Procuring Inaction

By Max Holland

Not all corporate CEOs aim to get the federal government to act.

Many CEOs go to Washington to persuade the government *not* to act. They aren't seeking regulatory relief, federal funds, or the passage of a law. They want to ward off Washington, and although it is easier than prodding the capital into activity, it still requires a CEO's time, effort, and sometimes a considerable financial investment.

With the possible exception of the '80s savings and loan debacle, nothing illustrates the pursuit of inaction better than the minuet between Washington and Wall Street over leveraged buyouts. From 1979 to 1989 LBOs grew until the leveraging of RJR Nabisco, the 19th-largest corporation in America. Washington uttered hardly a word; indeed the Reagan administration hailed buyouts as a natural outcome of its *laissez-faire* philosophy. Only following the outcry over RJR did Washington begin a brief and ultimately ineffective investigation.

No investment banking firm profited more from this boom than a relatively small Wall Street house called Kohlberg Kravis Roberts & Company (KKR). And no executive was more responsible for the government's inaction than KKR partner Henry R. Kravis. Kravis, a premier buyout artist, went to the capital as a kind of super CEO, the head of a holding-company empire larger than Texaco, Chrysler, or AT&T. By 1989 KKR controlled dozens of leveraged corporations, including RJR Nabisco, Duracell, and Safeway.

From the mid-1960s to the late '70s, buyouts garnered little attention on Wall Street, Main Street, or on either end of Pennsylvania Avenue. Deals were small and infrequent. But in 1979 KKR engineered the first leveraged buyout of a *Fortune* 500 company – Houdaille Industries, a manufacturer of industrial products. The Securities and Exchange Commission, which regulates the sale of all publicly owned companies, ordered KKR to produce a diagram illustrating the corporate shells and layers of debt needed to carry the buyout. But the SEC's scrutiny was nothing compared to Wall Street's reaction. For about $1 million, a trio of investment bankers had captured a controlling interest in a corporation boasting $400 million in annual sales. As one investment banker recalled, the SEC documents on the buyout "were grabbed up by every firm on Wall Street. That deal showed everybody what could really be done. We all said, 'Holy mackerel, look at this!'"

The Houdaille deal was even more impressive because Kravis and his partners, Jerome Kohlberg Jr. and George R. Roberts, had been in business for only three years. The men had met at Bear, Stearns in the late 1960s, and in 1976 they formed KKR with $120,000 in capital, most of which was Kohlberg's.

Three years after the Houdaille LBO, William E. Simon, who had been Treasury secretary under President Ford, headed a group that bought out Gibson Greetings, a greeting card manufacturer based in Cincinnati, with an investment of about $1 million. Within two years Gibson Greetings went public and Simon's stake of $330,000 was worth more than $66 million. Taking a public corporation private, paying off the buyout debt, and taking the company public again was yielding profits that had Wall Street scrambling to do the "LBO thing."

As buyouts increased, however, they began to attract unwanted attention from Washington. Buyouts had an Achilles' heel: they hinged on the tax treatment of corporate indebtedness. The IRS did not distinguish between debt incurred from building a new plant and debt resulting from a leveraged buyout. The interest payments on both were tax-deductible. In fact, the higher the interest payments the greater the deduction. This meant leveraged companies like Houdaille paid virtually no corporate income taxes for several years. In some instances the post-buyout deductions were so high the U.S. Treasury *owed* leveraged companies huge refunds on previously paid taxes. These tax savings, in turn, provided the safety margin of cash needed to pare down the debt. Or as Treasury Secretary Nicholas F. Brady put it in January 1989, "The substitution of interest charges for pretax income is the mill in which the grist of takeover premiums is ground."

Since these tax savings were central to every deal, buyout artists like Henry Kravis wanted to preserve the tax structure. That meant keeping the House Ways and Means and the Senate Finance committees from changing the tax treatment of corporate debt.

As the LBO phenomenon grew in the early '80s, a critic of corporate indebtedness popped up on the Ways and Means Committee – Democrat Byron L. Dorgan, North Dakota's lone representative. As a former state tax commissioner, Dorgan understood earlier than most of his peers that tax considerations fueled LBOs. In 1982 he proposed amendments that would limit the deduction for corporate debt incurred after a buyout or takeover. KKR, along with dozens of other Wall Street firms involved in corporate restructuring, hired lobbyists and tax lawyers to influence the Ways and Means Committee, derailing Dorgan's initiatives.

Aside from the tax structure, Kravis realized his burgeoning industry depended on the *laissez-faire* economic climate encouraged by the Reagan administration. Indebtedness forced many bloated corporations to become more efficient, and Kravis could point to a number of leveraged companies that seemed better off, including Fred Meyer Inc., an Oregon-based chain of discount stores, Norris Industries, a Los Angeles-based industrial manufacturer, and Golden West Television. But other companies, such as Houdaille Industries, Eaton Leonard Technologies, a California machine-tool company, and the Marley Company, a Kansas construction and manufacturing company, survived indebtedness only by deferring capital investments, slashing work forces, cutting research and development expenditures, or forcing workers to accept wage and benefit concessions. When corporations turned equity into indebtedness, their susceptibility to normal business problems – foreign competition, rising interest rates, and the business cycles – mounted. As John Shad, SEC chairman, observed in 1984, "The more leveraged takeovers and buyouts today, the more bankruptcies tomorrow."

Kravis and others realized that buyouts could be hampered if Democrats won the presidency in 1984. Consequently, maintaining a market unfettered by government became as important as preserving the tax deductions. Such a goal required more involvement and commitment. It's one thing to hire lobbyists to keep an eye on the Ways and Means Committee; it's another to try to keep a sympathetic administration in power. In setting such a goal, Kravis joined Wall Street's long tradition of raising hundreds of thousands of dollars for political candidates. Donations seldom buy votes outright, but they can ensure access to busy lawmakers. As former Montana Democratic Senator Mike Mansfield, a 33-year veteran of Washington, once observed, "If a fellow made a big contribution to me during my campaigns and wanted to see me, I'd see him and I'd listen to him. And I'd convince myself that I wouldn't be swayed by his contribution, but deep down [I'd] feel a little obligation."

Kravis was a minor contributor during 1979-80, giving a total of $3,000 to various candidates for the Republican nomination. Over the next two years, as KKR's deals grew, Kravis's contributions grew to $11,000 and expanded to include Republican senators. By the 1984 elections, he had donated $36,000, becoming one of the Republican Party's top contributors.

Reagan's 1984 win didn't mean there was nothing to worry about from Washington. In 1985 Paul Volcker, chairman of the Federal Reserve, vowed to curtail the issue of junk bonds by shell corporations, a key step in the financial engineering of LBOs. "We spend our days issuing debt and retiring equity, both in record volumes, " said Volcker, "and then we spend our evenings raising each other's eyebrows with gossip about signs of stress in the financial system." Andrew C. Sigler, CEO of Champion International, spoke for many of his *Fortune* 500 brethren when he hailed Volcker's proposal. But *laissez-faire* partisans inside the SEC, the Treasury, and the Justice Department denounced it. Treasury Secretary Donald Regan argued that Volcker would thwart the free market and that if he succeeded he would slam the brakes on a strong economic recovery. Volcker reluctantly backed down, and the way was clear for bigger deals.

In 1986, with an unprecedented injection of junk bonds and scarcely any equity, KKR took the Beatrice food conglomerate private for $6.2 billion. KKR's fee came to $45 million, then the largest transaction fee ever. "I don't think the fees were excessive given the new ground we were breaking," Kravis told *The New York Times*. Size no longer protected a company from a buyout, and the riskier the financial engineering the more enthusiasm a deal seemed to generate on Wall Street. The stock market rose precipitously as investors and arbitrageurs speculated about which corporations were going to be "put into play."

The pace of these events troubled KKR's senior partner, Jerome Kohlberg. After a serious illness he had returned to the firm in 1985, where he found the once-sedate business of buyouts transformed. Kravis and Roberts had learned to do without Kohlberg's guidance, and by May 1987 Kohlberg announced his departure from KKR, commenting on "the overpowering greed that pervades our business life." Without ethics, he warned, "we will kill the golden goose."

Buyout fever raged for five more months, until "Black Monday," the biggest one-day plunge in stock-market history. Although the October 1987 crash no doubt resulted from several factors, to Wall Street buyout artists the sole villain was the House Ways and Means Committee. Byron Dorgan had tentatively persuaded Chairman Dan Rostenkowski to propose a $5 million limit on debt-incurred tax deductions. The news of Rostenkowski's backing was enough to prick a speculative bubble. Fearful of blame for Black Monday, Democrats on Ways and Means abruptly backed away from changing the tax code and became snake-bitten. As Democratic New York Congressman Tom Downey explained, "A number of us agreed that [the proposed curbs] were not only bad for the operations of the free market – they were shaking up Wall Street."

With little more than a year to go before another presidential election, Kravis redoubled his efforts to keep the "right people" – politicians who believed in a free market – in office. After Black Monday and with increasing talk about corporate greed, fueled by Jerome Kohlberg, Kravis believed the unfettered market was in jeopardy. Opinion polls revealed widespread criticism of Wall Street's financial engineering, and Democrats argued that leveraged deals weakened too many companies.

Kravis's favorite candidate in 1988 was George Bush, who, during his vice-presidency, called Kravis for advice on issues such as "corporate debt and what that meant to the private sector," according to *The Money Machine*, a book about KKR by Sarah Bartlett. Kravis signed on as finance co-chairman for the New York Bush-for-President campaign, although Kravis knew Bush was not cut from the same free-market cloth as Ronald Reagan. Whereas Reagan Treasury Secretary Donald Regan was a staunch advocate of *laissez-faire*, Bush' secretary would be Nicholas Brady, a cautious Republican inclined against government intervention but far cozier with corporate chieftains like Andrew Sigler who railed against Kravis.

In December 1987, Kravis hosted a luncheon at Manhattan's Vista Hotel that netted the Bush campaign $500,000. Kravis donated another $12,000 to Bush and $152,000 to an assortment of Republican campaign committees, as well as generous amounts to nine of the 20 members of the Senate Finance Committee. Kravis's wife and KKR colleagues and their wives contributed too, for a total of $418,200. (It was later shown that Kravis exceeded the federal limit on annual donations by $37,000, costing him $8,000 in fines.) The dividend from his support was a candidate more inclined to Kravis's interest than any other Republican or Democrat. There would be no "turning back the clock to the malaise days" of the Carter administration and government over-regulation of the markets, George Bush told a Manhattan audience during the campaign.

That October, just weeks before Bush's election, F. Ross Johnson, then CEO of RJR Nabisco, announced he would initiate a management-led leveraged buyout of the company. Ultimately RJR did undergo a $26 billion buyout, the largest ever, but KKR and not Ross Johnson engineered it. At a pivotal moment, KKR turned public opinion against Johnson by leaking details of his bid to the press, including the fact that the CEO stood to gain $100 million. The possibility of such a windfall created a media firestorm, and Johnson loomed as the corporate equivalent of Ivan Boesky, the arbitrageur convicted in 1986 in of insider trading. After two months of frenzied bidding, the board turned with relief to an alternative proposed by Henry Kravis.

Although Kravis won RJR Nabisco, influential segments of the business community rebelled against KKR's financial engineering. Two insurance companies, Metropolitan Life and ITT's Hartford Insurance, sued RJR Nabisco because the bidding had turned RJR's gilt-edged bonds into junk bonds. "The value lost by the bondholders will unjustly enrich RJR Nabisco management and other leaders of the leveraged buyout," said John Creedon, CEO of Metropolitan, when the suit was filed. Paul Volcker, who had been largely unsuccessful in his effort to dampen buyout fever, called up Creedon and uttered one word: "Bravo."

Volcker's successor, Alan Greenspan, began urging Congress to explore bank exposure to LBO loans and how those loans might perform in a recession. Congress needed little encouragement to enter the fray. Prodded by headlines and opinion polls, nine House and Senate committees – including the House Ways and Means panel, the Energy and Commerce Committee, know for its thorough investigations, and the Senate Finance Committee – announced hearings on leveraged buyouts, among them the RJR deal. The furor reached such a pitch that President-elect Bush announced at a January 12 press conference that the Treasury Department would review the LBO issue, and if appropriate he would reduce the tax deduction that encouraged corporate indebtedness.

Bush's statement sent shivers through the buyout artists who had invested in his candidacy. Most deal-makers had predicted that with Bush in office no action would be taken despite the public furor. But now they feared Washington might indeed alter the tax provisions that encouraged indebtedness.

Until 1989 Kravis had secured government inaction with little direct lobbying. Besides retaining a law firm to track developments on the Ways and Means Committee, he had financially supported strategically placed politicians. But following the RJR buyout, a different kind of commitment was necessary. If he intended to fight restrictions on LBOs, Kravis would have to counter what he viewed as erroneous charges against buyouts. As he told *Fortune* in late December,

> one of the biggest missing ingredients in Congress right now is information and understanding about LBOs. We're prepared to take the necessary time, as are others in the business, to try to increase public understanding of these transactions. Sure there are bad LBOs. But they are only hiccups in the business, the exceptions. KKR hasn't had any like that.

Kravis's initial target, however, was not Congress but the administration, specifically the Treasury Department. If Treasury did not take the lead on such a sensitive tax issue, it was unlikely Congress would. Ways and Means Democrats still shuddered at the memory of being blamed for Black Monday. And Kravis knew his views would be taken seriously within the administration. Not only was he the premier buyout practitioner, but he had helped raise large sums for the Bush campaign. Indeed, as a reward, Kravis had served as co-chairman of the president's inaugural dinner. It seemed unlikely that the administration would take a position at odds with the interests of a major donor, even if, as budget chief Richard Darman told reporters, Secretary Brady privately agreed with Darman that LBOs were "nothing but paper shuffles."

Brady's refusal to meet with Kravis was a measure of the chilly political atmosphere. Instead he handed Kravis off to Robert Glauber, Treasury undersecretary. Still, when it came time for the administration to reveal its position, Kravis's view prevailed. In late January Brady testified before the Ways and Means Committee that although he was uneasy about the substitution of corporate debt for equity, Treasury would do nothing but monitor the LBO situation.

Tepid though it was, the new administration's endorsement of an unfettered market was a victory for Kravis. But the battle was not over. Economist Henry Kaufman, president of the money-management firm Henry Kaufman & Company, and congressional critics like Byron Dorgan continued to predict dire consequences if LBOs went unchecked. After Brady's testimony, Dorgan observed that the administration "believes the marketplace is a temple and they worship at it. It doesn't take anybody with a lot of training to realize what's going on in this country. [LBOs are] bizarre speculation." Despite the administration's position, several congressional committees remained intent on holding public hearings delving into aspects of the buyout business that Kravis preferred to keep private. At worst Congress could pass anti-LBO legislation and challenge Bush to veto a popular measure.

A further complication was that the buyout community was not speaking with one voice. While Merrill Lynch, Goldman Sachs, and the law firm of Skadden, Arps were mounting pro-LBO campaigns that reinforced KKR's efforts, some of Kravis's biggest rivals and knowledgeable critics were also petitioning Washington. Among them was Jerome Kohlberg, who was more alarmed than ever by his former partners' buyout tactics. Theodore J. Forstmann of Forstmann Little & Company, a buyout boutique ranked just behind KKR, was also buttonholing regulators and lawmakers with harsh criticism. Forstmann's rivalry with Kravis was legendary in buyout circles, and he seemed bent on exacting revenge for losing out to Kravis during the bidding war for RJR Nabisco. When Forstmann met with Davis S. Ruder, John Shad's successor at the SEC, in mid-January, Ruder expected to hear that LBOs were great. Instead Forstmann delivered a stinging indictment of Kravis's financial brinkmanship. And Forstmann was pushing Congress to eliminate the tax deduction for corporate bonds that didn't pay interest in cash, the type Kravis made frequent use of and that had often provided the margin for Kravis to outbid Forstmann. Forstmann steadfastly refused to use these securities, which he called the "fake 'wampum' of 1980s finance."

To ward off Congress Kravis would have to mount a sustained campaign assisted by a first-rate legal or lobbying firm. By early 1989 he had retained the well-connected D.C. law firm of Wunder & Diefenderfer. William M. Diefenderfer III was a former staff director of the Senate Finance Committee under Senator Robert Packwood (R-Oregon). Other members of the firm – Michael Forscey, Thomas M. Ryan, and Kenneth S. Levine – had solid contracts with Democrats throughout Congress and were active fundraisers for Independent Action, a political action committee that backed dozens of moderate and liberal members. Forscey had worked for Senator Edward Kennedy (D-Massachusetts) on labor issues, Ryan was formerly chief counsel to Michigan Democrat John D. Dingell, chairman of the Energy and Commerce committee, and Levine was a mid-level official in the Carter administration. These lobbyists blanketed the Hill. Key congressional aides who had never heard from KKR before 1989 were suddenly visited regularly by KKR lobbyists and partners.

The lobbyists set about countering any adverse testimony about LBOs. When John W. Dowdle, a retired senior vice-president at RJR Nabisco, testified that interest payments would force RJR to sell assets and/or undertake sever cost-cutting measures, KKR promptly contradicted him. Its spokesman suggested that "a former employee who has had no direct involvement with the company for years" was in no position to pass judgment. Added an RJR spokesman, "if Dowdle is right, then the special committee of the board of directors of RJR and their advisers, Lazard Freres & Company and Dillon, Read & Company, are wrong, KKR and its advisers are wrong, 40-plus of the world's leading banking institutions are wrong, and hundreds of investors who are investing in the debt and equity of the transaction are wrong." (Dowdle's prediction of trouble to come for RJR was proved accurate in 1990, however, when KKR had to given the company an emergency $1.7 billion infusion to prevent its bankruptcy.)

Negating criticism was only part of the strategy. Kravis also had to figure out how to present his case for buyouts before Congress. Because of the RJR deal, KKR faced more congressional queries than any other buyout firm. And Kravis, as the most prominent buyout artist, had invitations to testify before all nine of the committees that had announced hearings – a risky proposition. Committee members might accuse Kravis of acquiring his opulent lifestyle at the expense of blue collar workers and the middle class. While Kravis was an outstanding salesman, he was not known for modesty or patience. Wall Street traded anecdotes about his imperviousness and condescension, qualities that led actor Michael Douglas, Kravis's former classmate at Eaglebrook prep school in Deerfield, Massachusetts, to fashion his *Wall Street* character Gordon Gekko after Kravis. If you testify, KKR lobbyist Ken Levine told Kravis, "you'll be eaten up by the media."

Kravis understood the value of personal meetings with members of Congress, and a CEO who seemed aloof or arrogant could aggravate the situation. So Kravis decided to make himself available to influential members in private. Kravis was confident of his power of persuasion. "Nobody can tell the story as well as we can," he told a *New York Times* reporter. And Kravis believed he had a good story to tell: LBOs did not cause economic upheaval but the reverse. Buyouts were a financial solution to "suffocating and gridlocked corporate bureaucracies that were dragging the U.S. economy down the drain." They freed businesses from "the paralyzing clutches of hidebound corporate bureaucracies."

One of the first and most important meetings was a closed-door breakfast in Washington with members of the House Ways and Means Committee. Chairman Rostenkowski held these meetings to allow committee members to discuss proposed changes in the tax code with the people who would be directly affected. In this instance, Rostenkowski wanted Kravis to make his presentation at the same meeting as Forstmann. But to avoid an unseemly debate, Kravis held out for a separate meeting, where he and KKR partner George Roberts laid out their argument without interruption. Citing successful KKR buyouts like Fred Meyer, Beatrice, and Safeway, they argued that the discipline of debt revitalized corporations, forcing management to prune excess and bureaucracy, thus strengthening the economy.

Then Kravis broached the subject of corporate extravagance, saying that the executives of many debt-ridden companies had grown accustomed to using their fleets of jets as playthings. Among KKR's first acts following a buyout, Kravis claimed, was to ground those planes. Byron Dorgan, familiar with Kravis's lifestyle, interrupted Kravis to ask, "How did you get down here?" When Kravis replied, "We flew down in one of our planes," members chuckled. "But that's different," Kravis protested. "we own our jets."

Most of Kravis's meetings went more smoothly. A key reason was a KKR study prepared by its accounting firm, Deloitte Haskins & Sells. The SEC and the House Subcommittee on Telecommunications and Finance both had requested KKR and other buyout firms to provide confidential information about the effect of LBOs on employment, capital spending, and tax revenues. Kravis realized that by going one step further than the subcommittee's request, he might improve congressional understanding. He was accustomed to going into business meetings loaded with financial information and believed the same tactic would work with members of Congress. So KKR asked Emil M. Sunley, Deloitte's director of tax analysis and a former Treasury deputy assistant secretary, to fashion KKR's response. Deloitte's white paper purported to show what happened to KKR-controlled companies after they were leveraged so that Congress could judge the results for itself. The paper's survey of 17 KKR buyouts found that every company flourished after being taken private. It said that the number of employees grew from 276,000 to 313,000, and capital spending on new plants and equipment increased 14 percent. Despite charges of a decline in R&D spending and product development, the companies spent 15 percent more on these items. Finally, the white paper contended that KKR's buyouts resulted in a $2 billion tax bonus for the U.S. Treasury because capital-gains taxes outweighed any loss of revenue from reduced corporate tax payments.

Kravis was determined to present the study to every congressional member who could decide the fate of leveraged buyouts. And in most instances Kravis made an excellent impression. He certainly didn't appear to be the ogre depicted in some press accounts nor as dangerous as some critics from the buyout industry indicated. Kravis had a knack for walking into a meeting and striking the perfect note of urbanity, briskness, and confidence. The same characteristics that had won KKR the allegiance of countless pension fund managers, bankers, and corporate executives were now brought to bear on lawmakers. As Democratic Congressman Charles E. Schumer of New York commented, "He doesn't come off as a robber baron. He comes off as a nice, courtly gentleman."

During the winter of 1989, Kravis met with dozens of representatives and more than one-third of the Senate, concentrating on Finance Committee members. He sought out even the most determined opponents, although this tactic sometimes backfired. One such occasion was Kravis's meeting with Terry Sanford, a Democratic senator from North Carolina. Sanford, a former board member of the ITT Corporation, had introduced several bills curbing buyouts after watching indebtedness cripple Carolina textile companies like WestPoint Pepperell and Burlington Industries. "He had a sense that these financiers were marauders from New York," an aide told Sarah Bartlett. Sanford referred to takeovers as the "corporate killing fields," and so his proposals struck at the heart of buyout financing: the deductibility of interest payments. One Senate bill declared interest payments in excess of $5 million nondeductible if the debt-equity ratio of a leveraged company exceeded 3 to 1 and if that ratio was 50 percent greater than the pre-buyout ratio.

The meeting with Sanford was one of the few times Kravis lost his composure. According to Bartlett, Kravis confronted Sanford "demanding that he withdraw the bill." Kravis told Sanford, "You have no idea what you're doing. You don't understand this transaction, the financing." Sanford listened but explained that there was no procedure for withdrawing a bill once it was introduced. "Oh, there must be," Kravis argued. Sanford was taken aback at Kravis's brusqueness, but afterward took great delight in having "put one right between the [takeover king's] eyes."

Still, Kravis swayed far more members than he alienated, and his white paper played a key role. Although Capitol Hill leaned with public opinion toward curbs on LBOs, the report fueled a new uncertainty. If KKR's assertions were true, did buyouts deserve censure? Congress realized that the report, which KKR paid for, was self-serving. But the data and conclusions appeared reliable. There was, however, one curious feature: ordinarily lobbyists with favorable data are eager to share them, but KKR asked members of Congress not to share their copies without permission.

The KKR study didn't turn congressional members or staffers into advocates of buyouts, but it did "muddy the waters" at a crucial time, according to one financial reporter. Flak from constituents about the LBO craziness on Wall Street drove a thirst for information and action on Capitol Hill. The study deflated the anti-LBO movement by blocking political consensus. And KKR's stand emboldened other Wall Street firms, still cowering from bad publicity, to come out in praise of LBOs. The study stemmed the bad press, and with it congressional concern.

Some levers of power, however, remained beyond persuasion. Moved by the same alarms that had prompted Paul Volcker to take action in 1986, Fed Chairman Alan Greenspan pressured major banks to reduce their exposure to highly leveraged transactions. There was still no love lost between the Federal Reserve and Kravis. That spring E. Gerald Corrigan, president of the New York Federal Reserve, accepted an award from Columbia Business School's alumni association, nothing that the previous year's winner was Henry Kravis. "It raises in my mind a question about your definition of business," Corrigan said, drawing murmurs from the black-tie audience at the Waldorf-Astoria. Corrigan suggested that America needed more mechanical and electrical engineering and less financial engineering.

Kravis's other problem was John Dingell of the Energy and Commerce Committee. Dingell was intent on investigating the RJR deal and would likely subpoena key witnesses. Kravis's critics, such as Jerome Kohlberg, spent hours informing Dingell's investigators about the deal so they could probe its soft spots. Aided by Tom Ryan, one of his Washington lobbyists and former counsel to Dingell, Kravis walked committee investigators through the RJR deal. Kravis's position was that because of the buyout's size and the fact that RJR was the object of a bidding war, it was a less than representative case study, and the investigators eventually concurred. Consequently, Dingell never held a public hearing because, as one aide put it, "he is not known for putting on empty exercises."

By the spring of 1989, after four months of hard work, Kravis and others had checked the anti-LBO movement. But a new development marred that accomplishment. Two economists, William F. Long, a former Federal Trade Commission economist who was then a guest scholar at the Brookings Institution, and David J. Ravenscraft, an associate professor at the University of North Carolina's business school, were researching the economic effects of LBOs. They got their hands on KKR's white paper, and unlike Congress and the media they examined the data rigorously. The paper's only methodologically sound conclusion, they found, was that LBOs produced high profits for a handful of investors. The claims about greater economic efficiency, higher employment, and increased capital expenditures they deemed specious, based on projected estimates, not actual results.

That May, Massachusetts Democrat Ed Markey, chairman of the House Subcommittee on Finance, held one of the last hearings on LBOs in Congress, and half of it was devoted to KKR's apparent sleight of hand. Deloitte's Emil Sunley appeared on behalf of KKR and dismissed criticisms of the white paper as "mostly nits." Markey, however, took exception to that characterization and rebuked Sunley for producing a study whose figures were based on projections and presenting it as verifiable fact. KKR should not have given the subcommittee "quantitative data which cannot withstand critical scrutiny," observed Markey.

Kravis's Washington lobbyists were furious at Markey for holding the hearing. They accused the congressman of grandstanding and excoriated his staff for subjecting KKR's study to such scrutiny. Yet the subcommittee's criticism had come months too late to have any effect on the LBO debate. The political consensus that nothing should be done, shaped in the first place by the dubious study, was now unshakable. Still, KKR paid a price for providing suspect information. No experienced member of Congress expects a petitioner to supply anything but self-serving information. But KKR's study had crossed a line, attempting to parlay a congressional request for information into a questionable defense of the practice of leveraged buyouts that had made Kravis and his associates millionaires. "The credibility of KKR was impeached," said one Hill aide.

Within a few weeks of the hearings, KKR's reputation was further sullied. In August, after months of negotiations, Jerome Kohlberg filed a lawsuit charging that his former partners had enriched themselves by reducing his ownership share in several buyouts. On the heels of this development came more bad news. Three KKR buyouts, including Seaman Furniture and the Jim Walter Corporation, which just months earlier KKR's white paper had touted as great successes, were on the edge of disaster. Seaman and Jim Walter subsequently filed for bankruptcy. Nor could these looming defaults be papered over by re-leveraging. The junk-bond market was headed for a rout after the indictment of Drexel, Burnham junk-bond king Michael Milken in the spring of 1989, and as Milken's number-one borrowing client, KKR no longer had access to unlimited funds. *The New York Times* headlined its story CRACKS IN HOUSE THAT DEBT BUILT.

To Kravis adversaries on Capitol Hill, most notably Byron Dorgan, the adverse publicity was serendipitous. "If a good many of these companies begin to fail, "Dorgan told *The New York Times*, 'those who have been skeptics will have a substantial amount of ammunition to try to slow this [LBO] thing down." Dorgan's initiatives over the years had boiled down to the idea promoted by Ted Forstmann. Forstmann had lobbied the tax-writing committees to limit the interest deduction on non-cash-paying corporate bonds. These bonds accrued tax-deductible interest but did not simultaneously pay it out in cash. Forstmann argued that making these bonds less attractive would slow down buyouts without roiling the markets. The Bush administration cautiously approved the idea.

In the fall of 1989, one year after the leveraging of RJR Nabisco, the limited provision championed by Forstmann became part of the tax code, although it was akin to closing the barn door after the cows were gone. After UAL management failed to leverage United Airlines, the stock market crashed for the second time in as many years. The inability of United to secure the necessary junk financing proved that the party was over. Equity was in and debt was out, at least for the time being.

Henry Kravis's seven-year struggle to maintain an unfettered market illustrates several facets of doing business in Washington. Most clearly it demonstrates the importance of credibility no matter what the goal. Sharing unreliable information is the surest route to ineffectiveness in Washington. Kravis could not hold his own against Ted Forstmann primarily because KKR's assertions lost value after KKR's study backfired.

Kravis's efforts also suggest that procuring inaction in Washington can be just as important as and somewhat easier than securing action. To accomplish change a CEO has to build coalitions. To deflect action, a CEO can use Washington's political climate to help ward off unwanted attention.

Finally, Kravis's case illustrates important aspects of the relationship between money and politics. Kravis has denied have a quid pro quo in mind when he made political donations, but as one political scientist has observed, the special interests that most support an administration also ask the most. Kravis is forthright about his desire for a certain kind of financial environment during the 1980s. As he told Sarah Bartlett, "I have absolutely no agenda on this, and nobody understands this. I want the best person in office, to keep this country competitive and free. I'm very much of a free-market person. I don't want interference."

One irony is that while Kravis significantly slowed congressional action against the buyout phenomenon, he may have unwittingly undermined the candidate he most wanted to keep in office. When the U.S. economy began to slow in 1990, many economists predicted a soft landing, a minor recession before the business cycle perked up again. Corporate indebtedness was perhaps the most fundamental reason an economic recovery has been so long in coming. Taken together, these economic facts killed George Bush's chances for reelection during a campaign that was in many ways a referendum on 1980s-style economics and its chief beneficiaries.

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