

Tales from the Deal World

A conversation with the veteran investment banker on M&A and how SOX changed the boardroom.

Peter Solomon has served on 21 boards in his life. He now sits on only one. New independence rules have forced a choice between serving on boards and advising clients, and the choice, he says, is an easy one to make. It is just one more development in the corporate arena and on Wall Street, which Solomon, 68, has studied during his 44-year career. In 1989, he left Lehman Brothers, where he had been chairman of merchant banking, to found his own firm. According to Dealogic, a M&A data firm, so far this year Peter J. Solomon Co. ranks sixth in U.S. M&A advisory for the retail sector. He has also worked two stints in government: first as New York deputy mayor of economic policy and development under Mayor Edward Koch, and then as counselor to the U.S. Treasury in the Carter administration. In a wide ranging interview, Solomon talked with *Directorship* about how the deal world really works, the private-equity sector, his early days at Lehman, and the sometimes chilling impact SOX has had on the boardroom.

Was there a lot of tension between traders and investment bankers at many firms in the early days?

In truth, of course. Goldman Sachs was built by traders to a large extent so they didn't have that tension as much as Lehman. The absence of that dichotomy was very helpful to Goldman Sachs. They did have a lot of problems in the 70s, though. They almost went bankrupt because of Penn Central [which collapsed in 1970, embroiling Goldman in a commercial paper scandal.] But they never had the revolution that occurred at Lehman and some of the other firms because Gus Levy was a trader. He was the number-two person in the firm and in some ways the public persona of the firm. The reason Lew Glucksman [of Lehman] was viewed so badly by the investment bankers was not because he was a trader, but because he almost bankrupted the firm by trades that he didn't tell the partners about in the late 60s and early 70s. He entered into a series of repos. One was IBM Credit Corp. I believe we were forced to take back those securities at a huge loss. I became a partner in 1971. I was net negative at Lehman by 1975. It was a difficult time.

What were those early years at Lehman like and what made them difficult?

We were unincorporated and we were a partnership that had no capital. Incorporation changed Wall Street and then the capital raised by Salomon in 1981 [in an initial public offering] changed it yet again. Those two things forever shifted the relationship between partners because they now were employees and their capital was not at risk. Before that, all the partners of Lehman would sit together in the same room on the third floor so they could keep an eye on each other, because if your partner caused you to lose money there was unlimited personal liability...that was incredible.

How did you end up working in the White House?

[Patrick] Moynihan [the Harvard professor turned senator from New York in the seat now held by Hillary Clinton] had pushed me very hard to go to Washington and I finally called him to turn down the job...and he said, "You're an idiot." And I said, "I really like being called an idiot by the junior senator from New York." He laughed, actually. Then he said, "I want you to go to the White House or to the Treasury...I want you to view this as your PhD in government. A guy like you needs to know how the Treasury and the White House works." And he said there would never be another Democratic president. He saw this as an anomaly. It's going to be very hard to elect a Democrat and you're never going to get another chance to really go to Washington.

Let's talk about the role boards played then, compared to the one boards play today.

I've been on 21 public boards. I'm now on one. There's no question that boards were clubby, but they weren't exclusively clubby, and it doesn't mean that all boards were, either. Some boards were very unclubby, very tormented, very embattled, and very antagonistic. SOX has shined a light on boards. Even under SOX, though, we've had the options scandal so how can you argue that all SOX is appropriate when during this period you have boards committing acts that were totally avoidable?

The point is that boards have changed consider-

ably. Now, I have a lot of opinions, both pro and con. First, I think the increased responsibility of boards is a good thing. Two, I think SOX, like anything, in its first three or four years created a horrendous situation—the time spent covering one’s fanny, looking officious, and the fees of the service firms were outrageous—but like all things, that has settled down.

Why did you leave the boards that you were on?

I have left my boards because I cannot be an investment banker and be independent. But I think you might find—if you were to ask the Phillips Van Heusen board or the Office Depot board if they were better or worse off having someone on their board who really understands your business and has a relationship with you—that they would agree it doesn’t make sense [to limit it]. But if there has to be a bright line, and I can be your investment banker or I can be your board member, what choice do I have?

Is the liability of being on a board overstated?

I believe it’s overstated as long as there’s no self-dealing. So, if you conduct yourself appropriately, you’re protected sufficiently by the rules. I do think there’s an issue and I’ve read a little bit about this. I do think there’s been a change in the role that directors play. They need to be wiser and play more of a role as a monitor.

The average tenure of a board member is two to three times the average tenure of the CEO because CEO tenures are so short. Does that have an effect?

There’s definitely no alignment. I’m a little out of date because I’ve been off boards for the last two or three years, but I didn’t like the tension or the antagonism that I was starting to see between management and the board.

There are fewer investment bankers, or those who understand capital markets, sitting on boards today. Are boards making decisions around M&A without having close counsel?

This is an incredibly important point. Because directors are less experienced in the financial world, there should be someone in the boardroom who says to them, if you start thinking about an LBO, and you bring in a transactional adviser on the financing, they’re more likely to advise you to do an LBO. Why would they do that? Because they get a better fee if they sell you to Carlyle than if they sell you to Gener-

al Motors. For instance, if you do a billion-dollar deal, the adviser gets a one percent fee or \$10 million. But if you sell to KKR or Carlyle, the adviser gets that plus a fee of two or three percent on the financing, so there you are.

The economic cycle has started to turn south. What will happen to all of these financial deals when there is no longer a buyer sitting at the table?

I think you’re starting to see that now. No one knows the timing or place. The risk premium today is 300 to 400 basis points. So while the markets are backing up, it’s still half of what it’s been traditionally. We still have a long way to go. In the LBO business to be specific, companies that have been borrowing are likely to be in violation of their covenants – when those deals go south, those people may be fired, and at least in some cases, put in jail.

We do this every 10 years?

I know, but the firms don’t do anything about it. I guarantee that the guy would have been fired in the past, but today you don’t know. The point is these fellows were making loans earlier this year, giving options, doing a covenant-light deal—a five-to seven-year deal with no covenants. What are they thinking? What are they thinking?

Are there any clear winners or losers?

Not really. At the moment, the Blackstones of the world appear to be the winners because they have other people’s money and they have their loans on top of the bankers’ loans. There are some rumors around...I don’t know this to be true, that the major firms are going back to the LBO guys and saying, “We don’t want these loans on our balance sheets. Take them back.” That is going to be an interesting dance to watch. **D**

