Washington Decoded

6 December 1992

Silence of the Corporate Lambs: Where was Vernon Jordan?

By Max Holland

Vernon Jordan is a victim of guilt by corporate association. Because he serves on the boards of Xerox, American Express, RJR Nabisco and eight other corporations, he has been depicted by some as a *prima facie* threat to the new administration's tougher ethics. Yet the central issue shouldn't be where Jordan sits. Rather, it should be what President-elect Clinton's transition chief actually did at the powerful corporations he served, and the public policy implications of those actions. In this regard, nothing is more worthy of scrutiny than Jordan's role at RJR Nabisco, once the 19th-largest corporation in America.

This is not a reprise of the complaints about Jordan's involvement with a tobacco company. Nor does it discount his work in encouraging corporate America to diversify its workforce and to support worthy causes like the United Negro College Fund. It's the story of Jordan's involvement in the leveraged buyout of RJR Nabisco, a deal that in many ways epitomizes the '80s-style corporate greed and dishonesty that Bill Clinton ran against.

Like it or not, the corporate form of organization dominates the American economy. It would be surprising, even disturbing, if the Clinton administration excluded men and women who ably serve corporate America. Nevertheless, corporate directors can be pawns or independent voices, and the weight of the evidence shows that Jordan went along to get along while RJR Nabisco was being ill-served, first by its chief executive officer, and then by Wall Street buyout artists doing the mother of all deals.

At least two of Jordan's former colleagues on the board of RJR Nabisco now say that the company and the original shareholders would be better off today if there had been no leveraged buyout. One of them, John Macomber, a former chief executive officer of Celanese Corp., says that RJR Nabisco "lost [its] moral compass" in the 1980s. Jordan's acquiescence in such corporate excesses undermines his claim to represent the social conscience of corporate America.

Jordan declines to discuss his work as a corporate director, saying that to do so would be akin to breaching lawyer-client privilege. "I do believe directors have a responsibility to keep what goes on in board rooms confidential," he says. "Directors who comment even on [published] comments do a disservice to the process . . . . I have always abided by this, perhaps to my peril."

The tale begins in 1981, when Jordan left the presidency of the Urban League to join the Washington law firm of Akin, Gump, Strauss, Hauer & Feld. In private practice he began adding to an already impressive list of corporate directorships. He became a board member of R.J. Reynolds Industries at the invitation of Paul Sticht, the chief executive officer of the Winston-Salem tobacco company.

Sticht says he came to rely Jordan's "good horse sense." R.J. Reynolds had holdings in South Africa, and Sticht says he particularly prized Jordan's counsel "in those troubled political waters." Sticht also invited Jordan to the Bohemian Club's annual retreat outside San Francisco, a favorite social event of American businessmen and politicians. The gathering offered Jordan an unparalleled opportunity to be a "rainmaker," drumming up business for Akin, Gump.

Jordan was only doing what board members routinely do in addition to official duties, namely use their position to network and make deals. But in 1983, an R.J. Reynolds executive named Tylee Wilson became CEO of the company. Wilson's blunt, no-nonsense style did not appeal to Sticht's board, according to *Barbarians at the Gate*, a best-selling account of the leveraged buyout of RJR Nabisco. Wilson thought his job was to make R.J. Reynolds' operations as profitable as possible -- and that didn't include handing out goodies to curry the directors' favor. As reported in *Barbarians*, Wilson curtly told Jordan to make his requests for a bigger share of R.J. Reynolds' legal business to the company's general counsel.

In 1985, after R.J. Reynolds merged with Nabisco, the board replaced Wilson with a Nabisco executive named Ross Johnson. Wilson knew he was finished after he polled the board members privately. His last call, as reported in *Barbarians*, was to Jordan, who told him, "You'd better cut yourself a deal and get out."

The RJR Nabisco directors soon found themselves in the corporate equivalent of hog heaven. Johnson re-established an international advisory board that held meetings around the world to discuss global issues. A corporate villa sprang up in Colorado, augmented by a compound in Palm Springs and penthouses in Manhattan. All board members received cut-rate auto insurance and were promised annual retirement payments of $ 50,000 for 10 years. There was even talk of lifetime pensions for directors once they retired. "A few million dollars," Johnson was fond of saying, "are lost in the sands of time."

Within a year of Johnson's ascension, Sticht, now chairman of the board, was complaining about the new CEO's spend-thrift ways. At the Bohemian Club retreat in 1987, Sticht told Jordan how appalled he was by Johnson's behavior and suggested it might be time for the board to mount another coup. Sticht's recollection is that Jordan "didn't disagree" but did not join Sticht in pressing the issue. John Macomber says that "we were all somewhat culpable over the fact that Ross [Johnson] spent a hell of a lot of money . . . but it's not the biggest thing in the world." A few months later, Johnson ousted Sticht as board chairman with nary a word of complaint from the other directors.

In 1988, Johnson decided to reward himself with the ultimate corporate perk: a management-led leveraged buyout. The idea was to organize a select group of investors to borrow money to buy out all the public shareholders. When the investors captured control of the corporation, they could use all of its cash flow to retire the debt incurred in the buyout (rather than say, paying dividends). Once the debt was whittled down to acceptable levels, the investors could again sell the company's stock publicly, reaping windfall profits on their relatively small original investment. Within seven years Johnson expected that his personal pot of gold from the buyout would amount to at least $ 100 million.

Jordan warned Johnson about the danger of putting RJR Nabisco "into play." "Somebody might come along and buy this company for more than you can pay," Jordan is quoted as saying in *Barbarians*. "You might not win."

Johnson was not dissuaded. On Oct. 19, 1988, the board, including Jordan, expressed its "strong sense" that Johnson should go ahead with the deal on the grounds that it was their duty to maximize shareholder value. That evening Jordan and Macomber both expressed lingering uneasiness about the decision while meeting informally with other directors. In particular, they were concerned over what a leveraged buyout might mean for their promised $ 500,000 pensions, according to *Barbarians*.

As Jordan foresaw, putting RJR Nabisco into play was akin to putting down a pot of honey in front of a hive. Buyout artists, including the Wall Street firm of Kohlberg Kravis Roberts & Co. (KKR), swarmed to the deal. A special board committee was created to select the best bid. John Macomber, who served on the committee, says that he relied informally on Jordan's "good judgment and uncanny sense of people and ability to size up situations."

Macomber, like Sticht, now believes that the buyout was not in the best interests of the stockholders. The buyout was "a good deal," he says, "but all shareholders would all be better off today if they [still] owned RJR stock." For his part, Jordan says, "There's something to be said for that [view]. I've thought about it many ways . . . . It was an experience I would not want to repeat."

Midway through the bidding for RJR Nabisco, someone in Kohlberg Kravis Roberts & Co. apparently decided that it might help the firm's bid if the details of Johnson's offer were made public, especially his anticipated $ 100 million windfall. As the full dimensions of Johnson's perk-happy corporate empire became public -- the RJR air force, the villas, the $ 1,500 Gucci watches -- Jordan and other directors began to distance themselves from a CEO who was rapidly becoming a symbol of greed along the lines of Ivan Boesky and Michael Milken. Jordan called Charlie Hugel, the head of the special board committee created to select the winning bid, and expressed horror at the details of Johnson's bid, and how the whole sorry spectacle was unfolding.

But it is hard to tell if it was the ostentatious details of Johnson's bid that finally turned Jordan and other directors against Ross Johnson, or if it was merely embarassment about the revelations. Sticht says that he knew about the extent of Johnson's self-dealing. Jordan and the rest of the board plead ignorance, according to *Barbarians*. In any case, the board, eager to find a less notorious alternative to Johnson, accepted the KKR bid and the buyout was completed.

When Adolphus Green founded Nabisco in 1898, he believed that a corporation existed "not merely to make dividends for the stockholders . . . but to enhance the general prosperity." Of course, part of enhancing the general prosperity is paying corporate taxes. But consider what happened to RJR Nabisco's tax burden as a result of the buyout. As Treasury Secretary Nicholas Brady observed in January 1989, just after the deal, "The substitution of [tax deductible] interest charges for [taxable] income is the mill in which the grist of takeover premiums is ground."

In other words, the RJR deal worked only because the post-buyout financial structure would enable RJR to all but avoid paying corporate income taxes for years. In 1988, the year of the buyout, RJR Nabisco paid $ 893 million in taxes. In 1989, it received $ 222 million in refunds, and in 1990 paid only $ 60 million in taxes. The net effect of the buyout was a gigantic transfer of wealth from the U.S. Treasury to a small group of investors skilled in manipulating the tax code.

No one expects corporate directors to argue for higher taxes, but it is fair to ask them to consider the interests of stakeholders, meaning not just stockholders, but also workers, customers, suppliers and others with a stake in the corporation. And what was Jordan's attitude with respect to the impact of the buyout on the workers of RJR Nabisco, many of them women and minorities?

During the frenzied bidding, KKR representatives fleetingly assured the RJR Nabisco board that they knew the value of happy employees, according to *Barbarians*. But if Jordan and other directors had been at all curious, they could have learned that earlier KKR buyouts, such as one involving the Safeway supermarket chain, had resulted in plant closings, mass firings, worker give-backs and declines in real wages.

The actual impact of the buyout on RJR Nabisco workers has been mixed. On the Nabisco side of the company, the unionized work force has not suffered. The workers are represented by the Bakery, Confectionery & Tobacco Workers International, which represented Safeway workers before and after the KKR buyout. "We knew what KKR was capable of doing," says Ray Scannell, research director of the union. "We were not going to allow them to claim that paper losses were operating losses."

But non-unionized workers dominate the tobacco division and they have fared poorly, according to Scannell. He says that these workers have not had a pay increase in three years and that the worker's pension plan has been reduced and is underfunded.

Within a year of the buyout, RJR was on the brink of becoming the largest corporate bankruptcy in U.S. financial history. The company's ability to service its new debt was so razor-thin that Moody's downgraded RJR's junk bonds in January 1990. Kohlberg, Kravis, Roberts faced the prospect of resetting the interest rates on certain junk bonds to as high as 25 or 30 percent in order to restore the bonds' promised value. But at those interest rates, according to the book *Merchants of Debt*, by George Anders, RJR's balance sheet would soon disintegrate and the food and tobacco giant might be forced to default. The only reason RJR Nabisco did not go the way of Macy's or a hundred other busted deals is that KKR arranged an emergency equity infusion of $ 1.7 billion and an additional $ 2.25 billion in new bank loans in 1990.

Jordan has not personally suffered as a result of the buyout. RJR Nabisco remains a client of Akin Gump. As one of only two directors to be held over, Jordan is paid $ 50,000 annually to attend about five board meetings. As a director he is also entitled to a life insurance policy worth $ 100,000. He has received options on 30,000 RJR shares, worth approximately $ 270,000 at today's prices. Upon retirement, he is eligible for a pension worth $ 750,000 over 15 years. And unlike the pension he worried about in 1988, this plan cannot be terminated.

In short, Vernon Jordan deferred to a small group of Wall Street buyout artists who put an engine of American economic growth at risk for the sake of their own enrichment. His performance throughout the RJR Nabisco saga does not inspire confidence in him as a steward of the corporate economy or as a symbol of what is supposed to be a new era of investment.

This article first appeared in *The Washington Post*, 6 December 1992