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The Ghosts of Wall Street: A Book Note on the Last Partnerships by Charles Geisst

W. Winborne Boyles

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I. INTRODUCTION

The Last Partnerships by Charles Geisst is a historical account of the birth, development, and eventual transformation of Wall Street’s largest investment-banking partnerships into publicly traded corporations. Geisst attributes the replacement of Wall Street partnerships with public corporations to the American investment banking industry’s increased need for capital in the last half of the twentieth century. This work builds on one of Geisst’s earlier books, Wall Street: A History, in which he provides a chronological summary of investment banking in America. Other authors—notably Roy Smith and Lisa Endlich—have also documented this change in the structure of the investment banking industry. The works of both Roy C. Smith and Lisa Endlich reach the same conclusion as Geisst, but offer unique perspectives. In Comeback: The Restoration of American Banking Power in The New World Economy, Smith looks ahead to the future of the changed banking industry. Goldman Sachs: The Culture of Success by Endlich is a history of the famous firm that also provides an insider’s account of Goldman’s transition from a partnership to a publicly traded corporation.

2. Id.
5. See generally SMITH, supra note 4, at 112-117 (examining the changes taking place in the modern banking world); ENDLICH, supra note 4 (recounting the history of Goldman Sachs and providing a first-hand account of the firm’s decision to become a publicly traded corporation).
6. See infra notes 190-208 and accompanying text.
7. See infra notes 53-72 and accompanying text.
The Last Partnerships by Charles Geisst explores the history of the major Wall Street partnerships and their respective fates. The Last Partnerships first examines these financial firms' early beginnings prior to the Civil War, and then traces their histories through modern times. The book is rich with cultural and political history associated with these partnerships and the individuals that dominated them. Geisst highlights the interplay between these investment firms and the events taking place in the world around them, recounting the occurrences that shaped the firms, and the way in which the banks themselves influenced historical events.

One of the major themes of The Last Partnerships is the process by which the face of the American economy changed so as to bring about the extinction of Wall Street leading partnerships. The disappearance of these financial partnerships began in the late 1960s and was largely complete by 1990. Geisst tracks the historical events that combined to bring about the near-extinction of the investment banking partnerships. The Last Partnerships traces the changes in the American economy, the corporations that made up the economy, and government regulation of the investment banking industry. Through a comprehensive examination of the multi-faceted development of the investment banking industry, Geisst sheds light on how small, one-room offices became large international financial corporations.

9. Id.
10. Id. One such account focuses on the role that the Seligman family played in the famous American writer, Horatio Alger. Geisst, The Last Partnerships, supra note 1, at 49. Alger was apparently impressed with the way in which the family sought to encourage an individual's ability to work up to wealth from poverty while he served as a tutor in the Seligman home. Id. This rags-to-riches ideal was a theme in many of the famous writer's novels. Id.
11. See infra notes 23-36 and accompanying text.
14. See infra notes 73-189 and accompanying text.
15. Id.
16. See, e.g., Geisst, The Last Partnerships, supra note 1, at 282-313 (dealing with the humble beginnings, subsequent growth, and eventual sale of Goldman...
This book review traces the decline of Wall Street's investment banking partnerships in the latter part of the twentieth century, as described by Geisst in *The Last Partnerships*, as well as in other related works. Part II provides an overview of these partnerships' roles in American history.\(^\text{17}\) Parts III and IV describe the investment banking industry as well as the difference between banks organized as partnerships and those that are publicly traded corporations.\(^\text{18}\) Part V examines the changing American economy after World War II, and the way in which economic changes affected investment partnerships.\(^\text{19}\) The beginning of the partnerships' decline and the economic situation of the 1970s are outlined in Part VI and VII.\(^\text{20}\) Government regulations on the securities industry and their consequences for partnerships are addressed in Parts VIII and IX.\(^\text{21}\) Part X deals with the absorption of investment banks into large corporations.\(^\text{22}\)

II. THE ROLE OF WALL STREET'S PARTNERSHIPS IN AMERICAN HISTORY

*The Last Partnerships* emphasizes the way in which Wall Street's financial partnerships helped shape American history.\(^\text{23}\) The partnerships contributed financially to war efforts, funded the arts, and produced popular icons.\(^\text{24}\) Geisst provides an interesting contrast between these once-powerful firms and their eventual powerlessness in the face of the economy that they once controlled.\(^\text{25}\)

The influence of Wall Street's partnerships is particularly apparent in American military history, specifically in their assistance in financing many of America's war efforts.\(^\text{26}\) The role of investment bankers in American military history began during

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17. *See infra* notes 23-36 and accompanying text.
18. *See infra* notes 37-72 and accompanying text.
19. *See infra* notes 73-95 and accompanying text.
20. *See infra* notes 96-138 and accompanying text.
21. *See infra* notes 139-189 and accompanying text.
22. *See infra* notes 190-208 and accompanying text.
24. *Id.* at 314-16.
25. *Id.* at 315-16.
26. *Id.* at 3-6.
the War of 1812. S. & M. Allen & Co. sold lottery tickets for the United States Treasury to help raise funds for the war effort. During the Civil War, investment bankers assisted both the Union and the Confederacy. The Union relied heavily on revenue generated by bonds first issued by the treasury and then sold to the public by investment bankers. During World War I, the Allies capitalized on the investment bankers' ability to raise funds. Wall Street partnerships were successful in their efforts to generate capital for military funding, and provided the nation with firm financial backing in troubled times.

Investment partnerships also contributed to America's cultural development. The Metropolitan Opera and the Metropolitan Museum of Art, as well as many other cultural establishments enjoyed significant contributions from successful members of these partnerships. Wall Street personalities also received significant attention in the press and in popular culture.

The Last Partnerships examines Wall Street's considerable contributions to America in great detail, addressing the varied arenas in which they changed society and shaped history.

27. Id. at 11.
28. Id.
29. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 50. Henry Lehman helped the South to break the Union naval blockade and also attempted a relief effort for southern prisoners of war. Id.
30. Id. at 28. Jay Cooke assisted the Union through a number of bond issues. Id. One such issue, made on behalf of the Treasury, generated $500 million and was the largest issue to date. Id. at 27-28. Cooke, however, fell victim to criticism for the commissions he collected from the bond sales. Id.
31. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 3. Jack Morgan, at the request of the British Ambassador, helped the United Kingdom finance its war effort and also orchestrated the Anglo-French loan of 1915. Id. at 188.
32. Id. at 5.
33. Id. at 1.
34. Id. at 1 ("The names on the buildings of many college campuses read like a Who's Who of banking, especially those names famous before World War II.").
35. Id. at 2. Clarence Dillon was such a celebrity that one of his nicknames, "The Wolf of Wall St.," was the title of a popular movie in the 1920's. Id. The "robber barons" of the 1920's were also sources of attention for popular culture. Id.
36. See supra notes 23-35 and accompanying text.
III. THE INVESTMENT-BANKING INDUSTRY

The Last Partnerships focuses on the Wall Street firms commonly known as investment banks. Investment banks inform corporations and governments about finance and strategy. Investment banks typically advise on methods for raising capital, issuing stock, and pricing new issue. Investment banks also provide advice on mergers and acquisitions and assist with documentation of private and public offerings of stock. These firms also underwrite the issue of new stock for sale to investors. Changes in the financial industry have led such firms to expand the services that they offer. Larger investment banks often have trading, sales, wealth management, and compliance departments, enabling them to perform a wide array of financial services. These firms play an important role in corporate finance and in our economy generally.

IV. PARTNERSHIPS & CORPORATIONS

The Last Partnerships illustrates how investment-banking firms, as underwriters of new stock and bond issues, assumed increasingly larger amounts of risk as the economy expanded. The book then goes on to explain how firms, in purchasing these ever-growing securities issues, bore the burden of assuming more financial responsibility for the offered security until it was sold.

37. See generally Geist, The Last Partnerships, supra note 1.
39. Id.
40. Id. at 2. Such documentation often includes registration with the SEC as well as preparation of a prospectus that evaluates the company’s financial health, potential risks, and other disclosures required by the SEC. Kenneth M. Morris & Virginia B. Morris, The Wall Street Journal Guide to Understanding Money & Investing 42 (1999).
41. Morris & Morris, supra note 40, at 42.
42. Veale, supra note 38, at 1.
43. Geist, The Last Partnerships, supra note 1, at 8. Firms that offer diverse services are called “full service.” Id.
44. Id. at 6-8.
45. Id. at 6. By the late twentieth century, underwriting, block-trading deals, and mergers could individually be larger than the U.S. Treasury’s reserves in the 1800’s. Id. at 315.
46. Id. at 6.
Commercial banks provided the cash necessary to complete transactions such as underwriting, but partnerships needed equity to secure the short-term loans that were required as collateral for such transactions. Geisst stresses the fact that in order for partnerships to survive in the progressively competitive securities underwriting business, firms needed capital both to succeed and to survive. During the latter part of the twentieth century, investment-banking partnerships responded to their capital shortages by becoming publicly traded corporations. Corporations can raise needed capital through the issue of corporate stock for sale to outside investors. In contrast, partnerships must rely on the assets base of their partners. The Last Partnerships attributes both the strengths and weaknesses of partnerships to their limited and controlled capital.

In her book that discusses Goldman's decision to become a public corporation, Endlich makes clear that partnerships have advantages and disadvantages. Specifically, becoming a public corporation greatly affects a firm's privacy as well as the investors' risk exposure. Partnerships have the advantage of privacy. They are not required to publish their earnings, and business decisions are not in open view for media critique. Neither the internal workings of a partnership nor the problems it may experience are public information. Unlimited risk exposure, however, is the price a partnership pays for this privacy.

47. Id.
48. Id.
49. See infra notes 96-189 and accompanying text.
50. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 315-316.
51. Id. at 314.
52. Id.
53. ENDLICH, supra note 4, at 10.
54. See infra notes 55-72 and accompanying text.
55. See infra notes 56-57 and accompanying text.
56. ENDLICH, supra note 4, at 10. In discussions held at Goldman Sachs prior to their decision to go public, partners discussed the issue of privacy and were pleased that the firm's earning were not held to public scrutiny. Id. at 10; see also Rivanna Trawlers v. Thompson Trawlers, 840 F.2d 236 (4th Cir. 1988) (holding that general partnerships are not typically classified as securities).
57. ENDLICH, supra note 4, at 10.
58. Id.
stand to lose all that they have invested in a partnership because of the partnership’s inherent exposure to personal liability.  

In Goldman Sachs: The Culture of Success, Lisa Endlich’s first-hand account of her experience at Goldman—both as an investment banking partnership and as a corporation—stresses that incorporation dramatically alters the management structure and business objectives of a securities firm. First, it does away with the title and status associated with being a partner. Instead of partners, public corporations have managing directors who do not have a personal ownership interest in the firm; ownership interest in corporations is in the form of stock ownership. Further, partnerships do not have to answer to shareholders and the value of their equity in the partnership is not subject to market fluctuations. Thus, a partnership firm is free to focus on long-term gain without regard for quarterly earnings or shareholder demands. Culturally, such freedom is especially important to investment firms with a strong focus on client needs. Partnerships are free to make decisions that are in the best interests of their clients but at odds with short-term profits; corporations, however, must ultimately choose a balance between shareholders and clients. A partnership has the freedom to manage its own affairs, while corporations sometimes do not. This freedom is advantageous because it simplifies the complex world of investment banking.

Finally, Goldman Sachs: The Culture of Success examines the effects that a firm’s status, as either public or private, has on its ability to recruit. Endlich especially stresses the unfortunate plight of partnerships that went public later than others. As a recruiting

59. Id.
60. Id. at 237.
61. Id. at 235. “The partnership gave Goldman Sachs a very real edge in recruiting, and the motivation it provided was unmatched at public companies. People stayed at the firm... hoping one day to receive an offer of a partnership.” Id. at 12.
62. ENDLICH, supra note 4, at 235.
63. Id. at 10.
64. Id. at 12.
65. Id.
66. Id. at 12.
67. ENDLICH, supra note 4, at 12.
68. Id.
69. Id. at 235.
tool, the publicly traded firms effectively lured away the non-partner, vice-presidents from partnerships with the more prestigious title, and typically higher salary, of a managing director in the incorporated firm.\textsuperscript{70} Partnerships, however, found it difficult to attract managing directors from incorporated firms that they were not willing to enlist as a partner.\textsuperscript{71} The difficulty arose from the fact that transferring from the position of managing director in a corporation to vice-president in a partnership was considered a step down.\textsuperscript{72}

V. SEEDS OF CHANGE

In The Last Partnerships, Geisst stresses the need for capital in the post-World War II American economy as a major force in bringing about widespread incorporation of Wall Street financial institutions.\textsuperscript{73} The postwar economic boom of the 1950s was, at that time, unparalleled in American history.\textsuperscript{74} Unlike the boom of the 1920s, the 1950s economic expansion was founded on strong economic fundamentals that permanently expanded the nation's economy.\textsuperscript{75} American consumption expanded and American households experienced increased material success.\textsuperscript{76} This increased prosperity amongst the general public sparked increasing investment in the stock market.\textsuperscript{77} Small, individual shareholders grew in number, and mutual fund investments soared.\textsuperscript{78} The number of retail investors purchasing securities doubled between 1949 and 1959.\textsuperscript{79} The bull market began in 1952 with Eisenhower's presidential victory and continued for fifteen years.\textsuperscript{80}

\begin{itemize}
\item \textsuperscript{70} Id.
\item \textsuperscript{71} Id.
\item \textsuperscript{72} Id.
\item \textsuperscript{73} GEISST, THE LAST PARTNERSHIPS, supra note 1, at 6.
\item \textsuperscript{74} GEISST, WALL STREET, supra note 3, at 273.
\item \textsuperscript{75} Id.
\item \textsuperscript{76} Id. The material success of America at that time was reflected in America's choice in reading. Id. at 274. Vance Packard's book, The Status Seekers, became a national bestseller. Id. at 274; VANCE PACKARD, THE STATUS SEEKERS (1961).
\item \textsuperscript{77} GEISST, WALL STREET, supra note 3, at 274.
\item \textsuperscript{78} Id.
\item \textsuperscript{79} Id. at 280.
\item \textsuperscript{80} Id. at 274.
\end{itemize}
Geisst emphasizes that the change in the American economy did not immediately harm partnerships.\textsuperscript{81} The economic success that began in the 1950s greatly expanded the profits realized on Wall Street.\textsuperscript{82} Stock brokerages increased their sales forces, and the number of investment bankers also increased; both groups doubled in size between 1950 and 1960.\textsuperscript{83} The increasing success of the stock market largely benefited companies with progressive ideas and consequently left some older, more traditional companies behind.\textsuperscript{84} These older public corporations with less-exciting prospects suffered from undervalued stock prices.\textsuperscript{85} On the other hand, some popular corporations during the late-1950s traded at forty to fifty times earnings, and it was soon recognized that the market disparity could easily be exploited.\textsuperscript{86} The potential for bargain takeovers was high in the 1950s and corporate mergers became commonplace.\textsuperscript{87}

In \textit{Wall Street: A History}, Geisst chronicles the mergers of the late 1950s that consolidated many dissimilar corporations into diversified corporate conglomerates.\textsuperscript{88} Regulators typically viewed such mergers with distaste, but most acquisitions passed antitrust regulations because of the diverse enterprises of the newly consolidated entity.\textsuperscript{89} Such corporate conglomerates were popular

\begin{itemize}
\item \textsuperscript{81} Id. at 276-83.
\item \textsuperscript{82} Id. at 277.
\item \textsuperscript{83} GEISST, \textit{WALL STREET}, \textit{supra} note 3, at 277.
\item \textsuperscript{84} Id. at 283. Jones and Laughlin Steel Company was one such older entity with a low stock price. \textit{Id.} It was acquired by the Ling-Temco-Vaught (LTV) corporation in the late 1950's. \textit{Id.} at 285. Companies whose stock price increased were involved in the production of items such as television, air conditioning, and records. \textit{Id.}
\item \textsuperscript{85} Id. at 283.
\item \textsuperscript{86} Id. For example, Litton Industries began acquiring companies both inside of the electronics and outside of it. \textit{Id.} Litton was soon known as one of the first conglomerates. \textit{Id.}
\item \textsuperscript{87} Id. at 283.
\item \textsuperscript{88} Id. at 283-84. International Telephone and Telegraph (ITT) and Ling-Temco-Vaught (LTV) were notable conglomerates formed during this period. \textit{Id.} ITT purchased Hartford Insurance Co. as well as Sheraton Hotels. \textit{Id.} at 286.
\item \textsuperscript{89} GEISST, \textit{WALL STREET}, \textit{supra} note 3, at 284. SEC Chairman Manuel Cohen stated that conglomerates were “one of the very serious problems that is facing the American industrial capital structure... requiring the type of SEC remedies employed after the analogous 1920's merger wave had developed the public utility holding companies.” \textit{Id.}
\end{itemize}
amongst investors because of the stability typically associated with diversified corporate activities. Investment bankers realized great profits from the mergers of the 1950s and 1960s, and *Wall Street: A History* describes that period as a prosperous one for securities firms. Investment banks, whose profits were determined by the size of the deal, typically orchestrated the mergers. These mergers were not particularly capital intensive and typically only required advisory services. Because of the limited extent of the investment bankers' role in such mergers, little strain was placed on the assets of the participating partnerships. Unfortunately for partnerships, profitable deals such as these mergers, which placed little strain on capital resources, did not survive the bull market of the 1950s and 1960s.

VI. THE BEAR MARKET OF THE 1970s

Investment banks faced serious problems when the bull market ended in the late 1960s. In *Wall Street: A History*, Geisst identifies four primary difficulties faced by securities firms. First, a lack of investor confidence plagued securities firms. A number of financial firms failed because of customer alienation, fraud, and inefficiency; investor distrust resulted. Second, firms bore heavy financial losses when many customers failed to make margin calls as the market began to fall in the late 1960s. Third, new competition in the investment business was intense, and firms

90. *Id.*
91. *Id.* at 290.
92. *Id.* at 284.
93. *Id.*
94. *Id.* 284.
95. *See infra* notes 96-138 and accompanying text.
96. GEISST, *WALL STREET*, *supra* note 3, at 296. These problems, however, had roots before the actual fall in stock prices. *Id.* In the 1960s, a large number of firms failed because of fraud and inefficiency. *Id.*
97. *See infra* notes 98-104 and accompanying text.
98. GEISST, *WALL STREET*, *supra* note 3, at 296.
99. *Id.* at 297. Blair and Company, Orvis Brothers, Pickard and Company, and McDonnell and Company all failed and were forced to wind down by the New York Stock Exchange. *Id.* at 296.
100. *Id.* at 297. The New York Stock Exchange had established a special reserve to deal with failed margin calls, but the reserve itself was in danger of folding. *Id.*
struggled as the demand for investment services failed to keep up with new competitors entering the market. The fourth and most serious problem that the investment banking industry faced was the rise in market volatility. Market instability made the financial investment industry an increasingly risky business. Market volatility was further compounded by international politics and economics that left the U.S. dollar unstable.

The Last Partnerships makes clear that the capital structure of partnerships was a major factor in bringing about their eventual transformation into publicly traded corporations. Capital was the most needed asset for these partnerships, and an immense and stable capital base became increasingly necessary. The active partners' private equity, which was normally the extent of the capital available to partnerships, was becoming insufficient to meet the business needs of investment banks. The shortage of capital faced by partnerships was compounded by the problem of partners' redeeming or cashing out their partnership investment upon retirement. This occurrence made much-needed capital resources uncertain and unstable as partners neared retirement age.

101. *Id.* at 299. It was during this time in the 1970s that the term "Wall Street" came to include financial institutions outside of lower Manhattan. *Id.* at 300. Many Chicago commodities brokerage firms began to compete with traditional Wall Street investment firms. *Id.* The competition resulted from of the Chicago firms' use of new financial instruments to hedge traditional investment products. *Id.*

102. *Id.* at 299.

103. *Id.* at 299.

104. GEIST, WALL STREET, supra note 3, at 300. During the 1970s, events in the oil industry, combined with U.S. foreign policy decisions, devalued the U.S. dollar. Social unrest from the Vietnam War, coupled with inflation also hurt the U.S. economy. *Id.*

105. *Id.* at 7.

106. *Id.*

107. See supra notes 45-48 and accompanying text.

108. GEIST, THE LAST PARTNERSHIPS, supra note 1, at 256. The problem was put in perspective by W. H. Donaldson, a founder of Donaldson, Lufkin & Jenrette, who said that ninety percent of the capital on Wall Street was held by men over the age of sixty. *Id.* at 226.

109. *Id.* at 256.
In both *The Last Partnerships* and *Wall Street: A History*, Geist identifies the bear market as the beginning of the end for investment firms managed as partnerships. The bear market of the late 1960s laid the foundation for the eventual fall of the Wall Street partnerships. By 1970, the investment firm Goodbody & Co. was on the brink of failure. The firm did not have the mandatory capital requirements, and Goodbody’s back room operations were in complete disarray. There was little hope for the firm’s survival without outside assistance. The firm had been unable to cope with the technological automation requirements for trading stock at that time and was unable to deal with the increased volume of trading. The precarious situation of the firm was significant because Charles Dow, the founder of the Dow Jones Averages, founded Goodbody & Co. in the late nineteenth century. Due to the potential for significant loss in public confidence if this symbolic firm were allowed to fail, great efforts were made to secure outside assistance for Goodbody & Co. The needed assistance came from the well-known, private investment firm, Merrill Lynch. Merrill Lynch purchased the firm for fifteen million dollars, acquiring both Goodbody’s debt, as well as its 200,000 clients.

Geist points out that the problems that necessitated the Goodbody bailout in 1970 were indicative of the changing times that Wall Street firms faced. Like many other partnerships of its time, Goodbody’s backroom was in turmoil, and the firm was

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10. *Id.* at 223–30; *GEISST, WALL STREET*, supra note 3, at 296-327.
12. *Id.* at 225. Donald Regan, chairman of Merrill Lynch in the 1970’s blamed Goodbody & Co.’s failure on its “over-ambitious effort to automate . . . it was trapped in the midst of change: efforts to automate filed while manual procedure was deserted in anticipation of automation’s success.” *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
17. *Id.*
18. *Id.* at 226.
19. *Id.*
20. *Id.*
unable to keep up with the increasing trading volume. Most importantly, Goodbody lacked the capital necessary to sustain its business. Partnerships were simply not capable of handling the demands of the growing economy.

*The Last Partnerships* explains that the Goodbody bailout, combined with the existing market conditions, resulted in Merrill Lynch's decision to go public in 1971, only one year after its purchase of Goodbody. Geisst makes clear that in spite of the firm's status as the largest house on Wall Street, it was unable to cope with the financial pressures exerted on its capital resources. Donald Regan, Merrill Lynch's director remarked on the undercapitalization of the firm:

I can recall myself the day when Merrill Lynch had 117 partners. That made for a huge and unwieldy kind of organization... each year new agreements were drawn up, pored over, and then signed by each of the 117 individuals... whenever there was a need for additional capital the managing partner would go around to each of the partners and ask for additional capital contributions in order to finance Merrill Lynch's growing business.

Merrill Lynch became the first New York Stock Exchange member that was listed on the exchange itself. Additionally, Geisst notes that Merrill Lynch was highly successful after going public. Merrill Lynch reached the top position among Wall Street firms. Its capital resources exceeded

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121. *Geisst, The Last Partnerships*, supra note 1, at 226. "Backroom" refers to the processing of securities transactions, which was done manually by clerks before computers. *Id.* at 223.
122. *Id.* at 226.
123. *Id.*
124. *Id.* at 227.
125. *Id.*
127. *Id.*
128. *Id.* at 227-28.
129. *Id.* at 228. Merrill Lynch was long known as the "thundering herd." *Id.* The firm's advertising slogan: "Merrill Lynch is bullish on America," led to the common misconception that the "thundering herd" nickname was related to bulls. *Id.* Journalists, however, gave the firm this nickname not because of bulls, but rather
$500 million, far ahead of second-place Salomon Brothers. The firm was much larger than its competitors were, with 20,000 employees in 250 offices, and more than 500,000 accounts. Clearly, the firm was thriving as a publicly traded corporation when compared to its partnership competitors.

In both *The Last Partnerships* and *Wall Street: A History*, Geisst makes clear that finance in the 1970s changed as new investment techniques were developed in response to the economic conditions of the time, and competition amongst financial services providers was intensified. As inflation rose in 1974 and 1975, consumers invested less in the stock market and deposited more capital in savings accounts and certificates of deposit, taking advantage of the high interest rates that these methods of asset management offered. Wall Street’s response to the poor economy and consequent decline in stock market investment was money market mutual funds (MMMFs). These funds invested in money markets, such as Treasury bills and commercial bonds. The MMMFs returned more than the interest rate offered by banks on savings accounts and certificates of deposit, thereby resulting in withdrawals from commercial banks and reinvestment in the more profitable MMMFs. The rewards from this much-needed influx of capital to investment banks was not enough to sustain investments with financial firms; MMMFs generated capital for larger investment banks able to advertise to the general public, while the smaller partnerships continued to fail because of their inability to advertise. In 1929, the New York Stock Exchange had 650 partnership members; however, by 1979, approximately 200 members remained.

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130. *Id.*
131. *Id.*
133. GEISST, *WALL STREET*, *supra* note 3, at 309.
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.* at 309.
138. *Id.* at 315.
VIII. GOVERNMENT REGULATION OF THE INDUSTRY

A. Securities Investors Protection Corporation

Geisst recounts that the back room crises that were unfolding in the wake of the bear market of the 1960s and the subsequent failure of securities firms eventually came to the attention of Congress.\(^{139}\) It was clear that without some federal action aimed at addressing these issues, investment firms might go out of business.\(^{140}\) Concerns were based on the assertion that although investments can produce higher profits than bank deposits, the lack of protection for investments might eventually harm the economy.\(^{141}\) Although the federal government provided deposit insurance on deposits made with commercial banks and thrifts, no similar protection was afforded to customer assets or stocks held by investment firms.\(^{142}\) In 1971, Congress enacted the Securities Investors Protection Corporation (SIPC), which functioned as a rough equivalent of the Federal Deposit Insurance Corporation (FDIC) for the securities industry by protecting “accounts at brokers” from fraud and mishandling.\(^{143}\) Clearly, the enactment of SIPC afforded some protection to partnerships and their members, but the legislation would ultimately prove to be insufficient to prevent the unavoidable fate of Wall Street’s major surviving partnerships.\(^ {144}\)

B. SEC Rule 415

The enactment of Securities Exchange Commission (SEC) Rule 415 in 1982 and the changes it brought about in the investment world are stressed in both *Wall Street: A History and*

\(^{139}\) Geisst, *Wall Street*, *supra* note 3, at 297.

\(^{140}\) Id.

\(^{141}\) Id. "As the backroom crisis unfolded, many on Wall Street and in Congress realized that if something was not done to remedy the situation the whole process of raising new capital and trading securities could suffer seriously. Geisst, *The Last Partnerships*, *supra* note 1, at 226-27.

\(^{142}\) Id. at 297.

\(^{143}\) Id. The SPIC did not protect investors from declines in market value. Id.; SEC, Securities Investor Protection Corp. (SIPC), at http://www.sec.gov/answers/sipc.htm (last visited Mar. 4, 2002).

\(^{144}\) See infra notes 161-189 and accompanying text.
The rule made the continued existence of partnerships more difficult. Since the early 1900s, the process by which stocks and bonds were underwritten was a gradual one. Under the traditional system, a company wishing to issue new securities registered with the SEC and then waited a mandatory, three-week period before entering the marketplace. During the mandatory waiting period, the SEC gathered the necessary information before the investment banks were allowed to actively handle the deal. Meanwhile, the lead underwriter assembled whatever syndicate of investment banks was necessary to finance the issue. When the securities were put up for sale, the investment bank could, by virtue of having already assembled its investors, open and close the deal immediately; essentially the issue had been purchased before it was for sale. This process was amenable to the investment banks because they were not required to commit any money to a deal until it closed. Investment banks enjoyed a role in which they assembled investors and then passed the money to the issuer, less their commission. The Last Partnerships emphasizes SEC Rule 415 and the substantial changes it brought about. The rule altered the role of the investment banker as an underwriter as well as the process by which securities were issued for sale. Known as the "shelf registration rule," Rule 415 allowed issuing companies to preregister with the SEC and then wait for favorable market

145. GEISST, WALL STREET, supra note 3, at 332; GEISST, THE LAST PARTNERSHIPS, supra note 1, at 206.
146. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 206-08. Rule 415 was enacted on a trial basis and then was instituted permanently in 1983. SEC, supra note 143.
147. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 205.
148. Id. "The new 'shelf registration' provisions embodied in Rule 415, proved to be more controversial than the SEC had anticipated. . . . The SEC adopted Rule 415 on a permanent basis, but limited its use to 'traditional' types of delayed offerings and to primary offerings." DAVID L. RATNER & THOMAS LEE HAZEN, SECURITIES REGULATION: CASES AND MATERIALS 134 (5th ed. 1991).
149. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 205.
150. Id.
151. Id.
152. Id.
153. Id.
154. See infra notes 156-165 and accompanying text.
155. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 206-07.
conditions for a period of up to two years before actually making the securities available for sale. The three-week period during which investment banks arranged the financing for the issue was abolished. The net effect on investment banks was that they no longer could arrange financing before purchasing the stock. Underwriters were now obligated to purchase new issue before arranging a group of investors willing to buy it. Rule 415 required firms wishing to underwrite new stock and bond issuances to have vast amounts of readily available capital, thus placing additional strain on the investment firms' limited capital resources.

IX. RESPONSE TO GOVERNMENT REGULATION

Rule 415 heavily impacted Morgan Stanley. This old-line firm had long dominated the underwriting business and had helped originate the modern syndicate. The effects of Rule 415 dethroned Morgan Stanley from its position atop securities underwriters, as clients began turning to investment firms that had greater access to capital resources. Largely in reaction to the enactment of Rule 415, Morgan Stanley went public in 1986, selling twenty percent of its partnership equity. The partnership

156. Id. at 206. Money could be raised faster on the Euro market, where registration rules were more relaxed. Geist, Wall Street, supra note 3, at 331-32. “Wall Street need to change its procedures to win back business from the Eurobond market . . . The result was Rule 415.” Id.

157. Geist, Wall Street, supra note 3, at 332.

158. Geist, The Last Partnerships, supra note 1, at 206.

159. Id.

160. See id.

161. Id. Following enactment of the rule, Morgan Stanley fell out of first place in corporate underwriting for the first time in years. Id.

162. Geist, Wall Street, supra note 3, at 332.

163. Id. “Many Wall Street executives noted that a trend was beginning to take even more business away from old-line house. A window of opportunity was open for new, aggressive firms that banked on their expertise rather than tradition.” Id. This change took investors from old-line firms like Morgan Stanley. Id. Long-standing Morgan Stanley client, General Motors, began using other investment banks to underwrite its issue. Id. Solomon Brothers and Merrill Lynch, both no longer partnerships, took the first and second positions as leading underwriters. Geist, The Last Partnerships, supra note 1, at 205; see infra note 16b and accompanying text.

164. Geist, The Last Partnerships, supra note 1, at 207. The offer yielded $292 million. Id. The four leading partners held stock worth approximately $55
crumbled because the firm was unable to meet the capital needs of its underwriting business under the new requirements of SEC Rule 415.165

Chronicling the incorporation of another securities firm, Geisst explains that Salomon Brothers, like other investment banks in the early and mid-eighties, eventually responded to the increasing demand for capital by selling to Phibro Corporation, a commodities trading firm.166 Despite the fact that Salomon had underwritten IBM's 1979 billion-dollar bond issue, the firm recognized that as a partnership, it could not continue to meet the capital demands of the evolving market.167 In describing Salomon's decision to be bought by Phibro Corporation, William Voute, one of the firm's managing directors, remarked that Salomon: "saw the size of the market expanding and the U.S. Treasury needs expanding. We had only in the neighborhood of $300 million in capital, and it was felt that this wasn't enough to bring us into the next century."168 Retirement of Salomon partners also made it difficult to maintain the predictable and permanent capital base necessary for modern investment banking needs.169 Phibro's purchase of Salomon ended the firm's seventy-one year partnership history.170 Salomon's decision to end its existence as a

165. See generally id. at 206-07.
166. Id. at 256.

The merger between the two firms was actually a buyout of Salomon by Phibro. Phibro paid $550 million for Salomon, allowing the partners to take their cash out of the firm. The new holding company became Phibro-Salomon, and the two operating divisions retained their own original names. It was now a publicly traded company. Id. at 256. The new entity had capital of more than $1.7 billion. Id.
167. GEISST, THE LAST PARTNERSHIPS, supra note 1, at 252, 256.
168. Id. at 256 (citing ROBERT SOBEL, SALOMON BROTHERS 1910-1985 9 (1986)).
169. Id.
170. Id. at 256. Phibro control of Salomon ended shortly after Phibro purchased the firm. Id. The dominance ended when the Phibro commodities business collapsed. Id. John Gutfriend, a Salomon partner, orchestrated a reverse buy-out of Phibro. Id. at 257. Salomon then emerged with $65 billion in assets. Id. Gutfriend's tenure as CEO of Salomon was the subject of a best-selling book, Liar's Poker, by Michael Lewis. Id. The book, written by a former trader at the firm, is an insider's account of life at Salomon. Id. It describes wild speculation and personal wagers
partnership on the heels of such success as the IBM bond issue is a
testament to investment bankers' increasing reliance on extensive
capital resources.

Due to the numerous changes in the securities industry that
Geisst describes, the vast majority of Wall Street's major
partnerships had disappeared by 1990.\textsuperscript{171} Two investment banks,
Lazard Feres and Goldman Sachs, managed to maintain their
status as partnerships.\textsuperscript{172} These two traditional firms fought to
preserve their cultures by remaining intact as partnerships.\textsuperscript{173} In
1999, however, Goldman Sachs became a public company.\textsuperscript{174}
Lazard Feres still remains a partnership, but was forced to
consolidate its three separately operating divisions into a single
operation in 2000 in an effort to cut costs.\textsuperscript{175}

The Last Partnerships notes that Goldman Sachs was able
to maintain its status as a partnership for so long because of the
firm's enormous profitability.\textsuperscript{176} Nonetheless, the firm's decision
to withstand the pressure to go public brought about changes in
both the firm's identity and its policies.\textsuperscript{177} In 1989, the capital-
intensive investment banking business accounted for thirty-five
percent of the firm's profits; by 1993, this percentage had slipped
to sixteen percent.\textsuperscript{178} The decline in Goldman's underwriting was
offset by its trading successes.\textsuperscript{179} But, the firm's need for capital
was apparent to the firm's management.\textsuperscript{180} The partnership
agreement was rewritten every two years to keep up with market

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\textsuperscript{171} GEIST, THE LAST PARTNERSHIPS, supra note 1, at 282
\textsuperscript{172} Id.
\textsuperscript{173} See generally id.
\textsuperscript{174} See infra note 185-189 and accompanying text.
\textsuperscript{175} GEIST, THE LAST PARTNERSHIPS, supra note 1, at 313. "Lazard Freres
consolidated its assets as a single, global firm, recognizing that having three separate
operating units even under one chief executive was not feasible in the era of the giant
international financial services company." Id.
\textsuperscript{176} Id. at 307. Goldman's profit in 1986 was $750 million. Id.
\textsuperscript{177} ENDLICH, supra note 4, at 6. Goldman needed more capital to remain
competitive. Id.; see infra note 186 and accompanying text.
\textsuperscript{178} GEIST, THE LAST PARTNERSHIPS, supra note 1, at 303-09.
\textsuperscript{179} Id. at 309.
\textsuperscript{180} Id.
\end{flushleft}
conditions; these agreements contained numerous provisions aimed at maintaining the firm's control over partnership assets.\textsuperscript{181}

Geisst identifies 1994 as the year in which Goldman's fate was made clear.\textsuperscript{182} In that year, the firm sustained heavy trading losses.\textsuperscript{183} Although Goldman had the best reputation on Wall Street, the firm was in jeopardy of falling behind the increasingly global economy if it did not respond to its growing need for capital.\textsuperscript{184} In 1996, John Corzine proposed the idea of a public offering to the partners; the proposal was rejected.\textsuperscript{185} The firm managed to sustain its need for capital with tightened control on the partners' ability to withdraw capital from the partnership.\textsuperscript{186} Although the firm realized enormous profits in 1998, commercial banks targeted Goldman as a potential takeover candidate.\textsuperscript{187} That same year, Goldman Sachs filed a registration statement for the issue of public stock in the firm.\textsuperscript{188} Initially, the sale of the partnership was postponed because of unfavorable market conditions, but in May of 1999, the firm ended its existence as a partnership with an initial public offering on the New York Stock Exchange.\textsuperscript{189}

X. FURTHER CHANGES IN THE INVESTMENT BANKING INDUSTRY

In Comeback: The Restoration of American Banking Power in The New World Economy, Roy Smith describes changes, beyond simple incorporation that took place in the securities

\textsuperscript{181} See generally id.
\textsuperscript{182} Id. at 310.
\textsuperscript{183} GEISST, THE LAST PARTNERSHIPS, supra note 1, at 310. By the end of that year, thirty percent of Goldman's partners had left the partnership, taking their capital with them. Id.
\textsuperscript{184} Id.
\textsuperscript{185} Id.
\textsuperscript{186} Id at 310. The firm policy required partners to place their partnership assets into a capital fund upon retirement. Id. The amount deposited was paid to the retiree over a three-year period. Id.
\textsuperscript{187} GEISST, THE LAST PARTNERSHIPS, supra note 1, at 311. Goldman's profit for 1998 was over one billion dollars. Id.
\textsuperscript{188} Id.
\textsuperscript{189} Id. at 311-12. Goldman sold shares at fifty-three dollars. Id. at 312. It was the second largest IPO ever. Id. The sale of its stock was oversubscribed ten times. Id.
During the 1980s, some publicly traded investment firms became owned and controlled by other large corporations. Parent corporations were both financial and commercial. For example Dean Witter, a brokerage firm, came under the control of Sears Roebuck and Co. in 1981. Donaldson Lufkin and Jenrette became part of Equitable Life Co. in 1985. These diversified conglomerates were viewed as powerful, with diverse offerings of goods and services, as well as highly sophisticated marketing infrastructures. The expectations for the investment banking side of these large conglomerates were high. The anticipated success was based on a belief that the established infrastructure of the parent corporation would be adopted by the investment bank subsidiary and that the result would be increased efficiency. However, the expectations for and the reality of these subsidiaries were not compatible.

Smith identifies the primary reason for the investment banks' inability to excel by virtue of their connection with a parent corporation as the incompatible nature of the two entities. Investment banks, unlike ordinary businesses, rely on their freedom to respond to market fluctuations. A focus on adaptation for short-term gain is a necessary part of any successful investment bank. Successful employees are rewarded early in their careers with bonuses that are very different from ordinary businesses. Further, the cultures of the two entities are entirely at odds. While a typical enterprise is likely to benefit from control and discipline, investment banks succeed from an absence

190. See generally SMITH, supra note 4, at 111–14.
191. Id.
192. Id.
193. Id. at 111.
194. Id. Shearson Lehman was absorbed by American Express (two-step process) in 1979 and 1984. Id. Kidder Peabody became part of General Electric Co. in 1985. Id.
195. SMITH, supra note 4, at 112.
196. Id.
197. Id.
198. Id.
199. See generally id.
200. Id.
201. See generally SMITH, supra note 4, at 112.
202. Id. “Success is rewarded early and often by bonuses unthinkable in industrial companies.” SMITH, supra note 4, at 112.
Therefore, the expected benefits stemming from the parent corporation’s controlling policies and business practices were fundamentally incompatible with their investment bank subsidiaries.

Smith explains that the parent corporations were aware of the disparity between their own business practices and those of their investment banking subsidiaries, and they consequently made efforts not to disturb the subservient corporation’s practices. However, this policy was not stringently followed. Once the investment banks began losing money, parent corporations took measures to control the risks and improve the organizational systems of the financial subsidiaries. The eventual consequence of these parental controls was that many financial affiliates had to call on the controlling corporations for assistance in 1990.

XI. CONCLUSION

The incorporation of Wall Street’s partnerships is not unlike many of the changes that are now dominating the world in which we live. As the world grows smaller, the smaller businesses are disappearing. Geisst emphasizes that the consolidation of industry and mercantilism, coupled with America’s birth as a superpower, has brought in a new era of competition. This new competition places demands on businesses within the marketplace that cannot be met without a large capital base. The disappearing partnerships are like so many other American businesses, which have been forced to incorporate in order to raise the money necessary to compete. However, as Endlich notes, incorporation has led to mixed results for investment banking

203. See generally SMITH, supra note 4, at 112.
204. Id.
205. Id. “Acquirers . . . plan to leave the investment bank alone, to run its own affairs in its own screwed-up way.” SMITH, supra note 4, at 112.
206. Id.
207. SMITH, supra note 4, at 113. “They were playing with Mother’s money, and were quite willing to risk it.” Id. at 112.
208. Id. at 114.
209. See supra notes 45–187 and accompanying text.
210. SMITH, supra note 4.
211. Id.
clients.\textsuperscript{212} Expanded capital bases created by public ownership and secondary offerings has enabled investment bankers to meet the growing demands of the modern economy.\textsuperscript{213} Public ownership, however, must force investment bankers to balance the interest of clients against those of shareholders.\textsuperscript{214} Thus, as Smith notes, the increased abilities of incorporated investment banks come at price.\textsuperscript{215}

Expounding on the propositions set forth in Geisst’s work, Smith carefully notes that uncontrolled growth can yield diminishing returns.\textsuperscript{216} The checkered record of firms that were absorbed into other non-financial institutions indicates that capital, in and of itself, does not necessarily correlate with success.\textsuperscript{217} Accordingly, Wall Street’s financial institutions are likely to resist mergers with more wealthy corporations.

The Last Partnerships examines Wall Street’s partnerships and the major role that they played in the development of America. These partnerships helped to finance wars and to create the modern economy. Ironically, it was the very nature of the partnerships’ businesses that destroyed them. Government controls, coupled with the capital demands of the modern economy, destroyed the partnerships.

W. Winborne Boyles

\textsuperscript{212} See supra notes 45–68 and accompanying text.
\textsuperscript{213} Smith, supra note 4.
\textsuperscript{214} Id.
\textsuperscript{215} Id.
\textsuperscript{216} See supra notes 191-208 and accompanying text.
\textsuperscript{217} Smith, supra note 4.