new incentives to bypass small banks and keep deposits at large ones.

Continental Illinois served as a warning about the state of commercial banking in the 1980s. As banks lost their core lending business and tried to maintain profits, they ran into a lengthening list of disasters—in shipping, real estate investment trusts, energy loans, farm loans, and Latin American lending. The Glass-Steagall Act had attempted to insulate commercial banks from risk by separating them from securities work. Instead, it had confined them to a dying business and starved them of profits that might have kept them sane and healthy. By 1984, bank failures were running at a post-Depression high. During the 1980s, the commercial banks faced chronic instability while securities houses raked in record profits. This reversed Glass-Steagall's intentions and confirmed J. P. Morgan and Company in its decision to move further in the direction of becoming a global investment bank. By the 1987 crash, it would be earning more money from such fee business than from standard loan spreads.

FUNERAL rites for the old Wall Street were held in March of 1982, when the SEC enacted Rule 415, which provided for "shelf registration." This bland technical name masked a bold revolution. Instead of registering each new security issue separately, blue-chip companies could register a large block of stock and sell it off piecemeal on short notice over two years. Thus corporate treasurers could capitalize on sudden dips in interest rates. Rule 415 converted underwriting into a world of fast trades and split-second decisions rather than the old Morgan Stanley world of elegant syndicates formed over several weeks. Companies could even dispense with investment banks and sell straight to institutions. As one Dillon, Read executive gloated, "A lot of Morgan's biggest clients are the most sophisticated ones. They're more likely to say, 'Take a walk, pal.' "[19]

For Morgan Stanley syndicate chief Thomas A. Saunders III, a sinewy Virginian with thin lips and a wide mouth, the potential of Rule 415 hit him while out jogging one day. Staggered by the implications, he came into work the next morning and spluttered, "Hold it, fellers, this thing is *unbelievable*." Before long, he was phoning around the Street, telling people, "Holy God, this is insane."[20] As with the Mayday end to fixed commissions in 1975, Bob Baldwin led the effort to quash the ruling, again dressing up the effort as a crusade to save the regional firms. He hand-delivered a protest letter to the SEC: "The rule may produce fundamental changes in the capital-raising process . . . with undesirable consequences that have not been explored."[21] His warnings that Rule 415 would damage smaller firms and lead to a Wall Street monopolized by a few large, well-capitalized firms duly materialized.

Though Morgan Stanley claimed twenty-eight of America's one hundred largest corporations as clients, many of them favored Rule 415. Exxon, U.S. Steel, and Du Pont even plied the SEC with supporting letters. These rich captives were finally shrugging off their chains. Some critics feared 415 would sweep away fifty years of "due diligence," with investment banks vouching for the soundness of issues. A Morgan Stanley stamp of approval had always reassured investors. In the Casino Age, however, blue-chip firms no longer needed bankers to certify their health. They often had better credit ratings than their bankers.

The force of 415 was swiftly revealed in its trial usage by AT&T in 1982. A year earlier, Morgan Stanley had mustered a traditional AT&T syndicate of 255 houses. Now, for a $100-million shelf issue, AT&T invited bids from twenty-one underwriters. Instead of syndicates, Rule 415 operated through "bought deals" in which a firm or group of firms bought the whole issue and quickly resold it. Salomon Brothers and First Boston had been doing such deals for years. Morgan Stanley felt itself under excruciating pressure to win the open contest. "We had been AT&T's banker previously for all of their equity, as well as much of their debt, and we needed to show that we still were," said Saunders.[22] An internal memo warned of "reputation risk" on the AT&T deal: "We don't *need* to be first, but it will help establish our role."[23] This set the stage for a rash attempt by Morgan Stanley to show it could measure up in the savagely competitive new environment. That the crazy stunt succeeded didn't detract from its folly.

On May 6, 1982, Morgan Stanley agreed to buy two million shares of AT&T stock at $55.40 a share, $.15 above the current market price. It hoped to resell the entire parcel the next day. This "bought deal" was really a block trade from AT&T to Morgan Stanley with no syndicate to cushion the risk. Morgan's chief equity trader, Anson Beard, passed a miserable, sleepless night and later admitted that it was a reckless deal done "for the bragging rights."[24] Luckily, he disposed of the two million shares the next day, mostly at $55.65 or a $.25 profit over cost. If clever advertising, the maneuver exposed the risks associated with 415. For carrying a $100-million exposure overnight, Morgan Stanley netted a paltry $400,000. Later in the year, when AT&T raised $1 billion through a traditional syndicate, Morgan Stanley suddenly had to tolerate four co-managers. Corporate treasurers were the new potentates, and soon even General Motors relied on four investment banks, including Morgan Stanley.

In 1981, Morgan Stanley reigned as number one in underwriting, as it mostly had since 1935. By 1983—after the 415 shake-up—it plummeted to sixth place, with the trading-oriented Salomon Brothers arising as the new leader. Underwriting was now a banal commodity business in which capital and trading prowess counted for far more than did contacts with companies.

In a stunning rout, trading firms that were once the outcasts of Wall Street high society toppled the patricians. Morgan Stanley was hardly impoverished: it remained first in stock underwriting and second in the Euromarkets, but it had slipped in relative position and lost its special halo of success. It sometimes seemed to resent this new world. As syndicate chief Saunders griped: "But corporate treasurers are the same as you and me. They want to be innovative, they want to tell the board, 'Look what I did! I created this competitive situation, I got those five banks beating a path to our door, and wasn't it wonderful? I've taken the shackles off. The issuer is now in control of the world, and here I come.' "[25]

The arm's-length relationship between companies and bankers advocated by Louis Brandeis now evolved in response to market forces and at the behest of corporate America. Far from democratizing Wall Street, this market-based reform merely led to reshuffling among the top firms. Only the Wall Street powerhouses—Morgan Stanley; Goldman, Sachs; First Boston; Merrill Lynch; Salomon Brothers; and Shearson Lehman—had the capital to take big blocks of shares and unload them quickly. Where the six major firms handled a quarter of new debt before 415, they underwrote almost half of it afterward. So the demise of relationship banking didn't open the doors to scrappy newcomers, as reformers had hoped, but only strengthened the position of those firms that were already dominant.

Rule 415 came near the end of Bob Baldwin's tenure at Morgan Stanley, bringing down the curtain on his world of syndication. He once said that if Glass-Steagall were repealed, he would be first on line at Morgan Guaranty's doorstep the next morning. Yet as chairman of the Securities Industry Association in 1977-78, he had vigorously contested expanded underwriting powers for the commercial banks. "He dealt us a couple of mortal blows," said Jack Loughran, then Morgan Guaranty's lobbyist.[26] After his SIA stint, Baldwin returned to a Morgan Stanley he understood less and less well. Colleagues thought him lost in a new world of trading and risk that he himself had created.

One ex-partner observed, "When Baldwin came back from the SIA, he became an obstacle. He had lost control of the firm and only made more enemies. He treated everybody like a kid. He would start making a speech and nobody could talk. He was always trying to relive his days of glory as Under Secretary of the Navy. He wouldn't listen. At the end, nobody wanted him around." Said another: "He talked at people, he postured, he always liked to be the lordly guy from Morgan Stanley. He was always talking about himself, telling stories where he was the hero."

To the last, Baldwin remained hypercompetitive and bent on having his way. Yet for all his flaws, the tough, tactless Baldwin had emerged as the most important person in modern Morgan Stanley history, giving the firm the market skills to compete in a world no longer based on old-school ties. He had saved it from genteel obscurity, a languid demise. As the Baldwin era ended in late 1983 without an obvious successor, there was nervous jockeying among three prime contenders—Bob Greenhill, Dick Fisher, and Lewis Bernard. Much was at stake. In a decade, Morgan Stanley had grown tenfold. It now employed about three thousand people and had about $300 million in capital. Although there was no black or female managing director, the ethnic mix among its eighty managing directors was otherwise surprisingly diverse. But it was more tense and confrontational than in the old days, full of ambitious overachievers.

To prevent squabbling, Baldwin was replaced by a surprise choice: forty-nine-year-old Yale-educated S. Parker Gilbert, who claimed a unique Morgan lineage. His *wunderkind* father was the agent general of Germany in the 1920s and a J. P. Morgan partner in the 1930s. Tall and polished, with a wide face, aquiline nose, and urbane manner, Gilbert had his father's boyish smile but the reserve of Harold Stanley, his stepfather. "Parker was a compromise who wouldn't piss off Greenhill, Fisher, or Bernard," explained one former partner. Among the hard-charging deal makers, he had a light touch in arbitrating disputes. According to Robert A. Gerard, a former managing director, "Parker has two things going for him. He has a tremendous instinct for minimizing awkward situations and getting people to work together. Everybody respects his integrity. He really is the glue that holds the firm together."[27]

Gilbert was the most international of the top executives, having done tours in Paris and handled Middle East business. As one would expect, he was close to Morgan Guaranty and specialized in preserving old clients. One Morgan Guaranty vice-president called Parker "the old breed. It was the barracudas down below who had no sense of the relationship." He was meant to connote tradition at a time of rapid change. Said a former colleague: "Parker is where he is because his father and stepfather were where they were. He's a symbolic figure, like Harry Morgan." According to another ex-partner: "The general fiction that people lived by at Morgan Stanley was that he wanted to prove that he was getting ahead for reasons other than being Harold Stanley's stepson. Then he would go off and play golf." In fact, whatever the original plans, Gilbert turned into more than a figurehead and became an unexpectedly strong-willed chairman. His caution would be credited with sparing Morgan Stanley some of the ravages of the 1987 crash.

The real heir to Bob Baldwin was probably Dick Fisher. A polio victim who was paralyzed from the hip down and walked with a cane, Fisher applied for a job at Morgan Stanley upon graduating from Harvard Business School, but first he needed to conquer his own doubts about his ability to perform.

Partners also had wondered how a handicapped person could take business trips and move around freely. Bright, sociable, and popular, he would prove a master politician and an adept handler of people. “Dick is tough underneath but doesn’t appear so,” remarked a former colleague. “He can be a ruthless man with velvet gloves.”

Fisher found the answer to his handicap in the sedentary world of trading. Working out of a soundproof glass box, the so-called lean-to on the trading floor, he organized the new bond trading operation in the 1970s. (With nice symmetry, his brother David would head J. P. Morgan Securities.) It was a lucky choice. Like Dennis Weatherstone at Morgan Guaranty, Fisher’s stock rose at Morgan Stanley in direct proportion to the growing vogue for trading on Wall Street.

Another critical figure was Lewis Bernard, nicknamed Brainy Bernard, the first Jewish partner and probably the best strategic thinker in the firm. He chaired a 1979 task force to devise a ten-year plan for Morgan Stanley. It was Bernard who introduced the computerized, multicurrency system for global trading that would make Morgan Stanley a trendsetter. In 1983, he headed a new fixed-income division that belatedly led the firm into the trading of gold, precious metals, and foreign exchange and the issuing and trading of commercial paper, municipal bonds, and mortgage-backed securities—all tools to please increasingly demanding corporate customers. These activities also required more traders and salespeople, further transforming Morgan Stanley into an anonymous global financial conglomerate.

In a critical strategic step, Morgan Stanley, so averse to foreign markets in the early post-war era, made a major commitment to trade and distribute securities overseas. It wisely abolished all managerial distinctions between its domestic and international operations. As trading and mergers superseded underwriting at Morgan Stanley, elegance was out and brashness was in—a jarring experience for its once sedate culture. As the *New York Times* said in 1984, “Morgan executives, who for generations have seemingly enjoyed their reputation for being the aristocrats of investment banking, seem confused these days about their image.”[28] As its exclusive ties with clients lapsed, it had to hustle for business and encourage aggression. As at Morgan Grenfell, a firm once mocked for stuffiness proved it could be ruthless if necessary in preserving its privileges.

In the takeover area, Morgan Stanley shed all pretense of passivity. In 1978, merger specialist R. Bradford Evans had said, “We don’t pester our clients and say, ‘Why don’t you accept this company, or that company, anything to get a deal.’ ”[29] In 1981, Morgan Stanley still led Wall Street with $40 million in merger fees, doing a third of all deals. Then Goldman, Sachs, First Boston, and Lehman Brothers leapt ahead. By 1983, under intense competitive pressure, Morgan's takeover department of seventy-five professionals was scouring the landscape in search of target companies. They started banging on doors, using the hard sell. "In the past there was a reluctance to call people," said Bob Greenhill. "It was the culture to let the client call you."[30] Now Morgan Stanley would increasingly serve as an engine of the takeover boom.

As its underwriting business declined, Morgan Stanley turned to businesses it once would have rejected haughtily, entering the netherworld of junk bonds. These high-risk high-yield bonds were often issued to support takeovers by companies of questionable solidity. The new junk bond department coincided with Morgan Stanley's sudden interest in small start-up companies. As Bob Greenhill explained, "Morgan was building a high-technology effort at that time, and I said, 'How can we not be in a business that is so necessary for so many of our growing clients?' "[31]

Junk bonds revolutionized Wall Street by magnifying the money available to corporate raiders. Where conglomerate takeovers in the 1960s used share exchanges, and cash was the method of choice in the 1970s, the junk bond market let corporate raiders flout the Wall Street establishment and finance their incursions by selling bonds to investors. The merger frenzy was also fueled by abundant money from commercial banks, whose dwindling prospects in wholesale lending attracted them to the financing of takeovers. Thus both sides of Wall Street—commercial and investment banking—found takeover work a salvation from the fundamental crises in their core lending and underwriting business. The razzle-dazzle of Wall Street in the Reagan years would obscure this underlying fragility, the irreversible decline of traditional businesses, the obsolescence of the traditional banker.

With considerable hoopla, Morgan Stanley talked about gentrifying junk bonds, but self-congratulation proved premature. In mid-1982, Morgan Stanley joined with Hambrecht and Quist to sponsor the first public offerings of People Express, the pioneering no-frills discount airline. Buying up used Lufthansa planes and ripping out their first-class sections, People founder Donald C. Burr wanted to create cheap air travel for the masses; his feisty, hustling airline was the anti-thesis of a classic Morgan client. Between 1983 and 1986, Morgan Stanley underwrote more than $500 million in junk bonds for People. As if still leary of its junk bond departure, the firm overruled custom and let Charles G. Phillips, head of its junk bond department, take a seat on People's five-member board.

From modest beginnings at Newark International Airport, People rocketed to the top rank of American airlines. In the end, Burr was victimized by his own ambition, making an ill-fated purchase of Frontier Airlines and trying to beat the major carriers on their own turf. He financed his frantic expansion by a staggering accumulation of debt. Later it was alleged in lawsuits that Phillips egged on Burr to borrow and expand too quickly. Whatever the truth, when crisis struck People Express, some bondholders felt betrayed by Morgan Stanley. They not only suffered serious losses, with some paper trading as low as 35 percent of the original issue price, but accused Morgan Stanley of failing to maintain a market during the turbulence. By one account, Morgan Stanley bought People bonds until it had $40 million worth in its inventory.

There was a second dimension to the controversy. For two and a half months, as bondholders suffered, Morgan's M&A Department shopped People to potential customers, exposing the firm to a possible conflict of interest. Honoring the Chinese wall, Charles Phillips kept the merger talks secret and didn't notify the bond traders of these efforts. Yet bondholders felt deprived of information that should have been provided by Morgan Stanley as the bond underwriter. The problem here was not that Morgan Stanley neglected its duties. The problem was that the conglomerate structure of modern Wall Street presented Morgan Stanley with incompatible duties. For People investors, the end was short, nasty, and brutish. When Frank Lorenzo of Texas Air bought People Express, he paid 75 percent on the face value of unsecured bonds and 95 percent on secured bonds.

In the early takeover days, there had existed a clear-cut distinction for Morgan Stanley between its stalwart clients and their takeover targets. It would never represent a raider against a client because it then might sacrifice that client's lucrative underwriting fees. But as underwriting ties with blue-chip companies decayed, there was no reason why the firm shouldn't represent raiders as well. The very notion of a client list—a sacred group of companies—broke down. In the new transactional environment, Morgan Stanley might represent a raider one year, then defend another client against that same raider the next. So many deals were germinating in the big merger departments that shifting loyalties and conflicts of interest were inevitable.

The inescapable danger was illustrated by Morgan Stanley's relationship with T. Boone Pickens of Mesa Petroleum. Back in the 1970s, Morgan Stanley couldn't have dealt with a corporate predator like Pickens, because he menaced its seven-sister clients. But as the big oil companies grew less loyal to Morgan Stanley, so the firm gladly dealt with other energy firms. In 1982, T. Boone Pickens enlisted Morgan Stanley to raid the Dallas-based General American Oil. "They were delighted to get the business," recalled Pickens, "for GAO was not part of the establishment that Morgan caters to."[32] On January 6, 1983, Pickens signed a standstill agreement with GAO stipulating that he wouldn't buy stock or try to gain control of the firm; it was bought the next day by Phillips Petroleum. Morgan brokered a deal by which Phillips Pete bought 38 percent of Mesa's shares and even picked up its $15 million in fees to the bankers and lawyers. During the summer of 1983, Morgan Stanley and Pickens briefly thought of teaming up to bust up a major oil company. The deal fell through, Pickens thought, when Morgan decided not to “alienate some of their clients—the Good 01’ Boys in spades.”[33]

In December 1984, Pickens tried to swallow Phillips Pete, now represented by Morgan Stanley’s Joseph G. Fogg III, a young, prematurely balding man who wore clear-framed glasses and had a cool, precise, intellectual look. As with Greenhill, clients found him abrasive but tolerated him for his brilliance. He was a whirling dervish in the nonstop oil takeovers. In 1984, he advised Standard Oil of California in its $13.4-billion takeover of Gulf Oil, the largest on record. Morgan Stanley banked a royal fee of $16.5 million for its work, even though it had committed no capital and used perhaps a dozen people.

The 1984 battle for Phillips Petroleum ended up pivoting on the standstill agreement of early 1983. It was a ticklish situation. Fogg and Pickens, who were then partners, were now opponents, and their recollections of the agreement were different. Fogg said he and Joe Flom had told Pickens the agreement would apply to Phillips as well as GAO. Pickens had “recognized the fact, expressed lack of concern and proceeded to execute the agreement.” contended Fogg.[34] “Other people involved in the GAO deal remembered it differently,” replied Pickens, who claimed that the deal applied only to GAO. And it was Pickens who won a favorable court ruling. He observed, “Since Fogg was working for us at the time, it cost him and Morgan credibility on Wall Street.”[35]

Just as it seemed that Rule 415 had liberated companies from their Wall Street bankers and opened up a permanent distance between them, a new trend, called merchant banking, arose to obliterate the trend. Morgan Stanley had always been a service outfit, never compromising its objectivity by acting as an investor as well. Bob Baldwin had said in 1980, “We’re so client-oriented and so busy that most of us have done very poor jobs of investing our money. That would not be the case with some firms, which have had all kinds of entrepreneurial investments.”[36] That year, the firm conquered its prudery. It took a share in an Exxon oil-shale project in Australia, scouted timber investments, expanded its real-estate portfolio, and started to invest in high-tech start-ups. For the first time, Morgan Stanley was acting as a principal (investing its own money) and not just as an agent (advising clients on investing their money.) These investments foreshadowed a Wall Street fad that would entail a retrogression to some of the worst excesses of the robber baron era.

In 1982, to inaugurate the new merchant-banking operation, Morgan Stanley hired Donald P. Brennan, a former vice-chairman and fifteen-year veteran of International Paper. It was rare for an industrialist to work on Wall Street. The tough, fierce-willed Brennan would bring unique management skills, for he thought like a corporate executive. The firm set up a short-lived leveraged buyout fund with CIGNA Insurance, which reaped twenty-five times its original investment and whetted its appetite for more. Nobody envisioned how central the small merchant-banking group would eventually become to Morgan Stanley.

Breaking with another tradition, Morgan Stanley in 1980 began managing money for individuals and institutions. Another Chinese wall went up around another department. Some Wall Street firms balked at entering the business, fearing possible conflicts as they invested money in companies that were also takeover or underwriting clients. Once again, Morgan Stanley's decision conferred legitimacy on a dubious practice. As money manager Sanford Bernstein said, "If Morgan Stanley is in it, that means we're kosher."[37] In 1980, the firm had less than $1 billion under management, an amount that swelled to $10 billion by 1985. After details appeared in the press about Citibank's management of Kuwait's money, the sheikdom switched over about $4 billion in securities to Morgan Stanley's money managers. In the days of Harry Morgan, the firm had refused to do business with the Teamsters. Now it beat out twelve other firms for a contract to manage America's largest and most controversial pension fund, the $4.7-billion Teamsters Central States fund.

Morgan Stanley's new wing caused a small revival of the relationship with Morgan Guaranty. The Morgan bank was still legally barred from distributing mutual funds but could offer investment advice. So it agreed with Morgan Stanley in 1982 to create the first Pierpont Fund, with Morgan Stanley managing and Morgan Guaranty advising it. This family of funds would attract $2 billion through a time-honored Morgan formula of scorning the vulgar herd. They had a $25,000 minimum, versus the standard $1,000, and unlike other mutual funds, they didn't report their daily results in the newspapers. In the words of Morgan Stanley's Matthew Healey, "We didn't want to take the Pierpont funds into the competitive arena."[38] Everywhere else, however, Morgan Stanley was right smack in the middle of competition for the first time and was playing as rough as anybody.

CHAPTER THIRTY-FOUR
BANG

IN late 1986, Morgan Grenfell presented a curious study in contrasts. Outwardly it maintained a sedate air. Upholding a tradition of nearly 150 years, the bank posted no nameplate outside—the old brass plaques hung in the reception area—and the interior paid homage to the past. In the thickly carpeted, arched hallways, there were prints of Saint Paul's and the Bank of England, of hansom cabs rolling through gaslit streets in a *fin de siècle* City. Morgan Grenfell was said to have the last man in the City to wear a bowler hat—one Julian Stamford. It still seemed a civilized place.

But the calm was deceptive. Morgan Grenfell had charted a course roughly parallel to Morgan Stanley's, dispensing with politeness and becoming a tough, aggressive firm. For twenty years, it had revolted against its sleepy past. Starting with the American Tobacco fight for Gallaher in the late 1960s, it had enjoyed testing the rules. "They liked the image of being the most buccaneering firm in the City, of pushing out the boundaries," observed an ex-merger specialist with the firm. "Every deal was a little more provocative and cheeky and less British than the one before."

Morgan Grenfell's two leaders in the early 1980s reflected both the old and the new City. Chairman Bill Mackworth-Young had spent twenty-one years with the aristocratic brokerage firm of Rowe and Pitman, second in prestige only to Cazenove. If Morgan Grenfell wasn't particularly well known for brilliant executives, the bookish Mackworth-Young gave the firm intellectual cachet. He had been a star Eton pupil, along with his classmate Robin Leigh-Pemberton, later governor of the Bank of England. The son of an English civil servant and archaeologist in India and married to an earl's daughter, Mackworth-Young was a good salesman and a charming after-dinner speaker. He was especially adroit with Americans, having gone yearly to Bohemian Grove in California, the rustic stag camp for American power brokers. A warm, stocky man with a ready, avuncular smile, he lacked malevolence and was universally popular.

A heavy smoker, Mackworth-Young died abruptly of lung cancer in 1984. Later, the City would ritually repeat that had he lived, Morgan Grenfell would have been spared the Guinness scandal. According to a rival executive, "Mackworth-Young would have given free rein to the takeover *prima donnas*, but he would have been quite aware of what was happening. He would have taken a longer term view of how the business should be conducted." When things later went awry at Morgan Grenfell, Mackworth-Young only grew more saintly in memory.

Morgan Grenfell's chief executive and deputy chairman was Christopher R. Reeves, who epitomized the new, self-made City executive. A graduate of Malvern College, he worked at the Bank of England and the merchant bank of Hill Samuel before Sir John Stevens recruited him to Morgan Grenfell in 1968. He belonged to the first generation of Morgan Grenfell executives who didn't come from the old families and hadn't apprenticed at the Morgan bank in New York. Slim and blond with a chiseled, angular face, he had a photogenic grin and a look of gritty determination. In a firm once faintly embarrassed about seeking new business, Reeves didn't mind the hard sell. Tough and adept, he was enigmatic to his subordinates. "He was a superb presence but a bit of a sphinx," a former corporate finance director recalled. "Silence was his partner." He was drawn to the tough tactics of "corporate finance"—a term that in England signifies takeover work.

Neither Reeves nor Mackworth-Young was a master strategist. Unlike Morgan Guaranty or Morgan Stanley, Morgan Grenfell never operated by a blueprint or comprehensive vision of the financial future. Its history was devoid of planning conferences or retreats during which the firm could strategically reorient. Its postwar history had no Bob Baldwins or Lewis Bernards, no Henry Alexanders or Lew Prestons, and certainly no Siegmund Warburgs. Its moves seemed improvised, a snatching at sudden opportunities. To paraphrase Winston Churchill, it was a pudding without a theme, and this absence of a clear design would be its downfall. Both Reeves and Mackworth-Young ran a series of successful, often unrelated businesses without any single thread binding them together. By comparison, Morgan Guaranty and Morgan Stanley had a seamless quality, a smoothly coordinated approach to business that seemed to anticipate changes in financial markets.

Morgan Grenfell had enjoyed some remarkable successes, which masked long-term problems. It managed money for the world's two richest people—the sultan of Brunei and Queen Elizabeth II—and surpassed all other British banks in handling American pension funds. It specialized in international portfolios when many short-sighted asset managers were still mired in local markets. After years of torrid growth, by the 1987 crash it managed $25 billion. This dwarfed America's top asset manager among wholesale firms, Morgan Stanley, with its meager $11 billion. At 23 Great Winchester, pension money for San Francisco, the state of California, Fort Worth, and the Rockefeller Foundation was handled.

It was also distinguished in trade and project financing. Morgan Grenfell had led in financing North Sea oil and chalked up several energy triumphs, including the record $1.6-billion financing for Woodside Petroleum's natural gas project in Australia, the biggest such loan ever to hit the Euromarkets. It was also active in financing projects in the Soviet Union. And when other banks wrote off Africa in the 1970s as poor and hopelessly indebted, Morgan Grenfell established a business advising black African states. To please black Africa, it even ended most of its dealings with South Africa. Among the forty countries it advised outside of Europe were Sudan, Uganda, Tanzania, and Zambia.

Yet despite these accomplishments, Morgan Grenfell was vulnerable. Like other capital-short merchant banks, it was somewhat anachronistic in modern, global markets. Unlike Warburgs, it never graduated into the front ranks of the City's Eurobond and foreign-exchange markets. In that larger City, capital was decisive, with cosy ties counting for little—the reason takeover work had been such a godsend to Morgan Grenfell. The firm had thrived only in the insular City of British work, which would be a dangerous shortcoming as the decade progressed.

The so-called Big Bang deregulation of October 1986 tore down the walls that had divided the two Cities since the Euromarkets emerged in the early 1960s. To guarantee London's survival as a financial center, the Thatcher government decided to stop cosseting London banks and expose them to more domestic and foreign competition. Despite their evocative names, British merchant banks were tiny beside the new global conglomerates. Japan's Nomura Securities, with a $20-billion capitalization, *was forty times* the size of Morgan Grenfell. It could swallow all the merchant banks for breakfast. By opening the City's gates to foreign firms, the British government ensured London's survival as a financial center but not the survival of individual London houses. They would have to compete against American commercial banks, which wanted to build investment banking operations in London that they could then repatriate to the United States after Glass-Steagall tumbled. At the same time, the big British clearing banks—National Westminster, Midland, Barclays, and Lloyds—had begun to encroach on the traditional turf of the merchant banks.

In its specifics, Big Bang sounded innocuous. It ended the City's antiquated fragmentation into bankers, brokers, and market makers, let foreign firms enter these areas, and scuttled fixed brokerage commissions. These measures collectively threw the formerly closed City wide open to competition. Christopher Reeves was aware of the carnage on Wall Street after fixed commissions ended in May 1975. He warned, "Greater risks will be run by those firms which do not adjust their business to exploiting the new opportunities."[1] Oddly, Morgan Grenfell would be just such a laggard and would figure as a major casualty of Big Bang. In a failure of vision, it would move too gingerly, too indecisively, and would squander its chance to translate its eminence to an international sphere.

The little cottage industries of the City were swept away by Big Bang. Scores of small private partnerships, which had given the City its pleasantly Dickensian flavor, were taken over by world-devouring giants. At the same time, banker-company relations grew looser, more impersonal. As British corporate treasurers were besieged by foreign bankers, they got a new sense of what could be accomplished in global markets and were less content to rely on a single banker. Consolidations also meant sudden wealth for young deal makers and traders, whose salaries jumped as much as tenfold in a few years. Young bond traders were suddenly driving Ferraris and making six-figure salaries.

The elite world of merchant banking faded as the rhythms of the trader speeded up City life. Long lunches at Boodle's or White's gave way to twelve-hour days. It was impossible to equip all the trading desks with old Etonians, and so the City became a more egalitarian place. Some people, of course, resisted the new ways. When the *Economist* tried to track down City executives, it discovered several absentees: "Many were sighted at the Wimbledon tennis tournament, the Henley regatta and the Ascot horse races."[2] For the most part, however, the City was now a more hectic, grueling place, with people grabbing lunches at the fast-food restaurants and crowded sandwich shops scattered among the Wren churches and new office blocks. It grew in such helter-skelter style that it almost made Wall Street seem gracious by comparison.

Along with Warburgs and Kleinwort Benson, Morgan Grenfell had a chance to parlay past glory into modern power. Christopher Reeves welcomed Big Bang as an opportunity to form an integrated securities firm that could compete in world markets. This was a radical shift for Morgan Grenfell which had always shied away from the risks and capital investment associated with securities trading. Like Morgan Stanley in the 1950s, it had maintained an aristocratic distance from markets, drawing on brokers to price the securities it issued. Under the British underwriting system, the august "houses of issue," such as Morgan Grenfell, didn't put their capital directly at risk. They placed the issues with institutional underwriters, who provided a contingency backing for issues. Big Bang elicited predictions that "bought deals" would revolutionize London as they had New York after Rule 415. This meant that underwriting would suddenly require enormous piles of capital. Of the merchant banks, Warburgs responded with great clarity to Big Bang, while Morgan Grenfell vacillated and lagged fatally behind.

Morgan Grenfell's bungling of Big Bang would do more lasting damage than the Guinness scandal. Early on, a split developed, mostly between the younger directors, who favored audacious, far-reaching action in response to the challenge, and the traditional directors, who were fearful of venturing into risky new businesses. In 1984, Morgan Grenfell was approached by the brokerage house of Rowe and Pitman, Mackworth-Young's old firm, about a possible alliance. Afraid it would cost too much, 23 Great Winchester dithered and lost its chance; later Warburgs grabbed the firm, helping to make it preeminent among merchant banks in international markets. The most insistent foe of the Rowe and Pitman deal was evidently Graham Walsh, the takeover chief. "Walsh was *very* adamant against it," a former colleague recalled angrily. "He said, 'We're doing beautifully as we are, we're on the top of the pile, and it's risky to do this.' " So the easy, seductive profits of takeovers clouded the firm's strategic vision at a critical moment.

Morgan Grenfell frittered away other chances: it passed up the opportunity to buy Phillips and Drew and Wood Mackenzie; fumbled a chance to merge with Hoare, Govett by demanding majority control; and was blocked from taking over Exco, a financial services group, first by a Bank of England veto, then by its own indecision. It ended up doing Big Bang on the cheap, buying two firms that many thought booby prizes—the antiquated Pember and Boyle (a broker) and Pinchin Denny (a jobber, or market maker). Expressing a common judgment, an indignant former director said, "They hemmed and hawed and finally bought a cheap jobber and a cheap broker. They got the worst of all worlds." As time has confirmed, the new financial order would tolerate global firms offering a comprehensive package of services or domestic boutiques specializing in a few functions. It would be pitiless toward those, such as Morgan Grenfell, stuck in the middle bracket.

Right before Big Bang, in June 1986, Morgans overcame historic reservations and sold shares to the public to amass capital for trading. It raised £154 million ($229 million) and borrowed another £140 million ($200 million). Although some jowly die-hards were petrified that shareholders might demand shorter lunches or even interfere with weekend shooting (God forbid), most accepted the grim necessity. The Bank of England had just chastised the firm for having inadequate capital to back its share purchases during the Guinness takeover of Distillers, and raiding was becoming a more capital-intensive art. Like its Wall Street counterparts, Morgan Grenfell might someday have to provide temporary "mezzanine" financing or even issue junk bonds in takeovers.

There were also unspoken reasons for going public. A former corporate finance director explained: "A principal reason was to have publicly quoted shares as acquisition currency. It didn't work out that way." Another speculated that it was a way to appease the firm's takeover stars, Roger Seelig and George Magan: "I suspect they weren't making enough money and needed an equity hit. They both had standing offers from American investment banks to pay them $1 million to go to them—much more than they were getting from Morgan Grenfell."

The confused and halfhearted way that Morgan Grenfell reacted to Big

Bang reflected an unhealthy dependence on takeover work. The firm might boast that it offered thirty-two services, and it could point to twenty-two overseas offices, yet the heart of the operation was mergers. By Big Bang, the 120-person takeover unit was reportedly chipping in almost half the pretax profits in a firm of 2,000 people. As London's premier takeover house, it was handling an awesome volume of business—some fifty-one deals in 1986 valued at almost £14 billion.

Like Morgan Stanley, Morgan Grenfell usually took the offensive, earning a reputation as "the most aggressive agent in the City for the hostile bidder," in *Euromoney's* words.[3] As a blue-blooded firm, it legitimated a new, swashbuckling style of finance. On Wall Street and in the City, traditionalists were appeased when a Morgan firm validated controversial practices. Aware of the mounting takeover frenzy in the United States, Morgan Grenfell was determined to show it could slug it out with any Yanks that came to London.

Mackworth-Young and Reeves presided with a light hand over their circus of takeover *prima donnas*. The Seeligs and the Magans had great power in the firm, for they captured new clients; the old taboo about poaching clients was fading. Morgan Grenfell had an individualistic culture very unlike the team spirit drilled into recruits at Morgan Guaranty, S. G. Warburg, and Goldman, Sachs. Not surprisingly, it encouraged a flamboyant, free-wheeling star system among its young professionals, who became recognizable figures in London, like pop stars. But such freedom, if conducive to inventive takeover work, could also induce a perilous euphoria, a giddy sense of invulnerability.

The group's superstar was Roger Seelig. In a more innocent age, his background might have fitted him for tamer pursuits. In 1971, after taking a degree from the London School of Economics and working at Esso, Seelig joined Morgan Grenfell. (That he was Jewish apparently mattered less in those days before the petrodollar boom.) He and his mother shared a three-story Gloucestershire mansion—a very grand, formal place topped by a row of balusters. It wasn't far from the Prince and Princess of Wales's Highgrove House. The bachelor Seelig's girlfriend lived with him at his Marble Arch apartment, but he professed to be "too busy" to marry, as if matrimony might cost a valuable deal or two. He rode with the Beaufort hunt, belonged to the Royal Society of Arts, and was partial to official balls—not your usual corporate stalker.

At Morgan Grenfell, Seelig ran his own show and Reeves proudly touted him to clients as the most "entrepreneurial" of the takeover stars. Seelig made his own hours and served as his own boss. Carrying a mobile telephone, he would pop up at theaters or expensive nightclubs, Annabel's in Berkeley Square being a favorite spot. He was a high-tech dandy, financial impresario, and gentleman masher. Speaking in a clipped, affected manner, he had a smugly theatrical smile, with lips pursed and corners drawn down, like a rogue in a Restoration comedy. His debonair ascot-and-handkerchief style transported a country-house ethos into the cutthroat takeover world.

One former corporate finance director remembers him thus: “Roger loved to fly his spinnaker. He wore suits nipped heavily at the waist and had a Beau Brummel stride, with his chest thrown out. It was a metaphor for his personality. He liked to ‘mingle’ with grand people, like Jacob Rothschild or Henry Kravis. He was a talented banker, but his manner masked an inferiority complex.” Earning £250,000 annually for snuffing out targets, Seelig was London’s top deal maker. He was especially good at latching onto acquisition-hungry firms, such as the giant retailer Storehouse PLC, which owned the Habitat home-furnishing stores in England and Conran’s in the United States; Storehouse was chaired by Seelig’s friend Sir Terence Conran. With sixteen professionals in Morgan Grenfell’s takeover department, Seelig reportedly hauled in a quarter of the profits, encouraging management to view his tactics benignly and allow him considerable leeway. He developed an attitude that takeover rules were silly hindrances to be tested by clever financiers. In 1985, he boasted that rivals “may just be reading the rules. We *changed* most of the rules.”[4]

Mirroring Morgan Grenfell’s split personality, the other takeover star was George Magan, a short, sharp-faced man with glasses. His manner was entirely different from Seelig’s. The offspring of an old Irish family, an accomplished pianist with a dry, delightful wit, Magan was popular with his colleagues. He was nicknamed Teddy, short for teddy boy, because of his slicked-back hair and slick suits. Though unlike Seelig in other ways, Magan also gloried in aggressive tactics and talked of “using every inch of the playing surface.”[5] Ubiquitous on London’s takeover scene, he was involved in six of Britain’s top ten deals in 1985.

There was a lot of jockeying and rivalry among the *prima donnas*, and Morgan Grenfell created an unstructured environment that allowed them to wheel and deal without bumping into each other. This required a conciliatory figurehead to oversee the Corporate Finance Department. His name was Graham Walsh. An accountant and former director general of the Takeover Panel, Walsh was a shy, neat, introverted man who never quite made eye contact with other people. Known as a hypochondriac, he would shuffle about shutting windows in winter. Walsh feuded with Seelig, and they ended up scarcely on speaking terms. As he kept his department humming tidily along, Graham Walsh little dreamed that Margaret Thatcher would someday take a personal interest in his job.

Such an operation required a strong chief executive to curb the animal spirits of Walsh’s takeover professionals. Yet Christopher Reeves accentuated the impetuosity of the takeover team. He sometimes made rules sound optional: “Merchant banking is all about innovation. . . . We must not believe that rules are written in tablets of stone.”[6] As one former Morgan Grenfell official said bitterly, “He was imbued with this win-at-any-cost or by-any-means attitude. And it communicated itself down to the operatives in the Corporate Finance Department.” From 1980 to 1984, a healthy equilibrium existed between Reeves’s red-blooded dynamism and Mackworth-Young’s wise discretion. An outside adviser recalled, “Christopher Reeves had tremendous thrusting ability, but he needed the balancing factor of Mackworth-Young’s slightly wider and more public-spirited view. Christopher Reeves was all accelerator and no brake.” In 1984, when Mackworth-Young suddenly died, it robbed Morgan Grenfell of this temperate influence.

The dazzling team of Seelig and Magan made Morgan Grenfell untouchable in takeover work, with only second-place Warburgs remotely approaching it. Between 1982 and 1987, Morgan Grenfell ranked number one in mergers and acquisitions year after year. It was on such an intoxicating ride—in 1985, directors received twice the pay of the year before—that the gray old men of Morgan Grenfell tolerated the antics of the young hotshots. As the scale of the takeover wars escalated crazily, the temptation to break the rules heightened. Before 1985, London had never seen a £1-billion takeover bid; there were four on the table by year’s end. Much to the British Treasury’s annoyance, 23 Great Winchester blithely refused to work on Margaret Thatcher’s privatization boom. Why? Because corporate finance people thought the fees trivial and didn’t want to pull stars off the glitzy merger carousel.

The momentum was pushing Morgan Grenfell toward ever more hazardous enterprise. “Merchant banks tend to attract business by their reputation,” explained a former corporate finance director. “And Morgan Grenfell was being approached by more racy people because they were doing racier things.” The press noted this vicious circle. As London’s *Business* magazine said in 1986, “The mention of Morgan Grenfell in some banking circles gets the sort of reaction the sight of Attila the Hun must have provoked in Rome.”[7] One observer remarked, “They are trotting into action with all the arrogance of a crack Polish cavalry regiment in 1939.”[8] These would be prophetic judgments.

Morgan Grenfell’s balloon was finally punctured by the Guinness scandal, which convulsed Britain and focused more anger against the City than had any scandal since the “rascally stock jobbers” of the eighteenth century. It started with an exceptionally aggressive client—Guinness chairman Ernest Saunders. As his most famous product, black Irish stout, lost favor with wine-tippling yuppies, Saunders wanted to diversify his huge conglomerate. Like

Robert Maxwell, Saunders was an immigrant who craved acceptance by the British establishment. His Jewish parents had fled Nazi-controlled Austria in 1938 and settled in London. The Jewish-born Ernst Schleyer was re-invented as the Anglican Ernest Saunders. He would acquire all the trappings of upper class success, including a Buckinghamshire mansion.

At the start of his buying spree, Saunders booted out Guinness's old adviser, N. M. Rothschild, and brought in Morgan Grenfell. At a dinner at the Connaught hotel in early 1985, Christopher Reeves advised Saunders to expand aggressively, lest Guinness itself be a takeover target. In June 1985, advised by Tony Richmond-Watson of Morgan Grenfell, Saunders launched a £330-million hostile bid for the Scotch whisky and hotel company, Arthur Bell and Sons. Bell's chairman, Raymond Miquel, was flabbergasted, because Morgan Grenfell had represented his firm for twenty years, assisting in its purchase of the Gleneagles Hotel Group and even handling its public offering in 1971. When Miquel complained to the Takeover Panel, Morgan Grenfell countered with evidence that Bells had terminated its services in November 1984; Miquel cited more recent links.

Whatever the exact truth, Morgan Grenfell had twenty years' worth of intimate knowledge about Bells and thus subverted a tradition of merchant banker confidentiality. (This was the rationale for having traditional bankers: a company's innermost secrets were safe from competitors.) At first, the panel mildly rebuked Morgan Grenfell, then retracted even that. Some attributed its leniency to Christopher Reeves's informing the panel that Morgan Grenfell had booked only £20,000 in fees from Bells versus £6 million from Guinness in the previous two years. Such an argument, it was thought, swayed the banker-oriented panel.

There was no outright illegality in the Bell's takeover, but things were skirting the edge. Apparently a Guinness employee, pretending to be a Scottish reporter, questioned Raymond Miquel.[9] Also, Saunders had assured Bell's shareholders that he might sell the Piccadilly Hotel in London but keep the rest. Then through Morgan Grenfell's property arm, he set up a Dutch auction for the Caledonian and North British hotels in Edinburgh. The winning bidder, Norfolk Capital, came as a shock, because its chairman was none other than Tony Richmond-Watson of Morgan Grenfell. There were, predictably, accusations of favoritism and double-dealing. By this point, both Guinness and Morgan Grenfell seemed ripe for trouble. Christopher Reeves, meanwhile, kept telling Saunders that Guinness would have to digest another company if it wished to stay independent.

In January 1986, Saunders entered into a more massive takeover whose record size would make the city tremble. A supermarket chain, Argyll, had made a bid for the far larger Scottish brewer, Distillers. This David assault on Goliath—a new City phenomenon—had clear class overtones. Argyll's James

Gulliver was a husky, rough-hewn grocer's son, while Distillers was an aristocratic Scottish firm. From plush headquarters on London's St. James's Square, Distillers marketed drinks with a classy ring—Johnnie Walker, Haig and Haig, and White Horse scotch, Booth's and Gordon's gin. Behind the tony facade, however, the poorly run company was losing ground in the scotch market. And it had never completely overcome its infamy as the manufacturer of thalidomide, a sedative that when taken by pregnant women apparently caused cruel deformations in the developing fetus.

Distillers scoffed at the Scottish commoner Gulliver. "Gulliver deals in potatoes and cans of beans," said a deputy chairman of Distillers. "We are not selling brown water in cheap bottles. We are selling Scotch."[10] The Gulliver people exhibited their own class bias. Hoping to swoop down on Distillers by surprise, they favored an August raid, saying, "Let's shoot them up the backside while they're out on the grouse moor."[11]

So along came Ernest Saunders in January 1986, volunteering to be the "white knight" who would save Distillers from that coarse ruffian, Jimmy Gulliver. There was more than altruism here: Saunders was already considering pouncing on Distillers, anyway. If he could make a ceremonial entrance through the front door, well, so much the better. He even secured an agreement by which Distillers would defray Guinness's fees for taking it over—a highly unusual measure.

Saunders liberally distributed promises to win Distillers' support. Chairman John Connell was apparently led to believe he would chair the merged entity. Ditto for Sir Thomas Risk, governor of the Bank of Scotland. The duping of Risk would be one of the most disgraceful parts of the Guinness affair. The Guinness forces needed to placate Scottish nationalists, who would protest the loss of Distillers' autonomy. Charles Fraser, an Edinburgh lawyer and chairman of Morgan Grenfell, Scotland, was among those pressing for a Scottish non-executive chairman. To this end, Saunders and Seelig cajoled the respected Risk into agreeing to take such a post in the new firm, which would have its headquarters in Scotland. This promise was incorporated into takeover documents, and the Distillers board made it a precondition of the "friendly" bid; many institutional investors backed Guinness on its strength. Nevertheless, Guinness later reneged on its pledge, claiming that the two-tier structure was unworkable from a commercial standpoint. It even circulated rumors to blacken Risk's reputation, claiming that he was unduly concerned with retaining Guinness business for his bank. Morgan Grenfell protested the treatment of Risk but didn't resign. After an extraordinary general meeting, Risk was dropped by Guinness without legal repercussions. But the lingering resentment over the dispute would add extraordinary venom to the Guinness affair.

Tony Richmond-Watson should have been Morgan Grenfell's point man in the Guinness takeover. But he was busy helping United Biscuit complete a £1-billion merger with Imperial Group, so he bowed out. Roger Seelig took his place. (Some accounts say Saunders demanded the more aggressive Seelig.) According to Saunders, Reeves warned him that Seelig was a "very powerful personality and will want to do things his way."[12] As a member of the so-called Guinness war cabinet, Seelig sat by Saunders at meetings and was integral to everything that happened. Even before the later disclosure of share manipulation, it seemed a nasty campaign. Both sides stooped to such scurrilous ads that the Takeover Panel had to curb their use.

The essence of the Guinness scandal involved manipulation of share prices. The Lilliputian grocer, Jimmy Gulliver, was trying to take over a liquor company three times his company's size. Where a comparable bid in the United States would have been financed with cash and junk bonds, Gulliver hoped to pay primarily with shares of his own company, much as American conglomerates did in the 1960s. As it started bidding against Gulliver, Guinness also relied on a swap of its own shares and cash. So the decisive factor would be the price of Argyll and Guinness stock; the more they rose, the more their individual bids would be worth.

Guinness embarked on a campaign to pump up its own share price and thus enhance its bid. It wasn't illegal for people to buy Guinness stock, nor for Morgan Grenfell to tout it. Roger Seelig got his friend, the beefy, bespectacled Lord Spens—formerly of Morgan Grenfell but now a corporate finance director with Henry Ansbacher—to coax his clients into buying two million shares. Jacob Rothschild bought. Robert Maxwell reportedly picked up two million shares. L. F. Rothschild Unterberg Towbin bought a six-million-share Guinness block, which it sold back to Morgan Grenfell when the battle was over. The illegality would arise only if Guinness underwrote share purchases or guaranteed buyers against loss by doing so. That would violate the Companies Act of 1985, which prohibited companies from buying their own shares or assisting others in doing so. Whether or not criminal acts took place in connection with the Guinness "affair" will, of course, be resolved in criminal proceedings to be commenced in 1991, in which the defendents denied all charges.

Despite the law, Seelig, Saunders, and Guinness finance director Olivier Roux allegedly orchestrated what is called a concert party, or a fan club, to inflate the Guinness share price while deflating Argyll stock. They are said to have conducted their secret work on such a large and brazen scale that one wonders how, in the long run, they hoped to escape detection. The list of deals cut by the Guinness war cabinet makes for sobering reading. British businessman Gerald Ronson, chairman of Heron Corporation, had introduced Seelig to the notorious American arbitrageur, Ivan Boesky. At Seelig's urging, Boesky poured £100 million into Guinness and, for good measure, "shorted" Argyll stock to depress it. The Boesky link would later clarify a mystery of the Guinness takeover: why Argyll shares dipped each afternoon in London, just about the time New York trading opened. The American company, Schenley Industries, bought £60 million of Guinness stock. By coincidence, it received an extended contract afterward to market Dewar's whiskey in the United States. The biggest stake was taken by the venerable Bank Leu, Switzerland's oldest bank, which bought tens of millions of shares and was allegedly indemnified against any losses.

As Guinness's share prices spiraled wildly skyward, buoyed by the coordinated buying, Gulliver complained to the Takeover Panel about the share levitation. As it had since 1968, Britain still relied on the private panel to enforce the Takeover Code. This self-regulatory body seemed too genteel to deal with the harsh tactics and mercenary culture of the modern City. Much to its later embarrassment, the Takeover Panel failed to act on Argyll's complaint. Morgan Grenfell also accused Argyll of inflating *its* share price. A 25-percent jump in Guinness's share price finally tipped the scales in the takeover. On April 18, 1986, Ernest Saunders declared victory over Argyll, claiming to have more than 50 percent of Distillers' shares in a bid valued at £2.53 billion. Morgan Grenfell had won the biggest, ugliest, most searing takeover of the decade and basked in dubious glory.

Ethics aside, Guinness involved some risky financial footwork for Morgan Grenfell, providing further proof of its win-at-any-cost mentality. It had bought £180 million of Distillers shares, straining its capital resources of only £170 million—to say the least. This behavior was deemed so irresponsible by the Bank of England that it promptly issued new rules, limiting such share buying by a bank to 25 percent of its capital—an implicit rebuke of Morgan Grenfell. Once again, the firm that was the Bank of England's staunchest ally in Teddy Grenfell's day now seemed its chief nemesis.

As in any share-rigging scheme, there was a critical weakness: what would happen to artificially elevated share prices when the secret props were removed? Apparently Roger Seelig feared that friendly parties might suddenly dump up to 20 percent of Guinness's shares on the market. And the price indeed began to slide sharply from the 355-pence takeover price. If, as alleged, Guinness had promised to insure the concert party against losses, its liability could be tremendous if the share price plummeted. Seelig appealed to institutions to hold their shares until autumn. Mayhew of Cazenove, Guinness's broker, also worked out a plan for Guinness to buy back Morgan Grenfell's stake in Distillers, which would be converted into Guinness shares after the takeover.

More direct measures were taken to stop selling. Lord Spens had a two-million-share block for which Guinness allegedly paid him £7.6 million.

Seelig and Oliver Roux, Saunders's financial adviser, are said to have characterized the £7.6 million as an interest-free deposit in order to dissuade Spens from selling. It was hard to see what the difference would be between such a *de facto* guarantee and an outright purchase. It is also alleged that Bank Leu in Switzerland also got a £50-million "deposit" from Guinness to ensure that it wouldn't liquidate its shareholding. During the summer of 1986, Guinness transferred £69 million to a venture fund managed by Ivan Boesky, who had invested so heavily in Guinness shares. It was this aspect that later outraged the Guinness board and precipitated the dismissal of Ernest Saunders. When all the deals finally surfaced in the press, share manipulation apparently added up to a staggering £200 million.

To understand the fierce public outcry that greeted the exposure of the Guinness scandal, one must note several factors. Billion-pound hostile deals were becoming common for the first time. And during the Thatcher years, the number of shareholders in Britain had more than tripled, to nine million. Never before had so many people been riveted on the doings of the City. Big Bang was accompanied by a numbing barrage of publicity. And at least part of the populace revered the new money makers. At the time of Guinness, the white-hot Morgan Grenfell was receiving about fifteen hundred job applications yearly from university graduates, half from Oxford and Cambridge, for thirty places. So some of the public disenchantment reflected the earlier worship of new idols.

Among other factors was a growing sense that the City was corrupting the general culture and harming the economy. The *New Statesman* called the City "an unpatriotic casino which pays itself obscenely high salaries for dancing on the grave of British industry."[13] Sir Claus Moser of N. M. Rothschild warned, "the City is absorbing too many of our ablest people. If I were a dictator over Britain, I'd move 9/10 of them into manufacturing, industry and teaching."[14] As on Wall Street, high finance was no longer principally involved in financing the operations of industry. Instead, it was financing changes in the ownership of industry, to the stunning benefit of bankers and raiders. Add to this the sheer envy of ordinary Britons at the stratospheric salaries in the City, and one can understand the incendiary public reaction to Guinness.

The year 1986 was one of double scandal for Morgan Grenfell. Right after Big Bang and before the Guinness revelations surfaced, the firm was tarred by an insider trading scandal. Its new chief securities trader, thirty-five-year-old Geoffrey Collier, had been hired for Big Bang at a salary of $284,000. He had joined the firm the year before after setting up a New York office for Vickers da Costa, a broker later taken over by Citicorp. In the past, British authorities had taken a relaxed attitude toward insider trading, which wasn't even a criminal offense until 1980. This *laissez-faire* attitude was incompatible with the new conglomerates encouraged by Big Bang. There were now fears that traders would abuse information from their mergers departments. In global financial markets, there was also a need for higher universal standards—a particular concern of the Thatcher government in its quest to insure the City's worldwide standing. Right before Big Bang, Morgan Grenfell distributed a little in-house manual in which it stated that any staff purchases of shares had to be channeled through Morgan Grenfell's own brokers. The penalty for violating the rule was summary dismissal.

Collier made illegal purchases through his old firm, now Scrimgeour Vickers. He made small profits on a sixty-thousand-share purchase of Associated Engineering after he learned that Hollis, a Morgan client, was about to acquire it. He almost made a killing on his purchase of call options on Cadbury Schweppes, then being acquired by General Cinema, another Morgan Grenfell client. But his trade in Associated Engineering led to suspicions and forced him to sell the Cadbury options prematurely, at a loss. After Scrimgeour Vickers tipped off Morgan Grenfell about Collier's trading, the firm forced his resignation, on November 10, 1986, shocking the City. Collier got a one-year suspended sentence and £25,000 ($44,250) fine. The case fortified the resolve of those who wanted stricter regulation as firms turned into conglomerates fraught with potential conflicts of interest.

The Collier scandal was a mere curtain raiser for the next act in the drama. In late 1986, Morgan Grenfell was winding up a superlative year, bolstered by $833 million in capital, double the year before. Then Ivan Boesky pleaded guilty in November to one felony charge and agreed to pay a $100-million penalty for insider trading. Nobody yet dreamed of any Morgan Grenfell connection. But in the Collier investigation, the SEC had already shared information with Britain's Department of Trade and Industry under a new, bilateral pact. It was information from Boesky, relayed by American authorities to the British, that provoked the Guinness investigation. The suspicious stock gyrations during the takeover had not in themselves produced a full-blown probe.

Equipped with new Big Bang powers, investigators from the Department of Trade and Industry moved into action. In early December, three weeks after the Collier affair, they staged simultaneous morning raids on Guinness headquarters in Portman Square and on Morgan Grenfell to round up records. Then a month of revelations flooded London's press, drawing to the surface the latent public resentment of the City. Nobody at 23 Great Winchester quite saw the gathering storm. Seelig himself thought the firm would stand behind him. When a journalist said, "Mr. Seelig, your colleagues are going to throw you to the wolves," he was incredulous. "Now you're making me very angry," he replied. "We're very solid here."[15] But under intense pressure, Morgan

Grenfell told Seelig he was drawing too much publicity and had to be sacrificed. In a tumultuous series of late-December decisions, Morgan Grenfell resigned as Guinness's merchant banker and fired its brightest star, Roger Seelig. Since the Guinness board had already brought in Lazard Brothers as their new adviser, some observers saw an empty public relations gesture in Morgan Grenfell's resignation.

Morgan Grenfell hoped this would cleanse the firm and close the scandal. It circulated a reassuring letter to shareholders to that effect. But the public pressure to go further was unrelenting. Even within the City, there was thinly veiled satisfaction at seeing Morgan Grenfell punished. "When a firm has been so outstandingly successful on the back of very aggressive people and go no distance out of their way to be popular or help other firms—then the absence of friends shows up at once when they trip up," said a rival executive. "It was very noticeable that people didn't jump to their rescue."

Inside the firm, the shifting ground suddenly turned to quicksand. A former staffer recalled, "The first reaction was absolute shock and horror. It didn't happen as one big announcement. It was like a faucet dripping lousy water. It kept on coming. It was a real horror that tore the guts out of the firm." On January 9, 1987, Ernest Saunders stepped down as Guinness's chairman. A week later, Price Waterhouse outlined the £200-million share-support operation, mapping out links across several countries. They reported to the Guinness board the existence of £25 million in mysterious invoices. The operation seemed almost inconceivably vast.

Once Morgan Grenfell could have counted on the Bank of England's goodwill, but it had let that historic relationship lapse. Since the death of Sir John Stevens, in 1973, Morgan Grenfell hadn't had a director on the Court of the Bank of England. Some saw this as reflecting official displeasure; for others, it simply betokened an absence of executives of real stature at Morgan Grenfell. The bank's deputy governor, George Blunden, wasn't appeased by Seelig's removal and thought Reeves and Walsh were either knaves or fools. As late as January 18, 1987, Reeves, earning £300,000 a year, and Walsh, earning £200,000 a year, felt secure and insisted they would stay. They saw no systematic corruption that merited further action and so informed the staff. "They called together everyone in corporate finance," said an ex-director. "They said management had done an exhaustive, internal look at the big deals and not to worry. They said, 'We'll be sticking here; there'll be no resignations.' "

This wishful thinking was exploded within forty-eight hours. Expecting a general election in the near future, the Tories feared retribution if they seemed to coddle the City. Presumably, Margaret Thatcher saw a chance to steal the thunder of the Labour Party by seeming tough in disciplining her own kind. Many in the City also feared that the spreading scandal would bring calls for statutory regulation of a sort that was always abhorrent to the City. Robin Leigh-Pemberton, Governor of the Bank of England, told a dinner audience that Guinness was “a threat to the entire basis of trust which still predominates in our business life and in the City of London in particular.”[16] So great was the fear of seeming soft on the financiers that John Wakeham, chief Tory whip and close Margaret Thatcher adviser, was heard to say, “We’ve got to get the handcuffs on quick.”[17]*Handcuffs* became a metaphor that thrilled the public, with its suggestion of rough justice and a leveling of the mighty. It worked its way into several anonymous newspaper threats leaked by government officials.

Blunden called in Sir Leslie O’Brien, the former Bank of England governor who had set up the Takeover Panel and, ironically, chastised Morgan Grenfell a generation earlier for its behavior in Gallaher-American Tobacco and *News of the World* battles. In an odd turnaround, O’Brien was now on Morgan Grenfell’s International Advisory Council. Blunden laid down the law, citing Section 17 of the Banking Act, which gave the Bank of England authority to oust officials for imprudently managing a bank. This apparently didn’t have the desired effect on Reeves and Walsh. The firm issued a statement denying any further dismissals.

Now Thatcher began to pressure Nigel Lawson, chancellor of the Exchequer, to draw more blood from the Guinness affair. In an extraordinary intervention, she reportedly told Lawson, “I want Reeves and Walsh out today, not next week or next month, but by lunchtime today.” This was duly communicated to the Bank of England and transmitted, in turn, to a Morgan Grenfell delegation led by Lord Catto. In the office of Robin Leigh-Pemberton, governer of the Bank of England, the Morgan men were bluntly warned that if certain actions weren’t taken, Lawson would appear before the House of Commons to announce that the government was selecting a new Morgan Grenfell management. Afterwards, Catto and Sir Peter Carey, a Morgan director, met with Reeves and Walsh who were, as a Morgan Grenfell official phrased it, “politely forced out.”[18] As Thatcher had demanded, the heads rolled by lunchtime. It was a breathtaking reversal: the free-market prime minister striking down the City’s most entrepreneurial firm in the worst disaster to hit a City firm in many years. A columnist for London’s *Financial Times*, reflecting on the double disaster of the Collier and Guinness scandals, said, “It seems that there can be no end to the disasters that the market can dream up (or wish upon) Morgan.”[19]

The Guinness scandal had broad repercussions for the City. There were parliamentary calls to crack down on the bankers. As part of Big Bang, the government had set up a new Securities and Investment Board to oversee a cluster of self-regulatory groups. After Guinness, reformers wanted to toughen up the SIB, making it more like the SEC and less of a City-dominated body. There were proposals to outlaw guarantees for third parties who bought shares during a takeover (the “Seelig clause”) and to avert share buying by companies with a commercial stake in the outcome (the “Riklis clause,” after Meshulam Riklis of Schenley Industries). The City shifted further from the old-boy network to a strictly policed financial center.

Awaiting the outcome of the interminable government investigations, Morgan Grenfell found itself in a terrible limbo. In May 1987, Ernest Saunders was arrested for allegedly destroying and fabricating Guinness documents. Later that year, Roger Seelig was arrested and charged with faking £2.5 million in invoices that were used, at least in part, as covers to indemnify members of the “fan club.” Seelig was further charged with conspiring to create a false market and stealing £1 million from Guinness two weeks after the Department of Trade and Industry’s first raid on Morgan Grenfell in early December, 1986. Five other prominent City figures were arrested.

That year, the Takeover Panel ruled that Guinness had violated the code in the Distillers battle. This later made Guinness liable for compensatory payments of £85 million to former Distillers shareholders. Guinness could survive such a blow. But if the company turned around and filed a counterclaim against Morgan Grenfell, the smaller bank would clearly stagger. Throughout the DTI investigations, Morgan Grenfell officials lived with this constant nightmare; it was feasible that Guinness could deliver a mortal blow.

Short of such an outcome, however, it didn’t seem that Guinness would do lethal damage. The firm’s long-time rival, Warburgs, stepped briskly over its bleeding body to gain the number-one takeover spot, but Morgan Grenfell clung to second place in 1987. Looking only at publicly quoted companies, it actually remained in first place that year. Clients generally stuck by the firm, and there was no mass defection of staff. Perhaps most upset were the Third World countries that dealt with Morgan Grenfell for its classy aura and now had a tainted banker.

For several months in early 1987, Morgan Grenfell remained a ward of the Bank of England, which installed Sir Peter Carey—a short, mustachioed, highly respected former civil servant—as chairman. The firm could no longer indulge its takeover stars and give them free rein. Committees, bureaucracy, regimentation—these were the necessary correctives. Guinness exposed an absence of strong leadership and the managerial defects of an “oligarchy” that ran the firm like a private partnership. These older executives seemed a universe apart from the young takeover artists. As merger specialists were now subordinated to more organizational discipline, some people quit, notably George (“Teddy”) Magan and much of the takeover team in New

York.

"They were putting a saddle on a horse that never had one," said one departing star. "It had been an organic, free-wheeling organization of entrepreneurial spirit. People had booked into that. The most buccaneering of merchant banks started forming committees. But it was a franchise that hadn't been built on caution and procedures and checks and balances. Reeves and Walsh had created a magic bubble, a hothouse, and there wasn't the opportunity to do that anymore." Many people in Britain would have said "Amen."

Shortly after the takeover, a Morgan Grenfell official had told the press, "No man of the calibre of Ernest Saunders is going to employ Morgan Grenfell if we just tell him that Takeover Panel rules suggest that something can't be done."[20] This habit of bending or rewriting the rules had been growing remorselessly for twenty years. Now it had led Morgan Grenfell straight over the precipice. The Morgan name had always been synonymous with integrity and trust. Now, with Guinness, it became a byword for scandal in the modern City.

CHAPTER THIRTY-FIVE
BULL

WALL Street in the Reagan era self-consciously retraced the experience of the 1920s. Commentators noted eerie parallels between the decades—a booming stock market, Republican tax cuts, a Latin American debt crisis, fluctuating currencies, a merger wave, trade wars, farm and energy slumps. Fed chairman Paul Volcker served up the disinflation tonic, much as Ben Strong had in the 1920s, and the world suddenly swam in cash. Newspapers superimposed stock market graphs from the Coolidge and Hoover days onto those of the Reagan years, comforting bulls and bears alike. As in the 1920s, sages said old value measures were outdated and again worried about a shortage of common stock. The speculative froth on Wall Street was again regarded as a sign of economic dynamism.

In the 1920s, the United States was the world's chief creditor, a rising power with a bulging trade surplus. Armed with superior technology, American companies expanded around the globe. But the heady Wall Street of the 1980s masked America's declining economic position relative to that of Japan and Europe. Thanks to Reagan's tax cuts and budget deficits, the United States became a net borrower from the world. The stock market frenzy neither enhanced American competitiveness nor trimmed the trade deficits, which had been persistent since the early 1970s. Morning headlines screamed of billion-dollar deals that were supposed to improve the economy, but they never seemed to strengthen America's position in world markets.

As Wall Street returned to favor, America's youth flocked to the casino. By 1986, one of every ten Yale College graduates applied for a job at First Boston and over 30 percent of Harvard Business School graduates ended up at Morgan Stanley; Goldman, Sachs; Merrill Lynch; or First Boston. They came to a world that had little in common with the sedate, gentlemanly Wall Street of the early postwar years. Even the name now seemed a misnomer. "Except for Brown Brothers Harriman," said Martin Turchin of Edward S. Gordon Company, "I can't think of a major investment banking firm that has its headquarters on Wall Street."[1] They had all trailed their clients uptown.

The Reagan years saw the demise of relationship banking and with it the end of grace and civility on Wall Street. Wall Street was tougher, meaner, smarter, and more macho than ever before. The leisurely syndicate world faded after Rule 415, and the Gentleman Banker's Code was fully obsolete.

As the taboo against raiding clients and making cold calls broke down, investment bankers clashed with one another. There was no longer any agreed-upon etiquette to temper the greedy impulses that always existed in finance. Wall Street was run by bright, young executives who seemed curiously devoid of larger political or social concerns in their narrow pursuit of profits.

In 1985, Morgan Stanley named Eric Gleacher to succeed Joe Fogg as head of Mergers and Acquisitions; at Lehman Brothers Kuhn Loeb, Gleacher had been Adrian Antoniu's boss. A short, trim former marine commander of a rifle platoon, he had an MBA from the University of Chicago, believed in a gung-ho takeover style, and ran his department with martial discipline. Called a "steel wall" at the bargaining table, he had tremendous stamina and skied, golfed, and ran marathons in his spare time. Through Gleacher, Morgan Stanley would branch out from takeovers in behalf of blue-chip corporations to more direct involvement with corporate raiders. For example, Gleacher recruited as a Morgan Stanley client the cigar-smoking Ronald O. Perelman, who acquired Revlon Incorporated in a bitter 1985 fight.

In his merger factory, Gleacher had a team of ten bright young people who did nothing but cook up deals for the firm to sell to clients. In 1978, Bob Greenhill had said that Morgan Stanley was simply executing clients' deals, not iniating them.[2] Now passivity was scrapped: every deal announced in the morning newspaper was studied for a profit angle. Each morning, the ten high-priced well-educated dreamers lined up outside Gleacher's office to pitch their ideas in rapid-fire style. When a subordinate brought a three-inch-thick notebook full of figures for a possible deal, Gleacher dropped it in the wastebasket. "Come back when you know what you're talking about," he said.[3]

Wall Street no longer seemed subservient to corporate clients or simply the executor of their wishes; it had assumed a disturbing life of its own. Far from taking his cues from clients, Gleacher believed "deal makers should never take no for an answer," asserted *Fortune*.[4] The magazine told how he had badgered Robert Cizik of Cooper Industries in Houston into buying McGraw Edison. "Let me fly down and talk to you," Gleacher had said on a cold call. "It's my nickel."[5] His persuasive presentation the next day convinced Cooper Industries to make the $1-billion acquisition, netting Morgan Stanley $4 million. Gleacher also convinced Pantry Pride to take over Revlon, bringing in $30 million in fees in a Ronald O. Perelman raid financed by a flood of junk bonds. A decade earlier, naive bankers had trembled to ask for a $1-million fee.

The portion of corporate America now passing through the merger mills was staggering. Morgan Stanley handled $8.5 billion in merger transactions in

1982. Within two years, that figure zoomed to a record $52 billion. After some backsliding under Fogg, Morgan Stanley nosed out the First Boston team of Bruce Wasserstein and Joe Perella in 1985 to recover first place in merger work, booking an awesome $82 million in fees and giving Morgan Stanley Wall Street's highest return on equity. In the four years leading up to the 1987 crash, Morgan Stanley was involved in $238 billion worth of mergers and acquisitions. As Joe Flom would say in 1989, "We've gone through the most massive corporate restructuring in history over a period of 15 years."[6] The figures were now so fantastic that they seemed to have dazed and stupefied the public.

Many deals were spurred by needed change. At a time of technological flux, mature companies had to transfer money from dying industries to thriving ones. Foreign competition and deregulation were stimulating radical shifts in hitherto protected industries, including airlines, telecommunications, energy, media, and finance itself. Investment banks were the agents for the global integration of markets, much as they had welded together national markets in the era of Pierpont Morgan.

But too many deals seemed to be hatched by investment banks and corporate raiders merely for self-enrichment. The prototypical 1980s raiders —Boone Pickens, Carl Icahn, and Sir James Goldsmith—talked self-righteously about "cleansing" or "liberating" companies from "entrenched management." They claimed target companies were the victims of a harsh, Darwinian necessity, implying that they were invariably poorly run companies. Yet in 1978, before this became the party line, Bob Greenhill had said, "The acquiring companies are not simply looking for bargains, or corporations in trouble. Typically, they are interested in well-managed companies."[7] This was often the case.

Aside from the painful dislocations suffered by towns and workers, as a result of mergers, the takeover flurry penalized companies with clean balance sheets, little debt, and lots of cash. To stay independent, they had to cripple themselves by loading up on debt. The old Morgan Stanley had favored sound, conservative finance and was protective of the credit ratings of clients. The new Morgan Stanley stampeded companies into taking on debt, whether to conduct raids or to ward them off.

The firm's M&A people dismissed the existence of any problem. In 1986, with nationwide takeovers running at a robust $200 billion a year, Eric Gleacher said, "When you look at the debt of the world, the debt of the country, and the debt of the private sector, you can't with a straight face tell me that a few speculative merger deals are going to tip the balance and create disaster?"[8] Note that Gleacher doesn't praise the debt: it's more of a defensive everybody-is-doing-it kind of argument. There were also now more than "a few speculative merger deals." In 1970, only 10 takeover deals passed the million-dollar mark; by 1986, the figure had surged to 346 in a wave of consolidations that engulfed the economy.

Joe Fogg similarly had dismissed any problem. When asked whether the debt binge wasn't draining capital from productive uses, he called that notion "very silly and superficial. . . . The fact is, acquisition transactions merely reflect a change in ownership of capital assets. The money does not disappear. It is then used for other investments."[9] This was surely true of money changing hands in a takeover. But how was that additional takeover money raised in the first place? Typically by bank loans or junk bonds whose interest payments then siphoned off money from productive investment. This bias in favor of debt was strikingly at odds with the old Morgan Stanley, whose culture Bob Baldwin had described as "risk-averse" as recently as 1980.

Merger mania on Wall Street produced a stunning paradox in the 1980s: corporations grew financially weaker during the sustained Reagan boom. By the 1987 crash, nonfinancial corporate debt stood at a record $1.8 trillion, with companies diverting fifty cents of every dollar of earnings to pay off creditors—a far greater percentage than in earlier years. It was hard to see how corporate America could weather a severe recession without unspeakable destruction. As in the Jazz Age, much of the era's financial prestidigitation seemed premised on an unspoken assumption of perpetual prosperity, an end to cyclical economic fluctuations, and a curious faith in the Federal Reserve Board's ability to avert disaster.

Not surprisingly, Morgan Stanley was drawn to that most lucrative of 1980s fads—the leveraged buyout, or LBO. As a dangerous form of leverage, LBOs rivaled the pyramidal holding companies of the 1920s. In a basic LBO, a company's managers and a group of outside investors borrow money to acquire a company and take it private; the company's own assets are used as collateral for the loans, which are repaid from future earnings or asset sales. (Interest payments, significantly, are tax deductible.) In the 1970s, they were called "bootstrap financings" and seldom exceeded $100,000. André Meyer of Lazard Frères had taken equity stakes for years, but Wall Street didn't take notice until 1979, when First Boston did an LBO for a conglomerate called Congoleum. LBOs became popular as the conglomerates of the 1960s were dismantled and managers took over pieces of them. They became rampant as a byproduct of takeovers, with managers resorting to them to fend off raiders or even flush them out. The LBO was thus a natural sequel to the merger wave.

With its unerring instinct for profitable activities, Morgan Stanley noted the LBO profits at First Boston and Merrill Lynch. In 1985, it joined with CIGNA Insurance to create a leveraged buyout fund. It struck spectacular deals that made merger profits look like small change in comparison. In 1986, it joined with an Irish paperboard concern, Jefferson Smurfit, to purchase Container Corporation of America from Mobil for $1.2 billion. Morgan and Jefferson put up only $10 million apiece, borrowing the rest. Morgan Stanley pocketed a fast $32.4 million: $11 million for arranging the buyout, $20.4 million for underwriting nearly $700 million in junk bonds to effect the purchase, and a $1-million advisory fee. Such fees recalled investment banks feasting on new trust issues at the turn of the century. In LBOs, the target company suffered the pain and carried the risk, having to sell assets and cut costs to pay off the debt. Meanwhile, as a limited partnership, the Morgan Stanley buyout fund couldn't lose more than its tiny, original $10-million investment. The risks were remarkably limited in view of the enormous potential profits. And only three years later, Morgan's $10 million stake was worth $140 million.

Soon afterward, Morgan Stanley helped Kohlberg Kravis Roberts, the leading LBO firm, take over Owens-Illinois for $4.2 billion. Again it scored triple fees, this time of $54 million. Even though it had only $1.5 billion in capital, Morgan Stanley made a temporary $600-million bridge loan to effect the deal. (What bank would have gotten away with *that?* Yet investment banks could bypass SEC safeguards by issuing bridge loans through their holding companies.) Where the old Morgan Stanley minimized its capital risk and remained a financial intermediary, the new Morgan Stanley was gambling more of its capital in a new push into "merchant banking." Although Wall Street relished the historical associations of the term, it bore little resemblance to the mercantile financing engaged in by George Peabody and Junius Morgan. It simply referred to management buyouts, taking equity stakes in takeovers, or making temporary bridge loans to finance takeovers.

In 1986, to raise capital for these new activities and strengthen its position in world capital markets, Morgan Stanley sold 20 percent of its shares to the public. There was a wonderful irony here: it went public so it could take other companies private. To give these shares global distribution, a third of them were sold to buyers outside North America. The shares were offered in-house at $15.33, with the allotted number per person determined by a complex formula based partly on the amount an employee already had invested in the firm. On its inaugural day, the Morgan Stanley stock jumped from $56.50 a share to $71.25. This netted over $250 million for the firm and created instant fortunes for those irrevent young men who had transformed the firm in the early 1970s. Parker Gilbert had 772,133 shares worth $57.3 million by day's end (a rich reward for a compromise chairman); Dick Fisher had 729,574 shares ($54.1 million); Bob Greenhill, 710,275 ($52.7 million); and Lewis Bernard, 673,521 ($50 million). With its public offering, Morgan Stanley lost one of its last links to the past. It was now a vast, publicly traded company, with 114 managing directors (including its first female), 148 limited partners, and 4,000 employees worldwide. The firm now employed an astonishing number of multimillionaires. Only Goldman, Sachs remained an old-fashioned Wall Street partnership, and even it sold a stake to Sumitomo of Japan.

Bolstered by its public offering, Morgan Stanley pushed ahead with merchant banking. The next year, it launched the Morgan Stanley Leveraged Equity Fund II, with Tom Saunders eventually rounding up a $2.2 billion war chest, the largest ever assembled by a major investment bank and second in the world after that of Kohlberg Kravis Roberts. In its new dual role, Morgan Stanley would both manage the fund and invest $225 million of its own capital in it. As with hostile takeovers and junk bonds, Morgan Stanley took an activity of questionable benefit and made it acceptable in elite circles. It enlisted sixty institutions for its fund, including the General Motors and AT&T pension funds, Japanese trust companies, Middle East government agencies, Volvo, Barclays Bank, and several American commercial banks. Not only would Morgan Stanley receive about a third of the capital gains from the fund, but it would also skim off a 2-percent fee for managing the money. This was only the beginning, as the huge leveraged buyout of Burlington Industries would show.

In early April 1987, reports surfaced that raider Asher B. Edelman was accumulating stock in Burlington, the largest textile company in America, based in Greensboro, North Carolina. Frank Greenberg, Burlington's chief executive, cast about for a "white knight" to ward off Edelman and his partner, Dominion Textile of Canada. In a meticulous reconstruction of events published in an August 1987 issue of *Barron's*, Benjamin J. Stein chronicled what happened next. On April 15, thirty-two-year-old Alan E. Goldberg of Morgan Stanley telephoned Greenberg and said Morgan would be interested in buying Burlington while retaining current management. In a follow-up letter of April 21, Bob Greenhill reinforced the naked appeal to Greenberg's self-interest, saying, "We would have no interest in proceeding except upon a basis agreed to by your management."[10] At an April 29 meeting with Greenberg, Morgan Stanley laid out plans to give management a 10-percent stake in the buyout, plus another 10 percent if certain performance standards were met.

Facing a clear-cut choice between a hostile raider, who threatened his livelihood, and the Morgan LBO fund, enticing him with lucrative incentives, could Frank Greenberg render a fair, impartial judgment for his shareholders? As Benjamin Stein noted, Morgan Stanley customarily dangled before management promises of salary increases ranging from 50 percent to 125 percent after a buyout. In this tempting situation, Greenberg granted some exceptional concessions to Morgan Stanley. He agreed to give Morgan a $24-million "break-up" fee in the event it failed to acquire Burlington. Morgan Stanley justified this princely fee by citing interest it would allegedly forgo by locking up capital during the talks. Yet, as Stein noted, Morgan Stanley had no capital at risk until the takeover's completion—and then only $125 million of its own money. The break-up fee, however, worked out to interest that would have accrued on *$7 billion* over a two-week period. As Stein concluded, "The 'breakup' fee could be understood only as a form of payoff to Morgan from its *partners* on the Burlington board for being included in the deal in the unlikely event that the deal cratered. It simply made no sense otherwise."[11] Greenberg waited until mid-May before disclosing his secret talks with Morgan Stanley, which was privy to company secrets denied Asher Edelman and Dominion. It was hard to see how both bidder groups were being accorded equal treatment.

In late June, the Morgan Stanley group made a bid of $78 a share, or about $2.4 billion, for Burlington, defeating the Edelman raid. It got about a third of America's largest textile company for only $125 million and even most of that came from Bankers Trust and Equitable Life Assurance. It also earned $80 million in fees, including profits from underwriting almost $2 billion in junk bonds to finance the deal. Did Burlington profit equally with Morgan Stanley from this financial alchemy? Before the buyout, the firm had a clean balance sheet, with debt less than half the value of common shareholders' equity. When the LBO went through, the company suddenly struggled with over $3 billion in debt, or *thirty times* as much debt as equity. It subsequently had to fire hundreds of middle-level managers, sell off the most advanced denim factory in the world (ironically, to Dominion Textile), close its research and development center, and starve its capital budget to $50 million for a five-year period. All this not only upset the lives of Burlington employees, but drastically weakened the firm's ability to compete in global markets.

By the last quarter of 1987, Burlington Industries was losing money despite higher earnings from operations. Why? It had to pay $66 million in interest for the quarter. LBO defenders praised these high levels of debt as stimulating management to greater effort—an argument reminiscent of Dr. Johnson's observation that hanging wonderfully concentrates the mind. Did companies have to stare at the gallows to perform better? Most cost cutting and asset sales that followed LBOs weren't designed to improve company performance; they were just steps to pay for the LBOs and were often unnecessary without them. Many LBOs were quick bets on the bust-up values of firms rather than serious attempts to run a company for many years.

LBO supporters claimed that owners were more enterprising than managers and didn't have to attend slavishly to their stock prices. The claim was parroted at every turn. "An enormous amount of management time in this country is devoted to managing the market price of the shares," said Tom Saunders of Morgan Stanley. Yet for years, Bob Greenhill, Joe Fogg, and Eric Gleacher had warned companies to get up their share prices—or else. Who created that preoccupation with share prices and quarterly earnings from which companies were now being rescued? Ironically, many LBO specialists were being transferred over from merger work, where they suddenly had to adopt a long-term perspective. This defense also sounded odd coming from a firm that had managed the initial public offering of several companies in the 1980s. Finally, it ignored the simple fact that the objective of taking companies private was to take them public at a later date and reap a quick killing. Presumably, the firms would then tout the benefits of public ownership.

There were profound political and social issues at stake in the LBO fad. Participants hailed the trend as a return to the “good old days” when bankers put their own capital at risk. They didn’t look closely at that history and the conflicts of interest that had resulted from excessive cosiness between bankers and the companies they financed. As we have seen, it took decades of agitation and reform to fulfill Louis Brandeis’s vision of investment bankers’ having an arm’s-length relationship with companies. This had been the purpose of endless investigations—Pujo, Pecora, and Wheeler—as well as the purpose of the Medina suit and various government measures to mandate competitive bidding in railroads and utilities. Just when the 1982 Rule 415 had seemed to end the problem of banker-company collusion, investment banks reinvented it with merchant banking. It was no coincidence that Morgan Stanley’s entry into merchant banking occurred after the advent of Rule 415, for through LBOs it could restore the exclusive relationships lost in the transactional age. What better hold to have on a company than to own a large piece of it? Three of the five Burlington board members were suddenly Morgan Stanley managing directors.

The merger of industry and finance had made some sense in the Baronial Age and had given some stability to the American economy. Companies were then weak and had difficulty tapping capital markets, especially abroad. Only the banker’s reputation could reassure skittish creditors. That was no longer the case in the Casino Age, when companies were often better known than bankers. Burlington Industries needed no introduction to investors. The new merchant banking also differed from the old-fashioned relationship banking of the 1950s, when Wall Street firms had a purely advisory role and could provide objective advice. If the old Morgan Stanley had a firm grip on its clients, it also had no built-in temptation to mislead or abuse them.

The LBO trend ensnared investment banks in another set of potential conflicts of interest. Were they now advisers or investors? Were the roles of principal and agent compatible? LBOs put investment banks into the position of competing against their underwriting clients. After Morgan Stanley added Fort Howard Paper to a portfolio that already included the Container Corporation of America, its paper-industry clients were aghast. David J.

McKittrick, the chief financial officer of James River, had used Morgan Stanley to manage a number of stock offerings. “We have looked with concern at Morgan Stanley’s increasing equity position in the paper industry,” he said.[12] There were similar problems with takeover clients. If Morgan Stanley’s merger people spied an undervalued company, should they take it to a client or keep it for the firm? And if they recommended an LBO to a company, could they claim objectivity when the firm stood to make windfall profits in advisory fees and junk bond underwritings? According to one report, CIGNA insurance stayed away from the second Morgan Stanley LBO fund from a belief that the firm was chasing “elephant” deals that would generate giant fees.

People at Morgan Stanley recognized the potential problem but too quickly waved it away. “Our business is full of conflicts,” said Dick Fisher. “In an industry as integrated as ours, I don’t see how they can be avoided.”[13] He noted that if Morgan Stanley scouted a company for a client, that client had first crack. But what if the firm spied an opportunity on its own initiative? Was its first loyalty to its clients? Or to its shareholders? Bob Greenhill replied, “The first party that steps forward is the client; we talked to several companies about Burlington, but none were interested. The point is, because of our tradition, we bend over backwards to accommodate our traditional clients.”[14] So Morgan Stanley would save the scraps for itself and only take deals rejected by everybody else? Wall Street was now tangled so deep in ethical thickets that it could no longer fight its way out.

THE parallel with the 1920s had its inevitable sequel on October 19, 1987, when the Dow Jones industrial average fell 508 points. Some $500 billion in paper value—equal to the gross national product of France—vanished, though there were no untoward scenes at the Corner or mobs of ruined investors. No stock brokers executed swan dives from high ledges. Seventy percent of stock trading was now done by institutions—mutual funds, pension funds, and the like—which were averse to theatrics and tracked the market on computer screens. Depression, migraine headaches, even sexual impotence were later reported among investors, but no aerial artistry as in 1929. Aside from a somewhat longer visitors’ queue at the New York Stock Exchange, the Corner betrayed little sense of calamity on this Black Monday.

The Morgan houses were actually less remote from the 1987 crash than they’d been from the one in 1929. All the banks and brokerage houses were now trading operations. And Morgan Stanley was a major practitioner of stock-index arbitrage—computer-driven trades that exploited small price discrepancies between stocks in New York and stock-index futures in Chicago. Such transactions were blamed for wild market gyrations and even, unfairly, for the crash itself. In a secret, restricted computer room known as the Black Box for its sophisticated software—some programs forced traders to don 3-D glasses—fifty Morgan Stanley traders and analysts pored over information and scanned arbitrage opportunities. They took risks that would have harrowed Harold Stanley's soul. On September 11, 1986, after the market suffered a steep drop, Morgan Stanley, gambling on an upturn, had bought *$1 billion* in stock futures and suffered enormous losses. Such futures-related trading reintroduced leverage into the market that the government thought it had stamped out with stiffer margin requirements in the 1930s.

From 1984 to 1987, stock prices had risen without a 10-percent correction. This cheered bulls, muzzled bears, and blinded people to warning signals. Following exactly the 1929 pattern, the bond market slumped in the spring of 1987, and the Federal Reserve raised the discount rate in September. In early October, Morgan Stanley, fearing clients would miss the next leg of the bull market, exhorted them to be *100-percent* invested in common stock. Later, when it sent financial commentator Adam Smith an exuberant buy recommendation, he mused, "You had me one hundred percent invested in October and I lost half my money. How am I supposed to buy something now?"[15]

Where 1929 was a home-grown American crash, 1987 was a global panic. Around the world, stocks rose, crashed, then rebounded together. The same financial deregulation that had interlaced markets led to synchronized drops in Tokyo, Hong Kong, New York, London, Paris, and Zurich. "For days everyone just kept passing the bear market around the time clock," said Barton Biggs of Morgan Stanley. New links among world stock markets seemed to exaggerate movements in both directions, accentuating the instability of the world financial system instead of ironing out fluctuations.

From the standpoint of Morgan history, the significant aspect of Black Monday was the lack of any overt role in a rescue. *That* was the big script difference from 1929—the absence of a bankers' rescue. President Reagan, eager to echo Hoover, said, "the underlying economy remains sound."[16] John Phelan, the New York Stock Exchange chairman, played the Richard Whitney role, debating with advisers about whether to close the Exchange. There were again stock buybacks and early Exchange closings to deal with paperwork. But no bankers marched up the steps of 23 Wall. Phelan consulted mostly with William Schreyer of Merrill Lynch and John Gutfreund of Salomon Brothers—not with Morgan Stanley—reflecting the new importance of trading and retail houses, rank outsiders to the club in 1929.

The Federal Reserve moved with a dispatch that left no doubt as to its resolve. On October 20, Alan Greenspan issued a tersely effective statement affirming the Fed's "readiness to serve as a source of liquidity to support the economic and financial system."[17] The Fed bought dollars and engineered a sharp drop in interest rates. E. Gerald Corrigan, president of the New York Fed, personally pleaded with banks to continue lending to sound securities firms. Some New York Stock Exchange specialists ended Black Monday with bloated stock inventories as they tried to stem the decline, and they were floated by their chief lenders, including Morgan Guaranty, Manufacturers Hanover, and the Bank of New York. The Fed acted admirably; Wall Street no longer needed a House of Morgan, which couldn't have coped with a crisis of such magnitude. As Continental Illinois had showed, private rescues were passe in huge, unfettered global markets. There would never be another financier who bulked as large as Pierpont Morgan or Tom Lamont.

The crash exposed underwriting hazards of a sort forgotten during the bull market. In November 1987, when the British government sold its 32-percent stake in British Petroleum, investors couldn't absorb this mammoth $13.2-billion issue so soon after Black Monday. Four U.S. underwriters—Morgan Stanley, Goldman, Sachs; Salomon Brothers; and Shearson Lehman—stared at $350 million in paper losses. Disaster was averted when the Bank of England agreed to buy back shares at 70 pence per share. Higher oil prices and a Kuwaiti purchase of a 20-percent BP stake then rescued the Bank of England.

After the crash, Main Street again prayed that Wall Street had learned its lesson and gloated over its misery. "It's been a nice week for the have-nots of the world," said a GM auto worker. Stock brokers retired the haloes they had worn for several years. "Before the Crash," bemoaned one broker, "everyone wanted you to meet their daughter. Now we're the scum of the earth."[18] But the hobgoblins of sustained prosperity—consumerism, greed, and speculation—weren't to be slain so quickly. When a *Newsweek* cover asked, "IS THE PARTY OVER?" the unrepentant young staffers at Morgan Stanley used a copy of the glossy page as an invitation to a big bash, with the letters *NFW*—no fucking way—scrawled defiantly across the top.[19] Eric Gleacher, whose merger mill was grinding through two hundred deals at a time, asked, "Why shouldn't it go on?"[20] Morgan Stanley was proudly unscathed by the crash—it even offered to extend credit to one thunderstruck commercial bank—but the staff was shaken by a nearly 20-point drop in the firm's own newly issued stock.

Because the crash didn't usher in a recession, the public wasn't immediately galvanized into reform. Yet financial reform had lagged behind the 1929 crash by three to four years, arising only after prolonged Depression exposed the full economic consequences of the 1920s speculation. The closest analogy to the post-1929 outcry over pools and short selling was the controversy over computerized program trading. Once again there was a tendency to trace the crash to the internal mechanics of the market itself. In January 1988, Merrill Lynch, Shearson Lehman Hutton, and Goldman, Sachs suspended index arbitrage trading for their own accounts. But Morgan Stanley didn't need to worry about angry small investors and exhibited its new renegade stance, despite the fact that Parker Gilbert was a governor of the New York Stock Exchange. It suspended its own "proprietary" program trading only after pressure from Congressman Edward J. Markey's Subcommittee on Telecommunications and Finance. It was also notified by Maurice R. Greenberg, chief executive of the American International Group, a New York insurer, that his firm would cease business with houses that persisted in stock-index arbitrage for their own accounts.

On May 10, 1988, in a splashy coordinated effort, Morgan Stanley, Salomon Brothers, Bear Stearns, Paine Webber, and Kidder, Peabody announced they would stop the practice. Morgan Stanley had apparently orchestrated the move by alerting the others to its plans. Blocked from program trading in the United States, Morgan Stanley then went to Japan that December and caused a furor by introducing the practice there, spurring the Tokyo exchange to a record high. In 1989, it unabashedly led the resumption of program trading among the major firms after only a nine-month hiatus. The question of whether program trading increases volatility is complex and unresolved. What is worth noting is Morgan Stanley's apparent disregard of public opinion and greater willingness to defy financial authorities—behavior conspicuously at odds with Morgan Guaranty's strong sense of corporate citizenship.

If Main Street hoped that Black Monday would throw a cautionary fear into Wall Street, it was dead wrong. It only prodded the Street into more assertive, reckless behavior. Securities firms had already lost many safe, reliable businesses. Brokerage commissions dropped after Mayday in 1975 and underwriting margins shrank after Rule 415 in 1982. Now trading profits plunged with the crash, creating a large contraction in Wall Street and City employment. Mergers already accounted for half of Wall Street's profits, and with the decline of other opportunities, the attraction to such business became irresistible. To help things along, the crash and a weaker dollar created bargain prices for takeovers. And if raiders didn't materialize, Wall Street was prepared to do the raids itself through its new merchant-banking departments and junk bond syndicates.

So many companies had already passed through the merger mill that it was becoming harder to find suitable candidates. Everybody was scrutinizing the same lists, often with the same techniques. One solution was to target industries that by law or custom had been immune to hostile takeovers. Eric Gleacher, and all of Morgan Stanley, now overturned a sacred financial taboo: thou shalt not mount a hostile raid against a bank. It was always thought such raids might shake depositor confidence or jeopardize the dividends of the proverbial widows and orphans who held bank stock. So in the past, bank mergers were either friendly or forced on troubled banks by regulatory authorities.

Shortly before the crash, this etiquette was shattered when the Bank of New York launched a $1-billion raid against Irving Trust. It was a clash of two hoary institutions steeped in history. The Bank of New York was founded by Alexander Hamilton and his associates in 1784—no other bank had operated so long with the same name—while Irving was named after Washington Irving and dated from the mid-nineteenth century. The Bank of New York was advised by Eric Gleacher of Morgan Stanley and H. Rodgin Cohen of Sullivan and Cromwell and Irving Trust by Goldman, Sachs and Morgan Guaranty.

The year-long battle showed just how vicious and merciless Wall Street had become. These were genteel, old-line banks, the sort that pampered rich, elderly clients. Irving was so sleepy that it had sat out the trend for foreign-exchange trading that was a boon to other commercial banks. It seldom fired people and usually gave everybody a fat Christmas bonus equal to 15 percent of salary.

Bank of New York chairman J. Carter Bacot initiated the Irving raid because he feared his own bank would be swallowed by another firm. In their gorgeous art deco headquarters at 1 Wall Street, Irving executives first scoffed at the bid, sure the Fed would never countenance a hostile bank takeover. Gleacher and Cohen correctly predicted that Fed chairman Alan Greenspan would break the precedent. The Bank of New York stalked Irving with lawsuits, proxy fights, and strident exchanges of press releases. After the Bank of New York won, Gleacher quickly threw fear across the economic landscape, telling the press the hostile fight was "a precursor of things to come."[21] The Bank of New York had promised to pay for the takeover through normal attrition. By early 1989, it had begun to fire one hundred people from the foreign side. As an Irving executive said: "The bloodbath has begun."[22] No form of financial marauding was any longer off-limits to Morgan Stanley.

IN the wake of Black Monday, a new spirit was also blowing through 23 Wall. As it evolved from a purely commercial bank into a novel hybrid with many investment banking activities, its character changed. At an opulent postcrash Christmas party, Lew Preston said he was pleased to see so many spouses present, because now they would know that their husbands and wives would be working late over the coming year. At a second reception the next evening, he said he wanted to make sure everyone could hear him because the night before "some people didn't hear me and went home happy."[23] As if to underscore new perils facing the bank, Moody's Investors Service dropped its triple-A rating for J. P. Morgan and Company, the holding company of Morgan Guaranty. Standard and Poor's kept its triple-A rating for the holding company, and both still honored Morgan Guaranty Trust with the only triple-A rating for a large American bank. Moody's action was a small, but noticeable dent in Morgan's shining armor.

As J. P. Morgan and Company grew into a fifteen-thousand-person conglomerate, it tried to preserve the old partnership flavor. New management trainees underwent a rigorous six-month training program meant to acculturate them to the bank. Rarely did 23 Wall recruit from outside, and it spent millions annually on free lunches to promote camaraderie. There remained an ethic of not stealing credit or upstaging colleagues. "The Morgan feeling of collegiality is the most important thing we've got," said former Morgan president Rod Lindsay. Preston regularly sent memos admonishing employees that they worked for clients and the bank, not for themselves. In Lindsay's words, "We don't want people if they're going to be by themselves at the top of the list all the time."[24]

Morgan Guaranty had been much more respectful of tradition than Morgan Stanley or Morgan Grenfell and was recognizably the heir of the old, aristocratic House of Morgan. Yet its unique civility was threatened. The bank was engaged in a full dress rehearsal for the day when it would again be a "universal" bank, like the old House of Morgan. At home, it fused commercial lending and capital market activities into a corporate finance group that was an embryonic investment bank. It specialized in "deals that are sufficiently complex that they don't lend themselves to the commercial paper market," according to Preston.[25] It milked every legal securities business. It dealt in Treasury bonds, underwrote municipal bonds, advised cities, provided stock research and brokerage, and traded in gold bullion, silver, and foreign exchange. It continued to have the fanciest private banking operation, wooing rich customers with ads that promised to relieve their anxiety about possessing $50-million portfolios.

Abroad, Morgans stepped up capital market activity, specializing in interest-rate swaps, currency swaps, and other financial esoterica. It had merchant banks in Japan, Hong Kong, Belgium, and Germany. In London, the headquarters of its global capital markets operation, it spent $500 million to outfit two historic buildings near the Thames—the vacant Guildhall School of Music and Drama and the City of London School for Girls—with vast trading floors. Eventually fifteen hundred employees would work beneath stained-glass windows and timbered ceilings, flanked by busts of Shakespeare and Milton. As Preston noted ruefully, "We may be in the ironic position of becoming a global securities firm without being able to underwrite in our own market."[26]

To mark its emancipation from commercial banking, the House of Morgan increasingly substituted J. P. Morgan in its advertising for Morgan Guaranty, the old—and now shrinking—bank core. Morgan Guaranty Limited in London was rechristened J. P. Morgan Securities. Morgans had to reconstitute commercial bankers as deal makers and market men. It probably spent more on educating employees than any other bank. "We run almost a small university here," said group executive Robert Engel.[27] The bank hoped to maintain its gentlemanly culture by being brainy and innovative. Yet it wasn't clear that new products could be peddled with the old style. A lending officer could be a gentleman or a lady. But what about a currency trader? A takeover artist?

Takeover work was the acid test of the new Morgans. Until the late 1960s, it had provided such advice *gratis* as part of a total package. This informal operation—just a file on buyers and sellers—was offered to clients in exchange for million-dollar deposits. As early as 1973, Morgans had tried to systematize this and even picked up a $600,000 fee for arranging the takeover of Gimbel Brothers by British-American Tobacco. But the operation never got off the ground. As with Morgan Stanley, the bank was hampered by its long client list and found it hard to represent one client without injuring another. As a commercial bank, it still wanted to please everybody.

The problem was glaringly exposed in 1979, when American Express attempted to take over the McGraw-Hill publishing empire. AmEx chairman James D. Robinson III—a Morgan alumnus who'd been an assistant to Tom Gates when he was chairman in the 1960s—turned to the bank to finance the takeover. At first, Robinson thought he could arrange a friendly merger. Instead, he touched off a furious reaction from Harold W. McGraw, Jr., who called in Yerger Johnstone of Morgan Stanley and defense lawyer Martin Lipton and unleashed a blistering counterattack.

McGraw picked up any brickbat at hand. He sued American Express for libel, said it cooperated with the Arab boycott of Israel, asked the Federal Communications Commission and the Federal Trade Commission to study antitrust problems, chastised American Express as a menace to the First Amendment, and raised a dozen other issues, bogus and legitimate. In the ultimate slap, McGraw chided American Express for not paying interest on the float from its traveler's checks.

American Express had planned to borrow $700 million for the merger, with Morgan Guaranty as lead banker. This outraged McGraw, who considered himself a faithful Morgan client. In 1977, Morgan chairman Pat Patterson had thrown a lunch for McGraw to commemorate the fiftieth anniversary of the publisher’s relationship with the bank. In his desk drawer, McGraw still kept a sterling silver cigar box he had received on that occasion.

Now McGraw wondered aloud whether Robinson had deliberately chosen Morgans to rob him of his banker and whether Morgans had leaked confidential information to Robinson. He denounced AmEx for using “its financial power to cause a bank to violate its relationship with a client.”[28] It turned out the Morgan Trust Department held up to 1.8 million shares of McGraw-Hill stock in fiduciary accounts. To vote—or not to vote—the shares would hopelessly enmesh the bank in a conflict of interest. The proposed merger degenerated into such a noisy, unseemly squabble that American Express decided to quit, while Morgan Stanley collected a $1.5-million fee. It was hard to see how the omnipresent Morgan Guaranty could perform hostile takeovers without constantly stirring up a hornet’s nest of lawsuits and client conflicts. At the same time, the bank’s close relations with corporate clients created the potential for a formidable merger department.

In 1985, the Morgan bank formed a separate merger and acquisitions group, piloted by the Cuban-born, Yale-educated Roberto Mendoza. A big, brooding man with a slightly hooded gaze, he looked tougher and more determined than the average Morgan banker. He was more reminiscent of Morgan Stanley deal makers than of the sedate Morgan Guaranty bankers of old. A high-adrenaline type, he liked furious games of midnight tennis and drove his young charges to devise unorthodox deals. Mendoza thought investment banks were gouging clients and was willing to compete with them on price—perhaps the one taboo Wall Street still held sacred. He also thought high fees sometimes warped the judgment of investment bankers. Morgan Guaranty ran ads for its takeover group that needled the Street: “In M&A, clients who require totally objective advice, research free from conflict of interest . . . can rely on one firm. J. P. Morgan.”[29] One ad showed an empty tombstone and said pointedly: “We don’t promote M&A deals just to generate fees.”[30] It would soon pay a price for these holier-than-thou ads.

The bank knew its genteel image hurt in the slash-and-burn takeover game. As Bob Engel said, “When a chairman wakes up in the middle of the night with a phone call from someone saying, ‘We want to buy your company,’ he thinks of Morgan Stanley instead of Morgan Guaranty. It’s going to be a selling job, no question.”[31] Besides the image problem, Morgans faced the reluctance of companies to share secrets with large lending institutions, which might have trouble preserving secrecy or might use information to deny future loans.

By the late 1980s, Preston and Mendoza stated publicly that Morgans would not only back unfriendly raids but might even finance both sides in a takeover, setting up opposing teams. Once J. P. Morgan and Company placed its authority behind hostile raids, Wall Street's transformation seemed complete. The situation was not unlike 1929, when the bank submitted to the fad of forming holding companies with the Alleghany and United Corporation promotions.

Before the crash, Mendoza's department scored small victories but no big, attention-getting deals. Then, in January 1988, Morgans became the first commercial bank to counsel a hostile raider in a billion-dollar deal, advising F. Hoffman-La Roche on its $4.2-billion tender offer for Sterling Drug. The Swiss pharmaceutical company, F. Hoffman-La Roche, did a $6-billion-a-year business. After its Valium patent expired in 1985, it needed new products in order to fill the sales pipeline. Sterling made Bayer aspirin, Phillips milk of magnesia, and many other products. With its cartellike cosiness, the pharmaceutical industry had been ruled by gentleman's agreements and spared bloody takeover wars. This was the first time a large pharmaceutical firm had made a hostile assault against a healthy competitor. Adding to the shock was that J. P. Morgan and Company had been a banker to Sterling Drug for more than fifty years.

Advised by Mendoza, Hoffman-La Roche followed a frenzied raiding strategy known as a bear hug. It made an opening bid of $72 a share for Sterling, then twice stepped up the bid in rapid succession without any formal rejection of the earlier offers. Sterling chairman John M. Pietruski had jolted his firm from its former lethargy and lifted its earnings to healthy double-digit levels. He was consequently irate at Hoffman-La Roche's overture and called in Joe Fogg of Morgan Stanley and Joe Flom of Skadden, Arps as advisers.

Taking a leaf from Harold McGraw, Pietruski let loose a blast that Morgan Guaranty wouldn't soon forget. In an open letter, he said he was "shocked and dismayed by what I consider to be Morgan bank's unethical conduct in aiding and abetting a surprise raid on one of its longtime clients." The bank, he said, was "privy to our most confidential financial information."[32] He laid out their ties of recent years, including borrowing, Morgan work as Sterling's registrar and transfer agent, and Morgan's management of Euromarket issues for Sterling. It was a clever broadside, for Pietruski echoed the language of the old Wall Street, as if shaming the bank with recollection: "How many relationships of trust and confidence do you have to have with a client before you consider not embarking on a course of action that could be detrimental to [his] best interest?"[33]

In an unusual public rejoinder, Lew Preston hinted that the letter was hypocritical bluster crafted by a publicist. "It's kind of interesting that we're still their transfer agent," he said afterward. When the battle was over, Preston elaborated: "That wasn't a letter from the chairman of Sterling. That was a letter written by the investment bankers to embarrass this firm."[34] He disputed the notion that Morgan betrayed a deeply loyal client, noting that Sterling's principal banker was Irving Trust and that 23 Wall had only performed "mechanical functions" for Sterling. For Preston, the surprise was less in the raising of the betrayal issue—obviously anticipated in planning for the takeover—than in the way that Wall Street ganged up to bad-mouth Morgan's handling of the deal.

Indeed, investment bankers believed that Hoffman had made too low an initial bid and only ended up drawing other sharks into the water. Morgan Stanley brought in Kodak as a friendly suitor, and it snatched Sterling away for $89.50 a share. Although Wall Street crowed that Morgan Guaranty had bungled the deal—the glee was scarcely disguised—the bank hinted that Kodak had overpaid. The price was high—twenty-two times Sterling's estimated 1988 earnings. The investment banks, of course, had a vested interest in denigrating the performance of Morgan Guaranty, which was poaching on their territory. They were especially incensed when Mendoza charged a paltry $1 million for the losing effort, surely the most unforgivable sin of all.

Clearly, Morgans considered Hoffman-La Roche a much closer and more profitable client than Sterling Drug. But was this to be the new standard for choosing targets? Would the bank feed off stronger clients at the expense of weaker ones? Would it sacrifice those deemed less important? Then who would trust the bank in the future? The controversy also highlighted the multiple possibilities for conflicts of interest as big banks conducted raids. For instance, as transfer agent for Sterling Drug, Morgan Guaranty held its confidential shareholder list—information invaluable to any raider. (Later that year, the Morgan bank sold its shareholder service operation to First Chicago, terminating a corporate trust business over a century old. Preston denied a Sterling link, although such shareholder work was clearly incompatible with merger activity.) Even as the bank invoked its internal controls for protecting confidential information, it was encouraging loan officers to pass along ideas to the Mendoza team in its "one bank" concept of teamwork.

Lest McGraw-Hill or Sterling seem a freak, the bank again ran into trouble in April 1988. James R. Houghton, chairman of Corning Glass, announced an agreement to acquire International Clinical Labs, Incorporated, for $26 a share. A stout opponent of hostile deals, Houghton thought this deal was done and used Morgan Guaranty as his depository and lender. Then Smithkline Beckman unveiled a surprise bid, quickly kicking up the price to a winning $37 a share. The defeated Houghton was stunned: Smithkline's adviser was his own stalwart banker, Morgan Guaranty. More shocking was that Houghton sat on the Morgan board! On the eve of Morgan's annual meeting, Houghton threatened to resign and was pacified only after a talk with Lew Preston. Again, Morgan earned more by advising Smithkline than by being depository for Corning. But was this short-term calculus to be the new operating standard? Would the bank auction itself off to the highest bidder? It was moving toward a two-tier structure in which it coddled the larger clients and sacrificed the smaller. And in this, it was beginning—just beginning—to resemble the rest of Wall Street, which had now operated that way for many years.

CHAPTER THIRTY-SIX
SKYSCRAPER

IN 1989, Morgan Stanley, with sixty-four hundred employees, occupied seventeen floors of the Exxon Building on Sixth Avenue—more than Exxon itself. The building was now owned by a Mitsui unit. Stepping off the elevator into the thirtieth-floor reception area, one was greeted by a portrait of Jack Morgan and glimpses of old rolltop desks salvaged by now-retired partners. In the posh dining room, with its well-spaced tables and leather armchairs, uniformed waiters served Madeira or dry sherry, but (by Morgan tradition) no hard liquor. Such touches aside, the new Morgan Stanley—bold, rich, swaggering—had little in common with the mandarin firm that started life in September 1935 in a flower-banked room at 2 Wall Street.

Instead of underwriting, Morgan Stanley now stressed takeovers and merchant banking. After the crash, it de-emphasized securities distribution and edged out dozens of managing directors, largely from the sales and trading side. In 1988, Merrill Lynch, once scorned as plebeian, led domestic underwriters for the first time as Morgan Stanley slumped to sixth place. Morgan mostly pursued junk bonds, now the most profitable form of underwriting and an indispensable adjunct to takeover work. When Drexel Burnham lost ground with the investigation into junk bond king Michael Milken, Morgan Stanley briefly emerged as the top junk bond firm in America! Did the ghosts of Pierpont, Jack, and Harry Morgan shudder?

Morgan Stanley was an undoubted success story, an awesome performer. For over fifty years, it had stood at or near the peak of investment banking—a claim no other firm except First Boston could make. It had survived every competitive threat. Smart, with an uncanny surefire strategic sense, it alone seemed immune to the postcrash blues on Wall Street. In 1987, it was the one publicly traded securities house to boost earnings. As if invincible, it lifted the pay of its five top executives to about the $3-million mark, so that each made more than the chairmen at rival firms; Parker Gilbert was paid $4.4 million in salary and bonus. It registered $395 million in profits for 1988—an extraordinary 71-percent rise in a sluggish trading environment. At the same time, it had avoided the chronic dissension that debilitated many rivals.

Yet for all its astounding success, the Morgan Stanley story was profoundly troubling. It had followed a flawless instinct for profit into ever-riskier activities with greater potential hazard for the nation’s economy. As the 1980s ended, it resembled an industrial holding company more than a financial services firm. It had stakes in forty companies with over $7 billion in assets and seventy-two thousand employees. Morgan Stanley was suddenly a part owner of food chains and paper mills, textile plants and airplane-engine makers. These investments were reaping 40-percent returns and foreshadowed an even stronger tilt toward merchant banking and away from the trading and distribution of securities in New York, London, and Tokyo that had been the firm's salvation in the 1980s.

In the 1970s, LBOs had been small, largely friendly deals involving stable, recession-proof companies. Now the sheer scale of institutional money mustered by LBO funds—$25 billion in 1988, or enough to acquire $250 billion worth of companies—created irresistible pressure to take over all kinds of companies. In striking testimony to the speculative bent of American finance, 40 percent of the loan portfolios at large Wall Street banks were going to LBOs. Through pension fund stakes in such activity, corporate America was cannibalizing itself. With so much easy money at their disposal, LBO funds turned to hostile raids and now operated by the same ruthless logic as merger work.

The *reductio ad absurdum* was the $25 billion RJR Nabisco deal, the largest LBO ever. In 1985, Morgan Stanley had represented Nabisco Brands when it was being acquired by R. J. Reynolds; everybody lauded the diversification. Now, three years later, the same people spotted hidden values in busting it up. Along with Drexel Burnham, Merrill Lynch, and Wasserstein, Perella, Eric Gleacher of Morgan Stanley advised Henry Kravis, who defeated an investor group led by RJR Nabisco chief executive F. Ross Johnson and his investment banker, Shearson Lehman.

For a takeover that promised no economic benefit for the company, the RJR Nabisco deal showered bankers with huge rewards—almost $1 billion in fees and expenses. Morgan Stanley came away with a cool $25 million. Like most LBOs, it was executed almost entirely with borrowed money. In return, RJR Nabisco was burdened with over $20 billion in debt. Before it sold a cigarette or a biscuit each year, it was already in the hole for $3 billion in interest payments. It was forced to shoulder debt equal to the combined national debt of Bolivia, Jamaica, Uruguay, Costa Rica, and Honduras. Only ten countries in the world were more indebted. In more innocent days, investment bankers had put companies on a sound footing and jealously guarded their credit rating. Now, even as the Kravis forces toasted their victory, RJR Nabisco bondholders saw their A-rated bonds deteriorate into junk bonds, with $1 billion in value wiped out overnight. And by the summer of 1989, the company had announced plans to fire 1,640 workers as a way to save money to service the oppressive debt burden. That fall, a collapse in the junk bond market suggested that RJR Nabisco had indeed been the era's crowning folly.

In Morgan Stanley's high-risk, high-reward LBO strategy, some observers saw the prelude to a final deal—the firm would sell out to the highest bidder. Its executives had already profited royally from the 1986 public offering, earning tens of millions of dollars apiece; now they would gain a second bonanza. According to one theory, this ultimate deal would await S. Parker Gilbert's stepping down as chairman. As son of a J. P. Morgan partner and stepson of Harold Stanley, the prediction went, he didn't want to be Morgan Stanley's last chairman. The firm was also being rent by turf battles, especially between Dick Fisher and Bob Greenhill, and top people wearied of the infighting.

In another sign of the times, Morgan Stanley ended up in an insider trading scandal second in size only to Ivan Boesky's. In June 1986, Morgan Stanley hired Stephen Sui-Kuan Wang, Jr., who had recently left the University of Illinois, evidently without graduating. Wang, twenty-four, was first assigned to the LBO division, then in March 1987 was moved over to mergers.

In mid-1987, Wang was coaxed into an insider trading scheme by a Taiwanese investor named Fred Lee. From July 1987 to April 1988—undeterred by the crash—Wang fed Lee tips on twenty-five pending deals in exchange for a modest $250,000. Within a year, Wang—young and green—had obtained information on twenty-five proposed takeovers despite his personal lack of involvement in many of them. He started his criminal career right after the extensive publicity generated by the Dennis Levine and Ivan Boesky insider trading scandals. Armed with Wang's tips, Lee earned $16.5 million in ten months—while Boesky had taken five years to earn $50 million and Levine had taken five years to make a scant $12.6 million.

Though Morgan Stanley had no criminal involvement, it didn't escape criticism. U.S. District Attorney Rudolph Giuliani said, "You would think there would have been better controls, better procedures."[1] According to affidavits, junior analysts sat in a big space called the bull pen, where they openly discussed their deals. More embarrassing, the brazen Fred Lee had five trading accounts at Morgan Stanley and routed many trades through the firm itself. His account there showed over $2 million in profit. He frequently visited Morgan Stanley and had even developed an in-house reputation for pestering LBO fund analysts with calls. Morgan Stanley's computers had flagged Lee's trades, but when investigators challenged him on nine of them, he attributed his extraordinary luck to rumors and newspaper stories. The Morgan Stanley investigators swallowed this story, even though the trades occurred right before public announcements and tallied with Morgan Stanley's own deals. Among others, SEC commissioner David Ruder was puzzled by the firm's failure to detect such shameless operators.

In October 1988, Stephen Wang was sentenced to three years in federal prison, Federal District Judge Kevin T. Duffy telling him, "You had a brilliant future and you blew it on greed. . . . The first time you could have been a crook, you were."[2] Lee remained a fugitive from justice. Public reaction to the Wang case differed markedly from that to the Adrian Antoniu case early in the decade. Once again, the press noted the prestige of Morgan Stanley, but without the same sense of disbelief, the mournful sense of a smashed idol, that accompanied the earlier news. The firm had squandered its moral franchise. Morgan Stanley was now another big, wealthy Wall Street house out to make a buck and was distinguished only by the fact that it did so better than anybody else.

INSIDE 23 Great Winchester Street, Morgan Grenfell hardly seemed in ferment. With its green carpets and ornately framed portraits on pale yellow walls, it maintained its aristocratic dignity. Yet Morgan Grenfell was fighting for its future. After Guinness, it hired John Craven as chief executive, buying his boutique firm, Phoenix Securities, for $25 million and giving him a 5-percent stake in Morgan Grenfell. He already had several ports of call on his crowded résumé. A protégé of Sir Siegmund Warburg, he had been chairman of Crédit Suisse White Weld and Merrill Lynch International. He had quit Merrill after confronting then-chairman Don Regan over what he saw as meddling from New York. Creating and operating Phoenix Securities from his Chelsea home, he engineered two dozen Big Bang mergers and emerged as the deal maker's deal maker. Handsome, demanding, and restless, he didn't pass a full week in England in 1986 and crisscrossed the Atlantic forty times.

Although Craven envisioned Morgan Grenfell as a global investment bank on the American model, the firm wouldn't fulfill his goals. Unlike Morgan Stanley and Morgan Guaranty, 23 Great Winchester had gone too long without a carefully conceived strategy. The world of securities trading had been too alien to its former leadership. It hadn't anticipated change or focused the scattered energies of the firm. In retrospect, it had erred fatally by spurning its Morgan brethren at Bermuda in the early 1970s. It had sacrificed that one inestimable advantage—its association with the American House of Morgan.

Worst of all, distracted by the casual riches of takeovers, it had moved gingerly in preparing for Big Bang and gotten stuck with bit players. It never established a major presence in trading gilts (British government bonds) or equities. The firm's takeover clients never broadened their business to the firm's weak securities side. Craven himself had sounded warnings of disaster in the overcrowded London markets after the drop in share volume that followed Black Monday. Morgan Grenfell's trading rooms were bleeding the firm.

On December 6, 1988, Morgan Grenfell abruptly shut its securities operation, ending its chances of becoming an integrated global investment bank. There was a wholesale firing of 450 people, or a quarter of its entire payroll—one of the biggest sackings in City history. Some traders had earned £200,000 a year (about $370,000), and their fate underscored the City's transient wealth. Even the method of their dismissal was emblematic: by an accidental leak, the news first appeared on their trading screens. To offset the leak, the firm rushed out an announcement as people arrived for work. In this confused situation, some gilt traders continued dealing for an hour, unaware that they were jobless. Though Craven handled the massacre with commendable tact, arranging generous severance packages, it was a terrible blow to Morgan Grenfell. For the City, this biggest firing since Big Bang was a thunderclap that symbolically closed the frantic 1980s. In March 1989, John Craven announced a loss for 1988—perhaps the first in Morgan Grenfell's 151-year history.

The modern world wasn't charitable to capital-short banks, and Morgan Grenfell was stuck in that perilous middle rut. It still had a collection of choice businesses, especially the booming merger and global-asset-management departments. It had bought C. J. Lawrence in New York, an excellent institutional research and brokerage firm, which it merged with its American operation. Thanks to strength in export and project finance, it had over $600 million in government-guaranteed loans to strengthen its balance sheet. Finally, as a specialist in financing trade with the Soviet Union, it was the merchant bank best poised to capitalize on *perestroika.* And Craven moved aggressively to capitalize on such assets. Yet without a securities operation, these strengths didn't coalesce into a modern global bank.

Sheared of its money-losing securities business, Morgan Grenfell suddenly looked like a takeover target. Many City cynics suspected that Craven, an inveterate job hopper and shrewd deal maker, had a mandate to make the investment bank's strategy work or else auction off the firm. "I think John's goal is to turn Morgan Grenfell around, get it in shape, and then sell it, probably to Deutsche Bank," a friend remarked. (Deutsche Bank had bought a 4.9-percent stake in 1984.) "He's a bulldog—he won't let anything slip out of his bite." Morgan Grenfell had long been protected by loyal institutional shareholders. Yet the day after the crash, insurance broker Willis Faber said its one-fifth stake was up for sale. Morgan Grenfell was joining the faithless, rootless world of modern finance.

By 1989, Morgan Grenfell seemed ripe for the taking by bigger rivals. In shedding the bank's securities business and swiftly restoring profitability, Craven only added to its allure as a takeover target. And so the bank that had specialized in hostile takeovers found itself in November the object of an unwelcome embrace from Banque Indosuez of France. Craven brought in Deutsche Bank as a white knight and extracted a rich price for the firm: over

$1.4 billion, or more than twice its book value. This breathtaking bid settled the contest. Craven, the consumate negotiator, became the first foreigner invited onto the Deutsche Bank board. The hoopla was spiked by the grisly slaying of Deutsche Bank head Alfred Herrhausen by terrorists. The generous settlement also obscured the fact that 151 years of noble independence had been suddenly swept away.

OVER fifty years later, J. P. Morgan and Company appeared to have erred in its choice of commercial banking in 1935. If it saved Depression-era jobs, it also burdened the House of Morgan with what proved to be a dying business—wholesale lending. Large companies no longer turned to banks for short-term credit or seasonal lending—activities now relegated to the commercial paper market. So Morgans had gradually undone its history and grown into a hybrid investment bank, much like its rival down the block, Bankers Trust.

The House of Morgan led the fight to repeal Glass-Steagall. Like other banks, it tried to scramble into so many investment bank activities that Congress would have to rubber-stamp the marketplace reality. Lew Preston also believed in making an intellectual case for change, and in 1984 the bank produced a treatise called *Rethinking Glass-Steagall.* One patron was Alan Greenspan, then a Morgan director, who followed Paul Volcker as Fed chairman. “As a director, Greenspan was very instrumental in getting that document out,” said a Morgan insider.

Lew Preston knew that after Rule 415, straight blue-chip underwriting was a less lucrative auction business. The Morgan bank wanted to underwrite corporate bonds mainly to offer customers a full line of financial services. It was also necessary to finance takeovers. Although Morgans was dubbed the Fed’s bank, Preston could never budge Paul Volcker on Glass-Steagall. Still worried about banks performing “risky” securities work, Volcker would reply that he didn’t worry about Morgans, but about three or four other banks. Morgans was also reaping the highest return on equity and assets of any American bank during the Volcker years. “Unfortunately, we were having some pretty good earnings,” Preston conceded, “and so there was skepticism on the part of the Fed chairman.”[3]

Having helped Volcker at least three times—with the Hunt brothers, Continental Illinois, and the Brazil debt rescheduling—Preston fretted about the lack of a *quid pro quo.* A friend of Preston’s noted that “Lew was very close to Volcker in pulling acorns out of the firm. He had broken his back on those three cases. I remember Lew saying, ‘I had a lot of chits on Paul, and yet Paul is still against banks going into the debt markets.’ I’m absolutely positive that Preston felt somewhat betrayed by Volcker.” Other Morgan officials felt they had gained little for being such a model of obedience. As one Morgan insider said bitterly, “I’m tired of being the Fed’s pet.”

As recently as 1984, the *New York Times* had said it would be “a matter of seconds” before Morgan Guaranty and Morgan Stanley got back together if Glass-Steagall fell.[4] Twenty years before, this was indisputable. But as the 1980s progressed, the warmth between the Morgan brethren waned. Young hotshots at Morgan Stanley felt more kinship with the flamboyant Bankers Trust, which specialized in risky trading and merchant banking, than with the austere, circumspect Morgan Guaranty. One could more readily imagine Morgan Guaranty teamed up with Goldman, Sachs than with Morgan Stanley. The two Morgan houses no longer made a natural match and were especially keen adversaries in Tokyo and London.

Investment bankers were fatalistic about Glass-Steagall’s fall. As Fred Whittemore said of Morgan Stanley’s decision to go public in 1986, “We are taking advantage of a 3-to-5 year window, before the banks become full-fledged competitors, to become as large and powerful as quickly as we can.”[5] Morgan Stanley’s LBO war chest and large capital freed it from reliance on commercial banks in financing takeovers. With its new merchant-banking orientation, Morgan Stanley didn’t much care about Glass-Steagall’s demise, which would affect only a small, declining part of its operations. Morgan Stanley managing director Robert A. Gerard warned Congress, in strangely populist tones, that if Glass-Steagall fell, “there will be a vast increase in the concentration of economic power in large banking organizations.”[6] But his firm made only perfunctory moves against what it saw as a largely irrelevant law.

For commercial banks, exasperation over Glass-Steagall mounted as everything from car loans to mortgages was packaged as securities and placed beyond their reach. Preston quietly chafed at Volcker’s obstinacy. In a *Fortune* article in April 1986, he made a shocking admission: the Morgan bank had considered surrendering its commercial bank charter and simply becoming an investment bank. This would have sacrificed perhaps 20 percent of its business, forcing it to forgo checking accounts and deposit insurance. Although the statement apparently wasn’t a case of clever premeditation, Preston didn’t mind the uproar. Bob Engel reiterated the point: “If we became convinced that we would never get full expanded securities power, we would owe it to our shareholders to reconsider whether we still wanted to be a bank. We could still become a private bank—drop out of the Fed and the payments system.”[7] Some of this was tactical bluster, but it revealed the impatience at 23 Wall.

The 1929 crash had led straight to Glass-Steagall. Ironically, the 1987 crash would prove its undoing, as Black Monday deepened national discontent with

Wall Street. Morgan Stanley and the other big securities houses looked increasingly like a cosy cartel protected by Glass-Steagall —an outcome quite different from that expected by the New Deal reformers, who wanted to bust up concentrated Wall Street power. Meanwhile, commercial banks were the clear casualties of the 1980s. The Latin American debt crisis showed that lending was now far riskier than trading. The crisis mocked the spirit of Glass-Steagall, which had tried to guarantee the stability of deposit banks. With foreign banks able to underwrite securities in the United States, Glass-Steagall seemed only to penalize American banks and invite them to make rash decisions. With Japan now claiming seven of the world's ten largest banks, this competitive disadvantage was no small matter.

In Senator William Proxmire, chairman of the Senate Banking Committee, the banks found an unexpected ally. He was willing to grant them power to underwrite stocks and bonds provided big commercial and investment banks didn't merge. "Washington does not like the thought of Morgan Guaranty and Morgan Stanley making up after all those years," said the *Economist*.[8] As a J. P. Morgan director for ten years, Alan Greenspan had promised to excuse himself as Fed chairman from decisions affecting the bank. Yet Greenspan was the tutelary spirit behind a partial Glass-Steagall repeal. The banks had already secured permission to underwrite commercial paper and municipal revenue bonds. In January 1989, the Fed added limited powers to float corporate bonds. Among the first five banks streaming through the open gates was J. P. Morgan Securities—easily the largest such operation, with $400 million in capital and seven hundred employees. And in October 1989, it became the first American commercial bank since the Depression to float a corporate debt issue, managing a $30 million bond issue for the Savannah Electric and Power Company.

There was a disquieting side to all this. Would banks soon underwrite corporate raids with junk bonds? Would they palm off Latin American debt on bondholders, as they had in the 1920s? And how would banks insulate depositors from any future risks in securities work? The concerns were genuine. But such problems would have to be dealt with by Congress and the wisdom of bank regulators, for the status quo had become more dangerous to the commercial banks than any risks introduced by expanded securities powers.

The years ahead promise to witness the rise of vast universal banks at home and abroad, the Morgan bank certainly among them. In the view of *Institutional Investor*, commercial banks had "grandiose plans" to become "shimmering financial institutions as omnipotent as the old House of Morgan was prior to Glass-Steagall."[9] J. P. Morgan and Company was now a global entity, not just an American bank operating abroad. Three of its six top executives were non-American, as were half the people in its management-training program in New York. Every high official had served a tour of duty abroad.

By 1989, the bank had outgrown its shrine at 23 Wall. Lew Preston wanted a personal computer on every banker's desk, and trading desks required an exotic jungle of electric wiring. To accommodate a high-tech bank, Morgans bought a new forty-seven-story glass-and-stone tower at 60 Wall Street that was designed by Kevin Roche. It wasn't custom-made for the House of Morgan, as 23 Wall had been. To save time and money, the bank bought a real estate package assembled by developer George Klein. First budgeted at $530 million, the cost overruns at 60 Wall pushed the price up to $830 million. In 1988, the Morgan bank borrowed $400 million from the Dai-Ichi Mutual Life Insurance Company to help finance the new tower. Preston said that he hadn't picked the furnishings for his new office because Dennis Weatherstone might not like them. He thus mischievously telegraphed the message that Weatherstone, self-made son of a London transport worker, would succeed him as the first foreign-born bank chairman on Wall Street. On the eve of the bank's departure for 60 Wall in the summer of 1989, reports circulated that the bank would have to cut ten percent of its work force, or about fifteen hundred people. It was another reminder that the days of paternalism and coddled, lifelong employment were long gone.

TWENTY-THREE Wall had always reflected the House of Morgan. From the moment you stepped through the doors and stood beneath the radiant Louis XV chandelier, with its nineteen hundred crystal pieces, you could feel the self-confidence of the place, the massive weight of tradition. It had a splendid touch of theater about it. As the bank transferred to 60 Wall Street, there was talk of selling 23 Wall, which Lew Preston denied. "It's a monument," he said wistfully. "It's really got no value to anybody except us."[10] The little temple of finance, which had witnessed more history than any American banking house, was now a costly relic from a vanished world of civility.

Would any banking house ever again have the mystery of the old House of Morgan? Probably not. The Morgan partners were adornments of a world too closed and too collusive by today's more egalitarian standards. The spacious vision and cultivation of Tom Lamont, Dwight Morrow, and Russell Leffingwell sprang from a world of small partnerships and few competing sources of financial power. They worked on a quieter, slower Wall Street and could afford to be gentlemen and scholars.

Much of the bank's special flavor derived from its global outlook. As a conduit for capital transfers between America and Europe, the old House of Morgan had naturally looked abroad and was uniquely cosmopolitan at a time when America was still provincial and isolationist. Now the rest of the country had caught up. The Morgan bank’s foreign connections, once incomparable, might today be matched by those of many foreign ministries, central banks, or even multinational corporations. Financial power has become widely dispersed among American, European, and Japanese firms. No single firm will ever again be as lordly or preeminent as the House of Pierpont and Jack Morgan.

The old House of Morgan’s power stemmed from the immature state of government treasuries, companies, and capital markets. It stood sentinel over capital markets that were relatively small and primitive. Today, money has become a commonplace commodity. A company in need of capital can turn to investment banks, commercial banks, or insurance companies; it can raise it through bank loans, bond issues, private placements, or commercial paper; it can draw upon many currencies, many countries, many markets. Money has lost its mystique, and banking, therefore, has lost a bit of its magic.

The Morgan story is the story of modern finance itself. A Pierpont Morgan exercised powers that today are dispersed among vast global banking conglomerates. The activities once performed by a knot of side-whiskered men in mahogany parlors are now spread across trading rooms around the world. We live in a larger, faster, more anonymous age. There will be more deals done and more fortunes made, but there will never be another barony like the House of Morgan.

ACKNOWLEDGMENTS

Although I didn’t realize it at first, this was a propitious time in which to write a history of the House of Morgan, perhaps the first time anyone could do it justice. Secrecy has always been a Morgan fetish, and almost all earlier works were based on secondary sources and some guesswork. In recent years, however, new archives have opened up, offering a clear glimpse into the shrouded Morgan world and allowing a more authoritative account. As members of a private bank before 1940, Morgan partners had a proprietary feeling toward their papers and freely donated them to educational institutions. Consequently, the bank has lost control over much of its own records for the pre-World War II period—a curious and, I suspect, uncomfortable situation for such a secretive institution.

The life of Pierpont Morgan has inspired about ten books—and merits the attention. He is a figure of inexhaustible fascination. But the post-1913 history of the bank has remained virgin territory, even though it was the heyday of global Morgan power. Only a thin, academic volume, published in 1984, chronicles the life of J. P. Morgan, Jr., and I wanted to remedy that extraordinary omission. So while I have done some fresh research on nineteenth-century Morgan history, I have strongly emphasized the bank’s twentieth-century history. The post-World War II story of the three Morgan houses was, mysteriously, a total blank. Hence, this is the first all-inclusive history of the Morgan empire ever to appear.

Luckily, the new archives dovetailed with my emphases. After years of vacillation, Harry S. Morgan finally donated a rich trove of family and business papers to the Pierpont Morgan Library before he died in 1982. Though sketchy in the George Peabody-Junius Morgan-Pierpont Morgan era, it contains a comprehensive set of Jack Morgan’s papers. To this the library has added the papers of Martin Egan, bank publicist of the interwar period. I would like to thank the indispensable David W. Wright, as well as Inge du Pont and Elisabeth Agro of the library for steering me through these materials. And I warmly applaud John P. Morgan II and the Morgan family for allowing me to quote generously from the papers, despite their reservations about my use of some controversial material.

I have drawn heavily on the voluminous Thomas W. Lamont papers at Harvard and the Russell C. Leffingwell papers at Yale. Thanks to the courtesy of his grandson, Daniel P. Davison, I had access to Harry Davison’s cable

book. To a lesser extent, I have used the George W. Perkins papers at Columbia, the Edward R. Stettinius papers at the University of Virginia, and the Dwight W. Morrow papers at Amherst College. I also quote from several oral histories collected at Columbia University, most notably that of George Whitney. I would like to thank the staff members of all these institutions, especially Florence Lathrop at Harvard; Judith Schiff and William Massa at Yale; and Ronald Grele at Columbia. For the post-World War II period, I drew on materials from the Harry S. Truman Library, the Dwight D. Eisenhower Library, the John Fitzgerald Kennedy Library, the Lyndon B. Johnson Library, the Gerald R. Ford Library, and the Jimmy Carter Library.

Together, these unpublished papers offer a vast record of the bank's intrigue over many decades. Delving into such archives, I felt as if I were an explorer hacking his way through a lost continent and uncovering majestic, moss-covered ruins. I hope I have communicated a fraction of my daily excitement. These records do more than merely supply fresh details about familiar events. In many instances, they write brand-new chapters in our history, especially about the bank's dealings with Italy, Germany, Mexico, and Japan. My research strongly convinced me that financial history is a sadly neglected stepchild of the history profession.

Two of the three Morgan banks were receptive to my project. I received the contract for this book right before the Guinness scandal, which threatened to complicate access to Morgan Grenfell people. But when I spent two months in London in 1987, the firm did something extraordinary: they threw open their files to me without restriction. They installed me in a conference room and brought me soot-blackened files from a warehouse near the Thames. I examined records touching on controversies from the early 1900s right up through the 1960s and 1970s. Whether the firm's intention was to show confidence in its integrity after the Guinness scandal or to emphasize its scandal-free years, I do not know. But I was touched and impressed by its generosity. I would especially like to thank Desmond Harney for squiring me about 23 Great Winchester and Kathleen Burk, the Morgan Grenfell historian, who showed a true collegial spirit and sent me three chapters of her official history in galleys. I regret that their late arrival did not permit me to acknowledge her contribution in my footnotes.

J. P. Morgan and Company reacted with some ambivalence to my first appearance, fearing association with the suddenly notorious Morgan Grenfell. Yet here, too, timing worked in my favor, for in shifting toward investment banking, the Morgan bank has adopted a higher profile. Despite an initial reluctance, the bank ended up handling the book with customary polish and set up many appointments, including interviews with every living chairman, past and present. I treasured the bribery of the Morgan lunches, the best publicity weapon ever devised. Fred Allen and Jack Morris were consistently

courteous, intelligent, and professional in rendering assistance. They are a class act. I would also like to thank Melanie Smith for arranging access to the bank's in-house library, which has some fine unpublished memoirs.

Alone among the Morgan banks, Morgan Stanley refused cooperation and wouldn't consent to a single interview. The decision surprised me less than the way it was handled. Both management and publicity man Peter Roche tried to lower an iron curtain around the firm. They discouraged people, current and retired, from talking to me. When I wrote to Parker Gilbert and Dick Fisher deploring this adversarial atmosphere and asking for an explanation, I didn't receive a reply.

I am most grateful to those former Morgan Stanley partners who did cooperate. They were a tremendously impressive group—pound for pound, the most informative and perceptive people I talked to. Many of the interviews lasted several hours and more than compensated for the lack of official cooperation. Far from being disloyal, they performed a real service and enhanced my appreciation of the firm. Their enthusiasm made me doubly regretful of the current leadership's intransigence.

In writing the section on the Casino Age, I performed over a hundred interviews to get an "inside" feel comparable to that of the two earlier sections, which were based on hundreds of books and tens of thousands of unpublished documents. Since Morgan bankers would sooner swallow cyanide tablets than name clients, this was no small feat. A mute breed schooled in confidentiality, they weren't accustomed to talking openly about their business. This makes me especially grateful to the people I interviewed. Some patiently sat through talks that started in the morning and ended at dusk. Others typed out page after page of impressions. I am humbled by their generosity, which I cannot adequately repay. The pleasure of their company was one of the real pleasures of writing the book. I felt privileged to share their reminiscences.

Lest anyone take offense at a misplaced emphasis, I will simply list all those who answered questions in person, by phone, or by mail. My special thanks to the descendants of Jack and Pierpont Morgan, Dwight Morrow, Tom Lamont, George W. Perkins, Harry Davison, Russell Leffingwell, George Whitney, Vivian H. Smith, Teddy Grenfell, Thomas S Gates, Jr., Montagu Norman, Nancy Astor, and Charles Lindbergh for permitting me to quote from their unpublished papers. I owe a special debt to Edward Pulling, Paul and Cecily Pennoyer, and Laura Phillips, who not only answered questions, but permitted me to reprint photographs from their family albums. I especially thank those whose situation required that their names be omitted from the following list of acknowledgments: David Band, John Baylis, David Bendall, Jerry E. Bishop, H. P. K. den Boesterd, A. Bruce Brackenridge, William D. Brewer, James R. Brugger, Dr. Nicola Caiola, Rupert F. J. Carrington, Robert

Carswell, Lord Stephen G. Catto, Randall Caudill, Dorothy B. Colby, Frank W. Colby, J. E. H. (“Tim”) Collins, Edward Costikyan, Daniel P. Davison, Harry Davison II, C. Douglas Dillon, David Douglas-Home, Robert G. Engel, Edgar Felton, Max M. Fisher, John Douglas Forbes, George S. Franklin, Helena Franklin, John B. Fraser, Evan Gal-braith, Robert A. Gerard, Jackson B. Gilbert, S. Hazard Gillespie, Victor Got-baum, Raphael de la Guerronniere, Perry E. Hall, Charles E. A. Hambro, Keith R. Harris, Carl Hathaway, Robert K. Heimann, Robert A. Henderson, Michael Hildesley, Sir David Basil Hill-Wood, Longstreet Hinton, Guy Huntrods, Shiro Inoue, William M. Isaac, Robert Isom, Sir Martin Jacomb, Lord Roy Jenkins, Fred W. Kirby, Corliss Lamont, Edward M. Lamont, Ralph F. Leach, Jerome Levinson, Anne Morrow Lindbergh, Robert V. Lindsay, Jack Loughran, John McDaniels, Luis S. Mendez, John M. Meyer, Jr., Damon Mezzacappa, George S. Moore, Catherine Adams Morgan, Constance Morrow Morgan, Sir Jeremy Morse, Bruce Nichols, Sir Leslie O’Brien, fane Nichols Page, Walter H. Page, Ellmore C. Patterson, the late Frances Tracy Pennoyer, Joseph L. Ponce, Shep-pard Poor, Lewis T. Preston, Thomas L. Pulling, Clifford H. Ramsdell, Charles Rawlinson, Judson P. Reis, William Rhodes, Frank Rosenbach, Eugene Rotberg, George W. Rowe, Charles Ryskamp, William Salomon, David T. Schiff, Frederick H. Scholtz, Anthony M. Solomon, Andrew Spindler, Irvine Sprague, William Sword, David Taylor, Fred Tetzeli, Alexander C. Tomlinson, William D. Toomey, Guido Verbeck, Peter Vermilye, Fred Vinton, Norma Walter, Anthony Weighill, John Weinberg, Christopher Whittington, and Robert J. Wynn.

On the publishing end, I would like to thank my London agent, Deborah Rogers, for her able handling of the manuscript and Nicholas Brealey, editorial director of Simon and Schuster, Limited, for his astute readings of the manuscript. At home, I have enjoyed the steady support of a marvelous group of people. My agent, Melanie Jackson, is the sort writers dream of but seldom find. She has been a Rock of Gibraltar in support, a prodigiously hard worker, and a joy to work with. The book would not have appeared without her. My editor, Morgan Entrekin, had a clear vision of the story from the start and never wavered in his enthusiasm or generosity. He delivered excellent advice and timely shots of adrenaline that sustained me through a long, complicated task. I couldn’t have asked for stronger faith. My parents, Ruth and Israel, provided my only research assistance in the final stages of the book and helped with the mammoth task of collecting photographs. They proved ideally loving, self-sacrificing parents—which I already knew. I owe the largest debt to my saintly wife and lovely muse, Valerie. She had to make room for this sacred monster, the House of Morgan, that suddenly loomed in our midst. She was wise, tender, loving, and solicitous in nursing me through my obsession. Perhaps in the end, the monster devoured us both.

ABBREVIATIONS

AL	*American Lawyer*
AM	*Atlantic Monthly*
B	(London) *Business*
BA	*Barron's*
BE	*Brooklyn Eagle*
BM	*Bankers Magazine*
BW	*Business Week*
CB	*Current Biography*
CH	*Current History*
CUOH	Columbia University Oral History Collection, New York
CUOH-BB	Columbia University Oral History Collection, Boris Bakhmeteff
CUOH-EB	Columbia University Oral History Collection, Eugene Black
CUOH-GR	Columbia University Oral History Collection, George Rublee
CUOH-GW	Columbia University Oral History Collection, George Whitney
CUOH-LR	Columbia University Oral History Collection, Leonard Rist
CUOH-WJS	Columbia University Oral History Collection, William J. Schieffelin
DDE	Dwight D. Eisenhower Library, Abilene, Kansas
DE	(London) *Daily Express*
DH	(London) *Daily Herald*
DT	(London) *Daily Telegraph*
DWM	Dwight W. Morrow Papers, Amherst College Library, Amherst, Massachusetts
E	*Economist*
ERS	Edward R. Stettinius, Sr., Papers, Aldenham Library, University of Virginia, Charlottesville
EU	*Euromoney*
FA	*Foreign Affairs*
FB	*Forbes*
FD	(Hartford) *Financial Digest*
FO	*Fortune*
FT	*Financial Times*
GWP	George W. Perkins Papers, Butler Library, Columbia University
HFJ	*Hartford Financial Journal*
HLS	Herbert L. Satterlee Papers, Pierpont Morgan Library, New York
HPD	Henry P. Davison Cable Book, courtesy of Daniel P. Davison
HST	Harry S. Truman Library, Independence, Missouri
II	*Institutional Investor*
J	(New York) *Journal*

JPMJ	J. P. Morgan, Jr., Papers, Pierpont Morgan Library
JPMS	J. P. Morgan, Sr., Papers, Pierpont Morgan Library
JSM	J. S. Morgan & Co. and George Peabody & Co. Papers, Guildhall Library, London
LBJ	Lyndon Baines Johnson Library, Austin, Texas
ME	Martin Egan Papers, Pierpont Morgan Library
MGR	Morgan Grenfell Papers (1910 to the present)
N	*Newsweek*
NFP	*Newark Free Press*
NY	*New York*
NYDN	(New York) *Daily News*
NYH	*New York Herald*
NYHT	*New York Herald Tribune*
NYK	*New Yorker*
NYT	*New York Times*
NYTR	*New York Tribune*
NYWT	*New York World Telegram*
O	*Observer*
RCL	Russell C. Leffingwell Papers, Sterling Memorial Library, Yale University, New Haven, Connecticut
SEP	*Saturday Evening Post*
ST	(London) *Sunday Telegraph*
T	(London) *Times*
TI	*Time*
TSG	Thomas S. Gates, Jr., Papers, Van Pelt Library, University of Pennsylvania, Philadelphia
TWL	Thomas W. Lamont Papers, Baker Library, Harvard University, Cambridge, Massachusetts
WP	*Washington Post*
WSJ	*Wall Street Journal*

NOTES

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33. Chapple, *George Peabody*, p. 43.
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3. *NYT*, May 25, 1975.
4. *EU*, March 1982.
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8. *NYT*, May 14, 1973.
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19. *NYT*, October 9, 1986.
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4. Lord Stephen G. Catto, interview with author.
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