REMARKS OF
THE HONORABLE EDWARD J. MARKEY
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I am pleased to be here with you today to discuss tender offer reform and some of the other finance and securities issues that will face us during the 100th Congress.

I am Chairman of the House Subcommittee on Telecommunications and Finance, and it is our Subcommittee that has primary jurisdiction over the Federal Communications Commission, on the one hand, and the Securities and Exchange Commission, on the other. Our jurisdiction runs from "fairness" over the airwaves, to "fairness" on Wall Street. Thus, on one side of our jurisdiction, we hold hearings on "dial-a-porn," while on the other side, we investigate Dennis Levine's calls to his stockbroker, or as Levine used to call it, "Dialing for Dollars."

These are remarkably challenging times in the history of our capital and securities markets.

First, Wall Street right now is coping with the biggest spate of scandals in its history. Through it all, the integrity of and confidence in our markets must somehow be safeguarded. The small American investor remains the lifeblood of our market system. If he loses confidence in our markets, he takes pension funds, mutual funds and IRA investments with him. Our markets need these strong domestic sources of investment and our Subcommittee will do everything within its power to preserve market integrity and investor confidence.

Second, our economy is in the midst of a takeover binge that is unprecedented in our history. These takeovers, both the hostile kinds from the outside, and the leveraged buyouts from the inside, have been fueled by a five-year-old bull market and by historically high levels of junk bond-based corporate debt.

Third, the globalization of our securities markets has become a reality. Twenty-four hour trading is commonplace along the Tokyo-London-New York belt. As a result, new challenges are presented in protecting the interests of U.S. investors abroad and in monitoring and assessing the impact of foreign investment in U.S. markets.

Fourth, new trading techniques, such as program trading, and new trading instruments are being developed at an astonishing pace. As a result, our Subcommittee, as overseer of the securities markets, must separate the wheat from the chaff by determining whether any of these innovative techniques or instruments present intolerable risks to our markets.

Fifth, incident to globalization, the Eighties have seen U.S. commercial banks head offshore to purchase substantial interests in foreign securities firms. Through those firms, banking interests engage in trading and underwriting activities from which they are barred in the United States by the Glass-Steagall Act. I am concerned that this 54 year-old law, fashioned in different times and not designed for a world economy, might cause a nonstrategic outflow of U.S. dollars abroad and inhibit the growth of diversified financial services in the United States to the detriment of both our international competitiveness and, ultimately, our consumers.

I have already commenced a series of hearings on this issue. So far, we have heard from Alan Greenspan, Chairman of the Federal Reserve Board; David Ruder, Chairman of the Securities and Exchange Commission; William Seidman, Chairman of the Federal Deposit Insurance Corporation; and Robert Clarke, the Comptroller of the Currency. Earlier this week, we also heard from representatives of the commercial banking and securities industries.

One of the problems with any discussion of Glass-Steagall is that it elicits strong emotions from all sides and this sometimes inhibits progress in the debate. The questions typically posed are emotionally charged and predictive of dire consequences if the wrong turn is taken. For example: by preserving the Glass-Steagall barriers, are we really presiding over the demise of the banking industry, and ceding America's position of prominence in the world's capital markets? Conversely, by acting to lift restrictions on securities activities by banks, will we really be inviting a second Great Depression?

In order to quiet the Cassandras, I have set out a very precise list of questions regarding the current roles and practices of, and interrelationships between, the banking and securities industries. The questions I have posed leave no room for fluff or posturing. I have requested the Chairmen of the Fed, the SEC, and the FDIC, along with Comptroller Clarke and Treasury Secretary Baker to respond to these questions and to provide a blueprint for reform of our financial services industry by December 1. These responses will give us a basis for determining whether change is required and, if so, what form that change should take.

My principal goals in this area will be to further the interests of the domestic consumers, both individuals and corporations, who buy the products generated by our financial services industry and, second, to enhance our nation's international competitiveness. But I feel strongly that these goals must be accomplished at <u>no</u> expense to the overall integrity of our financial system.

As you can see, the Subcommittee is at the vortex of the major and constantly changing financial issues of our day. These are not esoteric issues of mere academic interest. Every one of them has significant long-term implications for our economy, and immediate implications for the lives and the personal economies of our people.

For example, one of the most heralded events of recent weeks has been the dramatic decline in the Dow Jones Industrial Average. On August 25, the Dow hit a record level -- 2722. Since that time, the Dow has fallen more than 350 points to the 2350 level, and, very significantly, more than 275 of those points were lost during the past nine trading days.

On October 6, the Dow set a record loss for one day -- down 91 & 1/2 points. This staggering loss, however, is already old news because on Wednesday of this week the Dow dropped 95 & 1/2 points to set still another record. Such instability in our securities markets is of critical importance to our Subcommittee and, in the interest of the investing public, we need to come to grips quickly with this increasing volatility.

Therefore, the day after last week's 91 point drop, I wrote a letter to the Chairman of the SEC. I asked the Commission to undertake a study of the factors that caused that decline, and to assess the market's current degree of stability.

It seems that whenever we experience a severe downdraft in the market, the papers are awash the next day with comments from brokers, market technicians and economists suggesting that the previous day's "correction" was "technical," or that it was an overreaction of a jittery market to fears of higher domestic inflation or West German interest rate increases. Others point out that even a 91-point drop is not significant in overall percentage terms because the Dow is at its highest levels in history. Last week every broker or market analyst with a pocket calculator couldn't wait to punch out the statistic that a 91-point drop was only 3 & 1/2 percent of the Dow, whereas on Black Tuesday in 1929, the Dow lost a full 12 percent of its value.

Well, who's kidding whom? As the Dow has reached its highest trading levels in history, it has begun to suffer increased intraday and end-of-day volatility. Rises and falls of 40, 50, 60 and now even 80 and 90 points are not uncommon. And my concern for maintaining stability in our securities markets is not met merely because the Dow has not lost, in percentage terms, the value it lost on Black Tuesday. That should not be our yardstick! Indeed, I believe that in absolute terms, the volatility in the market is increasingly so great, that the sheer magnitude of these numbers, coupled with the market's ever-increasing velocity as a result of program trading, could trigger an investor response that could, in turn, create a near free-fall situation. As I told the Chairman of the SEC, "In such a situation, investors will hardly be assuaged by the refrain of market apologists who urge that the initial stages of the decline were modest in percentage terms."

America's securities markets have been called the fairest, most liquid and most efficient in the world. I want to ensure that they stay that way. Therefore, whenever I see factors at work that could impair the integrity of those markets, our Subcommittee will scrutinize those factors to the Nth degree.

For example, during this summer, the Subcommittee held hearings on virtually all aspects of program trading, including index trading and risk arbitrage. We heard from the foremost experts in the United States on these innovative new trading techniques. Almost to the person, they assured the Subcommittee that computer-generated index trading and risk arbitrage do not contribute to market volatility and do not impair the market's integrity. Well, after assessing all of that testimony, I frankly remain unconvinced that program trading might not some day play an important role in a rapid and uncontrolled market decline. Our securities markets are too precious to be allowed to run on automatic pilot, and I intend to push and probe every step of the way to make sure that their integrity is protected.

My concerns about the stability of our markets have also led me to question the potential effects on those markets of foreign investment. Might sudden declines in particular foreign markets precipitate similar declines in our own markets?

In the last five years, foreign investment in the U.S. has doubled -- to $850 billion. As a result, more and more activity affecting the structural integrity of our markets falls outside of our supervision and control.

For example, the Tokyo stock market is even more "go go" than our own. In Japan, stocks are selling at an average of 75-80 times earnings, compared with 20 times earnings for companies on the New York Stock Exchange. Recently the Nikkei average -- the Tokyo Exchange's equivalent of our Dow -- crossed the 27,000 barrier for the first time.

Earlier this year, Nippon Tel & Tel issued a new offering on the Tokyo Exchange at <u>$7,775 a share</u>. Its recent price was over <u>$20,000 a share</u>; more than 250 times earnings. At that price, that company's value exceeds that of the entire West German stock market.

The interrelationship among world markets led me to wonder if, for example, the Tokyo market were to plunge from those dizzying heights, would the foreign interest in American stocks also crash? I take some solace from the fact that the Tokyo market has not joined the Dow in this most recent decline, but due to heavy Japanese investment in the U.S., I am not certain that the converse would be true. Therefore, during the coming months we will be examining the potential impact of foreign investment on our U.S. markets.

Amid this whirlwind of activity, the principal focus of my Subcommittee's attention during the past several months has been takeover reform. At least in this area, our attention is rewarded by some of the most colorful terms, and colorful characters, in the business world today.

One of my favorites among the new terms is "deal junkies." Deal junkies are usually lawyers or investment bankers or arbitrageurs who start to sweat if they go more than two days between takeover battles. Their financial instincts are extremely refined, but their vision is sometimes only as lofty as the next day's stock price.

Then there are the "arbs." Arbitrageurs have been around for centuries. The early currency traders were arbitrageurs. But today arbs have new-found notoriety. Everyone knows what an arb is today. Can you imagine what a blood-curdling feeling it must be for the board of directors of a target corporation to hear the cry, "The arbs are in!"

Even Carl Icahn has a healthy respect for arbs. Icahn once told his wife, "If I ever need a transplant, get me the heart of an arb because I'll know it's never been used!"

And you have to remember who Icahn is. During the midst of the TWA takeover, when tempers were getting hot, someone told Icahn that he wasn't going to make a lot of friends with his attitude. To which Icahn said, "If you want a friend, get a dog!"

These Wall Street warriors did not invent takeovers, but they have dramatically changed the order of battle. What is new in takeovers today is the size, hostility, the amount of debt created, and the destructive implications for corporations. Yet, these struggles for control are fought with such intensity--such urgency--that there is little time to think about their real economic value, or their place in the national interest.

No matter what you think of raiders, arbs, or hostile takeovers, they are all today an accepted part of the American corporate landscape. During recent years, abuses have crept into the takeover process that was established by the Williams Act. In order to address these abuses, on April 27, John Dingell and I introduced H.R. 2172, the "Tender Offer Reform Act of 1987."

Before I tell you about some of the more important provisions of this bill, I'd like to set our deliberations in context. Just days before introduction of our bill, the Supreme Court handed down a decision in the CTS case. In CTS, the Supreme Court held that Indiana's statute, which required a disinterested shareholders' vote to vest voting rights in an acquiror's control block and extended the tender offer period to 50 days, was constitutional.

Many legal authorities predicted that the CTS case would stampede other states to adopt similar laws. All eyes turned to Delaware expecting to see a statute passed in the mere blink of an eye. But Delaware slammed on the brakes and decided to sit and think about things for awhile. Apparently, the best business minds in the country couldn't decide whether the Indiana statute actually slowed down hostile takeovers or speeded them up. Others suspected that target corporations would lose access to most of the weapons in their defensive arsenal if laws were passed which provided for a shareholder vote to deal with changes in corporate control.

Even today the business community is still digesting the impact of the CTS decision. However, the one benefit of all this confusion is that a lot of questions are being asked about the role of the states in the tender offer process and we will be addressing those questions in our deliberations on this bill.

Now let me review with you some of the key provisions of H.R. 2172. First of all, the bill has something of a populist flair insofar as it deals with problems and terms that have become familiar to people who are not corporate raiders or investment bankers or takeover lawyers. Greenmail, poison pills, golden parachutes, ten-day windows -- these are all addressed by the bill.

For example, the bill restricts the availability of greenmail payments. It prohibits a company from purchasing its securities at a price above the average market price of the securities during the 30 preceding trading days, from any person who has held more than 3 percent of its shares for less than 2 years. Greenmail would be permitted only if a majority of the shareholders approve or if the company makes an equal offer to all other shareholders.

The bill also deals with "golden parachutes." It prohibits a company, during a tender offer, from entering into or amending agreements that increase the current or future compensation of any officer or director. The prohibition does not apply to routine compensation agreements made in the normal course of business. This provision is an extension of recent amendments to the tax code that discourage golden parachutes by increasing the tax imposed on them.

The bill also deals with poison pills, lock-ups and tin parachutes. It provides that a corporation cannot establish or implement, during the proxy or tender offer time period, without shareholder approval, poison pills, tin parachutes or lock-ups.

The bill requires shareholder approval for any defensive tactic that provides for severance pay or other lump sum payment to a large number of corporate officers or employees, when that payment is activated by a change in corporate control.

The bill would make it unlawful for any broker or dealer to trade any stock which has fewer or greater than one vote per share. One of the difficulties we will face in the coming months will be to develop a one share/one vote standard for corporate democracy that will operate in conjunction with an Indiana-type statute.

The bill closes the infamous 13(d) 10-day window by requiring anyone who acquires more than 5 percent of a company to announce the acquisition publicly, and repeat the filing to the Commission and to each Exchange on which the company is traded, within 24 hours. The acquiror is then precluded from acquiring additional securities of the same class for 2 business days after the acquisition. We may move to tighten this 13(d) filing period even further.

The bill, in this same section, Section 4, seeks to make certain that these filing requirements extend to groups acting in concert to acquire shares in a company. This new provision is designed specifically to prevent teams of raiders, bankers, and others from acting in a concerted manner to purchase more than 5 percent of a company without making the requisite disclosures. The SEC has implicated Ivan Boesky, Boyd Jefferies and others in such schemes.

The bill requires that tender offers remain open for at least 60 calendar days, rather than the present 20 business days.

In addition, Section 7 of the bill requires bidders to provide an "executive summary" -- in clear language -- of the terms and conditions of the offer, in addition to the usual tender offer materials received by shareholders. There is a feeling that today's tender offer disclosure documents are rather incomprehensible given the complexity of many of these transactions. This section would simply require a concise statement in plain English of the price, terms and key conditions of the offer, including financing arrangements.

The bill prohibits, in Section 11, "market sweeps." If you make a tender offer and terminate it, you are precluded from acquiring securities of the class you tendered for, for a period of 30 days, except by a new tender offer. The bill essentially requires a 30-day cooling-off period.

The bill also prohibits, in Section 13, "creeping tender offers." If you acquire 10 percent of a company, and if you want to acquire more, you must do so by tender offer.

And last, but certainly not least in importance, the bill provides for easier access to proxy materials. It gives free and equal access to the corporate proxy machinery to holders of 3 percent of a company's shares, or more than $500,000 of the corporation's voting securities (whichever is higher) for the purposes of nominating candidates for election to the board of directors.

We have gone to great lengths during the hearing process to make certain that all legitimate points of view were represented at our hearings. We have heard from acquirors such as Boone Pickens and Harold Simmons. We have heard from corporate management, from the principal takeover lawyers and investment bankers, from institutional investors, from representatives of the states and Federal Government, from shareholder groups, from labor, and from others.

By listening to and assessing these diverse points of view, we have been educated further. We have learned, for example, that there may be issues that the original bill should have addressed, but did not -- issues such as confidential voting, corporate debt, leveraged buy-outs and long-term versus short-term economic considerations in contests for corporate control. These are issues that we are considering now, and we may soon determine that they merit inclusion in the bill.

In case you haven't noticed, Congress is not always able to act immediately to solve particular problems or abuses. The process can be painfully slow. As we engage in that process, therefore, we must be certain that the problems we are addressing have not become yesterday's news, while new, emerging concerns go unnoticed. One can become fixated on the abuses that have developed with regard to hostile takeovers, and lose sight of the larger picture of which those abuses are only a small corner.

Let me put this concern in practical context. Earlier this year, we got Dennis Levine out of jail for a day to come to Washington to testify in a closed session before Congress. He met privately with me the night before the hearing. Mr. Levine told me how the large investment banks conspire with corporate raiders to put company after company "into play."

In a typical scenario, the M & A department of an investment bank will focus on a company that might make a convincing target. Its share price might be low because of a cyclical downturn; management might have lost a key employee; the company might make a commodity that is under pressure from imports. It might have a lot of cash on its books, or simply have underutilized debt capacity. There is an almost endless stream of factors that can be used to convince a company that it is a viable target.

The M & A department will then approach the prospective target with an offer to serve as its defensive adviser. If the company accepts, it means a large defensive restructuring fee for the investment bankers and the lawyers. If the company spurns the proposal, the investment banker "shops" the company as a potential target among the raider community. Once someone finds the company attractive, and has accumulated a sufficient amount of stock, the investment banker and the lawyers leap onto the offensive side of the fray.

The raiders, for their part, are almost always ready to put a target into play because there is virtually no downside for them. It reminds me of when Darrell Royal was the football coach at Texas. Royal used to say, "When you put the ball into the air, three things can happen, and two of them are bad."

Well, when a raider puts a company into play, three things can happen and all of them are good! The bidder can get the company. He can be greenmailed out of the action at a hefty profit. Or, he can tender his shares to a "white knight" at a substantial profit.

So, assuming the raider has a sufficient position in the stock so that his profits will cover his legal and financial advisor expenses, there is no downside to putting someone into play.

Now Congress could probably address a large portion of this problem by closing the 13(d) window, by tightening the definition of "group," and maybe by giving the SEC additional enforcement authority. Indeed, we will probably do all of that and more. But to stop there would be myopic. Rather, it is critical that we examine the outgrowths of these abuses and make every effort to try to address the broad economy-wide problems they create.

For example, in recent years, our economy has seen an enormous number of corporate restructurings. One of the principal reasons for these restructurings is to fend off hostile takeovers. Today, companies are loathe to be caught with extra cash in their coffers, even if it might be wise to keep such funds on hand for a rainy day, such as a recession or a market sector slump.

Similarly, times have changed in America with respect to borrowing. There was a time in this country when it was a very positive corporate development to have underutilized debt capacity. It meant that you would have easier access to funds in an emergency. Now, if a company is so well managed as to have underutilized debt capacity on its books, that company is a natural takeover target.

As a result, many otherwise strong companies have leveraged themselves to the hilt to look totally unattractive in the takeover market. And what is going to happen to those companies during the next recession or downturn? In my judgment, we are setting ourselves up for business failure after business failure, and some of our previously strong public companies will be the W.T. Grants of the late '80s and early '90s.

Let me offer one case that I have followed rather closely. In order to avoid falling prey earlier this year to British publisher Robert Maxwell, Harcourt Brace undertook a significant corporate restructuring at a cost of $3 billion in additional debt. Now does anyone really believe that Harcourt Brace is going to be a more vital company as a result of loading up with this new debt? Subsequent events lead me to believe that Harcourt Brace preserved its independence at a very significant cost.

First, Harcourt Brace's restructuring tripled the company's debt. It is now highly vulnerable to economic downturns and interest rate increases. It has drastically reduced its margin for error.

Second, Harcourt Brace recently announced its second quarter earnings -- a loss of $70.8 million. Last year, Harcourt Brace reported net income of $10.9 million for this same quarter. But here is the key figure: revenues for the second quarter this year were nearly $100 million more than for the same quarter last year!

So we have revenues increasing from $312 million to $409 million, yet whereas last year Harcourt Brace reported net income of $10.9, this year they reported a net loss of $70.8 million. The difference is probably interest on the debt.

Then, a few days after Harcourt Brace issued its second quarter report, it quietly put its magazine division on the market. Harcourt Brace was reportedly seeking $400 million for the sale of this unit to help service its debt.

Finally, earlier this week, the Wall Street Journal reported that Harcourt Brace had nearly completed the sale of its business publications unit and its school supply company. And although the buyer was not named, the Journal article speculated that it could be a management team lead by Harcourt's Vice Chairman and an investment bank.

And that leads to another type of problem that can arise from this takeover mania. It seems that corporate managers have learned something from the raiders and have tried to get in on the spoils themselves. The rise in leveraged buyouts in recent years has been nothing short of phenomenal. And again the abuses in this field have also been noteworthy.

Take the Metromedia LBO as just one example. In December, 1983, Metromedia's chairman proposed taking Metromedia private by means of an LBO. The management group offered to pay shareholders in the neighborhood of $720 million for the company. The prospectus included two "fairness" letters from Lehman Brothers and Bear, Stearns attesting to the fact that the price to be paid to shareholders was "fair." I should note parenthetically that according to a subsequent article in Barron's that Lehman Brothers was paid $750,000 for its two-page opinion, with another $3.25 million to be paid if the deal was consummated on the terms it endorsed. Bear, Stearns was paid $500,000 for its opinion, along with another $2 million if the deal went through on its recommended terms.

Well the deal did go through, but here is the interesting part. Within 24 months, the management group sold off a portion of Metromedia's assets -- TV stations, cellular systems, the

Harlem Globetrotters, the Ice Capades -- for almost $4.65 billion. Thus, they paid the shareholders $720 million for a company that two years later turned out to be worth at least six times that amount, with significant additional assets remaining in the original company.

Metromedia is not an isolated case. Indeed, abuses with regard to LBOs have become almost as pervasive as with hostile takeovers. My Subcommittee is currently reviewing filings made with the SEC under Rule 13e-3 by companies in "going private" situations to determine whether all material facts in the transactions were disclosed. In addition, in our SEC oversight capacity, we are determining what additional enforcement or penalty provisions may be necessary to assist the Commission in enforcing violations of this rule.

Is there a unifying theme to all of this? I think there is. Earlier in these remarks, I spoke of the need to maintain the integrity of our markets. Well now I would expand that to say that we must also maintain integrity <u>in</u> our markets. Congress is not interested in decreasing market activity, but rather in increasing market integrity.

Whether we are examining the work of an outside raider or an inside raider, whether a hostile takeover or an LBO, we must be certain that the <u>process</u> has integrity; that shareholders are not cheated and that our nation's future is not mortgaged. We need both moral integrity and fiscal integrity. Otherwise shareholders and deal makers alike will be content with their short-term paper profits while the rest of the world is running our financial affairs, providing us with credit for imported automobiles and computers, and writing down our debt.

The United States presently has over $7 trillion in debt on its books. Our consumer debt of $1 trillion and our public debt of $2 trillion are far outpaced by our corporate debt of $4 trillion. And in this era of proliferating junk bonds, the quality of much of this corporate debt has deteriorated. Remember that the overwhelming majority of junk bonds were issued during prosperous economic times. They have never had to endure a serious economic downturn or a period of steadily rising interest rates.

Moreover, much of this debt is of questionable economic utility. It is not plant and equipment debt, or research and development debt. As a nation we still spend far less on these components than, for example, Japan or West Germany. Rather it is LBO debt and defensive recapitalization debt. As John Shad, former Chairman of the SEC, said, "The more leveraged takeovers and buyouts today, the more bankruptcies tomorrow."

Alfred Malabre, of the <u>Wall Street Journal</u>, has just written a book entitled, <u>Beyond Our Means</u>. In it, he makes the interesting observation that as a country we underinvest in new plants and technologies while we overinvest in quick gratification. He points out that Americans live in the most wonderful houses in all the world, but have some of the most rusted and out-dated factories.

We all know people who live only for today. They get what they can, while they can, however they can, with no thought to the future. This is a bad philosophy for an individual, and a disastrous one for a nation. As Chairman of our Subcommittee, I hope always to keep in view important short-term goals, but will never permit immediate economic gratification to obscure the best long-term interests of our citizens and our economy.

Thank you.