1002 Hillside Ave.
Pacific Grove, CA 93950
January 16, 1989

The Honorable Donald W. Riegle, Jr.
105 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Riegle:

Hostile take-overs, poison pills, greenmail, junk bonds, golden parachutes, Chinese walls are new terms in the lexi-con of investment that relate to the phenomenon of leveraged buyouts. The recent RJR Nabisco acquisition, the largest manifestation of the phenomenon to date, justifiably raised the eyebrows of every segment of society, from investors to lawmakers, and the media compared the perpetrators, KKR and competitors, to nineteenth century robber barons. Particularly perplexing is the question of how KKR could acquire a $25 billion asset by putting down a mere .06% in cash and financing the remainder with securities, including junk bonds, when home-buyers, for example, are required to put a hefty 10-20% of the purchase price down before they can secure a mortgage. (Similarly, private investors are allowed to take over ailing savings and loan associations in Texas and California with very little cash but with the incentives of FSLIC fund infusion in the billions of dollars and massive tax breaks--but this is another subject.)

Such shenanigans led Federal Reserve Chairman Greenspan and Treasury Department and IRS officials to recommend discouraging the practice by deleting generous tax write-off provisions covering the interest payments on capital borrowings in leveraged buyouts and similar investments. This action would certainly be a step in the right direction, but additional and stricter legislation is required if the phenomenon is to be controlled.

Among the pernicious effects on the economy of leveraged buy-outs are the following. <u>First</u>, taxpayers not only subsidize the interest deductions on the financing, but, as consumers, pay higher prices for the products because the enormous corporate debt forces price increases. These products are often necessities--food, clothing, medicines, furniture and appliances, transportation, construction, etc.

<u>Second</u>, in many cases the productivity and efficiency of the companies taken over are compromised. Some examples are Montgomery Ward, Macy's, and Beatrice Foods. Owens-Illinois, the largest producer of glass, lost $40 million in 1987 and is saddled with $38 billion in debt. Safeway Stores closed/sold half of its 2,336 outlets and revenue fell from $18 billion in 1987 to $13 billion 1988, as the company went from no. 1 food retailer in the nation to no. 3. Revco Drugstores with over 2,000 outlets declared bankruptcy last summer. Of what possible value are leveraged buyouts when it is planned beforehand that profitable units will be sold off to reduce the enormous debt incurred? It seems ironic that just a few years ago the trend was for

major corporations to use their profits to acquire unrelated businesses, but now some of these mega-corporations are being purchased with the intention of selling off various subsidiaries to pay off the debts incurred in acquiring them. Mobil Oil's acquisition of Montgomery Ward was not a successful venture, and is no more a desirable management model than leveraged buyouts. Given that the current total corporate debt is $1.8 trillion, we must be concerned about what will happen to some of these leveraged buyout companies saddled with huge debts in the event of a recession.

Third, the take-over artists and their minions are parasites on the economy. Those who profit from leveraged buyouts are the brokers who arrange the financing, assorted middle men, lawyers, and accountants who have no connection either with buyer or seller; they reap hundreds of millions of dollars in commissions. Top executives of companies considered ripe for take-over are well-protected by golden parachutes. Companies which resist must swallow poison pills which soak up profits that should be used to modernize and expand. Boards of Directors and stockholders make a quick profit, but may be disadvantaged at tax time. Corporate bond-holders, middle and lower level employees, who may lose their jobs, and, of course, the tax-payer/consumer, as noted previously, are among the victims. Some of the effects are investor anxiety, an unstable stock market, and incalculable consequences to the economy.

Granted, this is a complex problem which does not admit of easy solution, and every facet must be considered before action is taken. For example, legislation to mitigate the worst effects of leveraged buyouts should not rule out the take-over of grossly mismanaged companies. The following are some corrective actions that can be considered: 1) disallowing the interest deduction on debt incurred; 2) outlawing junk bonds; 3) curtailing the selling off of certain assets/subsidiaries to pay off debt; 4) requiring a substantial downpayment (25%?); 5) establishing limits on commissions to middlemen; 6) abolishing the golden parachute gimmick for CEO's (Why should they have any more job security than ordinary workers?); 7) and passing federal legislation which would be stricter than current state laws that regulate corporate practices. In this regard, it is unclear if SB 1323 and HR 2172 would be as restrictive as some state laws. Indeed, we are not clear what the status and provisions of HR 2172 are at this date. Nevertheless, the unconstitutionality argument seems invalid since the products/services of all companies are distributed nationally and internationally.

Unfortunately, greed and selfishness cannot be legislated out of society, and those inclined will always find loopholes and justifications for their ethically questionable actions. If Congress itself were a better model of probity and integrity (see attached letter relating to honoraria and proposed pay raises), these qualities might rub off on the investment community.

Thank you for paying attention to our concerns about leveraged buyouts and our suggestions for outlawing them or at least mitigating their worst features. Please take appropriate action quickly!

Sincerely,

Wallace W. Notley

John R. Banister

Attachment