 13 (Del. Ch. Sept. 3, 2010) (TRANSCRIPT).

Commc'ns Inc. v. QVC Network, Inc, 637 A.2d 34, 48 (Del. 1994). In other words, the Board owed a duty to El Paso's shareholders to consider each of the possibilities, and to make a decision based on what was best for the shareholders. *Id.* at 43.

Far from fulfilling these responsibilities, the Board relied on financial advice received from parties laboring under conflicts of interest, thereby destroying *any possibility* that it would be able to discharge its duty to fairly evaluate its strategic alternatives and to select the option that would maximize shareholder value. The involvement of Goldman, Morgan Stanley, and Foshee and his cohorts – with their own private motivations to advocate for the KMI Merger over any other alternative – destroyed the fidelity of the sales process and made it impossible for the Board to have properly discharged its duties.

Where, as here, a board implements a flawed process that inhibits its ability to maximize value for shareholders, this Court has recognized the propriety of injunctive relief. *See, e.g., In re Holly Farms Corp. S'holders Litig.*, 1988 WL 143010, at *5 (Del. Ch. Dec. 30, 1988) (preliminary injunction granted where the board's sales process "was so substantially flawed that the Board's actions . . . were not likely to have maximized the value of the corporation for the shareholders . . ."); *In re Del Monte Foods Co. S'holders Litig.,* 25 A.3d 813 (Del. Ch. 2011) (preliminary injunction granted where board relied on conflicted financial advisor in selling the company).[136]

a. The Board's Reliance On Goldman Infected The Sales Process

KMI's submission of an offer to acquire El Paso presented a clear and undeniable conflict of interest for Goldman. Goldman's 19% stake in KMI is worth a staggering ***$4 billion.***[137] With

[136] That the Board may have been unaware of Foshee's aspirations to buy the E&P assets is not dispositive. Notably, the board in *Del Monte* was kept in the dark concerning Barclays' conflict, yet injunctive relief was granted. *Del Monte*, 25 A.3d at 833.

[137] *See, e.g.,* Kinder Tr. at 202:11-20 (Goldman's KMI stake "around $4 billion") (Ex. 6); Daniel Tr. at 22:24-23:8 (Goldman's stake in KMI is worth "billions of dollars") (Ex. 10).

about 778 million El Paso shares outstanding, every dollar that Goldman could shave off the ultimate purchase price would save Goldman about $150 million on its KMI investment – a figure far exceeding the amount of any reasonable advisory fee.[138] Conversely, even a marginally aggressive overpayment by KMI for El Paso would cost Goldman far more than any fees it could earn as El Paso's advisor on the transaction.[139]

To preserve any chance of maintaining the integrity of the sale process and complying with its fiduciary duties, the El Paso Board should have immediately excluded Goldman from any discussion of the KMI offer. The Board also should have limited its reliance on Goldman for advice with respect to the Spin, which was the alternative the Board was currently assessing. Foshee, who deemed it impossible that the Board would be bothered by Goldman's conflict,[140] permitted Goldman to taint the Board's assessment of KMI's offer at the September 5 Board meeting by having the bank present its views ***before*** calling the conflict to the Board's attention.[141] Inexplicably, after discussing Goldman's conflict, the Board not only continued Goldman's retention on the Spin, but – over the objection of its own counsel – actually ***expanded*** Goldman's role by retaining it to simultaneously serve as a co-advisor on the potential KMI deal.[142] This dual role positioned Goldman to advise the Board on the relative merits of these two competing strategic paths when it had a powerful incentive to steer the Board away from the Spin and towards a deal with KMI. Once KMI made its offer, Goldman had no business advising the Company on ***either*** transaction – let alone on ***both transactions simultaneously***.

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[138] *See* Foshee Tr. at 154:7-155:10 (Ex. 12).

[139] *See* Sult Tr. at 122:3-123:23 (Ex. 9).

[140] Foshee Tr. at 144:14-21 (Ex. 12).

[141] EP00000388 (Ex. 24); EP00000382 (Ex. 24); Foshee Tr. at 144:2 – 145:16 (Ex. 12).

[142] *See* MS00008953 ("Over Wachtell's objection, GS got a letter signed which engaged them as an advisor in the sale of the company.") (Ex. 42).

Shortly after placing Goldman in a position to sway the Board's decision regarding the Merger, the Board was confronted with evidence that this conflict was, in fact, affecting Goldman's advice.[143] Even then, the Board did not terminate Goldman's involvement. Instead, the Board decided to simply exclude Goldman from participation in further "tactical" discussions regarding KMI.[144]

This attempt to neutralize Goldman's conflict represents the proverbial lipstick on a pig. The term "tactical issues" was construed so narrowly that the only thing Goldman could *not* do was participate in discussions regarding El Paso's negotiating strategy with KMI after September 15.[145] Goldman was permitted to, and did, continue to provide advice to the Board that was intended to influence its decision-making with respect to the KMI proposal.[146]

Goldman took full advantage of its opportunity to sway the El Paso Board toward abandoning the Spin in favor of a deal with KMI. Goldman told the Board that the value of El Paso's E&P business had [REDACTED] by [REDACTED] in the five months between the May 2011 Board meeting where the Spin was approved and the October 2011 Board meeting where the Board jettisoned the Spin in favor of the Merger.[147] This decrease was attributable to declines in the EBITDA multiples of peer companies in the E&P industry – declines reflecting

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[143] EP00000392 (Foshee noted that "some of the advice that was received from the Houston team of Goldman Sachs recently raised management's concerns that they were ***receiving pressure from other parts of Goldman Sachs to avoid a strategy that might result in KMI going public and making a hostile approach on the Company***.") (emphasis added) (Ex. 29).

[144] EP00000392 ("In light of the potential conflict, Mr. Foshee indicated that … any discussions on tactical issues would be reserved for the discussions with Morgan Stanley.") (Ex. 29).

[145] Daniel Tr. at 104:24 – 105:5 ("Q: [H]ow did you understand him to be defining 'tactical matters'? A: I took that to mean dialogue with the company about, you know, what next to say to Mr. Kinder and so on down the line.") (Ex. 10); Foshee Tr. at 196:25-197:14 (Ex. 12).

[146] *See, e.g.*, Daniel Tr. at 163:6 – 166:17 (Goldman presented a discounted cash flow analysis to El Paso's Board on September 15, 2011, concerning the E&P business, the pipeline business, and the combined company to help the El Paso Board compare the value of the KMI transaction with the present value of the benefits to be achieved if the Spin were deployed) (Ex. 10).

[147] EP00000246 at EP00000259 (Ex. 25); EP00000128 at EP00000144 (Ex. 50); EP00000443 at EP00000456 (Ex. 38).

short-term fluctuations in the market, ***not*** declining long-term values. Goldman conveniently failed to explain to the Board the sensitivity of this analysis to short-term market swings, or that El Paso's E&P business was still performing at or above expectations such that its long-term value had not decreased at all.[148] Instead, Goldman led the Board to believe that the long-term value of the Spin was waning, thus making the Merger appear more attractive.

Goldman also presented to the Board a discounted cash flow analysis of El Paso's Pipeline and E&P segments.[149] For both segments, Goldman calculated a cost of equity percentage using a discredited methodology, resulting in a percentage that was significantly above that which Morgan Stanley used in its similar analysis, thereby materially reducing Goldman's valuations of both segments. Goldman also used an absurdly low terminal EBIDTA multiple for the E&P segment that reflected comparable company multiples for 2008 and 2009, a period encompassing the worst economic crisis since the Great Depression, which further contributed to Goldman's undervaluation of the E&P segment.[150]

"Because of the central role played by investment banks in the evaluation, exploration, selection, and implementation of strategic alternatives, this Court … has examined banker conflicts closely to determine whether they tainted the directors' process." *Del Monte*, 25 A.3d at 832. In *Del Monte*, the Court preliminarily enjoined a shareholder vote on the sale of Del Monte where the evidence showed that Del Monte's financial advisor had steered the Board towards a sale to a private equity party to further its own interest in earning fees on both the buy and sell sides of the transaction. 25 A.3d at 833.

Similarly, in *Khanna v. McMinn*, 2006 WL 1388744 (Del. Ch. May 9, 2006), the plaintiffs alleged that the acquiror's board of directors breached its fiduciary duties by relying

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[148] *See* Vagt Tr. at 119:18-120:6 (Ex. 7); Foshee Tr. 109:9-15 (El Paso has "had good performance all through 2011") (Ex. 12).

[149] GS00006379, GS00006372 (Goldman's Sept. 15, 2011 Board Discussion Materials) (Ex. 28).

[150] Clarke Decl. at 26-27.

upon advice from Bear Stearns despite knowing that Bear Stearns had a conflict of interest with regard to the merger because it had provided a $40 million bridge loan to the target and thus had an interest in ensuring the closing of the transaction. *Id.* at *25. The Court denied the directors' motion to dismiss because the plaintiffs had raised facts sufficient to "create a reasonable doubt that the transaction was the product of a valid exercise of business judgment." *Id.* If an advisor's $40 million bridge loan is enough to support a breach of duty by a board that relies on that advisor, an advisor's $4 billion investment in the bidder surely suffices.

In another case, the Court declined to approve a settlement that would have jettisoned a *Revlon* claim in favor of a disclosure-only resolution, where the plaintiffs alleged that the target board's financial advisor had played an inappropriate dual role in the transaction (and indeed had a far less severe conflict than Goldman has at bar). In *In re Prime Hospitality, Inc. Shareholders Litigation*, 2005 WL 1138738 (Del. Ch. May 4, 2005), Bear Stearns did not have a financial interest in the transaction at issue, but was advising the target board after having previously advised the acquiror in connection with two unrelated investments in the same sector. Given that "Delaware law favors the voluntary settlement of corporate disputes,"[151] the fact that such a comparatively insignificant conflict was deemed sufficient to warrant denial of a settlement speaks volumes.

Goldman's conflict of interest readily eclipses those in *Del Monte, Khanna,* and *Prime Hospitality.* None of those cases involved an advisor with a financial interest in the transaction that came anywhere close to Goldman's ***multi-billion*** dollar interest in KMI. Furthermore, unlike the Del Monte board, which at least was able to claim that Barclays hid its buy-side aspirations,[152]

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[151] *In re Triarc Cos., Inc. Class & Deriv. Litig.*, 791 A.2d 872, 876 (Del. Ch. 2001).

[152] *See Del Monte*, 25 A.3d at 833 ("But for Barclays' manipulations, the Del Monte process would have played out differently. If the directors had known at the outset of Barclays' intentions and activities, the Board likely would have hired a different banker . . . . Even if the directors decided to proceed with Barclays, the Board and its experienced counsel doubtless

here the Board was at all times actually aware of Goldman's substantial ownership interest in KMI,[153] yet nonetheless permitted Goldman to continue to advise it on both the Spin and the Merger. Only injunctive relief can purge the taint of the Board's reliance on such an obviously conflicted advisor.

b. The Board Compromised Morgan Stanley's Independence

The depth of Goldman's conflict should have made clear to the Board that it could never – no matter how many other purportedly independent banks it brought in – purge the taint of Goldman's involvement. *See, e.g., Ortsman v. Green*, 2007 WL 702475, at *1 (Del. Ch. Feb. 28, 2007) (granting expedited proceedings despite target's retention of second financial advisor where first advisor was conflicted by desire to provide buy-side financing).

Here, however, the Board's conduct goes far beyond its egregious failure to eliminate Goldman from the process. Having retained Morgan Stanley to serve as a "co-advisor" alongside Goldman, the Board took steps that prevented this measure from having any utility. First, the Board permitted Goldman and Morgan Stanley to freely share information in their roles as co-advisors in the early stages of the process,[154] thereby destroying any prospect that Morgan Stanley would ever be truly independent. Notably, Goldman and Morgan Stanley discussed "tactical" matters – the very matters from which the Board would subsequently bar Goldman and the Board went so far as to task Goldman with bringing Morgan Stanley "up to speed." Morgan Stanley simply had no hope of being "independent."

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would have taken steps to protect the integrity of the process. As soon as Barclays disclosed its buy-side aspirations, the Board likely would have followed *Toys "R" Us* and 'nixed that idea.'").

[153] Vagt Tr. at 89:22-90:4 (Ex. 7).

[154] Daniel Tr. at 108:11-24 (Morgan Stanley listened to Goldman's presentations at the September 5 and October 6 Board meetings), 114:18-25, 115:5-22 (Goldman shared information and discussed tactical matters with Morgan Stanley through at least September 12), and 122:12-16 (El Paso asked some Goldman bankers to "help the Morgan Stanley people get up to speed") (Ex. 10); Sult Tr. at 178:5-14 (Sult communicated with Goldman and Morgan Stanley together following the September 5 meeting) (Ex. 9).

Second, even if Morgan Stanley could have somehow divorced itself from the taint of Goldman's conflict, the Board ensured that Morgan Stanley would have no incentive to do so. By acquiescing in Goldman's refusal to relinquish exclusivity on the Spin, the Board denied Morgan Stanley any chance to obtain a fee if the Board pursued the Spin.[155] This ensured that ***both of the Board's financial advisors*** would have an interest in advocating for the KMI deal over the Spin.[156]

Having relied ***solely on financial advisors who had direct economic stakes in Merger,*** the Board had no reasonable basis upon which to conclude that the Merger was the path most likely to maximize shareholder value.

c. The Board's Reliance On An Interested Insider To Negotiate The Merger Further Infected The Sales Process

Compounding its reliance on tainted advice from Goldman, the El Paso Board delegated the negotiation process to Foshee, who was fatally conflicted by the anticipated $90 million payout he will receive if the KMI deal closes – most of which would not be available (or triggered) through the Spin. Controlling precedent makes clear that a board must proceed with great caution in delegating the task of negotiating a change in control transaction to an interested insider. In *Mills*, the Delaware Supreme Court held that injunctive relief was required when a board's lack of involvement in a sale process enabled interested insiders and their financial advisor to steer the deal to their preferred bidder. The Court recognized that the board's lack of oversight was inexcusable and tainted the entire process, noting that "[w]hen presumably well-intentioned outside directors remove themselves from the design and execution of an auction, then what occurred here, given the human temptations left unchecked, was virtually inevitable."

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[155] Cox Tr. at 190:20 – 191:2 (Morgan Stanley would receive no fee if the Spin went forward rather than the Merger) (Ex. 7).

[156] Sult Tr. at 137:10-138:21; 241:18-22 (Goldman refused El Paso's request to change Goldman's engagement terms to permit Morgan Stanley to receive a fee contingent upon completion of the Spin) (Ex. 9); Daniel Tr. at 194:8-195:19; 195:25-196:19 (Ex. 10).

559 A.2d at 1281. Ultimately, the Supreme Court found that the fundamental lack of oversight itself amounted to a breach of the duty of loyalty warranting injunctive relief. *Id*. at 1284 n.32.

Here, as in *Mills*, the Board corrupted the sales process by delegating the task of negotiating the Merger to an interested insider and then failing to adequately oversee his conduct. For example, after the Board internally determined that it would not accept any offer that provided less than $26.50 in cash and stock,[157] Foshee submitted a counteroffer to Rich Kinder to sell the Company for $26 in cash and stock, in direct contravention of the Board's instructions.[158] Director Vagt's testimony that he was "not particularly" surprised by Foshee's blatant disregard for the Board's clear instructions speaks volumes.[159] At a minimum, the Board should have required an independent board member to negotiate along with Foshee. Instead the Board decided that it was "comfortable" with Foshee negotiating alone.[160] The Board's reliance on an interested insider to negotiate this change of control transaction warrants injunctive relief.

2. Foshee Breached His Fiduciary Duties By Covertly Planning A Post-Merger E&P Buyout

Foshee also breached his fiduciary duty of loyalty to El Paso's shareholders by using confidential information he learned in his capacity as El Paso's Chairman and CEO to further his private interests, to the detriment of El Paso's shareholders. At the same time the Board was deciding between the Merger and the Spin, Foshee and two of his fellow El Paso executives – like the insiders in *Mills* – were contemplating making their own bid for the E&P assets.[161]

While El Paso management suspected since the fall of 2010 that KMI had no interest in the E&P assets, their suspicion was confirmed during their negotiation of the Merger on behalf of

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[157] EP00000413 (Ex. 34).

[158] KMI-EP009378 (Ex. 49).

[159] Vagt Tr. at 188:20-189:25 (Ex. 7).

[160] Sult Tr. at 172:2-173:4 (Ex. 9).

[161] *See* Foshee Tr. at 271:5-274:15; 276:5-24; 278:12-16; 278:20-279:14 (Ex. 12).

the Company.[162] After realizing that KMI's target price for the E&P assets presented a lucrative opportunity, Foshee and his colleagues disregarded their fiduciary duties as corporate executives and pursued the course of action that best advances their aspirations to buy the E&P business.

Foshee, of course, recognized that the less KMI paid for the Company, the lower the price he would have to pay KMI for the E&P assets.[163] Foshee's personal interest in seeing KMI pay a low price for El Paso's shares was in direct conflict with the shareholders' interests in maximizing the value received for their shares. Given this conflict, Foshee should have recused himself from any involvement in the KMI negotiations, but he did not do so. Instead he not only served as the primary negotiator with KMI, but he agreed to play a key role in helping KMI market the E&P assets to potential bidders. In that regard, he and other El Paso executives have made presentations to potential bidders and answered their questions about the E&P business.[164] These activities have placed Foshee in a position to influence those bidders in a way that will enhance his own buyout opportunity. This was a breach of his fiduciary duties. *See, e.g., Guth v. Loft,* 5 A.2d 503, 510 (Del. Ch. 1939) ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests.... The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by fiduciary relation."); *Mills,* 559 A.2d at 1284 ("corporate fiduciaries shall abjure every temptation for personal profit at the expense of those they serve"). Foshee is liable for this breach, even if he kept the remaining members of the Board in the dark about his plans. *See, e.g., In re Am. Int'l Group, Inc.,* 965 A.2d 763, 807 (Del.

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[162] *See* EP00005407 (September 28, 2011 sources & uses chart) (Ex. 33).

[163] Foshee Tr. at 276:20-24; 274:8-15 (Ex. 12).

[164] Pacha Tr. at 175:3-25 (Ex. 11).

Ch. 2009) ("Delaware law provides no safe harbor to high-level fiduciaries who group together to defraud the board."). Moreover, Foshee, Sult and Smolik – the three executives who were contemplating a post-Merger E&P buyout – were present at various Board meetings, yet never disclosed to the Board their aspirations to purchase the E&P assets. As fiduciaries and insiders of El Paso, they had a duty to disclose this highly material fact. Their silence speaks volumes. *See, e.g., Mills*, 559 A.2d at 1282 ("Given [the officer's] duty of disclosure under the circumstances, this silence is an explicit acknowledgment of their culpability.").

By failing to disclose his personal interest in acquiring the E&P assets, Foshee prevented the Board from making an informed decision as to whether he should serve as the principal deal negotiator. Moreover, as a result of Foshee's non-disclosure, the Board was duped into agreeing to have its executives help KMI with its E&P sales efforts, thereby placing Foshee, Sult and Smolik in a position to influence the purportedly competitive bids KMI would receive for the E&P assets. As the Court recognized in *Netsmart,* "[i]f management had an incentive to favor a particular bidder (or type of bidder), it could use the due diligence process to its advantage, by using different body language and verbal emphasis with different bidders. 'She's fine' can mean different things depending on how it is said." 924 A.2d at 194. Here, the threat that insiders could use "body language" to steer potentially interested parties away from buying the E&P assets amounts to much more than a theoretical threat: Foshee has actually discussed with Richard Kinder his desire to submit a bid for the very assets he is involved in shopping to others [redacted]

[redacted].[165]

[165] Foshee Tr. at 277:2 – 279:14 (Foshee discussed with Kinder submitting a bid for the E&P assets and [redacted] (Ex. 12).

3. The Board's Inaction Upon Learning That KMI Intended To "Flip" The E&P Assets Violates Its Fiduciary Duties

Having put in place a sales process that was tainted by the actions of Goldman and El Paso management, the Board passively continued with plans to sell El Paso to KMI instead of making the obvious response to KMI's plan to flip the E&P business – to make sure the profits from any sale of the E&P business went to El Paso's shareholders first. The Board's failure to ensure that El Paso's shareholders would share in the upside of these assets runs decidedly counter to its fiduciary duties.

The Board decided to abandon the Spin even though it had no independent advisor with respect to the Spin[166] and thus had no reasonable basis upon which to conclude that abandoning the Spin in favor of the Merger would maximize shareholder value. The Board never considered whether El Paso could increase shareholder value by first completing the Spin or selling the E&P assets to a third party, and then selling the remainder of El Paso to KMI (or another potential bidder).[167] Instead, the Board simply transferred the value of breaking up these assets to KMI. The Board did not even seize the tactical opportunity to insist on added consideration in return for allowing KMI to take any benefit from flipping the E&P assets,[168] [redacted]

[redacted][169]

[166] Cox Tr. at 21:19-25; 190:20-191:2 (Ex. 8).

[167] *See, e.g.*, Foshee Tr. at 246:4-20 (Ex. 12); Sult Tr. at 304:6-22 (Ex. 9).

[168] Sult Tr. at 276:15-18 (Ex. 9).

[169] EP00026479 [redacted]

Moreover, despite being told by Morgan Stanley that there were likely to be competing bidders for the Company's Pipeline business if it were sold separately from the E&P business,[170] the Board never tested the market for alternative buyers of the Pipeline business.[171] Notably, Kinder has testified that he purposely timed his bid to precede consummation of the Spin so as to *eliminate* competition for the Company's pipeline assets.[172] In other words, Kinder knew – as El Paso's Board should have – that while there were no buyers other than KMI willing to purchase all of El Paso, spinning off or selling the E&P business would yield a pool of potential buyers and the potential for a competitive auction of the Pipeline business. In derogation of their fiduciary duties, El Paso's directors never considered selling the Pipeline business separately, focusing myopically on a sale of the entire Company to KMI.

4. The Board's Agreement To Unreasonable Deal Protections Violated Their Fiduciary Duties

The Board also agreed to a host of deal protections that will effectively thwart any competing bid, either for the Company as a whole or for its constituent parts. The Board's decision to agree to such restrictive protections was not designed to maximize shareholder value.

[170] Cox Tr. at 196:4 – 197:4 (Ex. 8); Foshee Tr. at 166:17-24 (El Paso was aware (and Morgan Stanley likely explained) that there was "not a high likelihood that there was any company that would compete with Kinder Morgan for bidding for all of El Paso") (Ex. 12).

[171] Cox Tr. at 196:25 – 197:4 ("Q: And so there was – there was no effort to contact any party other than Kinder Morgan? A: Correct.") (Ex. 8).

[172] *See* Kinder Tr. at 23:14-24:3 (Ex. 6). Although the lead director of El Paso's Board shared this insight, he failed to act on it, to the detriment of El Paso's shareholders. *See* EP00013940, EP00013942 (marginalia by Director Talbert on August 30, 2011 KMI initial offer letter notes "Knowns: (1) Limit competition—pre rather than post-spin" and "KM—wants to limit competition by doing pre-spin.") (Ex. 40).

a. The Board Agreed To A "No-Shop" Provision With An Overly Restrictive "Fiduciary Out" Without Conducting A Pre-Signing Market Check

Morgan Stanley unequivocally informed the Board that while there was a reasonable prospect of competing interest for El Paso's constituent businesses, there was no likely buyer for the whole Company other than KMI. Nonetheless, the Board negotiated only with KMI and only with respect to a sale of the entire Company. The Board then agreed to a Merger Agreement containing a broad "no-shop" provision and a narrowly-defined "fiduciary out" that prohibits the Board from considering or accepting ***any*** third party bid for the E&P assets, no matter how attractive the offer.

Under the Merger Agreement, El Paso's Board must recommend approval of the Merger to El Paso's shareholders and cannot change or withdraw that recommendation – or solicit, facilitate or encourage any competing "Takeover Proposal" – except in very limited circumstances.[173] First, the Board may change its recommendation and/or participate in negotiations if the Company receives a Takeover Proposal that the Board concludes is or may lead to a "Superior Proposal," defined as a proposal to acquire ***more than 50% of El Paso's assets or equity securities***.[174] Because the E&P assets constitute less than 50% of El Paso's assets,[175] a proposal to purchase only the E&P assets could not constitute a "Superior Proposal."

Second, the Board may change its recommendation upon the occurrence of an "Intervening Event."[176] However, the Merger Agreement states that "in no event shall the receipt, existence or terms of a Takeover Proposal or any matter relating thereto or consequences thereof

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[173] Merger Agreement § 5.3 (Ex. 3).

[174] Merger Agreement § 5.3(b), (d), (f) (Ex. 3).

[175] *See* El Paso Form 10-Q filed on Nov. 7, 2011, at 24 (El Paso had $24.078 billion total consolidated assets as of September 30, 2011, of which $4.724 billion were E&P assets) (Ex 4).

[176] Merger Agreement § 5.3(e) ("An Intervening Event permits a change of recommendation, but does not permit El Paso to engage in discussions with competing bidders.") (Ex. 3).

constitute an Intervening Event."[177] Because a bid to acquire E&P's assets would be a Takeover Proposal,[178] the Merger Agreement would not permit the Board to change its recommendation in response to such a bid, ***no matter how favorable it is to El Paso***.

Given the Board's knowledge that KMI does not intend to keep the E&P assets, and its own advisors' prediction that KMI would not face competitive bidding for the sale of El Paso as a whole but that there could be significant bidding interest for El Paso's component parts, the Board abdicated its fiduciary duties by contracting away the ability to consider and accept offers to purchase the E&P assets alone. By relinquishing that right, even in response to a very high offer, the Board breached its fiduciary duties and ensured that no such offer will be made to El Paso, given the Company's inability to accept it. *See Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) (deal protection devices deemed unreasonably preclusive in the absence of an effective fiduciary out clause).

b. The $650 Million Termination Fee Precludes A Competing Bid For El Paso's Pipeline Business

In addition to the "no-shop" provision and overly restrictive "fiduciary out," the Board also unreasonably agreed to pay KMI a $650 million termination fee in the event the Board abandons the Merger Agreement to accept a "Superior Proposal." A sale of just the Pipeline business to a third-party would qualify as a Superior Proposal because the Pipeline business represents more than 50% of El Paso's assets.[179] A third party attempting to bid on just the Pipeline assets would be forced to pay the entire $650 million termination fee. This fee is

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[177] *Id.*

[178] "Takeover Proposal" includes a proposal to acquire assets of El Paso to which 20% or more of the Company's consolidated revenues or earnings are attributable. Merger Agreement § 5.3(f) (Ex. 3). For the nine months ended September 30, 2011, the E&P segment's earnings before interest and taxes ("EBIT") were $754 million, or 39.4% of the Company's total EBIT. *See* El Paso Form 10-Q filed on Nov. 7, 2011, at 24 (Ex. 4).

[179] *See* El Paso Form 10-Q filed on Nov. 7, 2011, at 24 (El Paso had $24.078 billion total consolidated assets as of September 30, 2011, of which $18.4 billion were Pipeline assets) (Ex. 4).

exorbitant in relation to the value of the Pipeline assets, representing a staggering 78% of the EBIT earned by the Pipeline business for the nine months ended September 30, 2011.[180]

5. The Board Disregarded Obvious Flaws In Morgan Stanley's Financial Analysis

In recommending that El Paso's shareholders vote in favor of the Merger, the Board relied upon a fairness opinion rendered by Morgan Stanley. The financial analysis underlying this fairness opinion suffered from a number of obvious flaws that should have caused the Board to question Morgan Stanley's conclusion that the Merger was fair to El Paso's shareholders – particularly given that Morgan Stanley had been exposed to Goldman's self-interested analysis and had its own financial interest in favoring the Merger over the Spin.

A discounted cash flow ("DCF") analysis is the valuation method that most appropriately captures the long-term business plans of both El Paso and KMI.[181] On September 26, 2011, Morgan Stanley presented its consolidated DCF analysis to El Paso's Board. Based on the midpoint range of the EBITDA exit multiples Morgan Stanley presented, El Paso's pipeline segment had a terminal value – *i.e.*, the value of all free cash flows expected to be generated by this segment from the year 2016 into perpetuity – of $25.1 billion, implying a 0.7% per year perpetuity growth rate.[182] The estimation that El Paso's pipeline segment would grow at only 0.7% – an amount substantially below inflation and GDP growth rates – was unreasonably low as should have been readily apparent to any reasonably attentive member of El Paso's Board.[183]

Even if the low 0.7% anticipated growth rate for El Paso's Pipeline business, standing alone, were somehow insufficient to trigger alarms in the minds of El Paso's directors, the Board should have realized something was amiss because the midpoint of the EBITDA exit multiples

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[180] *See Id.* at 22.

[181] Clarke Decl. at 4-5.

[182] Clarke Decl. at 8-9.

[183] *See* Clarke Decl. at 12-13.

Morgan Stanley applied to *KMI* in the same presentation yielded a 2.9% perpetuity growth rate for KMI.[184] As Foshee testified, and as the Board should have been well aware, the growth prospects of El Paso's Pipeline segment were brighter than those of KMI's pipeline segment.[185] It therefore makes no sense for the perpetuity growth rate of KMI to be more than ***four times greater*** than that of El Paso's Pipeline business. *Mills*, 559 A. 2d at 1271 n.14 (recognizing the Chancery Court's conclusion that in an economic analysis, what's good for the goose is good for the gander).

Morgan Stanley's DCF analysis of KMI was as obviously flawed. In valuing KMI, Morgan Stanley calculated the present value of KMI's future cash flows using a 7.5% cost of equity. Morgan Stanley, however, determined using a different methodology that the cost of equity of El Paso's general interest in EPB was in the range of 11.5% to 12.5%, and in reaching that conclusion cited KMI as a "comparable company" and determined that KMI's cost of equity was 11.8%.[186] The complete disconnect between the cost of equity rates Morgan Stanley applied to KMI in the very same presentation was a glaring red flag that should have alerted any Board member who was paying any attention at all that the 7.5% cost of equity Morgan Stanley used to value KMI was too low.[187]

As summarized above, the Board also failed to question similar clearly illogical assumptions and discrepancies in Goldman's DCF analyses of El Paso' Pipeline and E&P segments.

In light of these readily-apparent deficiencies, the Board did not act reasonably in relying on Morgan Stanley's fairness opinion with regard to the Merger.

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[184] *See* Clarke Decl. at 9-10.

[185] *See* Foshee Tr. at 65:8-66:7 (Ex. 12).

[186] *See* Clarke Decl. at 17-19.

[187] Clarke Decl. at 18. As noted above, the Board also failed to question similar clearly illogical assumptions in Goldman's DCF analysis of El Paso's Pipeline and E&P segments.

II. PLAINTIFFS HAVE DEMONSTRATED A DANGER OF IMMINENT, IRREPARABLE HARM IN THE ABSENCE OF THE REQUESTED INJUNCTIVE RELIEF

Plaintiffs seek to preliminarily enjoin the shareholder vote on the Merger, as well as the enforcement of the Merger Agreement's deal protection provisions, in order to allow El Paso's Board to (i) retain an independent financial advisor to guide it in assessing the Company's strategic alternatives, and (ii) receive and consider proposals for alternative transactions, including separate sales of the Company's Pipeline and E&P segments.

In the absence of an injunction, Plaintiffs and all El Paso shareholders face imminent, irreparable harm. If a board's duties under *Revlon* and the entire fairness doctrine are to have any force, injunctive relief must be available to remedy failings by a corporate board in a sale process. *See Police & Fire Ret. Sys. of City of Detroit v. Bernal*, 2009 WL 1873144, at *2-3 (Del. Ch. June 26, 2009) (harm flowing from deal protection devices that are alleged to have had an adverse impact by deterring potential bidders is "incalculable"; "shareholders' only realistic remedy for certain breaches of fiduciary duty in connection with a sale of control transaction may be injunctive relief"). By enjoining enforcement of the deal protection provisions, the Court will remove preclusive hurdles to the submission of competing bids for El Paso or its component businesses, thus providing the shareholders with their last opportunity to achieve a value-maximizing transaction (or combination of transactions). *See also Del Monte*, 25 A.3d at 838 (foreclosure of the opportunity to receive a pre-vote topping bid constitutes irreparable injury).

Moreover, under *Lyondell Chemical Co. v. Ryan,* 970 A.2d 235, 243-44 (Del. 2009), shareholders face significant hurdles in establishing that directors' dereliction of duty amounts to a breach of the duty of loyalty (hurdles which Plaintiffs believe they have crossed), and the Company's exculpatory charter provision under 8 Del. C. § 102(b)(7) precludes a damage remedy against the Company's directors for a duty of care violation. "Exculpation under Section 102(b)(7) can render empty the promise of post-closing damages" and "weigh[s] in favor of pre-vote relief." *Del Monte*, 25 A.3d at 838. *See also Bernal*, 2009 WL 1873144, at *3 ("injunctive

relief may be the only relief reasonably available to shareholders for certain breaches of fiduciary duty in connection with a sale of control transaction …").

III. THE BALANCE OF EQUITIES FAVORS ISSUANCE OF A PRELIMINARY INJUNCTION

The balance of equities favors issuance of a preliminary injunction to halt the vote on the Merger and the enforcement of the deal protections until the Board has complied with its fiduciary duties. The harm that El Paso's shareholders will suffer if an injunction is not granted is the irreparable loss of their fundamental right to be presented with a change of control transaction that maximizes shareholder value and was negotiated free of the taint of conflict of interest.

This Court has recognized that injunctive relief is the preferable remedy in actions challenging the terms of a merger that was the product of a flawed sales process. *See, e.g.*, *Del Monte*, 25 A.3d at 838 ("Absent an injunction, the Del Monte stockholders will be deprived forever of the opportunity to receive a pre-vote topping bid in a process free of taint of Barclays' improper activities.").

Defendants, in contrast, will suffer no hardship other than a delay in the vote on the Merger and, in KMI's case, the potential loss of a windfall in a transaction negotiated in violation of the Board's fiduciary duties – aided and abetted by KMI and one of its largest shareholders. Any hardship caused by delaying the vote is *de minimis* when compared to concern over the possibility that shareholders may be forever deprived of the right to be presented with a transaction that results from a process unmarred by the taint of self-interest. *See Del Monte*, 25 A.3d at 840 (enjoining vote to permit time for competing bid to emerge). Moreover, neither party can unilaterally terminate the Merger Agreement unless it has not been consummated by June 30, 2012 (subject to extension until December 31, 2012).[188] There is ample time between now and June 30 for the Board to retain an independent financial advisor, shop the Company and its

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[188] Merger Agreement § 7.1(b)(i) (Ex. 3).

component businesses, and still consummate the Merger if no superior transactions emerge. Further, the issuance of a preliminary injunction would not allow any party to terminate the Merger, because only a "final and nonappealable" injunction affords such a right. *See* Merger Agreement §7.1(b)(ii).

Because the harm Defendants would suffer from an injunction would be minimal in comparison to Plaintiffs' loss of their rights to be presented with a transaction produced by a conflict-free, value-maximizing process, the balance of the equities favors granting injunctive relief.

CONCLUSION

For the foregoing reasons, Plaintiffs' motion for a preliminary injunction should be granted, and the Court should enjoin the shareholder vote on the Merger as well as the enforcement of the deal protection provisions, so the Board can fulfill its fiduciary duty to maximize shareholder value by retaining an independent financial advisor to assist it in evaluating its strategic alternatives, including but not limited to the Spin and/or sales of the E&P and Pipeline businesses to separate buyers.

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