

## Chapter 1

# Genesis: Wall Street, Its Business and Culture

**O**n Wall Street there were no merger departments or specialists in takeovers for much of the twentieth century. *Financier* was the term used to describe those few on Wall Street who had the ear of America's most powerful chief executives. If advice was sought on takeovers, it was given mostly free of charge as part of a service, which led to the main business of an investment bank—underwriting a sale of securities.<sup>1</sup>

There were no skyscrapers in lower Manhattan stuffed with thousands working for a brokerage or investment bank. There were no neon signs or ticker tapes running along the side of buildings giving the latest stock prices and proclaiming the site the home of a mighty global firm. The Great Crash of 1929 and the subsequent Great Depression made firms intuitionally conservative. They kept small payrolls. Most firms had no more than 100 employees and just one office up until the early 1960s. When Morgan Stanley began business in 1935, it was on the nineteenth

floor of a building at 2 Wall Street.<sup>2</sup> Goldman Sachs rented eight floors of a building on Pine Street in 1947 and had hired virtually no one for two decades.<sup>3</sup>

Wall Street was divided between brokers and investment banks. Brokers sold and traded bonds and stocks. Bear Stearns, Goldman Sachs, and Salomon Brothers were brokers. Investment banks underwrote and managed the sale of securities. Morgan Stanley, First Boston, Dillon Read, Kuhn Loeb, Lazard Freres, and Lehman Brothers were investment banks.

In the pecking order of the street, the investment banks in their manners, airs, education, and furnishings believed themselves to be superior to the scrappy, blaspheming, uncouth, public school-educated brokers.

First Boston, Dillon Read, and Morgan Stanley were stuffy, white, Christian males whose business largely centered on managing bond offerings. The Jewish firms Kuhn Loeb, Lehman Brothers, and Lazard managed the sale of securities but also invested in companies. The Jewish and Christian firms all met when they formed syndicates to sell a bond or a stock. "Banking was dominated by the Protestants, and the Jews that were in the banking business acted like Protestants," recalled former Salomon Brothers Chairman John Gutfreund who started working on Wall Street in 1953.<sup>4</sup>

Investment banking was considered a gentleman's business. Firms were suffused with a sense of probity because they were partnerships. The capital of each firm was in the hands of those who were active in the business. A partner had unlimited liability. Every year, Wall Street hired very few new employees and promoted even fewer still to the coveted partnership, where a select few shared in the profits of the firm. Few graduates went to Wall Street. If you didn't have a personal connection to a partner at a Wall Street firm and weren't marked by your professors as brilliant, your chances of being hired were slim.

When John Whitehead graduated from Harvard Business School in 1947, only one Wall Street firm came to campus to recruit. Along with about 20 others, Whitehead signed up for an interview with the firm. Much to Whitehead's surprise, he was the only one of the candidates offered a job in the investment banking department of Goldman Sachs.<sup>5</sup>

Most of Whitehead's contemporaries who finished the two-year master of business administration at elite universities such as Harvard went to work in industry or commercial banking. American industry boomed in the years after World War II. Companies generated cash for their expansion from their own operations. They rarely merged. It was a sign of failure.

Alan "Ace" Greenberg joined Bear Stearns in 1949 and worked on the arbitrage trading desk, betting on whether takeovers would succeed or not. "If a merger was announced once every two months, it was a lot. A lot," recalled Greenberg.<sup>6</sup>

If corporations asked for advice from Wall Street, it was how to sell bonds to fund a new production line. Most of America's 100 biggest companies went to one firm to fund their expansion: Morgan Stanley.

Morgan Stanley was the most prestigious firm on Wall Street by dint of its having sprung from the loins of America's most famous financier, J. Pierpont Morgan. By 1935 Congress had forced J. Pierpont Morgan's son Jack to split his father's firm, J. P. Morgan. Jack decided J. P. Morgan would now deal with Main Street, commercial banking. A new firm, Morgan Stanley, would do Wall Street business, investment banking. Henry Morgan, grandson of Pierpont, lent his name and unparalleled list of corporate contacts to Morgan Stanley together with Harold Stanley, whose father invented the Thermos bottle.<sup>7</sup>

Wall Street genuflected to the new firm. One firm, Dominick & Dominick, simply turned over its blue chip investment banking clients, Shell Oil and Coca-Cola among others, to Morgan Stanley after senior partner Gayer Dominick decided the firm would concentrate on broking.<sup>8</sup>

The bankers of Morgan Stanley were generalists. They, like others on Wall Street, prided themselves on their ability to advise chief executives on everything from loans to bond and stock sales and mergers and acquisitions. The firm headed and organized the syndicates of investment banks that underwrote and managed the sale of bonds. As head of an underwriting syndicate (it refused to co-manage offerings), Morgan Stanley took responsibility for the documentation that was a securities offering. The firm would take the lion's share of fees as manager of an offering and pay everyone else to sell it.<sup>9</sup>

Morgan Stanley established a protocol of how securities offerings were written. Its prospectuses were printed on cream-colored stock with lavender ink that people referred to as “Morgan Stanley blue.” The agreements between the issuing company and Morgan Stanley, and the contracts between the firm and the sellers of the securities, were printed with the same typeface on the same cream-colored stock with ink that was “Morgan Stanley blue.”<sup>10</sup>

As befits a firm that had its own color scheme, Morgan Stanley’s culture was exacting. “Clients came first. Work had to be checked and rechecked. The worst thing was to go to a client with an error. No one was impressed if you had theater tickets that night. It was unpredictable when you would leave work,” said Richard Fisher, recalling his days as a young Morgan Stanley statistician in the early 1960s.<sup>11</sup>

In the days before personal computers, work was done by hand on large spreadsheets. Down in the corner there was a string of initials, arranged according to a protocol, of people who had participated in preparing the original spreadsheet.

The first person who laid out the spreadsheet and did the initial set of numbers put his initials on it. Then there was a colon, and the next set of initials was the person who had checked it, every number. Then there was a slash, and the next set of initials was a person who had done any significant set of revisions to the spreadsheet. Then there was a colon, and the next set of initials was the person who had checked the revisions. Sometimes there would be 10 sets of initials in the lower lefthand corner of the spreadsheet.<sup>12</sup>

“First-class business in a first-class way” was Morgan Stanley’s motto. Morgan Stanley was managed by committee. The partners met three times a week at 3 PM to discuss issues. Those partners who attended such meetings received \$20, part of a tradition of the firm.<sup>13</sup>

Morgan Stanley prided itself on being part of the WASP establishment, and its partners carefully associated only with the pillars of New York society, serving on the boards of the Presbyterian Hospital and the Metropolitan Museum of Art. Morgan Stanley didn’t court the press. It actively avoided it. “You led a very quiet, private lifestyle. You were always very careful who you talked to, how you handled yourself,” recalled Harry Morgan’s son, John Adams Morgan.<sup>14</sup>

To many, Morgan Stanley was the ultimate white-shoe Wall Street firm. Named after footwear that was popular on the campuses of Ivy League colleges in the 1950s, the term *white shoe* bore more than a smattering of anti-Semitism to some and reflected a stolid male patriarchy. Morgan Stanley didn't appoint a Jewish partner until 1973, when Lewis Bernard was named a partner.<sup>15</sup> In 1969, Morgan Stanley's usual outside counsel, Davis Polk & Wardwell, appointed its first Jewish partner, Joel Cohen, who remembered that when he joined Davis Polk in 1963 he was the only Jewish attorney in the firm.

"It was virtually impossible for a woman to get a job at a Wall Street firm unless they were going to be in trusts and estates," Cohen recalled.<sup>16</sup>

When Harvey Miller, who became America's leading bankruptcy and restructuring lawyer, graduated from Columbia Law School in 1959, he couldn't recall any women or blacks hired by Wall Street law firms. Miller's classmate was future Supreme Court Justice Ruth Bader Ginsburg, who graduated tied for first in her class. Ginsburg couldn't get a job. She had three strikes against her: she was a woman, she was Jewish, and she had a child. Someone, however, prevailed upon a tough, brusque federal judge, Edmund Palmieri, to offer her a job. Ginsburg became Palmieri's first female clerk.<sup>17</sup>

The hiring of Jews into Wall Street law firms was caused by a series of initial public stock offerings by companies in the garment district in the 1960s. As the garment district firms were run by Jews, Wall Street law firms hired Jews to help win business for them, Miller recalled.

"One of the great watersheds in American corporate life was that the law-finance silo that is Wall Street stopped being the domain of tweedy Ivy Leaguers," recalled a partner at a New York law firm. "That was probably around 1970. When I got out of Yale Law School in 1964, all of the non-Jewish big New York City law firms discriminated against Jews. Many of them were proud of it. For many, that was their lone distinction. Sorry, you're Jewish; you don't get a job here. We may be a third-rate firm, but what we don't do is hire Jews."<sup>18</sup>



Before the passage of the first federal law on takeovers, lawyers played a more central role than bankers in mergers. Acquisition agreements were

long and complicated, written by attorneys who directed the negotiations. Joel Cohen at Davis Polk helped buy and sell about 30 companies for R. J. Reynolds.<sup>19</sup> Prior to the 1960s there was little discussion on the legal rules that should apply to a company that was the target of a takeover. The conglomerate building of the late 1950s and 1960s would change that.

What brought mergers to the fore and set some on Wall Street thinking that advising on takeovers could be a viable, long-term business were men such as Jimmy Ling of LTV, Harold Geneen of ITT, and Tex Thornton of Litton Industries. From 1955 to 1969, LTV, ITT, and Litton bought hundreds of companies as accounting rules favored acquisitions. Pooling accounting meant that goodwill wasn't charged against earnings. This meant you didn't have to write anything off in the context of a deal.<sup>20</sup>

Ling, Geneen, and Thornton believed professionally trained management could run any type of business and many different types of businesses allowed a corporation to prosper through changing economic conditions. There was also a belief that businesses had to be big to succeed.<sup>21</sup>

A partner at Lehman Brothers, Warren Hellman, remembers taking a telephone call from Jimmy Ling. Ling wanted to merge his Braniff Airways with Continental Airlines, whose banker was Hellman. Hellman recalled asking: "Mr. Ling, how are you going to do it?" He said, 'We're going to borrow money to buy Continental Airlines.' I said, 'Okay, but I've looked at it and I think it will be too highly leveraged. This is a business with a ton of operating leverage and you heap a bunch of borrowing on top of it, it won't work.' He said, 'You don't understand leverage.' I said, 'I don't?' He asked, 'How do you define leverage?' I used my best Harvard Business School speak: 'the appropriate amount of debt for the continued operations of a business.' He said, 'No, no, no.' I said, 'Mr. Ling, how do you define leverage?' And he said, 'Leverage is the last dollar some sucker will lend you.'"<sup>22</sup>

Wall Street investment banks had an almost exclusive relationship with their clients. Bankers at rival firms generally didn't try to lure away a company from its long-established bankers. If a banker had an idea for a company that wasn't his client, he was expected to go to the company's traditional bankers first to pitch the idea.<sup>23</sup> In the case where a Wall Street

firm went directly to a company and bypassed its traditional advisers, a chief executive could be counted on to call his usual adviser.

Lehman Brothers were the bankers for Philip Morris. Lehman rival White Weld approached Philip Morris, suggesting it buy fellow cigarette maker Lorillard. Warren Hellman was called on the morning of White Weld's proposal and asked if he could be in the office of the Philip Morris chief executive at 2 PM to discuss White Weld's idea.<sup>24</sup>

Bankers were keen to keep mergers friendly. There weren't any federal laws governing takeovers. Control of a corporation could pass to someone who bought the majority of the company's stock on the stock exchange. It could be done overnight if lawyers didn't take out an injunction. Some who sought control of a company after buying a large percentage of a target's stock got into proxy fights. They submitted proposals to shareholders to replace management and the board with their own allies. Proxy contests were considered so *déclassé* that the major Wall Street investment banks and law firms stayed away from them.<sup>25</sup>

It wasn't until 1968 when Congress passed the Williams Act that America had a federal takeover law. In the wake of the Williams Act, two men went around the country giving seminars on mergers. One was Arthur Fleischer, a tall, self-effacing attorney with a preference for three-piece suits and a deep resonant voice that reminded many of a stage actor. The other was an unassuming lawyer whose diminutive stature and pithy homespun wisecracks belied his intellect. His name was Joe Flom. Flom had a head start over others in mergers and acquisitions. He was familiar with the tactics and methods of how to gain control of companies by dint of being America's foremost proxy fighter.<sup>26</sup>

