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AMERICA FOR SALE? AN EXAMINATION OF THE PRACTICES OF PRIVATE FUNDS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

NOVEMBER 19, 2019

Printed for the use of the Committee on Financial Services

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AMERICA FOR SALE? AN EXAMINATION OF THE PRACTICES OF PRIVATE FUNDS

Tuesday, November 19, 2019

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Velazquez, Sherman, Meeks, Clay, Green, Perlmutter, Foster, Beatty, Vargas, Gottheimer, Gonzalez of Texas, Lawson, Tlaib, Porter, Axne, Casten, McAdams, Ocasio-Cortez, Wexton, Adams, Dean, Garcia of Illinois, Garcia of Texas, Phillips; McHenry, Wagner, Lucas, Posey, Luetkemeyer, Huizenga, Stivers, Barr, Tipton, Williams, Hill, Emmer, Loudermilk, Mooney, Davidson, Budd, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, Gooden, and Riggleman.

Chairwoman WATERS. The Committee on Financial Services will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "America for Sale? An Examination of the Practices of Private Funds." I now recognize myself for 4 minutes to give an opening statement.

Today, this committee convenes for a hearing to examine the impact of private funds on businesses and workers. While there are some examples of private equity firms playing a beneficial role in the U.S. economy, there are far too many examples of private equity firms destroying companies, and preying on hardworking Americans to maximize their profits. Today, we are going to take a hard look at those practices and examine whether Congress should take action to prevent the drastic increase from the $250 million it spent in 2009 on those industries.

After the devastation of the foreclosure crisis in which millions of people lost their homes through no fault of their own, private equity firms swooped in and purchased hundreds of thousands of foreclosed homes at discounted prices. In many cases, they converted these homes to rentals, charged excessively high rents, and became absentee landlords without community ties. Private equity firms increasingly hold ownership of hospitals, nursing homes, and emergency services. In 2018 alone, private equity firms spent a total of $10.4 billion buying up hospitals and medical clinics, a drastic increase from the $250 million it spent in 2009 on those industries.

A New York Times investigation found that an ambulance company owned by private equity Rural/Metro Corporation had slower response times under private equity ownership and undertook, "more aggressive billing practices." According to the report, "Rural/Metro once sent 761 collection notices to an infant girl born in an ambulance."

In the retail industry, 10 of the last 14 companies that have declared bankruptcy are owned by private equity firms. For example, Toys R Us was acquired by private equity firms in a real estate investment trust in 2005. By 2018, Toys R Us had declared bankruptcy, laid off all 30,000 of its employees, and closed all of its stores. Meanwhile, the company's private equity owners had pocketed $470 million in fees and interest payments from the company.

Today, we will hear testimony from Ms. Giovanna De La Rosa, a former Toys R Us employee and advocate.

These are just a few examples of the harm that private equity firms have caused. Unfortunately, the private equity firms the committee invited to testify at this hearing today declined to send representatives to engage and answer questions about their activities. So I would like to thank Drew Maloney, president and CEO of the American Investment Council, which is a trade group that represents private equity firms, for joining us today and testifying on behalf of the industry. But while he will testify on private equity as an industry, Mr. Maloney will not be able to adequately speak to the practices or activities of specific firms.

And so, while we will get started with this today, we are going to have to determine what other actions we may have to take in order to get the information that we think we need in order to make some determinations about what exactly is going on in our society with private equity firms.

I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 4 minutes for an opening statement.

Mr. MCHENRY. I thank the chairwoman for holding this hearing today. And while my Democratic colleagues are not only down the hall attempting to undo the 2016 election, it appears today that committee Democrats are working to predetermine the 2020 Democratic nomination for their party.

Today's hearing is devoted to H.R. 3848, the House companion to Senator Elizabeth Warren's bill, and a key tenet of her Presidential platform. Hooray. We are here today to debate Presidential politics. Moreover, one of our witnesses testifying here today is cited in Senator Warren's press release from her Presidential campaign as providing "the economic analysis" of the bill and its impact.

This bad bill strikes at the foundation of American capitalism. I know there is a socialist lane in the Democrat primary for President. This clearly is that fight for that socialist lane. It has harmful effects as well. A recent, more detailed analysis of the bill found that in a modest-case scenario, the low range, this bad bill would reduce the American workforce by 6 million jobs and lead to $109 billion per year in lower tax revenue. That is the tax revenue piece only. To repeat, that is a conservative estimate. In fact, the worst-case scenario says that over 26 million jobs could be lost. To sum

up the Warren bill, this bad bill, if enacted, would be a disaster for American workers.

Congress should be focused on policies that make the economy more free, open up opportunities, and make the capital markets more attractive and more competitive against our competitors around the globe, rather than bills that add regulatory cost and harm our markets and hurt jobs. Good policies such as the bipartisan bills we passed in the last Congress could lead to greater opportunity and choices for everyday investors to grow their savings. Instead, this committee wants to use Full Committee hearing time to go after and vilify one industry.

There will likely be several misconceptions presented today by my Democrat friends, so I want to use some of my time here to address those. First, private equity is not just about large investors buying out large companies. Generally speaking, private equity is a variety of private investment from venture capital, to capital injections for small businesses, to lending so that small businesses could buy mismanaged other businesses that have potential, huge potential, if just managed correctly.

Second, the private equities business model does not involve intentionally bankrupting companies. Bankruptcy is failure. Failure is not a part of the business model; success is. That is where you see the job growth. That is where you see the returns. And so the idea that an industry could benefit by failing doesn't make sense.

Third, a misconception that some will present is that private equity is just about Wall Street. It is not. Private equity creates investment opportunities that lead to jobs. According to a recent Ernst & Young study of the impact of private equity in the U.S. last year, private equity supports at least 100,000 jobs in 27 States and over 10,000 jobs in each State.

Additionally, Americans directly benefit through pensions. U.S. pension funds invest about 9 percent of their portfolios in private equity, and that same study found that private equities outperformed investment in public equity, fixed income, and real estate over the last decade. That means that everyday investors, including teachers and firefighters and police officers, all benefit. But don't take my word for it. The chief investment officer of CalPERS recently said the following, "We need private equity to be successful, we need more of it, and we need it sooner rather than later."

With that said, I do want to note that private equity has become more important in the American economy due in no small part to increased regulatory barriers on public companies. We should remedy that public company piece, not have a Presidential rally for Senator Warren.

Chairwoman WATERS. I now recognize the gentlewoman from New York, Mrs. Maloney, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, for 1 minute.

Mrs. MALONEY OF NEW YORK. Thank you, Madam Chairwoman.

Many private equity funds have caused needless suffering for ordinary workers, especially in the retail sector. All too often when a private equity fund buys a company, they pile an excessive amount of debt onto the company and then use the bankruptcy system to slash pensions and benefits for ordinary workers. While not

all private equity funds are created equal, it is clear that our committee needs to closely examine these practices.

I am also pleased that this hearing will examine the Stop Wall Street Looting Act, which has been introduced in the House by Mr. Pocan and Ms. Jayapal. This bill would require private equity funds to share the liability for the debt that they pile onto their portfolio companies. I believe that there is a good case to be made for increased risk sharing between private equity funds and portfolio companies in order to deter the "heads I win, tails you lose" mentality.

Thank you, and I yield back. And thank you for having this important hearing.

Chairwoman WATERS. I now recognize the ranking member of the subcommittee, the gentleman from Michigan, Mr. Huizenga, for 1 minute for an opening statement.

Mr. HUIZENGA. Private equity (PE) is an important aspect of the U.S. capital markets that helps create jobs and bolster pension returns for Main Street Americans. Most PE firms make long-term investments in companies poised for growth as well as undervalued or underperforming businesses by providing critical working capital that would otherwise be unavailable through traditional banks. It is important to note that the U.S. private equity sector drives a significant amount of economic growth in the United States and supports more than 26 million American jobs, which contributes $475 billion in annual Federal, State, and local tax revenues.

Additionally, the profits from private equity are funding the retirement security of millions of pensioners. According to the American Investment Council, 91 percent of U.S. public pension funds have invested a portion of their portfolios in private equity. In Michigan, for the State of Michigan's pension fund, that means $71.2 billion. Needless to say, investments made by the private equity industry in our local communities all across the nation are playing a vital role in job creation, wage growth, and retirement savings.

In my district alone, private equity firms have helped create or sustain over 5,700 jobs, and private equity investment was $4 billion, helping companies such as JR Automation in Holland, Brillcast in Grand Rapids, Challenge Manufacturing in Walker, and I could go on. Private equity is a fundamental part of our economy and plays a direct role in our districts by working to make businesses more successful.

I look forward to hearing from our witnesses today, and I yield back the balance of my time.

Chairwoman WATERS. I want to welcome today's distinguished panel: Eileen Appelbaum, co-director, Center for Economic and Policy Research; Wayne Moore, trustee, Los Angeles County Employee Retirement Association; Giovanna De La Rosa, United for Respect, and a Toys R Us employee for 20 years; Drew Maloney, president and CEO, American Investment Council; and Brett Palmer, president, Small Business Investor Alliance.

Each of you will have 5 minutes to summarize your testimony. When you have 1 minute remaining, a yellow light will appear. At that time, I would ask you to wrap up your testimony so we can

be respectful of both the witnesses' and the committee members' time.

And without objection, all of your written statements will be made a part of the record.

Ms. Appelbaum, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF EILEEN APPELBAUM, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Ms. APPELBAUM. Chairwoman Waters, Ranking Member McHenry, and distinguished members of the committee, I am very pleased to be here today to discuss private investment funds.

Most private equity deals are used to acquire small and medium-sized companies, and here my research shows that private equity can bring know-how that makes a positive difference. These investments generally have higher returns than acquisitions of big companies. But in what one finance writer called the paradox of private equity, most private equity money goes into acquiring large companies that offer few opportunities for improving operations and many for financial engineering.

Activist hedge funds take small stakes in major companies and then call the shots. Hedge funds make money from short-term increases in share prices, then sell before the negative consequences are apparent.

Exemption from regulations that rule out risky behaviors enables private funds to gamble with the future of acquired companies while funneling money to wealthy private equity partners.

Private investment funds play a significant role in the U.S. economy. Over the past decade, assets managed by hedge funds and private equity funds have exploded. They doubled for hedge funds, septupled for private equity funds, and now exceed $3 trillion for each. There were nearly 10,000 private equity buyouts between 1980 and 2013, according to a study by Chicago and Harvard economists. They had data for 6,000 companies employing 6.9 million workers at the time of the buyout. Thirteen percent of workers at publicly traded companies lost their jobs in the next 2 years. Overall, 4.4 percent or 304,000 workers lost jobs.

Big private equity firms buy out large, viable companies and use their assets as collateral for risky levels of debt that the company and not its private equity owners must repay. This erodes the buffer that companies have to make it through hard times. Toys R Us is the poster child. It was purchased with $5.5 billion in debt. It went from a capital structure of 87 percent equity and just 13 percent debt before it was acquired to an upside down 17 percent equity and 83 percent debt. Yearly interest payments exceeded $400 million, and total advisory and other payments that went straight to the private equity firm were another $470 million eating up profits. Toys failed. Its stores were shuttered, and 33,000 workers lost their jobs.

It is this reckless loading of debt onto companies that the Stop Wall Street Looting Act would end by requiring the private equity firm and the fund's general partner to be jointly liable with the company for repayment.

Add-ons are another favorite tactic. Private equity firms buy small competitors to add onto an initial acquisition, building national powerhouses without any antitrust supervision. Private equity-owned Envision and TeamHealth own hundreds of doctors' practices and have more than 90,000 employees in hospitals and other health facilities across the country. Both have multibillion dollar loans to pay off. They use surprise medical bills or the threat of such bills to get much higher payments than other doctors receive, driving up healthcare costs.

Hedge funds pursue profits through the purchase and sale of stock in publicly traded companies. Stock buybacks that were illegal before 1982 because they are a form of market manipulation are widely used by hedge funds to raise share prices and then cash out before the effects of draining resources, like the plant closings at General Motors, become apparent. As we speak, AT&T management is capitulating to similar demands from a hedge fund that owns just 1 percent of its stock. At DuPont, the hedge fund firm used a small stake to break up the company and shut down a premier research facility that was a major source of U.S. innovation. It sold its shares before the reorganization was completed.

The Reward Work Act would make stock buybacks and manipulation of share prices illegal again. The Stop Wall Street Looting Act will bring the incentives for private investment funds in line with their stated aspirations: to improve operations at companies they invest in. This and other pending legislation will reduce opportunities for financial abuse and ensure that capital is deployed in support of economic growth and rising living standards.

Thank you.

[The prepared statement of Dr. Appelbaum can be found on page 66 of the appendix.]

Chairwoman WATERS. Thank you.

Mr. Moore, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF WAYNE MOORE, TRUSTEE, LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION (LACERA)

Mr. MOORE. Chairwoman Waters, Ranking Member McHenry, and members of the committee, I am honored to be here this morning as a public pension fund retiree, trustee, and taxpayer. As a fiduciary, I am responsible for protecting public pension plan assets and ensuring promised benefits are delivered. That begins with openness and transparency between us and the asset management industry.

Public pension funds will pay up to $45 billion in fees and expenses to the industry this year, a massive transfer of wealth from workers to Wall Street. My fiduciary duties include making sure we get what we paid for.

More than 20 million active and retired public employees have accumulated over $4.5 trillion in assets to provide for their secure retirements. They are often overlooked during discussions about complex legal and financial strategies, profits, and bonuses. It is past time for workers to exercise greater oversight over their assets.

Along with openness and transparency, we must have cost-efficient investment practices, fair returns, and outcomes that support a growing economy. My constituents expect no less. Last year, at the Los Angeles County Employees Retirement Association, where I am a trustee, 3,800 general members retired. They received an average annual retirement benefit of $45,400.

Controlling and minimizing the cost of investing through a more open and transparent data collection regime as proposed in H.R. 3848 is not an inconsequential exercise. If we could save just $1 million in the cost of investing, those savings invested at 6¼ percent would fund 2 average L.A. County pensions for 20 years, including a 2½ percent annual COLA.

While private equity is our pension fund's best performing asset, it is also our most costly asset. While just 10 percent of our portfolio, private equity makes up over half of our investment management costs.

Over the past decade, many initiatives have been launched to address transparency issues with private equity managers. While much has been accomplished, for example, California's AB–2833, more needs to be done. The disclosures proposed in H.R. 3848 are important to investors and the public as more complete information means sounder and more meaningful asset allocation decisions.

Public pension funds are eager to participate in the growing, worldwide private economy. As a matter of fact, in 2019, Preqin reported that 31 U.S. public pension funds provided 35 percent of worldwide allocations to private equity firms. We do not, however, want to participate through financial engineering, destabilizing our communities, and undermining our future for short-term gains.

Many fund sponsors, participants, and beneficiaries want to see ourselves in our investments; people who look like us making investments that will favorably impact our lives. If I lived in Ohio, I might want to see investments in manufacturing. In California, investments around agriculture and logistics are just as important as technology. Every dollar we earn from investment should be a good dollar.

Being informed by the impact of investment decisions on our constituents is good information. Being open and transparent means helping investors in private equity make good decisions.

Private equity is not a sector of our economy. They buy stakes in sectors of our economy. However, just buying and owning a company does not automatically make you a job creator or an engine of economic growth. It is the outcomes of what you do after the purchases that is important.

As a major stakeholder fueling the private equity industry, pension funds must have a greater oversight role in our investments. After all, it is our money.

Thank you.

[The prepared statement of Mr. Moore can be found on page 99 of the appendix.]

Chairwoman WATERS. Thank you.

Ms. De La Rosa, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF GIOVANNA DE LA ROSA, UNITED FOR RESPECT LEADER, AND FORMER TOYS R US EMPLOYEE

Ms. DE LA ROSA. Thank you, Chairwoman Waters, for inviting me to speak today. I am honored to be here.

My name is Giovanna De La Rosa, and I am from Chula Vista, California. I worked at Toys R Us as an assistant manager for 20 years before private equity firms drove it to bankruptcy. I am here today as a leader with United for Respect to speak on behalf of the 1.3 million workers who have lost their jobs to private equity.

I started working at the Toys R Us store in Chula Vista when I turned 18. I grew up in that store and have deep emotional ties to it. I got to work there with my sister and other family members. I met my husband at work, and our son was a true Toys R Us kid. And, of course, I gained a second family in my coworkers.

We loved working at Toys R Us, especially around this time of year. Our job was to bring joy to kids and their families. We knew our customers, and I was proud to work for a company that cared about its employees and treated us like family.

Then in 2005, two private equity firms, KKR and Bain, and a real estate investment trust, Vornado, acquired Toys R Us through a leveraged buyout. After that, the old culture was thrown out the window. From day one they started making all kinds of cuts that weren't needed. They cut staff and benefits, but we had to keep it together as a team with limited resources.

I thought these new Wall Street owners were coming in to make our company and operations work better. I had no idea what private equity or leveraged buyouts were, but they were making things worse, and then everything fell apart. My life changed that spring when news hit that Toys R Us stores were shut down nationwide, and they laid off over 30,000 of us without a dime of severance pay, despite our years of dedication to the company.

I started having breakdowns at home and work and had to pull it together for my team and for my son who has special needs. It was hard to imagine how I was going to make rent or afford healthcare for us. How could I tell my special needs son that someone on Wall Street made a series of decisions that turned our lives upside down? I couldn't find anything but seasonal work for over a year, despite my experience.

My coworkers and I were left with nothing, while the executives and private equity owners walked away with millions. I heard later that Toys R Us paid $470 million in fees to private equity owners. That would be enough to pay over $14,000 in severance to each employee who lost their job versus the $800 that I received.

That is why I got involved in the fight to hold private equity accountable. I joined United for Respect, along with thousands of other Toys R Us workers to demand justice and severance pay. We told our stories everywhere, from Congress to pension fund meetings to the press. And because of that, KKR and Bain finally started talking to us about a hardship fund for Toys R Us workers. They set up an historic $20 million fund for us, which helped a little bit, but it wasn't enough, and it didn't help us get back the financial security we had when we were working.

Luckily, Toys R Us is making a comeback, and the new owners reached out. Together, we formed a mirror board made up of three

former Toys R Us employees, including me, to help guide the new company. I am excited for the chance to bring Toys R Us back the right way.

Over the past year-and-a-half, I have learned that Toys R Us workers aren't the only ones who went through this buyout hell. Other retail workers are also going through the nightmare of having private equity firms or hedge funds putting their stores out of business. I met workers from Gymboree, Sears, Payless, Kmart, and Shopko, and they all had the same story as me, and they knew the names of the Wall Street firms that made them lose their jobs: ESL, Alden, Sun Capital, and many more.

Because of private equity investments in retail, 1.3 million jobs have been lost. That is 1.3 million people with kids, parents, and grandparents, who also lose their financial security.

We need real change like the Stop Wall Street Looting Act. The last time I was in D.C. was to help introduce the bill with our amazing partners at Americans for Financial Reform, the Center for Popular Democracy, and in Congress. I believe that this bill can protect jobs by regulating private equity so they can't make money by putting people like me out of work.

And now our fight has caught the public's attention, because more and more people from retail workers to nurses to grocery store workers are speaking out. The economy isn't successful and thriving when so many of us are losing our jobs. What would you do as a single mom raising a special needs child, then being left with nothing: no job, no income, no healthcare? We are counting on you to do the right thing and pass this bill. We are waiting to see which side you are on, working people or Wall Street billionaires.

Thank you.

[The prepared statement of Ms. De La Rosa can be found on page 83 of the appendix.]

Chairwoman WATERS. Thank you, Ms. De La Rosa.

Mr. Maloney, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF DREW MALONEY, PRESIDENT AND CEO, AMERICAN INVESTMENT COUNCIL

Mr. MALONEY. Good morning, Chairwoman Waters, Ranking Member McHenry, and other distinguished members of the House Financial Services Committee. Thank you for the opportunity to testify today.

My name is Drew Maloney. I lead the American Investment Council. We are proud to represent private equity firms of all sizes. Our industry creates jobs, powers the economy, and strengthens the retirements of millions of Americans. Our industry provides businesses with the capital and expertise to grow.

The term "private equity" is very broad, so before I go any further, I wanted to take a minute to talk about three main forms of private equity: venture capital; growth capital; and buyouts. Each describe investments at a different phase of the business cycle.

Venture capital represents those early investments in startups that need capital to exist. For example, private equity made early investments in Uber, Spotify, and Peloton long before those companies became household names.

Growth capital is when private equity invests to expand an existing company. Growth capital represents the largest part of the investment chain. A great example is Tate's Bake Shop founded in New York by Kathleen King when she was 21-years-old. She partnered with private equity to grow the business, and now Tate's cookies are in grocery stores across America.

Finally, buyouts. Buyouts are private equity investments in well-established companies that may be distressed or underperforming. Private equity helped Hilton Hotels almost double in size during its 11-year investment in the company. Hilton was recently recognized as the best company to work for in the United States.

The ultimate objective of each of these investments is to build a better business. Private equity provides patient, long-term capital that allows management to think beyond quarterly earnings and short-term fluctuations in stock price. Private equity also provides more than just capital. Firms bring operational expertise to each investment and often work closely with management of each company to define strategy and map out long-term growth objectives.

The biggest investors in our industry are pension funds and university endowments. Successful private equity investments strengthen the retirements of public and private sector workers, including teachers, firefighters, and police officers.

In total, the private equity sector in the United States employed 8.8 million people and paid $600 billion in wages and other benefits in 2018. That included more than 1.1 million jobs in California. Roughly a third of those private equity jobs were in manufacturing, construction, transportation, or warehousing.

Private equity invested $685 billion in more than 4,700 businesses across the U.S. last year. Most of these are small or midsized companies. Businesses of every size in every congressional district depend on private equity capital and expertise to grow.

In 2014, private equity invested in Inland Coatings, a small industrial coating manufacturer in Adel, Iowa. The investment helped the company grow to become an industry leader and provided healthcare and retirement benefits to its employees.

Ninety-one percent of public pension funds have invested a portion of their capital in private equity. And in 2018, we generated the strongest returns of any asset class over the last 10 years. The Los Angeles County Employees Retirement Association had one of the highest average annual returns in the country. Earlier this year, the chief investment officer of the California Public Employees' Retirement System (CalPERS), the country's largest pension fund, said, we need private equity, we need more of it, and we need it now.

These strong returns have become increasingly critical for pension funds at a time when many do not have enough money to meet their existing obligations. Private equity is proud to help close that shortfall.

Thank you again for giving me the privilege of appearing before the committee today. I am grateful for the opportunity and look forward to answering your questions.

[The prepared statement of Mr. Maloney can be found on page 94 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Palmer, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF BRETT PALMER, PRESIDENT, SMALL BUSINESS INVESTOR ALLIANCE

Mr. PALMER. Thank you very much.

My name is Brett Palmer, and I am the president of the Small Business Investor Alliance (SBIA). SBIA was formed in 1958 to represent small business investment companies, the original American venture capital and private equity funds.

As the small business investing market grew more complex, so did SBIA. And SBIA now includes small business investment companies, rural business investment companies, business development companies, as well as conventional private equity and debt funds. These private equity funds pursue a wide range of investing strategies because this is a continuum that spans from the early stage venture investors to the latest stage buyout and everything in between.

While we segment these investing styles for the sake of simplifying and explaining them, the reality is they are all inextricably interconnected. Our members also include institutional investors such as university endowments that invest in private equity, where they get their best returns.

Private equity is a real and mutually beneficial partnership. As such, our public policy goals are balanced and focused on maintaining a robust, healthy, and competitive market for investing in American businesses. Good public policy should increase the capital options available for a company's success, whether that company is a start-up business, proving its products in a competitive market; a small family-owned manufacturing business, managing through generational succession; or a larger company, including retail companies that are trying to adapt to a new competitive threat in the form of technology and e-commerce, as well as take advantage of those opportunities of e-commerce.

Our members grow businesses and are rightfully proud of what they do, of how they do it, and of the benefits their actions have on people and on communities, because private equity is a force for good, a source of job creation, and a driver of innovation.

Private equity supports the retirement security of millions of pensioners and provides endowments the money they need to provide scholarships and educational access to a new generation of college students. And private equity is also invested all over the country, including to areas of the country that are otherwise passed over or passed by. Most of our member funds are in places like Little Rock, Indianapolis, Buffalo, Kansas City, or other places that are far from Wall Street or Silicon Valley, but we do have investors there too.

But regardless of the investing style, private equity investors in small and medium-sized businesses make money by helping the businesses grow and succeed. The idea that private equity funds succeed by having businesses fail just isn't true. The only way to be a successful private equity fund in the lower middle market is to find smaller businesses, and help them grow to be bigger, better, stronger businesses. And private equity provides patient capital

that conventional banks cannot provide themselves. They help businesses make big leaps forward that they otherwise would not have been able to achieve on their own.

And not having the resources to embrace change that happens in the economy on a constant basis creates more risk. The more capital options a company has, the better chance it has to survive and succeed in the long term. If a business cannot survive and adapt to change, it cannot maintain its employees, much less add new employees.

If Congress can agree on one thing, we would hope that Congress should agree that regulatory and tax policy should promote and empower private equity to invest into more growing American businesses. Congress should reject policies that make it harder for private equity to provide access to capital, particularly the smaller and medium-sized businesses that already face disproportionate challenges to capital access. We need more investment, not less.

While providing growth capital is the core of what private equity does, it is not just money. Successful private equity managers invest in people. That is why SBIA partnered with the Ohio State University's business school to train business executives on how to grow their business. Just this month, over 45 small business executives took part in a 3½-day intense training seminar on how to maintain their employees, how to attract new employees, how to manage growth, how to successfully operate in a leveraged environment, and how to create successful strategies. In other words, our private equity funds are training their businesses how to grow their businesses by investing in their employees and by investing in their customers.

Again, private equity can only succeed when the businesses grow, and growing businesses need to retain their employees and they need new employees to help that growth.

I would like to close with a real-world example of what private equity does. The Florida Autism Center provides center-based autism therapy services to children throughout Florida. In 2016, Resolute Capital Partners out of Nashville invested both debt and equity capital in a small platform that had only 5 centers and served 50 children with 70 employees. The company will end this year with 51 centers serving over 1,000 children with over 900 employees and has expanded into Georgia. The company was founded by a woman who started her career as a behavioral therapist. It has been led by a female CEO throughout this stage of growth. This is a growing business. This is the kind of business that changes people's lives, and this is what private equity does.

With that, I yield back, and I am pleased to answer any questions you may have.

[The prepared statement of Mr. Palmer can be found on page 102 of the appendix.]

Chairwoman WATERS. Thank you very much.

Let me thank all of our witnesses for being here today.

Allow me to take a moment to say to Ms. De La Rosa that your testimony to us today was extremely revealing, and you have described to us the impact that this basically undermining of Toys R Us by private equity firms and managers such as Bain and KKR has had on you, your families, and other employees of Toys R Us.

As a matter of fact, Toys R Us is our case study about private equity firms, and so your being here today is not lost on us at all. Thank you.

Dr. Appelbaum, because people's lives and health are at stake, as well as concerns about equitable treatment for all communities, emergency medical services and other industries related to help and public safety do not operate like for-profit firms. Studies have shown that when private equity firms move into health-related industries, costs go up, standards and quality of medical care decrease, and emergency public health response times lag.

Just last year alone, ManorCare, the second-largest nursing home chain in the United States, realized an astonishing 26 percent increase in its total annual health code violations after it was acquired by the private equity firm The Carlyle Group. And according to The New York Times, Trans-Care EMS, which was taken over by the private equity firm Patriarch Partners, was forced to close its doors up and down the East Coast, including in Mount Vernon and Brooklyn, New York. Many have argued that there are certain sectors, especially industries related to public health and public safety, that are too sensitive for private equity firms to be operating in.

Now, you have heard and you know all about Toys R Us. I don't know what you know or understand about what I just described in relationship to health and public safety. Can you tell us, Ms. Appelbaum, why you think private equity firms should acquire public services such as health clinics and hospitals and fire departments, et cetera, given the information that has been, basically, understood now about what they do when they take over these kind of public safety entities?

Ms. APPELBAUM. I think the place to begin is that we are not talking about normal marketplaces when we talk about healthcare, especially when we talk about emergency care, whether it is ambulances, air ambulances, emergency rooms. These are situations in which you do not say, how much are you going to charge me for this? I would rather have a cheaper ambulance. It doesn't work like that. These are services that you are going to use because you urgently need them and you have no opportunity to bargain over price, which means that the services are able, if they so desire, to charge whatever prices they want, as high as they want, without losing any business.

Chairwoman WATERS. Do you think private equity firms should be allowed to take over these kinds of services?

Ms. APPELBAUM. I do not think so, because—

Chairwoman WATERS. What about you, Mr. Moore, do you think they should be allowed to take over these kinds of services?

Mr. MOORE. It depends on the strategies that they are going to employ in taking over the companies.

Chairwoman WATERS. I can't hear you.

Mr. MOORE. It depends on the strategies that they are going to employ—

Chairwoman WATERS. We have information now that they have slowed down response times, et cetera, et cetera. So given the information that we already know about them, do you think they should be able to continue to take over public health?

Mr. MOORE. Given that information, I would say no.

Chairwoman WATERS. What about you, Ms. De La Rosa?

Ms. DE LA ROSA. No, ma'am. The way we were—

Chairwoman WATERS. Mr. Maloney?

Mr. MALONEY. Yes. I believe we can be responsible investors in the healthcare investment community.

Chairwoman WATERS. I beg your pardon?

Mr. MALONEY. Yes. I believe that we can be responsible investors across all sectors, including healthcare.

Chairwoman WATERS. What about the evidence that we already have? Should we just forget about that?

Mr. MALONEY. I think there are some isolated cases that are unfortunate, but overall, there are very positive cases that—

Chairwoman WATERS. Our research shows that it is not isolated.

Mr. MALONEY. Madam Chairwoman, there are great examples of investments that we have out there in healthcare. For example, GrapeTree Medical Staffing in Iowa is a great example of private equity partnering with a business to increase the demand of nurses and healthcare professionals in Iowa. And after 2 years, that partnership has expanded into—

Chairwoman WATERS. Thank you very much.

Mr. Palmer, what do you think?

Mr. PALMER. I don't know anything about owning hospitals. That is not what our guys do. They are too big. But I will tell you that there are parts of the country that have healthcare now that did not have it until private equity bought small businesses that were healthcare providers and expanded them into communities that didn't have any. We gave an award to one of those companies, I think last year or the year before, because they provided the first primary care and emergency care services in Appalachia.

Chairwoman WATERS. Thank you. My time has expired, unfortunately. Thank you.

The gentleman from North Carolina, Ranking Member McHenry, is recognized for 5 minutes.

Mr. MCHENRY. Thank you.

According to Moody's, private equity-backed firms have no greater bankruptcy rate than nonprivate equity firms in this country. There is a big misunderstanding of what private equity is, though. So let's start with the business model, Mr. Maloney. If you are here on behalf of the industry, let's describe what a buyout fund does, since that is the largest piece of what private equity does, although not all of what private equity does. But how does a buyout fund work?

Mr. MALONEY. A buyout fund will pull resources from pension funds, and college endowments, and it will go invest with companies that are either in need of growth or large companies that are underperforming and work side by side with those companies.

And I would say that, as you suggested, the overwhelming majority of our investments are successful. That is the only way that we make a return for our pension holders. And if you look at what you said, the 6 percent bankruptcy rate, that means 94 percent of our deals are successful, so that the transactions like Hilton Hotels, Dunkin' Donuts—

Mr. MCHENRY. So the idea is you take capital and you bring some expertise with the capital to improve a firm. Is that how you would explain it, Mr. Palmer?

Mr. PALMER. That is right. And for a buyout, you are changing ownership. And when you are changing ownership, oftentimes it is a founder, someone who is retiring. There are a lot of baby boomers who started businesses, or post-baby boomers who are retiring, and you are taking the next generation. Oftentimes, of the people who work at that business management, you are buying out the owner. They go away. They stay on for a little bit. They retain some of the ownership of that business, but you apply new technologies. You buy new equipment. You grow it.

And that is how buyouts work in the lower and middle market, and they are a really powerful force for job creation and business growth and sustainability. Without that buyout, many of these businesses that are owned by baby boomers would literally shutter, even though they are profitable, good businesses that are employing people today, not because of bankruptcy, just because there is no one there to take it and run it.

Mr. MCHENRY. Okay. So if you have an investment, then you would get debt alongside that investment in order to purchase, right?

Mr. PALMER. That is right.

Mr. MCHENRY. As an individual, if I want to buy a small business, that is what I would do, I would go to a bank and get lending.

So how do you get lending if your business model is bankruptcy? A great shrug from everyone. It is very difficult to get lending if you are going to put the screws to your lender, right? And then, there is the question of liability.

So, Mr. Moore, you are an important member of the board for the investors, right? Do you have individual liability for the decisions that you as a board member make on behalf of your investment fund?

Mr. MOORE. No.

Mr. MCHENRY. Okay. Does any individual here on behalf of their association or their employer have individual liability if their employer makes a bad decision?

I will take that as a "no" across the panel.

As Members of Congress, for the decisions we make on behalf of our constituents, do we have individual liability? No.

The Warren bill here today would apply liability to the employees of the private equity firm and the investors of the private equity firm. That would be a new form of investing, which would be a real regression for investment capital and business structures. Along those same lines, the business model of bankruptcy doesn't get lending. So, therefore, the bankruptcy rate question, I think, is a material one here.

Now, the decision for your pension fund, Mr. Moore. I read that, recently, the board made a unanimous decision to deploy 150—was it million or billion?

Mr. MOORE. Million.

Mr. MCHENRY. Million—$150 million—it is Washington; I have to ask those questions, sorry—in a buyout fund. Is that correct?

Mr. MOORE. Yes.

Mr. MCHENRY. And did you support that decision?

Mr. MOORE. Yes, I did.

Mr. MCHENRY. Okay. So in terms of private equity, even with the high fees that you pay, as you testified, is private equity still your top performing investment for your fund?

Mr. MOORE. It has been for about the last 10 years.

Mr. MCHENRY. Okay.

Mr. MOORE. So we are active in the industry.

Mr. MCHENRY. Even after fees?

Mr. MOORE. Even after fees.

Mr. MCHENRY. Okay.

Mr. MOORE. It could be even more if the fees were lower.

Mr. MCHENRY. Of course. And I think in California, CalPERS and your fund have significant power in that. So with that, it looks like the business model is—we have a better understanding of that, the understanding of bankruptcies no higher than nonprivate equity firms, and the idea of new strict liability for individuals employed by private equity is not commensurate with who we are in our American capitalist structure.

I yield back.

Chairwoman WATERS. Thank you.

The gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, is recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman, and thank you for having this hearing today where I think that we need to have an important conversation and discussion, because I think we do get confused at times with where to go, and sometimes you want to knock the whole industry out as opposed to looking to see who may be on the bottom. What we can do, what is our responsibility as Members of Congress to make sure that individuals like Ms. De La Rosa and her family have a softer blow. But at the same time, we know, as I have heard from Mr. Moore, that we have individuals who are pensioners and others who are dependent upon a return on investment from private equity so that they can retire and live in a decent space. We want to make sure that they get that return on investment also.

We are still trying to figure out how we work it out so that the average, hardworking American gets the benefits that they deserve. And what do we do when we have a company that is—and going by what Mr. Maloney was saying, that is distressed, about to go bankrupt, about to go out of business?

I have right now a scenario where there is a company, it happens to be a minority-owned company in full disclosure, that I am trying to get some private equity dollars in, because if I don't, they are out of business. They are out of business. They have no—they are coming to me to say, "Help me. Can you help find somebody that would invest?" And part of my struggle is to make sure that some private equity firms are investing more in minority-owned firms so that they can continue to exist and grow and be part of the road capital. Because oftentimes, minority-owned firms don't get the road capital so they can expand their existing businesses and move forward, and I find the discrepancy therein.

And so part of what I want to do is to make sure that we are able to make sure that there is diversity in regards to my community, for example, JFK Airport. I demanded, working with my governor, 30 percent equity for minority firms in that airport, and we are getting it. And they need some investment. And oftentimes, some of those minority firms that are those 30 percent partners are getting that investment so that they can then do and they work in cooperation with the community, and in my case, in cooperation with SEIU and the Teamsters and other labor unions so that we are working collectively together, because the labor unions are also concerned about their pensioners. So we are all working together, and that is why this conversation is important.

I think, furthermore, what we need to explore, and I raised it previously in this committee, that I do have concern about, because when you talk about the overall economy, and I go back and forth and here is what effects—and I think this happened with Toys R Us and others—does leveraged lending have, and can that overburden us so that we can get into a financial crises in the manner that we did in 2008? And so, I want to continue to have dialogue and conversation. I don't fully understand it to be—you have made a decision, but I want to make sure that we look at it. I think we have a responsibility as a committee. That is why this hearing and others are tremendously important as a committee to look at what effects does leveraged lending have on our overall economy and what effects do take place.

I think what Chairwoman Waters was talking about, which I think is tremendously important, when you talk about public institutions, whether or not there are sacrifices that maybe we have to go overboard. For example, I know we had this big crisis in regard to the VA hospitals and timing and what happened. So do you put in measures that may increase the time that a medical person or a patient gets to see a doctor because of trying to manage it? What are the pros and the cons? I think that is a good discussion to have. And I think that is what she was talking about with reference to some of the evidence, and that is a good, healthy discussion to have.

I am about to be out of time, and I wanted to ask Mr. Maloney, specifically, though, because I see on the minority private investment companies, and you represent a lot of them, that they have outperformed a lot of the best market of all U.S. private equity firms. But despite that evidence, the number of diverse private equity firms remains very low.

So I was wondering what, if anything, that we can do to address the biases against diverse private equity firms that I see that is taking place in our country today.

Mr. MALONEY. Congressman, thank you for that question, and thank you for your leadership on this issue and your support of the JFK project. And I think the JFK project is one that highlights what we are continuing to do and can do on a national basis, which is not only do we partner with labor, but we also partner with minority-owned firms like we are in New York. And we all understand that diversity makes us stronger, and we are committed to working with you on projects like that and expanding this project.

Thank you.

Chairwoman WATERS. Thank you.

The gentlewoman from Missouri, Mrs. Wagner, is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Madam Chairwoman. And I want to start by thanking the witnesses for being here to testify today to examine the private equity industry.

Private equity helps grow American jobs and gives everyday Americans more comfortable retirements by providing returns to pension investments. The private equity industry supports American companies and jobs throughout the country.

And a recent study found that in 2018, the U.S. private equity sector directly employed 8.8 million workers who earned approximately $600 billion in wages and benefits. The average worker in a private equity-backed company earns approximately $71,000 in wages and benefits, and that translates to around $36 per hour.

In my congressional district alone, there are over 47,000 constituents working at private equity-backed companies. And over the past 5 years, Missouri's Second Congressional District has received $17 billion in private equity investment.

Without access to private equity, many American businesses would not be able to expand, hire workers, and provide the crucial services for their local communities.

Mr. Palmer, there have been claims that private equity funds are underregulated. What sort of regulations are private equity firms subject to?

Mr. PALMER. It depends a little bit on the type of private equity fund. You actually have a buyout fund in your district. Holly Huels, whom I think you have met in the past—

Mrs. WAGNER. Correct.

Mr. PALMER. —with Deloitte Capital. It specializes in investing in small manufacturers and taking them to the next level as they have generational transfers. But private equity funds are regulated as far as who is allowed to invest into them. If they are small business investment companies, they are regulated by the SBA. If they are conventional private equity funds, they are regulated by the SEC. There have to be all sorts of disclosures. There have to be controls on what they do and how they do it.

There are all sorts of protections that are in regulations that actually aren't formal government regulations that institutional partners like Mr. Moore put on private equity funds in a limited partner agreement. They require transparency and require good practices and prohibit bad actors and investing in businesses that institutionals would not be proud of. There are a lot of restrictions that are out there, but the funds themselves need to be able to move at the speed of business.

Mrs. WAGNER. How would the additional regulations being proposed today impact not only the private equity industry, but the companies backed by private equity, the employees of those companies, and the smaller pension funds seeking to maximize returns for pensions?

Mr. PALMER. The Stop Wall Street Looting Act, though well-intentioned, actually harms Main Street far more than it limits Wall Street.

Mrs. WAGNER. Absolutely.

Mr. PALMER. And it would cut off capital and create a significant disincentive to be investing in businesses because of the liability of being transferred up even for founders, because if you maintain 20 percent ownership in the business, which is in the bill, you are a control person. So if you have a founder who is retiring, buying out, but that he or she still owns a piece of the business for 3 or 4 years while they are helping the next generation take that business on, if that business were to fail because of some technological change or some market shock, that person not just loses their share, they have all this liability transfer. They lose everything. That is not the way this is supposed to work.

Mrs. WAGNER. The Stop Wall Street Looting Act, which is Senator Elizabeth Warren's bill, would establish vast liabilities on private equity investors and impose controls on when and how investors can receive their money back.

Mr. Palmer, in your view, what would the impact of this bill be on the private equity industry and on the middle market economy?

Mr. PALMER. I think there would be a lot less investing in businesses. There would be a lot less lending to businesses. Most lending works. And bankruptcy exists for a reason, but most lending works. Most of it is constructive, most of it is positive, most of it is growth-oriented, particularly for smaller businesses that aren't liquid. They can't just sell their stocks on the NASDAQ or the New York Stock Exchange. They have to go to private equity in the private markets. If they don't have access to capital, they don't grow. They get stale. They lose in the global competitive market.

Mrs. WAGNER. How many jobs would be jeopardized if the private equity industry was unable to provide capital to small and middle market businesses?

Mr. PALMER. You would have the ceasing of—for one, you would have some jobs that are lost immediately, but also on a going-forward basis, you would have millions of jobs that just wouldn't be created. And a lot of those jobs that wouldn't be created are in manufacturing and businesses that need to constantly be changing and that aren't in necessarily Silicon Valley or Wall Street—

Mrs. WAGNER. I don't have much time. Plainly, would there be more jobs or fewer jobs in America if H.R. 3848 became law?

Mr. PALMER. A lot fewer.

Mrs. WAGNER. Would there be more investment or less investment?

Mr. PALMER. Less investment.

Mrs. WAGNER. Would the university endowments be better off or worse off?

Mr. PALMER. Worse off.

Mrs. WAGNER. Thank you, sir.

I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Colorado, Mr. Perlmutter, is recognized for 5 minutes.

Mr. PERLMUTTER. I am just going to take a minute.

I guess on this subject, I am more where Mr. Moore is. There is a continuum of private equity folks, from good actors to bad actors, from those who are going to put in primarily equity and capital to those who are—it is mostly going to be debt driven, those who want

to bring good management skills and grow the organizations and stabilize the organizations to those who want to strip out whatever golden nuggets might be, you know, find gold under some retail operation. And so, this is definitely a one size-doesn't-fit-all.

And I practiced bankruptcy law for a long time before I was elected to Congress and business bankruptcy, and we saw leveraged buyouts where there were some real bad actors, primarily in the mining business and in the extractive industries. But a lot of this has to do with the chicken and the egg. Is there a problem? And I would say to Ms. De La Rosa, is there a problem with the organization going in? Are they struggling financially? Is retail sort of on the ropes because of an Amazon? Or is it because a group comes in that is predatory in nature and is just going to strip out the good things and leave nothing but the bones, those we call the vulture funds or the vulture capitalists?

So, Mr. Moore, I would like you to expand on your testimony. I would like to see the pension funds and the others have more information available to them. I certainly would like to see that.

And then, Ms. De La Rosa, I want to talk to you a little bit about the retail business and the future of it.

Mr. MOORE. Mr. Perlmutter, first off, I think it is a false narrative to say that money will not flow into companies that needed it to grow and expand just because they can't receive it through a private equity construct. The money will flow to where it is needed without regard to whether it comes through private equity, a bank, individuals, and multiple other sources.

Secondly, you were saying that there is a whole continuum of private equity investment strategies, and we have been successful at LACERA, at our pension fund, in identifying strategies in industries that looked promising, that didn't have negative impacts on our workers, and that looked like they were going to be in the future. For example, we were early investors in Silver Lake and Vista, and those companies focused in technology and family-owned businesses and helping them grow.

And no one can deny that some of the buyout firms' specific strategy was to go into companies that had value and extract that value and leave the company, because their timeframe is 5 to 7 years. They are not in it for the long term, many of them.

So in conclusion, I would just say that the strategies that are being employed by the companies are very important, and that is why we need to have transparency, and the regulations or the rules that are promulgated through H.R. 3848 would help us get the information we need, and all the other pension funds need, to make good, reasonable decisions on who to invest in, so that we don't have the type of problems that we had with Toys R Us.

And the last thing about Toys R Us is, if Toys R Us had not been layered with all of this debt, without the ability to invest in the infrastructure they needed to be an online retailer, they might still be here today, and all of those people would still have their jobs. But the buyout firms went in, took all the value and all the money they could get out of the firm, and then left it high and dry.

Mr. PERLMUTTER. Okay, thank you.

And I would just say, for you and the other pension funds and those that really bring the money, ordinarily, I am not sure we

have to have legislation, but I am happy to deal with that, but usually those with the gold make the rules. And I want to make sure our pension funds do get to develop the contracts.

Ms. De La Rosa, when you were working at Toys R Us, when they came in and made the buyout, did you see them strip out the value right away, or how did that work?

Ms. DE LA ROSA. Yes, sir, it was right away. cutting of jobs, positions, changing of operating companies that we used, contracts.

Mr. PERLMUTTER. Okay. Thank you for your time.

Chairwoman WATERS. The gentleman from Florida, Mr. Posey, is recognized for 5 minutes.

Mr. POSEY. Thank you, Madam Chairwoman, for holding this hearing, and I thank the ranking member, as well.

Today, we have before us a piece of legislation that could restrict one of the longstanding features of our market-based system of finance. The feature is a concept of limited liability or a limited liability corporation.

The history of our financial system is marked by innovations that have helped us manage risks that might have otherwise discouraged investment and growth in our remarkable economy.

One of those innovations was the limited liability corporation. New York law created the limited liability stock company. Robert Shiller, Nobel economist, says the law further democratized finance by clarifying that shareholders would never be held liable for the debts of corporations.

The law made it possible, for the first time, for a small investor to hold a diversified portfolio consisting of stocks in many companies. Prior to the advent of limited liability, one could not have done such a thing, for fear of a lawsuit from any of the companies that he held stock with. This development created a ready pool of investors with whom investment bankers could place newly issued shares.

After seeing the steady supply of capital for new businesses this innovation produced, countries all over the world copied it. We, of course, need to be cautious about restricting such an invention that has served us so well over the years.

I say this while also understanding the pain of business failures and the loss of jobs, tax revenues, and other economic contributions to our communities. I believe we have to realize that a private equity firm doesn't acquire a company to have it fail. They intend to make money from a stronger firm.

Unfortunately, their aims are sometimes frustrated by the market for goods or services of the underlying firm. But we must understand that success means stronger firms, job growth, and overall great contributions to our community and our countries.

Mr. Maloney, can you share with us your assessment of the economic impacts of the Stop Wall Street Looting Act of 2019, specifically which sectors of the economy are most likely to be affected if this bill becomes law?

Mr. MALONEY. Thank you for that question and your concerns, Congressman, about eliminating sort of the traditional limited liability protections that allow for investment in the current marketplace.

In a recent study by Professor Swenson from the University of Southern California, he suggests that the loss of jobs would be between 6.2 million and 26.3 million jobs in the U.S., and that the loss of tax revenue could be between $109 billion and $475 billion, and that public pensions would lose up to $329 million.

So what would happen is, if the public pensions don't have this top asset class to go to—and as Mr. Moore said, at his fund last year they returned, I believe, 21 percent—

Mr. MOORE. No, no, that is wrong. Sorry.

Mr. MALONEY. That's okay. But my point is, it is a high performer and you would have to switch asset classes to a class that doesn't perform as well.

Mr. POSEY. Okay.

Mr. Palmer, do you agree?

Mr. PALMER. I do. And you asked the question of which businesses would get less capital and what would come out. The businesses that are asset-light—and a lot of businesses in the new economy are asset-light—would not be able to get loans, they would not be able to get access to capital, and so you would really have a shrinkage in the access to capital.

Would capital be available? Yes, potentially, but it might be more expensive, and in many cases, it might not be available at all.

Mr. POSEY. Okay. The critics of private equity (PE) funds promote the perception that PE firms makes lots of money, even when one of its acquisitions goes bankrupt. Can you clarify the impacts of a typical case of such bankruptcy for a PE firm? Mr. Maloney, and then Mr. Palmer?

Mr. MALONEY. As we have discussed, bankruptcies in private equity are very rare, and nobody succeeds in a bankruptcy. We try to grow businesses and increase jobs.

Mr. POSEY. Thank you.

Mr. Palmer?

Mr. PALMER. With bankruptcies, you lose money. It is just that simple. There is no good way. You might be able to save a business in buying a business out of bankruptcy and try to reinvigorate it. That is possible. But in bankruptcies, there is no winning strategy.

Mr. POSEY. My time has expired. Thank you, Madam Chairwoman.

Chairwoman WATERS. The gentleman from Illinois, Mr. Foster, is recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman, and thank you to our witnesses.

As a scientist, and a businessman, I find myself a little bit frustrated. We seem to be having this argument by anecdote rather than statistics.

And the difficulty is—I guess I put myself to sleep last night reading one of the papers that was mentioned in the memo distributed by the committee from the University of Chicago called, "The Economic Effects of Private Equity Buyouts."

And there were some interesting numbers in there. For example, the employment at targets of private equity buyouts rises 13 percent in firms that were previously under private ownership and 10 percent on what are called secondary buyouts, where it is sales from one PE to another. However, the employment falls by 13 per-

cent in buyouts of publicly listed firms and falls by 16 percent in divisional buyouts.

And so, trying to understand the multiple faces of private equity that we have been talking about is, at least to me, sort of frustrating. And there are many variables in that. We have what sector the firms are operating in, what the holding period is, the target holding period is, whether they are public versus private firms, whether they are generational transfers or ongoing businesses, and, of course, just the size and degree of leverage.

Can any of you or all of you maybe come to an agreement on what the red flags are that signal a troublesome aspect of this versus things that tend to result in good results? What variables should we be looking at to try to separate the wheat from the chaff here?

Ms. APPELBAUM. I think that one thing that we have to say about the private equity business model that has not been said is that the debt is put on the company that is acquired. It has to repay it. But the decision to put the debt on it is made by the private equity firm.

So the private equity firm goes out, decides how much leverage to use, and then it is the company that has to pay it back. And the private equity firm and the general partner have no responsibility for this whatsoever.

This is the crux of the problem. In the small and medium-sized companies that we have been talking about, they have very little in the way of assets that can be mortgaged, and so the level of debt is quite reasonable. Those companies are not going to be affected by the Stop Wall Street Looting Act because the level of that is so low.

In the case of those publicly traded companies that you mentioned where all the jobs are lost, these are big companies. They are publicly traded. They already have good operations in place. They already have good business strategy in place.

Mr. FOSTER. Is that necessarily true? It is not clear to me. I don't know the history of Toys R Us, but a lot of big box companies, public and private, have had rough times in the last decades.

Ms. APPELBAUM. I did an analysis, looking at Albertson's, which is a private equity-owned supermarket, compared to Kroger's, which is not. They both faced the same kinds of problems: e-commerce, Amazon, Walmart, whatever you want to call it.

Kroger, because it controls its own resources, is not paying out to any private equity firm, it does not have high leverage, it is not paying interest on debts, so it has been able to modernize. It can do anything that Amazon can do. Its Moody's rating has gone up, its contributions to its workers' pension fund to make up for the financial crisis has gone up.

And Albertson's is on the ropes. It can't go back to the public markets. Nobody wants to buy it. It tried to do a reverse merger with Rite Aid, and those shareholders rejected it. It is on the ropes because it has not made the necessary investment.

Mr. FOSTER. You mentioned that by and large, you thought the smaller buyouts were not problematic and that—

Ms. APPELBAUM. That is correct.

Mr. FOSTER. —private equity was a plus—

Ms. APPELBAUM. That is correct.

Mr. FOSTER. —in sort of limited size buyout.

Is that something that the entire panel would agree with, at least that sector is probably an area where private equity is a net plus across the economy?

Mr. PALMER. That is where a lot of my folks are, and they certainly see it that way. There is certainly the greatest opportunity for growth because you are small. You can't shrink it and cut costs because if you shrink small, it goes to nothing.

So really, it is more growth-oriented in a buyout, but there is also much greater access to capital at the higher ends and much lower access to capital, both debt and equity, at the lower ends. In my written testimony, on page 5, I sort of have a visual of that. The small buyouts are good, but middle buyouts are also very good.

Mr. FOSTER. I am trying to understand, if there is a consensus that small or, say, middle, however you define, "middle," is also probably an area where private equity is a net positive and the existing regulation is perhaps adequate? Is that sort of the consensus here? And the problem, if it exists at all, is in the largest?

If any of you could follow up with me on whether we can actually segregate off one segment for higher supervision, I would appreciate it.

Chairwoman WATERS. The gentleman from Missouri, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman, and I thank the panel for being here this morning.

I was kind of curious, I think Mr. Maloney, you said something about 780 private equity investments last year. Is that what you said in your testimony a while ago?

Mr. MALONEY. 4,700.

Mr. LUETKEMEYER. 4,700, okay. I missed the "4" in front of it. Wow. Okay. Fantastic. And one of the charts up on the board hints that 35 businesses filed for bankruptcy since 2003. I guess that is major companies. But those seem to me to be an awfully small percentage of businesses filing bankruptcy versus businesses getting into business. Is that your take on that?

Mr. MALONEY. Yes. The bankruptcy rate in private equity and nonprivate equity is 6 percent. It is a low rate.

Mr. LUETKEMEYER. Very good.

I was kind of curious, Mr. Moore, what is the breakdown on returns with your investments on private equity versus other stocks and bonds—other bonds and CDs and other types of investments? What is the difference in rate of return?

Mr. MOORE. I can't give you the exact numbers, but I will—

Mr. LUETKEMEYER. Just ballpark is fine.

Mr. MOORE. Okay. Ten-year average, private equity for us is about 13 percent; public equity is in the range of 10; real estate, 8; and then the fixed income is less—

Mr. LUETKEMEYER. Okay. Would it be a fair statement to say that the more return you get, the more risk there is with the investment that you are making?

Mr. MOORE. You could say that.

Mr. LUETKEMEYER. So to me, as somebody who has been in this financial services world for years, return, interest rate, dividends,

whatever it is, is reflective of the risk you take. So, when you have private equity and you are getting much, much better return on that versus on less risky investments, you want a mix in your portfolio. So, it is important that you have a mix.

But you have to understand that when you make that investment in equities, there is more risk there. As we have just seen, there is the risk—6 percent of businesses are going to go under.

You indicate, Mr. Moore, you need more transparency in being able to, as a board member, be able to see how you want to invest in these equities. Can you give me some examples of things that you would like to see more transparency in, as an investor in equities?

Mr. MOORE. First of all, this bill talks about issues, at least from my perspective, that I am concerned about in just collecting information on how much it costs and what performance metrics are being used, and have that apply industry-wide and be available to everybody, so we can do comparisons.

But going beyond that, which is not in this legislation, we would probably want to be more engaged in seeing what kind of companies are in the pipeline, getting more financial information from portfolio companies, so we could have a better assessment of the risks that the companies are taking.

You mentioned risks. We want to try to control risk as much as possible. So, if we are noticing that there is a private equity company that wants us to give them an allocation, and they have been heavily engaged in these extractive financial engineering type of activities to generate returns, that might be something we would want to stay away from and look for less risky, more long-term beneficial investments.

Mr. LUETKEMEYER. It almost seems as if you have to have a crystal ball sometimes to see the trends in industries. For instance, if I was somebody 30 years ago and I was going to make an investment in somebody who builds rotary phones, lo and behold, I wouldn't have anything left today, would I?

Mr. MOORE. Not a dime.

Mr. LUETKEMEYER. So, you almost have to have a crystal ball to see what the trends will be, where technology will take you. Nobody who invested in a blacksmith shop 125 years ago is in business today either. So what could be a good investment today, tomorrow's technology or the fad or the general public's twist on things or preferences could change and suddenly what would seem in your situation to be a really solid investment to make could suddenly go south on you, couldn't it?

Mr. MOORE. Yes, but the better information and the more information you have, the better informed decisions—

Mr. LUETKEMEYER. Right.

Mr. MOORE. —you are going to be able to make, and over the long run, you are going to perform better.

Mr. LUETKEMEYER. Mr. Maloney and Mr. Palmer, I only have 15 seconds left. What about transparency, do you guys have some ideas on that as well?

Mr. PALMER. For low or middle market and middle market private equity funds, they get every bit of information that any LP

asks for, and LPs can ask for anything and they will pretty much get it. So if they want it, they get it, and they do their diligence.

Mr. LUETKEMEYER. Mr. Maloney, very quickly.

Mr. MALONEY. I agree. And we value the partnership we have with Mr. Moore and his pension funds.

Mr. LUETKEMEYER. Thank you.

Chairwoman WATERS. The gentlewoman from New York, Ms. Velazquez, is recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Chairwoman Waters.

Dr. Appelbaum, I am looking at an op-ed that you wrote in 2015 in The Hill paper, entitled, "Investors will benefit from greater transparency on performance." Can you summarize your position? And do you believe that limited partners should have more access to the fees and expenses and even disciplinary actions by the SEC of the general managers?

Ms. APPELBAUM. Yes, absolutely, for all the reasons that Mr. Moore has said. At the moment, all of the decisions in a private equity fund are made by the general partner. The limited partners, which are the pension funds, do not get to make those decisions.

So, Mr. Moore has to figure it out before he makes the investment. He has no control once he has given them the money.

Having transparency, understanding, for example, the monitoring fees that were taken out of Toys R Us, or taken out of many other companies, the limited partners generally have no knowledge of that. They have no idea of what the side contract is between the private equity firm and the company, and the limited partners in general do not have access to that information.

And so they have no idea how much is being taken out, which of course will affect the price that the private equity fund gets when it resells the company back to the public markets or to another private equity fund.

So, absolutely, they need that transparency in order to be able to do their own due diligence on behalf of their beneficiaries.

It is very difficult for most limited partners to get information, and those that ask for it or say, "I need to make public the contract that I have with you," they have been disciplined by the private equity firms.

You would think, because this is the source of the money, that they would have control. Somebody has already said that. My view is, the limited partners need a union, because if they acted together, they could demand information. But at the moment, the private equity firms have the power.

Ms. VELAZQUEZ. Thank you.

Mr. Moore, would you care to comment?

Mr. MOORE. I agree with Ms. Appelbaum.

I am a policymaker, so I don't have the depth of information and knowledge about the contracts. I set policy, I review processes and procedures, and I allocate resources to our staff to implement the policies that we establish, the asset allocations that we want to engage in.

And as I stated earlier, information is critical.

Ms. VELAZQUEZ. Right.

Mr. MOORE. And we lack everything that we need. We do a good job in our firm, our pension fund, because we allocate the resources

and staff to do due diligence and travel around the world and pound on our private equity firms that we have money invested in. But before we make those investments, we still have to engage in significant resources in order to dig up information that should just be available, not only to us who are actively engaged in it and allocate resources, but smaller pension funds that may not have the same level of resources.

Ms. VELAZQUEZ. Thank you.

And the fact that we, as legislators, care about that, more transparency, access to information, to look at the strategy in terms of making financial decisions, that doesn't make me a socialist, does it?

Mr. MOORE. No.

Ms. VELAZQUEZ. Okay. Good.

Mr. MOORE. It just means you are establishing the guidelines for capitalism that works for everybody.

Ms. VELAZQUEZ. Wonderful. Thank you.

Mr. Maloney, in March, New York City Comptroller Scott Stringer announced a $600 million expansion of the New York City retirement system in-house emerging managers program in private equity, which is intended to amplify opportunities for smaller managers, including minority and women-owned managers.

Are you supportive of programs like the one that Comptroller Stringer announced? And what steps are your organization and your members taking to expand opportunity for smaller managers, particularly minority and women-owned managers?

Mr. MOORE. I had a meeting last month with all of our asset class managers—

Ms. VELAZQUEZ. I'm sorry, I would like to hear from Mr. Maloney.

Mr. MOORE. Oh, okay.

Ms. VELAZQUEZ. Mr. Maloney. Thank you.

Mr. MALONEY. Thank you, Congresswoman, for that question and for your leadership on the diversity issues.

As I stated with Congressman Meeks, diversity makes us stronger. We are very supportive of the comptroller's plan. A lot of our firms take this very seriously.

Ms. VELAZQUEZ. What does "seriously" mean?

Mr. MALONEY. We are actively engaged with organizations like SEO, we partner with Harlem Capital Partners in New York, and the JFK project is another good one. But we are committed to working with you going forward on this.

Ms. VELAZQUEZ. Thank you.

Chairwoman WATERS. The gentleman from Michigan, Mr. Huizenga, is recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman.

And I do need to correct myself from my opening statement, briefly. I misstated a number. The State of Michigan retirement system, which has a pension system for 515,000 members, has $71 billion in total assets, of which $11 billion of that is directly invested in private equity.

I have a number of things I want to go through quickly. But, Mr. Moore, I do have a quick question for you. CalPERS has invested

$150 million in a PE buyout fund, correct? I think that is what you had told the ranking member?

Mr. MOORE. Yes.

Mr. HUIZENGA. Okay. So, H.R. 3848, which is the House version of the Warren bill, would impose joint and several liability on PE funds, including their partners, their limited partners (LPs). How does your board feel about being on the hook with liability?

Mr. MOORE. Well, I can't speak for the board because I am just one member.

Mr. HUIZENGA. Okay, then, are you comfortable with that?

Mr. MOORE. I am where our board is, which is we have a staff—

Mr. HUIZENGA. Wait a minute, are you speaking for the board or not speaking for the board?

Mr. MOORE. No. What I am saying is, I can't speak for the board. I am just one member of the board.

Mr. HUIZENGA. Yes.

Mr. MOORE. So as a member of the board, I am going to defer to my staff and my counsel to review this issue, to work with the—

Mr. HUIZENGA. Wait a minute. So, you are supportive. Okay. I thought I heard you say you were supportive of the Warren bill.

Mr. MOORE. I didn't say that.

Mr. HUIZENGA. Okay. My misunderstanding.

Mr. MOORE. I said the provisions that I would like to see implemented. I never said I support the Warren bill.

Mr. HUIZENGA. Got it, okay. I want to move on here. The Popeye's versus Chick-fil-A debate, Taylor Swift not being real happy with her private equity situation, notwithstanding, we have heard a lot about PE and about private equity being raiders and parasites and how they have basically failed businesses on purpose and a number of those types of things.

What I am really concerned about is, one, I think that those anecdotes that are out there really are not very insightful. But I do want to know why the private sector is turning to private equity versus IPOs. I mean, 20 years ago, we had 7,000 publicly traded companies. We are at about half of that right now.

And, Mr. Maloney, Mr. Palmer, feel free to jump in here. Why do companies turn to private equity instead of raising capital through IPOs or other more traditional methods?

Mr. MALONEY. Congressman, that is a great question, and it is one that I think you see much more often of a lot of companies staying in the private markets longer. It allows them to grow and sometimes not—as I said in my original testimony, that they don't have to meet a quarterly earnings statement where they can, if they have a growth stream ahead of them, it is much easier to do that in the private markets than it is in the public markets.

Mr. HUIZENGA. Mr. Palmer?

Mr. PALMER. A lot of these businesses are just too small, and they are companies that are never going to go public. Certainly, it is too expensive and too problematic to be public in many cases. There are too many burdens.

But in many of these cases, they are small businesses going to medium, and in many cases, they don't want to be publicly owned. They want to stay inside of a family, they want to stay closely held.

And so, it is a longer-term patient form of capital where they have greater control over their businesses.

Mr. HUIZENGA. In fact, I have a number of those in my own district—Challenge Manufacturing, JR Automation, Custom Profile, Hadley Products, Brillcast, just a couple of examples from west Michigan.

And I might add, I have about 5,700 jobs in my district attached to this. Sixteen Members on the other side of the aisle have 2 to 3 times those numbers of jobs, yet we are seeing the other side vilify an entire industry which is providing tens of thousands of jobs in their districts. I am a little confused by that.

But ultimately, it gets down to risk is a part of it. And Mr. Moore, I wrote this quote down from you. You want to control risk, yet it seems to me you want a full return on your money.

Well, less risk typically means lower returns. And these companies, for various reasons, sometimes can be riskier investments. Is that not true, Mr. Palmer?

Mr. PALMER. They can be riskier investments, and in many cases they require a whole lot more hands-on activities than institutional LPs, like large pension funds, can do. They just don't have the time to get in every business, and, frankly, they shouldn't be in every business.

Mr. HUIZENGA. In my remaining 2 seconds, I am going to let you know that I am going to be writing some letters, because I would like to hear how instead of demonizing your industry, what we can do to increase capital markets and make them more attractive.

Thank you.

Chairwoman WATERS. The gentleman from New Jersey, Mr. Gottheimer, is recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you, Madam Chairwoman.

If I can start, please, with Mr. Moore.

You serve on the board of the L.A. County Employees Retirement Association. Does your agency invest in private equity funds?

Mr. MOORE. Yes.

Mr. GOTTHEIMER. Do you know how much? Your 2018 annual report talked about a percentage. Do you know what percentage of all your assets that is?

Mr. MOORE. It is pretty close to 10 percent.

Mr. GOTTHEIMER. About 10 percent. Thanks. And is that consistent today?

Mr. MOORE. That is what our allocation policy states, is that is the range we want to be in.

Mr. GOTTHEIMER. And why does your agency invest in these funds, sir?

Mr. MOORE. Because it is our best performing asset historically, and going forward, I think there was a question just now about the private markets.

Mr. GOTTHEIMER. Yes, sir.

Mr. MOORE. That is where a lot of activity and a lot of growth activity takes place. And we want to be part of the growth in our country and the world, so that is where you have to be at some level.

Mr. GOTTHEIMER. Would you please speak to the returns and other fees your agency receives from these investments? Like maybe the last 10 years, if you could, a number on that.

Mr. MOORE. We have done extensive analysis in our fund, and I can tell you that our private equity fees and expenses have run about 4.5 percent.

Mr. GOTTHEIMER. And overall return, do you know the last 10-year returns?

Mr. MOORE. The returns, the 10-year returns have been about 13.1 percent.

Mr. GOTTHEIMER. 13.1 percent. And I think the stock market during that time—do you know what the—

Mr. MOORE. I can't tell you that.

Mr. GOTTHEIMER. We did a little research on that. I believe it was 7 percent. So, 7 percent versus 13 percent. And I know if you look at some of the other States, like Massachusetts, over that period of time, at a 13.6 percent return; Ohio, 13 percent; Minnesota, 11.7 percent.

Can you speak to the impact that some of the laws in front of us might have on the assets your association has under management, sir?

Mr. MOORE. I am particularly focused on disclosure and more information on fees and expenses.

Mr. GOTTHEIMER. Fees and expenses.

Mr. MOORE. Because that is like low-hanging fruit. If you reduce your costs, you have more money in the corpus of your fund. You can grow your fund a little bit more. You can fund a few more pensions. And in the long run, that is what we are looking for, to be able to deliver the benefits that we promise.

So, controlling costs is very critical to me, and those provisions in H.R. 3848 that deal with fees and returns get to that.

Mr. GOTTHEIMER. It is interesting, I represent the Fifth Congressional District in New Jersey, and pensions in my State support many of the hardest working members of our communities, our law enforcement officers and teachers and firefighters, who rely on their pensions to provide financial stability in their retirement.

Unfortunately, pensions in New Jersey and across the country, as you know, are struggling from years of underfunding, and that is why these returns are so important, and lower performance from low performance in the public markets.

The Wall Street Journal recently reported that New Jersey's teacher and public workers pension funds have an average of 43 cents for every dollar in benefits promised; a retirement crisis is happening before our eyes.

So you talk about these numbers, and the rates of return are incredibly important to make sure that we can shore these up and have the best rate of returns for our teachers and our firefighters and, of course, law enforcement.

The New Jersey Division of Investment, a public pension fund, has nearly 800,000 members and $78 billion of assets under management, $8.7 billion of those invested in private equity. The pension's private equity portfolio produced an annualized return of more than 10 percent over the past decade after expenses. Com-

pare this to the long-term Treasury bond yield of below 2.5 percent or the historic 7 percent return in the stock market.

It is clear why we are hearing from you, and why we are hearing from institutional investors looking to invest in private equity as part of their asset allocation strategy. And I think our job in the committee is to, of course, make sure that we are punishing bad actors while not interfering with those that produce good returns.

I don't know if you want to comment on that?

Mr. MOORE. No, that is exactly the way I see this bill. The bill doesn't attack the private equity industry as it is being portrayed. The objective that I see, and I can't vouch for the validity and the outcome of every single provision, but the trajectory is to try to rein in and put some guidelines around how we operate to keep the bad actors under control.

Mr. GOTTHEIMER. Because you don't want to walk away from this investment tool?

Mr. MOORE. No. We want the good actors to continue to receive our money and continue to grow our portfolios. And we want to do just like Walmart. Every year, we want to negotiate the costs, so we can get them down.

Mr. GOTTHEIMER. Thank you. Thank you, sir.

I yield back. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you.

This side of the aisle has not vilified an entire industry, as was indicated by the previous speaker.

The gentleman from Ohio, Mr. Stivers, is recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman. I appreciate you holding this hearing to illuminate a lot of issues in and around private equity.

My first question is for Mr. Moore. Following up on the gentleman from New Jersey, I understand you are concerned about fees. Can you tell me, first of all, what your best performing class of investment was at your pension over the last 10 years?

Mr. MOORE. I have said this 4 or 5 times. It has been private equity.

Mr. STIVERS. Oh, okay, thank you. I appreciate you restating that.

So does your pension fund calculate returns net of fees?

Mr. MOORE. Yes.

Mr. STIVERS. Always the best performing class, net of fees?

Mr. MOORE. Yes, that is what the performance measures—

Mr. STIVERS. Could you repeat it again, what is the best performing class net of fees?

Mr. MOORE. Yes, it is net of fees. That is the—

Mr. STIVERS. What is the best performing class?

Mr. MOORE. Private equity.

Mr. STIVERS. Thank you.

Mr. MOORE. Private equity is the best performing class, net of fees.

Mr. STIVERS. Thank you. So, that is really my first point.

I have a million pensioners in Ohio who are part of the public retirement system, either OPERS or the school employees system or the police and fire system. That is teachers, policemen, firemen,

public servants. They are getting, in Ohio, an annualized return over the last 10 years of about 13.3 percent from private equity, compared to about 7 percent from the stock market over the same 10-year period. Just to put it in perspective, that is almost twice the return from the stock market.

I understand you are concerned. That is why I asked about the return net of fees, that is really the point here, is even after the fees, the return is much, much greater.

My next question is for Mr. Palmer. In your testimony, you talked about how small businesses are seen as too risky for a lot of financial institutions now. Have the post-crisis capital and liquidity rules made it more or less difficult for middle market companies, Main Street companies, to obtain the funding they need through banks?

Mr. PALMER. In many cases, yes. The banks—

Mr. STIVERS. More difficult or less difficult to get?

Mr. PALMER. More difficult, yes.

Mr. STIVERS. More difficult to get financing. So, who typically fills that void today for middle market companies?

Mr. PALMER. Private equity does. Private equity comes in, and then sometimes enables the banks, but private equity is filling the gap.

Mr. STIVERS. I would like to ask the whole panel if they have heard of any of these companies in my district. CCPI, Blanchester? Probably not. Plaskolite in Columbus? Probably not. You might have heard of this one, The Oneida Group in Lancaster, Ohio. Nope. And Rolling Hills Generating in Columbus, Ohio.

These are mostly middle market companies. Oneida is the biggest one. It used to be called Anchor Hocking. Anybody heard of Anchor Hocking Glass? Still no? Okay.

They compete against China to make glassware all around this country. It is a tough market to compete in, and if it wasn't for private equity, thousands of employees at Anchor Hocking Glass would be out of a job, unemployed. They come in, and they keep the company going. Thousands of employees every day report to work, a lot of them union employees. And I am glad private equity was there to do that.

One last question, this one for Mr. Maloney. Do you think it is to the benefit of a private equity firm to drive one of its portfolio companies out of business?

Mr. MALONEY. No. That is never the goal, and that is not a successful form of business.

Mr. STIVERS. And we did talk about, in the past, there have been a few business models, very bad examples—and by the way, there is good and bad in everything—of people who essentially raid and split up companies. Everybody thinks of the corporate raiders of the 1980s. That was a long, long time ago.

Is that a frequent business model today, Mr. Maloney?

Mr. MALONEY. No, sir, it is not.

Mr. STIVERS. I have not seen that to be the case. And the small and medium-sized companies in my district have grown as a result of private equity.

I will tell you a story about a company called HFI, that the owner was ready to do something else, but he had a growth oppor-

tunity and he wanted to continue to grow his company. He brought in private equity. They now employ 200 more people in Canal Winchester, Ohio, than they did before. The company is thriving and doing well. It is an example of private equity at its best.

I know there are people who could point to bad examples, but there are a ton of great examples. And 26 million Americans are employed as a result of private equity investments, and I think we need to basically acknowledge that.

I am the co-Chair of the Middle Market Caucus, these middle market companies that dot this country and are in every congressional district in America, and private equity helps them. So I want to say, while there may be some more things that we can do, it is the best performing class, net of fees, and it is helping to grow jobs.

I yield back.

Chairwoman WATERS. The gentlewoman from Iowa, Mrs. Axne, is recognized for 5 minutes.

Mrs. AXNE. Thank you, Madam Chairwoman, and thank you to the witnesses for being here. I appreciate it.

We have spent a lot of time in this committee talking about affordable housing and the crisis that is hurting so many of our constituents across the country.

One possible solution to the crunch in my district is manufactured housing, which can be more than 30 percent cheaper than traditional housing. Nationwide, almost 3 million manufactured homes are anchored in land-leased communities, which means that residents own the homes, but lease the land underneath them, and many of these communities are being purchased by big outside investors, and increasingly, private equity firms.

So I would like to talk about how tenants are affected by increased private equity investment in land-leased communities.

Dr. Appelbaum, I would like to start with you. Why are these attractive investments for private equity firms?

Ms. APPELBAUM. Private equity is always looking for someplace where it can jack up prices, usually to pay off debt that it has put in place, not necessarily if these are smaller loans. But they are looking for a situation where people don't have a choice.

It is the same story as it was with the emergency room doctors. You have already bought the manufactured house. You have already put it on this spot. You are a low-income person or you would not be living in this situation, generally speaking. The rent has been very affordable. This has been a good opportunity for people who are low income to have a decent standard of living.

And then somebody comes along, a company, often private equity, not only private equity, buys up the company that controls the land, and then jacks up the rent. Why they do it, besides the fact that they make more money when they jack up the rent—there may be many different reasons for it. It may be that the actual physical real estate is valuable in the sense that if it had other kinds of businesses on it, for example, there would be a huge return.

We have seen this, for example, with Hahnemann Hospital in Philadelphia. Private equity buys the hospital. It was already failing. It did nothing to turn it around. But the minute it bought it, it separated the real estate, because it realized that real estate,

which was previously in a poor neighborhood but is now a gentrifying area, could be sold for other uses at much higher rates.

So, there are many motivations for these companies coming in and doing it. The jacking up of prices is usually to evict the tenants, to make them move someplace else, and do something else with the land.

Mrs. AXNE. Thank you for that.

So essentially, for these investors, it is a recession-proof revenue. They have a captive investment, and they are going to capitalize on it at the expense of hardworking people.

One trend we have seen in the market is when these communities are sold, rents can skyrocket. I saw how this happened firsthand to my constituents at Midwest Country Estates in Waukee. It is one of five manufactured housing communities that Havenpark Capital recently bought, and they are raising rents between 20 and 70 percent.

I want to reiterate that. Many of these people are on fixed incomes, and they are now being asked to pay 70 percent more in rent, on a fixed income.

If they can't afford it, they have very few options, as you implied. They can try to find a buyer, they can abandon all the equity that they have put into their home, or they can somehow come up with thousands of dollars, miraculously, that they couldn't find before.

Rent increases like this not only hurt the tenants by raising costs, but they also decrease the value of the homes that they live in.

Does this practice surprise you at all?

Ms. APPELBAUM. I just want to be clear, we do have many companies that are not behaving like this. But this is certainly one part of the business model, is to see about not how to make a business operate better, but how to maximize the returns that the private equity firm can get out of it.

So here you have a situation that you have described where the private equity firm owners are interested in their returns. They are not interested in whether this property can continue as a manufactured home property.

Mrs. AXNE. I appreciate that.

We all know that the homes in mobile home parks are truly not mobile and that the residents are effectively a captive audience.

What I would like to reiterate here is that manufactured homes can be a solution for affordable housing, a great solution, but only if we can address the problem of outside investors buying up MHCs and raising rents to extract as much profit as they can from the people who live there. So, we absolutely need to address that. We want to make sure that every person in this country has access to a nice roof over their head, and that their children can grow up in a safe environment.

Thank you so much for your testimony.

And I yield back.

Chairwoman WATERS. The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman.

Many of my Democrat colleagues today have highlighted instances where private equity-backed companies have restructured

the business model or cut jobs or filed for bankruptcy. And while it is true that successful buyouts may include cost-cutting, there are plenty of success stories that demonstrate how small businesses prosper through private investment and benefit from strategic insight that private funds can offer.

Mr. Maloney, I was impressed with your testimony that private equity invested $685 billion in more than 4,700 businesses across the United States in 2018, and that 94 percent of PE investments are successful.

One example of this success is Big Ass Fans, headquartered in my district in Lexington, Kentucky. As the colorful name suggests, this company makes, among other things, very large fans for commercial and residential facilities.

This private equity-backed business has grown at an astounding annual rate of 30 percent. Since their private equity investment, Big Ass Fans has added nearly 200 jobs, developed and introduced new products, and increased their distribution channels. They have international offices in Australia, Canada, Malaysia, and Singapore, sell products in more than 170 countries, and employ over 700 people, 550 of whom work in my district in Kentucky.

Their CEO, Lennie Rhoades, has told me that the stability provided by their private equity backers allows them to confidently make investments in their workforce, facilities, and technology because they have a partner with a shared goal of success. Big Ass Fans is innovating and pioneering the industry happily in the heart of central Kentucky and thriving no longer just as a fast-growing small company, but as the trusted producer on a global scale.

This is a shining example right in my backyard of the direct impact private investment can have on job creation, technological innovation, and community development.

Now, everyone here is sympathetic to Ms. De La Rosa's story and what happened to her. Everyone here is sympathetic to the other Toys R Us employees. And bankruptcies are unfortunate. And PE-backed companies are susceptible to market conditions just like other companies.

But, Mr. Maloney, the question is, what was a larger impact on the Toys R Us bankruptcy, was it the private equity firms, or was it the competitive pressures of Amazon?

Mr. MALONEY. Congressman, thank you for that question. And while I don't know the particulars, what I can tell you is that at the time, you saw much different market forces. People were buying a lot more online and, as you know, there were other toy manufacturers and toy stores that went out of business. Some of them were backed by private equity, and some of them weren't backed by private equity.

Mr. BARR. Let me ask you the question this way. Did private equity forestall bankruptcy of Toys R Us or did it cause it?

Mr. MALONEY. During the time of private equity's ownership of Toys R Us, they actually expanded the number of stores. It is just unfortunate that it ended up this way, and that is largely because of market forces, as you say.

Mr. BARR. Again, kind of a follow-up on Mr. Stivers' question, do private equity firms generally make more money investing in companies that go bankrupt or in companies that are successful?

Mr. MALONEY. We make more money for our investors when we are successful and we can exit.

Mr. BARR. That makes a lot of sense, because we see that at Big Ass Fans in Lexington, Kentucky.

And I want to add that the private equity backers of Big Ass Fans is a firm that touts, as one of its managers, former Obama Treasury Secretary Jack Lew. And I am just glad to see Democrats so actively involved in the provision of equity capital, like Mr. Lew, that has created a very positive difference in Lexington, Kentucky. I'm glad to see that this is a bipartisan issue.

Quickly, on leveraged lending, this hearing is obviously about private funds, and private credit deserves attention as well. Some of my Democrat colleagues have suggested that leveraged lending is systemically risky. I have noted this before. It is important to make the distinction between credit risk, which is simply the cost of doing business in the credit economy, and systemic risk.

In September, before this committee, SEC Chairman Clayton testified that he does not believe that leveraged lending poses a systemic threat. Mr. Maloney, do you agree with the SEC Chairman that leveraged lending does not pose a systemic risk to our economy?

Mr. MALONEY. Yes, Congressman, we agree with the regulators on that approach.

Mr. BARR. And final question, Mr. Palmer, can you elaborate on the stability that private funds can provide to the economy, especially in periods of distress?

Mr. PALMER. Sure. I will give you a real-world example. When the financial crisis happened, banks had to pull their loans on small businesses. Private equity funds stayed in them and kept those businesses alive. If you were backed by private equity, you were more likely to survive that downturn than if you just had a normal bank loan.

Mr. BARR. Thanks. I yield back.

Chairwoman WATERS. The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. I am not hostile to private equity. We have seen private equity attacked for doing things that are done elsewhere in our economy.

I think the gentlelady from Iowa is right, it is unconscionable to see these massive rent increases at mobile home parks. But I have seen that done by private owners, where you just have one owner. I have seen it done by traditional publicly owned corporations.

We see private equity companies acting like capitalists, raising rents when they can, making money, not caring, and responsible to investors who are demanding an extra tenth of a percent rate of return, otherwise the money will shift elsewhere. So if they do care too much, they don't get any equity investments.

We have seen a lot of stores close. We have seen stores close for a lot of reasons. I am not sure it is the private equity model.

But if private equity is no different from or should be treated similarly as other major economic institutions, this raises the issue

of whether we should get disclosures from private equity consistent to what we get from other ownership models. When we passed the Dodd-Frank Act, we didn't demand that every public company give us a complete report on all their societal impacts, but we did require reports on conflict minerals, mine safety, and resource extraction, three areas that this committee decided were so important that corporate America should give us a report on it.

A report released by the Trump Administration critiqued these requirements, saying if the intent is to use the law to influence business conduct, then this effort will be undermined by imposing such requirements only on public companies and not on private companies.

Dr. Appelbaum, should we require large companies owned through private equity to make the same kind of disclosures that we require of publicly held companies?

Ms. APPELBAUM. I think we should require them to make the same kinds of disclosures, and I think that they should be subject to the same kinds of regulation that other financial firms are subject to.

We do not have this kind of risky behavior from mutual funds, for example, because they are subject to other kinds of regulation.

The problem with leverage is not the use of leverage. It is the excessive use of leverage.

Mr. SHERMAN. Yes, I am not even talking about leverage. You could make a completely non-leveraged purchase of a company that does terrible mine safety and has resource extraction agreements with Third World countries that are rife with corruption, and there could be no leverage involved.

The focus here is on these disclosures. And I will say as a shareholder, because all of us are in the pension plans, and I see Mr. Moore here representing so many of my constituents in the L.A. County plan, they know, when you invest in a public company, their resource extraction rules. But when you invest in private equity, the ultimate owners, your pensioners, don't know, and they should.

I look forward to working with people here on legislation to require companies big enough to be public companies, companies with $50 million that happen to be private equity or privately owned, to make these disclosures that the Trump Administration says are unfair to require only of public companies.

Mr. Moore, we have the private equity companies not making some of the same disclosures to investors—that means you—that some would like. Would it make sense to form a union or association of pension plans and others to demand that the private equity firms provide you with information, particularly about fee and cost transparency?

Mr. MOORE. We do have the International Limited Partners Association that has been very vocal directly to the SEC and in support of this legislation on that very issue of disclosures. And the best disinfectant is always sunlight.

Mr. SHERMAN. I would hope that in addition to lobbying us, that association would lobby you and say, don't invest in a public equity firm that doesn't give you the disclosures.

I yield back.

Chairwoman WATERS. The gentleman from Colorado, Mr. Tipton, is recognized for 5 minutes.

Mr. TIPTON. Thank you, Madam Chairwoman.

I appreciate the panel taking the time to be here today.

Mr. Palmer, I wanted to go back to a comment that you had just made a little bit earlier in regards to PE being riskier investments. And ultimately, I would like to know, is the goal to be able to lose money or is it to be able to make money?

Mr. PALMER. The goal is to make money.

Mr. TIPTON. The goal is to make money. So, you don't want to be able to force anybody into bankruptcy?

Mr. PALMER. No.

Mr. TIPTON. The goal is to be able to provide an actual return, to be able to get the businesses going, and to be able to create some real job security for those businesses?

Mr. PALMER. Yes.

Mr. TIPTON. What is the best job security, really?

Mr. PALMER. The best job security is a good business, and for an employee to have options. If you have a strong economy, you can have a business that you are staying in forever or you can go some place else because you have other choices. Right now, we have an incredibly low unemployment rate, and private equity funds have a real vested interest in keeping and maintaining and supporting their employees, because getting new ones is hard.

Mr. TIPTON. Right. And I think that is an important point. We are at record lows when it comes to unemployment in this country. We have more jobs available than there are people to fill them. But the role that private equity can play is something that is of concern, actually, to me. I come from rural America, and we haven't really talked an awful lot about the makeup of the private equity industry. We know about the big private equity firms. The Carlyle Group has been mentioned. What is the real composition of that market right now?

Mr. PALMER. The composition of the market is—for the venture world, the early stage is overwhelmingly concentrated in northern California, in New York to Boston. Most of the smaller private equity is the inverse of that. Rural areas face unique challenges with that.

I was actually just with Congressman Hill last week in Arkansas talking about that, and we have a type of private equity fund called a rural business investment company that is fairly new, that we are trying to work with to help grow that part of the market, because rural areas have far more challenging access to capital than pretty much anybody else.

Mr. TIPTON. For me, that is an important point. A lot of the focus in this committee is, we get into the metropolitan areas, and I do not dispute the importance of that. But for rural America, when we are talking on a per capita basis, the impact of being able to have those businesses, we actually have one that is in my district, a polymer company that produces a very unique product. They have to be able to be innovative in terms of design, in terms of being able to market, ship worldwide, and rely on some private equity dollars to be able to have that. But the access to those dollars in rural America out of the traditional financing sources is actually

difficult. So that does play a real role in trying to be able to maintain those jobs in those economies in areas that are underserved.

I would like to maybe follow up, and, Mr. Maloney, you may want to speak to this as well. Is it reasonable for companies like the polymer company that I just described, for them to be able to look to private equity to be able to meet their financial needs?

Mr. MALONEY. Absolutely, and that is what role we play, Congressman, in the marketplace, is providing growth capital for companies like that to expand and grow their companies.

Mr. TIPTON. I do want to follow up because some of the conversation today is obviously on H.R. 3848. When we are going to be adding new regulations coming into place, all of a sudden, we have personal liability that you may actually be on the line. Is there going to—everyone understands. We are capitalists. We live in a free market. There are going to be good players, and bad players. I think many of us would argue that the majority, overwhelmingly, are people who are trying to do the right thing, but if we add those new regulations, is there actually some potential that we could be drying up some of that access to capital dollars, particularly when we are talking about rural America?

Mr. PALMER. Yes.

Mr. TIPTON. Mr. Maloney?

Mr. MALONEY. Absolutely, Congressman. And it is a real concern because there are a lot of businesses out there, as we talked about, in the mature space that need growth capital and need to be able to turn around. And if you impose liability, joint and several liability on the fund managers, no fund manager will ever take a risk and invest in any company. Again, they just won't do that, and that will leave a lot of businesses to fail much quicker than they will today.

Mr. TIPTON. Let's maybe explore, just kind of wrap up a bit here, in terms of some of the bankruptcies. Would you maybe determine these were caused by mismanagement within the company? Was it because private equity had stepped in? Or is it just market forces, primarily?

Mr. PALMER. I think it is a case-by-case basis. Generally, it is market forces, but sometimes, it is international issues. It can be—a flood could happen. There are innumerable reasons why things can go wrong, but it happens rarely.

Mr. TIPTON. Thank you, sir. I yield back.

Chairwoman WATERS. The gentlewoman from California, Ms. Porter, is recognized for 5 minutes.

Ms. PORTER. Thank you, Madam Chairwoman.

Dr. Appelbaum, you noted in your September 4, 2019, study on private equity and surprise medical billing that we the American people and those that we are elected to serve need to decide if the goal of healthcare is to increase profits or to improve patient outcomes. And hospital outsourcing of various departments has allowed physician practices to grow exponentially and operate those services independently. Once, there used to be solo practitioner doctors and very small partnerships. But today, private equity firms have become major players, as you said, buying out doctors' practices and rolling them up into large corporate physician staffing firms. We see it in a lot of different ways and creating a lot of dif-

ferent harms, including surprise billing. I have personally been a victim of surprise billing and I know how devastating it can be to receive one of those bills when you are trying to recover from an illness.

Families today are also buried in medical debt. The new report from the Consumer Financial Protection Bureau shows that debt collectors pursuing medical debt is making a sharp increase. We know that about half of all bankruptcy reasons have a component of illness or injury in medical debt to them. One Stanford study found that the likelihood of receiving a surprise bill rose from 32 percent in 2010 to 43 percent in 2016.

Do you think the involvement of private equity in physician contracts has increased the incidence of surprise billing?

Ms. APPELBAUM. Yes, absolutely, because what we have seen is that there are two really large doctor staffing firms. It is not unusual for a hospital to say to a local doctor's practice, we would like you to staff our emergency room. Those doctors come in. They are in network, the same network that the hospital is in. You go to the emergency room, you are treated by a doctor, and it's taken care of by your insurance.

In this situation, you have a very large company owned by private equity staffing the emergency room. Those doctors are not responsible for the billing, it is the overall company, and what they do is they take their doctors—either they take the doctors out of network, that is one company, and then they can charge you anything they want. If the doctor you see is out of network, you can be charged anything. You have done your due diligence. You are in a hospital that is in your network. You think the doctors will be covered, and then you get that big bill.

The other company uses the threat of surprise billing when it negotiates for in-network returns. And in both cases, what you see is that the doctors employed by these private equity-owned companies get payments that are way, way higher than the doctors who previously did the job or doctors in other hospitals not owned by private equity. So, this is a major driver of healthcare costs. We have healthcare costs rising.

Ms. PORTER. Yes. And the same Stanford study found that the amount of surprise bills went up from $220 in 2010 to $628 in 2018. So it is both the incidence and the harm.

Mr. PALMER. Yes.

Ms. PORTER. I received an ad at my own home from a shadow group known as Physicians for Fair Coverage, and that group, backed by private equity firms, including KKR; Blackstone; and Welsh, Carson, Anderson & Stowe spent more than $4.1 million lobbying against solutions to the problem of surprise billing. What would be the primary goal of those firms in trying to stop Congress from addressing surprise billing?

Ms. APPELBAUM. Of course, it is to protect their profits.

Ms. PORTER. Thank you. I have one last question.

Ms. APPELBAUM. Yes.

Ms. PORTER. Does the involvement of private equity in healthcare improve patient outcomes in any apparent way?

Ms. PORTER. There is no evidence that it does, and there is some evidence that the quality of care goes down. The price evidence is

very strong. The failure of quality is not quite as strong, but definitely, we don't see improvement for the extra money we are paying.

Ms. PORTER. Thank you so much.

Mr. Maloney, if a private equity fund owns the equity, the debt, and credit default swaps, might that private equity firm in some cases have an incentive to force a company into bankruptcy?

Mr. MALONEY. I don't see a scenario, Congresswoman, where that would be beneficial to the—

Ms. PORTER. Do you understand the concept of a credit default swap?

Mr. MALONEY. Most of our transactions don't involve the same private equity firm owning the debt and the equity.

Ms. PORTER. How would we know, since credit default swaps are not—they could own the debt, and they would have to disclose that in the bankruptcy petition. But if they bet the other way, that the company would go under by taking on a credit default swap, that very problem would be hidden from the bankruptcy court and the public, the employees, and all of those who are harmed by the bankruptcy.

Mr. MALONEY. I think that is a very unusual case, but thank you.

Chairwoman WATERS. The gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Madam Chairwoman.

I am a small business owner, and have been for 50 years. I am a Main Street guy, and I believe that the private equity industry is the epitome of capitalism. Large groups of investors pool their money together to look for businesses that can be restructured or infused with capital to expand product lines, hire more workers, and make a greater impact on communities in which they serve. Hundreds of thousands of jobs are being created throughout this country, and our schools' endowments are seeing huge returns, and innovative products are being brought to market because of this industry.

For those people who fundamentally think capitalism is broken, private equity is an easy bogeyman to place blame on when something goes wrong. The bottom line is if you take a risk, you should get a reward.

So before I go on to my next question, I would say, Mr. Maloney, you represent a sizable amount of people, and would you say that those folks are capitalists or socialists in your group? A quick answer.

Mr. MALONEY. Congressman, I would say that they are capitalists.

Mr. WILLIAMS. Are you a capitalist or a socialist?

Mr. MALONEY. Congressman, I am a capitalist.

Mr. WILLIAMS. Good. And, Mr. Palmer, would you agree, the same situation are the people you represent yourself?

Mr. PALMER. Unapologetic capitalist.

Mr. WILLIAMS. Okay. Well, you are a capitalist.

Mr. PALMER. Heck, yes.

Mr. WILLIAMS. Okay. I would just say this: Where I come from in Texas, private equity has invested almost $10 billion since 2013

and supports over 700,000 jobs. Not only have these investments pumped money into the Texas economy, they are necessary for the health of the pension system within the State. The Teachers' Retirement System in Texas, which has $154 billion in assets under their management, has $21 billion invested in private equity. Over the past decade, the annualized returns have been over 10 percent. We have heard that from many of you today on these investments to help support teachers' retirement throughout the State.

Before we consider any drastic changes to such a large contributor to our economy, we need to take an extremely close look at the consequences that this would have across a variety of industries.

Mr. Palmer, I know you have talked about this already, but I think it bears repeating again. Can you talk about the effects that the Stop Wall Street Looting Act would have on various sectors of the economy should it become law?

Mr. PALMER. It would be particularly damaging to the small private equity and medium-sized private equity economy. I showed a video, not a politicized video, but an actual video of the Senate sponsor of this bill explaining how private equity works and what this bill would do to a room of 500 small business investors, and the air left the room. It would really be profoundly damaging. And the intent of the bill on the Senate side—I am not saying the House side—the intent on the Senate side seems awfully hostile. We want this industry to work. We want to create jobs, but it would be bad.

Mr. WILLIAMS. Okay. It seems like my friends on the other side of the aisle believe that there is a perverse incentive as a result of the structure of private equity investments. I would like to read a quote from the Houston Firefighters' Relief and Retirement Fund chairman, Brett Besselman. He said, "We are very confident in the prospects for private equity investments in our long-term investment mix. Private equity opportunities far exceed those available in the stock market investing for the foreseeable future and are a welcome addition to our portfolio diversification effort."

If the incentives were off, I do not assume they would be receiving such high praise from the firefighters in Houston. So, Mr. Maloney, can you explain how private equity funds are set up in regard to the general and limited partnerships? And give your thoughts on if you think the incentives of the two parties are properly aligned?

Mr. MALONEY. Yes. Thank you for that question, Congressman. These investors are very aligned because the pension fund succeeds and gets a return when the private equity fund succeeds. And when that happens, everybody's a winner at the end of the day.

And I would say that both of these contracts between the GP and the LP are carefully negotiated. The LPs get full transparency from the fund and can ask any questions from the GP that they want to. And we are very committed. They are very important partners for us, and we share as much information as possible with the LP.

Thank you.

Mr. WILLIAMS. Okay. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Illinois, Mr. Casten, is recognized for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman. And thank you all for being here today.

I am here in no small part because of private equity. I am a freshman Member of Congress. I spent 16 years as the CEO of a couple of different companies. We put several hundred million dollars of private equity to work. We built projects inside industrials that recovered energy they were wasting, recovered it, and sold it back to them. They were really complicated projects. And I can say with complete confidence that there is no pocket of capital in the country that really maps to the investment size and the deal complexity of what we were doing.

And I think I can expand that more broadly to the broader challenge we have to invest in our infrastructure, clean or otherwise, that there is just a deal size and a complexity that public markets aren't very well-structured to do so. Venture is too small. And that is a positive thing.

I am also no longer in that company because of private equity, because the incentive structures within that private equity model, the 2 and 20 structure, the mid-teens return targets create this massive pressure for a steady stream of liquidity events. And so, having built a company and built a team who knew how to do something really important, I couldn't sustain it. Because once you have people with single digit money out there, you sell down. And when you sell down to cheaper money, you sell down to money that is less risk-tolerant. They don't build things.

I mention all that because one of my favorite descriptions—we had a limited partner whom we were pitching a deal to once, and he said, the central challenge we have with building infrastructure in this country is we that have a glacier of investment opportunities in the infrastructure—an ocean of investment opportunities in the infrastructure space that deliver really attractive dividend returns that is beautiful to this ocean, this glacier of money we have upstream, and we all hate the rivers. And I put that to you as a challenge.

Mr. Maloney, these are not "gotcha" questions, but I want to just run through a couple of quick yes/noes to get to the meat of this. One of my investors described his industry, private equity, as custodians of wealth. Would you acknowledge that there is a tension between the financial goals of the owners of wealth and the financial incentives, sometimes, of the custodians of wealth?

Mr. MALONEY. Congressman, it is a very good point, but I would say most of the time, the interests are aligned.

Mr. CASTEN. Okay. Do you agree that the mid-teens return targeted by private equity creates a very real incentive to take on debt and lever up equity returns?

Mr. MALONEY. I think that they invest in these companies and try to deliver the mid-teen target for the pension funds and the retirees, as we have talked about. And I think you have to have a careful balance between how much debt you load on to grow the companies, and I think that they make those determinations on a case-by-case basis.

Mr. CASTEN. Would you agree that having mid-teens return targets creates a very real incentive to sell to people with cheaper money if the opportunity presents itself?

Mr. MALONEY. I think it just depends on how you try to grow the company, and each case is separate.

Mr. CASTEN. Would you acknowledge that sort of the traditional 2 and 20 structure or the variants thereof incentivize private equity managers to create liquidity events either through debt raises or through sales?

Mr. MALONEY. I think the liquidity event is meant for the investors, which are the pension funds and the college endowments. So at some point, you need to give your investors and the retirees the return, and I think that is what the motivation factor is.

Mr. CASTEN. I guess I would put that back to what my LP said—we are a wealthy family office, and he once said to me, "I know I am smart, I know I am really good. The last thing I want to do is to give my grandchildren an obligation to make an investment decision. They want yield. They don't necessarily want to have to reinvest."

Would you agree that the carried interest deduction turbocharges the incentive to create liquidity events to the extent you can structure those liquidity events as capital gains?

Mr. MALONEY. Look, I think the carried interest provision encourages the building of long-term capital and rewards and aligns the incentives between the LP and the GP.

Mr. CASTEN. The reason I asked all those questions—and I get it, it is hard in a public forum like this to be totally forthcoming, but we have a massive need for investment and infrastructure in this country. And we can acknowledge that private equity is much better at that than a lot of other pockets of capital, but we have to acknowledge that it is still deeply flawed. And I want to work with you to try to figure out how to take away those flaws, but we have to first acknowledge, because I think every question that you said it depends, I disagree. I think those were all hard yeses, but we don't want to fix this by mandate.

I yield back.

Chairwoman WATERS. The gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. I thank the Chair. Thank you for holding this hearing today. I appreciate that you are showcasing Senator Warren's economic proposals. Perhaps after Thanksgiving, we can have a showcasing of Senator Sanders' economic proposals. I appreciate the opportunity to hear their impact on our economy.

A couple of weeks ago in Arkansas, I had the pleasure of hosting a venture ecosystem summit. And, Mr. Palmer, we appreciate you coming to Arkansas and graciously attending our event and talking about the current private funding market. It was very well-received.

Arkansas has a vibrant entrepreneurial community, and I wanted to bring together the stakeholders from across the State for a roundtable discussion to collaborate on ways we can foster the growth of our investing community, our entrepreneurial community, and craft better Federal legislation that will push and help growing businesses onto that next stage of success.

Mr. Palmer discussed some of the challenges associated with securing funding in States like Arkansas, and potential ways to overcome those funding challenges. And much like his testimony today, he strongly advocated for the need for private equity and its investment in growing businesses all over the country, particularly off the East and West Coast. I agree completely.

As an entrepreneur myself, and now Chair of the House Entrepreneurship Caucus, I want to emphasize how important it is to have a wide universe of funding options for new entrepreneurs to draw on of companies of all sizes. This is entrepreneurship week across the country, so whether you are an angel investor or a venture capital fund or a private equity fund, all of these forms of investment are important cogs in our nation's economy and they impact all of our citizens. Just in my district in Arkansas, private equity has created over 1,600 jobs and invested more than $2 billion over the last 5 years.

Pension funds, which touch a large portion of the American public, are clear examples of private equity beneficiaries. Mr. Maloney, public pension funds are large, sophisticated investors. Is that right?

Mr. MALONEY. Yes, sir, they are.

Mr. HILL. They are not mandated to invest in private equity, are they?

Mr. MALONEY. No, they are not.

Mr. HILL. And they have a lot of high-paid lawyers who work for them?

Mr. MALONEY. They do, indeed.

Mr. HILL. And they do insist on measuring performance before they make an investment as a pension fund?

Mr. MALONEY. Yes, sir.

Mr. HILL. Would you say that pension funds are pushovers when it comes to negotiating with private equity funds?

Mr. MALONEY. I think they drive a hard bargain.

Mr. HILL. Okay. We have talked a lot about performance. So, you would say pension funds are generally—they have benefited—and I appreciate Mr. Moore's repeated answers to those questions. I have a chart I put up which is public pension fund investment in private equity since 2000. And you can see it has grown from around 3 percent of assets under management up to about 8 percent of assets in that 20-year period. That is a pretty significant increase.

So, generally, I think the panel would agree that pension fund investors are pleased with their participation in private equity investing.

And pension funds are so important to the working people of this country. Whether you are a retired city councilman in Boston or a retired law professor in California, you earn pensions, and we have such an underfunding problem, anything that incrementally is better than the average return is so helpful to preserving those pension assets and retirement assets. And I think that is why CalPERS has argued we need private equity, we need more of it, and we need it now.

All that to say that limiting private equity is not the answer. The Majority has claimed today that private equity is bankrupting

American companies and laying off thousands of American workers, and that limiting private equity somehow can stop that. In my view, it will have the opposite effect. Limiting private equity will hinder business growth, constrain local employment, and hurt Main Street communities.

We need to work to lower the cost to investment burdens, whether it is in the public forum or in a venture capital environment or an SBIC fund or private equity, and encourage more investment. And that is what I think we have done by lowering the corporate tax rate and bringing capital back to the country. We haven't talked about that today, that by encouraging capital to come back in the United States, some of those profits now not double taxed will flow into the investing community and in through both angel investing and through firm investing.

Mr. Palmer, you have looked at rural States like Arkansas. What do you think is the best thing that we can do to enhance investing in a rural State?

Mr. PALMER. I think Arkansas is working on it right now, bringing together the universities, bringing together the financial leaders, the banks, the private equity funds that are there, and really trying to coordinate and get to critical mass with the entrepreneur ecosystem and incubators and others.

Mr. HILL. Thank you. I yield back.

Chairwoman WATERS. The gentleman from Utah, Mr. McAdams, is recognized for 5 minutes.

Mr. MCADAMS. Thank you, Chairwoman Waters, for holding this hearing. And thank you to the witnesses for your testimony today.

In a previous life, I was the mayor of Salt Lake County, and one of the areas where I was proud of our work was the ability to bring private sector resources to help address public sector problems. I often teamed up with many of the financial institutions in Utah to pursue innovative investments. For example, Salt Lake County pioneered many of the first pay-for-success or social impact bond programs in the nation. We expanded access to early childhood education, we targeted homelessness, and we reduced recidivism in our jails. And we couldn't have done these projects without financial partners.

But I know that the desire to invest in projects that have more than a monetary return is not just limited to government problems. You see a range of investments in clean energy technologies and social welfare issues, for example. Our State, local, and Federal Governments and nonprofits don't always have the resources to solve problems by themselves, and I know that firsthand. Establishing a framework to use capital markets for problems isn't just harnessing capitalism for the greater good. I also believe it is smart public policy.

Obviously, not every PE investment works out, and I don't agree with every decision or practice that PE funds make, and often employees of those companies that fail are, unfortunately, left behind. We should clearly do better by employees who are laid off to ensure that they can reenter the workforce, ensure that they have job training that they need to succeed, and also ensure a profit safety net.

With that said, I am interested in the trend for private equity firms to look at impact investing or investments that incorporate environmental, social, and governance goals into the fund's investment strategy.

So I guess my first question, Mr. Maloney is, for many of your member companies, are you seeing a growing desire from either the fund managers or the limited partners when they make investments to incorporate social impact projects or ESG targets into the fund's investment strategies? And could you give maybe a couple of examples or maybe general trends?

Mr. MALONEY. Yes. Congressman, thank you for that question, and thank you for your leadership on that issue in Salt Lake. Many of our members are very interested in this. We are committed as an industry to responsible investing. AIC, our organization, adopted a set of comprehensive, responsible investment guidelines that cover environmental, health, safety, labor, governance, and social issues, and we did that 10 years ago. And we have several of our funds that have specific social impact funds. And everyone sort of looks through a lens of ESG, and we are looking forward to working with you and coming in and speaking with you about how we can expand on that.

Mr. MCADAMS. Great. Thank you. And do funds report ESG metrics on their investments to the limited partners?

Mr. MALONEY. Yes. And many limited partners are actually asking for that information.

Mr. MCADAMS. I would be interested in exploring, maybe offline we can do this or later down the road, any legal or regulatory impediments to social impact investments or ESG investments that firms may see.

In my State of Utah, several pension plans invest in private equity funds. As others have discussed, this comes in the form of a limited partner with a contractual agreement with the general partner who manages the fund. For instance, the Utah Retirement System (URS) provides retirement benefits for more than 200,000 members in Utah, representing public sector employees. And I think at the end of 2018, URS' investment portfolio was at roughly 12 percent in private equity, and the rate of return for 2018 in that private equity investment was at 18 percent, clearly higher than other asset classes that URS has investments in. And I know the board and officers of the retirement system take seriously their obligations to provide retirement security to all of its members.

So, Mr. Maloney, in your members' conversations with limited partners, especially with retirement plans, why are they choosing investments in private equity versus other asset classes that they could be investing in? And has the share of private equity as a percentage of retirement system asset class changed over time, and any particular reason you could contribute to that?

Mr. MALONEY. Yes, Congressman. Great question. As we saw from the chart that was on the screen just a couple of minutes ago, the asset allocation for private equity has almost tripled over the past 20 years, and I think the reason for that is it is an asset class that has proven to outperform other asset classes. And for a lot of pension funds that are underwater right now, they need that extra delivery and investment income.

Mr. MCADAMS. Thank you. I thank the panel for their testimony, and I yield back.

Chairwoman WATERS. The gentleman from North Carolina, Mr. Budd, is recognized for 5 minutes.

Mr. BUDD. Thank you, Madam Chairwoman. And again, thank you to each of the witnesses for your time here today.

My colleague, Mr. Barr, touched on this earlier, and I think it is important to reiterate the point that during periods of economic downturn or strain, traditional financial institutions may pull back from providing commercial credit. So when that happens, it is private credit funds who step in to provide counter-cyclical support to businesses when they need it most.

This question is for you, Mr. Palmer, and also Mr. Maloney. Can you tell us how private funds support the commercial credit market during economic downturns when funding from traditional institutions may slow down?

Mr. PALMER. They can be more patient, and patience matters, particularly for smaller businesses that don't have access to public markets or just selling shares. And so, they are in it for the long haul, and they sustain those businesses. North Carolina is uniquely positioned to have, for its size, having an extraordinary number of capital providers that do that type of capital, not just in Charlotte, but also in Raleigh, in Greensboro, and now in Wilmington.

Mr. BUDD. Thank you.

Mr. Maloney?

Mr. MALONEY. Congressman, it is a great question, a great point. Private equity is there to help these companies grow. And over 70 percent of the companies in America are not investment grade, so a lot of times, the banks won't lend to them, and they have to go to these private credit funds that can facilitate their ability to grow.

Mr. BUDD. Thank you both.

Ms. Appelbaum, I appreciate your time here today. Yesterday, Senator Elizabeth Warren and Senator Bernie Sanders released a letter criticizing third-party research about the private equity industry. Ms. Appelbaum, do you produce third-party research about the private equity industry?

Ms. APPELBAUM. I am not sure what you mean by third-party research. I go out and collect data, I interview private equity firms, and I report on what I have learned.

Mr. BUDD. And it is research, right? You are not directly—

Ms. APPELBAUM. It is definitely research.

Mr. BUDD. Okay. Right. So, it sounds like third-party research. And does your organization accept donations from outside groups or from special interests?

Ms. APPELBAUM. No.

Mr. BUDD. AARP, AFL-CIO, Open Society Foundations, none of those?

Ms. APPELBAUM. We accept grants from foundations, so we may have—

Mr. BUDD. Okay. And those foundations typically have an interest—

Ms. APPELBAUM. We don't accept money from corporations, from governments, from foreign interests, but we do accept money from individuals and from foundations.

Mr. BUDD. Foundations. Okay. Understood. Can you tell this committee how your research on private equity was funded?

Ms. APPELBAUM. Yes. This is a very good question, because I spent 4 years—Rose Batt and I spent 4 years on a $25,000 grant from the Russell Sage Foundation. It was a labor of love. When we got into it, we started out by saying, hey, we do a lot with labor. Teachers of labor, economics don't understand what is going on. We should write something for them. We had in mind a small pamphlet. And then as we got into it, we discovered it is a very complex subject and a very interesting subject, and so we spent 4 years learning about it, writing about it, and producing a book that was a finalist for a very prestigious award from the Academy of Management. I think if you read the book, you will find it is very balanced.

Mr. BUDD. I mean, $25,000 over 4 years, that is definitely a labor of love.

Ms. APPELBAUM. It was a labor of love.

Mr. BUDD. I just wonder if any of these—do you think that some of the other contributions helped sort of offset that?

Ms. APPELBAUM. We have unrestricted funds that we get, at that time from the Ford Foundation, and that is—of course, somebody paid my salary with that.

Mr. BUDD. I understand.

Ms. APPELBAUM. But the money for—it is very difficult, to tell you the truth, to get money for private equity research because usually we are interested in labor issues, and it is really hard. Eyes glaze over when you mention finance to people who care about labor issues.

Mr. BUDD. Thank you.

Another question, Senator Warren actually linked to your research in her official press release announcing her anti-private equity legislation, referring to it as the legislation's economic analysis. So I assume you are in communication and in close coordination with Warren's team about this?

Ms. APPELBAUM. No. Actually, they wrote the legislation. It turned out they had read my book. They asked me for a meeting because they had other questions, and then when I got there, they said, you are probably in a room with the only four people who have read your book cover to cover. So I think the book may have inspired the legislation. Afterwards, they asked me if I would write a letter.

I want to say the legislation is not anti-private equity. It is anti-excess leverage, and this is what the problem is. It is true that most of the private equity-owned companies do not end up in bankruptcy, but in the last recession, 27 percent of the bankruptcies were highly leveraged companies.

Mr. BUDD. Just in the remaining few seconds—thank you so much—was there any discussion or coordination with the Warren team during the report's development, timing of release, or preparation for this hearing?

Ms. APPELBAUM. For this hearing?

Mr. BUDD. Yes.

Ms. APPELBAUM. No.

Mr. BUDD. Thank you. I yield back.

Chairwoman WATERS. The gentlewoman from North Carolina, Ms. Adams, is recognized for 5 minutes.

Ms. ADAMS. Thank you, Madam Chairwoman. Thank you for holding this hearing. And thank you to all of the individuals here to testify.

Dr. Appelbaum, a recent report published by Ernst & Young celebrated private equity's role in the economy, noting that they employ 8.8 million workers, but another report found that private equity investments have led to a loss of 1.3 million jobs in the retail industry alone. So should we be concerned that so many workers are vulnerable to private equity strategies and efforts to maximize their profits, often at all costs, with little to no regard for the devastating impact that they can have on workers, consumers, and communities?

Ms. APPELBAUM. Publicly traded companies would never put 83 or 87 or any large amount of debt like that on the company. It is not that private equity firms want to drive companies into bankruptcy, but if they use excessive amounts of debt, then, in fact, those companies are going to struggle. And in retail, where there are always changes going on, new fashions, new technology and so on, publicly traded retail companies have low levels of debt so they can make the changes they have to make. Private equity-owned companies do not, and that is why we see those particular failures.

Ms. ADAMS. Okay. So let's talk about a specific example that I find truly heartless and despicable. In 2018, Apollo Global Management funded the purchase of the Hahnemann University Hospital, an historic hospital that had been serving Philadelphia's poorest residents since 1848. That is 171 years in the community, providing a critical public good. And despite making no capital investments, the management company closed the hospital less than a year-and-a-half later, claiming that it wasn't profitable.

The closure of the hospital left over 2,500 union workers without jobs, and tens of thousands of Philadelphians without access to healthcare, yet the company still stands to profit by selling off the hospital's assets and prime real estate. So can you explain how the owner of the hospital can profit by shuttering the hospital and eliminating a huge source of the City's healthcare services?

Ms. APPELBAUM. Yes. This was truly outrageous behavior. The private equity firm came in, and bought the hospital with the idea that this is a possibility where you might want to improve things. The day that they bought the hospital, they separated the real estate and put it in a property company from the hospital, which was the operating company. And then—I studied healthcare as well. I won't go into details, but there are many things they could have done that would have helped turn that hospital around. They didn't lift a finger to do even one of those things, and so a hospital that was in trouble continued to be in trouble. Eighteen months later, they said, oh, well, the hospital is in trouble. We are going to declare bankruptcy, but the real estate was not included in the bankruptcy. The hospital has closed.

Ms. ADAMS. Okay.

Ms. APPELBAUM. The private equity fund still owns the real estate.

Ms. ADAMS. Right. So do communities or governments have any recourse when an institution like a hospital is shuttered by a private equity?

Ms. APPELBAUM. They have no recourse after the fact, no. My recommendations going forward, because this is the first time this has happened, and it is going to be a model for cities with failing—communities that have been poor that are gentrifying. When a not-for-profit hospital becomes for-profit, the city and the State have a lot to say about what happens. They need to put in the charter that if this property is not used for healthcare, then the property reverts back to the community.

Ms. ADAMS. Thank you, ma'am.

Mr. Maloney, as the head executive at the American Investment Council, you represent some of the largest private equity firms in the world. And given the profit maximizing model often employed by firms, do you believe that there are certain asset classes or investments that private equity firms should avoid, particularly industries related to public health that are incredibly sensitive in nature?

Mr. MALONEY. Congresswoman, thanks for your question, and thanks for your concern on these important health issues. I will say that we have a role to play and a positive role to play across the entire economy. Some of these hospitals and some of these medical facilities are private equity-backed. Some of them aren't private equity backed, but they are still private. And I think we can have a positive role to play in that, and we would love to work with you and others on the committee to continue that positive role.

Ms. ADAMS. Mr. Moore, as you know, in California public pensions are required to publicly disclose the fees and expenses paid to private equity funds. So why do you think this disclosure is necessary or helpful to investors?

Mr. MOORE. So that we can do the proper analysis of costs that are being charged to us and compare them between different funds for different strategies and different potential outcomes, but that is only one part of the data that we need.

Ms. ADAMS. Thank you very much.

I yield back, Madam Chairwoman.

Chairwoman WATERS. Without objection, I will enter into the record The American Prospect article, "Private Equity's Latest Scheme: Closing Urban Hospitals and Selling Off the Real Estate," relative to Hahnemann University Hospital in Philadelphia.

Without objection, it is so ordered.

The gentleman from Ohio, Mr. Gonzalez, is recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman. And thank you to our panel here for your attention today.

My fear as I look at the legislation and read some of the talking points is that we are looking at some of the worst examples that private equity has to offer, Toys R Us being one example. I don't think anybody involved in that deal would do it again if they had the opportunity. And we are taking a hatchet to an entire industry

that supports millions of jobs as an important source of returns for many of our pensioners.

Mr. Palmer, I will start with you. I am going to read a list of companies: Smile Direct Club; Slack; BeyondMe; Uber; and Lyft. They have all gone public this year. What else do they have in common?

Mr. PALMER. They are all backed by private equity funds, I think.

Mr. GONZALEZ OF OHIO. Every single one of them.

Mr. PALMER. Yes.

Mr. GONZALEZ OF OHIO. Yes. From start to finish, it turns out. And, Mr. Palmer, who ultimately is invested in these funds? Who are the returns ultimately going to?

Mr. PALMER. They are ultimately going to university endowments, pension funds, family offices, and individuals.

Mr. GONZALEZ OF OHIO. Teachers, firefighters—

Mr. PALMER. Absolutely.

Mr. GONZALEZ OF OHIO. —police officers. Wonderful.

And, Mr. Moore, just because I think it is such a strong example, what is the highest returning asset class net of fees?

Mr. MOORE. Let's see, I think this is the seventh time I have just—

Mr. GONZALEZ OF OHIO. Just again, I like to hear it.

Mr. MALONEY. It is private equity.

Mr. GONZALEZ OF OHIO. Okay. Wonderful. So to destroy the industry in its entirety would rob many of our pensioners—

Mr. MOORE. That is not the intent.

Mr. GONZALEZ OF OHIO. —of important returns. It's not the intent, but it would certainly happen.

Mr. Palmer, in your opinion, to follow up on that, would the Warren bill that we are talking about result in more money in private equity funds or less, in your opinion?

Mr. PALMER. Less, and particularly for smaller businesses which are otherwise seen as risky.

Mr. GONZALEZ OF OHIO. I want to talk about one specifically which happens to be in my district, Hyland Software. Have you heard of Hyland?

Mr. PALMER. I think I have.

Mr. GONZALEZ OF OHIO. You have. They are an awesome business. They are owned by Thoma Bravo. Are you familiar with Thoma Bravo?

Mr. PALMER. Yes.

Mr. GONZALEZ OF OHIO. Okay. So Thoma Bravo has owned the business for close to a decade or maybe a little more than a decade. They provided liquidity to the founding family, and have supported the growth of thousands of jobs. Thoma Bravo has been a great partner to Hyland. When I talk to folks at both Thoma Bravo and at Hyland, it's just an incredible story for our region.

Northeast Ohio, the community where I am from, is in need of more private capital, frankly. We need as much private capital into our community as we can get. We need more businesses like Hyland Software to grow in fast-growing, exciting industries and create jobs and opportunity for our community.

And again, based on what you just said, I think the fear that I have, and I think everybody should have, when we look at this Warren bill, which I think would be a disaster for jobs, and certainly for my community, is the effect that it would have on the real economy. I know research papers are nice and wonderful, but these have real implications for people on the street. And I am happy to see that the bill is not supported widely by my colleagues on the other side of the aisle, and I hope it dies here and in this committee.

And with that, I yield back.

Chairwoman WATERS. The gentleman from Illinois, Mr. Garcia, is recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Madam Chairwoman. And I would like to thank all of the panelists for joining us today.

I would like to begin noting Ms. De La Rosa's testimony, where you mentioned that you worked at Toys R Us for 20 years. When Toys R Us was bought by KKR and Bain in 2005, it was profitable. In fact, it had over $11 billion in sales the year before it was acquired. KKR and Bain's first order of business after they bought Toys R Us was to load it up with $5 billion in debt. By 2007, that interest consumed 97 percent of the company's operating profit.

Dr. Appelbaum, what kind of effect would loading up Toys R Us with debt have on making the company more valuable and allowing it to be sold at a profit to its new owners?

Ms. APPELBAUM. The purpose of loading it up with debt—and I agree with everyone who said that the goal is not to bankrupt the companies. But when you load a company up with debt and you sell it later, you make a massive profit just off of the sale because you have so little equity there.

But, of course, debt is a two-edged sword. You can sell the company and the private equity fund makes tons of money, but the company itself, which is responsible for repaying the debt, is at much greater risk of bankruptcy. I am not saying they all go bankrupt, but the risk of bankruptcy definitely increases with this debt. And we saw in the Toys R Us case what happened. They tried to go public. They didn't want to own it for all these years.

Mr. GARCIA OF ILLINOIS. Got it.

Ms. APPELBAUM. The public didn't want to buy it because they could see the debt. Publicly traded companies don't have debt at that level.

Mr. GARCIA OF ILLINOIS. Okay. Ms. De La Rosa, you were at Toys R Us both before and after private equity's takeover. How did things start to change for you?

Ms. DE LA ROSA. They immediately eliminated positions, like full-time positions, management positions, all around. We switched operating companies that we used to manage the stores that were—being in management, I was able to tell what the cost was, and switching companies, we were going to companies that were costing double what we did before. There were many different things that definitely cost; cut of hours, cut of positions.

Mr. GARCIA OF ILLINOIS. So things changed for everyone, for you as a manager, for workers, and many people lost their jobs. That is precisely why I am supporting the Stop Wall Street Looting Act, because it seeks to rein in the excesses that have occurred and con-

tinue to occur in our economy, not because anyone is running for President, whether it is Senator Sanders or Senator Warren.

So to summarize, jobs were cut, hours were cut, and inventory was cut. For private equity, investing in Toys R Us really meant squeezing workers at every opportunity. Private equity squeezed so hard that the company collapsed, leaving workers and their families and whole communities to pick up the pieces. The retail apocalypse.

Mass bankruptcies and closures of legacy retail stores is often blamed on online shopping and technology, but that doesn't tell the full story. As we have heard today, private equity is playing a big role too. It is estimated that nearly 600,000 retail workers like Ms. De La Rosa have lost their jobs at the hands of private equity over the last decade.

I want to talk about another sector that has experienced significant disruption in recent years as well. Although technology gets blamed, private equity is forcing layoffs in the media as well. In 2007, things hit close to home for me when the media company, the Tribune Company headquartered in Chicago, was saddled with over $13 billion in debt and driven into bankruptcy by what private equity investor Sam Zell called the deal from hell. More than 4,200 people lost jobs after that deal at newspapers and news stations around the country, including the Chicago Tribune, the Los Angeles Times, the Baltimore Sun, and more.

Dr. Appelbaum, what kind of job losses usually follow when private equity takes over media companies?

Ms. APPELBAUM. As you pointed out, I don't have the exact numbers on this, but there have been huge job losses. There has been huge consolidation. There has been less local news for people to be able to get. One of the big things that we see is not only are the jobs lost, but local people have no information about their local governments. The old beats that covered the things that were important to people so they could make decisions about their lives are gone now.

Mr. VARGAS. [presiding]. The gentleman's time has expired.

Mr. GARCIA OF ILLINOIS. Thank you. And that is why we are advancing this legislation, to rein in the excesses.

Thank you, Mr. Chairman. I yield back.

Mr. VARGAS. Thank you.

The gentleman from Virginia, Mr. Riggleman, is recognized now for 5 minutes.

Mr. RIGGLEMAN. Thank you, Mr. Chairman. And thank you to all the witnesses here today.

I find this very interesting as we are talking about this because we just had the megabank witnesses not too long ago. In that hearing, we were talking about really wanting to stop buybacks, especially in curbing investment returns, and private sector growth. And one of the reasons I ran for Congress—I have been in for 11 months now, and so I have lots of experience—but one of the reasons that I ran for Congress, specifically, was government overreach into my own businesses, but also to my wife and daughters. And this is why I am so interested in what is going on here.

When we talk about private equity, we are not just talking about large companies, pension funds, things of that nature. I know we

have mentioned this multiple times, but I wouldn't be here without private equity. First, in my Department of Defense business, I had a $90,000 investment from private equity. We were able to turn that into a 60-time multiplier on gross revenues where we had 20 direct employees and 50 subs.

Now, my wife owns a chemical manufacturing plant of distilled spirits, but the issue we had with private equity then is we couldn't get a bank loan. Even though this is what she wanted to do, and we put a lot of our own money into it, we couldn't get the banks—they did not know how to valuate anything when it came to cogs, when it came to overhead, when it came to labor salaries, based on the fact that we had to build specific types of inventory that they had no way to valuate as we went forward.

So as we are going forward in this, what I always fear is that the government is a board member on my company, on another company. What I also fear is when you see legislation this bad, which I call the "Stop Entrepreneurship Act," I am wondering if it is individuals writing this with good intentions not understanding the law of unintended consequences or the cascading effects of this type of damaging thing.

Let me ask a question, and I will start with Mr. Palmer and go to Mr. Maloney. I am talking about asymmetric companies and I am talking about companies that maybe are nontraditional. For example, when you start a niche company, say, in the Department of Defense and the intelligence community space, you are talking about maybe companies that have a very specific niche thing that they do. They can't get a loan to start. They can't even get a loan for office space. Do you know where they have to go? Your own money or private equity.

If you are starting a manufacturing plant, and you are one of the first three or four to do it the way that you are doing it, say, in a whole State that doesn't understand it, you cannot get a loan. You have to go to private equity.

Now, you have to have, as you know, pro formas. You have to know what pro formas are and P&Ls. You have to know all of those things.

But I think that is why the first thing I want to do before I get to the question is I want to—and this is a third-party report, Mr. Chairman. I want to submit the Economic Impact Analysis of the Stop Wall Street Looting Act and ask unanimous consent to insert it into the record, please.

Mr. VARGAS. Without objection, it is so ordered.

Mr. RIGGLEMAN. My question is this: When we are talking about private equity, we are talking about the things that drive the American economy. My question is, what happens to asymmetric or nontraditional businesses, Mr. Palmer, if this bill passes or something like this passes?

Mr. PALMER. They will have less access to capital. Private equity fills those gaps that don't fit neatly for a simple bank loan.

Mr. RIGGLEMAN. Mr. Maloney, same question.

Mr. MALONEY. I agree with Brett, that it will dry up capital needed for these asymmetrical businesses.

Mr. RIGGLEMAN. In this report that I am going to put in the record, it says this can result in the loss of 6.2 million to 26.3 mil-

lion jobs across the United States. That is a projection. Do you know what that should say? 6.2 million and 31, because it is the 31 jobs in our manufacturing facility that we wouldn't have right now. It is the 70 total jobs and the multiple subcontracting companies that we have that would not be in business today.

Now, I know it is not perfect. Trust me, I have dealt with private equity and venture firms. It is fantastic, and I would not recommend it to anyone. But anyhow, I think what is amazing is that they were able to get us started, and they were able to do great things. And right now, if you talk about Charlottesville, Virginia, in my district, without them, without that angel network, I wouldn't have 31 employees. My wife wouldn't have locations in Virginia and Pennsylvania, and I would never have been able to even get to that point without private equity.

I think as we go forward—and I had all these statistics that I wanted to throw out there, but I have 54 seconds, and people know how fast I talk on data, so we don't want to do that right now. This bill is not a law yet, and I think for me, as we are going forward and some of the other questions I wanted to ask and some of the things that blow my mind, if we actually—right now, if we were to do this, to actually create a loss of somewhere between $671 million to $3.36 billion per year, about half of which would be lost to pension fund retirees, I shudder to think that we are not going to go over this with a fine-tooth comb to make sure that we are not stopping the American economy in its tracks because we don't understand the law of unintended consequences, we don't understand cascading effects, and we don't understand the fact that government has no idea sometimes what it is doing in private business.

That is all I have right now. Thank you, and I yield back my time.

Mr. VARGAS. The gentleman yields back.

The gentleman from Florida, Mr. Lawson, is recognized for 5 minutes.

Mr. LAWSON. Thank you, Mr. Chairman. And I would like to thank all of you for being here today.

There is one thing that is very interesting. We have some of you testifying that if this bill passed, what it is going to do to the private equity market, and then we have some who are speaking in terms of, we need more transparency.

I would like to say that the Florida government pension system is one of the largest in the country. It plays an important role in the lives of over a million workers. Private equity is often the best-performing asset class for pensions. That is true in Florida.

How can private equity funds such as the Florida government pension system become more of a model for other private funds? And I would ask Mr. Moore that.

Mr. MOORE. The question is, how could Florida—

Mr. LAWSON. How could the pension program become a model for other pension plans, especially because a lot of them are having trouble all over the country?

Mr. MOORE. Okay. I think I met your chief executive officer a few weeks ago, and he is a leader in the Council of Institutional Investors, and I think that is the forum that your pension fund can lead in bringing thousands of pension funds in the country together to

kind of look at policy prescriptions that would make everyone more successful in implementing their programs and follow the success that you have had.

Mr. LAWSON. Thank you.

We are speaking of more transparency, Dr. Appelbaum, and that is what will be in this bill. What is the difference between my colleagues here, Mr. Palmer and all of them who say that this is going to cause a lot of problems in terms of investments that we need in private pension funds?

Ms. APPELBAUM. I think transparency is a problem for the private equity firms that do not wish to reveal even to their limited partners exactly what they are doing. It also makes it very difficult for anybody to do objective research.

Unlike publicly traded funds where you—companies where you have a lot of information available, we do not have information available from the private equity firms about the performance of their funds. There is no publicly available database. There is no place that you can go. We do not have publicly available information about any actions that have been taken by a regulator against these firms. So they have an interest in being able to keep private as much as they want to keep private. That is why they are called private equity. It is in order that they can protect that privacy, and it is not to the advantage either of the pension funds that do the investing or to the general public that wants to understand what is happening in the economy or to be able to really evaluate the returns across all of the private equity firms and all of the pension funds. We don't have that kind of information. We really just have snapshots, and I really don't know what measure is used.

The internal rate of return is a very poor measure of private equity performance. It is not used by finance professors anywhere to talk about private equity. We use the public market equivalent, and I don't really—which is now published by PitchBook on a regular basis, but I don't hear that being used. And on that basis, at the median, the middle pension fund has not—the private equity fund has not beaten the stock market since the financial crisis. They were great before that, not so great since. And it is true there is a sliver, there is 10 percent of the pension funds invested in private equity funds that are getting really good returns. But half of the private equity funds are not even matching the market.

So it's good that we have somebody here who represents a fund that does really well, but many, many pension funds are below water if you compare them with the public markets.

Mr. LAWSON. And I am very aware of it, because when I served in the Florida legislature, we looked at all of them across the country, and they really are. I don't have much time, but, Mr. Palmer, would you care to comment?

Mr. PALMER. Sure. The limited partners, these institutionals, they negotiate with the private equity fund before you start investing and before they decide whether they want to be in that fund or not. They get to choose what information they get or what they don't, and so they can get that. So Mr. Moore can get that or other institutionals can get that.

Particularly the smaller funds, they have to be very accommodating to pension funds in the information that they are looking

for. These large institutions have vast amounts of data on private equity in returns that may not be public but they have because they have done thousands of investments.

Mr. VARGAS. The gentleman's time has expired.

I now recognize myself for 5 minutes.

We are not here to vilify an entire industry, but we are also not here to canonize them either. And listening to my colleagues on the other side of the aisle, it seems like private equity has already been beatified and they are only waiting for sainthood.

No, it is not the case. There are a lot of bad actors. And I think there are a lot more bad actors in private equity than there are in the public companies. And what happened to Toys R Us is, I think, a good example of one of those very bad actors in private equity.

As has been noted up on the board here repeatedly, Toys R Us paid $470 million in fees and interest to private equity and wanted to give nothing, absolutely nothing, zero, in severance to the workers. In fact, after the buyout, my understanding from the testimony of Ms. De La Rosa—and I read all of your testimony—is they got rid of holiday pay, staff Christmas parties, birthday gifts, and some of the full-time positions started to get eliminated, health benefits for part-time employees were taken away. And this was supposedly the new technology.

It is always stated that human capital is the most important asset a company has. To act like this certainly shows that they didn't think that their human capital was the best asset that they had.

And I have to say, I am familiar with that store. I hate to shop, I have to admit, but in 1998, my daughter was 2-years-old, and I went to buy a present for her for Christmas, and it turned out that there was a beautiful kitchenette there. And I bought it.

I couldn't fit it into my Toyota Supra, so I had to get help to tie it onto the roof. And one of the employees at Toys R Us came and helped me tie it onto the roof. I drove it back, my daughter opened it up for Christmas, and I became a hero, of course.

And that was Toys R Us. I enjoyed going to Toys R Us because of the service that I got there, and also the selection, so I didn't have to go anywhere else. But that seemed to change quite a bit, did it not, Ms. De La Rosa, once you had private equity come in?

Ms. DE LA ROSA. Yes, it did, sir.

Mr. VARGAS. And how did it change in a negative way? Were people happy that they were there? Were the employees more satisfied with their work?

Mr. DELANEY. No. People were expected to do the jobs of three or four people. So productivity was increased, but, yes, for the half of the crew that was left with a job.

Mr. VARGAS. And I think that is one of the interesting things that a lot of the large companies, especially banks, have been saying recently, that it is not just about the bottom line. It is also about the community. It is about the workers. It is about the nation.

And I think that is one of the things we have to look at, and that is one of the things that private equity, unfortunately, I don't think does look at. It looks at simply the bottom line. And so that is why

I think we do have to take a look at the law and how to change it.

Now, my colleagues on the other side of the aisle say, well, we can't change the law at all because it is all about letting the private sector do what it wants.

Well, we change the law all the time. In fact, we have workers' compensation, we have workers' rights, you can't discriminate against people based on a whole bunch of issues. So absolutely we can have laws that demand more transparency disclosures, more fair workers' rights, we can do this. In fact, I think a well-running system demands this.

So, again, I am not here to vilify an entire industry, because I do think that there are in fact opportunities and times when private equity is appropriate. I am not here to vilify. But at the same time, to say that somehow they are beatified, they are somehow saintly in what they do, that is absolutely not true. I think there are a whole lot of problem, and I think we have to deal with them.

And again, I appreciate everyone who is here.

I would add, though, at the end, that one of the things that I think has to happen is that we have to take a look at what really is happening with the sense of who owns so much in the country. We talk about private equity and why do we have so few public companies and so many private. Because the money is going to the very few at the top. That is why.

You talked about pension funds, yes, but you didn't talk about the billionaires. And now we have people who are not only billionaires, but hundred billionaires, a person who has a hundred billion dollars. Yes, of course, they can afford then to put it in private equity, and they are paying less and less in taxes, and that is not right.

So that being said, I will yield back the rest of my time. And now the gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Thank you, Mr. Chairman.

And thank you all so much for coming before our committee and giving us a better sense of why it is important for us to oversee some of the activities of private equity firms.

There is a case that the Michigan ACLU is working on, that I want to talk to you all about, for one of their clients, Davontae Ross. Davontae is a resident of Detroit who spent days behind bars because he couldn't afford to pay the $200 of bail related to a 5-year-old ticket for allegedly staying in a park after dark. He missed a job interview, and even more critical was an appointment with a government caseworker. His life was turned upside down.

And this is a story of too many folks who live in poor communities, and struggle with paying cash bail throughout my district.

The largest bail bond company in the United States, Aladdin Bail Bonds, is owned by Endeavor Capital, a private equity firm that invests money on behalf of pension funds and endowments. Because Congress has yet to act to restrict private equity firms like Endeavor Capital, they continue to still be allowed to capitalize off of people behind bars simply because they are poor.

This question is for Mr. Moore, Trustee Moore. Is it appropriate for a private equity firm like Endeavor Capital to invest public em-

ployee retirement funds into predatory industries, like the bail bond industry, who prey heavily on poor communities?

Mr. MOORE. I personally think no, and I would not vote for us to engage in any activities with that kind of firm. Our pension fund doesn't have any direct investments in any organizations that are involved in private prisons and that whole associated group of companies.

Our only issue is that in the public markets, where we are invested in index funds—and index includes everything, so we had have to go in and ferret out and try to exclude those companies from our indexed and passive investments. But I would not support that at all.

Ms. TLAIB. There is a growing bipartisan consensus throughout our country that incarcerating so many of our neighbors, our people, and for-profit bail is a significant part of that problem. And The Washington Post last year highlighted private equity firms like Endeavor Capital's spending. They spent so much money opposing bail reform, noting that they are the largest funder of a campaign to roll back California's recently adopted bail reform law.

Ms. Appelbaum, you talked a little bit about this when it came to the healthcare industry. How much money does the private equity industry, like the cash bail industry, spend trying to keep government officials beholden to their interests?

Ms. APPELBAUM. Yes, it would be good if we had some public information about that.

Ms. TLAIB. That is right.

Ms. APPELBAUM. But just to set the record straight on the amount of money that was spent preventing the passage of really good bipartisan legislation in both the Senate and the House that would have reined in surprise medical bills and that really had a good chance to pass, which is why they spent so much money, they first spent the $4.1 million that was mentioned to lobby for an amendment. They got the amendment. It didn't do them any good, because the debt markets think that without being able to charge these high prices, they will not be able to make good on debt that is coming due in a couple of years.

And their debt became distressed. So now, they—the last figure I saw was a $28 million campaign by Doctors and Patients United, which is actually Envision and TeamHealth, backed by KKR and Blackstone, to prevent any legislation from passing, and they have just stymied it for the moment.

But these are bipartisan bills with a lot of support in both the House and the Senate. I think we are going to see them.

Ms. TLAIB. Thank you.

And, Ms. De La Rosa, I just want you to know, I think there are a lot of my colleagues, especially this new class, who understand corporate greed is a disease in our country. And you can see it just with the behavior of private equity firms.

Even when we are trying to do the right thing, a bipartisan effort, even around incarceration in our country, around surprise billing in our country, trying to address the issues around healthcare, corporate greed is tainting our democracy. And it is coming in a way that is pretty much hijacking any opportunity for regular folks like us to be able to have some sort of justice when it comes to

issues that we feel like in very many ways is weighing heavily on communities like mine.

I represent the third-poorest congressional district in the country. When I come here, I represent 650,000 people. And I have to do this and try to push for legislation like disclosures and reporting. And what does it lead to? Going around the table, using all of these coalitions of folks and pushing kind of a misleading, gaslighting folks that it is not the right thing to do.

Thank you all so much again for being here.

I yield back, Mr. Chairman. Thank you.

Mr. VARGAS. Thank you very much.

The gentlewoman from New York, Ms. Ocasio-Cortez, is recognized now for 5 minutes.

Ms. OCASIO-CORTEZ. Thank you, Mr. Chairman.

And thank you to all of our witnesses for coming here today.

I have to admit that I am quite upset throughout this hearing, because I feel like a lot of the initial questions that we are hearing almost betray the priorities that we have had in our economy that have eroded people's quality of life. Because the first question that I hear from so many members are, how are the returns? But the returns are great, aren't they? How are the returns?

I wasn't sent here to safeguard and protect profits. I was sent here to safeguard and protect people. And we are talking about reining in private equity, which is responsible for wiping out tens of thousands of jobs at Toys R Us alone. And then we are hearing, but what about the companies that made 100 jobs here or 200 jobs there?

Toys R Us, 30,000 jobs wiped out. Shopko, 14,000 jobs. Brookstone, David's Bridal, Payless. Not to mention the impacts, the undemocratic impacts on media companies, Splinter, Deadspin, Sports Illustrated, local and regional newspapers. In the last 10 years, private equity is behind 597,000 lost jobs.

And it is not just about the number of jobs, isn't that right, Ms. De La Rosa, it is about the quality of jobs, right? When private equity took over Toys R Us, did you see folks' work schedules get cut back?

Ms. DE LA ROSA. Yes, definitely.

Ms. OCASIO-CORTEZ. Did you see people's benefits in some other ways cut back?

Ms. DE LA ROSA. Yes.

Ms. OCASIO-CORTEZ. Did your access to healthcare get damaged after private equity took over Toys R Us?

Ms. DE LA ROSA. Yes, it was.

Ms. OCASIO-CORTEZ. Did your mental health care get—was your mental health sacrificed as a result of how your quality of life was changed?

Ms. DE LA ROSA. Very much so.

Ms. OCASIO-CORTEZ. Very much so.

We need to think about our economy not just in terms of the returns for stockholders, but in terms of how the lives of workers are impacted.

In May of this year I sent a letter, along with Senator Warren, to Secretary Mnuchin regarding the Treasury Department's involvement in decisions related to the Sears bankruptcy.

I want to take a step back and think about how some private equity companies, on the other end, take pension money on the front, to acquire poorly rated indebted companies.

Ms. Appelbaum, because of the high returns usually associated with private equity, pension funds invest the retirement funds of our teachers, firefighters, and civil servants in PE firms, correct?

Ms. APPELBAUM. They do. But the measure that they use, the metric for measuring success, is a very poor one. They use something called the internal rate of return. With more time I can explain why this is an algorithm that does not really measure money you can take to the bank.

Ms. OCASIO-CORTEZ. Right.

Ms. APPELBAUM. And so there is a lot of illusion-creating here. They could report the public market equivalent, which would give us a lot more information.

Ms. OCASIO-CORTEZ. Yes. And we hear from a lot of folks saying, okay, we are using teachers' pension funds to buy into private equity, and they are getting fabulous returns, this should be great, right? Can you explain to me why that may not be great?

Ms. APPELBAUM. One of the things that we know, if we measure this appropriately, is that since the financial crisis, about half of the private equity funds have underperformed the stock market. Another quarter of them have barely beaten the stock market.

CalPERS itself had to roll back its benchmark because it could not—it had a benchmark for its private equity returns. They are more risky, so they should yield more return. They could not meet that more return, so they have cut their benchmark in half.

Ms. OCASIO-CORTEZ. So private equity contains more risk than other parts of the market, correct?

Ms. APPELBAUM. Oh, absolutely, that is true.

Ms. OCASIO-CORTEZ. And so—

Ms. APPELBAUM. And the returns are good for the very top.

Ms. OCASIO-CORTEZ. And would you say that more of these teachers' and firefighters' pensions are exposed to more risk or to more private equity now than they were, say, 10 years ago in the 2008 financial crisis?

Ms. APPELBAUM. Yes. Yes, they are.

Ms. OCASIO-CORTEZ. They are. And if there is an economic downturn again, would they be exposed to more risk than they were before?

Ms. APPELBAUM. What I have not been able to say is that in the last economic downturn, 27 percent of highly leveraged firms went under. And what we know about private equity-owned companies is that they are highly leveraged.

So saying that today there is no difference between publicly traded and private equity-owned companies is not really the issue.

I agree with the regulators. Private equity, we are spending a lot of time on it here, is really small, compared to the rest of the economy. So those leveraged loans are not going to bring down the whole economy. But trust me, there will be a lot of pain. Many, many companies employing workers that we all care about, important to communities that we all live in, are going to go under in the next recession.

Ms. OCASIO-CORTEZ. Thank you. Thank you very much.

Mr. VARGAS. Thank you very much.

Without objection, I would like to add the following submissions for the record: Communications Workers of America; Private Equity Stakeholder Project; NewsGuild; Leo Hindery, co-Chair of the Task Force on Jobs Creation, member of the Council on Foreign Relations, former CEO of AT&T Broadband, managing partner of media-based private equity fund InterMedia Partners; Institutional Limited Partners Association; David Halperin, Republic Report; CalSTRS; the Center For Popular Democracy; Truthout; Americans for Financial Reform; Worth Rises; the Economic Policy Institute; Adam Levitin, professor of law at Georgetown University Law Center; Manufactured Housing Action.

Without objection, it is so ordered.

On behalf of Chairwoman Waters, I would like to thank our witnesses for the testimony here today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

[Whereupon, at 1:24 p.m., the hearing was adjourned.]

A P P E N D I X

November 19, 2019



Written Testimony before the
U.S. House of Representatives
Committee on Financial Services

Hearing Entitled "America for Sale? An Examination of the Practices of Private Funds."

Eileen Appelbaum, PhD
Co-Director, Center for Economic and Policy Research

November 19, 2019

Chair Waters, Ranking Member McHenry and distinguished Members of the Committee. I am pleased to be here today, at this important hearing, to discuss the role that private equity funds and hedge funds play in the U.S. economy today.

By way of background, I am currently the Co-Director of the Center for Economic and Policy Research. Prior to joining CEPR, I held academic positions as Distinguished Professor (Professor II) in the School of Management and Labor Relations at Rutgers, the State University of New Jersey and as Professor of Economics at Temple University. I earned a PhD in economics at the University of Pennsylvania. My co-authored book with Cornell University Professor Rosemary Batt, "Private Equity at Work: When Wall Street Manages Main Street," is a balanced account of private equity that was selected by the Academy of Management – the premier professional association of business school faculty – as one of the four best books published in 2014 and 2015. The book was a finalist in 2016 for the prestigious George R. Terry Book Award.[1]

Private equity funds and hedge funds are structured in a similar manner. They are sponsored by a private equity or hedge fund firm which recruits investors for its funds. A committee made up of partners and principals in the sponsoring private investment firm is the General Partner (GP) of the fund and makes all the decisions. Investors in the fund include institutional investors (pension funds, sovereign wealth funds, endowments and so on) as well as wealthy individuals. These investors are Limited Partners (LPs) and have no say in decisions about the fund's financial activities. The LPs put up most of the equity in these funds, with the General Partner typically putting in one to two cents (occasionally as much as 10 cents) for every dollar the Limited Partners contribute. The LPs pay a management fee to the GP (the private investment firm),

[1] http://aom.org/Meetings/awards/George-R--Terry-Book-Award-(2016).aspx

1611 Connecticut Ave NW, Suite 400 • Washington, DC 20009 • P (202) 293-5380 • F (202) 588-1356
cepr@cepr.net • http://cepr.net

typically 2% of the money they have committed to the fund. The larger the fund, the larger the no-risk payments to the GP (and thus the private investment firm). The GP also collects a lion's share of any profits, typically 20% (but may be as high as 30 %) of the fund's returns.

Private investment funds play a significant role in the U.S. economy. Over the past decade, assets managed by hedge funds and private equity funds have exploded: they have doubled for hedge funds since 2009[2] and septupled for private equity funds[3] since 2007. Global private fund assets exceed $3 trillion for both hedge funds and private equity funds, with about $1.6 trillion[4] of PE assets held in the U.S. A recent study of U.S. companies taken over by private equity funds[5] was able to identify 9,794 buyouts of U.S. companies between 1980 and 2013. The authors were able to confidently match about 6,000 (~60%) of these to information on the companies. These 6,000 companies employed a total of 6.9 million workers in their stores, warehouses, offices, factories, and service operations at the time of the buyout. Hedge funds operate differently, buying up distressed debt or acquiring a small but significant equity stake in large, publicly-traded companies that enables it to dictate business strategies at those companies. Both private equity and hedge funds charge investors high management fees without providing them with transparency or control of the fund's activities, typically take 20 percent of the profit, and finance their operations with high levels of borrowing that feed a growing market for risky, junk bond corporate debt that is reaching dangerous levels.

Private investment funds capture wealth that enriches the partners in the private equity firms that sponsor them. Partners in these funds can be found in the billionaire ranks of the 0.1 percent of richest Americans. But do these funds create value for the companies they acquire and for the economy? That is the question I want to address today.

[2] https://www.worth.com/the-hedge-fund-strategies-that-actually-work

[3] https://www.mckinsey.com/~/media/McKinsey/Industries/Private%20Equity%20and%20Principal%20Investors/Our%20Insights/Private%20markets%20come%20of%20age/Private-markets-come-of-age-McKinsey-Global-Private-Markets-Review-2019-vF.ashx

[4] https://pitchbook.com/news/reports/3q-2019-pitchbook-private-markets-a-decade-of-growth

[5] https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_2019122.pdf



Private Equity

A recent article[6] in *Institutional Investor*, a leading international business to business publication focused on finance, highlights what it called the 'paradox of private equity': smaller private equity funds outperform mega funds and tend to deliver the best returns to investors, but the bulk of the money invested in private equity flows to the really large mega funds. Better performance of smaller funds is actually not surprising. In our research, Rose Batt and I found that smaller PE funds typically acquire small and medium-sized enterprises that can benefit from the access to financing and improvements in operations and business strategy that private equity firms can provide. These PE funds use relatively low levels of debt, provide financing to upgrade operations, advise on implementation of modern IT, accounting, and management systems, and appoint board members that can assist with business strategy. These improvements in governance, operations, and strategy create value for the companies and the economy. These acquisitions, which represent the majority of deals by deal count, will not be affected by the Stop Wall Street Looting Act.

But while the large majority of PE deals are carried out by small funds, the bulk of the money raised by private equity flows to large or mega funds. Investors in PE funds have committed billions of dollars to massive investment funds sponsored by a handful of PE firms. The top 300 private equity firms worldwide raised $1.7 trillion between January 2004 and April 2019. Eight of the top 10 are based in the U.S.[7] Despite the fact that their mega funds are a tiny fraction of the nearly 4,000 PE funds[8] that Prequin reports were raising money in 2019, funds of these eight firms raised a total of $354.2 billion – a fifth[9] (21 percent) of all the money flowing into private equity funds in that five year period.

Mega funds have incentives to acquire large companies even if the returns are mediocre compared with smaller companies. A mega fund has a lot of capital it needs to deploy in a relatively short period of time. This is more easily done if the fund acquires a few large companies. The exception is when a PE fund buys up small competitors and adds them onto a large company it already owns, flying below the radar of antitrust regulators as it creates a national powerhouse. PE funds plan to exit their acquisitions in three to five years. This is too short a time horizon to 'turn around' a struggling company; in contrast to the myth that PE funds buy troubled

[6] https://www.institutionalinvestor.com/article/b1hx33sxljv1r0/The-Private-Equity-Paradox
[7] The 8 U.S. PE firms that are among the 10 largest PE firms in the world are (in rank order), Blackstone, The Carlyle Group, KKR, Warburg Pincus, Bain Capital, Thoma Bravo, Apollo Global Management, and Neuberger Berman Group.
[8] https://www.institutionalinvestor.com/article/b1hx33sxljv1r0/The-Private-Equity-Paradox
[9] https://www.valuewalk.com/2019/07/top-10-largest-private-equity-firms/

companies, attractive acquisition targets tend to be successful businesses. These companies present few opportunities for creating value by improving operations or business strategy. They nevertheless present opportunities for making money for PE firm partners.

How is it possible for a private equity fund to make money without creating value? The place to start is by understanding that the PE fund views the companies it acquires as financial assets in its portfolio – portfolio companies – whose purpose is to provide returns to the fund and its investors, including the General Partner (PE firm). The PE firm also has means to extract wealth directly from the portfolio company.

Let's begin with the use of debt. Large companies that are attractive targets for a private equity buyout possess considerable assets that can be used as collateral to finance the takeover of the company. A large amount of debt (referred to as leverage) is used to acquire the company for the fund's portfolio, and it is the company, not the PE fund that owns it, that is obligated to repay this debt. Debt is a double-edged sword. For the PE fund, high debt and little equity means that even a small increase in the enterprise value of the portfolio company translates into a large return to the PE fund. For the portfolio company, however, high debt increases the risk of financial distress or even bankruptcy and liquidation. Private equity is gambling with the future viability of the company when it loads it with debt. It is assuming that the company will be able to service the debt and to refinance it as it matures. In the case of an unanticipated development, however, the company may find its margin of safety has been eroded by debt payments. It may be forced into bankruptcy. The private equity firm will lose at most its equity investment in the portfolio company, and often this has already been repaid via fees the PE firm collects from the company. The PE firm has little to no skin in the game; it's the company, its workers, suppliers, creditors and customers that the use of leverage (high debt) has put at risk.

For many years, retail was the sweet spot for private equity. Retail is a cyclical business that can be undermined by a change in customer tastes or a downturn in the economy. To weather the inevitable bad times, retail chains typically have low debt burdens and own their own real estate. This protects them from having to pay rent or make high interest payments when things get tough. Retail is also a high cash flow business. These characteristics made retail an attractive target for private equity. There was room to load the company with lots of debt in the buyout. The real estate opened up the possibility of sale-leaseback transactions that benefited PE investors but would leave the chain paying rent. And the high cash flow meant the retail company would be able to make payments directly to the PE firm for advisory services and transaction fees pursuant

to an advisory agreement between the chain and the firm. A retail chain that was profitable, but less so than in the past, and whose share price was in the doldrums, was a perfect candidate for a private equity takeover.

Overloading retail chains with debt made them financially fragile. Payments on the debt stripped them of resources they needed to make necessary investments to meet the changing expectations of consumers. The depressed value of commercial real estate following the financial crisis complicated efforts to turnover maturing debt. Financial distress, bankruptcy and even in extreme cases, liquidation and the shuttering of stores are likely to follow. Toys 'R Us, owned by KKR, Bain Capital and Vornado Realty Trust, is the poster child for this. But there are many other well-known examples of private equity-owned retail chains that closed all stores and laid off thousands of workers. They include Sun Capital-owned ShopKo, Alden Global Capital and Invesco-owned Payless ShoeSource, Bain Capital-owned Gymboree, Sun Capital-owned The Limited, Leonard Green-owned Sports Authority, and Cerberus Capital Management-owned Mervyns Department Store among others.

Toys R Us was still profitable at the time of its takeover in 2005 by the KKR, Bain and Vornado consortium, though its sales were flat and its profit and share price had fallen substantially compared with a decade earlier. At the time it was acquired, the toy store chain was valued at about $7.5 billion, including nearly $1 billion in debt. Its capital structure was 87 percent equity and a very manageable 13 percent debt. This was turned on its head when the chain was acquired by the financial firms for $6.6 billion - $1.3 billion in equity contributed equally by funds sponsored by those firms and $5.5 billion in debt. With the almost $1 billion in debt the chain was already carrying, this raised its debt to $6.2 billion- a capital structure of 17 percent equity and 83 percent debt. This is a level of debt no publicly-traded company would burden itself with. It served no rational business need for Toys 'R Us, which now had to make interest payments on this debt that exceeded $400 million in every year and $500 million in some (see Appendix A for details and sources). But for the investment funds that owned the chain, the low amount of equity they paid in would mean a high return and very rich payoff if they exited the company in three to five years as planned. In 2010, five years after acquiring the company, KKR, Bain and Vornado attempted to return the company to the public market via an IPO. The effort failed however on concerns about the toy chain's ability to refinance its high debt load.

It is this reckless loading of debt onto companies that the Stop Wall Street Looting Act would end by requiring the PE fund's General Partner and the PE firm to be jointly liable with the company for repaying the debt it burdens companies with in a leveraged buyout.

Toys 'R Us would have been broadly profitable in the years following its takeover by the private investment funds if not for the interest payments, which largely ate up the company's profits. The chain struggled and ultimately collapsed under its massive debt load. 900 communities lost an important retail anchor as the stores closed, 33,000 workers lost their jobs. The Limited Partners in the PE funds had their investment in Toys wiped out. But KKR, Bain and Vornado managed to make money despite not creating – and, in fact, destroying – value. The funds that owned the chain each put in $433 million in equity each. Bain contributed 10 percent of the equity in its fund or $43 million. KKR put up $10 million (2.3% of the equity in its fund). Vornado's contribution is unclear. At the time of its acquisition, Toys 'R Us had entered into an advisory agreement with each of the three sponsoring firms (*not* the funds) that specified payments that Toys 'R Us would make to KKR, Bain and Vornado for advisory services. Over the life of the agreement, Toys 'R US paid Bain, KKR and Vornado a total of $185 million for these services, or $61 million each. Bain did not agree to share these payments with its limited partners so net of its equity contribution, it had a gain of $17 million. KKR had agreed to share 58% of its advisory fees with its limited partners, leaving it with $24 million. Net of its $10 million contribution to its PE fund, KKR had a gain of $14 million. It's not clear how much of Vornado's $61 million was a net gain. In addition to the advisory fees, the three companies collected a total of $8 million in expense fees, $128 million in transaction fees, and $143 million in interest on loans they had made to Toys 'R Us. In total, including advisory and other fees and interest, Toys 'R Us paid the firms that owned it $464 million. In addition, some of the chain's real estate was sold to Tornado and leased back by the stores, resulting in a total of $73 million paid to Vornado in rent (details and sources in Appendix A).

So, yes – as the Toys case illustrates, it possible for PE firms to make money without creating value.

Another very different example of how PE firms make money without creating value comes from the world of physician staffing firms.

Surprise medical bills – bills that insured patients receive when they are inadvertently treated by doctors not in their insurance network – have become a flashpoint for Congressional action. Private equity firms have been actively acquiring doctors' practices through leveraged buyouts and rolling them up into large, debt-burdened physician staffing firms. The focus of private equity acquisitions is on medical specialties such as emergency room doctors, radiologists, anesthesiologists, and neonatal specialists that treat hospital patients with urgent care needs. These patients are in no position to refuse medical attention and must accept treatment from the doctor assigned to them by the hospital. The doctors you have never met who pop up in the doorway

of your hospital room to inquire if you are okay – hospitalist doctors – may also be employed by a physician staffing firm and not be on the hospital's staff. If a patient is in a hospital that is in their insurance network, they may reasonably assume that the doctors working at the hospital are in their network as well and that any bills will be covered by their insurance plan. But this is not necessarily the case. The hospital may have outsourced these specialties to local doctors' practices or to major physician staffing firms. The result is that these doctors – who were assigned by the hospital to care for the patient, and not selected by the patient – may not be in-network and the patient may receive a surprise bill. Demand for these doctors' services is not sensitive to price and does not go down because the price is high.

The two largest physician staffing companies are Envision Healthcare and TeamHealth, currently owned respectively by funds of private equity firms KKR and the Blackstone Group. The two staffing firms have cornered 30 percent of the market[10] for outsourced doctors, and collectively employ almost 90,000 health care professionals that staff hospitals and other facilities across the U.S. Envision is the result of fifteen years of private equity transactions using debt to buy up and consolidate emergency room and specialty physicians' practices. In and out of private equity ownership since 2005, Envision most recently was acquired by a KKR fund. TeamHealth grew not only through leveraged buyouts of specialty doctors' practices but via the acquisition of a very large staffing firm that had consolidated many hospitalist doctors' practices. The company has experienced successive rounds of leveraged buyouts by Blackstone funds, punctuated by IPOs that returned it to the public markets, only to be taken private again. It is currently owned by Blackstone. Many of the acquisitions by both PE-owned companies were too small to trigger anti-trust oversight. The result is two highly consolidated physician staffing firms that are national powerhouses. Both firms are heavily indebted and rely on high fees they charge for doctor services to provide sufficient revenue to meet debt obligations.

Envision has come under heavy scrutiny for the huge out-of-network surprise medical bills it sends to ER patients. A team of Yale University health economists[11] examined the billing practices of EmCare, Envision's physician staffing arm. They found that when EmCare took over the management of hospital emergency departments, it nearly doubled its charges for caring for patients compared to the charges billed by previous physician groups. TeamHealth, according to the analysis by the Yale University economists, has taken a somewhat different tack. It uses the threat of sending high out-of-network surprise bills to an insurance

[10] https://isps.yale.edu/sites/default/files/publication/2017/07/surpriseoutofnetwrokbilling_isps17-22.pdf
[11] https://isps.yale.edu/sites/default/files/publication/2017/07/surpriseoutofnetwrokbilling_isps17-22.pdf



company's covered patients to gain high fees from the insurance company as in-network doctors. TeamHealth emergency physicians might go out-of-network for a few months, then rejoin the network after bargaining for in-network payment rates that were 68 percent higher than in-network rates received by the previous ER doctors. While this avoids the situation of a patient getting a large, surprise medical bill and allows Blackstone to say its staffing firm doesn't engage in surprise billing, it is clear that TeamHealth's business model relies on the threat of going out-of-network to get higher reimbursement rates for its doctors. And, in any case, TeamHealth's practices raises healthcare costs and premiums for everyone. Meanwhile, UnitedHealth, the largest U.S. health insurer, is pushing back. It plans to end high-reimbursement in-network contracts with TeamHealth over the next few months. TeamHealth may sue to prevent this.

Here again we have an example of how private equity firms make money without creating value. PE-owned firms Envision and TeamHealth have consolidated a previously fragmented sector, doctors' practices. They are now dominant players and are exploiting their market power to increase prices. In this way they are able to capture wealth from patients, rather than creating it.

Pushback from patients has led Congress to consider acting to protect them. In early summer, bipartisan legislation was introduced in the Senate Health, Education, Labor, and Pensions Committee (the Lower Health Care Costs Act)[12] and in the House Energy and Commerce Committee (the No Surprises Act).[13] The approach in both bills involves capping what is paid to out-of-network doctors by 'benchmarking' payments to rates negotiated with in-network doctors. This would threaten the private equity business model in owning doctors' practices; it is opposed by specialist physician practices[14] and by large physician staffing companies. They are lobbying intensively[15] for a second option that would allow doctors to seek a fee higher than the benchmark via an arbitration process. Physicians for Fair Coverage,[16] a private equity–backed group lobbying on behalf of large physician staffing firms, launched a $1.2 million national ad campaign[17] in July to push for this second approach. The campaign was effective and the House bill was amended to include an arbitration provision.

[12] https://www.congress.gov/bill/116th-congress/senate-bill/1895/text
[13] https://www.congress.gov/bill/116th-congress/house-bill/3630/text
[14] https://www.outofthemiddle.org
[15] https://www.axios.com/surprise-medical-billing-lobbying-congress-74f40358-998b-42ac-bdc6-1733ccac3c19.html
[16] https://www.endtheinsurancegap.org/about-us
[17] https://khn.org/news/doctors-argue-plans-to-remedy-surprise-medical-bills-will-shred-the-safety-net/



The arbitration amendment did not go far enough to satisfy debt markets that have been closely monitoring developments.[18] Envision Healthcare's $5.45 billion loan due October 2025 and Team Health $2.75 billion loan due January 2024 fell in July and dipped below 80 cents on the dollar by the end of August[19] - the threshold for a loan to be considered distressed. In late July, a mysterious organization, Doctor Patient Unity, launched a $28 million ad campaign aimed at preventing any legislation from passing. In September it was revealed[20] that Envision Healthcare and TeamHealth were behind the effort to stop legislation that threatened their business model.

In November, with the legislation and chances of passing legislation to rein in surprise bills in this Congress stalled, the loans have recovered somewhat. Envision's loan is holding steady in the low 80s and TeamHealth's in the mid-70s. But the legislation has bipartisan support and is expected to be reintroduced in 2020 or 2021. The intense lobbying and massive ad campaign may have backfired. The Energy and Commerce committee has demanded information on pricing practices[21] from KKR, Blackstone and Welsh, Carson, Anderson & Stowe. Senator Warren and Representatives Mark Pocan and Lloyd Doggett are seeking similar information[22] from these and two additional private equity firms about the role they are playing when patients receive exorbitant surprise bills. Legislation to cap out-of-network fees charged by doctors' practices will save patients who urgently need care from outrageous charges and will reduce health costs and premiums for all consumers.

Hedge Funds

Hedge funds are another type of private investment fund with a model for making money that differs from the private equity model. In general, most of private equity activity involves buying out companies and taking them private while hedge funds pursue profits through the purchase and sale of stock in publicly-traded companies. As was true of large private equity firms, hedge fund firms have found many ways to make money – the very top hedge fund managers make more than a billion dollars a year – without creating value.

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[18] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/leveraged-loan-news/healthcare-players-in-leveraged-loan-sector-keep-watch-amid-surprise-billing-battle

[19] https://www.ft.com/content/286210f4-c911-11e9-a1f4-3669401ba76f

[20] https://www.nytimes.com/2019/09/13/upshot/surprise-billing-laws-ad-spending-doctor-patient-unity.html

[21] https://www.modernhealthcare.com/politics-policy/house-leaders-investigate-private-equity-firms-over-surprise-medical-bills?utm_source=modern-healthcare-am-tuesday&utm_medium=email&utm_campaign=20190916&utm_content=article3-headline

[22] https://www.warren.senate.gov/newsroom/press-releases/warren-pocan-and-doggett-examine-role-of-private-equity-in-rise-of-surprise-medical-billing



In 1940, New Deal legislation was passed to protect Main Street companies and the economy from the speculative financial practices that generated the Great Depression. The legislation prohibited firms operating with pools of money drawn from investors from engaging in a range of risky practices. Wealthy families with their own private investment funds and fund managers were able to get an exemption for fund advisors with fewer than 100 clients who didn't offer services to the general public. In less than a decade and taking advantage of that exemption, the first hedge fund was formed. Still, by 1997, hedge funds worldwide held just $118 billion in assets[23] under management. Then in 1996, as part of a general move to deregulate financial services, Congress passed the National Securities Market Improvement Act which extended the exemption for fund advisors from 99 to an unlimited number of 'qualified purchasers.' This opened the door to institutional investors to become investors in hedge funds. Hedge fund assets under management quickly increased, and today they top $3 trillion worldwide.

How do hedge funds make money?

As with private equity funds, the high fees they charge limited partner investors in their funds and the lack of transparency about these fees are a steady source of income to partners in hedge fund firms. But it is the risky activities they carry out – all of which are prohibited in the New Deal era legislation from which they are exempt, that are the source of outsized earnings of hedge fund firm partners. Unlike mutual funds whose activities are governed by the restrictions against risky activities, hedge funds are able to engage in short sales (bets that a stock will go down instead of up), use leverage (debt owed to lenders) that magnifies returns but also increases risk, and take over the business strategy of corporations.

Activist hedge funds buy up shares in a publicly traded company and accumulate sufficient shares to pressure corporate managers and boards of directors to take actions that, at least in the short run, boost share price. This includes threatening to shake up companies in order to persuade them to carry out share buybacks, spin off parts of the company, or initiate some other major change.

Stock buybacks are a favorite hedge fund tactic for raising share prices and allow the hedge fund to cash in and sell its shares at a profit. The effect on the company and its workers are of no concern to the hedge fund. In 2015, four hedge funds that owned 2.1 percent of GM shares,[24] led by Appaloosa Management, used

[23] https://prospect.org/power/good-hedge-funds/
[24] https://www.forbes.com/sites/nathanvardi/2015/02/10/david-tepper-uses-activist-tactics-to-force-gm-stock-buyback/#33965f8741dd



harassing proxy fights and public threats to pressure GM to buy back $8 billion of its shares within a year. In March 2015, the company announced it would buy back $5 billion of shares. Later that year, it announced another $4 billion of buybacks. And in 2017, it announced it would buy back an additional $5 billion. By November 2018, GM had spent $10.6 billion on stock buybacks.[25] The hedge funds contributed nothing to creating value for GM, but they walked away with millions of dollars from the buybacks. The money GM spent on buybacks is double what the company will save by laying off up to 14,000 workers and closing five automobile facilities, including the Lordstown Assembly plant, which likely fell victim to a lack of investment as the company used its profits[26] for the payouts the activist hedge funds demanded. More generally, share buybacks enrich hedge funds, but they force companies to cut back on investment, research and development, and job creation. Share buybacks used to be illegal; Senator Tammy Baldwin has introduced legislation to make them illegal again.

Paul Singer's Elliott Management is another activist hedge fund noted for the hardball tactics it uses to extract short run profits from major companies. In early September 2019, the hedge fund announced it had taken a $3.2 billion stake (a 1% share) in $281 billion telecom and media giant AT&T.[27] Elliott demanded[28] a number of value-extracting initiatives at AT&T. These included carrying out stock buybacks, increasing dividends, monetizing (i.e. selling off) some of its assets, and laying off workers. Elliott also wanted to appoint two directors to the AT&T board. Seven weeks after Elliott made these demands, AT&T capitulated.[29] It committed to buying back stock, adding two new directors, and looking at its assets to see what could be jettisoned. AT&T expects to have sold off about $14 billion worth of companies it owns in 2019, and another $5 to $10 billion in 2020. AT&T CEO Randall Stephenson noted that AT&T's strategy to increase profits includes potential job cuts.[30] The Communication Workers of America (CWA) which represents over 100,000 AT&T workers strongly opposes the job cuts. The union estimates that meeting Elliott's demand will put 30,000 of its members jobs at risk. It notes that profits that will now be used for stock buybacks could be

[25] https://www.cbsnews.com/news/gm-bought-back-10-billion-in-stock-since-2015-double-what-job-cuts-will-save/
[26] http://hedgeclippers.org/hedge-funds-attack-general-motors-and-american-jobs/
[27] https://www.nytimes.com/2019/09/09/business/dealbook/att-activist-investor.html
[28] https://www.reuters.com/article/us-at-t-elliott/att-to-add-directors-sell-up-to-10-billion-in-assets-next-year-idUSKBN1X7145
[29] https://www.reuters.com/article/us-at-t-elliott/att-to-add-directors-sell-up-to-10-billion-in-assets-next-year-idUSKBN1X7145
[30] https://seekingalpha.com/article/4300238-t-settles-elliott-management-big-deal

better spent by the company "to increase investment in next generation wireless and fiber broadband networks and train its employees for jobs of the future."[31]

Almost everything in the agreement between Elliott and AT&T is focused on raising AT&T's share price in the short run. It's not clear how increasing stock buybacks and dividends prepares AT&T to succeed in the future. Moreover, AT&T gave in to Elliott's demands without getting a 'stand still' agreement that commits the hedge fund to not make additional demands. With the outcome for GM and its workers still fresh in everyone's minds, the fear that these measures will enrich Paul Singer and Elliott's investors at the expense of AT&Ts workers is very real.

A company that uses its profits to manipulate its share price – buying back shares so that the number of shares goes down and their price goes up – is failing its customers and employees because these are funds that could have been used to upgrade and improve the company's products and operations. Share buybacks enable hedge fund investors (as well as other shareholders) to make money without creating value for the company and, indeed, jeopardizing the company's future value creation and the employment of its workers. Prior to the Security and Exchange Commission's adoption of Rule 10b-18 in 1982, stock buybacks were recognized as a form of market manipulation and were illegal. In March 2019, Senator Tammy Baldwin reintroduced the Reward Whttps://www.baldwin.senate.gov/press-releases/reward-work-act-2019ork Act.[32] Specifically, it would repeal Rule 10b-18 and remove the incentive for hedge funds to demand stock buybacks by companies in which they own shares just to raise share price.

Elliott Management had a significant role in closing down a different major company in the U.S. and sending 25,000 jobs to China. Distressed debt hedge funds look for corporations or nations in financial trouble, buy up their bonds at pennies on the dollar, and then use their position as creditors to secure a high return for themselves. After auto parts maker Delphi,[33] a supplier to GM, declared bankruptcy in 2005, a group of hedge funds led by Paul Singer's Elliott Management bought up Delphi's debt, some for as little as 20 cents on the dollar. In 2009, during the financial crisis, when the U.S. Treasury was working on a deal to save GM, Treasury and the company came up with a plan to save Delphi. PE firm Platinum Equity offered to buy Delphi, and

[31] https://www.commondreams.org/news/2019/10/28/something-only-hedge-fund-manager-could-love-union-trashes-att-plan-boost-assets
[32] https://www.baldwin.senate.gov/press-releases/reward-work-act-2019
[33] For discussion of Delphi and Elliott Management, see https://www.russellsage.org/publications/private-equity-work



GM and Platinum came up with an arrangement that would have kept most of Delphi's plants open and saved most of the jobs. In the meantime, Elliott Management tripled its acquisition of Delphi's bonds. The creditors, led by Elliott, persuaded the bankruptcy judge to hold an auction. Platinum lost its bid to buy Delphi to a higher bid by Elliott and the creditors. The new owners quickly closed most of the plants and sent the work to China, along with 25,000 union jobs. Two years later, the consortium of creditors returned Delphi to the public markets via an IPO. Without its pension and health care liabilities, and with its debt substantially reduced, Delphi traded at $22 a share at its IPO[34] – resulting in a profit of more than 3,000 percent for Elliott and the group of creditors. Now known as Aptiv, the company is incorporated in the tax haven, Jersey – depriving the Treasury of needed tax revenue. Elliott Management made a lot of money, not by creating value but by destroying value for Delphi's American workers and the U.S. economy. Provisions of the SWLA that direct bankruptcy courts, where there are multiple offers, to approve the offer that best preserves the company's jobs and maintains the terms and conditions of employment for its workers, will prevent this from happening again.

Pressuring companies in which they own shares to strip assets by selling off the real estate that houses their operations is another hedge fund tactic. In 2014, Starboard Value – a shareholder in restaurant company Darden, the parent of Olive Garden and many other restaurant chains – noted that Darden owned both the land and buildings on nearly 600 of the restaurants and the buildings of another 670. Starboard estimated the value of Darden's real estate at $2.5 to $3 billion, and argued that a sale-leaseback of the properties "could create approximately $1 billion in shareholder value."[35] Unable to persuade Darden's management and board to sell off the real estate, Starboard made good on its threat to replace the Darden board with its own slate of board directors. Soon after, the new board forced Darden to monetize the value of its restaurants' real estate[36] to the benefit of shareholders. This exercise in financial engineering enabled the hedge fund to make money, but financial engineering doesn't create value.

The case of DuPont – once a giant chemical and agricultural company is a cautionary tale of how hedge fund activism to raise share price can undermine America's scientific prowess. In 2013, Nelson Peltz's $11 billion hedge fund firm Trian Fund Management took a $1.3 billion stake[37] in DuPont, bringing its share of the

[34] https://www.wsj.com/articles/SB10001424052970203611404577042724071266962
[35] http://www.shareholderforum.com/dri/Library/20140911_Starboard-presentation.pdf
[36] https://www.wsj.com/articles/darden-restaurants-to-spin-off-some-real-estate-assets-1435058666
[37] https://www.wsj.com/articles/activist-investor-buys-13-billion-stake-in-dupont-1376517017

company to 2.2 percent. By early 2015, Trian was ready to push DuPont to split into two companies[38] – an agriculture and nutrition products company and a materials company – and to dismantle its research and innovation center and end programs that allowed the company's 1,000 scientists and engineers to work together. Trian's push for change at DuPont came despite a doubling of the company's share price under CEO Ellen Kullman. Trian lost its bid for seats on DuPont's board, but in the months that followed, it looked as if Trian might have won anyway.[39] Kullman soon retired and her successor made it clear he was open to Trian's ideas.

In December 2015, DuPont announced it would be merging with the Dow Chemical company[40] and would later be broken up into an agricultural company, a specialty products company, and a material sciences company. DuPont would be laying off 1,700 workers, including nearly half the scientists at the Experimental Station, its famous research center – a bad omen for future innovation. The merger closed in August of 2017; the spinoff of new Dow (material sciences) occurred in April 2019 and of Corteva (agriculture) in June of that year. Trian wasn't sticking around to see how things worked out. It began reducing its stake[41] in the fourth quarter of 2015, and by December 31, 2017[42] it had disposed of the last of its shares. Early results of the merger and split were not good. In May 2019, the combined shares of Dupont/Corteva and new Dow were worth significantly less than the $150 billion the company was worth[43] when the merger and splits were first announced.

A number of initiatives in addition to the SWLA could help rein in the excesses of hedge fund firms. Most important would be rolling back section 209 of the National Securities Market Improvement Act that removed any limits on the number of investors a hedge fund could have and still be exempt from strict rules that reduce risky, speculative financial activities. This would return hedge funds to their original purpose – managing the money of the wealthiest U.S. families. It would end the activist funds' ability to extract wealth out of Fortune 500 companies and destroy jobs, and to make billions of dollars for hedge fund firm partners without creating

[38] https://www.ipwatchdog.com/2015/05/06/activist-investor-nelson-peltz-wants-to-dismantle-research-and-innovation-at-dupont/id=57358/
[39] https://www.usatoday.com/story/money/nation-now/2015/12/02/peltz-real-face-dupont/76704540/
[40] https://www.delawareonline.com/story/money/2016/04/29/duponts-wild-ride/83650956/
[41] https://fintel.io/i13f/trian-fund-management/2015-12-31-0
[42] https://fintel.io/i13f/trian-fund-management/2017-12-31-0
[43] https://www.inquirer.com/business/dupont-dow-merger-edward-breen-stock-hedge-fund-robber-barons-20190526.html

value. The Reward Work Act would make stock buybacks and manipulation of share prices illegal again, as they were prior to 1982. The common-sense provisions of the Brokaw Act – named for a small Wisconsin town that went bankrupt after Starboard Value bought a paper company and then closed the paper mill in Brokaw – would end financial abuses by activist hedge funds. The Brokaw Act[44] was first introduced in March 2016 by Senator Tammy Baldwin and reintroduced in 2017. It would reduce opportunities for investors in public companies to evade rules that govern disclosure requirements when hedge funds and other investors buy a 5 percent stake in a company's stock. The bill would also require that hedge funds that use derivatives to amass a larger stake in a company will have to include these derivatives in their disclosures.

Conclusion

In ways large and small, Main Street is being pillaged by Wall Street's largest private investment firms. Factories and stores have closed as wealth has been extracted from companies, hollowing them out and leaving them bereft of the resources they need to invest in technology and worker skills. Money has been funneled to millionaire and billionaire partners in these firms even when their firms do not create value and, indeed, may destroy it. Good jobs have been lost and inequality has worsened. Private investment firms take advantage of loopholes in laws and regulations that are not available to other financial actors to engage in the types of self-serving behavior documented here. It's time to close these loopholes and bring private equity and hedge funds under the same regulatory umbrella that limits risky behavior by other financial institutions. Passage of the Stop Wall Street Looting Act would go a very long way toward accomplishing this aim. Rolling back the National Securities Markets Improvement Act is another important step that needs to be taken. Legislation to halt particular financial abuses – hitting vulnerable patients with surprise medical bills, manipulating stock prices via share buybacks, or organizing 'wolf packs' to skirt reporting requirements while accumulating shares in publicly-traded companies - will also be necessary. Such legislation will reduce opportunities for financial abuse and assure that capital is deployed in support of economic development and rising living standards for working families.

[44] https://www.congress.gov/bill/115th-congress/senate-bill/1744/text



APPENDIX A: Toys 'R Us Financial Data



Fees Bain Capital, KKR, Vornado collected from Toys "R" Us ($ millions)

Fiscal Year	Advisory fee	Expenses	Transaction fee	Interest on debt	Total		Vornado lease agreements
2005	$4		$81		$85		
2006	$19			$9	$28		
2007	$17			$26	$43		
2008	$17	$1		$25	$43		
2009	$15	$1	$7	$18	$41		$7
2010	$19	$1	$29	$15	$64		$9
2011	$20	$1	$4	$14	$39		$9
2012	$21	$1	$7	$8	$37		$10
2013	$22	$1	~~$15~~	$10	$48		$8
2014	$17	$1	~~$32~~	$10	$60		$8
2015	$6	$1		$7	$14		$8
2016	$6			$1	$7		$8
2017	$2			$0	$2		$6
	$185	$8	$128	$143	$464		$73

Struck through transaction fees were accrued but later waived

Source: SEC Form 10-K, links for each year in Table.

Toys R Us Interest expense

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Interest expenses (US$ millions)	503	419	403	440	514	432	464	517	447	426	455

Source: SEC Form 10-K; See for example, p. 25 of
https://www.sec.gov/Archives/edgar/data/1005414/000100541417000011/tru201610k.htm

Written Testimony before the
U.S. House of Representatives, Committee on Financial Services

Hearing on
"America for Sale? An Examination of the Practices of Private Funds"

Giovanna De La Rosa
United for Respect Leader

November 19, 2019

Thank you Chairwoman Waters for inviting me to speak today. I'm honored to be here. My name is Giovanna de La Rosa and I'm from Chula Vista, CA. I am a daughter, a single mother of a 15-year-old son with autism, and a former Toys 'R' Us employee for 20 years before private equity firms drove it to bankruptcy. I'm here today as a leader with United for Respect to speak on behalf of the 1.3 million[1] workers who have lost their jobs to private equity. United for Respect is a multiracial movement of retail workers advancing a vision of an economy where corporate and financial players respect our work and recognize our humanity. I joined this movement to fight for Wall Street accountability after losing my job at Toys 'R' Us.

I started working at a Toys 'R' Us store in Chula Vista, my hometown in the San Diego metropolitan area, on July 28, 1998. I was 18 years old. What started as a summer job became a 20-year career. I put myself through college working at Toys 'R' Us. I met my then husband at Toys 'R' Us, and my son is a true Toys 'R' Us kid. My coworkers became my second family over the years. I worked my way up through the ranks, starting as a part-time hourly associate, then as a supervisor and eventually became an assistant store manager. I helped to set up and open our Babies 'R' Us. Toys 'R' Us wasn't just a job for me. I grew up in that store. It was a huge part of my life.

If you'd only been to a Toys 'R' Us store in the company's final few years, you might have a hard time understanding this. But Toys 'R' Us was different back then. Even though it was already a household brand and had locations nation-wide, it still felt like a family-run toys store. I loved working at Toys 'R' Us, especially around this time of the year. I loved bringing joy to families and to children. We knew our customers and their kids because they were regulars. I watched so many of the local kids grow up over the years while shopping in our store. Toys 'R' Us was a special place for all of us. I was proud to work for a company that cared about its employees and treated us like family.

In 2005 Toys 'R' Us was acquired by 2 private equity firms, KKR and Bain Capital, and a real estate investment trust, Vornado, in a $6.6 billion leveraged buyout. Like most people, I didn't

[1] https://united4respect.org/pirateequity/

know what private equity or leveraged buyout were back then. I thought these new wealthy Wall Street owners were coming in to make our companies and operations work better. But they were actually making things worse.

After the buyout, our old company culture was thrown out the window. They got rid of things like holiday pay, staff Christmas parties, and birthday gifts that made it special working at Toys 'R' Us. They immediately cut staff, and kept cutting over time. Full-time positions started getting eliminated, and then health benefits for part-time employees were taken away. But we had to keep it together as a team with limited resources. One of our managers resorted to paying people under the table in cash because these private equity firms made it impossible to run the stores with enough people. We were told to get more done with less hours and half the staff it took to meet our goals. Many of our part-time employees were parents trying to make ends meet, and I would get in trouble because I was letting them work more hours than we were supposed to.

And then everything fell apart. My life changed last spring when news hit that Toys 'R' Us stores would shut down nationwide and lay off over 30,000 of us without a dime of severance pay, despite our years of dedication to the company.[2] I was completely devastated when I heard about our store closing. I was on a conference call with the CEO Dave Brandon who said we have our jobs for just 60 more days. And then I had to walk on the store floor and tell my coworkers who had been there for 35 years they were losing their jobs.

I started having breakdowns and panic attacks at home and work, and I'd have to find a corner to pull it together for my team and for my son. It was hard to imagine how I was going to make rent or afford healthcare for us.

I closed down my Toys 'R' Us store, and I lost the only job I've ever had for 20 years. I went from someone who worked 6 days a week to not having anything to do. Shortly after my store closed, my son came down with bronchitis, and after a trip to urgent care and four prescriptions later, I spent all of my rent money that month. I would stay up all night thinking about my bills. I was depressed and couldn't leave my couch. I would sometimes drive by our empty store, sit in the parking lot and cry. I wasn't able to be there for my son and it caused him so much anguish and distress. How could I tell my special needs child that someone on Wall Street made a series of decisions that turned our lives upside down?

I couldn't find a job despite having 20 years of experience in retail and having been an assistant store manager. I only found a seasonal job last month after a year and a half of looking.

I now know what a leveraged buyout is. KKR, Bain Capital, and Vornado bought out Toys 'R' Us for the price tag of $6.6 billion, but used $5 billion of debt to finance the deal, and Toys 'R'

[2] https://money.cnn.com/2018/03/14/news/companies/toys-r-us-closing-stores/index.html

Us alone was liable to pay it all back. Every year, Toys 'R' Us paid hundreds of millions of dollars to service the debt, then doled out more to pay the private equity owners management fees and interests.

Toys 'R' Us had a decades-long severance policy: a week of pay for every year of service to the company. But when our company liquidated, the employees were left with nothing. We sacrificed so much for the company. We gave up holidays, Thanksgiving meals with our families, school plays, and our kids' birthdays, to work in the stores. We worked through illness and injuries to achieve higher and higher company goals. I lost 2 pregnancies due to overwork and stress. I have a torn rotator cuff and 2 herniated discs in my neck from an injury on the job. My coworkers and I were left with nothing while the executives and private equity owners walked away with millions. I remember hearing later that Toys 'R' Us paid $470 million in fees to private equity owners over the years. That would be enough to pay over $14,000 in severance to each employee who lost their job.[3]

Unfortunately my story is just one of 33,000 that had their livelihoods taken away when Toys 'R' Us liquidated. It's not right that working moms like me work so hard and count every dollar to take care of our families while these private equity firms get to walk away with all of our money.

So this is why I got involved in the fight to hold private equity accountable. I joined United for Respect, and thousands of other Toys 'R' Us workers, to demand justice and severance pay. We told our stories everywhere, from Congress to pension fund meetings to the press. It's painful to relive our struggles over and over again. But we did it because no one pays attention to the little people unless we make some noise.

And because of our organizing work, KKR and Bain finally started talking to us and set up a historic $20 million fund for Toys 'R' Us employees impacted by the liquidation. The money helped a little, but it wasn't enough and it didn't help us get back the financial security we had when we were working. Many, including myself, continue to struggle to get back on our feet to this day. There are women like Debbie Mizen in Youngstown, OH and Madelyn Garcia in Miami Beach, FL, who struggled to find sustainable employment after giving more than 30 years of their lives to Toys 'R' Us and taking care of the employees in their stores. Ann Marie Reinhart Smith in Durham, NC and Maryjane Williams in Waco, TX who started their Toys 'R' Us careers decades ago on Long Island as mothers with young children, were left with medical debt because they lost health insurance for themselves and their spouses. I met other mothers who worked hard to raise their families on their own like me: Brandy Mendoza in Fontana and Sad'e Davis in Van Nuys, CA; Madilyn Muniz and other incredible women in her Bronx, NY store; and Michelle Perez in Vancouver, WA who struggles to pay for insulin for her 3-year-old son. There were thousands of young people working at Toys 'R' Us like Tyler Dziendziel in

[3] https://ourfinancialsecurity.org/wp-content/uploads/2018/05/Toys-R-Us-2-pager_AFR-letterhead-1.pdf

Southgate and Teria Berry-Moore in Ypsilanti, MI, who lost a steady source of income and have to juggle multiple jobs to support themselves[4].

Toys 'R' Us is making a comeback and the new owners reached out to ask us to be a part of a "mirror board." This "mirror board" is made up of 3 former Toys 'R' Us employees, including me, to help guide the new company. I'm excited about this partnership and for the chance to bring Toys 'R' Us back into the lives of kids and families.

Over the past year and a half, I've learned that Toys 'R' Us workers aren't the only ones who went through this buyout hell. People working in other retailers are also going through the nightmare of seeing private equity firms or hedge funds put their stores out of business. I met employees from Gymboree, Sears, Payless, and ShopKo and they all had the same story as me. And they knew the names of the Wall Street firms that made them lose their jobs: ESL Investments, Alden Global Capital, Sun Capital and many more.

We are part of the 1.3 million people whose jobs were destroyed by private equity and hedge funds. Since 2012, 10 of the 14 largest retail bankruptcies were companies owned or controlled by private equity or hedge funds[5]. Retail job loss is growing, and 9,100 stores are closing in 2019[6] almost doubling 2018's count. Behind every job loss number is someone with kids, parents, grandparents, who also lost their financial security.

I read recently that the private equity industry claims to support millions of jobs. I want to share my experience with you today so that you can hear it direct from us: Buying up our companies with debt is not "supporting" our employment. "Increasing productivity" is a euphemism for eliminating positions and benefits and making us do more with less. Toys 'R' Us was steadily generating $11 billion in sales every year, and might not have been in bankruptcy if it wasn't for the $5 billion debt and other exploitative maneuvers that sucked value and assets out of our company[7]. I might still be working at my store if Toys 'R' Us spent $400 million every year on improving our e-commerce infrastructure rather than paying down interest on the debt. When private equity and hedge funds take control over our retail companies, they are not concerned with the long-term health and sustainability of the businesses. Their goal is to maximize short-term profits, and this has worked very well for themselves. But their riches come at the expense of long-term financial security of working families like mine. Our local communities are the ones that have to bear the burden of dealing with the aftermath of empty malls and shopping centers.

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[4] See Appendix I for more stories of the men and women that lost their jobs
[5] https://united4respect.org/pirateequity/
[6] https://www.businessinsider.com/stores-closing-in-2019-list-2019-3
[7] https://www.theatlantic.com/magazine/archive/2018/07/toys-r-us-bankruptcy-private-equity/561758/

We need real, deep change like the Stop Wall Street Looting Act. The last time I was in D.C. was to help introduce the bill with our amazing partners at American for Financial Reform, Center for Popular Democracy and in Congress. I believe that this bill can protect jobs by regulating private equity so they can't make money by putting people out of work. And now our fight has caught the public's attention because more and more people, from retail workers to nurses to grocery store workers are speaking out.

I almost couldn't make it today, due to my mother's serious medical procedure - she had a mastectomy. But as soon as I realized that she was taken care of and safe by the doctors, she made sure that I came here, because I'm here not for myself but for her and for all the other Toys 'R' Us, Sears, Kmart, Shopko, Payless and Gymboree family members out there. I want you all to really hear your constituents- those of us who have lost our jobs due to private equity, and the toll it takes on us financially and emotionally. The economy isn't thriving when so many of us are losing our jobs and forced into early retirement or underemployment. You all have a chance to pass this bill and put stronger laws in place that protect millions of working people like me. We're counting on you to do the right thing and we're waiting to see which side you're on- working people or Wall Street billionaires.

Thank you.

APPENDIX I

Jenny Allen (Tacoma, WA)
Originally from Queens, NY, Jenny Allen served in the military for six years, and her family eventually settled in Tacoma. After separating from her husband, Jenny has been raising her two daughters while working at Payless as a store manager. She often worked opening and closing shifts, and would go home after her children had already gone to sleep. After her Payless store closed, Jenny was unemployed for several months before finding employment at a warehouse, but she's taking home less than what she made before and lives paycheck to paycheck.

Teria Berry-Moore (Ypsilanti, MI)
Teria Berry-Moore was supporting herself through college while working in retail, first at JCPenney then at Toys 'R' Us. She was not able to afford her tuition and had to put a pause on finishing her degree, and had worked at Toys 'R' Us for 2 years before her store closed down last year. She has since been juggling 2 or 3 jobs to make ends meet, and works through illnesses because she doesn't have health insurance and can't get a doctor's note. Teria can't afford the cost of getting a driver's license, and she walks by her old Toys 'R' Us store everyday from work.

Sheila Brewer (Rockford, IL)
Sheila Brewer remembers when she used to get her birthday and holidays off at the local Kmart where she worked, before ESL Investments took over control of the company. Then raises were frozen in 2005 and benefits changed, and it was never the same. Sheila worked for 17 years at Kmart, and as a full-time employee was supposed to receive 8-weeks of severance after she helped close down the company. Her severance payment stopped when Sears filed for Chapter 11 bankruptcy protection in the following month. Sheila never received the rest of her severance.

Rebecca Cady (Louisville, KY)
Rebecca Cady loved working at Payless for most of the 21 years at the company. She worked her way up from a part time associate to multi-store leader until her last store closed in May 2019. She was devastated and felt like she lost her family members, after spending more than half her life with the company. In the end Rebecca only got 4 days worth of severance, even though she had been promised 12 weeks.

Sad'e Davis (Van Nuys, CA)
Sad'e Davis had worked at Toys 'R' Us for 4 years when her store closed down. She was already juggling multiple jobs to supper her daughters, her mother and grandmother, and her Toys 'R' Us job provided not only a steady income but also the opportunity to work at night so she can go to other jobs during the day. Sad'e found a second family in her Toys 'R' Us coworkers, many of whom worked at the same store for 20 years.

Tyler Dziendziel (Southgate, MI)
Tyler Dziendziel has been supporting himself ever since graduating from high school. He was working at Babies 'R' Us for 3 years when his store closed down, and saw many of his former coworkers struggle financially after giving decades to the company. As a part-time employee, Tyler had been piecing together an income from three jobs to cover his basic living expenses, and losing his job at Toys 'R' Us was a big blow to his income.

Madelyn Garcia (Boynton Beach, FL)
Madelyn Garcia is from Boynton Beach and worked at Toys R Us for 30 years until her store closed in June 2018. Madelyn started as a part-time associate and raised her daughters on her own while working long hours and during holidays at her store. She worked her way through the ranks and became a store manager, and helped to open 3 stores in Florida. Madelyn lost her mother and her job in the same week, and struggled through months-long unemployment. She is now working as a store manager at Dollar Tree, but the understaffing at her store causes her to work long hours and suffer from injuries at work.

Shania Hoadley (Sidney, MT)
There were 2 Shopko stores in Sidney, MT, and Shania Hoadley had been working as a cashier at one of them for 3 years when Shopko announced it was closing all stores. It has been an emotional and stressful period since Shania lost her job, and she is dipping into the little savings she put aside to cover her bills. Jobs are hard to come by in her small town of 6,000 residents. The closest major retail store, a Walmart, is a 40-minute drive away.

Lori Hoskins (Butte, MT)
Lori Hoskins was Softline Lead at her Kmart for 3 years, and she loved her job. When Lori's store closed in April 2018, Lori found out that many of her coworkers who had worked at the store for over 20 years did not receive any severance because they were part-time employees. Lori struggled to find a job for over a year, and found it incredibly hard to support her family on her and her husband's unemployment.

Alisha Hudson (Lexington, KY)
Alisha Hudson had been working at Babies 'R' Us for almost 3 years. While pregnant with her son, Alisha worked 12-hour shifts at an Amazon warehouse, and while shopping at Babies 'R' Us she jumped at the opportunity to apply for a job with the store. Alisha was pregnant with her second child when she found out her store was closing, and she lost her part-time job that was helping her family stay afloat on top of her husband's income. She has not been able to find steady jobs since her store closed.

Terry Leiker (Chesapeake, VA)
Terry Leiker worked at Kmart for almost 18 years and when she lost her job in 2018, she also lost her health insurance, pension, 401K, and her financial stability. For several months before

her store closed, she had noticed changes at her store: products weren't coming in, vendors weren't getting paid, and her store wasn't able to fulfill orders. Shelves were so empty customers thought they were closing, but Terry and her co-workers were told by the company they were just downsizing. Terry's last day was October 13, 2018, just one day before Sears filed for bankruptcy protection. Terry has seen the financial and emotional toll of going through a retail bankruptcy herself and for her coworkers, many of whom had even longer tenure in her store than her.

Elizabeth Marin (Silverdale, WA)
Elizabeth Marin is originally from Anchorage, AK where she began her career at Toys 'R' Us in 2013 as an overnight stocker, and she was able to stay with the company as her family moved. When Toys 'R' Us announced it was liquidating all stores, Elizabeth was working as the full-time front-end HR supervisor supporting her 3 children while her husband was finishing his degree. After her store closed, Elizabeth's family fell behind on bills, and barely pieced together enough money to cover rent when they were 3 days away from being evicted.

Trina McInerney (Dubuque, IA)
Trina McInerney started working at Shopko in 2007 until the Midwestern retailer liquidated all stores in June 2019. Trina was earning $8 an hour in 2007, and by the time she was helping to close her store in June, her hourly wage was $9.87 - $1.87 in raises over 11 years. She nonetheless built deep connections with her coworkers over the years, who were all devastated by the company's liquidation. After her store closed, Trina struggled through months of unemployment, and she would not have been able to afford rent if it weren't for her boyfriend.

Rona McLaughlin (Chicago, IL)
Rona McLaughlin started as a part-time associate with Payless in the South Pacific 21 years ago and worked her way up to store manager after moving to the U.S., working in Florida and finally in Illinois. As a multi-store manager, Rona found out her store wes closing from news on TV, and it was devastating. Payless and her coworkers were a huge part of her life; Rona had her baby showers in the break room of a Payless store. Since losing her job in June Rona is on unemployment for the first time in her life. Her 17-year-old son started working to help her and her husband. Rona does not know how she is going to pay for her son's college tuition next year.

Brandy Mendoza (Fontana, CA)
Brandy Mendoza is a former Assistant Store Manager at Toys 'R' Us, a job that allowed her to raise 5 children and support her mother on her own. Brandy had finally bought a house on her salary a year before Toys 'R' Us announced it was liquidating all stores. In the 15 years she spent with the company, Brandy missed holidays and birthdays with her children. After losing her job, she would skip meals to make sure her children could eat, while digging into her savings to pay her bills and mortgage.

Bruce Miller (Toms River, NJ)
Bruce Miller was a mechanic at the Sears Auto Center in Toms River, NJ for 36 years until his store closed in April 2018. Bruce started as a custodian, and eventually worked to become Automotive Technician Level 3. Bruce recalls servicing 100 cars per day at the height of Sears' days, and he was able to buy a house in 1996. Bruce's commission pay declined after ESL Investments took over control of Sears, and he fell behind his mortgage. After his Sears closed and his 8-week severance ran out, Bruce lost his health insurance and his house, He has not been able to find a full-time job since then.

Debbie Mizen (Youngstown, OH)
Debbie Mizen was an assistant manager at Toys R Us and worked for the company for 31 years. When Debbie lost her job last year, she and her husband faced financial insecurity as her husband's pension wasn't enough to support both of them. Fixing up their car put them in thousands of dollars in debt. In Youngstown, she's found the job opportunities limited, very physically demanding, and lower paid than what she earned at Toys R Us. She eventually found employment grocery store doing curbside express, a labor-intensive job that was challenging at her age.

Madilyn Muniz (Bronx, NY)
Madilyn Muniz has worked in retail her whole life, 20 years of which were at Toys 'R' Us as she raised her two children. Four years ago Madilyn moved her aging parents from Puerto Rico to live with her in the Bronx in order to care for them, and she found comfort in her tight-knit Toys 'R' Us coworkers, most of whom were decades-long employees like Madilyn and working to support their children and their families. After Madilyn lost her job, she struggled to support herself and her mother, who has Alzheimer's, on unemployment.

Mary Osman (Youngstown, OH)
Mary Osman worked as a cashier at her Toys 'R' Us store in Boardman, OH for 24 years. Mary missed 18 Thanksgiving dinners with her family and was looking forward to retiring in 3 years and spending time with her grandchildren, until her job was taken away last June. Her husband has put his retirement plans on hold, and Mary is concerned about their future as she has not been able to find a job at the age of 63.

Ondrea Patrick (Rockford, IL)
Ondrea Patrick is a single mother of 5 under the age of 11. She spent almost 9 years at Kmart, but because of her availability as a mother, she was only able to get part-time hours. Ondrea has seen the local economy crash around her. There have been several retail store closures in her town, so not only did she lose her job, but there is so much less opportunity for her to get another job to support her family. After her Kmart closed last September and losing her tight-knit work family, Ondrea nearly lost her house. It took her nearly a year to finally find new employment.

Michelle Perez (Vancouver, WA)
Michelle Perez crossed the stateline everyday to work at her Toys 'R' Us store in Janzten Beach, OR. She had worked at Toys 'R' Us for 4 years as a full-time supervisor, had health insurance for her and her two kids, and had just signed the lease on her first apartment. Her 3-year-old son was diagnosed with Type-1 diabetes on the day she found out her store was closing. As a single mother, Michelle has been thrown into a financial crisis after she lost her job, unable to find full-time, permanent employment for nearly a year and a half and struggling to pay for her son's medical bills and medication on top of her rent.

Jorge Saenz (Chicago, IL)
Jorge Saenz was a loyal and hardworking employee at Payless Shoe Source for 27 years. Jorge started his career as a part time associate and worked his way up to become a multi-store manager. Some of the hardest days of his life were when Jorge had to inform the employees in his stores, many of whom he considered family, that they were losing their jobs. Jorge is the head of household and supports his wife and two of his three daughters, and since losing his job in June this year, Jorge has been relying on credit cards to make ends meet. Still unemployed, Jorge has been able to secure health insurance for his daughters, but he and his wife still have not been able to get affordable healthcare coverage.

Ann Marie Reinhart Smith (Durham, NC)
In 1989 Ann Marie Reinhart Smith was a new mother buying diapers at Toys 'R' Us in Commack, NY when she applied for a seasonal position, and she never left. When her store in Durham, NC liquidated last March, Ann Marie found herself unemployed at the age of 59, without health insurance and competing for jobs with people half her age. In the 20 months after her store closed, Ann Marie has not been able to find a full-time position with healthcare, and works two part-time jobs while helping to care for her grandchildren. Ann Marie was able to be there for her young sons while working at Toys 'R' Us as a young mother, a luxury her daughter-in-law who also works in retail, does not have today.

Jacob Soha (Saratoga Springs, UT)
Jacob Soha is the sole provider for his wife and kids. Jake has worked in retail for 17 years and worked for Shopko for 4 years in loss prevention. After getting laid off from Shopko in June, Jake and his family lost the health insurance they had received from Shopko, which has been very difficult for his wife and children.

Victor Urquidez (San Diego, CA)
Victor Urquidez is an Assistant Manager at his Sears Auto Center, where he started part-time 8 years ago. In 2 months, he will be losing his job as his store is closing. Victor has been the sole provider for his wife and 2 kids on his income, but they lost their house after his commission pay was cut in 2017, resulting in nearly $1,000 less he took home every month. Victor and his family were homeless for 3 months, sleeping in their families' living rooms or in their car. They have

since found an apartment, but Victor and his wife, who started working, struggle to pay rent and cover their bills every month.

Brenda Urrutia (El Centro, CA)
Brenda Urrutia has decades of experience in the retail industry. Brenda worked at Sears for 21 years, during which time she raised two children as a single mother and bought a house on her own. She loved her job as a commission salesperson until her store closed abruptly in January of 2019. She and her coworkers received just 4 weeks of severance for decades of service. Brenda has been left with a pension that is not nearly enough to survive on, and is struggling to find employment at her age.

Kristi Van Beckum (Madison, WI)
Kristi Van Beckum was an apparel manager at Shopko for 14 years and took pride in working for a Wisconsin-based company with a family-oriented culture. Many of her coworkers had been with the company for decades, and they were all blindsighted when the company filed for bankruptcy protection in January. Despite her tenure, Kristi was promised only 4 weeks of severance, and she found out on her last day of work that she would not be getting it at all.

Maryjane Williams (Waco, TX)
Maryjane Williams was an assistant manager at Toys 'R' Us in Waco TX when her store closed. Maryjane started working for Toys 'R' Us in Commack, NY as a part-time seasonal employee, and after the 2005 leveraged buyout her full-time position was slashed and she was demoted back to part-time. But Maryjane continued to work with the company and rose through the ranks, while raising her five daughters with her husband. The day she lost her job at Toys 'R' Us, her husband was in an accident that put him in the ICU with head and neck trauma. Maryjane was able to find a job at Party City after taking care of her husband for several months, but still works at night in a cleaning business to supplement her income.

Sarah Woodhams (Harleysville, PA)
Sarah Woodhams started at Toys 'R' Us in 2011 as an overnight seasonal hire, and eventually became a Baby registry supervisor at her Babies 'R' Us. In 2018, Sarah was rushed to the hospital, and delivered her son who was stillborn. She was at home recovering when she found out on Facebook that her company was liquidating all stores. Facing unemployment and medical bills, she and her husband had to put their dream of buying their own house on hold. Sarah struggled for nearly a year to find employment.

Testimony before the
U.S. House Financial Services Committee

"America for Sale? An Examination of the Practices of Private Funds"

2128 Rayburn Building at 10:00AM

November 19, 2019

Drew Maloney
President and CEO
American Investment Council

Good morning, Chairwoman Waters, Ranking Member McHenry and other distinguished members of the House Financial Services Committee. Thank you for the opportunity to testify today.

My name is Drew Maloney. I lead the American Investment Council. We are proud to represent private equity firms, of all sizes. Our industry creates jobs, powers the economy and strengthens the retirements of millions of Americans.

Our industry provides businesses with the capital and expertise to grow. The term "private equity" is very broad, so before I go any further, I wanted to take a minute to talk about the three main forms of private equity: Venture capital, growth capital and buyouts. Each describe investments at a different phase of the business lifecycle.

- **Venture capital** represents those early investments in startups that need capital to exist. For example, private equity made early investments in Uber, Spotify and Peloton, long before those companies became household names.

- **Growth capital** is when private equity invests to expand an existing company. Growth capital represents the largest part of the investment chain. A great example is Tate's cookies, founded in New York by Kathleen King when she was 21. She partnered with private equity to grow the business, and now Tate's cookies are in grocery stores across America.

- Finally, **buyouts** are private equity investments in well-established companies that may be distressed or underperforming. Private equity helped Hilton Hotels almost double in size during its 11-year investment in the company. Hilton was recently recognized as the best company to work for in the U.S.

The ultimate objective of each of these investments is to build a better business. Private equity provides patient, long-term capital that allows management to think beyond quarterly earnings and short-term fluctuations in the stock price. Private equity also provides more than just capital. Firms bring operational expertise to each investment and often work closely with the management of each company to define strategy and map out long-term growth objectives.

The biggest investors in our industry are pension funds and university endowments. Successful private equity investments strengthen the retirements of

public- and private-sector workers, including teachers, firefighters and police officers.

In total, the private equity sector in the U.S. employed 8.8 million people and paid $600 billion in wages and other benefits in 2018. That total included more than 1.1 million jobs in California. Roughly a third of those private equity jobs were in either manufacturing, construction, transportation or warehousing.

Private equity invested $685 billion in more than 4,700 businesses across the U.S. in 2018. Most of those deals involved small- or mid-sized companies. Businesses of every size, in every congressional district, depend on private equity capital and expertise to grow.

In 2014, private equity invested in Inland Coatings, a small industrial coating manufacturer in Adel, Iowa. The investment helped the company grow to an industry leader and provide healthcare and retirement benefits to its employees.

Ninety-one percent of public pension funds have invested some portion of their capital in private equity, and in 2018, we generated the strongest return of any asset class over the last 10 years.

The Los Angeles County Employees' Retirement Association had one of the highest average annual returns in the country. Earlier this year, the Chief Investment Officer of CALPERs, the country's largest pension fund, said, "We need private equity, we need more of it, and we need it now."

These strong returns have become increasingly critical for pension funds at a time when many do not have enough money to meet their existing obligations. Private equity is proud to help close that shortfall.

Thank you again for giving me the privilege of appearing before the committee. I am grateful for the opportunity and look forward to answering your questions.

House Committee on Financial Services

Nov 19, 2019 Hearing: America for Sale? An Examination of the Practices of Private Equity
Written Testimony from Wayne Moore, Trustee, Los Angeles County Employee Retirement Association

Protecting public pension plan assets requires open and transparent relationships between all fiduciaries responsible for managing and investing these assets. Provisions of HR 3848 the Stop Wall Street Looting Act (SWLA) are designed to promote full disclosure of fees and returns from private equity funds to all intents and purposes to control and reduce the costs of investing for private equity fund investors, including pension funds. While percentage fees are relatively small, the billions of dollars transferred from pension fund assets to the financial services industry every year has a consequential impact on the long term health of pension funds and the benefits plan participants expect to receive. Strategies to reduce the cost of investing, especially in high cost asset classes such as private equity is a top priority for trustees, pension plan administrators and investment managers.

I was appointed a public pension fund trustee ten years ago. Over time and after doing my own research and analysis, I have come to believe the interests of the financial services industry and the interests of our public pension plans are not properly aligned. I am especially apprehensive about the asset based management fee construct and its lack of correlation with the services provided and the level of performance achieved in asset management. Given the significant amounts of money at stake, better industrywide information from private equity firms on fees, expenses and returns is needed to ensure the proper alignment of interests is realized.

The Fees as a Percent of Assets Management Construct

According to passive investing guru Charles D. Ellis, in a 2012 Financial Analysis Journal editorial, during the post WWII era most major banks managed pension fund assets as a customer accommodation for little, ¼ percent of assets under management, or no money at all. In a highly regulated financial system with fixed rate brokerage commissions, the banks exchanged commissions from brokers for agreed upon cash balances from pension funds. The brokers got "reciprocal" commission business, the banks got "free" balances they could lend at prevailing rates and pension funds got rebated back commissions and fees. Then in the late 1960's someone at Morgan Bank recognized that charging a very small asset based fee with no rebate could become a growing profit center, much like current bank overdraft charges. Thus began a steady 50 year rise in investment management fees accruing to the financial services industry. In 1974, there was $218 billion in public and private pension plans. Today, we have $7.7 trillion and an industry with a mature business model built around a fee construct that was never explicitly correlated to services or performance. Mr. Ellis opined in the same 2012 editorial, that even as fees calculated as a percent of assets are relatively small, investors already own the assets that are the basis of the fee calculations, thus investment manager fees should really be based solely on incremental returns above the market index. Stated more accurately, investment manager fees as currently calculated are remarkable high. In addition to these high management fees, invisible costs such as trading and transaction costs; legal fees, custodial, administration costs and regulatory expenses all combine to shave significant sums off the top of pension fund assets. Activists and academics in the

UK and the US have done extensive research and analysis on these costs and it would be fair to say that the invisible costs rival investment management costs in impact on pension fund assets.

The Macro View

As a trustee, I have taken a macro look at fees from a public plan perspective. According to the Investment Company Institute, at the end of the Q2 2019, state and local government pension plans held $4.5 trillion in assets. Historically there's been a lack of full disclosure of the actual fees and expenses charged by investment managers across all asset classes and especially the high cost asset classes such as private equity. Typically, pension funds only report fees and expenses paid and recorded in their general ledgers based on an invoice. Consequently, and particularly in private equity and other alternative asset classes, fees and expenses that are netted out of distributions are not accounted for nor is "carried interest" received by investment firm partners recorded in general ledgers. Private equity firms characterize carried interest as profit sharing. These firms typically invest 2% or less of their own cash into the funding vehicles they manage but reap 20% of the profits while the other 80% is shared amongst the limited partners of the investment fund they manage. My analysis includes carried interest as a performance fee because firms get a material return from a non-material investment. These and other factors make it difficult to estimate what the true overall pension fund portfolio fees and expenses are. However, based on published data from financial reports and detailed independent analysis done by researchers and some local government pension funds, a conservative assumption would be that at least 1% of pension fund assets are being transferred to the financial services industry every year. Although 1% is a small percentage, $45 billion (1% of the $4.5 trillion in assets) is no small sum of money coming from public pension plans. Over the past 30 years at 1% of assets under management, approximately $781 billion in nominal dollars has transferred from state and local government pension plans to the financial services industry in fees and expenses.

What This Means for Plan Participants and Sponsors .

Consider the impact of just $1 million dollars in savings from the cost of investing. In 2018 at the Los Angeles County Employees Retirement Association, the 3,787 general members who retired received an average annual pension benefit of $45,448. $1 million in savings invested at 6.25% would fund two average LA county retiree pensions for 20 years, including an annual 2.5% COLA.

Over the long term, reducing the costs of investment also increases net investment returns thus contributing to closing the gap between low return expectations and the required actuarial return objectives of our funds while marginally reducing overall portfolio investment risk. Further, the long term impact on total fund assets of reduced investment costs increases fund balances thus decreasing the unfunded actuarial accrued pension liabilities (UAAL) and the annual cost of fully amortizing these liabilities.

Recently, I reviewed a local government pension plan with $33.9 billion in assets and a UAAL of $7.1 billion. This government's annual budget to amortize that liability was $658 million. These annual amortization costs are funded with general funds which also pay for local government services such as safety, sanitation and street maintenance. Working with an outside consultant, we estimated and sensitivity tested the impact of their costs of investment management at 6 bps (10%) less than currently reported. The results were that over a 10 year period, this government could potentially increase total fund assets by $413 to $497 million, reduce unfunded liabilities by $253 to $300 million and reduce annual amortization costs by $20 to $25 million. Implementing investment manager cost savings strategies would require deliberate and intentional contract negotiating strategies, operations and administration changes and comprehensive reviews of compensation structures and rationales. None of this would be possible however, without full disclosure of fees, expenses, returns and performance measures.

Targeting more efficient resource management by lowering the cost of investing without sacrificing performance should be a major initiative for our pension plans. Full disclosure of fees and expenses however, is one component of the transparency public pension funds need to ensure the efficient, effective and efficacious use of its assets. In addition, pension fund managers and staff would be much better equipped to make investment recommendations to their Boards if they had more operational information from private equity firms.

What is Ahead for Us?

Over the next decade institutional investors face a low investment return environment. Horizon Actuarial Services, LLC surveyed 34 investment advisors whose capital market assumptions are included in their 2019 Survey of Capital Market Assumptions. The 10-year median annualized returns assumption for large cap equities was 6.03% and for small and mid-cap equities 6.55%. Private equity market assumptions we 8.97% in the survey. While these assumptions are not predictive, they still drive investors to accept higher risks and therefore increased costs in search of higher investment returns to meet their return objectives. Private equity firms are raising ever larger funds in the multi-billion dollar range and are holding assets for longer periods of time. These longer holding periods drive the necessity for greater transparency with pension fund managers and staff as they decide which companies and strategies they will recommend making these longer term commitments to. There will also be a need for more detailed and more frequent financial statement information from firms and the portfolio companies they are targeting and acquire. If the longer term relationships between private equity firms and investors is to be more successful, the private equity industry must be more willing to partner with and share information with their investment partners.

In a 2017 Preqin assessment of the top 100 private equity limited partners worldwide, 31 US public pension funds allocated $292 billion or 36% of worldwide private equity allocations. Further, all pension funds - public, private, foreign, domestic – allocated $441 billion or 56% of worldwide private equity allocations. In other words, most of the money

allocated for private equity investments worldwide came from workers' retirement funds. Pension funds have long term investment horizons. The short term gains on investments generated by the financial engineering of some private equity firm strategies put at risk the future value and sustainability of many companies. These private equity transactions end up putting at risk the jobs, local tax bases and investment portfolios of the workers whose money fuels their activities. Many of the portfolio companies become public and end up in passive indexed public equities portfolios of pension funds. Consequently, these financial risks imposed on public pensions should be critical factor when investment decisions are being made. This is where transparency comes into play.

First, limited partners, especially pension funds, have an interest, beyond short term gains, in private equity investment decision making. However, limited partners have a severely restricted role in that process. The California Public Employee Retirement System has proposed a new private equity business model that emphasizes more collaborative and strategic relationships with private equity firms. These relationships focus on cost efficiency and long term sustainable growth. More operational transparency must also be included in these new relationships. For example, full details on costs and expenses, periodic meetings with investment officers and detailed investment pipeline information would be critical components of this model. Given the significant role pension plans play in financing private equity activities, these are changes that must be addressed either voluntarily or through a more tightly prescribed regulatory regime.

Secondly, the Employee Retirement Income Security Act of 1974 (ERISA) protects private pension plan assets by requiring fiduciaries to operate and administer plans solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries in public plans, though not legally required to, have operationalized these same responsibilities over the past 45 years by making annual returns on investments – profits – the primary and almost exclusive objective of plans. Even after pension plans own assets were used to earn short term profits restructuring US manufacturing and helping to undermine the long term economic growth supporting US workers, no rethinking of the primacy of profit has taken place in either private or public pension plans. While the law does not necessarily need to change, how we protect the interests of our plan participants and beneficiaries is only partly driven by this year's profit and lost statements.

Conclusion

As a pension fund trustee, (not representing the Los Angeles County Employee Retirement Association Board of Investment), a retiree and a taxpayer, I believe H.R. 3848, the Stop Wall Street Looting Act, Title V – Investor Protection and Market Transparency includes important provisions that will help protect the money that millions of workers have saved through deferred wages and payroll deductions to have a safe and secure retirement. Section 501 addresses full disclosure of fees, expenses and returns to ensure efficient and effective utilization is pension fund assets. Additionally, Section 502 ensures that pension plan fiduciaries cannot waive or transfer their responsibilities

and Section 503 requires more transparency from private equity firms about their past performance and how they managed their portfolio companies. All of these disclosures will help investors in private equity funds make sounder and more informed decisions when entrusting the future well-being of pension plan participants into the hands of the private equity industry. Congress plays a pivotal role through the legislative process ensuring the long term sustainability of public pension funds. I am certain the public pension funds in your jurisdictions will be more than willing to provide you with facts about their systems that you will help inform your decisions.



Testimony before the

U.S. House Financial Services Committee

America for Sale? An Examination of the Practices of Private Funds"

2128 Rayburn Building at 10:00AM

November 19, 2019

Brett Palmer
President
Small Business Investor Alliance (SBIA)

Chairwoman Waters and Ranking Member McHenry, thank you for the opportunity to testify today and for holding this hearing, "*America For Sale? An Examination of the Practices of Private Funds.*" I am Brett Palmer, President of the Small Business Investor Alliance ("SBIA").

SBIA was formed in 1958 to represent Small Business Investment Companies, the original American venture capital and private equity funds. As the small business investing market grew more complex, so did SBIA. SBIA now includes Small Business Investment Companies (SBICs), Rural Business Investment Companies (RBICs), Business Development Companies (BDCs), conventional private equity funds, private debt funds and other funds investing in American private small businesses. These private equity funds pursue a wide range of strategies including, but not limited to: venture; venture lending; growth equity; minority equity; control equity; mezzanine and other private debt; unitranche; and other strategies. We also represent the institutional investors (e.g. university endowments, pension funds) who invest into these small private funds because we strongly believe in the importance of maintaining a strong and healthy alignment of General Partners and Limited Partners. The partnerships in private equity must be real and mutually beneficial. Our association's purpose is to represent the entire lower middle market investing ecosystem, both General Partner and Limited Partner. It is an alliance for professional fellowship, business opportunities, innovation, regulatory expertise and market data. As such, our public policy goals are balanced and focused on maintaining a robust, healthy, and competitive market for investing in American businesses. Our members grow businesses and are rightfully proud of what they do, how they do it, and the benefits their actions have on people and communities.

What is Private Equity

Private equity is a very broad category of capital providers who are commonly misunderstood and often misrepresented to be: solely massive in scale; bad for the economy; non-productive; job destroying; creatures of Wall Street or Silicon Valley; and even economic "vampires". The truth is investing by private equity is a powerful force for good.

Private equity is a positive force for job creation, innovation, and expanding prosperity to the people and places that are not yet fully benefitting from our system of free enterprise. The profits from private equity fund the retirement security of millions of pensioners and provide the scholarship money used to provide educational access to a new generation of college students. These private equity investments are commonly made in areas of the country that are otherwise passed over or passed by. Most of our member funds are located in Little Rock, Indianapolis, Buffalo, Omaha, Kansas City, and many other places that far from Wall Street or Silicon Valley. Regardless of investing style, private equity investors in small and medium-sized businesses make money by helping the businesses grow and succeed. The idea that private equity funds make money by having businesses

fail is utter nonsense. As one of our members told me "I have been an institutional limited partner into private equity funds for almost 20 years - working at pension funds and private investment firms and I have had literally thousands of pitches given to me. I have NEVER, not once, had someone pitch a "buy a company and break it up" strategy. NEVER! That does not exist. Companies sometimes fail. Yes, sometimes companies are over-levered (or become over-levered as they start to fail) but Private Equity firms don't ever want a company to fail."

Private equity helps business grow by not only providing critical, patient capital that conventional banks cannot, but also by helping the smaller business learn how to grow and make big leaps forward that they otherwise would not have been able to achieve on their own. The only way to be a successful private equity fund in the lower and middle market is to find smaller businesses and help them grow into bigger, better businesses.

To put it in the simplest of terms, private equity funds are investment vehicles that pool capital (largely from institutional investors like pensions and endowments) and then invest in businesses that are not publicly traded to help them grow.

Legislation

This Committee has a long bipartisan history of working together to promote the expansion of economic opportunity. We appreciate that history and the ongoing goals of continuing that work. There are several legislative proposals that are on the agenda for this hearing. Most of these proposals we have only recently been exposed to so I will be happy to discuss the concepts and issues in the question and answer sessions. We will follow up with more detailed and technical written comments once our members have had a chance to provide a deeper review.

However, there is one piece of legislation that is founded on such a profound misunderstanding of what private equity is, what private equity does, where private equity is investing, and the impacts of private equity that we feel obligated for our testimony to include a primer on private equity, particularly as it relates to small and medium-sized business investing. The "Stop Wall Street Looting Act" would unintentionally cause serious harm to small businesses' ability to access capital while hindering private equity funds' ability to invest in small and medium-sized businesses. Further, it would harm university endowments and pension funds that benefit from private equity investing. It would harm Main Street much more than it would harness Wall Street. It is bad legislation based on an incorrect concept of investing.

The best economic public policy attracts capital and ensures flexibility to increase the capital options available for a company's success, whether the company is a startup proving its products in a competitive market, a small family owned business managing through generational succession, or a larger company (like those in the retail sector) that are trying to adapt to new competitive threats from technology and e-commerce. Not having the

resources to help these companies deal with change puts them more at risk. The more capital options a company has and the more professional and aware the ownership and management teams are of these options, the better chances for success and survival. This translates to more jobs for our economy.

If Congress can agree on one thing, it should be that regulatory and tax policy should promote and empower private equity to invest in growing more American businesses. Congress should reject any policies that make it harder for private equity to provide access to capital, particularly to smaller and medium-sized business that already face disproportionate challenges to capital access.

The Private Equity Continuum

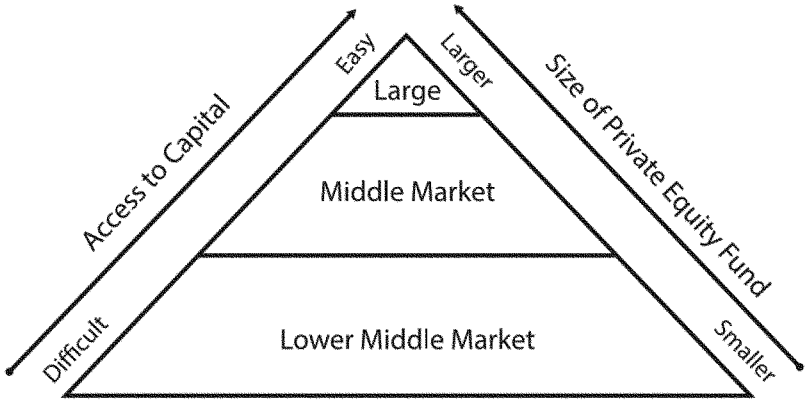
Private equity is a continuum that spans from the very early-stage small angel investors to the largest buyout funds and everything in between. A robust economy requires every segment of this continuum to be healthy. Without angel investors there would be less venture investing, with less venture investing there would be less venture lending; with less venture lending there would be less growth equity investing, and with less growth equity there would be less small buyouts and small spin off investing; and so on. While we segment these investing styles for the sake of simplifying and explaining them, the reality is that they are interconnected parts of the private equity continuum that commonly overlap. Each segment is inextricably interconnected. In a healthy economy every segment of this private equity continuum must exist and be allowed to work. Policymakers cannot harm any segment of the continuum without damaging the health of the whole investing market and reducing the positive benefits of private equity on the American economy.

The private equity continuum reflects the incredible diversity of American businesses and their capital needs. There are tens of millions of businesses in the United States, but the vast majority of them are individuals and sole proprietors. The pool of privately-held and public companies narrows significantly as they get larger. There are many more smaller businesses than there are large ones. Because of the effects of scale, smaller private equity funds are more likely to invest in smaller businesses, thus smaller funds have a far larger choice of businesses to invest in. It must also be noted that like the small businesses they invest in, the smaller the private equity fund the more painful and time-consuming regulatory burdens are. Many of these small business private equity funds are 3-5 people in middle America.

While there is more investing choice because there are a greater number of smaller business, investing opportunities are more difficult to make because smaller businesses require a far greater degree of hands on work by the private equity funds to make that growth happen, and have an inherently higher risk of failure because they do not have the "cushions" that larger businesses have.

What is commonly called "the middle market" contains less than 3% of all American businesses, approximately 200,000 American businesses. These middle market firms account for about one third of both the private sector employment and the private sector GDP.[1] Middle market firms loosely fall into three subsets: lower ($5-$150 million/annual revenues) (small businesses); middle ($150-$500 million/annual revenues); and, upper ($500 million-$1 billion/annual revenues) (the larger end of small businesses to medium-sized businesses). The large-company market has fewer businesses and includes the publicly-traded companies. Despite being the segment with the fewest number of firms, this large segment gets almost all of the public policy and media attention. Small business private equity invests in businesses just entering the lower end of the middle market and in small businesses growing up and into this middle market. Very few of these growing companies want to become publicly-traded companies and very few will ever have an IPO.

For all companies, small and medium-sized business in particular, access to capital is a distinguishing feature that often determines success or failure. Community and regional banks generally help finance small businesses with a stable revenue history and that have assets to borrow against. Local bankers, business brokers, independent sponsors, and investment bankers work with small businesses. The smaller and more rural the businesses the more difficult it is to access capital. Smaller businesses are seen as too risky for most banks and larger financial institutions. Smaller businesses need hands-on help to manage growth; navigate changes in the competitive landscape and generational changes; which is the kind of help that only private equity can provide.



[1] National Center for the Middle Market
https://www.middlemarketcenter.org/Media/Documents/NCMM_Info%20Sheet_2019_web.pdf

Generational changes deserve a special mention because private equity plays a critical role in successfully managing these changes, particularly for SBIA's funds. Most small businesses are "lifestyle businesses" that provide a fulfilling career and support a family, but the business will end when the owner ceases working. But there are also a large number of business that are meant to continue on past their founder's time and many of these founders are aging. There are hundreds of thousands of successful businesses, commonly small businesses, that were founded by baby boomers or post-baby boomers, whose owners need to retire and whose business still has its brightest days ahead. In many of these businesses the founder/owner does not have a child who is willing or able to take over this business. Without a buyer, often a private equity fund or a management team backed by a private equity fund, many of these otherwise successful small businesses will simply shut down – harming their employees, the economy, and their communities.

When these businesses facing generational transfer are sold to a private equity fund or to a private buyer these business grow. The new owners invest for the longer term – investing in new equipment, new technologies, new products, new selling into new markets, and hire new employees. These businesses innovate like a startup but do so with the critical advantage of a proven business model. It is common for the family or founder of the business to retain a minority ownership stake in the business and therefore participate in the ongoing success of the now growing business. The failure rate of these investments is low and the growth rate (both profit and employment) is high.

Change can be disruptive, but in the middle market it is far from heartless or callous to the human impacts of change. Embracing change keeps businesses alive and employing people while failing to change kills businesses and their ability to employ. Not surprisingly, a 2018 report by the National Center for the Middle Market found that the top concerns of middle market business leaders going through transitions were focused on the business' survival and growth because if the business failed then all the other concerns become moot. But 36% of these leaders managing change had "ensuring the well-being of their employees" and 26% had the "financial well-being of their employees" as their biggest concerns. It is my experience that these concerns for employees are particularly acute for smaller businesses and in areas of the country with less economic opportunity. Business owners and private equity investors both genuinely care about people.

Retirement Security and Educational Opportunities

Some of the biggest and least known beneficiaries of private equity are retirees and students. Pension funds and university endowments are some of the biggest investors in private equity because it gives them the best risk adjusted returns. These investments provide retirement securities to those with pensions and provide the capital that helps fund scholarships. Public pension systems in the United States are woefully underfunded and are a strain on taxpayers and beneficiaries alike. One of our members analyzed over 3,500 lower middle market and middle

market buyout transaction over a 20 year period and found that on average these transactions produced a 15+% Compounded Annual Growth Rate for the earnings of the companies that had a leveraged buyout. Pension plans need access to private equity investments like this if they have any chance of meeting their future financial obligations. As the Chief Investment Officer of CalPers recently stated, "We need private equity, we need more of it, and we need it now."[2]

SBIA's Private Equity Funds Invest in People

Accessing capital and empowering growth is core to what private equity is, but it is not just money. Successful private equity managers invest in people too. This is why SBIA partnered with the Fischer School of Business at the Ohio State University to train small business executives how to grow their small businesses and move them up into and through the middle market. Just this month, over 45 small businesses took part in a 3 ½ day intense training seminar NextLevel to teach them how to: attract and maintain employees; manage growth; successfully operate in a leveraged environment, create and implement successful growth strategies, etc. Again, small business private equity only succeeds when businesses grow - and small businesses need to retain employees and often need to add new people to achieve this growth.

Growing Businesses Means Growing Jobs

A 2017 study by the Research Division of the Library of Congress in conjunction with professors from Duke and Pepperdine found that businesses backed by Small Business Investment Companies created three million new jobs over the 20 year period they studied.[3] This study also found that these Small Business Investment Companies supported businesses that had an additional 6.5 million jobs. These employment numbers are even more impressive when the fact that the study covered the period of the Great Recession, the Tech Bubble bursting, and the 9/11 slowdown. Small business investing is longer-term, very illiquid investing so these private equity investors are committed to making these small businesses succeed through the good times and the bad times.

According to a recent Ernst & Young report prepared for the American Investment Council, 8.8 million workers are directly employed by the private equity sector (covering the range of private equity-backed business from small to large). These workers collectively earn $600 billion in wages and benefits. Moreover, suppliers to the private equity sector employed an additional 7.2 million workers that earned $500 billion in wages and benefits.

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[2] "CalPERS Not Alone on Private Equity Shift." Pension & Investments (April 1, 2019)

[3] Paglia and Robinson, Measuring the Role of the SBIC Program in Small Business Job Creation, Report for the Library of Congress, at 4 (January 2017) <https://www.sba.gov/sites/default/files/articles/SBA_SBIC_Jobs_Report.pdf>.

Where Do Companies Obtain Capital?

For the hundreds of thousands middle market companies, access to capital becomes easier with more options as the business gets bigger. Smaller businesses have a much harder time accessing loans (particularly based on cash flow) than do larger businesses. Similarly, smaller businesses do not have ready access to equity capital the way publicly traded businesses do. As a business becomes larger and more sophisticated, its revenue stream expands as do the options for capital access.

Companies in the upper-middle market have access to most of the capital market options available to large publicly-traded companies. These businesses may also attract attention from large investment banking firms, subject to their risk tolerance for the particular sectors where these upper-middle market business operate.

Commercial banks, merger and acquisition advisors, and private investment bankers often work with lower and middle-market companies. Smaller businesses can attract SBIC, VC, RBIC, BDC, or PE capital.

Women, Minorities, and Underinvested Areas

I was hired at SBIA by the first Chairwoman of the Board of any national private equity or venture capital association. In the years that followed, she has been succeeded by other women Chairs of our board. Both currently and for many years past, SBIA's board has had racial and gender diversity not only on the board, but in leadership positions, including our current chair of the board, several of our officers, and our current Northeast Regional President. We also have members of the Board from places that are not the center of financial universe. For example, our Chair of the Board is in Indianapolis. Our members regularly invest in areas of the country that are far from the financial centers, particularly for investments in manufacturing. While our leadership and membership is far more diverse than the private equity industry at large, it still does not proportionally reflect the population of America. Over time, this is changing, and we will continue to do our part to bring in more talented investing professionals into our segment of private equity.

Private Equity Fund Managers Have "Skin in the Game"

Private equity fund managers generally must invest a significant portion of their personal wealth to their fund before outside institutional investors will invest in their fund. Fund managers' interests are closely aligned with their outside investors. Fund managers lose their own money if their fund's institutional investors (pensions and endowments) lose money and they only make money if their institutional investors make money.

A sampling of private equity investments and their impact

Henderson Products, Inc. (Manchester, IA)

Henderson was founded in 1946 in Cedar Rapids, IA as a manufacturer of agricultural attachments and spreading equipment that was later moved to Manchester, IA in 1958. When Henderson received private equity investment, it was a leading manufacturer and up-fitter of heavy-duty truck equipment used by municipalities for snow removal and ice control. At the time of the SBIC investment, Henderson had full year revenue of approximately $55.4 million and employed 225 people. Around the time of the SBIC fund's exit, Henderson had full year revenue of approximately $66.8 million and employed 320 people.

Paragon Bioservices Inc (Baltimore, MD)

Paragon is an industry-leading contract development and manufacturing organization whose focus is the development of cutting-edge biopharmaceuticals.

In August 2018, Paragon received growth capital investments from Spring Capital Partners and Eagle Private Capital. Each Small Business Investment Company invested $9 million in a mix of subordinated debt and preferred equity. Paragon was able to use this capital to fund the build out of a new facility near Baltimore, allowing the business to hire new employees and sign contracts with leading gene therapy companies.

The company was ultimately acquired by a publicly traded firm in 2019 for over $1 billion and is on track to increase its employment by approximately 80 percent through the end of this year.

Televerde (Phoenix, AZ)

Televerde is a global demand generation company that provides sales and marketing solutions to help clients generate demand and nurture leads. Services include Marketing Technology Services, Strategic Engagement Planning, Data Intelligence, Demand Generation & Teleservices, and Inside Sales.

The company started out in a small trailer based at the Arizona State Prison Complex – Phoenix prison yard with eight incarcerated females as employees in its contact center. It has since expanded operations, and grown to over 500 employees, including many former inmates who are making the transition to their new, productive and independent lives. Approximately 250 members of Televerde's workforce are formerly incarcerated and who are now on path to independence

The BDC Main Street Capital Corporation has been invested in Televerde since 2011. "We are proud to partner with a company that has reduced recidivism from 68% for the general population to 6% for Televerde demand generation employees," said Vince Foster, CEO of Main Street Capital.

Private Equity Is Not One-Size-Fits-All

Private equity is a form of financing where capital, commonly pooled by from institutional investors (ranging from high-net worth individuals to state and local employee pension funds and university endowments) that seek strong and stable returns to counter current unfunded liabilities, is invested into a company in exchange for equity.

Today's PE funds are investing in a wide array of industry sectors and portfolio companies. The vast supply of those companies, moreover, are in the middle market. Baby Boomers own the bulk of those companies and many are ready to reduce their involvement in the companies that they built or transfer ownership entirely but do not have a succession plan or family member ready or interested in taking over. Without a willing buyer, those owners may have no practical option but to close operations, eliminating jobs and their economic contributions to local economies. PE fund investments create economic value for shareholders and economic growth for communities where those companies can continue to operate and create new and sustain existing jobs.

Private Equity Invests for the Long-Term

The fundamentals behind private equity are to take companies to the full potential by increasing revenue, expanding markets, increasing efficiencies, generally increasing performance, lowering the costs of doing business, and ultimately creating increased value so the business can be sold to a new buyer.

The private equity business model requires that funds eventually sell their portfolio companies at their highest valuation because this generates returns for investors in a fund. Strong returns may lead those investors to re-invest with the same fund managers. Good performance also helps attract new investors like public pension funds that have a fiduciary investment returns to help mitigate unfunded pension liabilities. The private equity process injects needed capital to continue the economic lifecycle and help more businesses that otherwise may have no other sources of capital available to them.

This improvement and growth process takes time. Generally, a private equity fund has a lifespan of about 10-12 years. The first several years are the period when the fund raises capital from investors. The fund then spends 3-5 years making investments in portfolio companies and then another 3-5 years harvesting those investments. Private equity funds are regularly buying, growing, and holding the business for over five years.

The form of a private equity fund is fairly uniform while the major types of PE investments vary:

- **Angel Investors.** These are generally wealthy individuals or groups of individuals who invest their own money into startup businesses or existing businesses with growth potential. Many angel investors were

successful entrepreneurs themselves and have a passion for sharing their expertise in growing local businesses.

- **Venture Capital**. Venture capital is regularly assumed to invest in brand new startups that do not yet have revenue. This is often true, but not universally true. Venture funds tends to invest in companies that are earlier stage, but they also invest in proven models that have not yet scaled or who have burned through the investments they received from friends/family, angel investors, or earlier round venture funds. Venture funds tend to be higher risk with a higher percentage of failed companies, but it is exactly that willingness to take on higher risk that makes them attractive to institutional investors looking for a higher reward commensurate with their higher risk. This type of investing is extremely geographically concentrated to California and the New York to Boston corridor. It is also highly concentrated in technology and biosciences. Venture funds commonly seek to take their successful businesses public via an initial public offering if they are able.

- **Venture Lenders.** Venture lenders are private debt funds that do what most bankers and lenders generally think is crazy. They loan money to fairly new companies with no assets that are losing money. These are extremely high risk loans. Getting a venture loan instead of a new equity round of investment allows a business to continue to grow without the founder and early investors being diluted. Venture lenders are generally paid back when the next equity round is received and they almost always take warrants in the business.

- **Growth Equity**. Growth equity investments seek to invest in companies that are no longer in the startup phase and could also be well-established businesses. They generally provide patient capital in the form of equity to finance growth of the businesses. A growth equity investment can be one for majority control, which is generally considered to be less risky, but sometimes less attractive to the diluted owner/founder. Growth equity can also be a minority investment. Minority investments are commonly seen as more risky because the private equity fund has less control over the company and therefore less control as to when their limited partners will be paid back for the investment. Growth equity generally does not use debt because all the available cash is being used for growth and not debt service.

- **Mezzanine Financing**. Mezzanine financing (or, "mezz-debt") is considered a hybrid brand of PE financing because it is essentially subordinated debt paired with an equity component. It is generally unsecured and subordinated to senior bank debt and comes with a higher interest rate because of the higher risk to the lender. Typical uses for mezzanine financing by a portfolio company include acquisitions, new product launches or business unit startups, and recapitalizations. This type of capital is often attractive

to "asset light" businesses with good cash flows that cannot access conventional bank capital. Normally, once mezzanine investments are made the business is then able to access additional capital from banks.

- **Unitranche Financing**. Unitranche debt is a PE structure that combines senior and subordinated debt within a single loan governed under a single set of loan documents. First used in the United States in 2005, unitranche debt is considered an alternative credit market for middle-market companies that may not have easy access to large credit facilities from traditional financial services firms. This makes it an especially attractive instrument for lower-middle market companies that need flexible capital.

- **Turnaround.** Turnaround funds invest in companies that are in trouble and are often on a path to failure. If the business is not turned around and saved, then all the jobs will be lost. If the business is saved, then some of the jobs are saved and some jobs may even be created. These are turnarounds are not easy and some business cannot be saved despite additional capital a extensive help. Turnarounds are not predatory. Turnarounds save businesses and jobs.

- **Buyouts**. Buyout (or, "leveraged buyouts" or "LBO") are generally change-of-control transactions where a PE fund purchases majority control in a portfolio company using its own capital and debt that has recourse only to the target company.[4] This strategy is best fit for portfolio companies that generate adequate cash flows necessary to service the debt incurred to purchase the company. Buyouts can be used to handle generational transfers, purchase of the company by employees, purchase of the business by a private equity firm, purchase of the business by a larger business, etc. Buyouts do not mean job losses. Buyouts regularly create jobs and aid innovation with the company under new management.

- **Rural Business Investment Companies.** Commonly called "RBICs" are private equity funds that are licensed and regulated by the US Department of Agriculture and invest nearly exclusively in rural areas.

- **Small Business Investment Companies.** Commonly called "SBICs" are private equity funds that are licensed and regulated by the Small Business Administration. SBICs invest exclusively in domestic small businesses.

- **Business Development Companies.** Commonly called BDCs are a form of private equity that is regulated by the Securities and Exchange Commission. BDCs must invest at least 70%, but commonly invest 100%,

of their assets in domestic companies that have less than $250 million in enterprise value. BDCs tend to invest in small business, but larger BDCs can invest in medium-sized businesses.

Like any large industry, there are examples of failure, which get all the attention. However, the overwhelming record of private equity is positive. Private equity is a powerful force for good in our economy and for our nation.

Thank you for the opportunity to testify before the Committee and I would be happy to take questions.

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America for Sale? An Examination of the Practices of Private Funds

Committee on Financial Services
U.S. House of Representatives

November 19, 2019

Testimony Submitted by AFL-CIO

Chairwoman Waters, Ranking Member McHenry, and the Members of the Committee, thank you for the opportunity to submit this letter for the record for the hearing, "America for Sale? An Examination of the Practices of Private Funds." The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), commends the Committee on Financial Services for holding this important hearing to consider the negative impact of private equity (PE) on our economy and working people.

The AFL-CIO is America's labor federation representing 55 national and international labor unions and more than 12.5 million working people. We strive to ensure that all working people are treated fairly with decent paychecks, good benefits, safe jobs, dignity, and equal opportunities. Working people need a well-regulated financial system that supports sustainable economic growth and a fair return on our work. We oppose the predatory practices of the PE industry that jeopardize the well-being of companies and workers.

The retirement savings of working people that are invested in PE funds also need protection. Since its founding, the AFL-CIO has fought for the retirement security of working people—through advocacy for Social Security and Medicare, and through collective bargaining for pension plans with employers. Today, working people have over $15 trillion in retirement plan assets. Those of us fortunate to have retirement savings need a safe place to invest. The PE industry needs to be made more accountable and transparent to pension plan investors.

The Stop Wall Street Looting Act

We are pleased to endorse the Stop Wall Street Looting Act (the "SWLSA") (H.R. 3848) that was introduced by Representatives Pocan, Jayapal, García, Grijalva, Khanna, Lee, Pressley, Schakowsky, and Tlaib earlier this year. If enacted, the SWSLA will shut down a series of loopholes in the securities, bankruptcy and tax laws that allow a handful of Wall Street millionaires and billionaires to profit at the expense of working people. It will:

- Make PE general partners ("GPs") accountable for damages suffered by workers when their employers end up in bankruptcy after a PE firm takes over;
- Require GPs to be accountable to pension investors and provide information about what they're doing with pensioners' money; and

- Close the carried interest tax loophole, which allows GPs to pay lower federal tax rates than regular working people.

The SWSLA will close exemptions in the securities laws that allow PE firms to avoid the disclosure requirements and U.S. Securities and Exchange Commission oversight applicable to other pooled investment vehicles. Like mutual funds, PE funds are of a similar size and impact in terms of the number and relative wealth of the individuals whose retirements and job security depend on their performance.

The SWSLA will also address loopholes in our bankruptcy and tax laws. The bankruptcy laws allow GPs to load companies with debt, pay themselves dividends, and walk away without any responsibility if the company ends up in bankruptcy. PE GPs also take advantage of tax loopholes such as the carried interest tax loophole and receive tax benefits when monitoring fees, payments they receive in exchange for consulting and advisory services, are considered business expenses allowing them to lower their tax bills.

The Private Equity Investment Model

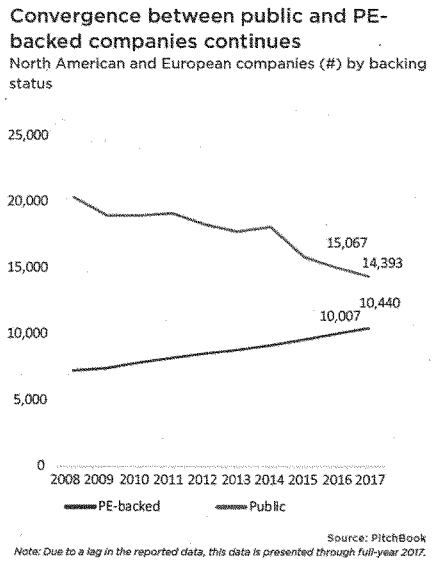
The PE investment model allows extremely wealthy GPs to take control of real economy businesses, which provide goods and services of value to the public, and extract wealth from these businesses. As a result, these PE-acquired companies are placed at greater risk of bankruptcy. This is accomplished using capital provided by outside investors, many of which are pension plans who pay exorbitant fees to the GPs for the privilege of investing.

The PE investment model is having a growing impact on the U.S. economy. Assets held by PE firms have increased from $1 trillion prior to the financial crisis to a new record of $3.1 trillion in 2017, with another $1 trillion in committed capital waiting to be invested.[1] Today, PE-owned companies employ 8.8 million American workers.[2] We have seen a decline in the number of publicly-traded companies over the last decade, while at the same time, the number of PE-backed companies has grown rapidly.

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[1] *Press Release: Private Equity Industry Grows to More Than $3tn in Assets*, Preqin, Jul. 24, 2018 *available at* http://docs.preqin.com/press/PE-Assets-Jul-18.pdf.

[2] Economic contribution of the US private equity sector in 2018, prepared by Ernst and Young for the American Investment Council, Oct. 2019, *available at* https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.



Comment by Eileen Appelbaum to FTC on Proposed Consent Agreement in the Matter of Staples/Essendant, Inc.

The term "private equity" is polite word for leveraged buyouts which gained notoriety in the 1980s. A leveraged buyout is a financing technique to acquire a company using a small amount of equity and a large amount of debt. PE GPs usually put a small amount of their own money towards the down payment, 1-3%. The remainder of the equity investment is provided by investors such as pension funds and wealthy individuals. In a typical leveraged buyout, around 30% of the purchase price is paid in as equity, and 70% is debt financing.[3]

When a PE fund acquires a company through a leveraged buyout, the acquired company is responsible for paying down the resulting loans, not the GP or its investors. Loan payments are paid out of the acquired company's earnings. If the company cannot make the payments, the PE fund is not responsible for the company's debts. It is common practice for a company that has been acquired in a leveraged buyout to take out additional loans to pay a special dividend to the acquiring PE fund in what is called a "dividend recapitalization."

Recent increases in the issuance of loans which are used to finance leveraged buyouts are raising concerns among regulators domestically and globally.[4] In the past five years, the value of

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[3] *Id.*

[4] Jim Puzzanghera, *Remember the subprime mortgage mess? $1.2 trillion in risky corporate debt is flashing similar warning signs*, LA Times, Jan. 20, 2019, *available at* https://www.latimes.com/business/la-fi-corporate-debt-risks-20190120-story.html.

outstanding leveraged loans has nearly doubled to $1.19 trillion.[5] Regulators are concerned that an economic downturn could lead to a wave of defaults.

Late last year, the Federal Reserve issued a Financial Stability Report which raised concerns about high levels of corporate debt and the increase in risky lending practices.[6] The report stated, "lenders have become more willing to extend loans with fewer credit protections to higher-risk borrowers. Moody's Loan Covenant Quality Indicator suggests that loan covenants are at their weakest levels since the index began in 2012..." [7]

The growth of leveraged lending market also poses systemic risks to our economy. In October 2018, Former Federal Reserve Chair Janet Yellen raised concerns, explaining that "I am worried about the systemic risks associated with these loans...There has been a huge deterioration in standards; covenants have been loosened in leveraged lending."[8]

Private Equity and Working People

The debt-servicing burden that a leveraged buyout imposes on a PE-acquired company often forces the company to forego investments that would make the company more competitive. PE industry observers are concerned that this investment strategy can result in lower wages and benefits for working people. PE acquired companies are also at greater risk of bankruptcy and layoffs. One analyst has concluded that more than 60% of the lost retail jobs between 2016 and 2017 -- around 130,000 jobs -- were at companies owned by PE firms.
[9] Below are three examples of how PE firms have destroyed jobs through leveraged buyouts.

1. Caesars Entertainment Corporation

The casino company Caesars Entertainment Corporation (formerly Harrah's Entertainment), was purchased by PE firms Apollo and TPG in a 2008 leveraged buyout that was financed using $23 billion of debt.[10] The company then conducted a series of financial engineering maneuver, culminating in a complicated bankruptcy and an asset sale.[11]

Under Apollo and TPG, Caesars made dramatic cuts to investments in its properties and its workforce. Before the leveraged buyout, Caesars spent $2.5 billion in 2006, $1.5 billion in 2007,

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[5] *Id.* See also *Risk-off shift brings banks back to leveraged loan market,* S&P Global Market Intelligence, Apr. 8, 2019, *available at* https://www.spglobal.com/marketintelligence/en/news-insights/trending/eCZ7eZ4RH8dpwSArc_UCbQ2.
[6] Board of Governors of the Federal Reserve System, *Financial Stability Report,* Nov. 2018, *available at* https://www.federalreserve.gov/publications/files/financial-stability-report-201811.pdf.
[7] *Id at 12.*
[8] Sam Felming, *Janet Yellen sounds alarm over plunging loan standards*, Financial Times, Oct. 25, 2018 *available at* https://www.ft.com/content/04352e76-d792-11e8-a854-33d6f82e62f8.
[9] Steve LeVine, *Vulture capitalists are killing off retail jobs*, Axios, Jan. 10, 2018 *available at* https://www.axios.com/private-equity-1515603080-efd39541-a9fb-474b-8c24-04623ee518fd.html.
[10] Gretchen Morgenson, *Caesars' Debt: A Game of Dealer's Choice*, NY Times, Sep. 13, 2014, *available at* https://www.nytimes.com/2014/09/14/business/caesars-debt-a-game-of-dealers-choice.html.
[11] Sujeet Indap, *What happens in Vegas . . . the messy bankruptcy of Caesars Entertainment*, Financial Times, Sep. 26, 2017, *available at* https://www.ft.com/content/a0ed27c6-a2d4-11e7-b797-b61809486fe2.

and $1.8 billion in 2008, or an average of $1.7 billion per year on capital expenditures to renovate and build new properties.[12] Between 2009 and 2016, under the Wall Street firms' management, Caesars spent just $3.7 billion or an average of $0.46 billion per year, about 25% of the pre-buyout average annual capital expenditure.[13] And, from 2006 to 2018, Caesars nationally shed 24% of its workforce, going from 85,000 employees[14] to 66,000.[15]

2. The Supermarket Industry

Economist Eileen Appelbaum and Professor Rosemary Batt recently compared the performance of supermarket chains owned by PE firms to those with other ownership structures.[16] Their research shows that the PE investment model leads to riskier capital structures at portfolio companies.

This leverage in turn makes it more difficult for companies to withstand outside pressures - whether from an economic downturn or from changing consumer preferences and technology - and can lead to worse outcomes for employees.

Since 2015, seven major supermarket chains have filed for bankruptcy. These companies employed a combined total of more than 125,000 workers. Some of the blame for these supermarket bankruptcies can be placed on competition from competitors like Walmart and Whole Foods (now owned by Amazon). Another significant factor, however, was the financial engineering of the PE firms who were behind all seven bankruptcies.[17]

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[12] Harrah's Entertainment, Inc., Annual Report (Form 10-K), at 35 (March 17, 2009). *Available at* https://www.sec.gov/Archives/edgar/data/858339/000119312509055861/d10k.htm.

[13] Caesars Entertainment Corporation, Annual Report (Form 10-K), at 47 (Feb. 15, 2017). *Available at* https://www.sec.gov/Archives/edgar/data/858339/000085833917000039/a2016q4cecform10-k.htm; Caesars Entertainment Corporation, Annual Report (Form 10-K), at 51 (March 17, 2014). *Available at* https://www.sec.gov/Archives/edgar/data/858339/000085833914000014/a201310-k.htm; Caesars Entertainment Corporation, Annual Report (Form 10-K), at 38 (March 4, 2011). *Available at* https://www.sec.gov/Archives/edgar/data/858339/000119312511056393/d10k.htm.

[14] Harrah's Entertainment, Inc., Annual Report (Form 10-K), at 8 (March 1, 2007). *Available at* https://www.sec.gov/Archives/edgar/data/858339/000119312507044315/d10k.htm

[15] Caesars Entertainment Corporation, Annual Report (Form 10-K), at 8 (Feb. 22, 2019). *Available at* https://www.sec.gov/ix?doc=/Archives/edgar/data/858339/000085833919000015/a2018q4cecform10-k.htm

[16] Rosemary Batt and Eileen Appelbaum, Private Equity Pillage: Grocery Stores and Workers At Risk, American Prospect, Oct. 26, 2018 *available at* https://prospect.org/article/private-equity-pillage-grocery-stores-and-workers-risk.

[17] *Id.*

PRIVATE EQUITY–BACKED CHAINS THAT WENT BANKRUPT

GROCERY CHAIN	P.E. SPONSORS	NUMBER OF STORES	NUMBER OF EMPLOYEES	BANKRUPTCY DATE
A&P (Food Basics, Food Emporium, Pathmark, Super Fresh, Waldbaum's)	Yucaipa Partners	296	28,500	July 2015
Fairway Market	Sterling Investment Partners	15	4,000	May 2016
Fresh & Easy	Yucaipa Partners	150	4,000	Oct. 2015
Haggen Food Grocery Store	Comvest Group	164	10,000	Sep. 2015
Marsh Supermarkets	Sun Capital	116	14,000	May 2017
Southeastern Grocers (Bi-LO, Bruno's, Fresco y Más, Harveys, Winn-Dixie)	Lone Star Funds	>730	>50,000	Mar. 2009, Mar. 2018
Tops Markets LLC	Morgan Stanley	170	14,800	Feb. 2018

Batt & Appelbaum, Private Equity Pillage: Grocery Stores and Workers at Risk

Appelbaum and Batt found that, "private equity owners have extracted millions from grocery stores in the last five years—funds that could have been used to upgrade stores, enhance products and services, and invest in employee training and higher wages."[18] These companies struggled to pay down excessive debt, and ultimately filed for bankruptcy that left workers, suppliers, and other creditors getting the short end of the stick. Employees were thrown out of work and forced to take cuts to their retirement benefits. [19]

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[18] *Id.*

[19] *Id.*

In September 2015 Haggen, Inc, a west coast grocery chain owned by Comvest Partners, declared bankruptcy after a failed expansion. According to Applebaum and Batt:

> Workers, vendors, suppliers, and landlords were losers in this story, but not Comvest... At the time that the P.E. firm agreed to buy the 146 stores, securities filings show it also reached a deal to sell the real estate underlying 20 of the new store locations for $224 million—and lease them back under a sale-leaseback agreement. It later engaged in sale-leaseback transactions for additional stores—for a total of 39 stores. Through these sales, Haggen made an estimated total of $300 million according to regulatory filings and real-estate documents—roughly equal to what it paid for the 146 stores... The unsecured creditors meanwhile—mainly laid-off workers, suppliers, and landlords—were owed roughly $100 million.

And in February 2018 Tops Markets declared bankruptcy:

> The northeastern chain of 170 grocery stores was bought out by Morgan Stanley Private Equity and Graycliff Partners in an LBO worth $310 million in 2007. Morgan Stanley pursued a number of LBO add-ons between 2007 and 2012, and then financed the buyout of the company, including all of its debt, by Tops management in December 2013. By that time, Morgan Stanley had loaded the company with $724 million in debt—more than twice the original purchase price. That included some $377 million in dividends that Morgan Stanley paid to itself and its investors—equal to 55 percent of the total debt that had accrued. This does not include advisory fees charged by Morgan Stanley nor the future interest payments that Tops had to shoulder...
>
> [T]he debt overhang left Tops with little wiggle room to reduce prices or resources to invest in store upgrades, new products, and online services needed to be competitive, as it reported itself in its bankruptcy filing. At the time of the bankruptcy, it had 14,800 employees... The company used the bankruptcy process to substantially reduce the pension

3. Toys 'R' Us

Toys 'R' Us is another example of a PE-owned company that ended up in bankruptcy. The iconic toy store was purchased by a consortium of PE firms in 2005 for $6.6 billion. Before it was acquired by PE, Toys 'R' Us had $1.86 billion in debt. As a result of the leveraged buyout, Toys 'R' Us was saddled with $5 billion in debt. The company filed for bankruptcy in 2018 despite having $11 billion in annual sales.[20] When the company was ultimately liquidated in bankruptcy, it left 31,000 employees out of work.[21]

Toys 'R' Us' PE owners have blamed its failure on competition from online retail providers, like Amazon, and other market forces. Multiple analysts, however, have said the blame rests to a very substantial degree with the company's unsustainable debt and warned that other retail chains could fail in a similar manner due to highly leveraged PE investments.[22]

Private Equity and Pension Investments

On average, pension plans in the U.S. have allocated 8.6% of their portfolios to PE.[23] In many situations, pension plans are under pressure to make up for insufficient employer contributions. To make up for these shortfalls, pension plans chase riskier investments that could produce greater returns. PE funds advertise that they have the ability to provide those returns. Unfortunately, the opacity, illiquidity and high fees associated with PE add to the risks of the investment and the difficulty in achieving returns sufficient to justify those risks.

A lack of transparency makes it difficult for investors to analyze the accuracy of claims that PE funds outperform other asset classes. The internal rate of return methodology that PE funds have traditionally used to report their performance has come under criticism by Warren Buffet and others for inflating returns.[24] The CFA Institute has explained that typical methods for comparing performance "work well (at least from a statistical perspective) only for those instruments that are publicly traded and are highly liquid. This is a major problem for private equity (PE) investments as they are not only 'private' and illiquid but also exhibit serious smoothing issues because of subjective appraisals and valuation lags."[25]

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benefits for [employees] by withdrawing from [union] defined benefit pension plans and replacing them with 401(k) plans.

[20] Jessica DiNapoli and Tracy Rucinski, *How $5 billion of debt caught up with Toys 'R' Us*, Reuters, Sept. 17, 2017 *available at* https://www.reuters.com/article/us-toys-r-us-bankruptcy-timeline/how-5-billion-of-debt-caught-up-with-toys-r-us-idUSKCN1BV0FQ.

[21] Chris Isidore, *31,000 Toys 'R' Us employees: No job and no severance*, CNN, Mar. 16, 2018 *available at* https://money.cnn.com/2018/03/16/news/companies/toys-r-us-employees/index.html.

[22] Dave Dayen, The Cause and Consequences of the Retail Apocalypse, The New Republic, Nov. 14, 2017 *available at* https://newrepublic.com/article/145813/cause-consequences-retail-apocalypse.

[23] American Investment Council, Public Pension Study, May 2018 *available at* https://www.investmentcouncil.org/wp-content/uploads/2018-public-pension-study-final3.pdf.

[24] Hema Parmar and Sonali Basak, *Private Equity's Returns Questioned, This Time by Buffett*, Bloomberg, May 5, 2019, *available at* https://www.bloomberg.com/news/articles/2019-05-05/private-equity-s-returns-questioned-again-this-time-by-buffett.

[25] Prasad Ramani, *Evaluating Private Equity Performance: PME vs. Direct Alpha*, Enterprising Investor, CFA Institute, Jul. 23, 2014 *available at* http://blogs.cfainstitute.org/investor/2014/07/23/evaluating-private-equity-performance-pme-vs-direct-alpha/.

In December 2018, the CFA Institute published a report titled "Private Equity: The Emperor Has No Clothes" that examined different models of private equity returns. It concluded that "Exposure to small caps likely explains private equity returns. Liquid alternatives to private equity can be created simply by buying small, cheap, and levered stocks… [Locked-up capital] keeps investors from redeeming their funds at market lows and helps private equity firms weather storms like the global financial crisis. But the same fund structure can be replicated through public equities at a fraction of private equity fees."[26]

Investment management fees are also a major problem for PE investors. Compared with other asset classes, PE funds charge high fees that take away from investors' returns. The typical fee structure, known as "2 and 20," means that the PE fund manager receives 2% annually of the total amount of assets under management plus 20% of the return on any investment. These high fees enrich GPs while weighing down the investment returns of PE investors.

PE investments are also illiquid, and therefore pose greater risks for investors. The average life of a fund is 10 to 13 years.[27] The secondary market for interests in PE funds is very limited. The total transaction volume in the secondary market in 2018 was estimated at $72 billion.[28] To put that in perspective the industry has around $4.1 trillion in committed capital – less than a 2% turnover rate.[29] Once an investor buys into a fund, it is very difficult to get out before the fund sells off all the companies in the portfolio.

The Dodd-Frank Act required PE fund managers to register with the SEC and to submit to periodic examinations. After the first round of exams, the then SEC Director of the Office of Compliance Inspections and Examinations Andrew Bowden revealed that extensive abuses had been uncovered. Bowden said in a 2014 speech, "When we have examined how fees and expenses are handled by advisers to private equity funds, we have identified what we believe are violations of law or material weaknesses in controls over 50% of the time."[30] The minimal reporting and examination requirements instituted by the Dodd-Frank Act revealed an industry where abusive practices towards investors were common practice.

Conclusion

Private equity has grown from a niche industry into a tremendous and dark force in the U.S. economy and the lives of millions of working people. Except for the GPs who profit from the PE investment model, the impact PE has on the lives it touches is often a harmful one. There is no

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[26] Nicolas Rabener, *Private Equity: The Emperor Has No Clothes, Enterprising Investor*, CFA Institute, Dec. 3, 2018 *available at* https://blogs.cfainstitute.org/investor/2018/12/03/private-equity-the-emperor-has-no-clothes/ .

[27] Robert Harris, Tim Jenkinson and Steve Kaplan, *Private Equity Performance: What Do We Know? Available at* http://faculty.chicagobooth.edu/steven.kaplan/research/kpe.pdf

[28] Coller Capital, *The Private Equity Secondary Market*, Coller Capital Ltd. 2019 *available at* https://www.collercapital.com/sites/default/files/Coller%20Capital%20%E2%80%93%20the%20private%20equity%20secondary%20market_0.pdf.

[29] *Press Release: Private Equity Industry Grows to More Than $3tn in Assets*, Preqin, Jul. 24, 2018 *available at* http://docs.preqin.com/press/PE-Assets-Jul-18.pdf.

[30] Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, Spreading Sunshine in Private Equity, May 6, 214 *available at* https://www.sec.gov/news/speech/2014--spch05062014ab.html.

public interest reason to allow the PE industry to continue carrying on business as usual.

PE executives should pay their fair share in taxes. They should share in the losses as well as the gains of their investments. PE should not be allowed to suck value out of viable businesses and leave workers, pensioners, and communities to deal with the repercussions. And, when PE invests other people's money, the GPs should be required to act in those people's best interests and provide honest information about what they're doing.

This is what the Stop Wall Street Looting Act will do if it is enacted. For too long, public policy has failed to grapple with the abuses of the PE industry. The SWSLA will remedy market failures by aligning the incentives of PE executives with companies, workers, and society as a whole. For these reasons, we strongly support enactment of the SWSLA.

AFR Americans for Financial Reform

America for Sale? An Examination of the Practices of Private Funds

Committee on Financial Services
U.S. House of Representatives

November 19, 2019

Testimony Submitted by Americans for Financial Reform

The private equity industry controls a large and growing portion of the economy, including businesses and other assets like housing, that workers and consumers rely upon for jobs, goods and services. It has increased in size eight-fold over the past two decades from $700 billion in global assets in 2000 to $5.8 trillion in 2018.[1] Today, the private equity industry controls 8,000 companies in the United States, more than twice as many companies as are publicly traded on U.S. stock markets.[2]

The business model followed by the dominant private equity firms today is fundamentally predatory and extractive. Current law permits and even encourages private equity firms to be structured in such a way that the general partners – the key individuals controlling the fund and holding decision making power over portfolio firms owned by the private equity fund — rewarded for maximizing immediate returns to themselves, and shielded from liability, accountability, and transparency for the decisions they make. They take advantage of this privileged position to extract value from portfolio firms, as well as limited partner outside investors.

A major mechanism of value extraction is the use of debt. This begins with the leveraged buyout transaction in which the target firm is acquired for the private equity owner's portfolio. These LBO transactions are funded with high proportions of debt, with the target firm used as collateral. The acquired firm – but not the private equity fund which is the beneficiary of the transaction – is responsible for repayment of the acquisition debt. All too often the portfolio firm emerges from the LBO with crushing levels of debt that force layoffs and prevent it from investing in its future due to the burden of debt repayment. Even in cases where an unsustainable debt burden created by private equity acquisition forces bankruptcy, those harmed by the failure of the firm have no recourse to the private equity owner. The debt excesses of private equity have driven levels of high-risk corporate debt to record levels, creating risks to the broader economy and the financial system.

Once the private equity firm owns the portfolio company, it is able to use its managerial control to extract value from the firm and its customers in other ways. There is a repeated record, across multiple industries, of private equity owned firms and their owners taking advantage of legal and regulatory loopholes, or simply defying authorities to enforce limits on exploitative business

[1] Elvin, Christopher. Preqin. "Private Equity Update." KPMG Private Equity Forum. November 2016 at 5; Preqin. "Private Equity Spotlight." Vol. 14, Iss. 1. January 2018 at 7; McKinsey & Company. "Private Markets Come of Age." 2019 at 15.
[2] Parmer, Hema and Jason Kelly. "The returns are spectacular. But there are catches." *Businessweek*. October 3, 2019.

practices, in order to maximize short run profits for the fund at the expense of worker and customer well-being. These extractive practices include simply forcing portfolio firms to pay unnecessary fees or charges to the private equity owner, or siphoning value out of the portfolio firms through arrangements like the sale and lease back of the sites where they do business. They also include creating monopolies or oligopolies by purchasing multiple firms in the same field, so that customers can be squeezed for monopoly profits. Private equity owned firms also exploit customers who have limited recourse in order to maximize their profits, such as taking advantage of tenants in private equity owned real estate, or extreme cost cutting in private equity owned health care companies that endanger the health of patients.

Even when the long-term viability of the portfolio firm is damaged by these practices, or the firm goes bankrupt, private equity owners have generally extracted enough value to ensure their own profit on the transaction. Since the private equity insiders generally do not have financial or personal liability for the debt owed or legal judgements against their portfolio firms, they can take these steps with relative impunity, so long as they have made back their own small equity investment in the deal.

Private equity firms claim to make their money by improving the operations, capacity, and business strategy of the companies they acquire. Some PE firms or transactions actually do this. But as documented in the testimony below, all too often the profits of private equity come not from genuinely improving the management of the portfolio firm but through predatory actions that create long-run damage for the workers, community, and customers of that firm.

Private equity firms also claim that their returns produce benefits for the broader investor public through the sharing of returns with limited partner investors, including union and other public pension funds. But their promises often rely on manipulated or misleading numbers, in addition to often resting on activities that will harm the medium and long-term interests of their own outside investors as well as other stakeholders in portfolio companies. Private equity firms benefit from favorable treatment and exemptions under the securities laws, which allow them to raise funds from outside investors without disclosing reliable data on their returns, fees and costs, or activities.

This testimony documents and shines a spotlight on some of the abusive practices of private equity. These include destroying retail jobs, saddling people with unmanageable medical bills through surprise billing, gouging students at for-profit colleges that fail to provide an adequate education, exacerbating the affordable housing crisis by buying up single-family houses, apartment buildings, and manufactured home communities after the financial crisis and raising rents and harassing tenants. We describe how private equity actions threaten the well-being of workers, consumers, investors, and communities, and how the measures taken by private equity to finance their activities threaten the integrity of debt markets. Private equity extraction is contributing to growing inequality and to increasing economic hardship and vulnerability for millions of Americans.

This testimony also describes and analyzes a critical legislative response to the issues in the private equity business model, the Pocan-Jayapal Stop Wall Street Looting Act (SWSLA, HR 3848). This legislation directly attacks the perverse incentives that reward predatory practices by private equity general partners. By closing loopholes and making fundamental changes in legal liability for private equity general partners, it would curb the excesses of private equity insiders, without affecting productive partnerships that genuinely assist portfolio firms. Critically, the SWSLA is designed to

address the incentives faced by the general partners of the private equity firm, and is aimed squarely at ending the power of private equity insiders to engage in behavior that exploits and harms portfolio firms and limited partners, and at strengthening workers, investors, and other stakeholders in dealing with PE We urge Congress to stand up for working people and for communities, patients and consumers, and enact the Stop Wall Street Looting Act.

I. The Growing Private Equity Industry

The private equity industry has an outsize influence on today's economy. Private equity (PE) funds control $5.8 trillion in global assets, including over 8,000 U.S. businesses with millions of employees. The PE industry owns hospitals, residential houses, restaurants, retailers, manufacturers, tech firms, for-profit colleges, payday lenders, and much, much more. Private equity is behind private corrections and prison services, bail bonds, electronic monitoring, and even prison hospitals as well as funding private migrant detention facilities that generate profits by disproportionately harm people of color.[3] And private equity is a major funder of fossil fuel extraction, transportation, and power production, worsening the climate crisis.[4]

Private equity firms are Wall Street investment companies that pool large volumes of private capital to buy companies, real estate, natural resources, and other assets. PE funds operate in their own private market — the companies and assets are privately owned by the PE firms, with values, earnings, and corporate information hidden from public view.[5] The investors include wealthy families, sovereign wealth funds, pension funds, endowments, and other institutional investors.

The PE firms recruit investors to put money into specific funds that then invest in assets (sometimes specialized into a single industry, like health care). These investors generally are required to keep their investments in the private equity fund for the entirety of its ten-year (or more) duration. The institutional investors are limited partners in the fund and the private equity managers are the general partners: the investors commit the funds that make up the majority of the equity stake and agree to pay a management fee and the PE firm manages the fund, determines which assets to buy, manages the portfolio, and controls the portfolio companies.[6]

The majority of the private funds go into corporate takeovers that buy publicly traded or private companies. Theoretically, the private equity firms share their capital and managerial expertise to strengthen the performance of the target firm and deliver higher earnings and profits.[7] Target firms include publicly traded or privately held companies that the PE firm thinks are undervalued, poorly performing, undercapitalized, or capable of becoming more profitable.[8] The PE firms control and

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[3] Burke, Garance and Martha Mendoza. "Trump admin shifting to privatize migrant child detention." *Associated Press.* October 3, 2019; Private Equity Stakeholder Project. "Continuing Incarceration: Apax Partners' Digital Shackles." October 2019; Private Equity Stakeholder Project. [Fact sheet]. "Private Equity-Owned Firms Dominate Prison and Detention Services." December 2018; McLeod, Marsha. "The private option." *The Atlantic.* September 12, 2019.

[4] Seidman, Derek and Donald Shaw. Public Accountability. "Presidential Candidates Take Money from Major Fossil Fuel Investors." September 9, 2019.

[5] Kelly, Jason. "Everything is private equity now." *Businessweek.* October 3, 2019.

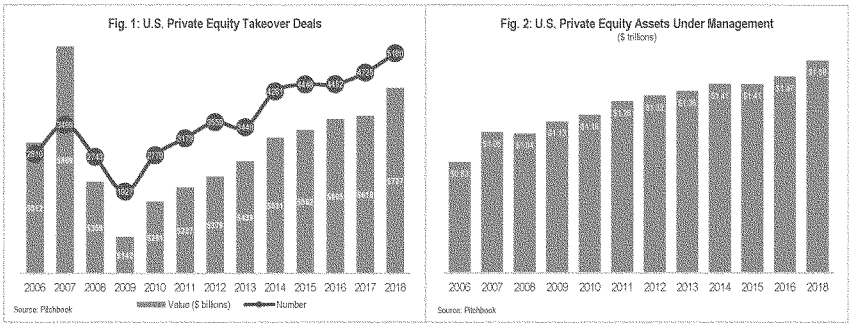
[6] Applebaum, Eileen and Rosemary Batt. Center for Economic and Policy Research. "A Primer on Private Equity at Work." February 2012 at 11.

[7] *Ibid.* at 2; Kelly (2019, "Everything is private equity now").

[8] Kelly, Jason. "The magic formula is leverage…and fees." *Businessweek.* October 3, 2019.

manage the target portfolio companies for a few years and either launch it as a public company through an initial public offering (IPO) or sell it to another firm.

Private equity takeover funds have been rapidly buying up U.S companies for the past decade. The number of deals, the scale of the investments, and the average size of the deals has soared (see Figure 1). As a result of the surge of deals, private equity owns a bigger stake in the U.S. economic landscape.[9] U.S. private equity assets under management (essentially a measure of the scale of PE-owned companies) has grown by $455 billion (or 40 percent) over the past decade from $1.13 trillion in 2009 to $1.58 trillion in 2018 (see Figure 2).[10]



Private equity has grown in the low interest rate environment during a bullish stock market that buoyed corporate values — the same conditions that led to the PE boom before the global financial crisis (and its subsequent bust). Importantly, while dealmaking slowed down in the immediate aftermath of the financial crisis, private equity's ownership stake in the U.S. economy grew steadily throughout the Great Recession.

Some of the "assets under management" are not companies, but committed investor funds that the private equity firms have not yet deployed in takeover deals. These committed but unused funding remains available as "dry powder." The global pool of dry powder reached a record $2.5 trillion by the summer of 2019, and private equity firms continued to raise money for even more funds as they searched for takeover targets.[11] Large pools of dry powder can increase the pressure on PE firms to buy assets even at high multiples of valuation, essentially overpaying for assets, which will in turn hinder long-term returns.[12] The ballooning dry powder has pushed PE firms to pursue more

[9] Linley, Graham. Pitchbook. "Here are 9 charts that describe the US private equity industry in 2Q." July 22, 2019.
[10] Black, Garrett James. Pitchbook. "The current US Private equity scene in 11 charts." August 1, 2017; Stanford, Kyle. Pitchbook. "A 17-chart breakdown of the US PE industry." June 6, 2017; Pitchbook. "Private Markets: A Decade of Growth." July 19, 2019 at 5 and 6. 2018 figure derived from global assets under management based on share of U.S. investments and share of private equity.
[11] Espinoza, Javier and Eric Platt. "Private equity races to spend record $2.5tn cash pile." *Financial Times*. June 27, 2019.
[12] Applebaum and Batt (2012) at 2.

aggressive takeovers — higher prices, more leverage, and bigger deals.[13] Moreover, dry powder represents potentially investible capital that is parked on the economic sidelines while PE firms decide what investment strategies and takeover targets to pursue.

Dry powder can be expensive for PE investors like pension funds. PE firms do not access committed funds until they are used to make a purchase, but institutional investors are required to park the money in easily accessible — and usually low yield — investments. The committed but undeployed fundraising constitutes a portion of a fund's dry powder.[14] But investors nonetheless must pay management fees on these dry-powder funds, meaning they are paying management fees on these sums even though the dry-powder funds are not being actually managed by the PE firms.

II. Predatory Practices and Financial Engineering by the Private Equity

The earnings and performance of private equity firms are generally not derived from superior management but from financial engineering that generates income for the PE executives but does not strengthen the takeover targets. The PE firm takes control of the company, often imposing severe cost-cutting measures and layoffs.[15] Private equity firms promise quick 20 to 25 percent profits which can often only be achieved by extracting value from the firm, not improving its long term productivity.

The economic benefits flow significantly to the general partners in fees, disbursements, and profit sharing. Limited partners (PE investors) gain if the portfolio assets are sold for more than the acquisition price, but they lose all or a portion of their equity stake if portfolio companies are liquidated or enter bankruptcy.

The PE firms have distorted incentives to engage in financial engineering and excessive risk taking. Because the private equity owner is largely shielded from downside risks that may fall on workers and customers of portfolio firms, it has an incentive to take actions that effectively transfer value from the firm to the private equity owner, even at the cost of the long-term productivity or sustainability of the target firm. Below, we describe several ways in which this occurs.

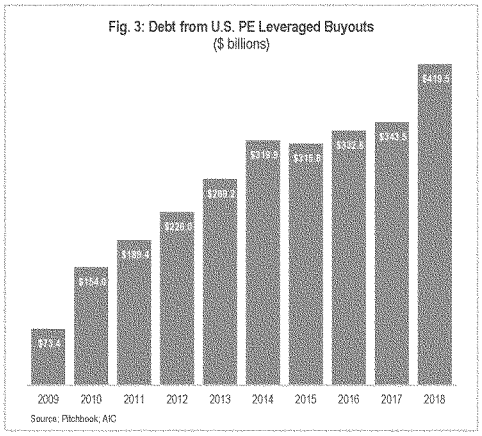
First, the leveraged buyouts load target firms with debt that diminishes their resiliency and capacity to respond to market shifts, and can drive them into bankruptcy. Second, the PE firms extract substantial value from target firms through excessive fees, dividends, real estate lease backs and other tactics. Third, private equity firms take advantage of tax loopholes, create complex corporate structures to sidestep corporate responsibility, and are a major force behind the current wave of merger mania that is rapidly consolidating the U.S. economy.

A. Private equity leveraged buyouts threaten target firms and the economy

Private equity investments rely on substantial amounts of debt financing to take over companies. This shifts the risk of the takeover to the target company and the benefits to the PE buyer. These leveraged buyouts are the "core of the business," according to *Businessweek*.[16] Target firms that

[13] Espinoza and Platt (2019).
[14] Applebaum and Batt (2012) at 1
[15] Kelly (2019, "The magic formula is leverage…and fees").
[16] *Ibid.*

prosper deliver outsized returns for PE firms when they are sold, because their small equity stake is multiplied when the portfolio is sold for more than it cost to takeover. But if the higher debt loads drive the portfolio firm into bankruptcy, the PE firm only loses its small initial equity investment (and institutional investors lose their comparatively larger equity stake); the target firm is solely responsible for repaying the debt imposed on it by its PE owner, which increases the risk of bankruptcy. The quick exit window means that PE managers are unconcerned about the imposed debt loads that can continue to burden the firms for years after the PE firm has exited.



The private equity firms have largely walked away unscathed, but there are all-too-frequent real and devastating impacts of the private equity leveraged buyout gamble. There have been a host of high-profile PE-driven bankruptcies in recent years, including retailers like Sears and Toys "R" Us, mining company Blackjewel, and Hahnemann Hospital in Philadelphia. These catastrophic collapses have harmed workers and communities.

Looming leveraged buyouts: Funds buy assets with the investors' money and a considerable amount of debt. Private equity firms generally pay a tiny portion of the purchase price to takeover target companies, meaning they have little invested in the financial future of the portfolio company. The PE firms pony up about 2 percent of the purchase price, the investors put in the rest of the equity, and the remainder is typically debt financing.[17]

These leveraged-buyouts (LBOs) are like investors that flip a house for profit. The PE firm buys the target company with a small equity down payment and borrows the rest of the purchase price, like getting a mortgage on a house that you intended to improve and resell. Unlike a mortgage, the target company must borrow to finance its own takeover and service the debt (sort of like the house repaying the mortgage).[18] If the PE deal is successful, when the PE firm sells the company or launches an initial public offering, it keeps the profits (the price appreciation since the takeover) and repays the debt. The debt makes the deal much more profitable.

[17] Slavkin Corzo, Heather. Testimony before the House Financial Services Committee, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets. U.S. House of Representatives. Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers. May 15, 2019 at 13.
[18] Applebaum and Batt (2012) at 1.

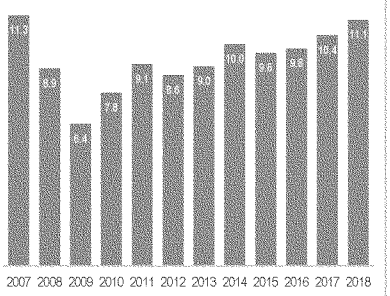
Over the past five years, the PE leveraged buyout deals have relied an average of 60 percent debt financing.[19] Many of these deals have had much higher leverage. The 2008 PE-backed leveraged buyout of Harrah's Entertainment (now Caesars Entertainment) was financed with $23 billion in debt – making the $31 billion deal over 75 percent leveraged (it collapsed in bankruptcy).[20] The 2006 KKR and Bain Capital $21 billion takeover of hospital chain HCA included $16 billion of debt, making it 76 percent leveraged.[21]

And as deal volume has grown, the total debt load from these leverage buyouts has ballooned as well. Over the past decade, debt from U.S. PE leveraged buyouts has grown nearly six-fold, from $73 billion in 2009 to $419 billion in 2018 (see Figure 3).[22]

The highly leveraged and indebted target firms are at risk of substantial financial distress if their earnings are insufficient to service their debt payments that can lead to bankruptcy and liquidation.[23] These risks are more pronounced during periods of slow or moderate growth or economic downturns, similar to the current conditions and economic forecasts given trade tensions and corporate debt loads. In 2019, there were 99 private equity-owned firms with distressed credit ratings that had a significant chance of defaulting on their debt.[24]

The debt from the LBO and any dividend recapture stays on the books of the portfolio firm, not the private equity firm that required the company to take out the loans. The target companies are responsible for making the debt payments out of the business earnings. The debt burden can make it harder or impossible for the target company to invest in the business to increase productivity, competitiveness, sales, or increase compensation for workers to provide family sustaining wages or benefits.

Fig. 4: PE Takeover Valuation Multiples



Source: purchase price/EBITDA; McKinsey 2019

High purchase premiums increase debt loads and leverage: PE firms are paying an increasing premium for target companies. Since 2009, the PE purchase price versus performance multiple (earnings before income taxes, debt, and amortization, or EBITDA), has risen by 73 percent (see

[19] American Investment Council (AIC). "Private equity trends 2019 Q1: Private equity firms continue to raise significant capital." 2019.
[20] Indap, Sujeet. "What happens Vegas ... the messy bankruptcy of Caesars Entertainment." *Financial Times.* September 26, 2017; Morgenson, Gretchen. "Caesars" debt: A game of dealer's choice." *New York Times.* September 13, 2014.
[21] "HCA agrees to $21 billion buyout." *CNN* July 24, 2006; Creswell, Julie and Reed Abelson. "A giant hospital chain is blazing a profit trail." *New York Times.* August 14, 2012.
[22] AIC (2019, "Private Equity Trends 2019 Q1"); Linley (2019). Debt load calculated by debt percentage for leveraged buyouts (AIC) multiplied by deal volume (Linley, Pitchbook).
[23] Applebaum and Batt (2012) at 2.
[24] Rodriquez Valladares, Mayra. "Distressed credit ratings for private-equity-backed companies have risen significantly." *Forbes.* October 22, 2019.

Figure 4).[25] In 2018, PE firms paid more than 11 times target firm's financial performance — approaching multiples not seen since before the financial crisis.

Higher purchase multiples may affect the financial returns for PE firms and their investors. First, these higher prices mean that the takeovers require more leverage and higher debt loads, leaving the target portfolio firm with a larger loan payment that could threaten performance. Secondly, it may be harder for PE firms to profitably sell assets that were purchased at high price premiums; if the purchase price was overvalued it would require higher exit prices to get promised returns.

B. The impact of private equity debt on the macro economy and financial system

The large number of private equity leveraged buyouts, their increasing leverage levels, and the borrowing used to finance them have been at the heart of a rapid growth in high-risk corporate debt. The volume of loans outstanding to companies that are already highly leveraged compared to their cash flow, often referred to as "leveraged loans," has doubled in size since 2007, to at least $1.2 trillion. Corporate sector debt is now at a record level as a proportion of the economy (gross domestic product or GDP). This increase in high-risk debt has repeatedly been singled out by analysts and regulators as a threat to the economy. For example, the last three financial stability reports by the Federal Reserve Board have all highlighted leveraged business debt as a key economic vulnerability.[26]

There is no question that private equity activity is at the heart of the growth in leveraged lending. The International Monetary Fund found that globally over half of leveraged lending in 2018 was acquisition-related.[27] In 2019, private equity portfolio firms were responsible for over half of U.S. leveraged lending.[28] And the private equity business model is built on taking advantage of the tax and other incentives that reward high levels of leverage.

High levels of leveraged lending pose several macroeconomic threats. First, they are likely to amplify the next recessionary downturn.[29] Current levels of leveraged lending mean that corporations will enter the next economic downturn with an unprecedented level of business debt. When companies experience a decline in their cash flow due to the recession some will become unable to service such elevated levels of debt and either lay off workers or go bankrupt. As documented elsewhere in this paper, we are already seeing this occur to private equity owned companies even without a broad economic downturn. Second, high levels of defaults on leveraged loans could contribute to the instability of the financial system due to losses experienced by banks and investors, in something like the way that high levels of foreclosures on mortgages stressed the financial system in 2008.

There is some uncertainty around this second point on the effects of leveraged lending on the stability of the financial sector. Some banks and regulators have argued that banks themselves are not exposed to losses due to leveraged loans, as most of these loans are sold on to other non-bank

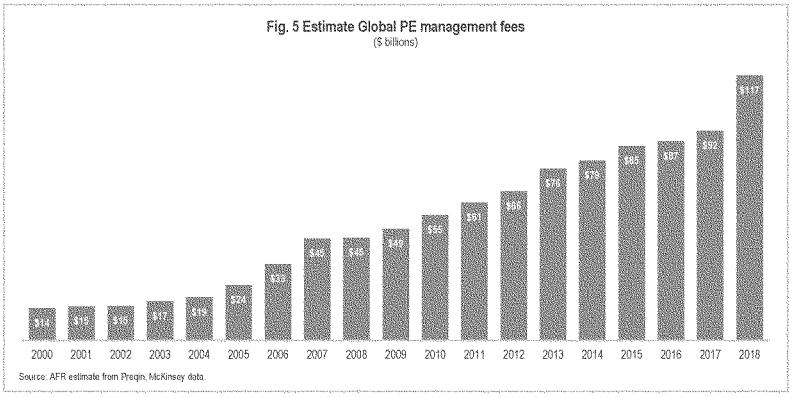
[25] McKinsey & Company (2019) at 23.
[26] Board of Governors, Federal Reserve System. "Financial Stability Report," 2019 and prior years.
[27] Adrian, Tobias, Fabio Natalucci, and Thomas Piontek. International Monetary Fund. [Blog]. "Sounding the Alarm on Leveraged Lending." November 15, 2018.
[28] Rodriquez Valladares (2019).
[29] Kaplan, Robert. Federal Reserve Bank of Dallas. "Corporate Debt as a Potential Amplifier in a Slowdown." March 5, 2019.

investors. High-risk leveraged loans are often repackaged into securitized products known as collateralized loan obligations (CLOs), which are sold to insurance companies, institutional investors, and investment funds. If there are substantial losses on these securitized products, such losses could occur at pension funds and insurance companies. While this would cause significant losses to retirement savings, these institutions are not as critical to credit intermediation as banks.

However, this is very similar to arguments made prior to the 2008 financial crisis concerning subprime mortgages and mortgage backed securities. Prior to the crisis banks also argued that losses on subprime mortgages and securitizations would fall on outside investors that were not critical to the financial system. But subprime mortgage defaults and the associated shutdown of securitization markets used to sell these loans did produce dramatic stresses on banks and the entire financial system. Banks turned out to have substantial inventories of unsold loans and to be more vulnerable to securitization losses than observers predicted. Non-banks such as the insurance company AIG which were exposed to credit risk turned out to be critical to credit intermediation. Large-scale defaults on leveraged loans and the shutdown of CLO markets could have similar unexpected impacts on the financial system and could endanger the flow of credit.

C. Private equity extracts value through fees, dividends and asset stripping

Private equity management and consultant fees: Private equity firms charge high fees for their purported management expertise. According to *Bloomberg*, these management fees now "yield a geyser of profit."[30] Institutional investors may be unaware of the fees and expenses charged to portfolio companies that can be high enough to affect the finances and cash flow of the portfolio firms.[31] Private equity firms charge monitoring fees and can require portfolio companies to pay "operating partner" consultants that are not fully or clearly disclosed to institutional investors.[32]



[30] Basak, Sonali and David Carey. "Private equity's biggest backers are tired of the fees." *Bloomberg*. October 26, 2017.
[31] Bowden, Andrew J. U.S. Securities and Exchange Commission. Director of Office of Compliance Inspections and Examinations. "Spreading sunshine in private equity." Speech before Private Equity International. May 6, 2014.
[32] *Ibid.*

Management fees alone generated tremendous income for PE firms. *Bloomberg* calculated that Blackstone's received $2.46 billion in management fees and Apollo received $1.12 billion in fees in 2016.[33]

PE firms typically charge 2 percent of the assets in the portfolio as well as 20 percent of any asset appreciation.[34] The 2 percent management fee is more than twice what most money managers charge and has not changed even as fund sizes have ballooned.[35] The fee includes committed but undeployed funds — so the PE firms charge a management fee for money the investors have not yet given to the fund to be invested.[36] Two percent can add up quickly. Americans for Financial Reform estimates that investors paid $117 billion in management fees to private equity firms in 2018 — more than double what they paid a decade earlier (see Figure 5).[37]

In some cases, PE firms may be charging institutional investors inappropriate fees or imposing fees or charges on investors without the general partners (the PE firm) bearing their share. In 2015, KKR & Co. paid $30 million to the SEC to settle charges that it imposed $17 million in "broken deal" expenses solely on its institutional investors without allocating any of the broken deal costs to KKR and without disclosing that the firm would not share in broken deal costs.[38] In 2014, the PE firm Clean Energy Partners, LLC and its chief executive paid $2.2 million for inappropriately charging investors for over $3 million in expenses that were improperly disclosed.[39] Also in 2014, Lincolnshire Management pad $2.3 million to settle SEC charges that it misallocated expenses to its investors by billing one fund for a portfolio firm's expenses that was owned by two Lincolnshire funds.[40] In 2018, Yucaipa Master Manager LLC agreed to pay $1 million to settle charges that it failed to disclose conflicts of interest and misallocated expenses that harmed investors.[41]

Dividend recapture schemes add debt: The private equity firms often require the target companies to take on more debt to pay the investors a dividend or repay a portion of the general partners' down payment, known as dividend recapture.[42] According to *Bloomberg* "buyout firms routinely extract large sums for themselves after taking companies private."[43] These dividend extractions benefit the PE general partners and investors, but additional debt loads can damage portfolio firms' credit ratings and even contribute to bankruptcies.[44] These dividend recaptures also juice reported earnings, making the portfolio firm artificially look more profitable even though the payments were made with debt.[45]

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[33] Basak and Carey (2017).
[34] McKinsey & Company (2019) at 27.
[35] Kelly (2019, "The magic formula is leverage…and fees"); Basak and Carey (2017).
[36] Applebaum and Batt (2012) at 14.
[37] Elvin (2016) at 5; Preqin (January 2018) at 7; McKinsey & Company (2019) at 15.
[38] SEC. [Press release]. "SEC charges KKR with misallocating broken deal expenses." Press Release 2015-131. June 29, 2015.
[39] Lynch, Sarah N. "Private equity advisor, CEO settle with SEC over fee allocations." October 17, 2014.
[40] Vardi, Nathan. "T.J. Maloney's private equity firm pays $2.3 million to settle SEC charges." *Forbes*. September 22, 2014.
[41] SEC. [Press release]. "SEC settles with investment advisor who failed to disclose conflicts of interest and misallocated expenses." File No. 3-18930. December 13, 2018.
[42] Slavkin Corzo (2019) at 13.
[43] Ronalds-Hanon, Eliza and Davide Scigliuzzoo. "Sycamore pockets $1 billion from deal that amazed Wall Street." *Bloomberg*. April 11, 2019.
[44] Lewis, Adam. Pitchbook. "PE firms keep deploying dividend recaps despite the risks." August 15, 2019.
[45] Parmar, Hema and Sonali Basak. "Private equity's returns questioned, this time by Buffett." *Bloomberg*. May 5, 2019.

Dividend recaptures can be substantial and impose additional debt loads on portfolio firms. In 2019, Silver Lake Management LLC and Singapore's sovereign wealth fund GIC took out $910 million in debt-financed dividends from Ancestry.com and planned to take another $150 million before 2020.[46] In 2017, Sycamore Partners bought office supply retailer Staples for $6.9 billion with $4 billion in debt, and within two years it extracted $1.3 billion in dividend recaptures, about 80 percent of the fund's initial equity stake. This also raised the firms total debt to $5.4 billion — nearly 80 percent of the purchase price.[47] Bain and KKR extracted a $1.75 billion dividend payment from hospital chain HCA the year before taking it public in 2011.[48] In total, *Barron's* estimated the dividend payments to the private equity owners (and the CEO) totaled $20.7 billion from 2006 to 2010.[49]

Stripping real estate and other assets: PE firms also shift assets out of target firms into other PE controlled subsidiaries. The PE firms create a series of shell companies, often separating the operating businesses (a nursing home or retail establishment) from the real estate assets, forcing the operating businesses to pay rent to a separate PE owned real estate shell company in what is known as lease-back. After Sun Capital bought the department store chain Shopko in a leveraged buyout, it sold off its real estate for $800 million and forced the chain to lease-back its formerly owned real estate. The added rent costs helped drive the store into liquidation that closed 360 stores and destroyed nearly 23,000 jobs.[50]

The PE-controlled hospital chain Paladin Healthcare bought two Philadelphia community safety-net hospitals, including Hahnemann University Hospital for $170 million.[51] Paladin quickly moved Hahnemann's prime real estate into a separate real estate business valued at $58 million.[52] The Hahnemann campus covered a city block near city hall that *CNN* reported would be "incredibly desirable for a high-end hotel or condominiums."[53] When Paladin moved Hahnemann into bankruptcy (ultimately shuttering the hospital, see below at pages 44 to 46), it kept ownership of the real estate; these valuable assets were excluded from the bankruptcy process.[54] Other assets can be looted as well. As Caesars Entertainment was sliding into bankruptcy, PE owners Apollo and TPG sold valuable assets like Planet Hollywood and Bally's to other Apollo and TPG controlled companies.[55]

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[46] Scigliuzzo, Davide. "Ancestry.com owners aim to extract $900 million payout with loan." *Bloomberg*. August 14, 2019.
[47] Ronalds-Hanon and Scigliuzzoo (2019).
[48] Advisen Ltd. Produced for OneBeacon Insurance Group. "Private Equity and Hospitals: Providence or Problem?" May 2011 at 7.
[49] Briloff, Abraham J. and Leonore A. Briloff. "Where did the $15.8 billion go?" *Barron's*. October 1, 2011.
[50] Coleman-Lochner, Lauren and Eliza Ronalds-Hannon. "What happens to a company when PE buys it?" *Businessweek*. October 3, 2019; Center for Popular Democracy, Americans for Financial Reform Education Fund, Strong Economy for All Coalition, United for Respect, Hedge Clippers, and Private Equity Stakeholder Project. "Pirate Equity." (Pirate Equity) July 2019 at 40.
[51] LaPointe, Jacqueline. "Tenet sells remaining Philly hospitals, announces divestitures." *Xtelligent Health Care Media*. September 11, 2017.
[52] Feldman, Nina. "Many fear Hahnemann's story will send a message: Buying a failing hospital pays." *WHYY FM-91*. July 31, 2019.
[53] DePillis, Lydia. "Rich investors may have let a hospital go bankrupt. Now they could profit from the land." *CNN*. July 29, 2019; Picchi, Aimee. "Private equity rushed into health care – now a nurse warns: 'Be scared.'" *CBS News MoneyWatch*. July 29, 2019.
[54] Adelman, Jacob. "As Hahnemann enters bankruptcy, 'gateway' development site could open up in Center City." *Philadelphia Inquirer*. July 1, 2019; "Hahnemann University Hospital owners file for Chapter 11 bankruptcy protection." *CBS News Channel 3 (Philadelphia)*. July 1, 2019.
[55] Indap (2017).

D. Private equity's tax loopholes, corporate structures, and merger-mania

Private equity dodges responsibility and liability: The PE firms distance themselves from liabilities by structuring the portfolio companies as separate partnerships owned by the PE firm.[56] This insulates the PE firm from responsibility for the actions of the portfolio company, even though the PE managers make the business decisions for the acquired firms. The portfolio firm is responsible for business losses (or bankruptcy judgments), not the PE firm. Similarly, the PE firm is insulated from liability from any dangerous result of cost-cutting directed by the PE firm — safety lapses, environmental accidents, or personal injury or negligence. For example, private equity adopts complex corporate partnership structures to takeover nursing homes that largely eliminates the PE firm's liability for negligence, malpractice, or government claims of overbilling Medicare or Medicaid and reduces the incentive to deliver quality care.[57]

Private equity's beneficial tax treatment: The private equity industry benefits from extensive tax benefits. First, the tax code allows businesses to deduct loan payments from their income, which lowers their tax obligations and increases net revenues and investor returns, which acts essentially as a transfer from taxpayers to private equity firms.[58] Additionally, private equity earnings from selling portfolio firms (either through sales or IPOs) are considered capital gains not corporate income, which is subject to lower tax rates. Private equity general partners also can take advantage of the carried interest loophole to pay lower rates on their income.

Private equity driving merger mania: private equity firms have supercharged the recent wave of merger-mania by financing nearly half of all U.S mergers. Private equity deals were less than one fourth of all North American mergers in 2009 (23.9 percent) but rose to nearly four in ten deals by early 2019 (39.4 percent).[59] Private equity firms not only fund merger-mania, but individual firms often pursue a monopoly strategy to roll-up fragmented industries. The PE firms use "add-on" deals to purchase multiple competitors of a portfolio company to create a much bigger player in an industry. Through the third quarter of 2019, 68 percent of all U.S. PE buyouts were add-on takeovers.[60] For example, the two largest helicopter ambulance firms are private equity-owned, were formed by PE buying up scores of separate firms, and now control more than half of the national market and routinely "surprise bill" transported patients as much as $30,000 to $40,000.[61]

Private equity operates in a regulatory blind spot that facilitates predatory practices: The private investments are inadequately regulated; they are not subject to the same level of federal oversight or required transparency as banks, stockbrokers, or mutual funds even though they provide similar services (credit and investments). The Center for Economic and Policy Research's Eileen Applebaum says private equity firms operate as part of the "growing shadow banking

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[56] Applebaum and Batt (2012) at 13.
[57] Pradhan, Rohit et al. "Private equity ownership of nursing homes: Implications for quality." *Journal of Health Care Finance.* June/July 2014; Rau, Jordan. "Care suffers as more nursing homes feed money into corporate webs." *New York Times.* January 2, 2018.
[58] Applebaum and Batt (2012) at 3.
[59] Lykken, Alex. Pitchbook. "PE's prominence in the M&A scene continues to grow." August 2, 2019.
[60] Lykken, Alex. Pitchbook. "This year could set another record for add-on activity." October 11, 2019.
[61] Tozzi, John. "Air ambulances are flying more patients than ever, and leaving massive bills behind." *Bloomberg.* June 11, 2018; Roland, Christopher. "Why the flight to the hospital is more costly than ever." *Washington Post.* July 1, 2019.

system."[62] The private equity industry grew to its current size by exploiting vagaries and loopholes in the U.S. financial regulatory system fostered by decades of deregulation.

These Wall Street investment firms to operate with no or minimal disclosures of their financial performance or governance and without prohibitions against conflicts of interest. Private equity funds that did not solicit unsophisticated or many investors were exempted from certain federal securities laws (notably the Investment Advisors Act and Securities Act among others) that allow them to operate with little financial disclosure (although the Dodd Frank Wall Street Reform and Consumer Protection Act required some registration and reporting for funds over $150 million).[63]

III. The risks and declining returns for private equity pension investors

The private equity industry promotes its investment funds as providing reliably superior returns to the stock market, but the reality is that PE investments are not necessarily better performers and these investments can pose risks for investors — including liquidity risk, lower transparency, and higher risks associated with debt leverage, along with reputational risks, and the risks that come from PE actions that undermine their members economic security outside of their pension funds.

Private equity investors are generally more sophisticated, more experienced, and more knowledgeable investors, but private equity funds can pose unique risks that can harm even these large institutional investors. The Securities and Exchange Commission director of compliance noted that PE funds can pose "risks and temptations that are not present" in the public market.[64] Although the PE industry offers rosy projections of high returns, the reality for investors like pension funds can be substantially more anemic. It is very difficult for investors to assess or track the performance of these investments for a host of important reasons. PE funds are not required to make comparable financial disclosures, it is difficult to value PE-held assets because they are not traded, and the performance results can be misleading.

A. Recent private equity performance lagging industry promises

The industry promotes its history of outperforming the stock market over the past quarter century, but its recent returns have been less impressive and more volatile as the low-hanging fruit of super-profitable opportunities are evaporating.[65] A 2015 study by the University of Virginia Darden School of Business found that the post-2005 vintage private equity funds did not exceed the performance of stock markets.[66] Newer vintages of funds might perform more poorly, as returns decline as PE fundraising increases, as it has over recent years.[67]

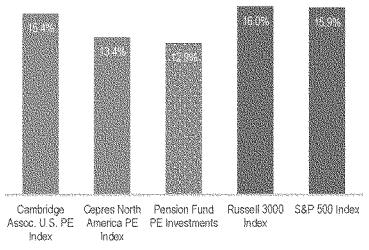
The private equity trade association American Investment Council's latest performance benchmark report demonstrates that PE investments do little better — or even worse — than comparable investments in the stock market. In 2019, AIC reported that the 10-year median return for major

[62] Applebaum and Batt (2012) at 4.
[63] *Ibid.* at 5 to 6.
[64] Bowden (2014).
[65] Parmer and Kelly (2019).
[66] Harris, Robert S., Tim Jenkinson, and Steven N. Kaplan. "How Do Private Equity Investments Perform Compared to Public Equity?" Darden Business School Working Paper No. 2597259. June 2015 at 10.
[67] *Ibid.* at 24.

PE indexes (excluding venture capital) was slightly below the 10-year return for stock indexes (including dividends) (see Figure 6).[68]

Over the past decade, pension fund investments in private equity performed even worse than typical PE investments and the stock market.[69] Collectively bargained retirement plans and pensions have over $7 trillion in invested capital.[70] Some pension funds are under pressure to rely on the promised higher returns from private equity to compensate for inadequate contributions from employers.[71] On average, about 9 percent of these funds are invested in private equity and the ten largest pension fund investments in private equity amounted to $163 billion in 2019.[72] Some pensions invest far more in private equity. As of 2019, two Pennsylvania public employee pension funds had over 14 percent of their portfolios tied up in private equity.[73] According to Preqin, 27 public pension funds have 15 percent or more invested in PE in 2019.[74]

Fig. 6: 10-Year Return Private Equity v. Stock Market



Source: AIC 2019; median PE fund index (without venture capital), stock indexes include dividends)

Limited partners rarely see the returns that the industry average indexes. Several studies have found that limited partners receive far less favorable returns than the PE industry advertises. In part this is because limited partners (like pensions) do not benefit from the fees and carried interest payments that go to the fund's general partner.[75] The industry highlights short- and medium-term returns, but the 10-year returns (which have recently been lower than stock market indexes) may better reflect the yields for limited partner investors that have their money locked-into private equity for the life of the fund. This is confirmed by a footnote in AIC's performance report that admits that PE investment returns that exceed stock market performance do not apply to the limited partner investors, only the PE fund (and general partners).[76]

Even when average returns appear rosy, many PE funds have indifferent performance, often comparable to the stock market, meaning that there is little premium for the loss of liquidity (locked-up investment) or opacity. One report suggests that more than half the PE funds perform only as well as — or worse than — the stock market.[77] A University of Virginia study found that

[68] AIC. "Performance Update 2019 Q1." 2019 at 2.
[69] *Ibid.* at 5.
[70] Slavkin Corzo (2019) at 1.
[71] Slavkin Corzo (2019) at 14.
[72] AIC. "Public Pension Study." July 2019 at 2 and 4.
[73] Idzelis, Christine. "Private equity managers are 'running a grift,' Pennsylvania Treasury says." *Institutional Investor.* August 26, 2019.
[74] Prequin. Public pension investor data. 2019.
[75] Applebaum and Batt (2012) at 24.
[76] AIC (2019, "Performance Update 2019 Q1") at 3.
[77] Parmer and Kelly (2019).

only the top quartile of funds exceeded the stock market; if investors put money into the bottom three-fourths of fund performers the results were comparable to or worse than the stock market.[78]

B. Private equity poses liquidity, transparency, and valuation risks for investors

Difficult for institutional investors to accurately value portfolio assets: It is almost impossible to assess the value of PE-owned businesses and assets while they are held by the PE firm. Unlike publicly traded assets, there is not the constant pricing data from investors continuously trading the stocks.[79] Fund values are basically the returns from portfolio exits and the net asset value of current portfolio holdings. But current, accurate net asset values are difficult to assess for assets that have not changed hands.[80]

The initial purchase price is often highly overvalued, with high and rising valuation multiples, which can make it hard to secure returns. In addition, it can be difficult to distinguish increases in PE-owned company values from overall appreciation in publicly owned companies during bullish stock markets.[81] General partners' earnings are tied tightly to raising money for future funds, which can affect the valuation of funds and potentially mislead investors. A 2013 study found that PE firms tended to fundraise for new funds after profitable exits and/or after artificially inflating net asset value (which was subsequently marked down after the fundraising).[82]

Liquidity risk: Investments in private equity funds are especially illiquid; investors are required to keep their money in the fund for its duration which can be a decade or more.[83] It is difficult for institutional investors to exit funds until the fund is wound down or the private equity firm sells off its entire portfolio of target firms and assets.[84] There is little secondary market for private equity investments. In 2018, there were only $57 billion in secondary private equity transactions — less than 1 percent of private equity's $5.8 trillion global assets under management.[85] The illiquidity of PE investments represents an opportunity cost, as these investments cannot be reallocated to other, potentially more profitable assets.[86]

Private equity opacity prevents performance assessments: It is difficult for institutional investors to assess the actual performance of private equity funds. The private equity firms are not obligated to provide the kinds of financial performance information that publicly traded companies are required to disclose. Efficient, healthy markets require that all parties have access to transparent material information to make investment decisions. The quality, quantity, and form of financial disclosure essential to providing equitable access to market information that is necessary for investors, the public, and functioning markets is not currently available for private equity investments. The limited disclosure required under the Dodd-Frank uncovered substantial lapses.

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[78] Harris, Jenkinson, and Kaplan (2015) at 20.
[79] Parmer and Kelly (2019).
[80] Barber, Brad M. and Ayako Yasuda. "Interim Fund Performance and Fundraising in Private Equity." December 16, 2015 at 2 to 3.
[81] Applebaum and Batt (2012) at 16.
[82] Barber and Yasuda (2015).
[83] Harris, Robert S., Tim Jenkinson, and Steven N. Kaplan. "Private equity performance: What do we know?" *Journal of Finance*. Vol. 69, Iss. 5. October 2014.
[84] Slavkin Corzo (2019) at 14.
[85] McKinsey & Company (2019) at 15 and 31.
[86] Parmar and Basak (2019).

More than half of the SEC's examinations of private equity advisors in 2014 found "violations of law or material weaknesses in controls."[87]

The PE industry's performance metric, the self-reported internal rate of return (IRR), can be easily manipulated. PE firms calculate the fund's IRR based on the performance of portfolio assets (from purchase to sale), not on the performance of investors' committed funds. But PE firms do not instantly purchase assets with the committed money, which is required to be held ready to make purchases. This can artificially shorten the performance horizon of the assets relative to the committed funds and raise the apparent rate of return, but that faster rate of return would not apply for the entirety of the investor's commitment.[88] Warren Buffett recently said that IRR returns were "really not calculated in a manner I would regard as honest."[89]

Private Equity also does not report clearly or adequately to investors about the fees they are collecting, and how much investors have paid and will be required to pay. In fact, the funds may require investors to sign agreements specifically stating that they do not have the right to know what fees they are collecting. Finally, PE's lack of transparency to investors about what portfolio companies they own and acquire, and about the business strategies they plan to pursue at those firms, is another serious impediment to investors effective assessment of the costs and benefits of specific fund investments.

IV. Private Equity Accountability and the Stop Wall Street Looting Act

The disturbing impacts of private equity ownership – increased indebtedness, more worker layoffs, a greater risk of bankruptcy, and an increase in abusive practices toward customers and communities – spring directly from the private equity business model.

A central feature of that business model is a lack of accountability for the general partners of the private equity fund. General partners advance only a tiny fraction of the funds used for private equity activities — on average, less than 3 percent of the fund's equity, which implies far less than 1 percent of the total funds used for acquisitions.[90] Yet they are the key insiders who control the fund's decisions and the management of portfolio firms. Private equity general managers have been able to manipulate the limited liability framework of corporate law to shield themselves from the downside risk of their actions, while using their control of portfolio companies to capture the upside profit. This lack of accountability creates skewed incentives which undermine the long-term well-being of private equity owned companies, their workers, their customers, and the communities in which they operate.

The relationship between a portfolio company and its private equity owner begins with a leveraged buyout in which the portfolio company takes on debt to pay for its own acquisition by the private equity fund. The portfolio company is responsible for re-paying this debt but the private equity owner is not.

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[87] Bowden (2014).
[88] Parmer and Kelly (2019).
[89] Parmar and Basak (2019).
[90] Segal, Julie. "Having skin in the game isn't so easy anymore for private equity managers." *Institutional Investor*. February 19, 2019

In order to service the portfolio company's enormous acquisition debt, the private equity fund owner will impose extreme cost-cutting on the portfolio company, which endangers the long-term future of the company. At the same time, the private equity fund will extract various types of fees and distributions from the portfolio company, leaving the portfolio company even more thinly capitalized, but increasing the short-term profits of the private equity fund. In some cases, the private equity fund might insist on cost-cutting measures that involve legal violations, such as environmental pollution or workplace safety violations, for which the portfolio company, not the private equity fund, is legally responsible.

If the portfolio company is able to service the enormous acquisition debt, it will be sold by the private equity company. If not, it will end up in a bankruptcy in which the acquisition lender will be paid off the top from the company's assets because of its security interest, leaving other creditors (including the federal government) and the employees of the company with recourse only to whatever scraps are left over, not the resources which the private equity owners have drained from the company during the period between acquisition and bankruptcy. The leveraged buyout is in essence a "heads-I-win, tails-you-lose" proposition for private equity.

Lack of accountability extends not only to the relationship with the portfolio firm, but to the relationship between general partners and their passive investor limited partners, who provide the great majority of the fund's equity. Private equity funds are not subject to the disclosure framework intended to protect investors in publicly registered funds such as mutual funds. General partner insiders have taken advantage of that fact to routinely mislead or deceived limited partners regarding overall returns to investments, as well as other issues.[91]

A central goal of the Stop Wall Street Looting Act (SWSLA) is to impose accountability on private equity general partners and their fellow insiders for their actions with respect to portfolio companies and outside investors. The new restrictions on private equity general partners and their insiders in the SWSLA are designed to protect portfolio companies — and their stakeholders — by eliminating the incentives and capability of the general partners to engage in harmful actions. Elements of the law also protect limited partners by requiring general partners to follow disclosure and other rules designed to protect outside investors. In addition, the legislation increases worker protections in bankruptcy procedures and eliminates certain tax advantages enjoyed by private equity insiders.

Title I of the bill imposes joint and several liability on the private equity firm's general partners and their insiders for liabilities of the portfolio companies owned by the private equity fund. This includes debt incurred in the takeover of the portfolio company, as well as legal penalties due to lawsuits or regulatory actions against the company. The joint and several liability makes the general partners of the private equity fund liable for debt that is incurred by a company in a private equity takeover, as well as for any costs of regulatory violations or legal judgements involving customer harm at the company. SWSLA also extends this liability to the insiders of general partners, so the actual control persons have liability for the wrongdoing they direct.[92]

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[91] Applebaum, Eileen and Rosemary Batt. Center for Economic and Policy Research. "Fees, Fees and More Fees: How Private Equity Abuses its Limited Partners and U.S. Taxpayers." May 2016.

[92] Congress has previously mandated such control person liability for violations of federal consumer financial law as part of the "related person" liability under the Consumer Financial Protection Act.

SWSLA's joint-and-several liability provision are necessary to appropriately align the incentives of private equity general partners, who currently have an extremely lopsided risk-reward balance because of the combination of limited liability and their enormous leverage. This lopsided risk-reward balance is problematic because the general partners control the portfolio firm, so they are able to encourage it to pursue riskier strategies, such as undue cost-cutting and disinvestment. Importantly, SWSLA does not change the liability of the limited partners in private equity funds.

Title II of the bill restricts the mechanisms private equity funds use to drain value from their portfolio companies after they are taken over. The title includes a two-year ban on dividend payouts from the portfolio company up to the private equity fund, and a complete ban on so-called "monitoring fees" which are payments from the company to the fund that are not clearly tied to services rendered. The two-year ban on distributions mirrors the EU's 2011 Alternative Investment Fund Managers Directive.[93] It also includes a provision that strengthens federal fraudulent transfer law enabling certain transfers of value from the portfolio company to the private equity firm, including transfers in the initial acquisition process for the company, to be reversed and recaptured in cases where the portfolio company goes bankrupt. This means that resources taken from the company by the private equity firm will be available to pay obligations to workers of the company in case of a bankruptcy. Finally, the title includes a provision that ends tax benefits for excessive leverage at a portfolio company.

Title III of the bill elevates the priority of worker claims in bankruptcy cases, and also restricts mechanisms by which management insiders are able to take outsize shares of the bankruptcy estate ahead of worker claims. This means that in cases in which private equity owned firms (as well as other firms) go bankrupt, the claims of ordinary workers for severance pay and pension obligations are more likely to be honored.

Title IV of the bill eliminates the "carried interest" tax loophole, which permits private equity general partners to qualify their income for the lower capital gains tax rate rather than the ordinary income rate paid by wage and salary workers. The section provides that the returns to partnership interests received for providing investment management services be classified as ordinary income and taxed at the ordinary income rate.

Title V of the bill responds to ways in which private equity funds engage in deceptive marketing practices in attracting outside investors, and also ways in which they take advantage of outside investors (limited partners) once their funds are committed. Like hedge funds, private equity funds benefit from exemptions to the securities laws and do not have abide by disclosure requirements that normally apply to investment managers in funds that are registered investment companies (e.g. mutual funds). The title addresses this problem by mandating that private equity firms provide standardized disclosures to their investors in critical areas such as fees, returns, leverage, portfolio firms owned, and the activities of other funds managed by the private equity firm. Furthermore, it imposes fiduciary duties on the private equity general partners as regards any investments of pension fund money, requiring them to respect the interests of limited partners who are entrusting them with pension fund resources to manage.

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[93] European Parliament and European Council. "Directive on Alternative Investment Fund Managers." Directive 2011/61/EU. June 8, 2011.

Title VI of the bill reverses a 2018 legal decision that exempted Collateralized Loan Obligations (CLOs) from key risk protections imposed by the Dodd-Frank Act.[94] CLOs are a key financing mechanism used by private equity firms to fund their acquisitions. Leveraged buyouts are financed with syndicated loans. CLOs are securitizations of pieces of these syndicated loans, enabling bond market investors to invest in the loans that fund leveraged buyouts. This title restores the Dodd-Frank "skin in the game" requirement that some of the risk from these securitizations be retained by the entity selling the CLO. This creates an incentive not to deceive investors concerning the risks of loan securitizations, as occurred during the 2008 financial crisis.

A. Private equity interests have misrepresented the SWSLA

Insiders at private equity funds have a great deal of wealth and power, and the SWSLA would greatly increase their accountability for the decisions they make. Indeed, it would effectively cut off many of the most lucrative mechanisms private equity insiders use to enrich themselves at the expense of portfolio firms and outside investors. So private equity firms have every incentive to lobby against it, and are doing so.

In their efforts to stop the SWSLA, private equity interests have significantly misrepresented the nature of the bill. They have consistently claimed that the SWSLA would harm companies owned by private equity, which employ millions of workers, and also that it would increase liability for private equity limited partners. Neither of these claims are true. As described above, the SWSLA is aimed directly at private equity general partners, increasing their liability for actions they take and also increasing their disclosures to outside investors. Since, as described elsewhere in this testimony, actions taken by private equity general partners to drain value from portfolio firms have frequently been harmful to workers, firms, and communities, these steps can be expected on net to help firms that are or might be the targets of private equity acquisition. The same is true for private equity limited partners, who would be helped by the new disclosures and accountability measures in the SWSLA.

A good example of extreme industry misrepresentation is the recent report by the Center for Capital Markets at the U.S. Chamber of Commerce, purporting to estimate the economic effects of the SWSLA.[95] The report estimates that the SWSLA could lead to the loss of up to 26 million jobs. This implies that the SWSLA alone would lead to the loss of almost one in five (17 percent) of the total jobs in the economy, almost triple the job losses experienced in the 2008 financial crash and the Great Recession, and comparable to all the job losses experienced from 1929-1932 in the worst period of the Great Depression.[96]

These numbers are based on the obviously faulty assumption that if returns to private equity general partners are reduced due to increased liability, a significant share or even all of the firms owned by private equity firms would simply go out of business. But private equity-owned companies do not owe their existence to private equity. Private equity does not create businesses. Instead, it generally acquires them when they are already established mature firms with a proven business model. Firms

[94] U.S. Court of Appeals for District of Columbia. Loan Syndications and Trading Association v. Securities and Exchange Commission and Board of Governors of the Federal Reserve System. No. 17-5004. February 9, 2018.
[95] Swenson, Charles. Center for Capital Markets and U.S. Chamber of Commerce. "Economic Impact Analysis of the Stop Wall Street Looting Act." November 12, 2019.
[96] Bureau of Labor Statistics. "Labor Force, Wages, and Working Conditions." 1945.

owned by private equity are not funded day to day by the private equity money used to acquire them, but by their own earnings from ordinary business operations. As documented elsewhere in this testimony, the tactics used by private equity funds divert the cash flow of the portfolio firms away from business operations and investing for the future, and toward servicing debt imposed in the leveraged buyout of the firm, or fees levied by the private equity owners. By reducing incentives for these kinds of predatory activities, the SWSLA would in fact increase the stability of firms targeted by private equity.

Furthermore, it is not true that the SWSLA imposes new liability on passive investor limited partners of the private equity firm, as is claimed in the Chamber of Commerce report. The report asserts that the new liability for debt and legal judgements in the SWSLA extends not just to general partners and insiders of the private equity fund, but to limited partner investors such as pension funds and charitable foundations. In fact, SWSLA's definitions expressly exclude passive limited partners from the reach of these provisions.[97]

In general, in their lobbying against the SWSLA private equity insiders are seeking to blur the distinction between their own financial liability and the well-being of the firms they own and the pension funds they are entrusted to manage. But the SWSLA is effectively aimed at increasing the accountability of private equity insiders specifically, and reducing their incentives to take actions that are harmful to targeted firms and outside investors, as well as to their customers and the public.

V. Private Equity Abuses Threaten Workers' Economic Security

Workers frequently pay the price for PE takeovers. First, cost cutting strategies to boost profits are often taken out of workers through workforce downsizing, lowering wages or eliminating raises, reducing benefits like health care and retirement, and eliminating severance payments.[98] Even for workers in unions, many PE takeovers have forced benefit or wage concessions (cuts) from workers and even occasionally efforts to decertify existing unions or marginalize union workers (by shifting work to non-union facilities, for example).[99] The PE-imposed cost-cutting "inevitably means job cuts," according to *Businessweek*.[100]

Second, the leveraged buyouts, financial engineering including dividend recapturing, and asset stripping can leave target firms in a financially precarious condition. The downward pressure on performance can lead to further downward pressure on wages and benefits, but it also can lead to bankruptcy. If the portfolio companies do not generate enough revenue to finance the higher debt burden, the companies can and do slide into bankruptcy and liquidation, costing even more workers their jobs, livelihoods, and economic security. Since private equity controls a growing share of the economy, both cost-cutting driven downsizing and bankruptcy-driven layoffs pose significant risks to U.S. workers and their families. Finally, the PE firms shield themselves behind a complex veil of corporate shell subsidiaries, that prevent the PE firms and PE managers from being held

[97] Specifically, the bill defines "the holder of an economic interest" in a fund, a status required by the bill for the attachment of liability, to exclude any "person that is not an insider with respect to a control person." (SWSLA, sec. 3(8)(C)(ii)). The terms "insider" is then defined as a "control person" of the private equity fund (SWSLA, sec. 3(9)). But "control person" is defined to expressly exclude passive limited partners in a fund.
[98] Coleman-Lochner and Ronalds-Hannon (2019).
[99] Applebaum and Batt (2012) at 20.
[100] Dmitrieva, Katia. "It might be making inequality worse." *Businessweek*. October 3, 2019.

responsible for pension losses, unpaid benefits, or owed severance pay. The Pennsylvania state treasurer observed that "too often, private equity firms instead buy companies, load them with debt, and pay themselves off in secret while decimating a firm and a community."[101]

The PE industry brags about the number of people that work at PE-owned businesses, without acknowledging the increased job insecurity this creates from layoffs and bankruptcies. It makes sense that as private equity buys up more businesses, the industry would employ a lot of workers. But it is not the case that private equity creates jobs, it merely buys employers and in many cases the number of workers at those companies shrinks after the PE takeover.

Fig. 7: Job growth at PE Firms v. U.S. job growth v. PE investment growth

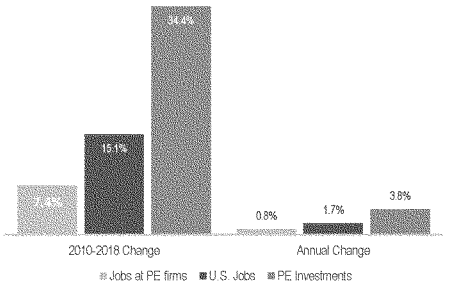
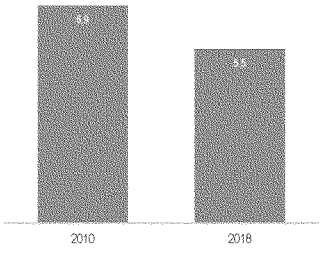


Fig. 8: Jobs at PE firms per million dollars invested



Sources: AFR calculations from AIC, Pitchbook and BLS data.

Nor does private equity sustain jobs or foster job growth. PE investments are rising much faster than the workforce at PE owned businesses and the number of jobs at PE-owned firms is declining. In 2010, the private equity industry trade association reported that PE-owned firms employed 8.1 million workers; by 2018, it claimed the figure was 8.7 million workers – a modest increase of 0.8 percent per year, about half the rate of the nation's overall annual job growth of 1.7 percent (see Figure 7).[102] But U.S. PE assets under management (companies) grew much faster, rising 27.1 percent from $1.1 trillion in 2010 to $1.5 trillion in 2018.[103] Because PE investments have grown far faster than the number of workers at PE-owned firms, every million dollars of PE investments accounts for fewer jobs today than a decade ago. In 2010, every $1 million in PE assets employed 6.9 workers, but that figure fell to 5.5 workers per $1 million invested in 2018 (see Figure 8).[104]

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[101] Idzelis (2019).

[102] Applebaum and Batt (2012) at 12; Ernst & Young. Prepared for the American Investment Council. "Economic Contribution of the US Private Equity Sector in 2018." October 2019 at 4. Number adjusted to exclude the 1 percent of private equity direct employees that work at private equity firms (1 percent of the 8.8 million estimate, bringing the number of workers at PE-owned firms to 8.7 million); BLS. Seasonally adjusted full-time employees 16 years and over. BLS Series No. LNS 12500000.

[103] Black (2017); Pitchbook "Private Markets: A Decade of Growth" (2019) at 5 and 6. 2018 figure derived from global assets under management based on share of U.S. investments and share of private equity.

[104] *Ibid.*; Applebaum & Batt (2012) at 12; Ernst & Young (2019) at 4.

A. Private equity abuses worsen economic inequality

Predatory and extractive practices by the PE industry have exacerbated economic inequality by enriching a tiny number of PE executives while slashing jobs and pushing down on wages for working families. PE general partners fare very well under the industry's business model. The top private equity executives earn tremendous amounts each year. In 2019, managing general partners and CEOs salary, bonus, and carried interest distribution reached $4.2 million and senior partners earned $3.3 million.[105]

All this income makes many PE executives very, very rich. The share of PE firms as the sources of the wealth behind the Forbes 400 richest Americans doubled from 1992 to 2011, when nearly 7 percent of the richest fortunes were derived from private equity.[106] The 2019 Forbes 400 listed many private equity leaders among the nation's richest people, including Blackstone's Steven Schwarzman ($17.7 billion net worth), Apollo Global Management's Leon Black ($7.7 billion), KKR & Co.'s George Roberts ($6.1 billion) and Henry Kravis ($6.0 billion), and Platinum Equity's Tom Gores ($5.6 billion).[107]

This astounding wealth is accumulated at working people's expense. Private equity takeovers generate operational savings through cost-cutting that frequently involves layoffs, offshoring, and depressing wages and benefits.[108] The financial engineering and debt loads imposed on target firms make them more financially precarious. PE-owned firms are more likely to slide into bankruptcy and liquidation, costing even more workers their jobs and economic security. By raising already sky-high earnings for top executives, financializing a broader swath of the U.S. economy, and destroying family sustaining jobs, private equity is exacerbating the gulf between the haves and have-nots in America, and increasing economic insecurity for working people.

B. Private equity downsizing and layoffs (even without bankruptcy)

Firms taken over by private equity are more likely to shed workers than non-PE firms. A 2019 study by University of Chicago and Harvard economists found that after two years, companies taken over by private equity had reduced the workforce (layoffs) by 4.4 percent compared to companies that were not taken over.[109] If the effects of this peer-reviewed, empirical analysis of employee rolls were applied to the PE industry's 2018 estimate of employees at PE-owned firms, about 400,000 of the workers in the industry sponsored study could lose their jobs by 2020. A 2014 study by the same authors found that the two-year job losses doubled within five years after a PE takeover.[110] These job losses were mostly middle-class, family sustaining jobs. A 2016 study found that private equity

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[105] Dorbian, Iris. "Compensation spikes across PE as fundraising nears record level, ex-Lariat partner re-activates independent sponsor shop." *PE Hub Wire.* October 30, 2019.
[106] Kaplan, Stephen N. and Joshua Rauh. "It's the market: The broad-based rise in the return to top talent." *Journal of Economic Perspectives.* Vol. 27, No. 3. Summer 2013 at 47.
[107] Kroll, Luisa and Kerry A. Dolan. "The Forbes 400: The definitive ranking of the wealthiest Americans." *Forbes.* October 2, 2019.
[108] Dmitrieva (2019).
[109] Davis, Steven J. et al. "The Social Impact of Private Equity Over the Economic Cycle." January 1, 2019 at 5.
[110] Davis, Steven J. et al. "Private equity, jobs, and productivity." *American Economic Review.* Vol. 104, No. 12. December 2014 at 3958.

layoffs were concentrated among middle-class workers and that workers at PE-firms had twice the risk of unemployment due to offshoring or automation compared to non-PE workers.[111]

The PE business model incentivizes downsizing and benefits cuts, as increased revenues can be captured by the PE owners. Private equity firms aim to sell their portfolio companies fairly rapidly, ideally within 5 years. This encourages managers to extract value quickly. This often involves slashing costs through downsizing of employees that can juice profits and productivity as fewer workers struggle to perform the same workload.

For example, private equity firms have bought hundreds of newspapers in the past decade. The financial crisis accelerated the newspaper industry's loss of revenues from online advertising competition that depressed the value of newspaper companies; private equity eagerly bought up these cheaper news companies. The five largest private equity and hedge fund-backed newspaper chains went from owning 226 daily newspapers in 2004 to 785 in 2019.[112]

The PE investors demand severe cost cutting by firing reporters, editors, designers, and printing-press operators to drive revenues and profits.[113] Alden Capital slashed two-thirds of its newspaper staff including unionized newspaper guild workers in the first seven years after it took over the Digital First Media newspaper chain.[114] Alden also shifted $900 million worth of newspaper real estate — offices and printing plants — into a separate Alden subsidiary, stripping assets out of the newspaper businesses.[115] The *American Prospect* concluded that "Private equity has been gobbling up newspapers across the country and systematically squeezing the life out of them to produce windfall profits."[116]

The staff cuts and asset stripping has compromised local news coverage and undermined democracy itself. For example, the Fortress Investment Group's GateHouse Media downsized the *Peoria Journal Star* so severely that it reduced downstate Illinois coverage from 23 counties to only 3.[117] Especially for daily papers in smaller cities, firing or dramatically cutting the newspaper staff has reduced coverage of local governments and businesses. For example, even the *Arizona Republic* now has only one reporter covering the Phoenix city government.[118] A 2014 report by American University researchers found that the decline in the number of newspapers contributed to lower voter turnout and democratic participation.[119] In August 2019, GateHouse announced a leveraged buyout of Gannett, owner of *USA Today* and many others, to create the nation's biggest newspaper chain with 280 daily papers, 300 weeklies and a circulation of 8.7 million.[120] The deal was financed

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[111] Olsson, Martin and Joacim Tåg. Research Institute of Industrial Economics. "Private Equity, Layoffs, and Job Polarization." May 2016 at 2.
[112] AFR analysis of the Database of Newspapers. University of North Carolina at Chapel Hill's Center for Innovation and Sustainability in Local Media. Available at https://www.usnewsdeserts.com/. Accessed
[113] Posner, Michael. "Hedge funds and newspapers: A bad mix." *Forbes*. January 18, 2019.
[114] Reynolds, Julie. "Meet the vulture who savaged the Denver Post." *The Nation*. April 13, 2018.
[115] O'Connell, Jonathan and Emma Brown. "A hedge fund's 'mercenary' strategy: Buy newspapers, slash jobs, sell the buildings." *Washington Post*. February 11, 2019.
[116] Kuttner, Robert and Hildy Zenger. "Saving the free press from private equity." *American Prospect*. December 22, 2018.
[117] Tracy, Marc. "A paradox at the heart of the newspaper crisis." *New York Times*. August 1, 2019.
[118] O'Connell, Jonathan. "As Gannett merger nears completion, union claims 'journalism will suffer' under deal." *Washington Post*. November 8, 2019.
[119] Hayes, Danny and Jennifer L. "As local news goes, so goes citizen engagement." *Journal of Politics*. Vol. 77, No. 2. February 2015.
[120] Arbel, Tali. "GateHouse, Gannett to merge for $1.4B, build newspaper giant." *Associated Press*. August 5, 2019.

with a $1.8 billion loan from Apollo and the company planned to cut $300 in costs annually.[121] The takeover threatens the jobs of 1,200 newspaper guild workers at 33 Gannett newspapers and newsroom staff at the *Arizona Republic* voted to unionize in advance of the private equity acquisition.[122]

The private equity takeover of other businesses has cut staff, reduced wages and benefits, and eliminated raises. The Cerberus-purchased Steward hospital network in Massachusetts reduced staffing, closed units and eliminated jobs to meet budget targets.[123] The nurses' union said these moves caused dangerously low staffing levels.[124] The nurses' union also accused Steward of reneging on commitments to support their pensions, refusing to base pension contributions on all work (including overtime), and balking at joining a multiemployer pension plan.[125] Immediately after Bain Capital, KKR, and Vornado Realty Trust bought Toys "R" Us, it slashed jobs and froze or drastically lowered annual pay raises, even for long-time employees.[126]

C. Private equity-driven bankruptcies destroy jobs

The private equity industry's reliance on leveraged buyouts that burden the takeover target firms with often unsustainable debt loads can — and often do — imperil the finances of portfolio companies and even drive them into bankruptcy. Other financial engineering can further compromise the balance sheet of portfolio companies, including paying management fees and additional debt to fund dividend recapitalization payments to the PE firms. In addition, PE asset stripping of real estate can force portfolio companies to pay rent for occupying buildings they once owned. The PE industry contends that it delivers management expertise and needed financing to struggling or undervalued firms, but portfolio firms often struggle to pay fees, rents, service new and higher debt loads, *and* deliver higher profits for PE owners. When revenues are insufficient to cover debt obligations, these firms slide into bankruptcy and/or liquidation.

Portfolio firm bankruptcies and liquidations cost workers their jobs, benefits, severance payments, and retirement security. Other businesses that supply or provide services to bankrupt firms can go unpaid as well, potentially harming workers at these firms. Even without liquidation, bankruptcy can significantly hobble portfolio firms because of the legal, organizational, and debt restructuring costs and because the devaluation of corporate assets combined with the bankruptcy filing makes securing future credit more difficult and expensive.[127]

Private equity portfolio firms are much more likely to go bankrupt than firms that were not taken over by private equity. A 2019 California Polytechnic State University study of nearly 500 leveraged

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[121] O'Connell (November 8, 2019).

[122] The NewsGuild-Communications Workers of America. "GateHouse-Gannett Merger Threatens Journalism." November 2019; O'Connell, Jonathan. "Newsroom staff at Arizona Republic, a Gannett paper, moves to unionize ahead of GateHouse deal." *Washington Post.* November 20, 2019.

[123] Applebaum, Eileen. Center for Economic and Policy Research. "Everyone Wondered How a Private Equity Firm Would Make Money in a Leveraged Buyout of a Struggling Non-Profit Hospital Chain—Now We Know." October 2015 at 4; Encarnacao, Jack. "Quincy Medical nurses end strike; layoffs begin." *Quincy (MA) Patriot Ledger.* April 12, 2013.

[124] Encarnacao (2013.

[125] Laroque, Marc. "Morton Hospital nurses: Cerberus more concerned with profits than patients." *Taunton (MA) Daily Gazette.* December 21, 2011; Kronenberg, Jerry. "Hub nurses hound health giant." *Boston Herald.* December 21, 2011.

[126] Guthrie Weissman, Cale. "Why work has failed us: Because companies aren't sharing the profits." *Fast Company.* September 4, 2018.

[127] Applebaum and Batt (2012) at 2.

buyouts between 1980 and 2006 found that 20 percent of the firms went into bankruptcy — ten times higher than the 2 percent of comparable non-LBO firms that went into bankruptcy.[128] A 2019 Pitchbook analysis confirmed that this trend is still continuing. Between 2016 and 2018, more than one-eighth (12.1 percent) of PE public-to-private takeovers over $500 million went bankrupt, nearly two-and-a-half times the 5.4 percent bankruptcy rate for other comparably sized transactions, which Pitchbook attributed to the tremendously high levels of debt from the leveraged buyouts.[129]

These PE-driven bankruptcies have cost jobs. The highly leveraged PE takeover of Harrah's Entertainment (now Caesars Entertainment) ended in disaster for workers. PE firms Apollo Global Management and TPG loaded up the casino company with $24 billion in debt during the 2008 takeover; the company's debt payments of $2 billion annually exceeded its revenues and it went into bankruptcy in 2015.[130] Workers paid the price for the PE gamble. By the time Caesars came out of bankruptcy, there were 19,000 fewer workers at the casino chain than before the PE takeover.[131]

Several PE takeovers of health care companies have led to job slashing bankruptcies. The PE-driven bankruptcy of Hahnemann hospital this year not only affected the community, but the fate of the health care workers. In early 2019, Hahnemann stopped paying into the pensions for its workers.[132] By the summer, Paladin moved Hahnemann into bankruptcy and announced it would shutter the hospital.[133] The shutdown cost 2,500 jobs, including those of 800 union nurses, and left nearly 600 physicians-in-training without residency placements.[134]

Starting in 2010, Enhanced Equity Funds created the ambulance chain First Med EMS by rolling up a series of ambulance companies with leveraged buyouts that incurred $30 million in debt.[135] By early 2013, First Med was unable to pay its debts and it collapsed abruptly into bankruptcy liquidation two weeks before the Christmas holiday season, firing 2,300 workers and cutting off their benefits without notice.[136] Another PE-owned ambulance company, TransCare, went into liquidation in 2016, unexpectedly reducing ambulance coverage and costing EMTs and paramedics their jobs (and final paychecks).[137]

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[128] Ayash, Brian and Mahdi Rastad. California Polytechnic State University. "Leveraged Buyouts and Financial Distress." July 19, 2019.
[129] Dowd, Kevin. Pitchbook. "Are take-private buyouts worth the risk?" April 17, 2019.
[130] Indap (2017); "Caesars casinos files for bankruptcy." *Reuters.* January 15, 2015.
[131] Harrah's Entertainment, Inc. U.S. Securities and Exchange Commission (SEC). Form 10-K. March 1, 2007 at 8; Caesar's Entertainment Corporation. SEC Form 10-K. February 22, 2019 at 8.
[132] Rush, Mariah. "Hahnemann University Hospital's inner turmoil: A timeline of changes, layoffs, and closing." *Philadelphia Inquirer.* July 1, 2019.
[133] "Owners of Hahnemann University Hospital file for bankruptcy protection." *WPVA ABC-6.* July 2, 2019.
[134] "Hahnemann University Hospital to close, leaving thousands out of work." *WCAU NBC-10.* June 26, 2019; "Hahnemann's closure will leave medical residents scrambling." *WHYY FM-91.* July 5, 2019.
[135] Maricopa Ambulance, LLC. Maricopa Ambulance's Written Closing Argument. In the Matter of Maricopa Ambulance, LLC. Certificate of Necessity. Arizona Department of Health Services. Matter No. 2015A-EMS-0190-DHS. February 8, 2016 at 41 to 42; Second amended complaint. In re: American Ambulette & Ambulance Service, Inc. et al. U.S. Bankruptcy Court. Eastern District of North Carolina, Wilmington Division. Case No. 13-07673-8-SWH. Adversary Proceeding No. 15-00043-8-SWH. October 118, 2016 at 2, 11, 12, and 14 to 15.
[136] Second amended complaint. In re: American Ambulette & Ambulance Service, Inc. et al. (2016) at 14 and 76; Sweigart, Josh. "Dozens left jobless when private ambulance company abruptly closes." *Dayton Daily News.* December 14, 2013; "Major ambulance service shuts down without notice in six states." *NBC News.* December 9, 2013; "Lawsuit filed against shuttered ambulance service that stranded hospitals in six states." *NBC News.* December 10, 2013.
[137] Otis, Ginger Adams. "EMTs, paramedics lost final paychecks after private ambulance company TransCare went bankrupt." *New York Daily News.* April 1, 2016; Otis, Ginger Adams. "Exclusive: Private ambulance company TransCare that answered FDNY 911 calls ceases operations in Bronx, Manhattan." *New York Daily News.* February 24, 2016; Coyne, Matt and Michael

D. Private equity behind retail apocalypse that destroyed nearly 600,000 jobs

The PE takeovers of retail chains have been particularly disastrous. Over the past decade, private equity firms and hedge funds have rapidly expanded into retail, snapping up over 80 major retailers.[138] The highly-leveraged retail takeovers had frequently led to bankruptcies and significant job losses, destroying the economic security of working families and sapping the economic vitality from local communities. Today, one out of eight retail workers are employed by a chain controlled by private equity — about 1 million out of the total 15.8 million U.S. retail workers.[139] These workers are especially vulnerable to future layoffs.

Over the last ten years, PE-driven layoffs, bankruptcies, and liquidations have destroyed 597,000 jobs, according to a 2019 study by Center for Popular Democracy, Private Equity Stakeholder Project, Americans for Financial Reform Education Fund, and United for Respect.[140] These job losses suggest that private equity has slashed 40 percent of the jobs at PE-owned retailers, since today the industry reports there are 900,000 workers were employed by PE-owned retailers (meaning that before the layoffs, there were about 1.5 million jobs).[141]

Private equity owned retailers both shed store locations and cut the retail workforce. A 2014 study found that PE takeovers of retail companies cut 12 percent of their workforce within five years.[142] The biggest job losses came from PE-controlled retail bankruptcies. The PE industry and other analysts put the blame for these job losses on competition from e-commerce (especially Amazon), but the business failures and job losses have been highly-concentrated in the PE-owned retailers. As one financial analyst observed, the debt-backed PE retail takeovers with "high-leverage, especially in this difficult [retail] environment, can be fatal."[143]

PE-owned retailers were the vast majority of retail bankruptcies. Ten out of the 14 (or 71 percent) of the largest retail chain bankruptcies since 2012 were at private equity-acquired chains. Among the retailers that filed for Chapter 11 bankruptcy in 2016 and 2017, two-thirds were backed by private equity.[144] There were at least six more PE-owned retail bankruptcies in 2018 and layoffs at Sears alone cost over 250,000 jobs (Sears, Southeastern Grocers, Nine West, David's Bridal, Top's Market, Claire's Stores).[145]

Many of these failures were at grocery stores. Over the last decade, private equity firms have taken over at least 14 grocery store chains. Six of them (43 percent) went into bankruptcy and 2 of those were liquidated (14 percent).[146] These included nationally known chains like A&P and important

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D'Onofrio. "TransCare ambulance service abruptly halts Westchester service." *White Plains (NY) Journal News.* February 24, 2016.

[138] Pirate Equity (2019) at 4.

[139] BLS, "All Employees: Retail Trade [USTRADE]," retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/USTRADE, May 13, 2019; Private Equity Stakeholder Project analysis of PitchBook data related to total employees at private equity acquired companies.

[140] Pirate Equity (2019) at 4.

[141] Ernst & Young (2019) at 5

[142] Davis et al. (2014) at 3978.

[143] Coleman-Lochner and Ronalds-Hannon (2019).

[144] Covert, Bryce. "The demise of Toys 'R' Us is a warning." *The Atlantic*, July/August 2018.

[145] Pirate Equity (2019) at 40 to 44.

[146] *Ibid.*

regional grocery chains like Marsh Supermarkets in the Midwest and DeMoula's Market Basket in New England. These bankruptcies and liquidations cost 69,700 supermarket jobs.[147]

Other private equity takeovers of supermarket chains have stripped assets and siphoned off fees that have imperiled the financial viability of the grocery businesses. For example, Cerberus Capital Management began its investment in Albertsons-Safeway in 2006; since then it has raised the company's debt load to $8.6, sold off $2.6 billion of the supermarket real estate requiring a leaseback, and extracted nearly $350 million in fees.[148] In 2019, Albertsons-Safeway is trying to strip the pension benefits of grocery workers in Maryland, West Virginia, Virginia, and Washington, DC during union contract negotiations.

The profits from the PE retail takeovers were vacuumed to Wall Street, but the costs of these takeover blunders fell squarely on low-wage retail workers, most commonly women of color. Retail employers often provide poor quality jobs with low pay and no benefits, stagnant wages, high rates of underemployment (despite many workers wanting full-time hours), and unstable schedules that fluctuate week to week.[149] As a result, one out of four retail workers live below or near the poverty level.[150] Retail workers of color face high rates of occupational segregation and are concentrated in the retail jobs and sub sectors with the lowest pay and limited mobility (such as cashier positions in apparel).[151] Faced with poor job quality and widespread racial discrimination, very high numbers of retail workers of color — two out of five of Black (43 percent) and Latinx (42 percent) workers in this sector — live in or near poverty.[152]

VI. Private Equity's Impacts on Affordable Housing, Consumer Debt, and Students at For-Profit Colleges

The private equity industry has a growing influence over several sectors directly under the House Financial Services Committee's jurisdiction, including housing, consumer lending, and student lending. In all of these areas, private equity has been a driving and sustaining force in predatory and extractive profiteering, including practices that target households of color and lower-income households, and that exacerbate social and economic inequality.

A. Private equity threatens affordable housing and tenants

Private equity's investment in real estate exploded after the 2008 financial crisis. PE real estate speculators snapped up single-family homes as foreclosures rose and real estate values plummeted. PE firms also bought multifamily apartment buildings and manufactured home communities where they could generate steady profits by extracting higher rents. In some cases, the private equity investments were facilitated by taxpayer-subsidized loans from the government sponsored

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[147] *Ibid.*
[148] United Food & Commercial Workers Local 400 and Private Equity Stakeholder Project. "Private Equity's Biggest Retail Gamble: Albertsons Safeway." November 6, 2019.
[149] Center for Popular Democracy (CPD), Fair Workweek Initiative. "Job Quality and Economic Opportunity in Retail Key Findings from a National Survey of the Retail Workforce." November 2017.
[150] Ruetschlin, Catherine and Dedrick Asante-Muhammad. Dēmos. "The Retail Race Divide How the Retail Industry Is Perpetuating Racial Inequality in the 21st Century." June 2, 2015.
[151] CPD (2016) at 1 to 2.
[152] Ruetschlin and Asante-Muhammad (2015).

enterprises Fannie Mae and Freddie Mac that have a statutory mandate to encourage affordable housing, but the predatory practices of private equity landlords have undermined that goal.

Globally, PE real estate investments rose by about 50 percent in recent years, from around $600 billion in 2011 to over $900 billion in real estate assets owned by 2018.[153] About two-thirds of the real estate deals in 2018 were in the United States (4,400 deals worth $206 billion) and about one-fifth of that was in residential real estate (about $40 billion). [154] Today, private equity landlords own at least one million apartment units, nearly 250,000 single-family homes, and 150,000 manufactured home sites.[155] The private equity industry views rental properties as just a new asset class that can generate yield for investors through families paying their monthly rent.[156] Blackstone has become the world's biggest landlord with over $230 billion in residential and commercial properties.[157]

PE purchases are backed with mountains of debt, and made with an eye to creating high levels of return for the PE firm, so PE firms often pursue aggressive cost cutting and revenue enhancing strategies like raising rent, adding new fees and charges, skimping on upkeep, and aggressively pushing tenants to depart (including through evictions) to further raise rents and revenues. The web of corporate subsidiaries and limited partnerships can shield private equity owners from legal consequences for pursuing these aggressive — and sometimes illegal — tactics to generate higher profits. PE investments in residential rental properties are contributing to the affordable housing crisis across the country. Families are finding it harder to find decent affordable rental homes and potential first-time homebuyers are less able to purchase faced with competition from deep pocketed PE-backed buyers that can make all cash offers.

Private equity profits from housing collapse: After millions of families lost their homes during the foreclosure crisis, private equity bought up tens of thousands of homes across the country. The private equity industry frequently bought those homes at a substantial discount as a result of the mortgage crisis,[158] profiting off the economic losses that were especially deep in lower- and moderate-income neighborhoods and communities of color. The PE firms took real estate investment trusts (REITs) private and merged many companies together to form consolidated owners of single-family rental homes.

Today, private equity firms own at least a quarter million single-family rental homes estimated to be worth nearly $40 billion.[159] The biggest of the PE investors, Blackstone Group-controlled Invitation Homes, was formed out of a series of mergers that created a company with 82,000 rental homes in

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[153] EisnerAmper and Preqin. "2019 Private Equity Real Estate Market Outlook." 2019 at 8. Includes dry powder behind real estate PE funds.
[154] *Ibid.* at 14 to 15.
[155] National Multifamily Housing Council (NMHC). "NMHC 50 largest apartment owners, 2018." 2019; Americans for Financial Reform Education Fund, Alliance of Californians for Community Empowerment, and Private Equity Stakeholder Project (AFREF, ACCE and PESP). "The Continuing Threat of Private Equity Investment in Single Family Rentals." April 2019; Private Equity Stakeholder Project, Manufactured Housing Action, and Americans for Financial Reform Education Fund (PESP, MHA, and AFREF). "Private Equity Giants Converge on Manufactured Homes." February 2019 at 4.
[156] Gopal, Prashant and Patrick Clark. "PE snapped up houses after the real estate crisis." *Businessweek.* October 3, 2019.
[157] Flood, Chris. "Blackstone leads global surge in property investment." *Financial Times.* May 22, 2019.
[158] Casselman, Ben and Conor Dougherty. "Want a house like this? Prepare for a bidding war with investors." *New York Times.* June 20, 2019.
[159] "Single-Family Rentals Growing as an Institution-Owned Asset Class." *National Real Estate Investor.* December 2018.

17 metropolitan areas.[160] As a result, Blackstone alone owns nearly one out of every 200 rental houses and its Invitation subsidiary share price has risen by 50 percent since it went public in early 2017.[161] The PE presence is much more extreme in some specific local markets. According to the *Atlantic*, institutional investors own one in every five single family homes in some Atlanta neighborhoods, and in one zip code they bought almost 90 percent of the 7,500 homes sold between January 2011 and June 2012.[162]

These distant PE landlords often hike rents, avoid investing in repairs and upkeep, gouge tenants with additional fees and costs, and are more likely to evict tenants.[163] On investor calls, they boasted of cost-cutting measures like pushing increasing responsibility for basic maintenance and repairs onto tenants, along with generally reducing spending in these areas. The consequences for families can be both increased costs and unsafe or unlivable homes.[164] The substantial waves of private equity money into the single-family housing market has also made it harder for families to become homeowners. In some markets, these private equity funds are pushing up home prices and outbidding — often with all-cash offers — potential first-time buyers.[165] The negative effects have fallen disproportionately on low- and moderate-income families and communities of color – the very families most impacted by the predatory subprime lending spree that led to the financial crisis.

The buy-up continues today. In 2018, investors bought about 20 percent of the available starter homes — the cheapest third of single-family houses.[166] Private equity-funded SFR companies including Progress Residential (Pretium Partners), FirstKey Homes (Cerberus Capital Management), Tricon American Homes (Tricon Capital), and Main Street Renewal (Amherst Holdings) have continued to be aggressive acquirers and are raising a combined $3.25 billion to invest in single-family rental properties.[167]

Private equity's multifamily empire: Private equity and private real estate managers own at least a million apartment units around the United States, based on data from the National Multifamily Housing Council, more than twice the number of apartment units owned by publicly-traded apartment real estate investment trusts (REITs).[168] Many private equity funds held few multifamily buildings before the financial crisis, but capitalized on the real estate collapse by buying hundreds of thousands of apartment units. Today, private equity-backed buyers are the primary drivers behind multifamily residential property investments.[169]

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[160] Invitation Homes. [Press release]. "Invitation Homes and Starwood Waypoint Homes complete merger." November 16, 2017.
[161] Gopalt and Clark (2019); Invitation Homes share price rose from $20.63 when it was launched January 29, 2017 to about $30 during September 2019. Ticker INVH.
[162] Semuels, Alana. "When Wall Street is your landlord." *The Atlantic.* February 13, 2019.
[163] ACCE Institute, Americans for Financial Reform and Public Advocates. "Wall Street Landlords Turn American Dream into a Nightmare." January 2018.
[164] Semuels (2019).
[165] *National Real Estate Investor* (2018).
[166] Casselman and Dougherty (2019).
[167] Premium Partners LLC. [Press release]. "Premium Partners raises more than $1 billion for single-family rental platform." July 9, 2018; Tan, Gillian and Patrick Clark. "Cerberus is seeking more than $500 million for rental homes." *Bloomberg.* August 20, 2018; Tan, Gillian and Patrick Clark. "Amherst seeks more than $1 billion for rental houses." *Bloomberg.* August 22, 2018; Semuels (2019.
[168] *Ibid.*
[169] Jones Lang LaSalle. "JLL Multifamily Investment Outlook, H1 2017." 2018.

These buyers can demand quick and high returns that can ultimately harm tenants. Lone Star Funds acquired Home Properties and promised investors it intended to generate a 25 percent internal rate of return.[170] These high returns can be financed with loads of debt (up 80 or 90 percent in some cases), and also by raising rents and fees, sometimes quite sharply, to extract more cash from the apartment properties. This can include purchasing more modest buildings, pressing working class tenants to leave in order to then upgrade the apartments and raise the rents, attract more affluent tenants and sometimes flip the properties for a profit.[171]

Some private equity buyers have adopted a business strategy of pushing out long-time lower-income tenants – through rent hikes, harassing frivolous legal actions, spurious eviction notices, avoiding upkeep, and letting buildings fall into disrepair – to convert buildings in gentrifying areas into high-rent properties that can be sold for much more than their purchase price.[172]

The most notorious PE takeover of multifamily is BlackRock and Tishman Speyer Properties $5.6 billion 2006 leveraged takeover of the 11,000-unit Stuyvesant Town and Peter Cooper Village, a pool of affordable housing in high-priced Manhattan.[173] Tishman Speyer and Blackrock invested a combined $224 million of their own money in the deal, the rest was equity from PE investors like pension funds as well as a $3 billion mortgage; Tishman Speyer pocketed $18 million in fees annually until the deal soured.[174]

When PE bought the property, there were over 8,000 rent controlled apartments, but Tishman quickly and aggressively pushed to deny 800 rent-controlled lease renewals in order to convert them into higher-priced apartments – 40 percent of the tenants prevailed, but Tishman's aggressive legal intimidation encouraged 30 percent to move out.[175] In 2009, the New York Court of Appeals fined Tishman Speyer $200 million for illegally raising rent on 4,400 apartments.[176]

In 2010, Tishman-Blackrock defaulted on the apartment complex and PE investors had their equity stake in the building wiped out; one major fund alone lost $500 million.[177] Because of the partnership structure, Tishman Steyer and Blackrock only lost their initial investment, and it is unlikely that tenants will recover the damages from illegal rent hikes.[178] In 2015, when PE firm Blackstone bought Stuyvesant Town/Peter Cooper, there were 20 percent fewer rent controlled units than when PE first took over the complex and Blackstone only committed to maintaining them as rent-controlled for a limited time (10 or 20 years).[179]

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[170] "Lone Star Gears Up for Another Mega-Fund." *Commercial Real Estate Direct.* December 17, 2015.
[171] Wishnia, Steven. "How forcing tenants to move became a business model for NYC landlords." *Village Voice.* September 18, 2017; Kim, Julia. "Inside Manhattanville tenants' fight against predatory landlords." Columbia Spectator. February 21, 2018.

[172] Morgenson, Gretchen. "As investment firms buy up buildings, tenants see bullies." *New York Times.* May 9, 2008; Wishnia (2017); Kim (2018); Anderson, Scott Thomas. "Sacramento is the land of corporate landlords." *Sacramento News & Review.* February 8, 2018; Shabazz, Rasheed. "Wall Street comes to Alameda." *East Bay Express.* May 23, 2018.
[173] Fernandez, Manny and Charles V. Bagli. "Tenants roiled by challenges on residency." *New York Times.* May 27, 2008; Bagli, Charles V. "Buying landmarks? Easy. Keeping them? Maybe not." *New York Times.* January 16, 2010.
[174] Bagli (2010).
[175] Fernandez and Bagli (2008).
[176] Bagli, Charles V. "Court deals blow to owners of apartment complex." *New York Times.* October 22, 2009.
[177] Bagli (2010).
[178] Gottensdiener, Laura. "How Wall Street screwed over tenants in New York City." *Mother Jones.* April 8, 2014;
[179] Schiffman, Betsy. "Blackstone to buy Stuy Town in $5.3 billion deal." *Forbes.* October 20, 2015; Bagli (2010).

This month, private equity firm Greystar Equity Partners announced it had raised $2 billion for a new multifamily property fund.[180] It already held nearly 50,000 apartment buildings, including a building in Northern Virginia that threatened to evict a senior citizen over a misunderstanding about cookies before a *Washington Post* column publicized the reportedly common occurrence of threatening tenants for very minor infractions like cursing.[181]

Buying up manufactured home communities: Private equity firms have purchased and rolled-up hundreds of manufactured home communities (also known as mobile home parks) with an estimated 150,000 homesites.[182] Until recently, most of these communities were owned locally by mom-and-pop landlords, but in the last decade private equity firms have followed the lead of a first wave of corporate owners and snapped up scores of manufactured home communities, building large portfolios that can control the financial fate of hundreds of thousands of families. The PE firms have utilized the same profiteering practices as in single-family and multifamily takeovers: rent hikes, fee gouging and penalties, repeated baseless eviction notices, inadequate investment in maintenance, and more to generate more revenues from the communities' residents.[183]

Manufactured home communities are a vital pool of affordable housing for seniors on fixed incomes, low-income families, immigrants, people with disabilities, veterans and others, especially in rural and sprawling metropolitan areas. Manufactured homes offer an affordable homeownership opportunity for 20 million people; 70 percent of the homes sold for less than $125,000 are manufactured homes, and households that live in these communities typically earn $39,000 annually, far short of the national median income.[184] Residents generally own the manufactured home and rent the land where the home sits; about 3 million families own or rent manufactured homes with these land-leases.[185]

Private equity buyers have bought up these communities because the tenants are a captive audience paying rents that generate steady revenues even during downturns. Although manufactured homes are sometimes called mobile homes or trailers, it is generally infeasible to move them. It can cost over $10,000 to move a manufactured home even if a family could find a new place to put it.[186] That means that private equity landlords can and do rapidly raise rents and the trapped community members have little choice but to pay escalating rents and fees.[187] PE firms have jacked monthly rents up by 40 percent to 70 percent and added new fees and penalties to generate even more revenues.[188] Oftentimes, private equity-owned communities skimped on upkeep and providing basic services to extract more revenues from the communities. As a result, residents could end up paying

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[180] "Greystar raises $2bn for tenth US multifamily property fund." *IPE Real Assets.* November 6, 2019.
[181] NMHC (2019); Vargas, Theresa. "She's 83 and might get kicked out of her apartment. Among her violations: Taking too many cookies." *Washington Post.* October 16, 2019; Vargas, Theresa. "'Yawhoo!': The 83-year-old grandmother hit with a lease violation for taking too many cookies won't have to leave." *Washington Post.* October 23, 2019.
[182] PESP, MHA, and AFREF (2019) at 4.
[183] Brown, Jennifer and Kevin Simpson. "Mobile home parks move from mon-and-pop to corporate." *Associated Press.* September 15, 2019.
[184] *Ibid.*
[185] U.S. Consumer Financial Protection Bureau (CFPB). "Manufactured-Housing Consumer Finance in the United States." September 2014.
[186] Dubb, Steve, "Mobile home affordability threatened by private equity." *Nonprofit Quarterly.* June 24, 2019.
[187] Sullivan, Esther. *Manufactured Insecurity: Mobile Home Parks and Americans' Tenuous Right to Place.* University of California Press: Oakland. 2018 at 183 to 184.
[188] Whitford, Emma. "Affordable housing is disappearing. These mobile home residents are fighting to protect theirs." *Time.* November 30, 2018; "Private equity firms rapidly investing in mobile home parks." *Associated Press.* April 20, 2019.

nearly $700 per month for rent that only covered modest basic services — like water, sewer, and basic landscaping or snow removal — that sometimes were not even provided.[189]

Many of these PE firms own large portfolios of manufactured homes. Private equity-backed Equity Lifestyle Properties own over 200 communities with over 70,000 homesites[190] After it took over a mobile home park for senior citizens in Florida, it tripled the eviction rate, kicking out over 12 percent of the households.[191] In California, Equity Lifestyle Properties settled a $10 million suit for failing to maintain a community, including unannounced water shutoffs, frequent sewage backups, electricity blackouts, potholes, and more.[192] Smaller PE firms like Havenpark Capital have bought up communities across the Midwest and steeply raised rents so that they became unaffordable for those on fixed incomes. In some cases, they have increased rents by 40 percent to 70 percent and to close to 80 percent of monthly Social Security benefits — forcing hard-pressed residents to choose between paying their rent and buying food or medicine or keeping the lights on.[193]

B. Private equity-owned consumer lenders prey on vulnerable consumers

Private equity firms have pushed into the high-priced, consumer loan industry, offering payday loans and other consumer loan products that trap borrowers in a cycle of debt. As the *Washington Post* reported, "sensing profits in loaning money to cash-strapped Americans, private equity firms have jumped into consumer lending."[194] By the end of 2017, private equity firms owned more than 5,000 storefront payday lenders as well as a host of online lenders that offer comparably steep prices with triple-digit annual percentage rates (APR) loans.[195] Some of the largest and most well-known payday lending companies, like ACE Cash Express, Speedy Cash, Money Mart and the Check Cashing Store, have been owned by private equity firms.[196] Private equity is also an increasing force in the high cost installment loan business, which typically involves somewhat larger loans paid back in installments over longer periods and can involve similar (as well as additional) abusive practices.[197]

Payday and car title loans are structured to create a long-term debt trap that drains consumers' bank accounts and causes significant financial harm, including delinquency and default, overdraft and non-sufficient fund fees, increased difficulty paying bills like mortgages, rent, utilities, and other bills, loss of checking accounts and bankruptcy. Consumers borrow several hundred dollars at high rates to be repaid when they get their next pay check or Social Security check; but most borrowers

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[189] Durst, Noah J. and Esther Sullivan. "The contribution of manufactured housing to affordable housing in the United States: Assessing variation among manufactured housing tenures and community types." *Housing Policy* Debate. Vol. 29, Iss. 6. June 2019; Rucker, Patrick. "Fannie Mae: Mobile-home loan program leaves evictions, billionaire profits in wake." *Capitol Forum.* May 16, 2019; Whitford (2018).

[190] PESP, MHA, and AFREF (2019) at 17.

[191] Rucker (2019).

[192] Kaplan, Tracey. "Mobile home park victory: A negligent owner, $10 million settlement and San Jose residents who prevailed." *San Jose Mercury News.* March 5, 2017.

[193] *Associated Press* (April 20, 2019).

[194] Whoriskey, Peter. "Senate bill would prohibit mailing checks worth thousands of dollars to strangers." *Washington Post.* December 11, 2018.

[195] Americans for Financial Reform and Private Equity Stakeholder Project. "Private Equity Piles into Payday Lending and Other Subprime Consumer Lending." December 2017

[196] Whoriskey, Peter. "'A way of monetizing poor people': How private equity firms make money offering loans to cash-strapped Americans." *Washington Post.* July 1, 2018.

[197] Whoriskey (July 1, 2018).

have to refinance their loans again and again because they cannot afford to repay the high-cost loans. More than 80 percent of payday loans are rolled over or renewed within two weeks.[198]

These high cost lenders' business model is based on using the coercive tactic of withdrawing money directly from a bank account (or holding a car title that may be worth many times the amount of the loan as collateral in the case of car title loans) to extract money from economically vulnerable people. In addition to various strategies to try to evade existing state anti-predatory lending laws, many of the companies in this sector and their trade associations spend heavily on lobbying and political contributions to try to head off new rate caps and other regulations, which have consistently high levels of popular support.

About one in 25 families take out at least one payday loan each year, according to the Federal Reserve, and African American and Latinx consumers are two to three times more likely to have a payday loan than whites.[199] These high-cost lenders extracted $8 billion in interest and fees from consumers that took out payday and car-title loans.[200] Longer-term (installment) payday loans have extremely high refinance (37 percent) and default (38 percent) rates, clear signs that they are not typically affordable.[201]

FFL Partners' Speedy Cash payday lender sells high-priced loans that skirt consumer protection laws: San Francisco-based PE firm FFL Partners bought Curo Financial, the parent company of Speedy Cash and Rapid Cash in 2008.[202] Speedy Cash interest rates and fees make the loans very expensive: a $400 loan could carry an annual percentage rate of 389 percent and cost $2,300 to repay over 18 months.[203] In 2018, Speedy Cash paid $750,000 to settle allegations that it evaded California rate-cap rules and repay 6,400 borrowers that were deceptively steered into larger and higher-interest rate loans.[204]

Speedy Cash aggressively pursued consumers that fell behind on their payday loans. Speedy Cash has filed suits and garnished paychecks to extract repayment, sometimes seeking attorney fees and court costs that can be 50 percent of the original debts.[205] In 2013, *ProPublica* found that Speedy Cash filed over 9,300 collection lawsuits in Missouri against delinquent payday borrowers — about 20 percent of all the payday lawsuits in the state even though it only had 6 storefront locations.[206]

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[198] Burke, Kathleen et al. CFPB's Office of Research. "CFPB Data Point: Payday Lending." March 2014 at 4 to 5.
[199] Bricker, Jesse et al. Board of Governors of the Federal Reserve System. "Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances." *Federal Reserve Bulletin.* Vol. 103, No.3. September 2017 at Table 5 at 27. See Table 5; Burhouse, Susan et al. Federal Deposit Insurance Corporation. "2013 FDIC National Survey of Unbanked and Underbanked Households—Appendices." October 2014 at Table 12A at 83
[200] Standaert, Diane, Delvin Davis, Charla Rios. Center for Responsible Lending. "Payday and Car-Title Lenders Drain Nearly $8 Billion in Fees Every Year." April 2019 at 3.
[201] CFPB. "Supplemental findings on payday, payday installment, and vehicle tile loans, and deposit advance products." June 2016 at 15 and 22.
[202] FFL Partners. Portfolio Companies: Speedy Cash. Internet Archive December 2008. Accessed November 2019.
[203] Kiel, Paul. "When lenders sue, quick cash can turn into a lifetime of debt." *ProPublica.* December 13, 2013.
[204] California Department of Business Oversight. [Press release]. "DBO continues crackdown on interest rate cap avoidance entering consent order with California check cashing stores." January 22, 2019.
[205] Bulusu, Siri. "How small short-term loans draw vulnerable borrowers into big long-term debt." *Medill Reports Chicago.* April 9, 2016.
[206] Kiel (2013).

In late 2018, FFL Partners took Curo public, but it retained a nearly 20 percent stake in the company even in late 2019.[207] Curo has begun to make more installment loans than payday loans — loans with their own triple-digit interest rates that get paid back in installments instead of lump-sum repayment — and that are designed to evade regulatory limits on payday lenders.[208]

Most recently, Curo has told its investors that it plans to evade a new interest rate cap in California by setting up a sham partnership with a bank, which would involve falsely claiming the bank (which is not generally considered subject to state interest rate caps) is the true lender.[209]

Online payday lender dodges state usury laws, goes bankrupt from lawsuits: Private equity startup firms Sequoia Capital and Victory Park Capital as well as other investors backed an early internet lender, Think Finance.[210] This online lender described itself as serving the unbanked, but pushed high-cost but convenient loans that posed the same risks as storefront payday lenders: sky-high interest rates and fees that trap consumers in a cycle of debt.

Think Finance was charged with multiple violations, including using front companies on tribal land to circumvent state interest rate caps and charge higher interest rates.[211] The Consumer Financial Protection Bureau found that Think Finance made $49.1 million in loans that were void under various state laws and that it had collected $85.8 million in principle, interest, and fees on these loans between 2013 and 2015.[212]

Ultimately, Think Finance settled a raft of additional lawsuits by agreeing to pay $39.7 million to 21 million borrowers.[213] The lawsuits contended that many borrowers received unsolicited mailings that promised loans — for $1,000 or more — merely by going online; a $500 loan could have an interest rate of 438 percent, making it cost nearly $1,800 to pay off the debt.[214] Pennsylvania's Attorney General secured a settlement with Think Finance as part of its bankruptcy to erase remaining loan balances for 80,000 Pennsylvanians who were sold $133 million in illegal online payday loans that charged effective interest rates as high as 448 percent.[215] In 2017, Think Finance went into bankruptcy in part because of the lawsuits over its predatory loans.[216]

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[207] Dugan, Kevin. "Payday lender's IPO gets a 'meh' from Wall Street." *New York Post.* December 7, 2017; CURO Group Holdings Corp. SEC form DEF-14A. April 16, 2019 at 16.
[208] Weinstein, Austin. "Payday lenders are making bank on high-interest products." *Bloomberg.* June 5, 2018.
[209] National Consumer Law Center. [Press release]. "Advocates Urge FDIC, OCC, Federal Reserve to Stop Banks from Helping Payday Lenders Evade State Interest Rate Limits." November 7, 2019.
[210] Rao, Leena. "Sequoia-backed Think Finance gets a $90 million credit line to help serve 'the unbanked.'" *TechCrunch.* September 23, 2010; Shubber, Kadhim. "Why this subprime lender funds loans through the Cayman Islands." *Financial Times.* January 19, 2016; Brickley, Peg. "Think Finance bankruptcy exposes fallout with Victory Park Capital." *Wall Street Journal.* October 24, 2017.
[211] Howland, Jack. "Fort Worth firm allegedly violated payday loan laws for years. Now it's paying $39.7M." *Fort Worth Star-Telegram.* June 28, 2019.
[212] CFPB. CFPB v. Think Finance, LLC. Complaint. U.S. District Court of Montana, Great Falls Division. November 15, 2017 at 25.
[213] Howland (2019).
[214] Tompor, Susam. "Westland woman had 350% interest rate on $1,200 loan and a loophole allows it." *Detroit Free Press.* July 12, 2019.
[215] "State attorney general announces relief for 80,000 Pennsylvanians targeted by online payday loan scheme." *Fox WPMT-43.* July 24, 2019.
[216] Tompor (2019).

Warburg Pincus' Mariner Finance reaps revenue from high-cost installment loans: In 2013, New York-based private equity firm Warburg Pincus bought installment lender Mariner Finance for $88 million.[217] Mariner Finance has over 44 branches in 22 states and has about 500,000 borrowers.[218]

Mariner sends unsolicited "live checks" to potential borrowers without consideration of their income, current debt obligations, or whether they can repay new debts.[219] Once borrowers sign and deposit the checks, they are obligated to repay the loans; cash-strapped consumers may not be aware of the terms, fees, and, conditions of the loan.[220] The business of what one former Mariner manager trainee called "monetizing poor people" has generated ample profits for the company.[221]

Mariner installment loans may carry lower nominal interest rates than payday loans, sometimes 35 to 36 percent, but it also charges fees that inflate the cost of the loans — adding hundreds of dollars on top of the interest, so that APRs are well above the nominal interest rate (and Mariner also makes still higher rate loans)[222] It also push-markets loan insurance of dubious value that can add nearly $400 more to the cost of the loans.[223] Insurance of this kind has repeatedly been found to be predatory, and often sold in illegal ways, in connection with mortgages as well as personal loans.

Mariner also relentlessly badgers delinquent borrowers with daily calls — even calling friends and relatives — and pursues them in court.[224] It has sued borrowers that have fallen behind for nearly three times the original debt principle, asking $3,300 for the loan principle, interest, loan fees, attorney costs, and court fees for a $1,200 loan[225]

C. Private equity drives student debt at for-profit colleges

Private equity firms have helped fuel the e for-profit college industry in the United States by buying up chains like the University of Phoenix, Art Institutes, Walden University, and Ashford University.[226] Between 2007 and 2019, private equity firms bought over 100 for-profit colleges.[227] The PE firms use leveraged buyouts to acquire for-profit schools and roll-up additional campuses into national companies. The PE firms cut educational expenses while increasing marketing to lure more students and their federally-backed loans to maximize profits.

PE-takeovers surged in the wake of the financial crisis, as people enrolled in schools when there were fewer job opportunities; the anticipation of an economic downturn has now also contributed

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[217] Hyde Park Capital. "Consumer Finance Industry Update." May 2014 at 3.
[218] Mariner Finance. Corporate description at website home page. Accessed November 2019; Apple, Alex. "Lending companies target need Americans with loans sent in the mail." *Fox News WZTV-17 Nashville, Tennessee.* July 5, 2018; Whoriskey (July 1, 2018).
[219] Nicastro, Steve. "Here's the catch to those 'checks' you get in the mail." *MarketWatch.* December 28, 2018.
[220] Whoriskey (December 11, 2018).
[221] Whoriskey (July 1, 2018).
[222] Mariner Finance. "Itemized Schedule of Charges (Delaware) Closed End Loans." June 2017.
[223] Whoriskey (July 1, 2018).
[224] *Ibid.*
[225] Apple (2018).
[226] Americans for Financial Reform and Private Equity Stakeholder Project (AFR and PESP). "Private Equity's Failing Grade." March 2018.
[227] Unglesbee, Ben. "Private equity's role in the rise — and fall of for-profit colleges." *EducationDive.* May 6, 2019.

to reinvigorated private equity interest.[228] But private equity firms have been particularly emboldened by the Trump administration's roll-back of student borrower protections, including the repealing the gainful employment rule that can discipline schools that have too many students leaving with unmanageable debt.[229] There were at least 5 private equity for-profit college deals in 2018 and in 2019, including the purchase of University of St. Augustine for Health Sciences by Atlas Partners for $400 million.[230]

These takeovers have harmed students that end up incurring substantial debts often without having received an education that prepares them for a job. And the harm has been particularly severe for students of color. For example, African Americans are more than one-fifth of the students at for-profit colleges, as compared to 13 percent of the students at public colleges.[231]

For-profit schools have a poor record overall on graduation rates, impact on student earnings post-graduation, and portion of revenues devoted to teaching as opposed to marketing. A 2018 National Bureau of Economic Research (NBER) study found that students at for-profit colleges earned less after attending school than they did before their enrollment and that the income decline after attendance was twice as big at chain for-profit schools.[232]

Research points to PE owned for profit schools doing still worse. A 2019 NBER study found that 88 private equity takeovers of for-profit colleges and post-secondary schools managed to triple their profits largely through steep tuition hikes, marketing to drive higher enrollment, and reduced spending on instruction. This in turn caused significant declines in (already troubling) graduation rates (13.0 percent) and loan repayment (5.6 percent) compared to before the PE purchase.[233] The study concluded that the private equity profit incentives, along with reliance on public sources like federal student loans for 90 percent of revenues "is a purely rent-seeking phenomenon and is unambiguously not in the students' or taxpayers' interest."[234]

The short-term profit maximization, ability to evade liabilities, and increased pressure caused by the debt burden created by highly leveraged acquisition supercharge predatory practices. They incentivize extreme forms of revenue extraction through increasing enrollment to collect federal student loan dollars at the expense of providing a meaningful education. Students saddled with unpayable debts pay a high price. Because the for-profit schools rely overwhelmingly on federally backed student loans for revenue, so does the public purse. In the 2017-2018 school year, for profit colleges accounted for $16.6 billion in federal grants and loans, including GI bill student loans.[235]

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[228] Unglesbee (May 6, 2019).
[229] Givant Star, Marlene. "For-profit secondary education M&A poised for quiet comeback." *Merger Market.* October 15, 2018; Kreighbaum, Andrew. "DeVos issues final repeal of gainful employment." *Inside Higher Ed.* July 2, 2019.
[230] Givant Star (2018); Unglesbee, Ben. "For-profit Laureate sells St. Augustine for $400M, holds onto Walden U." *EducationDive.* February 7, 2019.
[231] Kahn, Suzanne, Mark Huelsman, and Jen Mishory. Roosevelt Institute, The Century Foundation, and Dēmos. "Bridging the Progressive Policy Debate: How Student Debt and the Racial Wealth Gap Reinforce Each Other." September 2019 at 10.
[232] Reigg Cellini, Stephanie and Nicholas Turner. "Gainfully Employed? Assessing the Employment and Earnings of For-Profit College Students Using Administrative Data." Working Paper No. 22287. January 2018 at 21.
[233] Eaton, Charlie, Sabrina T. Howell, and Constantine Yannelis. National Bureau of Economic Research. "When Investor Incentives and Consumer Interests Diverge: Private Equity in Higher Education." NBER Paper No. 24976. April 4, 2019 at 2 to 4.
[234] *Ibid.* at 2 and 8.
[235] U.S. Department of Education (Dept. of Ed.). Office of Federal Student Loans. Title IV Program Volume Reports. 2017-2018 Disbursements; U.S. Department of Veterans Affairs. Post 9-11 GI Bill Data. 2017 Tuition & Fees.

For example, Endeavor Capital-owned Southern Careers Institute (a subsidiary of Tall Oak Learning) derived more than 98 percent of its revenue from federal student loans, $32.4 million of $33.0 million in 2015, in violation of Department of Education rules that schools cannot take more than 90 percent of revenues from federal education aid and the highest rate in the country in 2015.[236] A decade after starting at Southern Careers, former students from the Austin campus had average annual earnings of $20,500 — about $5,000 less than average Austin residents with only a high school diploma.[237] Only 19 percent of these students had paid back *any* of their federal loan principle 3 years after leaving school, half the national rate of 46 percent.[238]

Private equity takeover of Art Institute parent, creates fraudulent "enrollment mill," resale, subsequent collapse, and re-resale to private equity-affiliated foundation: The private equity backed for-profit schools have been mired in controversy for fraudulent enrollments, illegal recruitment, and other violations. Private equity firms Providence Equity Partners and Leeds Equity Partners joined by Goldman Sachs took over Education Management Corp. (EDMC) in a $3.4 leveraged buyout in 2006 that left the company saddled with $1.4 billion in debt even six years later.[239] KKR got a 90 percent stake in EDMC after taking over its bad debts in 2014.[240] EDMC ran one of the nation's biggest for-profit college chains including Art Institutes and Brown Mackie Colleges.[241] The private equity owners pushed EDMC to swell enrollment to drive profits, doubling its student body by 2010.[242]

The EDMC enrollment growth was fueled by fraud. In 2015, EDMC paid $95.5 million to settle charges that it illegally payed recruiters bounties to secure ballooning enrollment that generated taxpayer-backed student loan revenues, including recruiting unqualified and unprepared students who accumulated unsustainable debt that they frequently defaulted on.[243] Attorney General Loretta Lynch said that EDMC operated "essentially as a recruitment mill, EDMC's actions were not only a violation of federal law but also a violation of the trust placed in them by their students — including veterans and working parents — all at taxpayers' expense."[244] EDMC separately paid a $102.9 million settlement to states attorneys general for paying recruitment bonuses that burdened students who enrolled and took out loans but then dropped out of school.[245]

In 2017, EDMC was on the verge of going bankrupt because of its PE-driven debt load and it's 65,000 student operation was sold for $60 million, about 2 percent of the original leveraged buyout

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[236] Halperin, David. "Inside a for-profit college conversion: Lucrative ties, troubling actions." *Republic Report.* May 16, 2018; Endeavor Capital. "Tall Oak Learning." Available at https://endeavourcapital.com/ec/tall-oak-learning/. Accessed November 2019; Dept. of Ed.. Proprietary School Revenue Percentages Report for Financial Statements with Fiscal Year Ending Dates Between July 1, 2014 and June 30, 2015; VA GI Bill Comparison Tool profile for Southern Careers Institute-Austin. Accessed October 22, 2017.

[237] AFR and PESP (2018) at 2.

[238] *Ibid.*

[239] Ananthalaskmi, A. "Analysis — EDMC flirts with debt covenant breach as profits slide." *Reuters.* September 20, 2012.

[240] EDMC. Securities and Exchange Commission filing DEF-14A. October 7, 2013.

[241] Douglas-Gabriel, Danielle. "Art Institute campuses are being sold to L.A.'s Dream Center Foundation." *Los Angeles Times.* March 3, 2017.

[242] Unglesbee (May 6, 2019).

[243] U.S. Department of Justice (DOJ). [Press release]. "For-profit college company to pay $95.5 million to settle claims of illegal recruiting, consumer fraud and other violations." November 16, 2015.

[244] *Ibid.*

[245] Pohle, Allison. "One of nation's largest for-profit chains will forgive loans for 80,000 former students in settlement." *Boston Globe.* November 17, 2015.

price, to the non-profit faith-based Dream Center Education Holdings.[246] A year later, Dream Center could not pay its debts, one of its schools, Argosy College, had its student loans cut-off after misappropriating $13 million in student loans, and it collapsed into receivership, stranding its remaining 26,000 students, many of whom were stuck with the debt but unable to finish their education.[247] Dream Center sold the Art Institute campuses to the Education Principle Foundation, a non-profit with close ties to the private equity firm Colbeck Capital in 2019.[248]

High debt, low educational value, low graduation rates at Apollo's University of Phoenix: In 2017, Apollo Global Management and other investors bought the parent company of the for-profit University of Phoenix chain for $1.1 billion.[249] Although University of Phoenix once had nearly half a million students annually, its enrollment dropped to about 100,000 by 2018.[250] University of Phoenix spent $27 million in online advertising between 2016 and 2017, the latest data available.[251] But it spent only 21 percent of its tuition dollars on educational instruction in 2016 and 15 percent of tuition on instruction in 2017.[252] Fairly few University of Phoenix students leave with a degree: only 17 percent of first-time, full-time students received a degree,[253] far below the 60 percent graduation rate at all colleges and even below the 21 percent rate at private for-profit schools over all.[254]And University of Phoenix students typically incurred nearly $32,000 in debt.[255] A 2019 study found that barely half (50.8 percent) of University of Phoenix graduates earned more than people with only a high school degree.[256] With such low earnings, it is perhaps unsurprising that more than one-in-eight (12.3 percent in 2015) University of Phoenix students defaulted on that debt,[257] far higher than the national average default rate of 10.8 percent.[258]

VII. Private Equity's Healthcare Takeover Threatens Patients

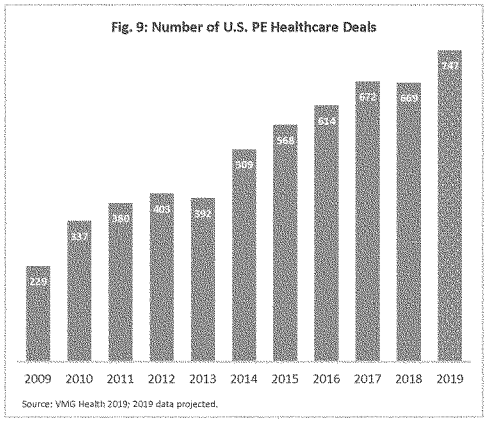
Private equity firms now own health care companies from birth (fertility clinics) to death (hospice care) and everything in between. PE firms own hospitals, ambulances, surgery centers, physician practices, dialysis, cancer care, nursing homes, autism treatment, drug and alcohol rehabilitation, fertility clinics and more.[259] Private equity has been a major force in the healthcare industry for over

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[246] Moore, Daniel. "EDMC completes sale of schools to Dream Center." *Pittsburgh Post-Gazette.* October 18, 2017; Unglesbee (May 6, 2019).
[247] Cowley, Stacy and Erica L. Green. "A college chain crumbles, and millions in student loan cash disappears." *New York Times.* March 7, 2019.
[248] Moore, Daniel. "Dream Center, blaming EDMC, turns to foundation with ties to private equity to revive Art Institutes." *Pittsburgh Post-Gazette.* January 23, 2019.
[249] Cohen, Patricia and Chad Bray. "University of Phoenix owner, Apollo Education Group, will be taken private." *New York Times.* February 8, 2016; Fain, Paul. "University of Phoenix hires new president." *Inside Higher Ed.* April 26, 2017.
[250] McKenzie, Lindsay. "The 100K club." *Inside Higher Ed.* April 23, 2018.
[251] Hall, Stephanie. The Century Foundation. "How much education are students getting for their tuition dollar." February 28, 2019.
[252] *Ibid.*; Veterans Education Success. "Should Colleges Spend the GI Bill on Veteran's Education or Late Night TV Ads." April 2019 at 5.
[253] University of Phoenix. "2019-2020 Consumer Information Guide." November 2019 at 6.
[254] National Center for Education Statistics. "Retention and Graduation Rates." May 2019.
[255] University of Phoenix (2019) at 5.
[256] Veterans Education Success (2019) at 6.
[257] University of Phoenix (2019) at 5.
[258] Dept. of Ed.. [Press release]. "National federal student loan cohort default rate continues to decline." September 25, 2019.
[259] Bain & Company. "Global Healthcare Private Equity and Corporate M&A Report 2019." 2019 at 17, 29, and 30; Whoriskey, Peter and Dan Keating. "Overdoses, bedsores, broken bones: What happened when a private equity firm sought to care for society's most vulnerable." *Washington Post.* November 25, 2018; Whalen, Jeanne and Laura Cooper. "Private-Equity pours cash into opioid treatment sector." *Wall Street Journal.* September 2, 2017; Liss, Samantha. "Private equity sees

a decade,[260] but the pace of PE takeovers is accelerating.[261] Over the past ten years, the number of PE healthcare deals tripled (see Figure 9), with $100 billion in takeovers in 2018.[262]

Private equity's aim to rapidly increase profitability can conflict with delivering quality health care. A *Journal of the American Medical Association* editorial observed that the PE drive for "high returns on investment on a fast time horizon may conflict with the need for investments in quality and safety."[263] PE firms typically increase revenues by cutting staff and reducing expenditures on care delivery that can harm patients, especially those that are sicker, elderly, lower-income or desperate. One PE healthcare specialist admitted the PE involvement in health care had "a reputation of acquiring to basically strip down and over-leverage and cash out, and everyone else left in its wake be damned."[264]



The gaps oversight and distorted incentives have allowed private equity firms to profit from healthcare takeovers at the expense of patients. First, the PE takeovers have been fueled by leveraged-buyouts,[265] often with substantial debt loads that can leave healthcare companies with little financial wherewithal to provide quality care for patients. Second, PE takeovers of healthcare facilities — hospitals and nursing homes — have included stripping real estate assets into separate subsidiaries or partnerships that further compromise financial viability. Third, the PE takeovers are frequently part of a roll-up or add-on merger wave where the PE firm aggregates many smaller businesses (like ambulance companies, medical practice groups, like dermatologists or dental offices) into larger firms that can negotiate for higher prices, charge consumers excessive fees by staying out-of-network (a surprise billing

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ripe opportunity in health care this year." *HealthcareDive.* March 25, 2019; Objective Capital Partners. "M&A in fertility outpatient care remains strong." *Healthcare Insights.* June 11, 2019; RegionalCare Hospital Partners. [Press release]. "RegionalCare Hospital Partners to be acquired by funds affiliated with Apollo Global Management." November 12, 2015; BainCapital. [Press release]. "U.S. Renal Care to be acquired by investor group." February 13, 2019.

[260] Robbins, Catherine J., Todd Rudsenske, and James S. Vaughan. "Private equity investment in health care services." *Health Affairs.* Vol. 28, No. 5. September/October 2008 at 1391.

[261] PwC Health Research Institute. "Top Health Industry Issues of 2019: The New Health Economy Comes of Age." 2019 at 29.

[262] Liss (2019); Meindl, John and Winston Smart. VMG Health. "Healthcare M&A Report." 2019 at 25.

[263] Gondi, Suhas and Zirui Song. "Potential implications of private equity investments in health care delivery." *Journal of the American Medical Association.* February 28, 2019 at E1; Flynn, Maggie. "New private equity firm eyes 'good buying opportunity' as skilled nursing prices cool." *Skilled Nursing News.* June 26, 2019.

[264] Flynn, Maggie. "New private equity firm eyes 'good buying opportunity' as skilled nursing prices cool." *Skilled Nursing News.* June 26, 2019.

[265] Meindl and Smart (2019) at 25.

strategy), or offer ancillary services that are uncovered by insurance coverage to drive up revenues.[266]

Finally, the PE owners also shield themselves from legal responsibility for any negligence or low-quality care that might occur under aggressive cost-cutting and profit-maximizing strategies. The PE firms often shield their ownership behind a maze of shell companies and partnerships that immunizes the PE firms and partners from being responsible for any wrongdoing.[267] This potentially creates a disincentive to provide care. For example, the *Journal of Health Care Finance* reported that PE-owned nursing home chains adopt complex corporate structures to limit liability for negligence and malpractice that reduces the incentive to deliver quality care.[268]

A. Private equity-controlled nursing home quality disasters

Private equity's investment in nursing homes has compromised the quality of care for the most vulnerable patients. In the early 2000s, private equity firms began snapping up major nursing home chains, and by 2010 PE firms owned 40 percent of the biggest for-profit chains.[269] After the PE takeovers, nursing home chain profits increased, staffing (especially registered nurses) declined and patient care suffered.[270]

Private equity-owned nursing homes often split nursing homes into real estate partnerships (that own the nursing homes) and operating businesses (that run the individual nursing homes). The real estate shell companies own the nursing homes and rent them back to the operating businesses, which is profitable for the PE firm but dangerous for the nursing homes. Lease-backs strip assets out of the nursing home chains and generate rental revenue for the PE real estate subsidiary, but they undermine the finances of nursing homes by adding additional business costs (rent) and reducing their assets that could be used to secure operating credit or other financing.

The individual nursing homes can be separate companies that not only pay rent to another PE subsidiary but may also contract for services and purchase supplies from other companies owned by the PE parent firm.[271] The nursing home subsidiaries are technically separate corporations, but the PE owners still exert control over business operations, review financial reports, and approve or modify budgets.[272] Despite the PE operational control over the nursing homes, the real estate subsidiaries and other corporate subsidiary structures also insulate the PE firm and the real estate assets from responsibility and liability that might arise from lawsuits over negligent care or government claims of overbilling Medicare or Medicaid.[273]

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[266] American Medical Association (AMA). Proceedings of the AMA 2019 Annual Meeting. 2019 at 446.
[267] Kirchhgaessner, Stephanie. "Private equity swoops in on nursing homes." *Financial Times.* October 27, 2010.
[268] Pradhan et al. (2014).
[269] Bos, Aline and Charlene Harrington. "What happens to a nursing home chain when private equity takes over? A longitudinal case study." *International Health Economics & Finance.* Vol. 54. 2017 at 1.
[270] Duhigg, Charles. "At many homes, more profit and less nursing." *New York Times.* September 23, 2007.
[271] Mills, Ryan and Melanie Payne. "Neglected: Florida's largest nursing home owner represents a trend toward corporate control." *Naples (FL) Daily News.* May 31, 2018; Rau (2018).
[272] Southwick, Ron. "Pa. Health Department ordered to turn over leases on nursing homes." *Harrisburg (PA) Patriot-Leader.* December 8, 2018.
[273] Rau (2018).

The quality of care is lower at private equity-owned nursing homes. The Government Accountability Office found that PE-owned facilities had higher rates of care deficiencies than non-profit facilities and lower overall staffing levels than other for-profit and non-profit nursing homes.[274] A 2014 study found that private equity delivered lower quality than other for-profits, which deliver poorer care than non-profit nursing homes.[275] It found that PE-owned nursing homes had 29 percent fewer registered nursing hours per patient, 9 percent more pressure sores and 21 percent more deficiencies than for-profit homes.[276]

A 2007 *New York Times* analysis found that private equity-owned nursing homes had worse performance for 12 of 14 quality of care indicators like bedsores than the national average and that "serious quality-of-care deficiencies—such as moldy food and the restraining of residents for long periods or the administration of the wrong medications—rose at every large nursing home chain after it was acquired by a private investment group."[277]

The private equity ownership of two major nursing homes ended in financial disaster that also threatened the safety of their residents: ManorCare went into bankruptcy and the operating business of Beverly (renamed Golden Living) was sold off to several companies that subsequently went out of business.

Carlyle drives ManorCare into bankruptcy and threatens patient care: In 2007, the Carlyle Group purchased the nation's largest nursing home chain, ManorCare, in a leveraged buyout for $6.3 billion including $4.8 billion in debt — 76 percent leveraged.[278] Carlyle contributed only $65 million, the rest of the $1.3 equity for the purchase came from the limited partner investors.[279]

In 2011, ManorCare sold most of its facilities to the real estate investment trust HCP in a $6 billion sale-leaseback deal (later spun off into a separate REIT called QCP).[280] The deal included a $1.3 billion payout to Carlyle investors, which covered the initial investment, but Carlyle also recovered nearly $90 million in transaction and management fees — more than its initial equity stake.[281] HCP's CEO touted annual 3.6 percent rent hikes on ManorCare properties that would "fund an awful lot of dividend increases."[282] By 2012, ManorCare's revenue did not cover its rental costs.[283]

While the ManorCare operations struggled under the PE-imposed debt and rent burden, its 25,000 patients suffered under increasingly perilous health risks, according to a *Washington Post* examination. ManorCare laid off hundreds of employees to cut costs and for years it operated with fewer nurses than other nursing homes.[284] From 2013 to 2017, ManorCare's health-code violations increased 26

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[274] Government Accountability Office (GAO). "Private Investment Homes Sometimes Differed from Others in Deficiencies, Staffing and Financial Performance." GAO-11-571. July 2011 at 16 and 20.
[275] Pradhan et al. (2014).
[276] *Ibid.*
[277] Duhigg (2007).
[278] Zaborney, Mark. "Despite recent troubles, HCR ManorCare has a rich history." *Toledo Blade.* April 29, 2018; Whoriskey and Keating (2018).
[279] *Ibid.*
[280] Davies, Megan. "HCP and Carlyle's ManorCare in $6 billion asset deal." *Reuters.* December 14, 2010; HCP, Inc. [Press release]. "HCP, Inc. completes spin-off of Quality Care Properties, Inc." October 31, 2016.
[281] Whoriskey and Keating (2018).
[282] Rucinski, Tracy. "ManorCare wins court approval to exit bankruptcy under landlord." *Reuters.* April 13, 2018.
[283] Kosman, Josh. "Nursing home chain's collapse has been a decade in the making." *New York Post.* March 5, 2018.
[284] Whoriskey and Keating (2018).

percent annually to almost 2,000 violations at its 230 facilities the year before its bankruptcy.[285] The violations were likely related to chronic short-staffing that left patients vulnerable to the documented bedsores, infections, falls, and the failure to assist patients with eating or cleaning.[286]

The Carlyle-imposed debt load made the nursing home operations financially unviable. ManorCare's revenues were not enough to cover its rent payments to HCP; it had fallen $446 million behind in its nearly $40 million monthly rental payments.[287] By 2018, ManorCare's $7 billion-plus debt load dragged the company into bankruptcy.[288]

State governments forced to takeover floundering former Golden Living nursing homes: In 2006, private equity firm Fillmore Capital bought the troubled for-profit chain Beverly Enterprises in a $2.3 leveraged buyout and renamed it Golden Living.[289] Beverly already had a history of low-quality care and many residents and their families had sued the chain for inadequate or negligent care.[290] Fillmore created layers of limited liability companies between itself and the nursing homes and shifted the real estate into a separate subsidiary that leased them back to the Golden Living operating companies.[291]

While Filmore owned and operated Golden Living, debt rose dramatically and quality did not improve — patients and families continued to bring lawsuits for negligent care and staffing levels declined after the purchase.[292] In 2013, it paid more than $600,000 to settle a federal lawsuit for allegedly providing inadequate wound care that the U.S. Attorney said "placed at risk the life and health of individuals who were entrusted to its care."[293]

A 2018 Arkansas study found persistently low staffing levels that Golden Living knew about and continued to press facilities to keep staffing levels low and under budget.[294] The Arkansas facilities failed to promptly administer medications or make necessary patient transfers to hospitals as well as having many lapses in delivering basic care that compromised patients' dignity and comfort.[295] Golden Living settled a lawsuit over these issues for $71 million in 2017.[296]

In Pennsylvania, state and federal regulators as well as the media documented low-quality conditions that imperiled patients' health. Pennsylvania and the federal government put one facility under heightened regulatory scrutiny for its persistent low staffing levels and violations; even after

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[285] *Ibid.*
[286] *Ibid.*
[287] Rucinski (April 13, 2018).
[288] Rucinski, Tracy. "HCR ManorCare files for bankruptcy with $7.1 billion in debt." *Reuters.* March 5, 2018.
[289] Bos and Harrington (2017) at 2 to 3.
[290] Brambila, Nicole C. "Golden Living Centers divests operating interest in all of its Pennsylvania facilities." *Reading Eagle.* March 3, 2017; Rustad, Michael L. "Heart of stone: What is revealed about the attitude of compassionate conservatives toward nursing home practices, tort reform, and noneconomic damages." *New Mexico Law Review.* Vol. 35, Iss. 2. Summer 2005 at note 189 at 365; Hilzenrath, David S. "Nursing home firm settles fraud case." *Washington Post.* February 4, 2000; California State Senate. Committee on Health and Subcommittee on Aging and Long-Term Care. "Nursing Home Quality in the 21st Century: Staffing Adequacy and Complaint Investigation." July 20, 2005 at 23 to 25.
[291] Bos and Harrington (2017) at 2 to 3.
[292] *Ibid.* at 6 to 7.
[293] DOJ. [Press release]. "Golden Living nursing homes settle allegations of substandard wound care." January 2, 2013.
[294] Harrington, Charlene and Toby S. Edelman. "Failure to meet nurse staffing standards: A litigation case study of a large US nursing home chain." *Inquiry.* Vol. 55. 2018 at 5 and 8.
[295] *Ibid.* at 7 to 8.
[296] *Ibid.* at 9.

Pennsylvania removed the home from the special focus list still had one of the worst staffing levels in the nation and was fined over $59,000 for violations that included finding maggots in a patients feeding tube.[297]

Violations like that spurred Pennsylvania to sue Golden Living in 2015 for "fail[ing] to meet residents' most basic human needs" including risking bedsores, leaving patients in soiled diapers, allowing residents to miss meals or showers and more.[298] A year later, a Lancaster, Pennsylvania television station found a local Golden Living home was not meeting requirements for long-term care facilities, including medication error rates over 5 percent.[299]

Pennsylvania's crackdown on Golden Living spurred the company to start selling its nursing home licenses to other chains while keeping the real estate in 2016.[300]
Fillmore officially exited the nursing home business. It remained the profitable landlord for the debt-saddled facilities while shielding itself from liability or regulatory oversight for managing the nursing homes.[301] But the new operators contended their leases required them to buy services and supplies from other Fillmore subsidiaries that effectively maintained the PE-firm's operational control.[302]

The debt loads and rent payments at the former Golden Living homes made them financially unsustainable. Some staff bought snacks for patients and gas for nursing home vehicles and even hoarded cash to pay vendors unwilling to take checks from troubled facilities.[303] At least two of the nursing home operators that took over Golden Living nursing home operations collapsed in bankruptcy that required state governments to take over the facilities within a few years of buying the licenses from Fillmore.
Skyline Healthcare bought Golden Living operating licenses in several states but could not survive under the debt loads. In 2018, Skyline, collapsed into bankruptcy and several state governments including Nebraska, Kansas, Pennsylvania, and South Dakota had to put scores of Skyline homes into receivership after some operations stopped paying utilities, worker wages and benefits, and nearly ran out of food.[304] Fourteen Skyline homes closed permanently, displacing over 900 residents who were forced to relocate often with little notice.[305] The Dycora chain was unable to pay its rent,

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[297] Rau, Jordan. "Poor patient care at many nursing homes despite stricter oversight." *New York Times.* July 5, 2017.
[298] Smith, Paul. "Attorney General announces legal action against Golden Living nursing homes." *WMPT Fox Channel 43 (York, PA).* July 1, 2015;
[299] "Violations found at Golding Living Center in Lancaster." *CBS Channel 21 (Lancaster, PA).* June 1, 2016.
[300] Simmons-Ritchie, Daniel. "Worst nursing homes continue to fail the frail despite lawsuit and promises." *Harrisburg (PA) Patriot-News.* November 26, 2018.; "Golden Living planning to sell three service companies, shed more nursing home operations." *Talk Business & Politics (AR).* August 16, 2016; Brambila, Nicole C. "Failing Care: 'Bad actor' ran operations at nursing homes in Pa. for 14 months before being ousted." *Reading (PA) Eagle.* February 10, 2019
[301] Brambila (2017)
[302] Simmons-Ritchie, Daniel. "Has Golden Living really left Pa.?" *Penn-Live/Harrisburg (PA) Patriot-Leader.* November 26, 2018.
[303] Brambila (2019).
[304] Stoddard, Martha. "Chain of 21 Nebraska nursing homes placed in receivership after missing payroll." *Omaha World-Herald.* March 26, 2018; Pfankuch, Bart. "Wave of nursing home closures hitting small communities." *Mitchell (SD) Daily Republic.* December 14, 2018; Flynn, Maggie. "New investigation puts skyline Healthcare back in the spotlight." *Skilled Nursing News.* July 19, 2019.
[305] Strickler, Laura, Stephanie Gosk, and Shelby Hanssen. "A nursing home chain grows too fast and collapses, and elderly and disabled residents pay the price." *NBC News.* July 19, 2019.

employee wages, or its vendors.[306] In 2019, California and Wisconsin moved a total of 11 Dycora nursing home operations into receivership.[307]

B. Private equity destroys community hospitals

Private equity has targeted hospital chains for takeovers since the late 1990s because they generate stable cash flow from private and public insurance.[308] Local hospitals can make vulnerable takeover targets because their often-troubled finances – from uncompensated care, underinsured patients, and low reimbursements – make them eager for cash infusions and management expertise that PE purports to provide.[309]

The rise in private equity hospital takeovers and mergers coincided with an increase in hospital closures and declining total number of hospitals, especially rural hospitals.[310] The PE-owned chains are the most profit-oriented of the for-profit hospitals. The majority of studies have found that for-profit hospitals have lower quality (some finding higher risks of death), worse access to care and provide less uncompensated (or charity) care for patients unable to pay.[311]

Many private equity hospital chains have sold their hospital facilities to real estate companies to raise money (that can be funneled to the PE firms), but then the hospitals are forced to lease back the property they once owned (raising the hospital operating costs). These sale-leasebacks divide hospitals into real estate companies and operating companies that must deliver health care profitably while paying rent to a firm often held by the same PE owner.[312]

Regulatory blind spots and misaligned incentives allowed private equity firms to extract tremendous wealth from these hospitals but left some of them precariously burdened with unsustainable debt. PE firms engineered these takeovers with mountains of debt, extracted exorbitant management fees, shifted hospital properties into real estate shell companies, and increased revenues by cutting staff and services. Some hospitals have been driven into bankruptcy, some have been shuttered, and even the more apparently "successful" takeovers have burdened the hospitals with debt.

Private equity cannibalizes Philadelphia safety-net hospital: In 2017, the private-equity hospital chain Paladin Healthcare bought two Philadelphia community safety-net hospitals for $170 million.[313] The deal was financed with at least $35 million in debt provided by Apollo Global Management, which later loaned Paladin another $20 million backed by Hahnemann's real estate.[314]

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[305] Spanko, Alex. "Golden Living takes back control of 8 Dycora skilled nursing facilities in receivership." *Skilled Nursing News.* April 5, 2019; Boulton, Guy. "8 Wisconsin nursing homes operated by Dycora, including 3 in the Milwaukee area, put into receivership." *Milwaukee Journal Sentinel.* April 4, 2019; Promnitz, Donald A. "Fresno nursing home enters receivership." *Fresno Business Journal.* April 19, 2019.

[307] Boulton (2019); Promnitz (2019).

[308] Robbins, Rudsenske, and Vaughan. (2008) at 1393 to 1394.

[309] Advisen Ltd. (2011) at 2 to 4.

[310] Ellison, Ayla. "State-by-state breakdown of 102 rural hospital closures." *Becker's Hospital Review.* March 20, 2019; Flanagan, Cristin. "U.S. hospitals shut at 30-a-year pace, with no end in sight." *Bloomberg.* August 21, 2018.

[311] Rosenau, Pauline Vaillancourt and Stephen H. Linder. "Two decades of research comparing for-profit and nonprofit health provider performance in the United States." *Social Science Quarterly.* Vol. 84, No. 2. June 2003.

[312] Applebaum (2015) at 1.

[313] LaPointe (2017).

[314] DiStefano, Joseph N. "Hahnemann Hospital's demise should not be a revelation to any politicians in Philly." *Philadelphia Inquirer.* July 12, 2019.

Hahnemann University Hospital and St. Christopher's Hospital for Children were former non-profit hospitals that had been financially troubled and previously purchased by non-profit and for-profit chains before being sold to private equity.[315]

Hahnemann was an over 170-year old hospital that provided essential health care for some of Philadelphia's most vulnerable residents and served as the teaching hospital for Drexel University's medical school.[316] Two-thirds of Hahnemann's patients were African American or Latinx and nearly half were on Medicaid.[317]

Paladin moved Hahnemann's centrally located facilities, assessed at being worth $58 million, into a separate real estate business.[318] The Hahnemann campus covered a city block of prime real estate near city hall, the convention center, and an arts district that *CNN* reported would be "incredibly desirable for a high-end hotel or condominiums."[319] By moving the real estate into another company, these valuable assets were excluded from the hospital bankruptcy process.[320] Real estate investors are already eyeing the Hahnemann campus as part of a "gateway development" that might include luxury condominiums or a hotel to serve the nearby convention center, allowing the Paladin owners to make real estate profits from the collapse the PE-takeover facilitated.[321]

Hahnemann struggled under its debt load and was losing upwards of $5 million each month.[322] Within two years, Paladin pushed Hahnemann and St. Christopher's into bankruptcy and announced plans to shut down Hahnemann – starting by closing the emergency room to new trauma patients.[323] The city's two other safety net hospitals had to accommodate Hahnemann's 40,000 annual emergency room patients.[324] It subsequently stopped accepting OBGYN patients, forcing around 800 expectant mothers to find new hospitals to deliver their babies.[325]

The closure of Hahnemann left much of central Philadelphia without a safety-net hospital to serve the most vulnerable and lowest-income population as well as the elimination of a key trauma center for the city.[326] While many rural hospitals have shuttered over the past decade, Hahnemann's closure in September 2019 was the first major urban hospital affiliated with a medical school to shut down.[327]

Hospital workers were stranded by the bankruptcy. Hahnemann had already stopped paying into the pensions for its workers in early 2019, before it filed for bankruptcy.[328] The shutdown cost

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[315] LaPointe (2017).
[316] *WCAU NBC-10*. June 26, 2019.
[317] Elk, Mike. "Private equity's latest scheme: Closing urban hospitals and selling off the real estate." *American Prospect*. July 11, 2019.
[318] Feldman (July 31, 2019).
[319] DePillis (2019); Picchi (2019).
[320] Adelman (2019); *CBS News Channel 3* (July 1, 2019).
[321] Adelman (2019); DePillis (2019).
[322] Feldman, Nina. "Hahnemann closure will be a public health emergency, nurses union says." *WHYY 90.9-FM*. June 26, 2019; "Hahnemann University Hospital to close, leaving thousands out of work." *NBC TV-10*. June 26, 2019.
[323] *WPVA ABC-6* (July 2, 2019).
[324] Elk (2019).
[325] Conti, Allie. "Rich investors were supposed to save this hospital. Instead they helped destroy it." *Vice*. July 17, 2019.
[326] DePillis (2019).
[327] Rnagarajan, Soumya. "The closure of a historic hospital is an ominous warning sign." *Scientific American*. September 17, 2019.
[328] Rush (2019).

2,500 jobs, including 800 union nurses, and left nearly 600 physicians-in-training without residency placements.[329] Paladin is attempting to sell these residents (actually residency program placements) in the bankruptcy auction proceedings, but the federal Centers for Medicare & Medicaid Services has opposed this sale of residencies.[330] While the status of workers' benefits remains unknown in the bankruptcy proceedings, the bankruptcy lawyers hired by the PE firm expected the legal and accounting fees for the bankruptcy to reach upwards of $7 million — considerably more than the $2 million in unpaid pension and benefit contributions Hahnemann owes its workers.[331]

Cerberus closes community hospital in Quincy, Massachusetts: In 2010, Cerberus Capital Management purchased the non-profit 6-hospital Caritas Christi hospital network to form Steward Health Care System in a $895 million leveraged buyout (including $475 million in debt and pension liabilities); Cerberus promised to maintain the hospitals at least through 2018 and fund the pensions of the mostly unionized workforce.[332] Cerberus made more add-on purchases to expand Steward into a chain of 9 for-profit hospitals in Massachusetts.[333]

Steward sold its facilities to a real estate investment firm a few years after the Cerberus takeover, which funded a dividend to Cerberus and forced the chain to lease back the facilities it once owned.[334] Cerberus invested $150 million in the real estate firm as part of the deal—so the PE firm would reap rewards as Steward paid rent for its own hospitals.[335]

Steward cut costs to service its debt and pay rent on its facilities. It reduced staffing, closed units and eliminated jobs to meet Cerberus budget targets.[336] The nurses' union said these moves caused dangerously low staffing levels.[337] The union also accused Steward of reneging on commitments to support their pensions, refusing to base pension contributions on all work (including overtime), and balking at joining a multiemployer pension plan.[338]

In 2014, Steward closed the Quincy Medical Center, making Quincy the largest city in Massachusetts without a hospital.[339] The closure of the 196-bed hospital was the biggest Massachusetts hospital shutdown in a decade; although Steward kept the emergency room open, the shutdown cost 700 jobs and seemed to violate Cerberus' commitment to remain operational at least through 2018 and provide 18-months' notice before closing the facility.[340]

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[329] *WCAU NBC-10* (June 26, 2019); *WHYY FM-91* (July 5, 2019).
[330] Patel, Nisarg A. "Private equity is trying to sell medical residencies for profit." *Slate.* October 21, 2019; Feldman, Nina. "Judge puts freeze on sale of Hahnemann residency program — for now." *WHYY FM-91.* September 17, 2019.
[331] Brubaker, Harold. "Hahnemann University Hospital sued by union funds over nearly $2 million in unpaid bills." *Philadelphia Inquirer.* May 2, 2019; Brubaker, Harold. "Hahnemann bankruptcy pays millions to consultants, lawyers charging up to $795 an hour." *Philadelphia Inquirer.* August 28, 2019.
[332] Applebaum (2015) at 2 and 4; McCluskey, Priyanka Dayal. "Steward gets $1.25b to fund expansion, repay Cerberus." *Boston Globe.* September 26, 2016.
[333] McCluskey (2016).
[334] *Ibid.*
[335] Mohl, Bruce. "Steward's asset-light philosophy." *Commonwealth Magazine.* January 10, 2017.
[336] Applebaum (2015) at 4; Encarnacao (2013).
[337] Encarnacao (2013).
[338] Laroque (2011); Kronenberg (2011.
[339] Ronan, Patrick. "Critics of Quincy hospital closure question Steward donations to Coakley." *Quincy (MA) Patriot Ledger.* January 17, 2015.
[340] McCluskey, Priyanka Dayal and Robert Weisman. "Quincy Medical Center to close." *Boston Globe.* November 6, 2014; Ronan, Patrick. "Quincy hospital property sold in major deal with downtown implications." *Quincy (MA) Patriot Ledger.* December 8, 2016.

In 2019, Steward closed the Quincy emergency room which had continued to treat nearly 17,000 patients annually after the hospital closed, forcing people to go to more distant emergency rooms that have twice the emergency response time for the 100,000 Quincy residents.[341]

PE-takeover of HCA Holdings burdened company with debt, curtailed quality care: In 2006, KKR, Bain Capital and the hospital's CEO took over the nation's largest hospital chain HCA Holdings (formerly Hospital Corporation of America) in a $33 billion leveraged buyout.[342] The leveraged buyout forced HCA to double its debt to $26 billion to fund the takeover and reward PE investors.[343] HCA was politically connected (Senator Rick Scott (R–Florida) was the former CEO and former Senator Bill Frist's (R–TN) family founded the chain) and had the dubious distinction of settling one of the biggest Medicare fraud cases in history.[344]

While Bain and KKR owned HCA, the quality concerns and federal investigations and settlements continued. HCA raised revenues by billing more for services, reducing staffing costs and deterring patients from emergency room visits — strategies that critics contended created inadequate staffing, risked patient care, increased incidences of bedsores, delaying dialysis, or not administering drugs.[345] While PE-owned, HCA paid millions in dollars in fines to resolve or settle federal charges for paying kickbacks for referrals, unnecessary laboratory tests and double billing, and filing false Medicare claims.[346]

The private equity owners extracted tremendous revenues from HCA. From 2006 to 2010, Bain, KKR, and the CEO extracted $20.7 billion in dividend recapture payments and fees, according to a *Barron's* accounting analysis.[347] In 2011, Bain and KKR converted HCA back into a publicly traded company, though they still controlled three-quarters of the stock.[348] The PE firms charged another $120 million for management and transaction fees for the HCA IPO.[349]

KKR and Bain began selling their HCA stake in 2012 and by 2014 had netted another $6.3 billion from the sale of HCA stock.[350] In 2016, KKR sold another 9 million shares back to HCA for $750 million.[351] While the private equity stake dwindled, HCA still held the debt that had swollen since the leveraged buyout to $32.8 billion at the end of 2018 and the company admitted its "substantial leverage" could hinder its ability to raise or borrow money and its hospital revenues might be insufficient to service the debt.[352]

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[341] Tiernan, Erin. "Quincy may soon be the largest city in Mass. without an ER. Then what?" *Patriot Ledger.* August 9, 2019.
[342] Wechsler, Pat. "HCA plans biggest U.S. private equity IPO at $4.28 billion." *Bloomberg.* February 22, 2011; Briloff and Briloff (2011).
[343] Creswell and Abelson (2012).
[344] *Ibid.*
[345] *Ibid.*
[346] DOJ. [Press release]. "HCA settles allegations of billing for unnecessary lab tests and double billing for fetal testing for $2,000,000." November 16, 2015; DOJ. [Press release]. "Hospital Chain HCA Inc. Pays $16.5 Million to Settle False Claims Act Allegations Regarding Chattanooga, Tenn., Hospital." September 19, 2012; DOJ. [Press release]. "Fifty-five hospitals to pay U.S. more than $34 million to resolve False Claims Act allegations related to kyphoplasty." July 2, 2013.
[347] Briloff and Briloff (2011).
[348] Wechsler (2011).
[349] Primack, Dan. "How much did Bain really make on HCA?" *Fortune.* March 11, 2011.
[350] "HCA's top private equity owners to sell 29.5M shares." *Becker's Hospital Review.* May 21, 2014.
[351] De Lombaerde, Geert. "Health care finance: HCA in big buyback deal." *Nashville Post.* May 12, 2016.
[352] HCA Healthcare, Inc. U.S. Securities and Exchange Commission Form 10-K. Fiscal year ended December 31, 2018 at 31 to 32.

C. Private equity drives surprise billing nightmare for patients

Private equity-owned healthcare companies have relied on surprise billing techniques to charge more for healthcare services to generate profits. Patients are vulnerable to expensive "surprise" medical bills when they unknowingly receive out-of-network care that insurers will not cover or fully reimburse, leaving patients to cover an often-expensive balance. These bills can not only be unexpected, they are typically much larger because patients must reach higher out-of-network deductibles and have higher co-payment or out-of-pocket limits.[353]

Patients often assume that ambulances and emergency room doctors are covered by their insurance, but the private equity industry has created the epidemic of surprise medical billing by buying up medical practice groups and services that hover outside the insurance industry's networks. This can happen when in-network hospitals contract with PE-owned doctors' groups to provide services or when PE firms buy up ambulance companies that appear to shun contractual agreements with insurers.

Private equity practice groups gouge patients at the emergency rooms Private equity firms have pursued a roll-up strategy to buy and aggregate medical practices and physician groups into large companies that rely on patients paying out-of-pocket to generate profits. In 2019, the *Annals of Internal Medicine* reported that the takeover of physician practice groups "increased dramatically" over recent years.[354] PE firms bought nearly 200 practice groups between 2017 and 2018 and sought returns of at least 20 percent.[355]

PE firms have been focusing their practice purchases on practices that can generate higher revenues, including out-of-network, out-of-pocket services and procedures.[356] The American Medical Association reported that PE-owned practices raised prices, increased the volume of ancillary out-of-pocket services, and could drive up self-referrals within PE-owned networks.[357] For PE-owned doctors' groups, out-of-network, surprise billing has been "a key to their highly profitable business strategy," according to *Kaiser Health News*, because it allows them to charge whatever rates they want since they are not part of insurance networks.[358]

The PE-owned doctor groups have made their way into hospitals that have shifted to outsourcing some departments. The third-party physician staffing companies replace hospital specialty departments, like emergency room doctors, radiologists or anesthesiologists.[359] These third-party providers are the primary source of surprise billing because they are not necessarily in the approved

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[353] American Academy of Actuaries. "Surprise Medical Bills: An Overview of the Problem and Approaches to Address It." September 2019 at 1.
[354] Casalino, Lawrence P. et al. "Private equity acquisition of physician practices." *Annals of Internal Medicine*. Vol. 170, No. 2. January 8, 2019.
[355] *Ibid.*; American Medical Association (AMA). Proceedings of the AMA 2019 Annual Meeting. 2019 at 446.
[356] Meindl and Smart (2019) at 26.
[357] AMA (2019) at 447.
[358] Bluth, Rachel and Emmarie Huetteman. "Investor's deep-pocket push to defend surprise medical billing." *Kaiser Health News*. September 11, 2019.
[359] *Ibid.*

hospital or insurance provider networks. The rise in outsourced physician staffing groups, like emergency room departments, has dramatically increased the rate of surprise billing.[360]

Private equity owns the two largest emergency room physician staffing groups that control one-third of the nation's physician staffing firms and supply doctors to hundreds of hospitals.[361] Blackstone bought TeamHealth for $6.1 billion in 2016.[362] KKR bought Envision Physician Staffing in 2018 in a $9.9 billion leveraged buyout including $4 billion in debt; it was 2018's biggest PE deal in the world.[363] A Yale University study found that these two ER staffing companies raised prices by two-thirds compared to bills before the PE-backed ER outsourcing firms arrived.[364]

Surprise billing has been on the rise as PE-firms have bought up doctor staffing companies. Surprise bills rose from 32 percent of emergency room visits in 2010 to nearly 43 percent in 2016, according to a 2019 Stanford University study.[365] The study found that surprise billing for hospital inpatient stays rose from 26 percent to 43 percent over the same period—and the cost of those out-of-network bills rose to over $2,000.[366]

The proposed federal legislation to curtail surprise billing would limit the ability of PE-owned health care companies to continue price gouging patients, which is essential to their business model. In 2019, Fitch Ratings put both Envision and TeamHealth on its list of "loans of concern" because it would be difficult for the firms to cover their debts without surprise billing.[367] The private equity industry has mounted an aggressive campaign to derail any meaningful surprise billing legislation. In the summer of 2019, Envision and TeamHealth financed the Doctor Patient Unity coalition that launched $28.6 million in television advertisements and advocacy efforts to block the congressional effort to curb surprise billing.[368] A Yale University associate professor of public health noted that "Private equity firms are buying up physician practices that allow them to bill out-of-network, cloaking themselves in the halo that physicians generally receive and then actively watering down any legislation that would both protect patients but affect their bottom line."[369]

Private equity takeover of ambulance industry delivers surprise bills to patients: Before the 2008 financial crisis, ambulances were mostly operated by local governments (fire and emergency medical services), local non-profit hospitals, or local private companies. After the recession, private equity firms began to snap up ambulance companies.[370]

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[360] American Academy of Actuaries (2019) at 4.
[361] Bluth and Huetteman (2019).
[362] Sanger-Katz, Margot, Julie Creswell, and Reed Abelson. "Mystery solved: Private-equity-backed firms are behind ad blitz on 'surprise billing.'" *New York Times*. September 13, 2019.
[363] Bain & Company (2019) at 28; Liss (2019).
[364] Applebaum, Eileen. "Private equity is a driving force behind devious surprise billing." *The Hill*. May 16, 2019; Cooper, Zack, Fiona Scott Morton, and Nathan Shekita. Yale University. "Surprise! Out-of-Network Billing for Emergency Care in the United States." March 2018 at 4.
[365] Sun, Eric C. et al. "Assessment of out-of-network billing for privately insured patients receiving care in in-network hospitals." *JAMA Internal Medicine*. August 12, 2019.
[366] *Ibid.*
[367] FitchRatings. "Fitch U.S. Leveraged Loan Default Insight." August 27, 2019 at 4 and 9.
[368] Sanger-Katz, Creswell, and Abelson. (2019); Roubein, Rachel. "Health care groups backed dark money campaign to sink 'surprise' billing fix." *Politico*. September 13, 2019.
[369] Bluth and Huetteman (2019).
[370] Webb, Olivia. "Private equity chases ambulances." *American Prospect*. October 3, 2019.

Patients are vulnerable to surprise ambulance bills because they cannot select among ambulance services based on price or whether the services are covered by insurance. Often bystanders or police often call 911 for ambulances and emergency dispatchers determine which ambulance is sent to the scene, making it impossible for patients to choose their medical transportation.[371] As many as 80 percent of ambulance trips are for non-urgent, non-emergency medical care, but ambulance companies still bill for the emergency trip.[372]

More than 80 percent of ambulance services resulted in surprise bills for patients in 2016.[373] Ambulance companies frequently refuse to join insurance and hospital networks, making private ambulance trips out-of-network services that impose surprise bills on patients for the full cost of the trip.[374] Many ground ambulance bills can run $2,000 to $4,000, depending on the distance to the hospital and the medical treatment, some private ambulances bill separately for things like oxygen.[375]

The surprise billing is especially expensive for patients transported by air ambulance. Air ambulances provide a key service for patients in rural areas, where many hospitals have been closed and others have moved specialized care to regional medical centers.[376]

Private equity firms have bought up the majority of air ambulance services. In 2002, there were no for-profit air ambulance operators.[377] By 2018, PE-firms owned two of the three biggest for-profit helicopter ambulance services that controlled two-thirds of the industry.[378] KKR bought Air Medical Group Holdings, including its Air Evac brand, in 2015 and American Securities bought Air Methods for $2.5 billion in 2017.[379]

Most air ambulance trips lead to surprise bills. the GAO found that more than two-thirds (69 percent) of air ambulance trips were out-of-network transports in 2017.[380] The air transport firms benefit from being outside of insurance networks because they earn more per flight by imposing surprise, out-of-network bills on their patients.[381] By remaining out of the networks, they can "charge whatever they wish," according to Consumer's Union.[382]

Patients are often slapped with huge surprise bills.[383] Air ambulance helicopter prices rose by 60 percent between 2012 and 2017 to a typical price of over $36,000.[384] American Security's Air

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[371] Bailey, Melissa. "Ambulance trips can leave you with surprising – and very expensive – bills." *Washington Post.* November 20, 2017.
[372] Webb (2019).
[373] Sun. et al. (2019).
[374] Elmore, Charles. "Florida bill aims for fewer billing surprises after 911 calls." *Palm Beach Post.* February 25, 2015.
[375] Bailey (2017).
[376] GAO. "Air Ambulance: Available Data Show Privately-Insured Patients Are at Financial Risk." GAO-19-292, March 2019 at 15.
[377] Perry, Angela Elizabeth. Consumers Union. "Up in the Air: Inadequate Regulation for Emergency Air Ambulance Transportation." March 2017 at 2.
[378] Tozzi (2018).
[379] *Ibid.*
[380] GAO (2019) at 8 and 16.
[381] Perry (2017) at 4 and 5.
[382] *Ibid.* at 4 and 5.
[383] Greene, Jan. "Air ambulance turbulence: Consolidation, cost shifting, and surprise billing." *Managed Care Magazine.* March 28, 2019.
[384] GAO (2019) at 17.

Methods has taken an aggressive approach to collecting the unpaid exorbitant fees, including debt collectors, lawsuits, wage garnishment, and imposing property liens on patients' homes.[385]

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Present laws permit and in fact reward a predatory private equity business model that takes wealth from people, communities, and viable businesses and transfers it to a very small number of very rich people leading PE firms. The rules reward unchecked short-term greed. The process destroys jobs, and it also hurts patients, customers, students, renters, the planet, and more. It increases inequality and makes millions of people's financial situation more precarious. These harms are not inevitable. We urge you to support and pass the Stop Wall Street Looting Act to stop these abuses, realign incentives to promote accountability, and protect workers and communities.

For more information, contact:

Marcus Stanley
Policy Director
Americans for Financial Reform
marcus@ourfinancialsecurity.org

Patrick Woodall
Senior Researcher
Americans for Financial Reform
pwoodall@ourfinancialsecurity.org

[385] Perry (2017) at 6; Tozzi (2018); DeQuasie v. Air Methods Corporation. U.S. District Court for the District of Colorado. Civil Action No. 1:19-cv-1951. July 5, 2019.

Jack Ehnes
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November 18, 2019

The Honorable Maxine Waters
Chairwoman, Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member, Committee of Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairwoman Waters and Ranking Member McHenry:

The California State Teachers' Retirement System ("CalSTRS") writes regarding the hearing scheduled for November 19, 2019, titled **"America for Sale, An Examination of the Practices of Private Funds**." We strongly support the provisions of the *Investment Adviser Alignment Act,* which will ensure greater alignment of interests between investment managers and investors and improve transparency and governance in the operation of private equity funds.

CalSTRS acts as the fiduciary for the retirement benefits of over 949,000 public school educators and their families in California. CalSTRS has $242.1 billion of assets under management as of 9/30/2019, with an asset allocation to private equity of 9.1% as of August 31, 2019, representing approximately $22 billion. Private equity provides necessary returns and asset diversification required by CalSTRS to meet our fiduciary obligations to our beneficiaries. We are also active members of the Institutional Limited Partners Association ("ILPA"), serving on the Board of Directors, and back their efforts to improve the long-term sustainability of the private equity industry.

CalSTRS strongly supports the specific transparency and governance reforms in the management of private equity funds that are provided in the *Investment Adviser Alignment Act.* CalSTRS is concerned about recent trends in the private equity industry that seek to reduce the fiduciary obligations owed to limited partners. In addition, as a California public pension plan, we are required under California law to receive fee and expense reporting from the private equity managers with whom we invest. Finally, we welcome efforts to ensure that the limited partners in a private equity fund are informed of the identity of their fellow investors and that restrictions are removed that prevent communications among investors in the fund. Each of these items is addressed in the *Investment Adviser Alignment Act.*

CalSTRS appreciates the opportunity to comment on this important topic and encourages the Committee to move forward with the necessary reforms in the *Investment Adviser Alignment Act* to ensure the long-term health of the private equity industry.

Respectfully Submitted,

Jack Ehnes
Chief Executive Officer
California State Teachers' Retirement System (CalSTRS)



To: U.S. House Financial Services Committee
Re Committee Hearing: "America for Sale? An Examination of the Practices of Private Funds"
Hearing Date: November 19, 2019
Written Testimony Submitted by: Center for Popular Democracy

Thank you Chairwoman Maxine Waters and members of the U.S. House Financial Services Committee for holding this timely and important hearing. This written testimony is being submitted by the Center for Popular Democracy (CPD), a national network of 53 grassroots community organizations in 131 cities across 34 states, Puerto Rico, and Washington, DC. Our network reflects hundreds of communities around the country at the frontlines of the fight for economic and racial justice.

Today we submit written testimony in support of the "Stop Wall Street Looting Act," which would address the problems currently being created by private equity firms and hedge funds while preventing these problems in the future.

This is an urgent issue for low-income communities and communities of color organizing in our network, who are directly impacted by Wall Street's predatory and risky financial practices. Every day, people are faced with the harsh realities of corporations that exert more and more power in our economy and their lives. From the moment they wake up, people are increasingly subject to the whims of unregulated corporate power that determines where people live, how they work, and even their ability to access live-saving healthcare.

At the center of this shift is private equity, a business model that puts profit over people's lives and puts unprecedented power in the hands of corporations. This business model has gone unregulated for too long, and too many lives have suffered as a result, for it to continue. Congress has the power to stop these predatory practices and define an alternative vision for a properly regulated financial sector.

The Rapid Expansion of Private Equity

Private equity firms have forced a seismic shift in how American businesses are run, as they reshape companies and industries to fit their need to extract large profits quickly.

From retail to healthcare to manufacturing, private equity (PE) firms own, control, and manage an increasingly large number of companies. Prior to the global financial crisis, private equity firms managed around $1 trillion in assets, with investors ranging from public pension funds to

university endowments.[1] Today, these firms manage more than $5 trillion in assets and own almost 8,000 U.S. companies.[2]

Private equity industry proponents often claim that fund managers find companies that are either struggling or prime for growth, make improvements in the company, and sell the company for a profit.

But in reality, private equity firms make sweeping changes to acquired companies, imposing pay freezes, layoffs, business closures, price increases for consumers, and rent hikes for families.

When these companies go bankrupt, the PE firm is insulated from risk -- while the struggling or bankrupt company's workers, vendors, and creditors face unemployment and financial ruin. Wall Street owners have repeatedly used the bankruptcy process to dump their obligations to current and future retirees.[3]

Hedge Funds Expand, Despite Poor Returns

Hedge funds currently have $3.18 trillion in assets under management.[4] This is despite studies showing that fees given to fund managers outweigh returns to investors;[5] that hedge fund fees contribute to pension shortfalls;[6] and that hedge funds don't adjust for risk when they advertise.[7]

The Hedge Clippers campaign, which includes the Center for Popular Democracy and CPD affiliates, has issued 70 separate reports[8] explaining how hedge funds have destroyed the

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[1] Danielle Ivory, Ben Protess and Kitty Bennett, "When you dial 911 and Wall Street answers," *New York Times*, June 25, 2016, https://www.nytimes.com/2016/06/26/business/dealbook/when-you-dial-911-and-wall-street-answers.html.
[2] "The rise and rise of private markets," McKinsey Global Private Markets Review 2018, McKinsey & Company, February 2018, https://www.mckinsey.com/~/media/McKinsey/Industries/Private%20Equity%20and%20Principal%20Investors/Our%20Insights/The%20rise%20and%20rise%20of%20private%20equity/The-rise-and-rise-of-private-markets-McKinsey-Global-Private-Markets-Review-2018.ashx;
"PwC Deals: US Private Equity Deals insights Q2 2018" 2018, PwC, https://www.pwc.com/us/en/private-equity/publications-overview/assets/pwc-private-equity-q2-2018-deals-insights.pdf 1.
[3] Eileen Appelbaum and Rosemary Batt, "Private Equity at Work: When Wall Street Manages Main Street," New York, Russell Sage Foundation, May 2014.
[4] Rob Kozlowski, "Hedge fund AUM rises in Q1 despite continued outflows," *Pensions & Investments*, April 17, 2019, https://www.pionline.com/article/20190417/ONLINE/190419859/hedge-fund-aum-rises-in-q1-despite-continued-outflows.
[5] "All That Glitters Is Not Gold: An Analysis of U.S. Public Pension Investments in Hedge Funds," American Federation of Teachers, Haas Institute, ReFund America Project, Roosevelt Institute, November 6, 2015, https://rooseveltinstitute.org/all-glitters-not-gold-analysis-u-s-public-pension-investments-hedge-funds/.
[6] "The Big Squeeze How Money Managers' Fees Crush State Budgets and Workers' Retirement Hopes" American Federation of Teachers, May 2017, http://hedgeclippers.org/partner-report-no-6-with-aft-the-big-squeeze-how-money-managers-fees-crush-state-budgets-and-workers-retirement-hopes/.
[7] James B. Stewart, "Hedge Funds Should Be Thriving Right Now. They Aren't," *New York Times*, July 12, 2018, https://www.nytimes.com/2018/07/12/business/hedge-funds.html.
[8] For more information see: http://hedgeclippers.org.

economy, rigged the political system, hurt families and communities, exploded inequality, and supported the politics of hate and division.

Our reports demonstrate how hedge fund managers have secured enormous management fees while cutting jobs,[9] driving up the price of prescription drugs, profiting from the opioid and overdose epidemic, contributing to climate crisis[10] and environmental damage,[11] and forcing austerity on the people of Puerto Rico.[12]

Wall Street's Growing Dominance is Hurting Our Communities
Wall Street's rapid expansion in every key sector of our economy poses an enormous risk to communities across the country.

The following section discusses private equity and hedge funds numerous and far-reaching negative impacts, as well as the human cost of Wall Street profiteering. This section specifically highlights several key sectors where Wall Street firms are amassing enormous profits at the expense of workers, renters, retirees, and people engaged in the criminal and immigration legal systems.

Wall Street's gamble on retail led to more than 1.3 million job losses in the last ten years
Private equity firms and hedge funds have rapidly expanded into retail, acquiring over 80 major retailers in the last decade.[13] These risky deals have led to bankruptcies and significant job losses which have had far-ranging impacts on working families and local economies.

In July 2019, the Center for Popular Democracy, along with the Private Equity Stakeholder Project, United for Respect, Americans for Financial Reform, and Hedge Clippers, published the report "Pirate Equity: How Wall Street Firms are Pillaging American Retail."[14] This original analysis revealed Wall Street-driven retail bankruptcies have led to more than 1.3 million job losses in the last ten years.

Nearly 600,000 people working at retail companies owned by Wall Street have lost their jobs during a period where the total retail industry *added* over one million additional jobs.[15]

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[9] "Hedge Papers No. 42, Billionaires Leon Black and Stephen Schwarzman Attack Momentive and Upstate New York," Hedge Clippers, January 2017, hedgeclippers.org/wp-content/uploads/2017/01/520160913_HedgeClippers_Report_37_Final_V4-1.pdf.
[10] "Hedge Papers No. 67, Vulture Hedge Funds Attack California," American Federation of Teachers, Hedge Clippers, June 2019, hedgeclippers.org/wp-content/uploads/2019/06/HP67_PGandE-Wildfires-CA_final.pdf.
[11] "Hedge Papers No. 12, Cancerous Cash: How Hedge Funds Destroy American Health," hedgeclippers.org/wp-content/uploads/2015/05/HP12.pdf.
[12] "Hedge Papers No. 68: Pain And Profit Rosselló Is Gone But Vultures Still Prey On Puerto Rico," August 13, 2019, hedgeclippers.org/hedge-papers-no-68-pain-and-profit-rossello-is-gone-but-vultures-still-prey-on-puerto-rico/.
[13] Private Equity Stakeholder Project analysis of PitchBook data related to private equity acquisitions.
[14] Maggie Corser, Jim Baker, and Eli Vitulli, "Pirate Equity: How Wall Street Firms are Pillaging American Retail," Center for Popular Democracy, Private Equity Stakeholder Project, United for Respect, Americans for Financial Reform, Hedge Clippers, July 23, 2019, https://populardemocracy.org/pirateequity.
[15] U.S. Bureau of Labor Statistics, "Employment, Hours, and Earnings from the Current Employment Statistics survey," Accessed May 1, 2019

Bankruptcies and store closures at retailers have also spurred layoffs at suppliers, affecting an estimated additional 728,000 indirect jobs.

These layoffs were concentrated in retail sub-sectors that employ larger numbers of women and people of color.[16] As a result, Wall Street-driven retail job losses are disproportionately impacting women and people of color. In the coming years, the stakes remain high for the one million additional people who currently work at private equity and hedge fund-owned retailers and how may be at increased risk of losing their jobs in the future.

Job cuts and stock buybacks at GM and AT&T

General Motors recently announced large-scale plant closures and layoffs, with top executives claiming the company needs $4.5 billion in savings to stay afloat, including closing the legendary Lordstown manufacturing plant in Ohio.[17] However, GM has given over five times as much money -- $25 billion -- to Wall Street hedge funds and other investors in the past four years, including over $10 billion in controversial stock buybacks.[18]

For economists and long-term investors, stock buybacks are problematic moves that divert profits away from innovation and investments in workers.[19]

Stock buybacks also exacerbate racial wealth gaps. Share ownership mirrors broader inequality in this country, with shareholders being more likely to be wealthy and white. As a result, stock buybacks are significantly less likely to benefit low-income communities and communities of color.[20]

Unfortunately, hedge fund managers often use stock buybacks to demand cash from companies they fund. If the company doesn't agree to pay, the hedge fund "activists" often start agitating, threatening to mount costly proxy battles and sometimes waging negative PR campaigns.[21]

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https://data.bls.gov/timeseries/CES4200000001?amp%253bdata_tool=XGtable&output_view=data&include_graphs=true.

[16] U.S. Bureau of Labor Statistics, "Household Data Annual Averages 18. Employed persons by detailed industry, sex, race, and Hispanic or Latino ethnicity," Current Population Survey, January 18, 2019, https://www.bls.gov/cps/cpsaat18.htm. U.S. Bureau of Labor Statistics, "Household Data Annual Averages 18. Employed persons by detailed industry, sex, race, and Hispanic or Latino ethnicity," Current Population Survey, January 18, 2019, https://www.bls.gov/cps/cpsaat18.htm.

[17] "Hedge Papers No. 66, Hedge Funds Attack General Motors and American Jobs," American Federation of Teachers, Hedge Clippers, March 8, 2018, hedgeclippers.org/hedge-funds-attack-general-motors-and-american-jobs/.

[18] "Hedge Papers No. 66, Hedge Funds Attack General Motors and American Jobs," American Federation of Teachers, Hedge Clippers, March 8, 2018, hedgeclippers.org/hedge-funds-attack-general-motors-and-american-jobs/.

[19] Irene Tung and Katy Milani, "Curbing Stock Buybacks: A Crucial Step To Raising Worker Pay And Reducing Inequality: An Analysis of Three Industries—Restaurant, Retail, and Food Manufacturing," National Employment Law Project, Roosevelt Institute, July 2018, http://rooseveltinstitute.org/wp-content/uploads/2018/07/The-Big-Tradeoff-Report_072618.pdf, 6.

[20] Susan R. Holmberg, "Who Are the Shareholders?" Roosevelt Institute, June 2018, http://rooseveltinstitute.org/wp-content/uploads/2018/06/The-Shareholder-Myth.pdf, 8-9.

[21] William Lazonick, "The Curse of Stock Buybacks," *The American Prospect,* June 25, 2018, https://prospect.org/power/curse-stock-buybacks/.

Companies like GM often divert their profits to stock buybacks in order to fend off the possibility of hostile proposals from hedge funds and other short-term profit seekers.

Recently, Elliott Management, the hedge fund controlled by billionaire Paul Singer, made a similar "activist" attack on AT&T, the communications and media conglomerate in which Singer had amassed a $3 billion stake.[22] The hedge fund attack on AT&T threatened an estimated 30,000 jobs at the company[23] and, predictably, resulted in a large-scale corporate plan for $30 billion in stock buybacks.[24]

The Communications Workers of America called the plan "something only a hedge fund manager could love."[25]

Hedge fund demands--and the billion-dollar stock buybacks that come in the wake of hedge fund "activism"--are hollowing out American companies and destroying good jobs across the country, with devastating impacts on local communities and local economies. The "short-termism" promoted by aggressive hedge funds should be sharply limited by new laws and regulations designed to promote investments, productivity, and broad prosperity for all of us.

Puerto Rico's current debt crisis was fueled by years of Wall Street's risky and predatory practices, and now those same investors stand to gain.

Even before 2017's Hurricane Maria caused thousands of deaths and an estimated more than $100 billion in damages, millions of Puerto Ricans were already burdened by damage to the island's social services and economy due to its $72 billion in public debt.[26] While the Puerto Rican debt crisis is often framed as a result of financial mismanagement and reckless borrowing by the Puerto Rican government, Wall Street played a key role in pushing the unsustainable levels of debt.

Wall Street investors--attracted by federal and state tax exemptions, high rates, and legal guarantees they would be repaid regardless of PR's financial outlook--aggressively pushed

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Kai Haakon Liekefett and Sidley Austin, "The Hypocrisy of Hedge Fund Activists," Harvard Law School Forum on Corporate Governance and Financial Regulation, June 4, 2018 https://corpgov.law.harvard.edu/2018/06/04/the-hypocrisy-of-hedge-fund-activists/.

[22] Aaron Pressman, "AT&T's CEO Appeased Activist Investor Elliott Management," *Fortune*, October 28, 2019, https://fortune.com/2019/10/28/atts-ceo-appeased-activist-investor-elliott-management/.

[23] Olga Kharif, "AT&T Union Says Elliott's Proposals Could Affect 30,000 Jobs," *Bloomberg*, October 16, 2019, https://www.bloomberg.com/news/articles/2019-10-16/at-t-union-says-elliott-s-proposals-could-affect-30-000-jobs.

[24]Aaron Pressman, "AT&T's CEO Appeased Activist Investor Elliott Management," *Fortune*, October 28, 2019, https://fortune.com/2019/10/28/atts-ceo-appeased-activist-investor-elliott-management/.

[25] "AT&T's New Financial Plan Caters to Wall Street and Leaves Customers and Employees Behind," Communication Workers of America, October 28, 2019, https://cwa-union.org/news/releases/atts-new-financial-plan-caters-wall-street-and-leaves-customers-and-employees-behind.

[26] Mary Williams Walsh, "How Puerto Rico Is Grappling With a Debt Crisis," *New York Times*, May 16, 2017, https://www.nytimes.com/interactive/2017/business/dealbook/puerto-rico-debt-bankruptcy.html "Puerto Rico lost $43 billion after Hurricane Maria, according to govt. report," *Associated Press*, December 4, 2018, https://www.nbcnews.com/news/latino/puerto-rico-lost-43-billion-after-hurricane-maria-according-govt-n943441.

predatory financial deals like capital appreciation bonds and toxic swaps.[27] Over the past six years, hedge funds like GoldenTree Asset Management bought Puerto Rico government bonds for cents on the dollar as the Puerto Rican economy dove ever deeper into an economic crisis.[28]

Now, those same hedge funds are poised to profit as the island goes through bankruptcy and restructures its enormous debt. Puerto Rico's debt restructuring process is overseen by an unelected federal control board, the Financial Oversight and Management Board for Puerto Rico (FOMB) that is itself rife with conflicts of interest.[29]

The FOMB is currently pushing a second debt restructuring deal through federal court, brokered with a coalition of hedge funds led by GoldenTree Asset Management, that offers to pay bondholders for bonds previously deemed illegal and null. In January 2019, the oversight board questioned the legality of $6 billion of Commonwealth bonds on the grounds that they violated the constitutional debt limit (that total illegal debt later increased to over $9 billion).[30]

As they did with $17 billion worth of sales tax-backed bonds (COFINA) in 2018, the FOMB is now proposing to pay this additional $6 billion of illegal debt, and gloss over the question of the debt's legality.[31] Other debt adjustment plans, covering the embattled water and power utilities' bonds, propose highly regressive rate hikes for Puerto Rico's residents and businesses, which would burden already struggling families.[32]

Throughout this process, Wall Street firms have attempted to secure lucrative deals that maximize their profits at the expense of Puerto Rican families and retirees. For example, private equity firm the Blackstone Group has been fueling a foreclosure crisis on the elderly with

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[27] Saqib Bhatti And Carrie Sloan, "Broken Promises: PROMESA is a Model for Undermining Democracy and Pushing Austerity Elsewhere in the U.S.," Action Center on Race and the Economy, ReFund America Project, Hedge Clippers, et al, https://static1.squarespace.com/static/58d8a1bb3a041137d463d64f/t/5c41f2522b6a28e6c0cdf940/1547825771189/Broken+Promises+-+August+2017.pdf, 4.

[28] "Hedge Papers No. 68: Pain And Profit Rosselló Is Gone But Vultures Still Prey On Puerto Rico," Hedge Clippers, August 13, 2019, hedgeclippers.org/hedge-papers-no-68-pain-and-profit-rossello-is-gone-but-vultures-still-prey-on-puerto-rico/.

[29] "Hedge Papers No. 65 Insured To Profit: Conflicts Of Interests In The Career Of José Carrión III," Hedge Clippers, October 2018, hedgeclippers.org/wp-content/uploads/2018/11/HedgePaper_65_Insured-for-Profit_CarrionReport.pdf; "Pirates of the Caribbean: How Santander's Revolving Door with Puerto Rico's Development Bank Exacerbated a Fiscal Catastrophe for the Puerto Rican People," Hedge Clippers, December 13, 2016, http://hedgeclippers.org/pirates-of-the-caribbean-how-santanders-revolving-door-with-puerto-ricos-development-bank-exacerbated-a-fiscal-catastrophe-for-the-puerto-rican-people/.

[30] Abner Dennis and Kevin Connor, "Six Billion Reasons to Go After the Banks," Public Accountability Initiative, February 20, 2019, https://public-accountability.org/report/six-billion-reasons-to-go-after-the-banks/; Mary Williams Walsh, "Puerto Rico Seeks to Have $9 Billion in Debt Ruled Unconstitutional," *New York Times*, May 2, 2019, https://www.nytimes.com/2019/05/02/business/puerto-rico-debt-banks.html.

[31] "Hedge Papers No. 68: Pain And Profit Rosselló Is Gone But Vultures Still Prey On Puerto Rico," Hedge Clippers, August 13, 2019, hedgeclippers.org/hedge-papers-no-68-pain-and-profit-rossello-is-gone-but-vultures-still-prey-on-puerto-rico/.

[32] "Hedge Papers No. 68: Pain And Profit Rosselló Is Gone But Vultures Still Prey On Puerto Rico," Hedge Clippers, August 13, 2019, hedgeclippers.org/hedge-papers-no-68-pain-and-profit-rossello-is-gone-but-vultures-still-prey-on-puerto-rico/.

reverse mortgages.[33] Blackstone went so far as to foreclose on these families in the aftermath of Hurricane María.[34]

Wave after wave of austerity measures have crippled Puerto Rico's economy and quality of life, including the closing of over 400 public schools, slashing half of the budget of the University of Puerto Rico, drastically cutting the budgets of local government municipalities tasked with providing essential services, and impending pension cuts that affect over 65,000 Puerto Rican retirees and 158,000 working families on the island.[35]

Private Equity firms cash in on the prison and immigrant detention industries

Private equity firms have seen enormous profits through rapid expansion into the criminal justice and immigrant detention industries--industries that are booming as a result of laws unfairly targeting and criminalizing Black and Latinx communities.[36] Hundreds of thousands of people are currently being held in prisons, jails, and detention facilities where private equity-run companies receive lucrative government contracts.[37] Private equity firms like H.I.G. Capital, Platinum Equity, Endeavour, and American Services run companies that provide health services, phone services, commissary services, and bail bonds within public and private prisons.[38]

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[33] Matthew Goldstein, "The Next Crisis for Puerto Rico: A Crush of Foreclosures," *New York Times,* December 16, 2017, https://www.nytimes.com/2017/12/16/business/puerto-rico-housing-foreclosures.html.

[34] "TPG Capital and Blackstone affiliates at center of Puerto Rico foreclosure crisis," Private Equity Stakeholder Project, January 26, 2018, https://pestakeholder.org/tpg-capital-and-blackstone-affiliates-at-center-of-puerto-rico-foreclosure-crisis/.

[35] Patricia Mazzei, "Puerto Rico's Schools Are in Tumult, and Not Just Because of Hurricane Maria," *New York Times,* June 1, 2018, https://www.nytimes.com/2018/06/01/us/puerto-rico-school-closings.html.
Vann R. Newkirk II, "The Situation in Puerto Rico Is Untenable," *The Atlantic,* September 20, 2018, https://www.theatlantic.com/politics/archive/2018/09/hurricane-maria-anniversary-puerto-rico-trump/570928/.
Elizabeth Redden, "Deep Cuts in Puerto Rico," *Inside Higher Ed,* July 11, 2019, https://www.insidehighered.com/news/2019/07/11/university-puerto-rico-faces-deep-cuts-appropriations.
Abner Dennis, "A Guide to Puerto Rico's Debt Adjustment Plan: Cuts for Pensioners and Payments on Allegedly Illegal Debt," Little Sis, October 16, 2019, https://news.littlesis.org/2019/10/16/a-guide-to-puerto-ricos-debt-adjustment-plan-cuts-for-pensioners-and-payments-on-allegedly-illegal-debt/.

[36] U.S. Bureau of Justice Statistics data for 2017, analyzed by The Sentencing Project, "State-by-state Data," Accessed November 15, 2019, https://www.sentencingproject.org/the-facts/#map?dataset-option=SIR; Mayra Rodriguez Valladares, "Private Equity Should Stop Profiting From Immigration Detention Centers And Private Prisons," *Forbes,* July 27, 2019, https://www.forbes.com/sites/mayrarodriguezvalladares/2019/07/27/private-equity-should-stop-profiting-from-immigration-detention-centers-and-private-prisons/#7fbec6df6dd3.

[37] "Private Equity-owned Firms Dominate Prison And Detention Services," Private Equity Stakeholder Project, December 2018, https://pestakeholder.org/wp-content/uploads/2018/09/PE-Incarceration-Detention-PESP-122018.pdf. "The Prison Industrial Complex: Mapping Private Sector Players," Worth Rises, April 2019, https://static1.squarespace.com/static/58e127cb1b10e31ed45b20f4/t/5cc7c27b9e3a8d00018649c5/1556595324791/The+Prison+Industrial+Complex+-+Mapping+Private+Sector+Players+-+2019.pdf.

[38] "Private Equity-owned Firms Dominate Prison And Detention Services," Private Equity Stakeholder Project, December 2018, https://pestakeholder.org/wp-content/uploads/2018/09/PE-Incarceration-Detention-PESP-122018.pdf.

These prison and detention facilities are rife with human rights abuses, including sub-par medical treatment, unsafe conditions, and even death.[39] In addition, these Wall Street firms have been criticized for predatory financial practices in correctional facilities. For instance, the prison phone provider Securus Technologies, owned by Platinum reportedly charged as much as $25 for a 15-minute phone call from local jails, in addition to extensive fees.[40]

Against a backdrop of Trump's "zero tolerance" and family separation policies, the private immigrant detention industry is booming. Over 60% of immigrants in detention are held in private facilities that private equity firms either run or provide contracted services to.[41] As of April 2019, one in six immigrant children being held by the government were in a shelter owned by a single private equity owner, Thomas Campbell from DC Capital Partners.[42] DC Capital Partners owns Comprehensive Health Services (CHS), the only for-profit youth migrant shelter operator in the country.[43] In 2018 alone CHS received more than $210 million from the federal government to run immigrant shelters.[44]

Until recently, up to 3,000 immigrant children and youth were held at the Homestead, Florida-based shelter, including some who had been separated from their families as a result of Trump's immigration policies.[45] Following public outcry and intense scrutiny, the federal

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[39] Jim Baker, "Hig Capital's And Wellpath's Correctional Healthcare Investment Risks," Private Equity Stakeholder Project, July 2019,
https://pestakeholder.org/wp-content/uploads/2019/07/HIG-Capitals-Correctional-Healthcare-Investment-Risks-PESP-070819.pdf;
Marsha McLeod, "The Private Option," *The Atlantic,* September 12, 2019,
https://www.theatlantic.com/politics/archive/2019/09/private-equitys-grip-on-jail-health-care/597871/.

[40] Laura Davison, "Warren, Ocasio-Cortez Probe Private Equity Firms With Prison Ties," *Bloomberg,* October 1, 2019,
https://www.bloomberg.com/news/articles/2019-10-01/warren-ocasio-cortez-probe-private-equity-with-prison-ties.

[41] "Private Equity-owned Firms Dominate Prison And Detention Services," Private Equity Stakeholder Project, December 2018,
https://pestakeholder.org/wp-content/uploads/2018/09/PE-Incarceration-Detention-PESP-122018.pdf;
Livia Luan, "Profiting from Enforcement: The Role of Private Prisons in U.S. Immigration Detention," Migration Policy Institute, May 2, 2018,
https://www.migrationpolicy.org/article/profiting-enforcement-role-private-prisons-us-immigration-detention; "Detention by the numbers," Freedom for Immigrants, https://www.freedomforimmigrants.org/detention-statistics.

[42] Deniz Cam, "One In Six Migrant Children In The U.S. Are Staying At A Shelter Operated By A Private Equity Tycoon," *Forbes,* April 10, 2019,
https://www.forbes.com/sites/denizcam/2019/04/10/one-in-six-migrant-children-in-the-us-are-staying-at-a-shelter-operated-by-a-private-equity-tycoon/#7f788fc4687e.

[43] United States Securities And Exchange Commission, "Caliburn International Corporation: Form 2-1 Registration Statement," October 19, 2018,
https://www.sec.gov/Archives/edgar/data/1750690/000119312518303218/d632104ds1.htm#toc632104_2, 31; Deniz Cam, "One In Six Migrant Children In The U.S. Are Staying At A Shelter Operated By A Private Equity Tycoon," *Forbes,* April 10, 2019,
https://www.forbes.com/sites/denizcam/2019/04/10/one-in-six-migrant-children-in-the-us-are-staying-at-a-shelter-operated-by-a-private-equity-tycoon/#7f788fc4687e.

[44] Deniz Cam, "One In Six Migrant Children In The U.S. Are Staying At A Shelter Operated By A Private Equity Tycoon," *Forbes,* April 10, 2019,
https://www.forbes.com/sites/denizcam/2019/04/10/one-in-six-migrant-children-in-the-us-are-staying-at-a-shelter-operated-by-a-private-equity-tycoon/#7f788fc4687e.

[45] U.S. House of Representatives, "Child Separations by the Trump Administration Prepared for Chairman Elijah E. Cummings Staff Report Committee on Oversight and Reform U.S. House of Representatives," July 2019,
cdn.cnn.com/cnn/2019/images/07/12/staff.report.-.immigrant.child.separations.pdf.

government announced in August 2019 that Homestead would be closed.[46] However, as of October 2019, CHS was seeking permission to expand its Texas-based migrant detention operations.[47]

Private equity has played a particularly pernicious role in the affordable housing crisis
The private equity industry began targeting the housing market in the wake of the 2008 housing crisis (a crisis which was caused by risky Wall Street deals and financial engineering schemes). As millions of American families lost their homes to foreclosure, firms like the Blackstone Group, which owns the single family rental subsidiary Invitation Homes, began buying houses by the thousands, at a fraction of their value.[48]

Today, Blackstone is the world's largest landlord.[49] Blackstone's business model relies on driving rents up as high as possible.[50] On average, Blackstone raises rents by 5%, which is double the national average of about 2.7%.[51]

Rent-burdened households struggling with rising rents, have little money for necessities and little ability to contribute to local economies by patronizing local businesses. Across the rental market, tenants at private equity-owned rental properties also face a higher eviction rate than those with traditional landlords.[52]

Graham Kates, "Migrant children facility in Homestead, Florida, to close," *CBS News,* October 29, 2019, https://www.cbsnews.com/news/migrant-children-holding-facility-in-homestead-florida-to-close/.

[46] Graham Kates, "Migrant children facility in Homestead, Florida, to close," *CBS News,* October 29, 2019, https://www.cbsnews.com/news/migrant-children-holding-facility-in-homestead-florida-to-close/.

[47] Edgar Walters, Ryan Murphy, and Darla Cameron, "Thousands of migrant kids are living in Texas shelters," *The Texas Tribune,* October 4, 2019, https://apps.texastribune.org/features/2018/texas-migrant-children-shelters/.

[48] Janet Morrissey, "Big Money Bets on a Housing Rebound," *New York Times,* December 8, 2012 http://www.nytimes.com/2012/12/09/business/financiers-bet-on-rental-housing.html?mtrref=undefined&mtrref=www.nytimes.com&gwh=67C0602261D30FDE18EFC5340CB18156&gwt=pay; Motoko Rich, "Investors are Looking to Buy Homes by the Thousands," *New York Times,* April 2, 2012 http://www.nytimes.com/2012/04/03/business/investors-are-looking-to-buy-homes-by-the-thousands.html?mtrref=undefined&mtrref=www.nytimes.com&mtrref=www.nytimes.com&gwh=B6B9B2B7615959AF77CE8A85142CD946&gwt=pay.

[49] Stephen Gandel, "Private Equity Likes the Look of Blackstone's Real Estate Model," *Bloomberg,* February 13, 2019, https://www.bloomberg.com/news/articles/2019-02-13/private-equity-likes-the-look-of-blackstone-s-real-estate-model.

[50] *See* Invitation Homes SEC filing 10-K, Year Ending December 2016 *listing inability to increase rents among the company's risk factors,* https://www.invh.com/Cache/391435636.PDF?O=PDF&T=&Y=&D=&FID=391435636&iid=4426247, 15; Invitation Homes, Earnings Release and Supplemental Information Third Quarter 2017, *boasting of "another quarter of 5% renewal rate growth" or rent increases,* https://www.invh.com/Cache/1001229447.PDF?O=PDF&T=&Y=&D=&FID=1001229447&iid=4426247, 2.

[51] U.S. Census Bureau, American Community Survey, Housing: Financial Characteristics 2005-2016. Invitation Homes, 10-K, Year Ending December 31, 2016. https://www.sec.gov/Archives/edgar/data/1687229/000168722917000005/a123116ihallfs10k.htm#s3240a6ba23cf48f1bd498bc1530e9431.

[52] Federal Reserve Bank of Atlanta, "Corporate Landlords, Institutional Investors and Displacement: Eviction Rates in Single Family Rentals," December 2016, https://www.frbatlanta.org/community-development/publications/discussion-papers/2016/04-corporate-landlords-institutional-investors-and-displacement-2016-12-21.

High eviction rates, or ever-increasing rents that force families to keep moving, disrupt community ties, decrease job security,[53] complicate healthcare access,[54] and interfere with children's schooling.[55] Rising rents not only displace long-term residents of "hot markets," but prevent low and middle income residents from moving to those cities that may offer them the greatest opportunity for gainful employment or quality education for their children, contributing to income inequality.[56]

The affordable housing crisis is particularly acute in low-income communities, who overwhelmingly pay a large portion of their already-small income on housing,[57] and communities of color, who have faced decades of legal and extra-legal residential segregation, housing discrimination, predatory lending, and exclusionary lending practices, such as redlining.[58]

Private funds are driving economic inequality

The 2019 Forbes 400 list of the very richest Americans includes 19 private equity billionaires (18 white men and one African-American man) with total fortunes of $82.8 billion and 22 hedge fund billionaires (all white men) with total fortunes of $158.6 billion.[59]

That's 41 billionaires who made *$244.5 billion* in wealth from private funds -- all while Wall Street-owned companies were evicting tenants, driving austerity in Puerto Rico, killing jobs and extracting resources from communities of color.

Despite being some of the wealthiest people in the country, private equity and hedge fund managers use a number of tax avoidance schemes, including the carried interest loophole, all of which allow them to pay taxes at a lower rate than many working Americans.[60]

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[53] Matthew Desmond and Carl Gershenson, "Housing and Employment Insecurity Among the Working Poor," *Social Problems,* 2016, 0, 1–22.
http://scholar.harvard.edu/files/mdesmond/files/desmondgershenson.sp2016.pdf?m=1452638824.

[54] Megan Sandel,, et al. "Unstable Housing and Caregiver and Child Health in Renter Families," Pediatrics, January 2018. http://pediatrics.aappublications.org/content/early/2018/01/18/peds.2017-2199.

[55] Martha Galvez and Jessica Luna, "Homelessness and Housing Instability: The Impact on Education Outcomes," Urban Institute, December 2014,
https://tacomahousing.net/sites/default/files/print_pdf/Education/Urban%20Institute%20THA%20Homelessness%20and%20Education%202014-12-22.pdf.

[56] Peter Ganong and Daniel Shoag, "Why has Regional Income Convergence in the US Declined?" Harvard University,
https://scholar.harvard.edu/files/shoag/files/why_has_regional_income_convergence_in_the_us_declined_01.pdf.

[57] "The Gap: A Shortage of Affordable Homes," The National Low Income Housing Coalition, March 2019,
https://reports.nlihc.org/sites/default/files/gap/Gap-Report_2019.pdf.

[58] john a. Powell and Kaloma Cardwell, "Homeownership, Wealth, and the Production of Racialized Space," Joint Center for Housing Studies of Harvard University, October 2013,
https://www.jchs.harvard.edu/sites/default/files/hbtl-07.pdf; Sarah Burd-Sharps and Rebecca Rasch, *Impact of the US Housing Crisis on the Racial Wealth Gap Across Generations*, Social Science Research Council and the American Civil Liberties Union, June 2015, https://www.aclu.org/sites/default/files/field_document/discrimlend_final.pdf.

[59] Luisa Kroll and Kerry A. Dolan, "The Forbes 400: The Definitive Ranking Of The Wealthiest Americans," *Forbes,* October 2, 2019, https://www.forbes.com/forbes-400/#445e0b357e2f.

[60] "The Buffett Rule: A Basic Principle of Tax Fairness," The National Economic Council, April 2012,
https://obamawhitehouse.archives.gov/sites/default/files/Buffett_Rule_Report_Final.pdf, 6. U.S. Bureau of Labor Statistics, "Occupational Employment and Wages, 29-1141 Registered Nurses," May 2017,
https://www.bls.gov/oes/2017/may/oes291141.htm; US Bureau of Labor Statistics, "Occupational Outlook Handbook: Firefighters," April 12, 2019, https://www.bls.gov/ooh/protective-service/firefighters.htm; U.S. Bureau of Labor Statistics, "Occupational Outlook Handbook, High School Teachers," April 23, 2019,
https://www.bls.gov/ooh/education-training-and-library/high-school-teachers.htm.

Straightforward and forceful reform and regulation of private funds is necessary to reverse runaway inequality and restore basic fairness in our economy, with an eye towards facilitating broader prosperity for all Americans.

How do private equity firms and hedge funds get away with these businesses practices?

The private equity industry claims it amasses huge profits by using investor capital to buy "undervalued" or inefficient companies, using their management expertise to make the companies' operations more efficient, and then selling the companies at a profit.

In reality, private equity funds often load massive and unsustainable amounts of debt onto the companies they buy, strip them of their assets, shrink worker pay and benefits, and extract exorbitant fees, guaranteeing payouts for themselves with little regard for how the company performs long term. They can walk away from workers, consumers, communities, and investors if their bet goes bad and the company fails.[61]

Private funds follow a playbook to insulate financial firms from risk and secure enormous profits at the expense of working people

First, they often exploit a range of lucrative tax loopholes and bankruptcy code manipulations to boost profits and avoid regulations.

And second, they protect themselves from sharp scrutiny and appropriate oversight by rigging the system with huge campaign contributions, multi-million dollar lobbying campaigns and other dark-money efforts.[62]

Last year's debacle at Toys "R" Us was the last straw: it marked the beginning of a strong fightback effort by workers, communities and principled elected officials against the greed and self-dealing of private funds.

In a nationwide grassroots effort, Toys "R" Us workers fought the private equity funds that destroyed their company, shining a bright spotlight on the damage suffered by their families and communities while a small number of fund managers, lawyers and corporate executives got huge payoffs.

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[61] Eileen Appelbaum and Rosemary Batt, "Private Equity at Work: When Wall Street Manages Main Street," New York, Russell Sage Foundation, May 2014.

[62] Ben Protess, Jessica Silver-Greenberg and Rachel Abrams, "How Private Equity Found Power and Profit in State Capitols," *New York Times,* July 14, 2016, https://www.nytimes.com/2016/07/15/business/dealbook/private-equity-influence-fortress-investment-group.html; "Industry Profile: Private Equity & Investment Firms," Open Secrets - Center for Responsive Politics, Accessed November 15, 2019, https://www.opensecrets.org/federal-lobbying/industries/summary?cycle=2018&id=F2600; Alan Rappeport, "Trump Promised to Kill Carried Interest Deduction. Lobbyist Kept It Alive," *New York Times*, December 23, 2017, https://www.nytimes.com/2017/12/22/business/trump-carried-interest-lobbyists.html.

Organized as United For Respect, these workers won a landmark $20 million hardship fund for themselves and their families[63] -- but they didn't stop there.

They kept working with allies at CPD, Americans for Financial Reform and others to help inform and push for the first comprehensive legislation in decades aimed at reforming private funds and reining in Wall Street greed.

The "Stop Wall Street Looting Act" is designed to strengthen the regulatory oversight of private equity firms and hedge funds, while closing key loopholes -- it would essentially make what happened at Toys "R" Us illegal. This bill represents a new popular push by regular Americans to fight financialization and demand an economy that works for the many, not just the billionaires.

The "Stop Wall Street Looting" Act will:

Require Private Investment Firms to Take Real Responsibility for Their Deals. Firms will share responsibility for the liabilities of companies under their control including debt, legal judgments and pension-related obligations, to better align the incentives of private equity firms and the companies they own. In order to discourage irresponsible leverage, the bill ends the tax loophole for excessive leverage and closes the carried interest loophole.

End Looting of Companies They Own. To give private equity owned companies a shot at success, the proposal bans dividends to investors for two years after a firm is acquired and ends the extraction of value from acquired companies through excessive fees.

Protect Communities, Workers, and Customers. This proposal prevents private equity firms from walking away when a company fails and protects stakeholders by:

- Prioritizing worker pay in the bankruptcy process and improving rules so workers are more likely to receive severance, their promised pensions, and other payments they earned.
- Creating incentives for job retention so that workers who are always the hardest hit can benefit from a company's second chance.
- Ending the immunity of private equity firms from legal liability when their companies break the law, including the WARN Act. When people are abused at private prisons or children are hurt at child care facilities because private equity firms force portfolio companies to cut corners, the firm should be liable.
- Ensuring consumers are not left with worthless gift cards from failed companies by giving them higher priority in bankruptcy proceedings.

Empower Investors by Increasing Transparency. Private equity managers will be required to clearly disclose fees and returns so that investors can monitor their investments and shop

[63] Erin Corbett, "Former Toys 'R' Us Workers Will Receive $20 Million via a Hardship Fund," *Fortune,* November 20, 2018, https://fortune.com/2018/11/20/toys-r-us-workers-20-million-hardship-fund/.

around. The bill will also prevent firms from forcing investors to waive their fiduciary duties and end secret side deals that privilege some investors over others.

Require Risk Retention. Reinstates the Dodd-Frank provision that requires arrangers of corporate debt securitization to retain some of the risk.

Hedge fund reforms are also needed

Leading lawmakers have also introduced legislation to limit hedge fund "wolf packs" and to crack down on hedge fund abuses.[64]

However, there is a solid case to outlaw hedge funds altogether. Hedge funds, which were accidentally created by a loophole in the "1940 Investment Company Act," were later enormously expanded in the "1996 National Securities Market Improvement Act."[65]

Legislation that amends the "1940 Investment Company Act" to push highly speculative hedge fund managers back into limited business lines and the "1996 National Securities Market Improvement Act" to limit investment from pension funds, endowments and other institutional investors could end the hedge funds' disastrous impacts and sweeping power over the economy, workers and communities.

Conclusion

It's time to level the playing field, protect workers, consumers and investors, and force private funds to take responsibility for the success of companies they control. This can be achieved by closing the key loopholes that allow them to capture all the rewards of their investments while insulating themselves from risk. As detailed in this written testimony, the Center for Popular Democracy enthusiastically supports the "Stop Wall Street Looting Act." Our national network of 53 grassroots community organizations in 131 cities urges the House Financial Services Committee to continue its timely and important discussions on the key policy solutions that will ensure greater Wall Street accountability.

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[64] Liz Moyer, "2 Senate Democrats Introduce Bill to Curb Activist Hedge Funds," *New York Times,* March 17, 2016, https://www.nytimes.com/2016/03/18/business/dealbook/2-senate-democrats-introduce-bill-to-curb-activist-hedge-funds.html.

[65] David Dayen, "End Hedge Funds," January 25, 2019, https://tinyletter.com/DavidDayen/letters/end-hedge-funds.



Communications Workers of America
Chris Shelton | *President*

Government Affairs Department
Dan Mauer | *Director*

November 19, 2019

The Honorable Maxine Waters
Chairwoman
Financial Services Committee
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Waters:

Thank you for holding todays important hearing , "America for Sale? An Examination of the Practices of Private Funds." I am writing to share views on H.R. 3848, the Stop Wall Street Looting Act, on behalf of the officers and 700,000 members of the Communications Workers of America (CWA). This important legislation would significantly curtail abuses by private equity funds that have devastated workers and communities.

Predatory corporate takeovers by private equity firms all too often are structured to loot real-world businesses, while allowing Wall Street billionaires to profit enormously. Most concerningly, private equity takeovers often are financed with enormous debt, for which the private equity firm is itself not liable. This structure creates a "heads I win, tails you lose" dynamic, as the debt financing creates huge returns if a company is returned to profitability, yet also raises the risk of bankruptcy or liquidation, leaving workers or retirees holding the bag. Because private equity firms now manage more than $4 trillion in assets and own firms that employ millions of workers, this perverse structure risks the well being of workers and communities across the country.

Private equity exploitation has harmed a number of important industries, including retail, health care, news media and manufacturing. A study published earlier this year found that private equity has cut over one million retail jobs. Meanwhile, Alden Global Capital, in particular, has attacked the local news industry and has cut over 1,000 jobs in that sector alone since 2012--a 71% documented cut in jobs at Digital First Media. Cuts have been so severe that reporters have been forced to buy their own pens and calendars, while one single editor has been put in the impossible position of editing more than 50 dailies and weeklies across California.[1] Other industries have likewise suffered--Athenahealth announced earlier this year that it would cut 4% of its workforce after a takeover by Elliott Management affiliate Evergreen Coast Capital.[2]

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1 https://dfmworkers.org/hedge-fund-alden-cuts-costs-by-putting-one-editor-in-charge-of-scores-of-california-papers-as-it-aims-for-usa-today-chains-real-estate/
2 https://www.beckershospitalreview.com/ehrs/athenahealth-to-lay-off-nearly-4-of-employees.html

Elliott also has demonstrated the harms that private equity can impose on struggling businesses in bankruptcy. Elliott and two other funds seized control of auto parts manufacturer Delphi in 2009, after which the funds both stopped a proposed sale that would have preserved a substantial portion of Delphis U.S. operations, and ultimately drained more funds from the company, resulting in the closure of all but four plants.[3] Moreover, Elliott and its allies who had taken control of Delphi refused to pay U.S. worker pensions, resulting in major expenses for the Pension Benefit Guaranty Corporation and cuts between 30 and 70 percent in over 20,000 retirees pensions. [4]

Unfortunately, current law incentivizes this predatory behavior. The fact that private equity firms can finance transactions with enormous debt for which they are not legally responsible is legal makes this business model attractive. Furthermore, these funds benefit from tax advantages, limited transparency, weak protections in our bankruptcy code, and the weak regulations that make it easy for the funds to siphon money and useful assets out of the companies they acquire. The Stop Wall Street Looting Act enacts common sense change that would address all of these problems, including imposing joint and several liability for controlling funds; limiting buybacks, fees and fraudulent transfers; strengthening bankruptcy protections for workers; closing the carried interest loophole; and adding significant transparency for investors in private equity funds. By doing so, this important bill would significantly limit predatory private equity behavior and protect good jobs.

CWA strongly supports the Stop Wall Street Looting Act and urges this Committee to advance this important legislation expeditiously. I also note that, while the specific leverage buyout model employed in private equity transactions is especially harmful to workers and retirees, many of the hedge funds that engage in private equity takeovers also cause significant job loss and disinvestment in other parts of their funds. For instance, the aforementioned Elliott Management recently acquired a $3 billion stake in AT&T and immediately began a push to force the company to cut productive capital expenditures and good jobs, with the goal of having the company spend half of its post-dividend free cash flow on stock buybacks. As such, I urge the Committee to also begin exploring ways to better align the incentives of hedge funds with the interests of American workers and communities in the near future.

Thank you in advance for your consideration.

Sincerely,

Daniel J. Mauer

Dan Mauer
Director of Government Affairs
Communications Workers of America (CWA)

Cc: Members of the Financial Services Committee

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3 https://cwa-union.org/sites/default/files/cwa-att-elliott-factsheet.pdf
4 See https://www.freep.com/story/money/business/michigan/2015/03/01/rodney-oneal-delphi-turnaround-retire-pensions/24156921/ and https://www.thenation.com/article/mitt-romneys-bailout-bonanza/.

November 18, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
United States House of Representatives
2221 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
United States House of Representatives
2004 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Waters, Ranking Member McHenry, and Members of the Committee:

In advance of tomorrow's hearing, "America for Sale? An Examination of the Practices of Private Funds," I am submitting written testimony in support of the "Stop Wall Street Looting Act of 2019," a comprehensive bill aimed at stemming abusive practices employed by some private equity firms to line their pockets at the expense of workers, institutional investors, creditors, and others with stakes in the companies they acquire—and too often destroy. As I told Senator Elizabeth Warren in an earlier letter, the legislation will not hinder those private equity firms that prosper by delivering efficiency gains to underperforming companies in their portfolios. Instead, it will simply remove tax and other incentives that allow some firms to realize large gains by inflicting even larger losses on other stakeholders. This type of negative sum strategy is pursued too often in the private equity industry and requires a legislative and regulatory response.

Private equity's rocky history. Investment firms engaging in leveraged buyouts first caught the public's attention in the 1980s with the hostile takeovers of high-profile companies such as RJR Nabisco, whose acquisition and subsequent collapse became the subject of a bestselling book and HBO movie, *Barbarians at the Gate*.[1] Bad publicity about failed deals put a damper on leveraged buyouts in the 1990s, but the same business model, now known as private equity, made a comeback in the early 2000s and rebounded after the Great Recession. According to the private equity industry lobby, investment has more than doubled over the past 10 years, with $3.4 trillion invested between 2013 and 2018 and 5.8 million Americans employed in private-equity-backed businesses.[2]

Abetted by short memories, deregulation, and low interest rates, private equity firms have trained their sights on companies with assets that can be easily sold off if necessary, such as store chains with real estate holdings. This has left in their wake what hearing witness Eileen Appelbaum has described as a "retail apocalypse"—in which profitable companies such as Toys "R" Us are saddled with debt and stripped of assets before filing for bankruptcy.[3] While toy, apparel, grocery, and other chains acquired by private equity undoubtedly face competition from online and big box retailers, their ability to adapt

to meet these challenges has been hamstrung by debt service and payments to private equity partners in the form of fees and special dividends.

In a series of studies, economist Steven J. Davis and various co-authors find that though portfolio companies tended to be strong performers before their acquisition by private equity firms, job losses at these companies increased significantly (relative to similar companies) after their acquisition, often after establishments were shuttered.[4]

In the most recent working paper, Steven J. Davis, John Haltiwanger, Kyle Handley, Ben Lipsius, Josh Lerner, and Javier Miranda examine two-year outcomes of private equity buyouts occurring between 1980 to 2013, finding that employment in target firms fell by 4.4 percentage points relative to comparable firms not backed by private equity, netting out gains and losses from post-buyout acquisitions and divestitures. The effect varied by type of buyout, with public-to-private deals showing larger losses.[5]

Not surprisingly given these job losses, the authors found that real revenue per worker increased in firms targeted by private equity relative to comparable firms. However, it is not clear to what extent, if any, these productivity gains reflected a more efficient deployment of workers or similar operational efficiencies as opposed to simply squeezing more work out of fewer workers. The latter tactic may not be sustainable if it leads to increased worker turnover or a declining reputation among customers. In any case, growth in revenue per worker, as opposed to revenue per hour worked, is an imperfect way to measure productivity growth since it may simply reflect longer work hours.

The authors also found that workers did not share in the gains from these supposed productivity improvements. Even after restricting the sample to establishments that were still in operation two years after the buyout, earnings per worker fell by 1.7% at target companies relative to comparable firms. This likely understates wage losses for ordinary workers, since average compensation includes compensation of managers, who are often given raises and retention bonuses after buyouts. The measure is also based on earnings per worker rather than hourly pay.

What are the purported benefits of private equity? Proponents say private equity can play a constructive role in the economy by streamlining and, if necessary, breaking up underperforming companies—what economist Joseph Schumpeter has famously called "creative destruction."[6] In this view, private equity addresses the problem of empire-building CEOs whose interests are not closely aligned with those of shareholders because their pay and prestige reflects the company's size rather than its performance. Solutions to this agency problem involve giving investors more control or managers a greater stake in profit maximization. With private equity, the result is a highly leveraged and multilayered business model that blurs the line between owners and managers.

How does private equity function in the real world? While leverage and direct control by equity investors can impose discipline on bloated companies, much of what private equity firms do is simply destructive—absent the "creative" part. Private equity firms often engage in what economists call "rent-seeking," or unproductive behavior designed to take advantage of loopholes in the tax code, banking and securities laws, and bankruptcy provisions, rather than creating value through efficiency gains.

Private equity firms have rigged the system so that they share in the upside risk but minimize losses from bad bets—a "heads we win, tails you lose" strategy enabled by a tax system that encourages equity investors to load companies up with debt. If a portfolio company thrives despite being saddled with debt, it can be resold at a profit. If not, private equity partners recoup some or all of their minimal investment by selling assets and siphoning off cash through fees and debt-funded dividends.[7]

Meanwhile, suppliers and other creditors are kept in the dark if the company slides toward insolvency. The biggest victims are often workers, who risk losing not only their jobs, but also back wages, pension benefits, and severance pay, in bankruptcy proceedings tilted in favor of creditors with more political clout. Consumers are also harmed as companies they like are driven out of business, market concentration increases, and they are left with worthless gift cards and unfulfilled orders.

Banks, bondholders, limited partners, and other investors may suffer immense losses while private equity's general partners emerge unscathed from bad deals. As one observer has noted, private equity is engaging in the systemic abuse of limited liability.[8] Private equity firms were behind the largest commercial real estate default in U.S. history, the result of their vastly overpaying for the Stuyvesant Town and Peter Cooper Village apartment complexes in Manhattan. Underlying this bad gamble was a projection that income would triple in five years, based in part on a strategy of improperly converting rent-stabilized units. When the deal went sour, the private equity partners lost only a tiny equity stake in the deal, while other investors lost billions.[9]

While some of the risk is borne by wealthy investors who can afford to suffer losses, ordinary Americans are indirectly exposed, notably workers whose pension funds are among the largest investors in private equity funds. The scale and riskiness of private equity transactions has also increased our economy's vulnerability to financial crisis, especially as leverage has increased while standards have declined.[10]

Private equity markets itself to pension funds and other limited partners with the promise of outsize returns. However, these claims are based on cherry-picked statistics, manipulated earnings, and ignored risk. While early investors and insiders in some of the best-performing funds may prosper, more objective research finds that most investors do not achieve higher risk-adjusted returns to compensate for illiquidity and lack of transparency, so even non-risk-averse institutional investors would fare better by investing in, say, small cap index funds.[11]

In addition to shifting risk, private equity general partners also shift the tax burden to others through tax-avoidance strategies. The best known of these is classifying their compensation as lightly taxed "carried interest."[12] While the revenue losses are hard to estimate because they depend on assumptions about how this income might be taxed if the loophole were closed, estimates have ranged from $18 billion annually to 10 times that amount.[13]

In short, private equity partners often prosper at the expense of others—investors, suppliers, creditors, workers, consumers, and taxpayers—rather than managing portfolio companies more efficiently in ways that foster economic growth. Even when private equity management appears to bring about efficiency improvements, these are typically short-term gains that come at the expense of the long-run health of the company and the economy.

Private equity is not in it for the long term. The industry and its backers tout the supposed productivity gains from reduced staffing levels in retail and other industries. However, there is little reason to believe that managers in highly competitive industries such as retail were complacent about labor costs before private equity came on the scene. Rather, private equity overseers may have reduced staffing below sustainable levels in order to boost short-term profits, ignoring employee turnover, customer complaints, and even worse outcomes. For example, the *Washington Post* reported that after private equity firm Carlyle bought nursing home company HCR ManorCare, serious health code violations—including violations placing patients in immediate jeopardy or causing actual harm—rose by 29% annually before the company filed for bankruptcy.[14]

Short-termism helps explain why private equity is often drawn to industries where reputations matter, such as health care and journalism, since this is where the gap between short-term and long-term profits is often greatest. Because there is often a delay between the cost savings achieved by layoffs and the reputational impact of poor service and deteriorating quality, private equity can enrich itself by stripping a brand of reputational value the same way it strips target companies of other real and intangible assets—whether brick-and-mortar stores or creditors' trust.

Thus, for example, before private equity recognized the opportunity to make outsize profits, most medical providers were reluctant to engage in surprise medical billing, whereby vulnerable patients—often those experiencing medical emergencies—are presented with extortionate bills by out-of-network providers, such as ambulance services or anesthesiologists. This practice is not just terrible public relations, it is likely to eventually be shut down by regulators. It makes no business sense for a hospital or other health care provider with community roots and a long-term outlook to engage in such practices, but it makes sense as a get-rich-quick scheme for private equity.[15]

Similarly, private equity takeovers have gutted media companies around the country, including local newspapers such as *The Denver Post*, leading magazines such as *Sports Illustrated*, and popular websites such as *Deadspin*.[16] While industry consolidation cannot all be blamed on private equity, private equity's attempt to drain any remaining profits from media companies that produce original content, which are already competing with social media behemoths for scarce advertising dollars, has sped up the process. Admittedly, the targeted media companies may not have been maximizing profits—publishers have balanced a public and a business purpose long before the concept of a "B Corporation" was formalized. However, it is difficult to imagine how our economy, democracy, and culture benefit when media companies focus single-mindedly on short-term profits.

Imperviousness to bad publicity and lust for short-term profits also explains private equity's entrée into the residential real estate market, which has been abetted by preferential tax treatment. *The Washington Post* reported that Cerberus Capital Management, the largest owner of single-family homes in the Memphis area, filed for eviction at twice the rate of other home property managers in the area and threatened renters with removal at the highest rate among the area's large management firms.[17] These are not isolated incidents. The problem is large and worldwide, to the point where the United Nations' Special Rapporteur on adequate housing singled out private-equity firm Blackstone Group for exploiting tenants, wreaking havoc on communities, and contributing to a global housing crisis.[18]

Such practices not only harm those communities that are directly impacted, but they may heighten systemic risks in the broader economy.[19] The most recent study by Davis et al. finds that private equity deals that occur amid easy credit conditions appear to be more driven by private returns from financial engineering—leveraged buyouts and buybacks—as opposed to operational improvements, a pattern that could exacerbate cyclical swings in economic activity.[20]

A comprehensive solution is at hand. The Stop Wall Street Looting Act will not outlaw private equity partnerships, but rather will force them to do what they already claim to be doing—restructuring underperforming companies to make them more productive. It does this through a number of provisions aimed at removing the tax and other incentives that encourage private equity firms to gamble with other people's money, loot and destroy productive resources, and enrich themselves at the expense of other stakeholders.

To this end, the bill

- holds those who have ultimate decision-making authority responsible for damages and debts, including employee back pay and benefits;
- limits or prohibits the looting of assets through fees and capital distributions;
- reduces the incentive for risk-taking by prohibiting interest on excessive debt obligations from being tax-deductible;
- limits enhancement of executive compensation, and prioritizes unpaid wages, severance pay, contributions to employee benefit plans, and damages from violations of labor and employment laws, during bankruptcy proceedings;
- directs bankruptcy courts to give substantial weight to the effect on employees in directing the sale of company properties;
- puts consumers with unredeemed gift cards or undelivered services just behind employees in bankruptcy proceedings, along with people who purchased, leased, or rented property from the company;
- closes the carried interest loophole that gives preferential tax treatment to private equity partners' income;
- protects outside investors by requiring detailed disclosure of fees and returns, as well as the performance of past funds, including the outcomes for target firms;
- clarifies that fund managers have a fiduciary duty to pension plans whose assets they manage;
- prohibits giving favorable treatment to certain limited partners;
- requires managers of collateralized debt obligations to retain a share of the risk according to the credit risk retention requirements in the Dodd-Frank Act; and
- provides effective enforcement mechanisms to ensure compliance with these provisions.

Industry response. The Stop Wall Street Looting Act tackles a business model based on rent-seeking and extracting short-term profits at the expense of long-term value. It should not deter private equity partners who have a genuine expertise in identifying undervalued companies and managing them better. Because the legislation focuses on removing incentives to engage in socially undesirable business

practices, it is not surprising that the industry's response has largely avoided defending these incentives and practices, relying instead on exaggerated claims of the industry's economic importance.

The industry lobby claims private equity supports millions of jobs and invests trillions in struggling companies, as if these workers and resources would otherwise remain idle.[21] Not content to claim credit for jobs in companies wholly owned by private equity, the lobby commissioned a report from Ernst & Young that inflated that number by including all jobs in companies where the industry has partial ownership. Likewise, the Ernst & Young report inflated workers' average earnings by including the private equity partners' sky-high compensation in the average. Perhaps most absurdly, the report credited the industry with an estimate of taxes paid based on "the historical relationship between federal, state, and local tax collections (by tax type) to economic activity," rather than on what the famously tax-dodging industry actually paid.[22]

Conclusion. A telling aspect of the private equity business model is that risks and rewards are not evenly distributed among investors. While private equity managers invest little of their own money, they capture a disproportionate share of gains through layers of fees and other opaque arrangements. Meanwhile, other insiders make private side deals, leaving less connected investors, such as pension funds, with the dregs. If the private equity business model were truly about using expertise to identify undervalued companies and manage them better, we would expect the partners to invest more of their own money. Instead, outside investors, such as pension funds, are brought in to bear more of the risk and reap less of the profit.

Rather than promoting efficient market outcomes, private equity often thrives on identifying, creating, and perpetuating tax and regulatory loopholes that distort economic incentives, perverting our political system in the process. If the Vikings had had public relations teams, they would have claimed to be making better use of the resources of the fishing villages they pillaged. Private equity often leaves a similar trail of destruction—looting productive resources rather than salvaging unproductive ones. This bill addresses serious problems with the private equity business model, without getting in the way of firms that actually do produce allocative or operational efficiencies that strengthen the U.S. economy.

Sincerely,

Thea Lee
President
Economic Policy Institute

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FPPA | Fire & Police Pension Association of Colorado

November 18, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairwoman Waters and Ranking Member McHenry:

Fire and Police Pension Association of Colorado, ("FPPA") writes regarding the hearing planned for November 19, 2019, titled **"America for Sale, An Examination of the Practices of Private Funds**." We strongly support the provisions in the *Investment Adviser Alignment Act*, which will ensure greater alignment of interest and improved transparency and governance in the private equity asset class.

FPPA acts as the fiduciary for the retirement assets of over 26,000 current or former public safety employees. We are also active members of the Institutional Limited Partners Association ("ILPA"), and support their efforts to improve the private equity industry. FPPA has $5.3 billion of assets under management, with an asset allocation to private equity of 25%. Private equity provides necessary returns and asset diversification that FPPA requires to meet our fiduciary obligations to our beneficiaries. FPPA is supportive of targeted reforms, such as those in the *Investment Adviser Alignment Act*, that seek to improve the asset class.

FPPA is concerned about recent trends in the private equity industry that seek to reduce the fiduciary obligations owed to limited partners. We also actively seek fee and expense reporting from the private equity managers we invest with and find it critical to ensure the investment contract we signed with the GP is complied with. Finally, we support efforts to ensure LPs are informed of who their partners are, and that prevent limitations on communications among investors in a private equity fund. Each of these items are addressed in the *Investment Adviser Alignment Act*, which is supported by ILPA.

FPPA appreciates the opportunity to comment on this important topic and encourages the Committee to move forward with the reforms in the *Investment Adviser Alignment Act* to ensure the long-term health of the private equity industry.

Respectfully Submitted,

Dan M. Slack
Executive Director

FPPAco.org
5290 DTC Parkway • Suite 100
Greenwood Village, CO 80111
(303) **770-3772**
(800) 332-3772
(303) 771-7622 fax

David Halperin
Attorney & Counselor
1530 P Street NW 2nd Floor
Washington DC 20005
davidhalperindc@gmail.com

November 18, 2019

The Honorable Maxine Waters, Chair
U.S. House Committee on Financial Services
Washington, DC 20515

Dear Chairwoman Waters:

I submit the attached article, which I published in September on my website *Republic Report*, for your committee's consideration in connection with your November 19 hearing entitled, "America for Sale? An Examination of the Practices of Private Funds." My article discusses private equity investments in for-profit higher education.

I have been studying the for-profit college industry, and advocating for students on higher education issues, for more than a decade, starting when I was senior vice president at the Center for American Progress and director of the Center's youth organizing arm. Since 2012 I have been working on these issues, part-time, as a self-employed lawyer, advocate, and reporter. (My higher education work is funded entirely by charitable foundations concerned with the quality and affordability of higher education.)

Thank you for your important work reviewing these issues and related legislation.

Please let me know if you have any questions.

Sincerely,



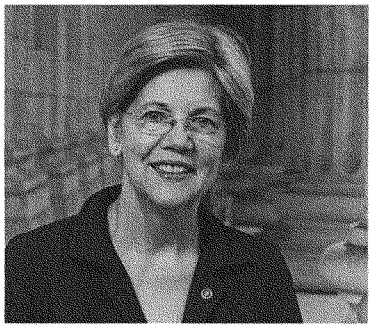
David Halperin

REPUBLIC REPORT

SEPTEMBER 17, 2019

Warren Probes Private Equity Owners of For-Profit Colleges[1]

POSTED AT 2:58 PM BY DAVID HALPERIN[2]



Senator Elizabeth Warren (D-MA), joined by Rep. Mark Pocan (D-WI), has written to six U.S. private equity firms regarding their investments in for-profit colleges.[3] In light of growing evidence that private equity-owned for-profit colleges are some of the worst actors in an industry rife with bad behavior, Warren and Pocan have asked the firms to answer questions about their marketing, tuition, federal aid, profits, and graduation rates, as well as about any law enforcement investigations and lawsuits against their schools.

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[3] https://www.warren.senate.gov/imo/media/doc/2019-09-10%20Letters%20to%20PE%20Firms%20re%20For%20Profit%20Colleges.pdf

The firms to which Warren and Pocan sent letters, dated September 10, are KKR[4], Sterling Partners[5], Altas Partners, Vistria[6], Leeds Equity Partners[7], and Apollo Global Management[8]. Controversial for-profit college chains connected to one or more of those firms include the University of Phoenix, the Art Institutes, Argosy University, and Walden University.

As Warren and Pocan note, a 2018 research paper by professors from the University of California, University of Chicago, and NYU found that private equity takeovers of for-profit schools led to "higher tuition, higher per-student debt, lower graduation rates, lower student loan repayment rates, and lower earnings among graduates."[9] Another report released last year, by the advocacy group Americans for Financial Reform, reached a similar conclusion.[10]

A document recently obtained from the Department of Education's Office of Federal Student Aid lists 57 school groups and holding companies that operate or operated for-profit schools in multiple states.[11] It appears to confirm the private equity ownership of some schools (e.g. DeVry University[12]), where public information has been lacking.

Warren and Pocan charge that over the past two decades private equity firms have stripped the assets of companies they acquired, loaded them with debt, and taken excessive fees and payouts before walking away. Private equity takeovers of for-profit colleges are particularly destructive, Warren and Pocan assert, because of the harms caused to students and taxpayers.

The two lawmakers are sponsors of the Stop Wall Street Looting Act, which aims to hold private equity firms responsible for the debts of companies under their control and require greater transparency in private equity firms' operations.[13]

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Members of the minority party in a house of Congress sometimes struggle to get outside parties to respond to requests for information, especially because subpoena power resides with the majority. But, of course, Rep. Pocan's party now controls the House of Representatives. And with Senator Warren rising in the presidential polls, targets of her letters will ignore her at their peril.

UPDATE 09-18-19 10:00 am:

Some additional thoughts:

In the early part of this decade, when government[14] and media investigations began digging into abuses by for-profit colleges, the central focus was on publicly-traded schools -- Corinthian, ITT, University of Phoenix -- which critics felt were particularly inclined to abuses because of Wall Street pressure for quick profits. But at least publicly-traded corporations are required to disclose financials, personnel changes, and law enforcement investigations in public filings with the Securities and Exchange Commission. Privately-held firms do not have such disclosure obligations, so abuses are more easily shielded, and that likely is one reason why conversions to private ownership are appealing to some operations. (Other for-profits have engaged in troubling conversions to non-profit status, which also has provided regulatory benefits.[15])

Even if GOP fealty to their campaign contributors in the for-profit college and other industries prevents passage of the Warren-Pocan legislation, the Department of Education could, as a condition of providing access to federal grants and loans, require all for-profit colleges, whether publicly-traded or privately-held, to make the kind of public disclosures that the SEC requires. That's a reform well worth implementing, although the Trump-DeVos regime at the Department has made clear they have no interest in changes that would help students and taxpayers, so it will have to wait.[16]

Meanwhile, as Senator Warren and Rep. Pocan pursue answers from the six private equity firms they wrote to last week, there are others they might consider contacting, including:

-- Texas-based Ancora Education, which last year greatly expanded its portfolio of trade schools; Ancora is owned by another firm, Connecticut-based Marblegate, and Ancora's CEO, Michael Zawisky, is the former chief operating officer of disgraced scam school ATI;[17]

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[14] http://www.protectstudentsandtaxpayers.org/harkin-report-on-for-profit-colleges/

[15] https://www.republicreport.org/2018/betsy-devos-facilitates-profit-colleges-conversion-therapy/; https://www.republicreport.org/2019/gao-probing-for-profit-college-conversions-as-devos-retreats-on-approvals/

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-- Bradley Palmer and his Palm Ventures, which last year seemed to shield its acquisition of the former publicly-traded giant DeVry University;[18]

-- New York-based JLL Partners, owners of Maryland-based Education Affiliates, operators of All-State Career School and other chains; in 2015, Education Affiliates agreed to pay $13 million to settle U.S. Justice Department allegations that the company altered admissions test results to admit unqualified students, created fraudulent high school diplomas, and falsified students' federal aid applications;[19]

-- New York-based The Wicks Group of Companies, owners of Florida-based, privately-held Southern Technical College, which in 2014 bought Southwest Florida College from Sextant Education Corporation (in which Betsy DeVos has held a financial stake);[20]

-- TA Associates, owners of collapsed, predatory Vatterott College and of Full Sail University; TA's head, Bill Heavener, is a major donor to, and now political appointee of, Florida governor Ron DeSantis, and was a donor to and investment partner with Mitt Romney (R-UT), now Warren's fellow U.S. senator;[21]

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-- Quad Partners, the politically-connected, New York-based owners of several for-profit chains; former investors in the disgraced, shut-down Marinello Schools of Beauty;[22]

-- CM Equity Partners, investor in Grantham University, which used the deceptive website Army.com to recruit students, until the Federal Trade Commission shut that site down.[23]

They also might have questions for Willis Stein Partners, investors in the now-shut down predatory Education Corporation of America chains of schools.[24]

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Written Testimony of Leo Hindery, Jr
U.S. House of Representatives Committee on Financial Services
"America for Sale? An Examination of the Practices of Public Funds."
November 19, 2019

In the way of introduction, I am co-chair of the Task Force on Jobs Creation and a member of the Council on Foreign Relations. Formerly the CEO of AT&T Broadband and its predecessor, Tele-Communications, Inc. (TCI), I am currently an investor in media properties and the Chairman and CEO of a NYSE-traded SPAC. In the course of my career I have started and overseen seven private equity (PE) funds.

If you look at our economy only from 30,000 feet, it's easy to believe that we're living in boom times.

But if you get closer to the ground, where too many good jobs are being replaced by precarious ones, where large-scale employers waver at the brink of going under, and where profits overwhelmingly go to the wealthy, you can see a practice escalating across the economy, a practice that has already had disastrous effects on workers generally and that has the potential to take down hundreds of thousands more jobs and put investors and consumers alike in jeopardy.

That practice is the unchecked and reckless overuse of heavy burdens of debt, and then of bankruptcy laws, by some PE firms and hedge funds to the overwhelming detriment of employees and retirees.

Particularly devastated has been America's retail sector where "hedge funds and retailers don't mix" (*Wall Street Journal*, August 7, 2019, https://www.wsj.com/articles/riches-to-rags-hedge-funds-and-retailers-dont-mix-11565175602?mod=searchresults&page=3&pos=9). According to the *Washington Post* (July 24, 2019, https://www.washingtonpost.com/business/2019/07/24/private-equitys-role-retail-has-decimated-million-jobs-study-says/), "More than 1.3 million Americans have lost their jobs in the past decade as a result of private equity ownership in retail. That includes 600,000 retail workers, as well as 728,000 employees in related industries...Women and people of color have been disproportionately affected by the layoffs as debt-ridden retailers closed thousands of stores, according to the report by six progressive nonprofit organizations and workers' advocacy groups, including Americans for Financial Reform and the Center for Popular Democracy."

All of this is why we need to pay attention to proposals in Congress that would curtail the threat which financial predators pose and remove the incentives for them to further harm our economy and American workers. These proposals would also eliminate a tax abuse I have written against numerous times, namely, the pernicious 'carried interest tax loophole'.

Though the existence of private equity firms and hedge funds is taken for granted today, I'm long enough in my career to remember when the PE boom took off in the mid-1980s.

Before the fictional Gordon Gekko and his maxim that "greed is good," things worked differently. Private equity investors had a specialization that they focused on, and when they invested, they invested for the long term usually with reasonable amounts of debt leverage.

It was a different time.

It was before hundreds of thousands of workers across the retail sector lost their jobs as retailer after storied retailer closed their doors, crushed by the debt that some PE firms and hedge funds imposed on them.

It was before some PE firms and hedge funds began taking over nursing homes and major hospital systems and cutting costs to in order to turn a quick buck, sparing nary a thought for the patients and senior citizens who would lose quality care.

It was before some PE firms took over and privatized the water systems of a growing list of cities, spiking costs for a resource that's critical to life.

As of 2017, there were around 8,000 private-equity owned businesses in the U.S., which is nearly twice as many as there were publicly listed firms. Today, too many PE fund managers are generalists, with little or no experience in the industry they're investing in. And we're seeing them use a much-discredited playbook: raise debt, take out cash for their own short-term benefit, add little genuine competitive value, and then slash jobs and worker benefits in a desperate bid for greater operating cash flow.

According to the *Financial Times* (July 29, 2019, https://on.ft.com/2YoSukC) this "stems from the way that private equity deals are structured. When buyout firms acquire a business, they fund the transaction primarily with borrowed money. This is then pushed down on to the portfolio company, which has to service those heavy debts."

"The result is a company that may be leaner because of the so-called 'discipline of debt'. Remember, financial engineering is a core skill for private equity. But it's also far less resilient to business downturns or idiosyncratic problems. Its main recourse when these strike is simply to sell assets, cut back on staff numbers or squeeze the amount the business invests." (*FT*, stet)

"By raising debt levels, buyout insiders increase the gearing on the call option that equity ownership of any company represents. This gives them an incentive to shuffle collateral out of the reach of creditors, whether by taking fat fees for such marginal activities as 'monitoring' or extracting assets in the form of leveraged dividends. If the deal ultimately flourishes; great. But if it doesn't, well, they're fine too." (*FT*, stet)

Congress should hold predatory private equity firms and hedge funds liable for the damage they cause, it should close the tax loopholes which encourage excessive debt and which also let executives avoid paying their fair share of taxes, and it should limit the debt that predatory firms can access in order to seize control of companies. And, tremendously importantly, any such bill should protect workers when employers go bankrupt, giving them added recourse to pursue the severance that is currently denied them.

These solutions don't come out of nowhere. They are what workers, consumers and pension fund investors have been calling for across the country. But they shouldn't have to fight for them. Adequate severance – and other protections for workers – should be the bare minimum provided in a bankruptcy.

Private equity isn't going away, nor should it, as in the right hands and with the right target companies, it can bring great value to investors and employees alike. But we must restore appropriate balance among these funds, their investors and employees.

The legislative actions being considered are not perfect in every respect. But they are an excellent start to bring about very needed changes to abuses that have demonstrably harmed entire classes and groups of employees, and which if not fixed will continue to ravage ever greater numbers of employees.

Fundamentally, "private equity must show more transparency, and politicians are right to shine the light on the industry's practices. The PE industry owns assets in every sector, from critical infrastructure to retailers. Persistent low interest rates have helped funds raise large sums of money; recent figures show they have up to $2.5 trillion to spend." (*Financial Times*, October 15, 2019, https://www.ft.com/content/e5efa950-ec17-11e9-85f4-d00e5018f061)

With this greater power should come greater accountability. As it is, some private equity-controlled companies have deliberately and unfairly exploited the limited liability company regime to pay big dividends from increased debt just before investment collapsed.

Another appropriate response would be to whip away the most harmful PE industry incentives, specifically by withdrawing the privilege of limited liability for private equity investments and making the acquiring PE firm appropriately liable for the debts of its portfolio companies. If a private equity-controlled business goes bust, certain creditors (such as employee pension funds) should in some circumstances be able to go after as well the assets of the PE fund, and transfers, including monitoring fees and special dividends, which shifted collateral out of the reach of lenders should be deemed fraudulent unless proven otherwise.



November 18, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairwoman Waters and Ranking Member McHenry:

The Institutional Limited Partners Association ("ILPA") appreciates the opportunity to submit comments in conjunction with the November 19, 2019 hearing, **"America for Sale, An Examination of the Practices of Private Funds**."

ILPA serves the shared interests of more than 530 institutional investors that direct capital to private funds globally, otherwise known as Limited Partners ("LPs"[1]). These members include public and private pension funds, university endowments, insurance companies, charitable foundations, sovereign and treasury funds, Taft-Hartley plans and family offices, among others. One-third of our membership represents American public pension funds, which rely on the returns and diversification generated by private equity to deliver a secure retirement to hundreds of thousands of teachers, policemen, firemen and other public workers across the United States.

As such, ILPA supports the Committee's desire to evaluate legislative changes that ensure the health of the private equity industry for the long-term. The industry's scale and range of investment activities requires a meaningful discussion of reforms that level the playing field for LPs, while also safeguarding the fair treatment of workers at underlying portfolio companies and engaging productively with a wide range of stakeholders.

We are strongly in favour of targeted reforms for private equity aimed at enhancing governance, alignment of interests and transparency, and believe such change can be achieved through the adoption of provisions outlined in the *Investment Adviser Alignment Act.*

With that said, while ILPA believes targeted reforms are necessary, we have significant concerns about any changes that would hobble the industry and prevent LPs from earning the returns necessary to support their beneficiaries. The goal of policymakers and regulators should be to achieve better balance without fundamentally disrupting an investment model that has, in aggregate, served our pensions, endowments, foundations and other long-term pools of productive capital so well.

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[1] For a partial list of ILPA's member institutions that have agreed to be publicly disclosed, please visit: https://ilpa.org/member-list/.

Additional commentary on topics covered in the November 19 hearing is below:

I. ILPA Strongly Supports the Investment Adviser Alignment Act

Over the past year, ILPA has engaged with policymakers in Congress regarding the challenges LPs face in the private equity market, and we have encouraged specific reforms that are focused on transparency between private equity fund managers ("GPs") and LPs. We believe the *Investment Adviser Alignment Act*, a targeted, bipartisan reform package that establishes minimum standards in law and protect millions of beneficiaries who rely on the LPs' ability to negotiate and invest knowledgably on their behalf, represents a compelling solution.

Over the past decade, it has become increasingly difficult for LPs to negotiate reasonable terms with private equity funds and accurately monitor fund performance. There is immense competition to access top-performing funds that provide the returns they require, resulting in LPs often being unable to measurably improve the skewed investment terms for fear of having their investment allocations reduced or excluded. Once invested in a fund, information flows regarding fees and expenses, as well as other pertinent information, are not always provided in a consistent fashion or otherwise, resulting in an information asymmetry that negatively impacts decision making.

ILPA believes Congress should take action on three fronts. First, Congress should eliminate the loophole in the Investment Advisers Act of 1940 ("Advisers Act") that permits GPs to reduce or eliminate their fiduciary duties of care and loyalty in their investment contracts. Second, Congress should require GPs to disclose to their investors how much they are charging them, on a quarterly basis, in fees and expenses. Third, Congress should require GPs to share pertinent information that is not always being disclosed today with their investors, including the organizational identity of fellow investors (for communication purposes), as well as any compliance issues the Securities & Exchange Commission ("SEC") has uncovered. Each of these provisions are components of the *Investment Adviser Alignment Act and detailed as follows:*

A. Fiduciary Duties Are the Foundation of Trust in Private Equity

Strong fiduciary duties—of care, loyalty, and good faith—are the foundation of the trust between LPs and GPs, and give investors' confidence to invest in the illiquid private markets, which by their very nature are less transparent. As the Chief Justice of the Delaware Supreme Court, Leo Strine, recently noted: "*[a]mong the hallmarks of [contractual agreements in private equity] are broad waivers of all fiduciary duties, including the duty of loyalty. Traditionally, the duty of loyalty provided the most meaningful protection to passive investors in corporations and partnerships.*"[2] This dynamic results in a difficult choice, according to the Chief Justice, "*the practical alternatives for a skeptical*

[2] Leo Strine & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom,* Harvard Law School John M. Olin Center Discussion Paper No. 789, (August 1, 2014) p. 3, *available at:* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2481039.

investor are often stark: invest without adequate protection against self-dealing or avoid the asset class altogether."[3]

The primary sources of fiduciary obligations owed by GPs to LPs are found in two places: the Advisers Act and those included in the investment contract between the LP and the GP, generally governed under the laws of the state of Delaware. The fiduciary duties under the Advisers Act are only enforceable by the SEC, and only apply to the fund as a whole, not to the individual LPs within it, and therefore are less helpful to LPs. Contractual obligations around duty of loyalty are understandably critical to LPs, given their passive role as investors in these funds and the possibility of conflicts of interest.

Eighteen of the SEC enforcement actions against private fund advisers since 2014 included breaches of fiduciary duties, such as the failure to disclose either real or potential conflicts of interest or inappropriately charged fees and expenses. While these enforcement actions may have deterred similar behaviors, they have spawned a "mountain" of disclosures in the investment contracts known as limited partnership agreements ("LPAs") that LPs sign with GPs. Even a sophisticated LP may find it difficult to truly give informed consent when confronted with written terms and disclosures that are broad, opaque, voluminous, and sometimes contradicted by the oral statements of the GP.

Contracts negotiated by GPs increasingly feature diminished fiduciary obligations to LPs, allowable under Delaware and Cayman law, where most of these funds are domiciled. Some of the largest U.S. institutions have been forced to walk away from investment opportunities due to unsatisfactory duty of care or loyalty, e.g., language that permits the GP to act in its "sole discretion", putting its own interests ahead of those of the LPs in the fund. This is a particularly acute problem for some U.S. public plans, who to some extent are statutorily proscribed from reducing their own fiduciary obligations through contract.

These practices are harmful for investors who must accept reductions in fundamental protections in order to invest and are not in the best long-term interest of the industry. Congress must take action to ensure that GPs subject to the fiduciary requirements of the Advisers Act are not reducing or eliminating those same duties for their investors in the investment contracts.

B. LPs Should Be Sufficiently Informed About the Fees & Expenses being Charged

ILPA has sought greater fee and expense transparency in the private equity industry for several years. The lack of fee and expense transparency in the marketplace as an issue became apparent soon after the SEC began examining GPs. In 2014, the SEC indicated after their initial round of 150 examinations that *"[w]hen we have examined how fees and expenses are handled by advisers to private equity funds, we have identified what we*

[3] *Id* at 4.

believe are violations of law or material weaknesses in controls over 50% of the time."[4] A 2016 speech by then-SEC Division of Enforcement Director, Andrew Ceresney further highlighted the transparency challenges around costs facing LPs: *"[I]nvestors in certain circumstances do not have sufficient transparency into how fees and expenses are charged to portfolio companies or the funds. Sometimes fees are not properly disclosed, conflicts are not aired, expenses are misallocated, and investors are defrauded… even experienced [and sophisticated] investors can be defrauded if they lack transparency into the various fees, expenses and practices."* As LPs became more aware of these issues in the industry, they needed a solution to ensure they could verify the fees and expenses they were being charged.

In 2016, ILPA released its Reporting Template[5] as an industry standard format for reporting fees and expenses to investors to satisfy this need. Many GPs and LPs have adopted the template as the solution for providing LPs with a consistent view into fund charges. As of April 2019, 26 GPs have endorsed the template[6], committing to provide the template data to any LP requesting it. A number of states, including California and Texas, have also imposed requirements to require fee reporting to be received by their public pensions, creating a bifurcation between various LPs in the marketplace.[7] Moreover, the Financial Conduct Authority, the United Kingdom's securities regulator, has also recognized the opacity in this market and taken action to encourage enhanced fee and expense reporting in the UK, including the ILPA template as an option.[8] Given the complexity of the fees and expenses charged to the fund and to portfolio companies, quarterly fee and expense reporting is critical to investors and must be included in any reform seeking transparency in private equity.

C. Free Flow of Information Is Critical for Fund Governance

Often, private equity LPAs include provisions limiting the ability of LPs to communicate with one another about the fund, even within that same partnership. In addition, GPs do not routinely provide a complete list of all LPs in the fund. Investors are therefore impeded from exercising their contractual rights with respect to fund governance where matters require investor consent or a vote within the partnership.

Additionally, since SEC registration of private equity managers was enacted in 2010, the SEC has examined a significant portion of the industry. While the default expectation is

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[4] Andrew Bowden, *Spreading Sunshine in Private Equity,* PEI Private Equity Compliance Forum 2014, New York, May 6 ,2014, *available at:* https://www.sec.gov/news/speech/2014--spch05062014ab.html

[5] https://ilpa.org/reporting-template/

[6] Template endorses include significant GPs like Apollo, Blackstone, Carlyle and KKR, among others. https://ilpa.org/reporting-template/template-endorsers/

[7] *See AB 2833 New California Law Opens Lid on Private Fund Fees,* REED SMITH CLIENT ALERT, October 4, 2016, *available at:* https://www.reedsmith.com/en/perspectives/2016/10/ab2833-new-california-law-opens-lid-on-private-fun
; Christine Williamson, *Texas to Peek Over Shoulders of Public Funds,* PENSIONS & INVESTMENTS, (June 24, 2019), *available at:* https://www.pionline.com/print/texas-peek-over-shoulders-public-funds

[8] Alex Lynn, *Fee Reporting Template Becomes a Focus for UK Regulator,* PRIVATE FUNDS CFO, November 8, 2010, *available at:* https://www.privatefundscfo.com/uk-regulator-taps-uss-exec-catalyse-fee-template-adoption/

that GPs will follow the terms of the contract, there have been material exceptions. When a GP has been examined, LPs should be privy to compliance or other shortcomings identified by the SEC—today, this information is protected, and most GPs refuse to share it with existing and prospective LPs. LPs must be informed if the SEC uncovers compliance issues, including non-compliance with the terms of their LPAs.

II. ILPA's Views on the Stop Wall Street Looting Act (H.R. 3848/S.2155)

This summer, Senator Elizabeth Warren and Representative Mark Pocan introduced the *Stop Wall Street Looting Act* (S. 2155 and H.R. 3848) (the "Pocan Bill"). **The Pocan Bill represents a far-reaching overhaul of the private equity industry, which poses substantial risks to LPs being able to rely on much needed investment returns and portfolio diversification from private equity. While there is overlap between certain provisions the Pocan Bill and the Investment Adviser Alignment Act, we view portions of the Bill as harmful to the industry, our LP members and their beneficiaries.** We strongly urge the Committee to instead consider a targeted and constructive set of reforms, again, with the *Investment Adviser Alignment Act* serving as a roadmap for a healthier industry. Specifically, we view the following provisions in the Pocan Bill as being generally aligned with the *Investment Adviser Alignment Act*:

Fiduciary Duty (Section 502): ILPA is supportive of provisions in the Pocan Bill that prevent the waiver of fiduciary duties under the Investment Advisers Act. This issue concerns many LPs and is a core reform sought by ILPA. ILPA believes that the provisions which amend ERISA fiduciary protections, while well meaning, should be removed, as these would only apply to ERISA-governed plans, predominantly Taft-Hartley (union) plans and corporate pensions. These provisions would not elevate the standard of care required for public pension investors and may result in ERISA plans not having access to the returns and diversification provided in the private equity market.

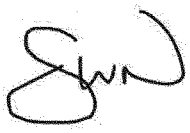
Fee & Expense Reporting (Section 501): ILPA is supportive of provisions that require GPs to report their fees and expenses to investors. While the Pocan Bill requires these to be reported annually, we believe they should be reported quarterly to be relevant to investors. Additionally, we believe this provision should be drafted to ensure all current and future conceived direct and indirect fees are covered.

Disclosure of other LPs in the Partnership (Section 501): ILPA supports provisions which permit LPs to know who their fellow LPs are in private equity funds. These provisions help LPs exercise governance rights in the LPA, which often require active coordination among LPs in the fund. LP names must already be disclosed in the UK public register and many public pensions report this information. While we support sharing LP names amongst other investors in the fund, we do not necessarily support sharing these names publicly.

III. Conclusion

On behalf of its members and their beneficiaries, ILPA appreciates the opportunity to engage on this important topic and encourages the Committee to move forward with sensible reforms, like those in the *Investment Adviser Alignment Act*, to ensure the long-term health of the private equity industry.

Respectfully Submitted,



Steve Nelson
Chief Executive Officer
Institutional Limited Partners Association



Testimonty Provided by Holly Hook, a resident of a Havenpark Capital-owned community, Swartz Creek Estates, in Swartz Creek, MI.

My name is Holly Hook, and I'm from Swartz Creek, Michigan. I'm a member of MHAction and helped found the Michigan Mobile Home Residents for Affordable Housing.

I moved into my manufactured home community so I could have an affordable life. My neighbors are mostly low-income seniors who survive on fixed incomes, like my friend who gets just $800 a month from disability. I, along with 150+ families that call this community home, loved the stability and community closeness Swartz Creek Estates provided.

Our hopes of living in an affordable, decent home in a healthy, vibrant community were dashed when a real estate investment company named Havenpark Capital bought our community. In one year, they increased the rent we pay for the land our homes sit on by 30%. Havenpark also increased the fees that we have to pay out for garbage pickup and sewage and water services almost another 10%.

Michigan, like most states, provides our community little protection against these predatory equity schemes. Although what Havenpark is doing is legal, it's immoral.

Havenpark's predatory business model has put me and my neighbors on shaky footing. Many are unsure if we'll have a place to call home as Havenpark continues to gouge our communities for profit.

We are not alone in Michigan. As of today, over 2 million people who live in manufactured home communities now write their monthly rent checks to large corporations, increasingly to private equity groups, like Havenpark. And these investors are being fueled by low-cost loans from Fannie Mae that should instead go to resident-cooperative, non-profit, and publicly-owned communities.

As investors prey on low income residents, one of the few remaining affordable housing options is vanishing. That's why our community is joining with many others across the country to fight back.

Residents question Havenpark Capital's 61% rent increase

KCCI DES MOINES
Updated: 7:01 PM CDT Jun 27, 2019

Adam Brower
Reporter

WAUKEE, Iowa —

Havenpark Capital is raising rent by nearly 61% for residents of its newly acquired property, Midwest Country Estates mobile home park in Waukee.

"I'm going to still stay there, no matter what, even if I have to go get extra hours at work," said Joan Bailey, a resident.

She, along with other residents, received a notice that rent would be rising from $310 to $500 per month. Bailey said she doesn't want to keep working but might have to.

"We have small families trying to get their first house as a starter home. You have elderly that are on a fixed income, you have low-income people, handicapped people," said Matt Chapman, a resident.

Bailey shared her frustration with dozens of other Midwest Country Estates residents Wednesday night in Waukee after seeing a new lease in the past few weeks.

"What do I do?" Bailey said. "Dig a hole somewhere and be a cavewoman? No. I've been there for 25 years, and it's my house, and I should have what I want in my house."

Some of the changes include water fees and added pet fees.

"They're coming up with so much a dog and all that, so what would they say if I got a billy goat? You know, at my house," Bailey said.

June 30 is the deadline to sign if residents want to stay.

"One of the things it said in there is anyone who hasn't signed by June, then they are considered delinquent, and they will start eviction proceedings," Chapman said.

In a closed-door meeting back in May, the company agreed to stagger the rent increase, increasing it by only 39% on July 1 and instituting the full 69% increase by April 1, 2020.

But right now, this lease, tenants say, isn't good enough.

"I want to sign it, but I don't, and I guess we have to sign it in order, because it's hard to tell what they'll do if we don't," Bailey said.

KCCI's Adam Brower contacted Havenpark Capital for comment. The company's Iowa legal representative talked with Iowa Legal Aid attorneys. Havenpark is expecting a list of lease questions, but has not received it.

Havenpark also said it welcomes the opportunity to answer and discuss any questions residents have.



Testimony Submitted for the Record

U.S. House Committee on Financial Services

Hearing: "America for Sale? An Examination of the Practices of Private Funds"

November 19, 2019

Bernie Lunzer, President, NewsGuild-CWA

Chairwoman Waters, Ranking Member McHenry: Thank you for the opportunity to offer written testimony.

My name is Bernie Lunzer. I am President of The NewsGuild-CWA. The NewsGuild represents over 20,000 employees in the news industry. CWA represents working men and women in telecommunications, customer service, media, airlines, health care, public service and education, and manufacturing.

I want to testify here on the role of private equity in the news industry. In particular, I want to discuss one newspaper chain, MediaNews Group (MNG) which is also known as Digital First Media. This is a newspaper company with such venerable titles as the *Boston Herald, the Denver Post, the Detroit News, the Orange County Register, the San Jose Mercury News*, and the *St. Paul Pioneer Press*. MNG is controlled by the Alden Global Capital which is both a private equity firm and a hedge fund. The NewsGuild-CWA represents 500 workers at 13 MNG papers.

Alden has played a particularly destructive role in local journalism. Since it has controlled MNG, it has slashed staff and sold real estate to extract cash from the news organizations without regard to the role news organizations play in communities. Alden has depleted newsrooms, eliminated beats, and made it virtually impossible for local papers to tell fully the stories of their communities.[1] Alden has also extracted hundreds of millions of dollars in profits from its newspaper holdings to invest in unrelated businesses, some of which have gone belly-up.

The hollowing out of local news is no mere inconvenience. Because of the draconian cuts, many local newspapers can no longer cover city meetings, community events, school board votes or high school sports. Recent research from the University of Illinois–Chicago and the University of

Notre Dame found that communities that have become "news deserts" pay higher taxes and bond rates and are at greater risk of political corruption.[2] Other studies show lower voter turnout and increased partisanship.[3] In other words, when the watchdogs are gone, democracy dies. Private equity has helped kill the watchdogs.

Alden's Destructive Impact on Media Businesses

The headline in the *Washington Post* from February 2019 summarized succinctly Alden's activity in the news industry: "A hedge fund's 'mercenary' strategy: Buy newspapers, slash jobs, sell the buildings."[4] *The New York Times* referred to Alden as "the destroyer of newspapers."[5] Joe Nocera compared Heath Freeman, Alden President, to Gordon Gekko from the movie "Wall Street": "His papers are intended not so much to inform the public or hold officialdom to account, but to supply cash for Freeman to use elsewhere. His layoffs aren't just painful. They are savage."[6] In another article, Nocera describes Alden's approach to the news industry:

> [I]t cuts and cuts, and then cuts some more, until there's little left but a carcass. Speaking truth to power, the importance of the Fourth Estate to a functioning democracy, the idea of bearing witness — none of that matters to Freeman and his fellow hedgies at Alden Global. Their only goal is to suck out cash and redirect it elsewhere.[7]

According to media analyst Ken Doctor, Alden's strategy appears to be to "milk its newspapers until they run dry."[8] In an interview with Colorado Public Radio in March 2018, Doctor concluded that Alden's strategy is to run papers into the ground and then leave: "If it's not profitable you turn out the lights."[9] Dean Singleton, founder of the Media News Group, who sold his controlling interest to Alden in 2013, quit as Chairman and member of the editorial board of the Denver Post in May 2018, saying of Alden: "They've killed a great newspaper."[10]

We recognize the effect of the Internet on the news industry. Revenues from print advertising have fallen and digital advertising has not compensated. Moreover, the digital ad space is now dominated by Facebook and Google. According to the Pew Research Center, newsroom employment has declined by 23% in the decade after the financial crisis.[11] The employment in TNG-CWA units at Digital First Media, however, has dropped 71% between 2012 and 2019.

Converting MediaNews Group into a Private Equity Firm

Under Alden's ownership, MNG has been converted into a private equity firm, investing balance sheet capital in unrelated companies and assets through a wholly-owned subsidiary Strategic Investment Opportunities LLC. Funds were extracted from the news business to invest elsewhere.

Between 2016 and 2018, MediaNews Group invested around $168 million in shares of Fred's Inc.[12], a discount pharmacy chain that recently filed for bankruptcy.[13] So rather than investing

in local journalism, under Alden's stewardship MediaNews Group made a money-losing investment in an unrelated retail chain.

In the last few years, MNG has also invested in online job site owner Monster Worldwide[14], coal miner Peabody Energy[15], Payless Holdings debt[16], Gannett[17], New Media Investment Inc.,[18] and Alden's own Alden Global CRE Opportunities Master Fund LP.[19]

Investment of MediaNews Group Employees' Pension Funds in Alden funds

It is not simply that Alden has dramatically downsized employment at its papers and extracted cash from operations. It has also toyed with the retirement security of its employees for its own benefit. Beginning in 2013, MNG invested nearly $250 million from multiple pension funds of MNG employees and retirees in funds managed by Alden Global Capital.[20] This appears to be financially imprudent and legally suspect.

Between 2013 and 2018, the San Jose Mercury News Retirement Plan, three pension funds for Denver Post employees, and the MediaNews Group Defined Benefit Plan for Certain Employees all invested in multiple Alden Global Capital managed funds, including Alden Global CRE Opportunities Fund and the AGBPI Fund.[21] In 2015, for example, the San Jose Mercury News Retirement Plan had 89.5% of its assets invested in Alden-managed funds with 77.3% of the pension fund's assets invested in the AGBPI Fund alone.[22]

The pension investments have triggered federal scrutiny despite the fact that these pension funds seem to have divested their Alden assets. In April 2019, a spokesman for Alden confirmed that it was being investigated by the Department of Labor for management of the pensions.[23]

Sale of MediaNews Group Real Estate

Alden has a set of real estate companies that focus on the purchase, sale, leasing and redevelopment of newspapers' offices and printing plants.[24] While this real estate operation has been used by different newspapers, it mostly serves to strip assets from MNG.

In 2013, Alden affiliate Twenty Lake Holdings began taking ownership of some of the real estate owned by MediaNews Group newspapers. In some cases, MNG has sold the newspapers' real estate to Twenty Lake and then leased back all or part of the space. After MediaNews Group acquired The Denver Post, for example, it sold the paper's printing plant and its offices to Twenty Lake Holdings, meaning the MediaNews Group-owned newspaper is now a tenant of Alden-controlled Twenty Lake Holdings. Twenty Lake claimed to have acquired more than 180 properties and 2.3 million square feet of real estate in 29 states.[25]

The sale of the real estate appears to be more of a liquidation strategy than a strategic move by the company since the cash it has generated has not been returned to newsrooms. Instead, the real estate sales deplete that balance sheet and remove an asset that could benefit the newspapers.

Alden's Destructive Behavior Extends beyond News

We mentioned the investment in Fred's by Alden through MNG subsidiary Strategic Investment Opportunities. Under Alden Global, the pharmacy chain filed for bankruptcy protection in September 2019 with plans to shutter all of its stores.[26]

Alden bought 24% of Fred's in December 2016 and entered into an agreement in April 2017 under which Fred's agreed to appoint two Alden executives to its board. It added a third director – Alden President Heath Freeman – in August 2017. In May 2018, it added a fourth director to the board at Fred's, by which time Fred's had reduced its board to five members.

Unfortunately for Fred's other shareholders, in the three years after Alden's investment in the company, the company's performance and share price have plummeted. The share price on April 21, 2017, the day Alden directors joined the board, stood at $13.28. On the day of its September 2019 bankruptcy filing, it traded at $0.12 a share, a fall of 99%. In the period after entry to the board, the company lost a total of $150 million. A total of 6,572 Fred's employees lost their jobs.[27]

This is the second job-killing action by Alden in 2019 alone. In February 2019, Payless Holdings, the owner of a chain of discount shoe stores, announced its bankruptcy and the liquidation of all 2,100 U.S. stores, resulting in the elimination of 16,000 jobs. Alden owned 66% of Payless at the time. Alden was also a creditor. It loaned $45 million to a Payless company not in bankruptcy, giving it senior status in the bankruptcy proceedings. While the U.S. stores have been liquidated, Alden continues to own part of the non-U.S. parts of Payless.

Both Payless and Fred's moved their headquarters from Topeka, Kansas, and Memphis, Tennessee, respectively, into a Dallas office building owned by Randall Smith, the founder of Alden.[28]

Between Payless and Fred's, Alden Global Capital will have killed over 22,000 retail jobs in 2019. That does not include the cuts in newspaper jobs at MNG which TNG-CWA estimates in 2019 alone to have been 25%. In recent years, Alden Global Capital has killed at least 2,000 jobs in California, at least 1,500 jobs in Kansas, at least 1,400 jobs each in Texas, Mississippi, and Georgia, more than 1,300 jobs in Tennessee, more than 1,200 jobs in Florida, and more than 1,100 jobs in New York. See Table One in the Appendix for a list of job cuts by company and by state engineered by Alden Global Capital.

Conclusion

The actions by Alden and MNG are unacceptable. They rate with the worst of private equity and hedge fund excess that we have seen at Toys R Us and Sears. TNG-CWA supports legislation that will end the abusive practices employed by some private equity firms and hedge funds to profit at the expense of workers, institutional investors, creditors, and the communities in which these companies are located.

TNG-CWA endorses the Stop Wall Street Looting Act (H.R.3848). When enacted, private equity executives will be legally liable for the damage they cause. In particular, Section 101 would ensure that the principals at Alden would be responsible for debt they incurred on behalf of MNG newspapers. Section 102 would ensure that investors in private equity firms like Alden Global Capital would incur partial liability for the actions taken by the private equity firm. Sections 201 and 203 would limit the amount of cash the private equity firms can extract from the companies they control. Section 301 would give greater protection for workers, like those at Payless and Fred's, whose private-equity-owned companies filed for bankruptcy and liquidation. Section 403 would ensure that private equity investors, such as Alden's president Heath Freeman, will pay taxes on the fees they receive at the higher income tax rate and not at the capital gains tax rate.

For the sake of our future and our children's future, we need to slow and eventually reverse the financialization of the U.S. economy.

Thank you very much.

Appendix

Table 1: Job Losses Triggered by Alden Global Capital

	Payless Stores Closed 2019	Payless Employees (est.)	Fred's Stores Closed 2019	Fred's Employees (est.)	Payless + Fred's Employees	MediaNews Group cuts since 2012 (TNG-CWA units only)	Total
California	260	1,820			1,820	248	2,068
Kansas	20	1,524			1,524		1,524
Texas	187	1,309	14	154	1,463		1,463
Mississippi	13	91	120	1,320	1,411		1,411
Georgia	59	413	90	990	1,403		1,403
Tennessee	23	161	75	1,149	1,310		1,310
Florida	170	1,190	6	66	1,256		1,256
New York	159	1,113			1,113	22	1,135
Pennsylvania	107	749			749	194	943
Alabama	13	91	71	781	872		872
Arkansas	15	105	62	682	787		787
Louisiana	26	182	55	605	787		787
Michigan	85	595			595	70	665
New Jersey	85	595			595	42	637
Colorado	36	252			252	368	620
Illinois	79	553	4	44	597		597
Ohio	80	560			560		560
South Carolina	17	119	35	385	504		504
North Carolina	32	224	15	165	389		389
Washington	53	371			371		371
Maryland	52	364			364		364
Arizona	50	350			350		350
Virginia	50	350			350		350
Missouri	40	280	6	66	346		346
Minnesota	21	147			147	168	315
Indiana	41	287	1	11	298		298
Massachusetts	42	294			294		294
Kentucky	15	105	12	132	237		237
Connecticut	32	224			224		224
Utah	27	189			189		189
Nevada	23	161			161		161
Oregon	23	161			161		161
Oklahoma	19	133	2	22	155		155

(Table 1 Continued)

	Payless Stores Closed 2019	Payless Employees (est.)	Fred's Stores Closed 2019	Fred's Employees (est.)	Payless + Fred's Employees	MediaNews Group cuts since 2012 (TNG-CWA units only)	Total
Wisconsin	20	140			140		140
New Mexico	18	126			126		126
Iowa	16	112			112		112
Nebraska	13	91			91		91
Idaho	12	84			84		84
New Hampshire	11	77			77		77
Rhode Island	11	77			77		77
Delaware	7	49			49		49
West Virginia	6	42			42		42
Maine	5	35			35		35
Montana	4	28			28		28
North Dakota	4	28			28		28
Vermont	4	28			28		28
South Dakota	3	21			21		21
Wyoming	0	0			0		0
	2,088	16,000	568	6,572	22,472	1,112	23,584

Methodology: Because neither Payless nor Fred's broke out their employment data by state, we needed to make some assumptions. We knew overall employment and the number of stores in each state. We then assumed that 5% of total employment was located at headquarters - Topeka, KS, for Payless, and Memphis, TN, for Fred's. We subtracted that 5% from the total for each company to get a store total, then divided that number by the number of stores. The multiplier was 7 employees per Payless store and 11 per Fred's store. Finally, we added the 5% to the total for headquarter states - Kansas and Tennessee.

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America for Sale? An Examination of the Practices of Private Funds

Statement by Jim Baker, Executive Director, Private Equity Stakeholder Project

November 19, 2019

Madam Chair and members of the Committee,

Thank you for holding this hearing on the growing impact of private funds investments.

The Private Equity Stakeholder Project is a nonprofit organization that seeks to understand the impacts of private equity and other private funds investments on workers, communities, consumers and other stakeholders and lift up the voices of those stakeholders in pursuit of more just outcomes.

While there are a variety of issues to raise regarding private funds investments, today we wish to focus on two specific issues: (1) the growing impact of private funds investments on the environment and climate change, and (2) the fluctuating numbers of jobs at private equity-backed companies cited by private equity industry groups.

The growing impact of private funds investments on the environment and climate change

The private equity industry and more broadly the private funds industry – encompassing private equity, venture capital, private debt, private infrastructure, private real estate, and similar asset classes – has grown dramatically over the past several years, from $1 trillion prior to the global financial crisis to a record $5.8 trillion in assets under management in 2018.[1] Private equity and other private funds have come to account for a larger share of many institutional investors' assets, a trend that is expected to continue.[2]

As private funds have grown, they have increasingly come to impact the environment, with their investments playing a growing role in generating atmospheric carbon and driving climate change.

For example, private funds managers have come to play growing part in the exploration, production, and transmission of fossil fuels as well as fossil fuel-fired power generation.

A number of private equity firms substantially increased their investments in fossil fuels following the 2015 decline in oil prices, taking advantage of the dislocation to buy or invest capital into smaller oil exploration and production companies and to buy assets that the publicly-traded oil majors and independents, in need of cash, were looking to offload. Private equity funds dedicated to natural resources raised nearly $70 billion of capital in 2015, according to SailingStone Capital Partners, an energy-focused investment firm, and over $100 billion in 2016. Today, 35 percent of all horizontal drilling (i.e. fracking) is done by privately backed companies.[3]

Rather than funding the development of renewable energy sources, private equity firms have too often been investing new capital in fossil fuel exploration and infrastructure. And while publicly traded energy companies, following demands from investors and others, have increasingly provided greater transparency regarding the impacts and risks of their investments, private equity firms have remained largely opaque regarding their investments in fossil fuels.[4]

The Blackstone Group, for example, the largest alternative asset management firm in the world, has raised at least $20 billion to invest in the energy sector in the past several years.[5] Of the dozens of energy firms Blackstone has invested in, just a handful appear to have made renewable energy

Contact: Jim Baker
jim.baker@PEstakeholder.org

investments. Instead, Blackstone has invested in oil pipelines[6], coal-fired power plants[7], and tar/oil sands.[8]

Beyond fossil fuel investments, Blackstone has recently drawn scrutiny for exacerbating deforestation in the Amazon Rainforest through its investment in a Brazilian infrastructure firm, Hidrovias do Brasil, that operates a grain transshipment station in the middle of the Amazon.[9]

The Amazon Rainforest, where a record number of fires have been raging, is the world's largest rainforest. It absorbs a significant amount of carbon dioxide, a major contributor to the climate crisis. The fires are mostly a man-made event, set to clear land for agriculture.[10]

Hidrovias do Brasil runs a shipping terminal at Miritituba in the Pará state of Brazil to export grain and soybeans.[11] In the spring of 2019, the government of Jair Bolsonaro announced that Hidrovias would partner in the privatization and development of the B.R.-163 roadway through the Amazon. Hidrovias paid for a feasibility study on a 10-year concession of B.R.-163 which would include paving of the unpaved sections of the road.[12] Developing the roadway itself causes deforestation and helps make possible the broader transformation of the Amazon from jungle to farmland.[13]

The attached memo, "Blackstone investments driving Amazon deforestation and other climate concerns," takes a closer look at both Blackstone's connection to Amazon Rainforest deforestation and the firm's investments in fossil fuels, including coal-fired power plants, oil pipelines, and tar/oil sands.

The American Investment Council has failed to explain the decline in millions of jobs at private equity-backed companies in estimates it has cited since late 2017

The Committee will receive testimony today from Drew Maloney, President and CEO of the American Investment Council, the main private equity lobbying group.

The private equity industry, most notably the American Investment Council, has repeatedly cited job creation by private equity firms to defend the lucrative tax breaks, most notably the carried interest tax loophole, that private funds firms and executives benefit from.

Yet rather than job creation, the American Investment Council's own numbers suggest a marked decline in jobs at private equity-backed firms in the past two years.

In December 2017, Laura Christof, a spokeswoman for the American Investment Council, told *Fox Business* "more than 11 million Americans in all 50 states and in every congressional district" were employed by the private equity industry.[14]

Around the same time, the American Investment Council and others emphasized private equity's role in creating jobs to justify maintaining the carried interest tax loophole in the 2017 Tax Cuts & Jobs Act.[15]

Yet just seven months later, in July 2018, the American Investment Council reported that "there are 4.9 million Americans who are employed by both small and large companies backed by private equity."[16]

In other words, over a period of seven months, the American Investment Council's estimate of the number of jobs at private equity-owned companies dropped from 11 million to 4.9 million.

This suggests a 6.1 million job decline at private equity-owned businesses, a 55% drop.

This decline happened against a backdrop of substantial job growth in the US economy more broadly and growth in private equity assets under management.[17]

Private Equity Stakeholder Project

Contact: Jim Baker
jim.baker@PEstakeholder.org

The American Investment Council in April 2019 revised its estimate of jobs at private equity-backed companies upward to 5.8 million, a 21% increase from the prior year but still 47% (5.2 million jobs) fewer than the number it had used in December 2017.[18]

Most recently, the American Investment Council in October 2019 released a study conducted by Ernst & Young that found that in 2018, the US private equity sector directly employed 8.8 million workers.[19]

This 8.8 million worker number is still 2.2 million jobs/ workers (20%) less than the number (11 million) the American Investment Council cited in December 2017.

The Private Equity Stakeholder Project, along with United for Respect, the Center for Popular Democracy, and the Americans for Financial Reform Education Fund this summer looked at private equity investments in the retail industry and found that while the retail industry as a whole added more than a million jobs in the last decade, private equity-owned retailers shed nearly 600,000 jobs over that period.[20]

In addition, a recent study by academics at Harvard Business School and the University of Chicago found that private equity takeovers result in significant job losses.[21]

In August, we sent a letter to Mr. Maloney seeking an explanation for the American Investment Council's declining job numbers. I have attached a copy the of letter. Despite following up with Mr. Maloney multiple times, the American Investment Council still has not provided an explanation of why the number of jobs it cites at private equity-backed companies has dropped so significantly since late 2017.

Thank you.

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Private Equity Stakeholder Project

Contact: Jim Baker
jim.baker@PEstakeholder.org

Private Equity Stakeholder Project

September 2019

BLACKSTONE INVESTMENTS DRIVING AMAZON DEFORESTATION AND OTHER CLIMATE CONCERNS

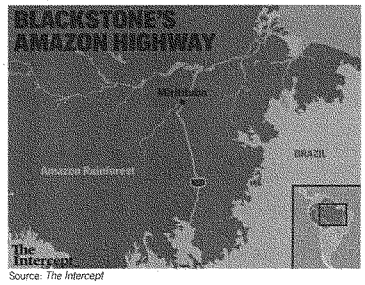
In recent weeks, global attention has focused on the record number of wildfires in the Amazon this year and their broader impact on atmospheric carbon and global warming.

In August, an article in *The Intercept* highlighted investments by private equity firm The Blackstone Group in a Brazilian infrastructure company that has spurred deforestation in the Amazon rainforest. In recent weeks, global attention has focused on the record number of wildfires in the Amazon this year and their broader impact on atmospheric carbon and global warming.

The Amazon, where a record number of fires have been raging, is the world's largest rainforest. It absorbs a significant amount of carbon dioxide, a major contributor to the climate crisis. The fires are mostly a man-made event, set to clear land for agriculture.[1]

The article in *The Intercept* highlighted Blackstone's investment in Hidrovias do Brasil. In the spring of 2019, the government of Jair Bolsonaro announced that Hidrovias would partner in the privatization and development of the B.R.-163 roadway through the Amazon. Hidrovias paid for a feasibility study on a 10-year concession of B.R.-163 which would include paving of the unpaved sections of the road.[2] Developing the roadway itself causes deforestation and helps make possible the broader transformation of the Amazon from jungle to farmland. Hidrovias do Brasil runs a shipping terminal at Miritituba in the Pará state of Brazil to export grain and soybeans.[3]

The leading edge of the invasion of the jungle is being cut by grileiros, or "land-grabbers," who operate outside the law with chainsaws. The grileiros then sell the newly cleared land to agribusiness concerns, whose harvest is driven on the highway to the terminal, before being exported.[4]



Source: *The Intercept*

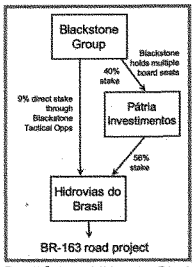
The International Finance Corporation, an affiliate of the World Bank that backed the project, noted that, "the construction of the Miritituba port, close to still-intact areas of the Amazon forest, is likely to lower transport costs for farmers and thereby accelerate conversion of natural habitats into agricultural areas, particularly for soy production."[5] Lax regulation by Bolsonaro's government has encouraged deforestation.

Private Equity Stakeholder Project
Jim Baker
jim.baker@PEstakeholder.org
312.933.0230

BLACKSTONE DRIVING CLIMATE CONCERNS

BLACKSTONE CONNECTIONS TO HIDROVIAS DO BRASIL

Blackstone has investments in Hidrovias do Brasil both directly and through Pátria Investimentos, a Brazilian private equity firm in which it owns a significant minority stake.



Blackstone is directly invested in Hidrovias do Brasil through its Tactical Opportunities funds.[6] A spokesperson for Blackstone told *The Intercept* that Blackstone owns 9.3 percent of Hidrovias.[7]

In addition, Blackstone owns a 40% stake in Pátria Investimentos, a Brazilian private equity firm that is the majority owner of Hidrovias do Brasil.[8] In addition to Blackstone's 9% stake, Pátria Investimentos owns another 55.8% of Hidrovias do Brasil, according to *The Intercept*.[9] In 2010, when Blackstone announced its investment in Pátria, Blackstone CEO Stephen Schwarzman said, "Partnering with Pátria will enable Blackstone's limited partners and advisory clients to benefit from the fast expanding business opportunities in the country" (i.e. Brazil).[10] Prakash Melwani, Chief Investment Officer of Blackstone's private equity group, and Martin Alderson Smith, a Senior Managing Director at Blackstone, serve on Pátria's board.[11] Viral Patel, another Blackstone Senior Managing Director, is involved in Blackstone's investment in Hidrovias.[12]

Pátria Investimentos emphasizes its relationship with Blackstone, featuring the company's logo on its website and notes it is "in partnership with" Blackstone.[13]

OTHER BLACKSTONE INVESTMENTS RAISE CLIMATE CONCERNS

Beyond its investment Hidrovias do Brasil, The Blackstone Group has made a number of other investments that raise climate concerns, including a coal-fired power plant, several investments in fossil fuel extraction and transmission, and a number of investments in carbon-intensive cement production.

COAL AND GAS-FIRED POWER PLANTS

Lightstone Generation – Owns 2,665 MW coal-fired Gen. James M. Gavin Plant in Ohio, three gas-fired power plants.[14]

Sithe Global – Owns one and is building another coal-fired power plant in the Philippines.[15]

OIL AND GAS PIPELINES AND INFRASTRUCTURE

Cheniere Energy Sabine Pass LNG export terminal[16]
Rover Pipeline[17]
Tallgrass Energy[18]

OIL AND GAS EXPLORATION AND PRODUCTION

Tar/ Oil Sands – Osum Oil Sands Corp[19]
Fracking – Western Eagle Ford Assets[20], Jetta Permian[21], Osprey Energy/Falcon Minerals[22], Guidon Energy[23], Eagleclaw Midstream[24], Huntley & Huntley[25], Alta Energy[26]
Offshore - LLOG Exploration[27], Kosmos Energy[28]

CEMENT PRODUCTION

Summit Materials – Blackstone created Summit Materials in 2009 and used it to acquire more than 35 companies to establish a major U.S.-based supplier of aggregates, concrete and asphalt. Blackstone took Summit public in 2015.[29]

BLACKSTONE RESISTANCE TO CARBON FOOTPRINTING

Despite its growing investments in fossil fuels, carbon intensive industries, and investments like Hidrovias do Brasil that spur deforestation, Blackstone has been resistant to measuring the carbon footprint of its portfolio. Blackstone's Chief Sustainability Officer in a 2017 report called measuring a company's carbon footprint "madness," noting "Somehow, carbon has become the maypole for the sustainability community and the "E" in ESG, including attempts to make public disclosure of carbon footprint a mandate associated with corporate transparency."[30]



Blackstone's Lightstone Generation owns the James N Gavin Plant coal-fired power plant in Ohio

Private Equity Stakeholder
Jim Baker
jim.baker@PEstakeholder.org
312.933.0230

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Private Equity Stakeholder Project
Jim Baker
jim.baker@PEstakeholder.org
312.933.0230

August 3, 2019

Drew Maloney
President and CEO
American Investment Council
799 9th Street, NW, Suite 200
Washington, DC 20001

Dear Mr. Maloney,

I write to better understand a significant discrepancy in recent statements by the American Investment Council on the number of jobs at private equity-backed companies in the United States.

In June 2016, James Maloney, a spokesman for the American Investment Council, told the *New York Times*: "Over 11 million Americans work for private-equity-backed businesses."[1]

In December 2017, Laura Christof, a spokeswoman for the American Investment Council, told *Fox Business* "more than 11 million Americans in all 50 states and in every congressional district" were employed by the private equity industry.[2]

Around the same time, the American Investment Council and others emphasized private equity's role in creating jobs to justify maintaining the carried interest tax loophole in the 2017 Tax Cuts & Jobs Act.[3]

Yet just seven months later, in July 2018, the American Investment Council reported that "there are 4.9 million Americans who are employed by both small and large companies backed by private equity."[4]

In other words, over a period of seven months, the American Investment Council's estimate of the number of jobs at private equity-owned companies dropped from 11 million to 4.9 million.

This suggests a 6.1 million job decline at private equity-owned businesses, a 55% drop.

This decline happened against a backdrop of substantial job growth in the US economy more broadly and growth in private equity assets under management.[5]

The American Investment Council in April 2019 revised its estimate of jobs at private equity-backed companies upward to 5.8 million, a 21% increase from the prior year but still 47% (5.2 million jobs) less than the number it had used in December 2017.[6]

How does the American Investment Council explain this discrepancy?

How were the December 2017 (11 million jobs), July 2018 (4.9 million), and April 2019 (5.8 million) numbers calculated?

Given the 6.1 million job drop in the American Investment Council's estimate between December 2017 and July 2018, how is the American Investment Council confident that there was indeed an increase in jobs at private equity-owned businesses in the past year?

Sincerely,

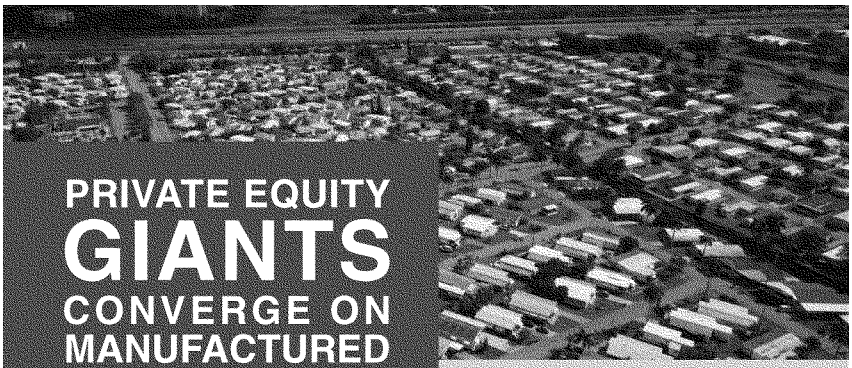
Jim Baker
Executive Director
Private Equity Stakeholder Project
jim.baker@PEstakeholder.org
312-933-0230

2513 N Central Park Ave
Chicago, IL 60647

The mission of the Private Equity Stakeholder Project is to identify, engage, and connect stakeholders affected by private funds with the goal of engaging investors and empowering communities, working families, and others impacted by private capital investments.

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[1] "When You Dial 911 and Wall Street Answers," New York Times, Jun 25, 2016.
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[3] "Money Talks: Blackstone, Carlyle, KKR dial up donations to key GOP lawmakers as tax bill protects carried interest loophole," Fox Business, Dec 20, 2017.
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PRIVATE EQUITY GIANTS CONVERGE ON MANUFACTURED HOMES

How private equity is manufacturing homelessness & communities are fighting back

February 2019

KEY POINTS

- Within the last few years, some of the largest private equity firms, real estate investment firms, and institutional investors in the world have made investments in manufactured home communities in the US.
- Manufactured home communities provide affordable homes for millions of residents and are one of the last sectors of affordable housing in the United States. Across the country, they are home to seniors on fixed incomes, low-income families, immigrants, people with disabilities, veterans, and others in need of low-cost housing.
- In these communities, homeowners own their homes but rent the land on which their homes sit from a community owner. For most residents, it is nearly impossible to move their homes – the structures cannot withstand the move, the costs of moving them are unaffordable, and finding a new spot is untenable. When community owners raise the lot rents, residents are trapped, choosing between paying rent and abandoning their home.

Continued on page 2

Private Equity Stakeholder Project
Jim Baker, Private Equity Stakeholder Project
jim.baker@PEstakeholder.org

MHAction
Liz Voigt, MHAction
evoigt@mhaction.org

AFR Americans for Financial Reform Education Fund
Linda Jun,
Americans for Financial Reform Education Fund
linda@ourfinancialsecurity.org

MASSIVE INVESTORS PILE INTO US MANUFACTURED HOME COMMUNITIES

Within the last few years, some of the largest private equity firms, real estate investment firms, and institutional investors in the world have made investments in manufactured home communities in the United States, a highly fragmented industry that has been one of the last sectors of housing in the United States that has remained affordable for residents.

In 2016, the $360 billion sovereign wealth fund for the Government of Singapore (GIC) and the $56 billion Pennsylvania Public School Employees Retirement System, a pension fund for teachers and other school employees in the Pennsylvania, bought a majority stake in Yes! Communities, one of the largest owners of manufactured home communities in the US with 44,600 home sites. Yes! Communities has since grown to 54,000 home sites by buying up additional manufactured home communities.[1]

In 2017, private equity firm Apollo Global management, with $270 billion in overall assets, bought Inspire Communities, a manufactured home community operator with 13,000 home sites.[2]

Continued on page 3

THE PRIVATE EQUITY STAKEHOLDER PROJECT, MHACTION, AND AMERICANS FOR FINANCIAL REFORM EDUCATION FUND CAME TOGETHER TO PRODUCE THIS REPORT

because we believe that all families should have a place to call home and that manufactured home communities offer a critical source of stable, healthy affordable housing and need to be protected. We hope that this report helps residents, investors, officials, and the public understand the trend of private equity investment in the manufactured housing sector, the impact on low-income seniors and families, and the stories of residents who are fighting to protect their communities.

We would like to acknowledge the courage of Beth, Lupe, Maribeth, Laura, Judy, and Pat, who shared their stories, and the manufactured home residents across the country whom they represent.

Key Points (continued)

- This structure makes manufactured home communities a very stable source of revenue for investors, including during economic downturns, and makes residents vulnerable to exploitation. Real estate investment groups seized on this vulnerability and built a highly profitable business model with devastating effects on low-income seniors and families.
- The world's largest private equity firms are now piling into the sector. These firms invest capital from institutional investors into businesses, increase cash flow in a short-period of time, and sell the businesses or take them public through an IPO after four to six years. Like other real estate investors, private equity investors are relying on manufactured home residents' limited mobility to ensure steady revenues, squeezing fast profits out of low-income families and seniors.
- The private equity and real estate firms and institutional investors that have bought into manufactured home communities in recent years have extremely deep pockets – they manage more than $1.77 trillion dollars in assets. Yet they have little incentive to invest that capital into communities. Residents report that instead investor owners make cosmetic changes at most and fail to provide basic maintenance.
- The private equity and institutional investments in manufactured homes covered in this report include:
  - YES! Communities – Stockbridge Capital, Government of Singapore Investment Co, Pennsylvania Public School Employees Retirement System
  - RHP Properties–Brookfield Asset Management
  - RV Horizons/ MHP Funds–TPG Capital
  - Inspire Communities–Apollo Global Management
  - Kingsley Management Company
  - Horizon Land Company–Federal Capital Partners/ Texas Employees Retirement System
  - Carlyle Group
  - Treehouse Communities–Blackstone Group
  - Carefree Communities–Centerbridge Capital
- Many of the private equity firms and institutional investors that have recently invested in manufactured housing communities have been major investors in apartment buildings and single family homes. As housing costs have increased in other types of housing, investors have looked to manufactured homes as a relatively untouched sector.
- Private equity firms will likely use the manufactured housing community owners and operators they have invested in as platforms to invest in additional manufactured home communities, spreading the impact of their investment to many more low-income seniors and families.
- The massive private equity firms and institutional investors have been aided in their acquisitions of manufactured home communities by the US Government-sponsored mortgage lender Fannie Mae.
- Manufactured home community owners as well as local, state, and federal governments must take steps to minimize the detrimental impact of investments on manufactured home residents' health, housing, and economic security by:
  - Preserving affordability through rent stabilization
  - Prohibiting unjust evictions
  - Ensuring safe and healthy community maintenance
  - Ensuring residents fair and equal treatment
  - Instituting transparent, meaningful complaint procedures for residents
  - Providing a meaningful path for resident or public community ownership
  - Stemming predatory investments
- To demand action by corporate owners and government officials, manufactured home residents across the country are organizing their neighbors, establishing resident associations, collaborating with tenants, and fighting to protect their homes and communities.



"Our community was bought by an out-of-state investor, Sunrise Capital Investors (SCI), in November 2017. After they purchased our community, we were shocked when they tried to double our lot rent. We got together as a community and worked with elected officials and the New York State Department of Homes and Community Renewal to stop the increase. We found out their rent increase proposal violated the law that said our rent can only increase once in a twelve-month period. We won. But then as 2018 rolled around, we began to see massive problems with community upkeep. The roads in the winter became unsafe because SCI failed to do proper snow removal. Our water billing system became increasingly confusing, and residents became worried that our water would be shut off. In August, SCI came back with another proposed lot rent increase. We decided enough was enough and went out on rent strike. Their proposed rent increase will economically evict many of our neighbors. We are demanding that SCI sit down and negotiate with us on rent levels and community maintenance issues. Our campaign has made it clear to us that we need greater protections for residents under New York State law to prevent predatory investors, like SCI, from destroying our communities. Everyone deserves a place that they can call home, and these corporate owners need to treat our communities with respect."

MARIBETH SHEEDY, AKRON, NY,
LIVES IN A SUNRISE CAPITAL INVESTORS-OWNED COMMUNITY

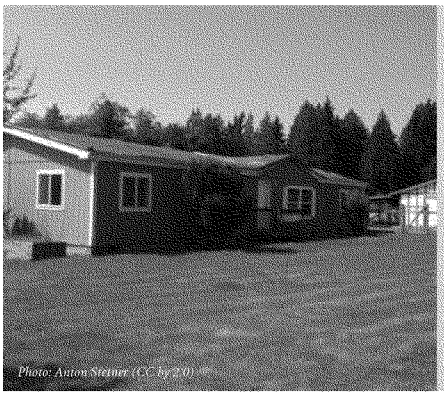


Photo: Anton Stetner (CC by 2.0)

Continued from cover story

In mid 2018, Blackstone Group, one of the largest private equity and real estate firms in the world with $457 billion in assets, bought a portfolio of manufactured home communities in Arizona and California.[3]

The private equity and real estate firms and institutional investors that have bought into manufactured home communities in recent years have extremely deep pockets – they manage more than $1.77 trillion dollars in assets.

It is likely that these investors will seek to buy up additional properties and drive up rents for manufactured home owners and renters.

The top 50 manufactured housing community owners own around 680,000 home sites. With more that 150,000 home sites, private equity firms and institutional investors now control a substantial portion of manufactured home communities.

JUDY PAVLICK, SUNNYVALE, CA, LIVES IN A CARLYLE GROUP-OWNED COMMUNITY

I moved in to Plaza Del Rey in 1989. At the time it was a family owned park, the space rent was $350, and that included garbage, water, cable, etc.

I decided to buy a home of my own so I could paint the walls yellow if I wanted to! I figured why am I spending $500 a month for an apartment when I could be building equity in a home I own. I chose to move into a manufactured home community because I could afford it, period. The real estate market in California has been getting more and more expensive. As a single person it was important for me to find an affordable housing option. Manufactured housing was perfect. The neighborhood was very friendly. People helped each other. It was a happy place to live. I could get a loan for a mobile home.

In October of 2015, the Carlyle Group bought our community. Since they took over, there is a dark cloud that has fallen over the community. The previous owners didn't tell us that our community was for sale. It was just dropped on us like a bomb. When we got our first rent increase of 7-8%, no one could believe it. Previous increases had been 3-4%. All of a sudden we were hit with an increase of $75 or more per month. That's a lot of money for many people in our community. Nearly half of us are on fixed incomes. People are having to move. It's unfair.

The lot fee increases are also impacting people who want to sell their homes. They are charging new homeowners in the community $2,250/month in lot fees. That is much higher than the $800-1,200 charged in other parks just within a mile of us, and it makes it more difficult for homeowners to sell their homes. They have to lower the price to sell and then they lose money on the sale. And I think it will drive up lot fees in other manufactured home communities in Sunnyvale. Other property owners will probably look at what Plaza del Rey is doing and say, oh we should charge that much too. That would impact thousands of people in Sunnyvale.

Carlyle claims that they've spent over $100,000 on capital improvements in our community, and justifies rent increases because of that. But we don't see what improvements they've made. They put in a play structure and re-paved some streets. We don't see how that adds up to $100,000. What we do see is that they've promised their investors a return of 7-8%. The same amount our rents went up.

Many people on a fixed income in my community are seniors who have been here for decades. It seems like the attitude is that they should just get out of here. The seniors that are living here built Silicon Valley, and now we're being tossed aside. It's a sad situation. We think that Carlyle is just greedy with no heart.

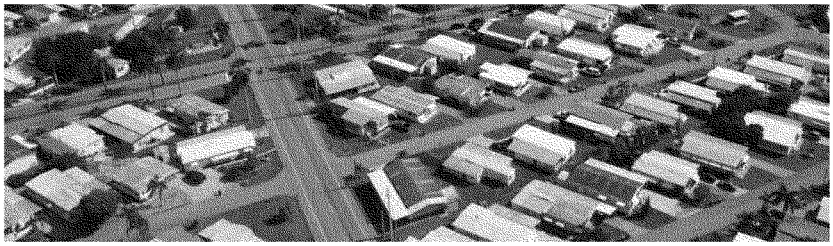


RECENT PRIVATE EQUITY INVESTMENTS IN MANUFACTURED HOME COMMUNITIES

Company/ Owner	Homesites	Owners	Acquisition Date	Owner Overall Assets
Yes! Communities	44,600	Stockbridge Capital (29%); Govt of Singapore Investment (GIC); Pennsylvania Public School Employees Retirement System (PSERS)	Singapore and PA PSERS bought in in 2016	Govt of Singapore (GIC): $360 billion Pennsylvania PSERS: $56 billion Stockbridge: $12 billion
RHP (partial) (RHP Western Portfolio Group, American Home Portfolio Group, AMC Portfolio And MHC Portfolio IV)	33,010	Brookfield Asset Management (BSREP II) is 85% capital partner in a number of RHP communities	2016	Brookfield Asset Management: $283 billion
RV Horizons (partial)	31,652	TPG Capital	2018	TPG Capital: $94 billion
Inspire Communities	13,000	Apollo Global Management	2017	Apollo: $270 billion
Kingsley Management	11,600		Unknown	Unknown
Horizon Land Company	10,200	Texas Employees Retirement System (ERS), Federal Capital Partners	2018	Texas ERS: $28 billion Federal Capital Partners: $2 billion
Treehouse Communities	4,000	Blackstone Group	2018	Blackstone Group: $457 billion
Carlyle Group - AZ, FL Communities	5,000	Carlyle Group	2015-2017	Carlyle Group: $212 billion

WHAT ARE MANUFACTURED HOME COMMUNITIES?

MANUFACTURED HOUSING PROVIDES AFFORDABLE HOMES TO 18 MILLION PEOPLE.



U.S. manufactured homes are sometimes referred to as "mobile homes" or "trailers" but in fact are a specific type of factory-built housing, constructed in accordance with the U.S. Department of Housing and Urban Development's (HUD's) Manufactured Home Construction and Safety Standards Code.[4] Many of today's manufactured homes resemble single-family residences, with several bedrooms, backyard patios or decks, and most are secured to a concrete foundation.

Manufactured homes may be placed on individual land plots that are owned by the manufactured home owner, or the homes may be placed on rented land, including on leased lots within manufactured home communities.[5] Today, approximately 2.9 million of the nation's manufactured homes are in land-leased communities in which residents own or rent their homes and rent the land under their homes.[6] In these communities, residents pay lot fees or ground rent and additional fees for shared amenities, services, and utilities.

Manufactured housing is an important source of affordable housing, in particular for rural and low-income residents.[7] Nearly three-quarters of households living in manufactured homes earn less than $50,000 a year and the median household income of manufactured home residents was $30,000 in 2009.[8] The median net worth among households that live in manufactured housing is about one-quarter of the median net worth among other households.[9] Prices for the manufactured homes are substantially lower than typical housing. Residents often purchase the homes at prices that can range from less than $10,000 to up to $200,000.[10]

Manufactured home communities offer affordable homes to low-income families. In particular, it is an important source of low-cost housing for Latinx families in the U.S.[11] Further, many communities serve seniors, some with community age-restrictions.

5

HOW DID MANUFACTURED HOUSING BECOME A HIGHLY PROFITABLE REAL ESTATE INVESTMENT?



Over the past 20 years, manufactured home communities increasingly have gone from "mom and pop" enterprises to ownership by large, multi-state corporations. These newer corporate owners generally escalate lot fees to increase revenues.[12] Homeowners have few options and are forced to pay if they possibly can. They cannot move their homes because they are attached to a foundation, the structures cannot withstand the move, or moving costs are prohibitive.[13] It is often difficult to resell homes because of the restrictions on home sales placed by the community owner, such as exclusive agent arrangements.[14] In addition, lot rent increases hurt homeowners looking to sell – realtors estimate that for every $100 increase in space rent, a manufactured home loses $10,000 in value.[15] With limited affordable housing options to turn to, the homeowners are forced to choose between paying for increasing housing costs and other basic necessities, like food and medicine, or abandoning their homes.

A manufactured home park "is like a Waffle House where the customers are chained to their booths."

FRANK ROLFE,
RV HORIZONS CO-OWNER

This economic trap is not a side effect but a building block of the business model. RV Horizons co-owner Frank Rolfe notoriously said that a manufactured home park "is like a Waffle House where the customers are chained to their booths."[16] Kevin Bupp, CEO of Sunrise Capital Investors, advises other prospective manufactured home investors to "raise rents upon purchase, as doing so 'goes immediately to your bottom line.' Charging residents for utilities 'allows you to pass your expense directly on to the resident and make a ton of extra money,' he adds."[17]

Residents also report that these corporate owners use community rules and regulations to squeeze more money out of them. A resident of a Kingsley Management community in Santa Ana, CA reported: "They constantly change the rules and fines, just to make more money off of us. If they want new stairs, you have to get new stairs on your home. If they don't want our cars in the drive, they charge us extra fees. The ever-changing requirements puts a lot of strain on residents. We feel harassed and stressed."

The corporate investors also own and rent out homes in the manufactured communities that they acquire from evicted residents or residents who left. The rental agreements sometimes include rent to own arrangements through which residents make payments toward the home and are held responsible for home upkeep like owners but can be evicted like tenants and lose their investments in the home.[18]

Suffering under this ownership structure, low-income seniors and families report devastating impacts on their economic and housing security and health.

BETH HEMLICK, FLORIDA, LIVES IN EQUITY LIFESTYLE PROPERTIES-OWNED COMMUNITY

I live in Buccaneer Estates in North Fort Myers, Florida with my husband and my mother. We moved here in October 2017. Before that, we lived in our RV in an RV park nearby, but it was destroyed by a big rain storm. The water was up to our waists and our park was flooded. The water destroyed our RV's electrical system and then after sitting in outdoor storage through Hurricane Irma it was totally rusted out. We stayed with our daughter and her family for a bit but we quickly needed to find a new home.

That's when we looked at houses in Buccaneer. The manager who works for the owner, ELS, told us she had the perfect home for us. We were in a hurry so we moved quickly to buy our house. But right after we moved in, we all started getting sick. It turns out there was mold behind the shower and under the house. There were leaks and big holes in the floor. The hot water heater fell through the floor because it deteriorated from the mold. My husband has been redoing each problem as he can while he works so it's getting better. But it was a mess.

We bought our house for cash with our insurance payout on our RV. We paid $28,000 for it but we've been told it wasn't worth more than $10,000. The manager who works for ELS sold us the house – she did the paper work – but it was owned by an investor. Before us, there was another family that owned the house but ELS evicted them and got their house. ELS sold it to the investor and then we bought it from the investor. That's the same way houses are going when people are hit by a hurricane too – they are forced to give up their house and ELS turns around and sells it again.

My husband and I were so upset when we realized what a mess it was. We were hurt. We were stuck because we bought it as is. There was nothing we could do about any of the damage. And we were mad at ourselves that we rushed because we didn't have somewhere to live. But ELS and the investors all benefitted off of that. As long as they get their money, they don't care.

It's the same with our rent. We pay $702 in rent plus water, sewer, and trash. You can't get an apartment for that so it's kind of affordable. But you have to take care of your house too. And many of the older people can't keep up with the rent. One of my elderly neighbors says that they keep raising her rent and nitpicking on every little thing. That's her retirement they're taking. She thought she would live here forever but she can't. She's trying to get into some affordable senior places but the wait lists are years long and she can't take her dogs. She said she's choosing between her medicine and her rent.

Plus, we're paying rent but there's no benefit for us. There are problems with the pools and the heaters and the club house. They force us to trim the trees on their property. And I'm sure the folks in the office barely make minimum wage. So you know the big guys are getting all of the money.

I feel aggravated. I want ELS to start taking care of the people and the property. I want them to back off the seniors and stop picking on them for little things. I want to see rent stabilization so the older folks can stay. What I really hope is that we can own our own community. I believe everyone has a right to a decent, stable home. And if we owned the property, we would maintain it and the seniors could stay and everyone could live decently.



Beth Hemlick

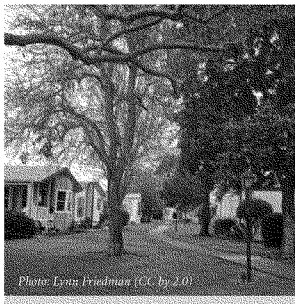


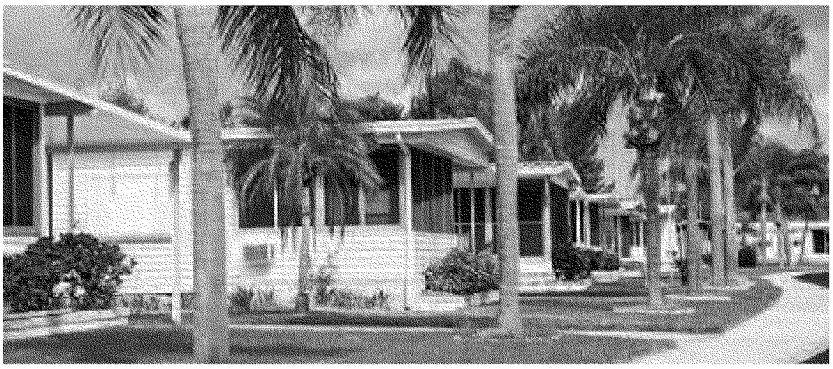
Photo: Lynn Friedman (CC by 2.0)

"I've had a few personal issues over the past several months that have caused me to need to set up payment plans and other arrangements with the manager of my manufactured home community. They've been very cooperative and willing to work with me. I'm grateful my manager has been helpful, because I know this is not always the case. The bottom line is the rent will continue to rise unless corporate or state policies change, and I just won't be able to afford it. Even a good manager can't change the company wide policies that are aiming to make as much money off of all of us as possible. That's why I'm pushing for corporate changes and working to legalize rent control in Illinois. Our communities need immediate relief from rising housing costs. Our local elected officials need rent control in their policy toolkit to protect our low-income seniors and struggling families. To me, these fights for changes to corporate policies, and to our state policies go hand in hand."

PAT BOHLEN, URBANA, IL
LIVES IN A TPG CAPITAL-OWNED COMMUNITY

"There was nothing we could do about any of the damage. And we were mad at ourselves that we rushed because we didn't have somewhere to live. But ELS and the investors all benefitted off of that. As long as they get their money, they don't care.

WHAT IS PRIVATE EQUITY?



Private equity firms invest capital from institutional investors into businesses, attempt to make changes to those businesses to increase cash flow, and then attempt to sell those businesses or take them public through an IPO after four to six years.

Private equity firms generally seek to generate 15-25% annualized returns on their investments. By comparison, the S&P 500 Index generated a 6.1% annualized return over the last twenty years.[19] To generate these returns, Private equity firms generally put down a limited amount of their own capital and rely heavily on debt (i.e. the leverage in leveraged buyouts) to magnify their returns and reduce the tax liability of the companies they own.

In discussing the Carlyle Group's acquisition of the Plaza del Rey manufactured home park in Sunnyvale, California, Erik Gordon, a professor at the University of Michigan's Ross School of Business noted, "Their challenge is to turn something they bought for $100 million into something that's worth $300 million. That's the end game for a private equity fund."[20]

"[Private equity firms'] challenge is to turn something they bought for $100 million into something that's worth $300 million. That's the end game for a private equity fund"

ERIK GORDON, PROFESSOR AT THE UNIVERSITY OF MICHIGAN'S ROSS SCHOOL OF BUSINESS

Private equity owners generally seek majority stakes in companies in order to drive strategy and determine leadership at the businesses they own.

The private equity industry and more broadly the private funds industry – encompassing private equity, venture capital, private debt, private infrastructure, private real estate, and similar asset classes – has grown dramatically over the past several years, from $1 trillion prior to the global financial crisis a record $5.2 trillion in assets under management in 2017.[21]

The largest firms in the industry have grown extremely large. The Blackstone Group, for example, has $457 billion in assets under management.[22]

Private equity-owned companies employ more than 11.3 million American workers.[23] As private equity firms have branched out, they serve not just as employers, but as lenders, landlords, owners of schools and social service providers impacting tens of millions of Americans.

As the private equity industry has expanded private equity firms have increasingly made investments that impact low-income communities and communities of color, for example buying up single family homes and apartments, acquiring nursing homes and healthcare providers, and investing in subprime and payday lenders.

"As private equity firms have branched out, they serve not just as employers, but as lenders, landlords, owners of schools and social service providers impacting tens of millions of Americans."

WHY ARE MASSIVE INVESTORS BUYING INTO MANUFACTURED HOMES NOW?



Photo: Lynn Friedman (CC by 2.0)

Many of the private equity firms and institutional investors that have recently invested in manufactured housing communities have been major investors in apartment buildings and single-family homes. Investors have looked to manufactured homes as a relatively untouched sector.

Homeowners with limited ability to move mean steady, rising rents for investors

In manufactured home communities, private equity firms and institutional investors have found a stable source of growing revenue with limited maintenance costs. Because of residents' inability to move and a high demand for affordable housing, cash flows from the investments tend to be highly stable, even during economic downturns.

According to analyst Green Street Advisors, the manufactured home sector is the only major real estate asset class that has not experienced a year-over-year decline in net operating income in any year since 2000. Green Street views manufactured home communities as offering the most favorable return profile among all property sectors (including apartments, office buildings, retail, hotels, industrial, and self-storage).[24]

In mid 2018, analysts for investment bank Evercore ISI said that they expect manufactured housing fundamentals to remain strong, with projected core same-store net operating income growth of 4 percent to 4.5 percent annually over the next three years, substantially above the 2.5 percent average growth the firm expects from U.S. real estate investment trusts.[25]

This consistent revenue stream is the direct result of homeowners' limited mobility and vulnerability. In materials for a "boot camp" for aspiring mobile home park investors Mobile Home University, run by RV Horizons co-owners Frank Rolfe and Dave Reynolds, noted "The fact that tenants can't afford the $5,000 it takes to move a mobile home ... makes it easy to raise rent without losing any occupancy."[26]

Further, "mom-and-pop owners have kept their rents more or less low," said Kyle Baskin, a senior director of Marcus & Millichap's National Manufactured Housing Communities Group based out of Cincinnati. As a result, private equity investors see an opportunity to buy the communities from mom-and-pop owners and dramatically increase rents to quickly increase profits.[27]

Even if homeowners could move theirs homes, there are limited other sites to relocate. Local zoning and regulatory constraints are worsening the problem as local governments are reluctant to give new communities permits because of the stigma attached to them.[28] And the limited supply of other kinds of affordable housing only worsens a manufactured homeowners' choices when they face a dramatic rent increase. As a result, residents are trapped and can be squeezed for every dollar.

Residents report that elderly neighbors on fixed incomes are forced to choose between rent and medicine or food and working families struggle as rents dramatically increase but their income does not.

In materials for a "boot camp" for aspiring mobile home park investors Mobile Home University, run by RV Horizons co-owners Frank Rolfe and Dave Reynolds, noted "The fact that tenants can't afford the $5,000 it takes to move a mobile home ... makes it easy to raise rent without losing any occupancy.

MARIA (LUPE) GUADELUPE RICO AGUILAR, SANTA ANA, CA, LIVES IN A KINGSLEY MANAGEMENT-OWNED COMMUNITY



Maria (Lupe) Guadelupe Rico Aguilar

I am from Mexico City. I have been living in Coach Royal manufactured home community in Santa Ana, California since 1998. I take care of people's homes – cleaning and taking care of children – for a living. I first moved into my community because we wanted more space to raise a family. We looked at apartments first but realized we couldn't afford an apartment that would fit my family.

When we first moved here our rent was $250 for a space and $400 for the house payments. Now we are paying $1,330 a month just for the space. We knew that there would be some increase each year and we know that nothing is free but we can't take the injustices, stress, and harassment.

They constantly change the rules and fines, just to make more money off of us. If they want new stairs, you have to get new stairs on your home. If they don't want our cars in the drive, they charge us extra fees. The ever-changing requirements puts a lot of strain on residents. We feel harassed and stressed. What upsets me the most is the way residents' homes are taken from them because they are unable at one point to pay all of these fees.

Currently my neighbor is going through tough times. She is an elderly woman who has been left to take care of her three grandchildren, who are disabled. Her son, who was the owner of the house, passed away recently. He had been dealing with diabetes for a while but had attributed the rapid decline of his health to all the stress he was experiencing because of management's harassment. The owners are in the process of trying to evict his family now. The grandmother was devastated to have her son suddenly pass. And, now after living in that house for 20 years, the management is saying that she must leave because her name is not on the title. Due to all of the stress that this elderly woman is under, she is thinking of leaving the house behind.

There are many Spanish speakers in my community. Some of them are undocumented. They are very vulnerable and easy targets for harassment. Management takes advantage of them. They tell families that to get a service request filled you have to show a California ID, knowing that many undocumented people don't have an ID, just to avoid the request. If an undocumented person comes to buy a house with cash, no problem – all they want is the money. But once they're in, they do everything in their power to take that home. They target Latino people to take advantage of them.

The worst practice affecting the undocumented is the rent to own contracts. When you are on a rent to own contract you are living in constant fear that at any point management will evict you. Management can enter your home, fine you for something they don't see fit, and if you don't pay it, they take your house. It is traumatic having people inspect your home against your will, looking for any little thing to evict you. These owners have no shame. They don't care if you're paraplegic, like my friend, or elderly, or have young children.

These are the stories that I hear when people come to our homeowner association meetings. Many come to me asking for advice on what they should do when they're threatened with eviction and harassed. When I hear their stories, I tell them to fight and not to give up. I tell them to stay, protect your home and your family – that is your right!

Unfortunately, many people who do not have the strength or energy to stand up against the harassment from management end up leaving their homes behind. When this happens, the owners are quick to recover the house, make a few improvements, and then flip it for a profit. This is a horrible and ugly process.

At the end of the day I'd like to see everybody in the park treated with respect and to feel secure in their homes. I don't want to see people living in fear of losing their homes. The best thing that could happen to the Coach Royal is that the residents eventually own it.

Investors have few incentives to invest in properties

In 2016, the *Wall Street Journal* noted that the costs of maintaining manufactured housing communities are limited for investors, especially in the communities in which the owner simply rents pads and leaves upkeep of the homes to the renter.[29]

Because manufactured homeowners are often unable to move, the private equity owners of manufactured home communities have limited incentives to invest in the upkeep of the communities. Manufactured home residents complain that investors only make cosmetic changes when they buy communities and fail to maintain roads, trees, and other common areas.

A resident in an RV Horizons/ Impact Communities-owned community in Utah shared her experience: "Since RV Horizons has taken over, they've only done surface makeovers, like taking out old shrubs and putting in some flowers and wood chips. But there are bigger issues, like streets with huge pot holes that can ruin our cars and the trees that are going to fall. Last spring the office told us they would be repairing the pot holes this year, but nothing has happened and now there is a rumor they won't do it because of the money. When we asked the office to maintain the trees, they told us we can do it ourselves. It's the owner's responsibility to maintain the trees since they are supposed to maintain the property they own. We don't have money to pay to have the trees trimmed – that's what we pay lot rent for."

There are also reports that investors simply "reposition" empty lots or homes for residents who are willing to pay substantially more. For example, after the Carlyle Group acquired the 85-acre Plaza Del Rey manufactured home park in Sunnyvale, California in 2015, the firm raised the space rents for new residents to $1,600, nearly 40% more than the park average.[30]

EXPANSION BY FIRMS THAT HAVE BOUGHT INTO MANUFACTURED HOME COMMUNITIES IS LIKELY TO GROW

Private equity investment in manufactured home communities is likely to increase now that a number of larger firms have made initial investments in the industry. Private equity firms will likely use the manufactured housing community owners and operators they have invested in as platforms to invest in additional manufactured home communities, either on a property-by-property basis or by buying up other companies that own manufactured home communities.

For example, in May 2018 YES! Communities, owned by Stockbridge Capital, the Government of Singapore Investment Company, and the Pennsylvania Public School Employees Retirement System, announced that it had acquired a portfolio of 24 manufactured home communities, comprising over 6,800 residential home sites in the states of Michigan, Indiana, Illinois, and Texas, from affiliates of Four Leaf Properties.[31]

The Blackstone Group, which first invested in manufactured home communities in mid 2018 when it acquired a 14 community portfolio, has been on a buying spree since. In a November 2018 post on a Mobile Home University forum, a staffer for Blackstone's Treehouse Communities noted:

> *"I am with the acquisitions team at Treehouse Communities, and we are a real estate investment group that specializes in mobile home and RV communities/resorts. As you may have already noticed, we are in the market to buy. If you are a broker, owner, operator, or have information on a perspective selling party, please reach out. We currently own and operate 2-5 star, all age, and age-restricted communities. In the past four months, we have acquired over $400 million in manufactured housing assets that have since been improved and maintained through our company's access to capital and outstanding management."*[32]

In a job posting for an acquisitions analyst, Blackstone's Treehouse Communities noted:

> *"Treehouse Communities has established itself as one of the fastest growing operators in the manufactured housing space. In 2018, we acquired over 4,000 manufactured housing units in more than forty communities across three states with a mandate to deploy over $1b in investment capital the space."*

GOVERNMENT-SPONSORED FANNIE MAE PLAYS CENTRAL ROLE IN FINANCING SALES TO PRIVATE EQUITY

The massive private equity firms and institutional investors have been aided in their acquisitions of manufactured home communities by the US Government-sponsored Federal National Mortgage Association (FNMA), commonly known as Fannie Mae.

Founded in 1938 during the Great Depression as part of the New Deal, Fannie Mae's purpose is to expand the secondary mortgage market by securitizing mortgages in the form of mortgage-backed securities (MBS), allowing lenders to reinvest their assets into more lending and in effect increasing the number of lenders in the mortgage market.

While Fannie Mae is publicly traded on the New York Stock Exchange it is majority-owned by the US Department of the Treasury and regulated by the Federal Housing Finance Agency (FHFA).[33]

In recent years, Fannie Mae has provided billions of dollars in financing to private equity firms and institutional investors to acquire manufactured home companies.

In 2016, Fannie Mae provided $1 billion in financing to Yes! Communities. The Fannie Mae loan, made through delegated lenders KeyBank and Wells Fargo, corresponded with $360 billion sovereign wealth fund Government of Singapore Investment Corporation (GIC) and the Pennsylvania Public School Employees Retirement System (PSERS) acquiring a majority stake in Yes! Communities. At the time, Fannie Mae noted that the Yes! Communities mortgage was its then-largest manufactured housing loan.[34]

In 2018, KeyBank, acting as a delegated underwriter and servicer for Fannie Mae, provided more than $200 million in financing to assist private equity firm TPG Capital in acquiring dozens of manufactured home communities operated by RV Horizons.[35]

While Fannie Mae characterized the $1 billion Yes! Communities loan as supporting affordable housing, it is unclear whether the mortgages actually include requirements that limit rent increases or otherwise ensure that the manufactured housing communities remain affordable to residents.

THE IMPACTS OF PRIVATE EQUITY INVESTMENTS ON RESIDENTS AND THEIR FIGHT TO PROTECT THEIR COMMUNITIES

As more and more private equity and real estate investment firms invest in manufactured home communities, the residents of these communities – seniors, low-income families, immigrants, veterans, people with disabilities, and people displaced from higher cost places – fear the investments will manufacture homelessness.

Private equity investments striving for short-term gains and a quick exit are not intended to create a sustainable housing system or community. "Well-capitalized private-equity and publicly traded REITs are eager to acquire these properties, invest capital on cosmetic or deferred maintenance items, and realize improved performance [of] the properties typically within the first two years of ownership," Paul Adornato, an analyst with BMO Capital Markets, told the *Wall Street Journal* in 2016.[36] They will leave behind low-income residents who cannot afford the rent hikes and are pushed to homelessness, and communities that suffer from limited maintenance and frayed infrastructure.

This business model's impact on residents is exacerbated by the physical distance between the investors and the residents whose lives they are impacting. Unlike a local landlord, investment managers likely see the communities simply as speculative investments, not homes or humans. At the same time, residents who receive mysterious notices of management changes are left wondering who owns their community, who is dictating the decisions about upkeep of their community and their rent, and how residents can reach them.

But even in the face of multi-billion-dollar, multi-national investors, residents are joining together and fighting to protect their communities. Across the country, manufactured home residents are organizing, researching the real estate and private equity investors that have bought their communities, engaging their public officials and allies, and building coalitions with tenants. Powered by the love of their communities and compassion for their neighbors, they are demanding their homes, economic security, and health are protected from the impacts of short-term speculative investment.

ACTIONS COMMUNITY OWNERS AND POLICYMAKERS MUST TAKE TO PROTECT MANUFACTURED HOME RESIDENTS

Residents are demanding that private equity firms and institutional investors take steps to minimize the negative impact of their investments on manufactured home residents and the pool of affordable manufactured housing.

They also believe that local, state, and federal governments play a critical role in protecting manufactured home residents from exploitative community owners and stemming predatory investments.

They call for the following steps:

PRESERVE AFFORDABILITY

The critical mechanism for protecting residents from exploitation and preserving affordability is stabilizing rent and fees, including lot fees, rents paid by tenants, and utility costs.

Corporate owners determine rent and fee levels and should work directly with residents to ensure that rents are reasonable.

Local and state government should establish rent regulations to stabilize rents and protect against unconscionable rent hikes. Such regulations allow for reasonable and gradual rent increases. Government regulations should be protecting against other abusive rent and fee practices, including demanding transparent, itemized billing, prohibition on passing on communal utilities, and ensuring moratoriums on rent collections when homes are destroyed in disasters.

Preserving affordability also requires local governments to use local zoning and regulatory powers to allow for the development of manufactured home communities and protect existing communities from closure and conversion.

PROHIBIT UNJUST EVICTIONS

In addition to rent hikes, a key strategy of corporate community owners is aggressive eviction. If evicted, manufactured home owners can often only resell their home for a fraction of what they paid for it or cannot resell at all and hand it over to the corporate owner. The residents leave the community with no equity – and, in many cases, no other home. Renters of manufactured homes face a similar fate, some after investing in their home through a rent to own contract. Further, without protections against eviction, residents are not safe to register complaints about maintenance problems or to negotiate rent hikes out of fear of losing their homes.

States must enact good cause eviction laws to prohibit such manufactured home eviction mills. Good cause eviction laws enumerate allowable reasons for evicting a resident, such as nonpayment of rent or criminal activity, and mandate a notice period, an opportunity for the resident to cure the cause for eviction, and due process for eviction proceedings. And, critically, when there is no good cause for eviction, the community owner is required to offer the resident a renewal lease when the existing lease expires.

ENSURE SAFE AND HEALTHY COMMUNITY MAINTENANCE

As the owner of the land and all common spaces, the corporate community owner is responsible for keeping the community habitable, safe, and healthy. Another mechanism for extracting short term profits out of these communities is limited or even decreased maintenance. This leads to health and safety risks for residents, from sewer system failures to unplowed roads. Community owners, especially those with deep pockets, must invest in community infrastructure and safety and on-site managers.

Local, state, and federal government must ensure that community owners are held to a strong code of maintenance, implement transparent systems for residents to have input on maintenance, and have on-site managers. Basic standards include safe walkways and roads, well-maintained water and sewer systems, tree clearing, elimination of standing water, and accommodations for people with disabilities.

ENSURE RESIDENTS FAIR AND EQUAL TREATMENT

To feed their business model, corporate community owners also use their power to push vulnerable residents into exploitative arrangements and discriminate and retaliate against residents. Through consumer protection and civil rights laws and meaningful private and public enforcement of those laws, local, state, and federal governments must ensure residents are protected from:

- **Retaliation** for organizing their neighbors, speaking up, complaining about community conditions, or otherwise attempting to enforce their rights or protect their community;
- **Discrimination** at the hands of corporate investors on the basis of race, national origin, familial status, gender, sexual orientation, gender identity, disability, religion, age, or other protected classes, including exploiting residents based on their language proficiency or immigration status;
- **Fraudulent or exploitative lease terms**, such as rent to own contracts that deny residents basic tenant protections and force them to lose the investments they made in the home;
- **Corporate community owners serving as exclusive real estate agents and controlling homeowners' right to sell their home**, which often leaves residents with no choice but to abandon their homes, while corporate community owners benefit at their expense.

INSTITUTE TRANSPARENT, MEANINGFUL COMPLAINT PROCEDURES FOR RESIDENTS

Residents need a clear path to report problems with health and safety risks, mismanagement, lease provisions, invoices, and any other problems in their communities. This is especially true when the owner of their community is an out-of-state investor that they do not know and cannot contact. Community owners need to institute transparent, meaningful complaint procedures and states should require them.

PROVIDE A MEANINGFUL PATH FOR RESIDENT OR PUBLIC COMMUNITY OWNERSHIP

A critical step to protecting the affordability, viability, and safety of manufactured home communities is creating a path for residents or non-profit or public agencies to own them. Around the country, cooperative ownership of manufactured home communities has proven to work. When residents own their community, families and

seniors can afford to stay and they invest in their community, its buildings, amenities, and infrastructure.[37]

State government can provide a meaningful path for resident or public ownership. Effective laws:

- Require the community owner to **notify the residents**, including but not limited to resident associations, as well as local and state governments, whenever the owner receives an offer to buy the community, is putting the community on the market, or intends to change the use;
- Give residents a **sufficient waiting period** to decide if they want to purchase the community and make an offer;
- Require seller to negotiate in good faith with the residents and offer them the **right to purchase the community** if they can match the existing offers;
- Provide **public resources** to help the residents, public agency, or nonprofit finance the purchase; and
- Enforce **residents' rights** and penalize non-compliance by community owners.

STEM PREDATORY INVESTMENTS

We believe that the federal government and the government-sponsored enterprises (GSEs) play a key role in developing and sustaining affordable housing and healthy communities. We must ensure that the government is using its powers to protect low-income people from predatory investments and is not pressured by investors to support wealth extraction from low-income communities.

Manufactured housing is one of the three underserved markets that Fannie Mae and Freddie Mac are required to serve as part of their obligations under the Duty to Serve Program. Fannie Mae and Freddie Mac must increase financing opportunities for residents, government entities, and nonprofit organizations to purchase manufactured home communities.

By reducing the housing quality and increasing the expenses for manufactured housing residents, private equity investors are decreasing access to manufactured housing for those who rely on it. Fannie Mae and Freddie Mac should also take steps to prevent their other investments from undermining their duty to serve the manufactured housing market by requiring all purchasers to commit to the following as a condition for their financing:

- **Implement and comply with FHFA's pad lease protections for tenants**, including one-year renewable leases, 30-day written notice of rent increases, the right to cure defaults on rent payments, the right to sell the manufactured home without relocating it and assigning the pad lease to the new owner, and 60-day written notice of a planned closure or sale of a community
- **Preserve affordability** with gradual rent increases and **prohibit unfair lease terms** like rent to own contracts and excessive fees
- **Maintain safety and habitability** with regular property maintenance and responsiveness to resident concerns

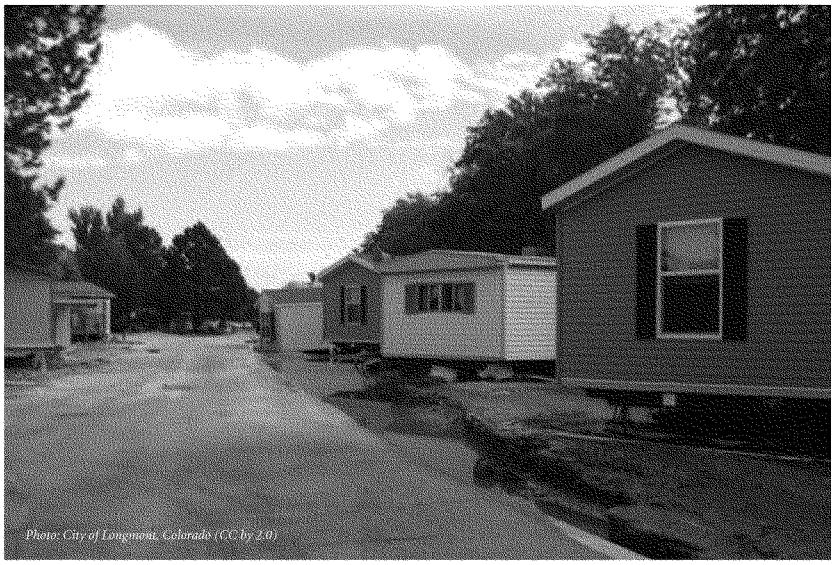
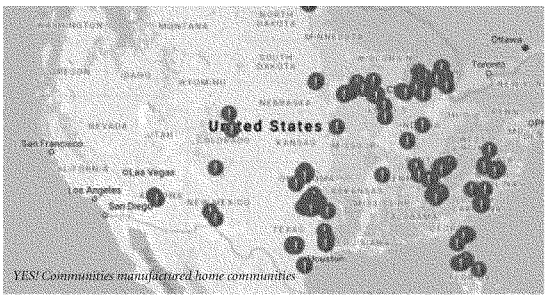


Photo: City of Longmont, Colorado (CC by 2.0)

PROFILES OF PRIVATE EQUITY INVESTORS IN MANUFACTURED HOME COMMUNITIES



YES! Communities manufactured home communities

YES! COMMUNITIES – STOCKBRIDGE CAPITAL, GOVERNMENT OF SINGAPORE INVESTMENT CO, PENNSYLVANIA PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM

54,000 HOME SITES

YES! Communities has 213 manufactured home communities in 18 states across the country with major concentrations in Florida, Georgia, Iowa, Michigan, North Carolina, Oklahoma, South Carolina, Tennessee, and Texas and continue to grow in other key markets.[38]

YES! was formed in 2008 by Stockbridge Capital, a private equity real estate manager.[39]

In August 2016, Stockbridge sold more than two-thirds (71%) of YES! Communities to two institutional investors, the sovereign wealth fund Government of Singapore Investment Company (GIC) and the Pennsylvania Public School Employees Retirement System (PSERS), the pension fund for teachers and other school employees in Pennsylvania.[40] The sale enabled certain of Stockbridge's investment funds to exit the YES! Communities investment.

Adam Gallistel, Regional Head for Americas, GIC Real Estate, said, "The manufactured housing sector is a unique and highly-attractive niche in the U.S. residential market, which GIC has been exploring for some time. Given the relative lack of consolidation, it is very difficult to enter this sector in scale."[41]

Government Sponsored housing lender Fannie Mae provided financing for the transaction.[42]

In June 2016, prior to the deal closing, the *Wall Street Journal* reported that the deal valued YES! at more than $2 billion. The Journal reported that GIC would get an initial yield from the company of slightly more than 6%, in addition to any appreciation in value of the underlying real estate.[43]

YES! Communities has proven a very lucrative investment for the Government of Singapore Investment Company (GIC), the Pennsylvania Public School Employees Retirement System (PSERS), and Stockbridge Capital. As of the end of 2017, Pennsylvania PSERS reported that its investment in YES! Communities has increased in value by 33% since the pension fund invested in August 2016. YES! Communities had already returned $13.5 million in cash to Pennsylvania PSERS.[44] YES! Communities likely paid out tens of millions of dollars more in distributions to the Government of Singapore and Stockbridge Capital.

YES! has continued to add new communities to its portfolio. In May 2018 YES! announced that it had acquired a portfolio of 24 manufactured home communities, comprising over 6,800 residential home sites in the states of Michigan, Indiana, Illinois, and Texas, from affiliates of Four Leaf Properties.[45]

YES! Communities' business consists of:

Home site rental – YES! charges site rent to all residents, both those that rent their homes and those that own them. As of October 2017, YES' average home site rental rate was $415 per month. YES! Communities' home site rental business accounted for 60% of the company's revenues in 2016.[46]

Home rental – Charging home rent to the 28% of YES! Communities residents who rent their homes. As of October 2017, YES' average home rental rate (in addition to home site rental) was $474 per month.[47]

Home sales – YES! sells homes to new and existing residents, and continues to charge home site rent to those residents. In 2016, YES! sold 1,800 manufactured homes to new and existing residents.

Home loan acquisition – YES! utilizes third party lenders (selected by YES!, using the company's specified terms and underwriting criteria) to finance residents' home purchases, then acquires the loans from the originating lender. In 2016, YES! acquired 850 additional loans. YES! loan portfolio had a principal balance of $185 million as of October 2017.[48]

YES! has been able to grow the rent it charges residents. The company's home site rental rate and home rental rate both grew by around 4% between 2016 and 2017, according to Pennsylvania PSERS.[49]

In early 2018, Pennsylvania PSERS reported that from 2014 to 2016, YES! achieved same-community compound annual Net Operating Income growth of 12%.[50]

RHP PROPERTIES – BROOKFIELD ASSET MANAGEMENT

60,100 HOME SITES (33,000 OWNED BY BROOKFIELD)

In May 2016, Brookfield Asset Management, a Toronto, Canada-based real estate and private equity manager with $285 billion in assets, acquired 135 manufactured home communities in 13 states with a total of 33,010 home sites. Brookfield paid around $2 billion for the communities.[51]

Specifically, Brookfield Strategic Real Estate Partners II acquired four portfolios of manufactured home communities operated by RHP Properties: RHP Western Portfolio Group, American Home Portfolio Group, AMC Portfolio And MHC Portfolio IV.[52]

Brookfield Strategic Real Estate Partners II is a $9 billion private equity real estate fund that began investing in 2016. Investors in the fund are a diverse group of more than 100 institutional investors, including sovereign wealth funds, financial institutions and public and private pension plans.[53]

Brookfield Strategic Real Estate Partners II is targeting a 16% annual return, according to a consultant's report for an investor in the fund.[54]

In addition to its manufactured housing investment, Brookfield owns over 25,000 apartments throughout the United States.[55]

RHP settles class action lawsuit, pays out six-figure settlement to residents of Massachusetts community

In 2017, RHP agreed to a six figure settlement with residents of its Chelmsford Commons mobile home park in Chelmsford, Massachusetts who alleged the company violated state law and 1990 master lease agreement that said rent increases should be tied to the Boston Consumer Price Index.[56] Plaintiffs in the suit also said the company improperly passed costs onto residents following a 2015 water main break.[57] In all, RHP paid $145,881 to settle the case.[58]

"People at Chelmsford Commons have been overcharged for years and we're glad the park has owned up to this error," said Ethan Horowitz of Northeast Legal Aid, who represented residents of the park.[59]

RV HORIZONS/ MHP FUNDS – TPG CAPITAL

31,600 HOME SITES (PARTLY OWNED BY TPG CAPITAL)

In early 2018, TPG Capital, a large San Francisco-based private equity firm, acquired dozens of manufactured home communities in Colorado, Illinois, Indiana, Iowa, Kansas, Kentucky, Minnesota, Nebraska, North Dakota, Texas, Virginia, and West Virginia managed by manufactured home operator RV Horizons.

Government-sponsored mortgage lender Fannie Mae reported that TPG has invested $400 million in manufactured housing properties in the 24 months ending September 2018, making it one of the top ten investors in manufactured home communities during the two-year period.[60]

Fannie Mae appears to have provided financing for the TPG acquisition. KeyBank, acting as a delegated underwriting and servicing (DUS) lender for Fannie Mae, provided at least $206 million to TPG for the RV Horizons acquisition under a Master Credit Facility Agreement.[61]

A manufactured home park "is like a Waffle House where the customers are chained to their booths."

Frank Rolfe, RV Horizons co-owner

RV Horizons, which manages the properties acquired by TPG, has relied on manufactured home owners' inability to move their homes or affordably relocate to push for rent increases. RV Horizons co-owner Frank Rolfe notoriously said that a manufactured home park "is like a Waffle House where the customers are chained to their booths."[62]

In materials for a "boot camp" for aspiring mobile home park investors Mobile Home University, run by RV Horizons co-owners Frank Rolfe and Dave Reynolds, noted "The fact that tenants can't afford the $5,000 it takes to move a mobile home ... makes it easy to raise rent without losing any occupancy."[63]

Residents of one RV Horizons-owned community in Austin, Texas in 2015 sought to fight back against large rent and utility increases that RV Horizons charged after acquiring the community.

In 2015 (i.e. prior to TPG acquisition of RV Horizons properties), Aljazeera America noted:

> *"RV Horizons purchased North Lamar. One of the first actions of the new management was a rent hike, bringing the monthly cost from $380 per month to $450. Residents were also told they had to pay for water and sewage separately, adding $150 a month. With new fees for such things as having more than two cars or more than four people living in a home, residents in North Lamar say, they were looking at a monthly housing cost of close to $800 per month."*[64]

Alleging that their existing leases were broken, the residents of North Lamar decided to fight back. They sued the new owners in May 2015, claiming they breached existing contracts with the rent hikes.[65]

RV Horizons residents at multiple communities acquired by TPG recently received notice that the new properties owners have decided to create a new management company called Strive Communities. It is unknown whether Strive will be separate from RV Horizons or simply a new brand.

Residents in other RV Horizons communities have been notified that they are now under the management of Impact Communities, which appears to be a rebranding of RV Horizons communities. Residents in these communities report being confused and frustrated by the lack of communication about the changes in management and added stress from the uncertainty.

TPG foreclosures in Puerto Rico following Hurricane Maria

TPG's acquisition of RV Horizons properties is not the private equity firm's first investment in housing.

Over the last few years a TPG affiliate acquired thousands of mortgages on the island of Puerto Rico, which has suffered a more than decade-long recession and was devastated by Hurricane Maria in late 2017.[66]

Following the hurricane, TPG affiliate Roosevelt Cayman took hundreds of actions in court to advance foreclosure suits. TPG filed the majority of its foreclosure suits in Puerto Rico in federal court, where filings are in English, making them less accessible to homeowners. TPG affiliates have filed several motions to evict homeowners since the Hurricane.[67]

INSPIRE COMMUNITIES – APOLLO GLOBAL MANAGEMENT

13,000 HOME SITES

Apollo Global Management, a New York-based private equity firm with $270 billion in assets, in 2017 acquired Inspire Communities, a developer, owner, and manager of manufactured housing communities nationwide.[68]

Inspire Communities has 38 communities with around 13,000 home sites around the country.[69]

In 2016, the *Associated Press* reported on the housing crisis faced by residents in Inspire Communities' Knoll Terrace community in Canyonville, Oregon. Residents reported that the hillsides on which their homes stood were shifting, melting, causing small landslides and cracking the homes' foundations.[70]

Owners of traditional single-family homes would have to suck up the costs of stabilizing a foundation themselves. But manufactured homeowners face a unique predicament in that they own the home, but not the land. They rent the plot much like a recreational vehicle rents a space in a campground.[71]



Residents broached the issue with Inspire Communities in February 2016, then sent an official letter in April. The company subsequently sent its regional manager to speak to residents, then an engineer showed up in August to assess damages inflicted onto several properties.[72]

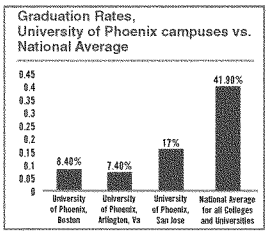
When the *Associated Press* story was published in November 2016, Inspire Communities still had not taken steps fix things and did not respond to requests for comment.[73]

Apollo investments prey on low and moderate income people

Apollo Global Management has a history of investing in businesses that prey on low and moderate income people, including subprime lender OneMain Financial and for-profit college chain University of Phoenix.

The private equity firm in early 2018 acquired OneMain Financial (formerly Springleaf Financial) the largest subprime installment lender in the United States.[74]

OneMain reportedly charges as much as 36% interest on the consumer loans it makes,[75] yet additional fees and charges can increase the true interest that a borrower pays.



In early 2017 Apollo Global Management acquired the (then unrelated) Apollo Education, the owner of the University of Phoenix for profit college chain. While University of Phoenix enrollment has fallen sharply from its 2010 peak, the chain still enrolled 171,000 students in 2017, the *Associated Press* reported.[76]

Based on federal data, graduation rates at University of Phoenix campuses are dismally low – from 17% at the University of Phoenix campus in San Jose, California[77] to 8.4% in Boston[78] to 7.4% in Arlington, Virginia.[79] These compare to national average graduation rate of 41.9% for all colleges and universities.[80]

According to the US Department of Education's College Scorecard website, the average University of Phoenix student ended up with $32,813 in federal student debt. This does not include private student loans.[81]

KINGSLEY MANAGEMENT CORP

11,600 HOME SITES

While privately-owned, Utah-based Kingsley Management Corp uses many of the same aggressive practices as the investment firms now buying up manufactured home communities.

Kingsley Management Corp. owns more than 50 mobile home communities nationwide.[82]

Kingsley and other manufactured home community operators have recently drawn scrutiny from regulators.

> *"New Yorkers across the state are already struggling to afford a home – and these companies took advantage of that struggle, promising home ownership and instead leaving families with default, eviction, and financial devastation"*
>
> **New York Attorney General Barbara Underwood, October 2018**

Kingsley, Horizon Land Company settle with New York Attorney General over "rent-to-own" practices

In October 2018, Kingsley Management Company was one of several manufactured home community operators that entered into a settlement agreement with New York Attorney General Barbara Underwood over the firm's "rent-to-own" practices.[83]

"New Yorkers across the state are already struggling to afford a home – and these companies took advantage of that struggle, promising home ownership and instead leaving families with default, eviction, and financial devastation," said New York Attorney General Underwood.[84]

In recent years, in response to the housing crisis, "rent-to-own" agreements have become popular throughout the country among low-income individuals with poor credit hoping to achieve home ownership.[85]

Through its investigation, the Attorney General's office found that by marketing "rent-to-own" and "lease-option" contracts as home sales, and treating the optionee as an owner rather than a tenant, many manufactured home park owners are able to operate in a "gray" area, using rent-to-own contracts that often lack basic tenant protections. As a result, for the vast majority of those renting to own, manufactured home home-ownership remains elusive – while default, eviction, and financial devastation are all too common.[86]

The Attorney General's office heard from many individuals and families who fell behind on their monthly payments or were unable to afford to make the costly repairs required to keep the manufactured home in habitable condition. Some of these families had abandoned their homes due to terrible living conditions, such as non-working septic systems or extensive mold. Other families were facing eviction. In each instance, they faced the loss of non-refundable deposits of thousands of dollars, as well as any money spent on repairs, maintenance, and improvements.[87]

Horizon Land Company (see below), which manages manufactured home communities owned by private equity real estate firm Federal Capital Partners and the Texas Employees Retirement System also entered into the settlement agreement with the New York Attorney General's office.[88]

As part of the settlement agreement, both Kingsley Management Company and Horizon Land Company agreed to discontinue rent-to-own practices found to be unlawful by the Attorney General.[89]

HORIZON LAND COMPANY – FEDERAL CAPITAL PARTNERS/ TEXAS EMPLOYEES RETIREMENT SYSTEM

9,000 HOME SITES

In mid 2018, the Texas Employees Retirement System, a $28.4 billion public pension fund for state employees in Texas, invested $50 million in MH Legacy Fund II, a real estate fund that is jointly managed by manufactured housing community operator Horizon Land Company and private equity real estate firm Federal Capital Partners. According to *Pensions & Investments*, a news publication that covers pension fund investments, MH Legacy Fund II invests in manufactured home communities in the U.S.[90]

"We acquire moderate income multifamily communities, then create significant value by repositioning these properties"

Federal Capital Partners website, accessed December 2018

As of November 2018, the fund (also known as Horizon MH Communities Fund II) had raised $190 million from 279 investors, according to a filing by Horizon Land Company with the US Securities and Exchange Commission.[91]

This is Horizon Land Company's and Federal Capital Partners second manufactured housing-focused investment fund. In 2016, Horizon Land Company and Federal Capital Partners raised a $106 million fund, Horizon MH Communities Fund I. The Texas Employees Retirement System committed $42 million to the earlier Horizon-Federal Capital Partners fund.[92] With debt, the earlier fund had $350 million in total purchasing power.[93]

Federal Capital Partners and Horizon Land Company first began investing together in 2012, when the companies made an investment in a Mid-Atlantic portfolio of manufactured home communities.[94]

Federal Capital Partners was formed in 1999 by former Carlyle Group principals Esko Korhonen and Lacy Rice. Private equity firm the Carlyle Group (below) has also been investing in manufactured home communities in recent years.[95]

Federal Capital Partners is a privately held real estate investment company that has invested in or financed more than $6 billion in assets since its founding in 1999.[96]

Beyond its investments in manufactured housing communities, Federal Capital Partners also invests in multifamily communities, specializing in acquiring moderate income communities and "repositioning" them (i.e. raising rents) to create value.[97]

Horizon Land Company operates 56 manufactured housing communities with 9,000 home sites in the Eastern United States, in New York, New Jersey, Pennsylvania, Ohio, Maryland, Delaware, Virginia, North Carolina, and South Carolina.[98]

All of Horizon Land Company's communities appear to be owned by Federal Capital Partners (FCP) Realty Fund II, Fund III, or Horizon MH Communities Fund I.[99]

On its website, Horizon notes that it "is aggressively pursuing additional investment opportunities across the Continental United States," that it seeks deals of up to $200 million and is "prepared to close all-cash."[100]

Like Kingsley Management Company and other manufactured housing community operators, Horizon Land Company in October 2018 entered into a settlement agreement with the New York Attorney General's office and agreed to discontinue rent-to-own practices found to be unlawful by the Attorney General (see above for more detail).[101]

CARLYLE GROUP

5,000 HOME SITES

Like other companies mentioned in this report, the Carlyle Group is a massive private equity firm with $212 billion in assets under management.

The Carlyle Group was among the first of the large investment firms to invest in manufactured homes, acquiring two Florida communities in 2013. The two communities that Carlyle acquired, Village of Ponce de Leon in Melbourne Beach and Sun Valley Estates in Tarpon Springs, both cater to those 55 and older.[102]

At the time, analysts highlighted the deal as evidence that big investors are betting that the demand for low-cost manufactured housing will rise as other housing alternatives become too expensive for a number of Americans, especially seniors.[103]

In 2015 the Carlyle Group acquired the 85-acre Plaza Del Rey manufactured home park in Sunnyvale, California. The Sunnyvale community counts 722 units. Plaza Del Rey is located near growing campuses occupied by tech companies like Apple and Google, where housing is highly sought after.[104]

After buying the Sunnyvale, California park, the Carlyle Group began quickly raising rents. On top of doubling the space rent increase in 2016 from previous years (residents have long paid increases of 3% to 4% a year, comparable to neighboring parks), Carlyle raised the space rents for new residents to $1,600, nearly 40% more than the park average.[105]

According to the *Los Angeles Times*, the Carlyle Group offered residents a five-year lease that would cap rent increases at 4% a year, but only if they also agreed to sign a contract that would give Carlyle the right to make the first bid if a homeowner decided to sell.[106]

In a place like Silicon Valley, where tech salaries are among the highest in the country and the housing market is among the most competitive, it won't be hard to find someone willing to pay $1,600 or more for space rent.[107]

"They won't care if it's seniors or young people," said Erik Gordon, a professor at the University of Michigan's Ross School of Business. "Their challenge is to turn something they bought for $100 million into something that's worth $300 million. That's the end game for a private equity fund."[108]

The rent increases led residents to begin organizing to pass a rent control ordinance in Sunnyvale.[109] In January 2017, Carlyle sent Dave Kingery, its managing director of U.S. real restate, to a Sunnyvale City Council meeting in January 2017 to argue against rent control.[110]

TREEHOUSE COMMUNITIES – BLACKSTONE GROUP

4,000 HOME SITES

Private equity and real estate manager Blackstone Group LP in July 2018 acquired a portfolio of 14 manufactured home communities.[111]

Blackstone acquired the Tricon communities for a gross transaction value of approximately $172 million.[112]

The properties are located in Arizona (11) and California and comprise 3,065 rental pads. Thirteen of the communities are age-restricted.[113]

Since acquiring the initial portfolio, Blackstone operating partner Treehouse Communities has acquired nine additional manufactured home communities, and is looking to acquire more. In a November 2018 post on a Mobile Home University forum, a staffer for Treehouse Communities noted:

> *"I am with the acquisitions team at Treehouse Communities, and we are a real estate investment group that specializes in mobile home and RV communities/resorts. As you may have already noticed, we are in the market to buy. ...We currently own and operate 2-5 star, all age, and age-restricted communities. In the past four months, we have acquired over $400 million in manufactured housing assets that have since been improved and maintained through our company's access to capital and outstanding management."*

In a job posting for an acquisitions analyst, Blackstone's Treehouse Communities noted:

"Treehouse Communities has established itself as one of the fastest growing operators in the manufactured housing space. In 2018, we acquired over 4,000 manufactured housing units in more than forty communities across three states with a mandate to deploy over $1b in investment capital the space."[115]

Blackstone, which has $457 billion in assets under management, is one of the largest owners of real estate in the world and the largest owner of housing in the United States. Blackstone's Invitation Homes owns 82,000 single family homes around the United States which it rents out to tenants. Invitation Homes has been criticized for pushing up rental prices and displacing residents.[116] Multiple executives from Invitation Homes serve as executives of Treehouse Communities' parent.[117] In addition, Blackstone owns more than 70,000 apartments around the country.[118]

"In the past four months, we have acquired over $400 million in manufactured housing assets"

Tim Ryan, Treehouse Communities, November 2018

Blackstone recently spent millions to oppose rent control in California

Blackstone recently contributed $6.2 million the campaign to defeat Proposition 10 in California, which would have repealed a California law that limits how cities enact rent control. Following heavy spending by Blackstone and other large real estate companies, Proposition 10 was defeated in November.[119]

The defeat of Proposition 10 in California will directly benefit Blackstone. Invitation Homes had more than 12,800 single family rental properties in the state as of September 2018.[120] In addition, Blackstone owns at least 37 apartment complexes in California.[121]

The portfolio of manufactured housing communities Blackstone acquired includes three communities in California: Riverdale Estates and Palmdale Estates in Indio and Springdale Estates in San Marcos.[122]

CAREFREE COMMUNITIES – CENTERBRIDGE CAPITAL

17,700 HOME SITES, SOLD TO SUN COMMUNITIES IN 2016

In June 2013, private equity firm Centerbridge Capital acquired National RV Communities, an owner and operator of 61 destination RV resorts and senior MH communities from Almanac Realty Investors, another private equity manager. Centerbridge renamed it Carefree Communities, Inc. and began acquiring additional properties. The Wall Street Journal reported that Centerbridge spent more than $1 billion to buy and expand Carefree.[123]

"Carefree is well-positioned to acquire additional senior manufactured housing and recreational vehicle communities in what remains a very fragmented industry," said Centerbridge senior managing director William D. Rahm.[124]

By March 2016, Carefree Communities and Centerbridge had acquired more than 40 additional manufactured housing communities, bringing its portfolio to 103 manufactured-housing and RV communities concentrated in California, Florida and Ontario.[125]

In March 2016, Centerbridge sold Carefree Communities to publicly-traded manufactured housing REIT Sun Communities for $1.68 billion. At the time of the Sun deal, Carefree owned 103 manufactured-housing and recreational-vehicle communities with 27,554 total sites.[126]

EQUITY LIFESTYLE PROPERTIES – EQUITY GROUP INVESTMENTS

72,000 HOME SITES[127]

Publicly-traded manufactured housing Real Estate Investment Trust (REIT) Equity Lifestyle Properties, chaired by billionaire investor and Equity Group Investments founder Sam Zell,[128] is perhaps the earliest example of private equity investment in the manufactured home industry.

Equity Lifestyle Properties is the largest owner of manufactured home communities in North America with more than 200 communities totaling more than 72,000 home sites. Equity Lifestyle Properties also owns a large network of RV resorts and campgrounds.[129]

Sam Zell and Equity Group Investments took Equity Lifestyle Properties public through an initial public offering in 1993. Equity Lifestyle Properties has grown steadily since its 1993 IPO. Twenty years ago, the company owned 154 manufactured home communities with 53,000 home sites.[130]

As of March 2018, Sam Zell only owned around 3.4% of Equity Lifestyle Properties.[131] Large investment managers including The Vanguard Group, Fidelity, Blackrock, and Cohen & Steers are Equity Lifestyle Properties' largest investors.[132]



Equity Lifestyle Properties Chairman Sam Zell Photo: Bill Couch (CC by - NC-ND 2.0)

Yet Zell and Equity Group Investments still make their mark on Equity Lifestyle Properties. Zell previously served as Interim CEO of Equity Lifestyle Properties and currently serves as the company's Chairman.[133]

Despite his limited ownership stake, Equity Lifestyle Properties has rewarded Sam Zell handsomely. Zell has received at least $12.7 million in director's fees and stock awards from Equity Lifestyle Properties in the last five years. Zell also serves on the boards of four other publicly traded companies.[134]

Sam Zell started Equity Group Investments in 1969. The private investment firm today invests in energy, logistics, transportation, manufacturing, communications and health care.[135]

Residents win multimillion dollar settlement after suing Equity Lifestyle for failing to maintain community

In 2017, Equity Lifestyle Properties agreed to a $10 million settlement with residents of the California Hawaiian mobile home park in South San Jose, California.[136]

In 2007, dozens of residents of the California Hawaiian Mobile Home Estates banded together and sued Equity Lifestyle Properties for failing to maintain the property.[137]

At California Hawaiian, residents say they were plagued by sewage backups, potholes, electrical blackouts, and a swimming pool filled with goose droppings. Water for the entire park of 420 households often was shut off without notice for up to 20 hours at a time, they said.[138]

David McIntyre, a resident, was evicted on Christmas Eve after complaining that an avocado tree growing underneath his South San Jose mobile home had burst through his shower wall.[139]

In 2014, a Santa Clara County jury found Equity Lifestyle Properties negligent and awarded residents a record $111 million in compensatory and punitive damages. But the judge in the case overturned the award on the grounds it was excessive, prompting the parties to settle in December for just under $10 million to avoid a second trial on damages.[140]

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U.S. House of Representatives
Committee on Financial Services

Hearing Entitled "America for Sale? An Examination of the Practices of Private Funds."
Eileen Appelbaum, PhD

Co-Director, Center for Economic and Policy Research

Responses to Questions for the Record

9. Dr. Appelbaum: A key finding of a report conducted by the American Investment Council and Ernst and Young states, "The US private equity sector provides employment and earnings for millions of workers."[1] However, economists at Harvard University and the University of Chicago found in a recent 2019 study that when private equity firms buy out large publicly traded companies with numerous employees there is about a 13% decrease in jobs in the first two years.[2] If a private equity acquires a struggling company, or even a company that has already filed for bankruptcy, how are employees' benefits, wages, and severance packages typically affected? Are there examples of employees' receiving increased benefits and wages as a result of a private equity acquisition of a bankrupt company?

The claim by AIC and E&Y that the private equity industry supports 8.8 million jobs can easily be misconstrued as saying that private equity has created these millions of jobs. This is not true.

As noted in the question, a careful study of the economic effects of private equity by economists at Harvard and the University of Chicago looked at what happens to jobs when a PE firm buys out a Main Street company with offices, stores, warehouses, supermarkets, or other establishments and takes it over. The study found that, overall, when private equity takes over companies, employment in the establishments of those companies goes down by 4.4 percent in the first two years following the buyout. When private equity buys out big companies with lots of employees that trade on a stock market, the job loss is even more dramatic – 13 percent in the first two years.

For workers at companies that have been acquired by a private equity firm, these are the numbers that matter – these numbers reflect the probability that workers at the company will lose their jobs.

So, what are AIC and E&Y talking about?

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PE firms today are sitting on a huge pile of cash that they are having a hard time spending. When there is a promising target company to buyout, the competition is keen. Companies today are being bought for 12 times earnings – an incredibly high price. So, PE buys up lots of smaller companies that it can acquire cheaply and adds them onto the original target company. These smaller companies can also be expected to lose on average 4.4 percent of employment over their first two years in PE hands. But here's the thing: If you look at the original target company, it will have acquired the workers at these "add-on" companies, and its total employment will have gone up.

AIC and E&Y, as they acknowledge in the report, have taken a snapshot of a moment in time, so their analysis can't address questions of job creation vs. job destruction. The rosy picture they paint is not of much use to workers in companies acquired by private equity or to policy makers interested in attracting businesses that will create jobs. All it tells us is that private equity has bought up many companies – companies that in total employ millions of workers.

Private equity funds buy companies with the goal of selling them at a profit in three to five years. They tend to buy healthy companies. Only a small slice of the private equity industry is engaged in trying to turnaround distressed companies. Some PE firms that buy distressed companies are adept at finding ways to make money without improving the operations of the failing businesses. The PE firm may have noticed that the real estate that houses the business is more valuable than reported in the bankruptcy filing, for example, and then acquired the company and sold off the real estate, leaving the company in even worse shape than before and the workers with little economic security. little chance of seeing wages and benefits increase, and virtually no chance of receiving severance payments if the company fails again. But some private equity companies rescue companies that they believe can be restored to health. They are not always successful in turning the failing company around. But when they do succeed, workers at the company may see increases in wages and benefits.

10. Dr. Appelbaum, can you explain why acquisitions by small and medium private equity funds have a lower rate of bankruptcy and why these funds tend to outperform the larger, Wall Street megafunds?

    Dr. Appelbaum: In his written testimony, Leo Hindery, who has run 7 private equity funds, noted that in 2017, there were around 8,000 private-equity owned businesses in the U.S., which is nearly double the number of publicly listed firms. He also argues that because many private equity fund managers are generalists with little to no experience in the industries or companies they are investing in, they have to engage in predatory practices such as loading an acquired company with debt, and slashing jobs and worker benefits in order to generate returns to pay their investors, rather than focusing on creating long-term value for the acquired company. Can you please discuss how, as Mr. Hindery has labeled it, this has become the "much-discredited playbook" that many private equity firms are engaging in instead of creating long-term company value?

Small and medium-sized companies have very little in the way of real estate or other assets that can be mortgaged. As a result, the debt placed on them when they are acquired is not excessive and is similar to the amount of debt that publicly-traded companies typically carry. Because lenders will not provide them with very much credit, their PE owners cannot have the company take on more debt – junk bond debt – and use the proceeds to pay them dividends. In these and other ways, typical PE financial engineering strategies are not available to the company's PE owners. On the other hand, many small and medium-sized companies lack modern IT systems, modern accounting systems, experience marketing nationally or internationally. There is a lot of low-hanging fruit that provide opportunities for the PE owners to make improvements that raise the company's performance and then to sell it at a profit. The low debt on the company reduces the risk of bankruptcy. The PE firm may specialize in acquiring companies in an industry it knows well. It will know what investments to make in the company to improve its IT, accounting systems and other operations as well as improvements in business strategy. This will raise the productivity of these companies and lead to high returns for investors.

The exception to this is the acquisition of small businesses by large PE funds as add-ons to an existing platform company, as described in the answer to the previous question. In this case, the debt to acquire the add-on is placed on the platform company raising that company's debt and interest payments.

In contrast to the acquisition of small and medium-sized companies, the predatory practices Mr. Hindrey describes are very common when a large PE fund takes over an established company. The private equity owners take wealth out of the acquired company to enrich themselves via sales of assets, dividend recapitalizations (issuing junk bonds and using the proceeds to pay themselves dividends), having a PE firm subsidiary participate in the debt placed on the acquired company. In these ways – as we saw in the case of Toys R Us – the PE firm repays itself for its initial investment and makes a profit regardless of what happens to the company. PE owners do not want their portfolio companies to go bankrupt and would prefer for them to survive and be resold. However, the high levels of debt loaded onto portfolio companies increases their risk of financial distress, bankruptcy, and even liquidation. We should note, however, that while bankruptcy is more common among companies owned by PE than among publicly-traded companies, most PE-owned companies do not go bankrupt.

11. Dr. Appelbaum: As you know, a company's bankruptcy can be devastating for workers, consumers, and communities. Is a private equity fund just as devastated if one of their portfolio companies goes bankrupt? Can a private equity fund make a profit despite, or even because of a company's bankruptcy proceedings?

The capital in private equity funds comes almost entirely from the limited partner investors in the funds – pension funds are the largest investors and they are joined by endowments, sovereign wealth funds, insurance companies and other wealthy institutions and individuals. The private equity firm, through the contribution to the PE fund from the fund's general partner, typically puts up one to two cents for every dollar the limited partners contribute. (The general partner, it

should be noted, is typically not an individual but a committee made up of founders of the PE firm, other partners, and other principals of the PE firm who act in the interest of the PE firm.) The predatory practices and financial engineering described in the answer to the previous question assures that the PE firm will not lose money and will generally make a profit despite the bankruptcy of a portfolio company. The investments of the limited partners in the bankrupt company will typically be wiped out and these investors will suffer a loss on this investment and a lower overall return on the capital they have invested in the fund. In general, a PE fund will make a profit even if it takes a loss on one of the companies in its portfolio when that company goes bankrupt.

12. Dr. Appelbaum: During its ownership of Southeastern Grocers, one of the largest supermarket portfolio companies in the country, which includes Winn-Dixie and Harveys and employs approximately 45,000 people,[3] the private equity firm Lone Star ran the company into bankruptcy twice. Even after the company emerged from the first bankruptcy in 2010, Lone Star continued to saddle the company with more debt. Over the next 8 years, Lone Star would collect a total of $980 million in dividends in addition to spending over $860 million acquiring the company's competitors.[4] By 2018, the company was once again unable to service its loans and forced into bankruptcy. Why do you think Lone Star chose to continue taking out loans on behalf of Southeastern Grocers?

The bankruptcy of Southeastern Grocers, owned by private equity firm Lone Star Funds, provides a classic example of how private equity drives companies into bankruptcy while extracting millions of dollars for themselves and their investors. Southeastern is the owner of well-known brands BI-LO, Fresco y Más, Harveys, and Winn-Dixie, located in seven southeastern states. While all supermarket chains face intense competition and thin profit margins, Southeastern's regional competitors, such as Publix Super Markets, have survived and flourished.

Lone Star first bought out Southeastern's predecessor, BI-LO, in 2005 in a leveraged buyout, and took the company private. It ran the company into bankruptcy by 2009 and emerged from Chapter 11 in 2010. It tried to sell the chain to publicly traded Kroger and employee-owned Publix Super Markets, but these companies were not interested. After six years of ownership, Lone Star was overdue in paying promised outsized returns to its investors. So, it executed a "dividend recapitalization" – meaning that, as described above, it loaded the company with even more debt to pay dividends to itself and its investors. Between 2011 and 2013, Lone Star paid itself and its investors $839 million in dividends. The struggling grocery company became saddled with interest payments. One loan of $475 million, used to pay dividends of $458 million to Lone Star, required Southeastern's BI-LO chain to pay $205 million in interest between 2014

[3] Southeastern Grocer, Forbes (accessed 11/17/2019) (available at https://www.forbes.com/companies/southeastern-grocer/#75fa7618757d).
[4] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.

and 2018. Lone Star's owner, John Grayken, is a billionaire who famously renounced his U.S. citizenship to avoid paying taxes.

As if this weren't enough debt, Lone Star sent Southeastern on a buying spree rather than invest in existing stores. Too impatient to invest in Southeastern's existing stores to improve performance organically, Lone Star set out to grow its total profits by buying up other grocers. This, it hoped, would make Southeastern an attractive company for an IPO. In 2012, Southeastern bought out Winn-Dixie for $561 million, creating a chain of 690 stores and 63,000 employees. In 2013, it added another 165 stores (Harveys, Sweetbay, and Reid's) in an LBO worth $265 million, as well as 22 Piggly Wiggly stores in an LBO worth $35 million. Lone Star renamed the company Southeastern Grocers.

To offset the growing debt due to dividends and LBOs, the company sold the real estate of a distribution center for $100 million and several stores for $45 million, and then required the affected entities to pay rent on the buildings they used to own—further undermining their financial stability—referred to in financial parlance as a "sale/leaseback." In need of more cash, Lone Star secured a series of revolving credit loans and debt financings between 2014 and 2017. In the meantime, between 2011 and 2018, Lone Star took out a total of $980 million in dividends from Southeastern Grocers, according to Moody's Investors Service.

By March 2018, Southeastern filed a "pre-packaged" Chapter 11 bankruptcy. Once used for unique situations, private equity firms now treat them as a staple in their bankruptcy proceedings, allowing the P.E. owners to fast-track the process by working out a deal with senior creditors before the bankruptcy filing. Unsecured creditors—mainly vendors, suppliers, and workers who are owed back wages, vacation pay, health insurance, and other payments—have little time to respond and are often left out in the cold. When the company exited bankruptcy in June 2018, about 2,000 workers had already lost their jobs. The deal reduced debt from about $1.1 billion to $600 million, with creditors swapping debt for equity and the company agreeing to close 94 stores, affecting thousands more workers' jobs.

This all too familiar story is not about "disruptive" new competitors or price wars—it is about private equity extracting wealth and driving companies into bankruptcy

13. Dr. Appelbaum: A recently released report by accounting and consulting firm EY about private equity lauded their contribution to the tax base. And yet, state and local governments have also been left unpaid when private equity drives a company into bankruptcy. For example, after being acquired by private equity firm Sun Capital Partners and paying tens of millions of dollars to its private equity investors in dividends and consulting fees, Shopko was forced into bankruptcy, closed 360 stores, terminated 14,000 employees, and left taxpayers holding the bag with over $13.5 million owed in unpaid taxes and penalties to the

state of Wisconsin.[5] Do you think private equity companies should be responsible for paying back the taxpayers?

Yes, I do. Private equity firms like to claim that they are passive investors in the companies they buy just like when ordinary people by shares of stock in a company. If you or I own shares of stock in a company that goes bankrupt without paying its taxes or making required payments to its workers' pension fund, we are not held responsible for the unpaid taxes or pension liabilities. Private equity wants to be treated just like you and me. But there is a big difference between a private equity firm that owns a company and ordinary people and other investors that own shares of stock in a company.

Ordinary shareholders in a company do not have any control over decisions by the company that may land the company in bankruptcy. PE firms, on the other hand, via the General Partner of the PE fund that acquired the company, makes all the decisions about how much debt to put on the company, whether to take dividend recapitalizations, whether to sell its real estate or strip it of other assets – and decisions to engage in these behaviors greatly raise the risk that a portfolio company will go bankrupt. If, despite this predatory behavior by the PE firm, the portfolio company can be sold in a few years at a profit, the PE firm will happily pocket a disproportionate share of these profits. If, instead, the portfolio company collapses under the burden of all the debt the PE firm has loaded onto it, the PE firm walks away as if it had nothing to do with the fact that the company is now bankrupt.

Private equity owners are NOT like shareholders in a publicly-traded company, and the bankruptcy rules need to be revised to acknowledge this great difference. PE firms need to be held responsible for the decisions of the general partner and the PE firm that led to the bankruptcy, and should be liable for any unpaid taxes, back wages, and pension liabilities.

14. Dr. Appelbaum: United for Respect issued a report that found that 1.3 million Americans, including 600,000 retail employees, have lost their jobs as a result of private equity over the last decade alone.[6] The report further found that women and people of color have been disproportionately affected by these practices.
    a. Can you please discuss how the currently regulatory regime surrounding private equity can incentivize private equity firms to engage in extractive, reckless behavior at the expense of workers and acquired companies?
    b. What should Congress do to stop these predatory practices while letting good private equity actors continue to do their work?

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[5] Jeff Bollier, *Shopko used borrowed money to pay dividends; owes Wisconsin $13 million in taxes, fees*, Green Bay Press Gazette (Mar. 1, 2019), https://www.greenbaypressgazette.com/story/money/2019/03/01/shopko-dividends-under-investigation-also-owes-wisconsin-13-5-million/2906336002/.

[6] Jim Baker, et al., *Private Equity: How Wall Street Firms are Pillaging American Retail*, at 8, (July 2019).

The retail sector has been a sweet spot for private equity for three reasons. The retail sector is highly cyclical. In a downturn, consumers can put off buying new clothes, electronic gadgets, toys for their children. It is also subject to sudden changes in consumer preferences – for plant-based food, for example, or for ugly dolls for their children. To survive these periodic challenges, retail chains including grocery stores have adopted certain practices: they own much of their own real estate so that they don't have to make rent payments in tough times; they keep their debt burden very low so they don't have to cover high interest payments when business is slow; and they are high cash flow industries. It is these three characteristics that, in the past, have made retail chains an attractive investment for PE. There are extensive real estate assets that can be stripped; the low debt held by retailers means that lots more debt can be loaded on them during the leveraged buyout; and the high cash flow allows the PE owners to dip their hands in the till to collect fees from the stores for so-called advisory services and to pay themselves dividends. The high debt means a low equity investment, so stripping assets and collecting fees allows the PE firm to quickly recoup its investment and make a profit. The current regulatory regime enables all of these practices.

Despite some well-known bankruptcies in the past, most retail chains survived the hollowing out by private equity owners and were ultimately sold to strategic investors or returned to the public markets via an IPO. This is no longer the case for two reasons – first the amount of debt loaded onto retail chains like Toys R Us, Shopko, Gymboree, Staples and many others is higher than in the past and has proven unsustainable. These debt burdens were decided by the PE firm purchasing the chain; the retail company had no say. Second, the changing dynamics of the retail industry – the rise of e-commerce, same day delivery, and other new practices require that the retail chains retain profits and resources to finance investments necessary to remain competitive. Yet, private equity owners are focused on extracting wealth from the retail chains they own, not making adequate investments in them.

The most important regulatory change to rein in this excessive use of debt is to make the PE firm and the general partner of the PE fund (a committee of members of the PE firm as described earlier) jointly responsible with the portfolio company for repaying the debts they loaded onto the portfolio company. This will lead PE firms to consider what is a reasonable amount of debt to load onto companies its funds acquire. Guidance from bank regulators in 2013 noted that debt in excess of 6 times earning greatly increases the risk that a company will face bankruptcy. This regulatory change would provide a strong incentive to PE firms to keep debt loaded onto portfolio companies below the high risk threshold.

Many private equity deals already occur at debt levels well below six times earnings, and portfolio companies in this situation have a very low probability of going bankrupt. The business model of PE firms that do not make excessive use of debt will not be affected by this regulatory change.

15. Dr. Appelbaum: Many are warning that private equity firms are beginning to cause serious problems in housing by forcing traditional mom-and-pop landlords out of the single-family

housing market in favor of large corporate buyers, in addition to buying up hundreds of thousands of homes formerly available for would be homeowners.[7] Indeed, large PE buyers such as Blackstone Group, the largest PE firm in the United States whose CEO has become known as "America's landlord," purchased hundreds of thousands of foreclosed single-family homes in working-class neighborhoods with high percentages of minority residents and converted them into rental properties.[8] Can you please discuss the impact this has had on housing prices and tenants, particularly in vulnerable and low-income communities?

In the wake of the financial crisis and aided by the actions of federal agencies, private-equity owned companies were able to buy up hundreds of thousands of foreclosed homes and turn them into rental properties. The purchases were concentrated in cities and neighborhoods especially hard hit by the foreclosure crisis – working class communities and communities of Black residents and people of color. The wealth of many working class and minority residents that had been tied up in the equity in their homes was destroyed. Starter homes and affordable housing disappeared from the real estate market, making it impossible for younger adults or those in low-income jobs to access home ownership. Instead, these people have found themselves with no option other than to rent from large, corporate, absentee landlords. Local mom and pop landlords, as you note, have been forced out of business. This stranglehold on rental properties in cities such as Atlanta, Baltimore and Los Angeles has enabled these corporate landlords to drive up rental rates, neglect to make necessary repairs, and move quickly to evict good tenants who face temporary financial difficulties. It is a very lucrative situation for the corporations that own large numbers of homes in these communities, but it has put housing – either renting or owning a home – out of the reach of low and even middle-income people. This has been carefully documented by investigative reporter Aaron Glantz.[9]

16. Dr. Appelbaum: The United States' criminal justice system disproportionately targets Black and Latinx Americans and has allowed private prisons and companies providing support services to correctional facilities to rake in billions of dollars at the expense of incarcerated individuals, their families, and taxpayers for decades. Government agencies spend $80 billion annually on vendors to support this system and private equity vendors are a specific part of this market.[10] Private equity firms are one of the owners of such companies, and often charge exorbitant rates and fees for simple services like phone calls and providing over-priced, subpar food and healthcare services. Can you explain how these companies are able to take advantage of the noncompetitive marketplace to take advantage of incarcerated individuals and their families through our criminal justice system?

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[7] Sarah Edelman, et al., *When Wall Street Buys Main Street*, Center for American Progress (Feb. 27, 2014), https://www.americanprogress.org/issues/economy/reports/2014/02/27/84750/when-wall-street-buys-main-street-2/.
[8] Alana Semuels, *When Wall Street Is Your Landlord*, The Atlantic (Feb. 13, 2019), https://www.theatlantic.com/technology/archive/2019/02/single-family-landlords-wall-street/582394/
[9] Aaron Glantz, *Homewreckers*, NY: Harper Collins Publishers, 2019.
[10] Tim Requart, *How Private Equity Is Turning Public Prisons Into Big Profits*, The Nation (May 13 2019), https://www.thenation.com/article/prison-privatization-private-equity-hig/.

Media outlet Axios did a deep dive into who profits from the prison system.[11] The U.S. incarcerates people at a higher rate than any other country — 655 people for every 100,000 of the population. Skyrocketing incarceration rates beginning with the war on drugs in the 1980s that disproportionately affect Black and Latinx Americans led state and local governments to turn to for-profit prison companies to increase prison capacity and to other private companies to provide prisoner services. In other words, many government entities reached out to private companies and invited them to provide everything from the private prison itself to prisoner services – telephone, food, toiletries, and more – in publicly-owned prisons.

As documented in the Axios article, two private-equity-owned companies – Secarus and GTL – handle about 80% of inmate phone calls. Because of their near-monopoly, they are able to charge outrageous fees. Hedge fund-owned medical services company, Corizon Health, operates in 220 facilities in 17 states. It charges very high prices. It lost its contract with the state of Arizona for cheating. Publicly-traded food service companies, Aramark and Trinity Services, provide meals to prisoners in about 800 state and local facilities. Michigan pulled its contract with Aramark when it found a range of violations, including meal shortages and maggots in the food. After bad experiences with Trinity as well, Michigan halted outsourcing prison food services to for-profit companies. Prison Transport Services is the largest provider of prisoner transportation services in the U.S. and is widely used by jails and prisons. It charges very high prices to transport prisoners. Its guards have been accused of sexually assaulting prisoners and at least four people have died while being transported. The largest for-profit prison companies, CoreCivic and GEO Group, have seen their profits and their share prices soar as their practices endanger the health and safety of people incarcerated in their prisons.

For-profit prison and prisoner service companies are motivated by the pursuit of profit. The penetration of U.S. jails and prisons by a handful of these companies and the lack of competition enables them to charge high prices and provide shoddy services. Private prisons understaff guards, resulting in dangerous conditions for inmates. Governments should not be allowed to privatize these public functions and for-profit companies should not be able to profit from mistreatment of prisoners. In November 2016, President Obama used an executive order to end federal contracts with private prisons. This order was rescinded by President Trump.

17. Dr. Appelbaum: Just last year, a Washington Post investigative report found that after being acquired by private equity firm Carlyle, ManorCare, the second-largest nursing home chain in the United States exposed tens of thousands of patients to health risks such as medication errors, failure to treat bed sores, and failure to provide special care for patients needing special services like colostomies and prostheses. Additionally, ManorCare realized an astonishing 26% increase in annual health code violations after being acquired by Carlyle. Many have argued that there are certain sectors, especially industries related to public health,

[11] Stef Kight, Alison Snyder, Dan Primack, Erica Pandey, Michael Sykes and Jessie Li, *1 big thing: Profiting from prison*, Axios AM (June 8 2019).
https://www.axios.com/newsletters/axios-am-133561d8-1d90-4941-92b3-5b4896e52de2.html?chunk=0&utm_term=emshare#story0

that are just too sensitive in nature for private equity to be operating in. Would you agree with that?

Professor Rosemary Batt and I have spent the past year studying the role played by private equity in several healthcare sectors and have identified negative outcomes for patients and communities related to ownership by private equity firms. PE ownership in these segments raises out-of-pocket medical fees paid by patients, raises healthcare costs for everyone, and subjects people struggling with medical debt to aggressive bill collecting practices. Private equity ownership of doctors' practices and other healthcare businesses should be tightly regulated or banned if it threatens the physical health or economic well-being of patients. I summarize the main findings of our research below.

- Private equity firm investments in healthcare are largely short-term financial transactions – designed to make 'outsized returns' for themselves and their limited partner investors in a three to five-year window. The median, or typical, 'hold time' for a PE investment in healthcare was 4.9 years in 2016-2019.
- Private equity's current interest in healthcare is driven by market opportunities to consolidate enterprises in highly fragmented markets. PE serves as a market aggregator and reseller, using a well-developed 'buy and build' strategy. It establishes a 'platform' by buying out one enterprise and then adding on and rolling up a series of similar enterprises -- consolidating them to achieve market power and raise prices at the local, regional, or national level, contributing to rising healthcare costs and making care unaffordable for many Americans. The buy-and-build strategy is an effective way to build market power without falling under the scrutiny of government antitrust agencies because each acquisition is too small to require review by the Federal Trade Commission.
- The private equity model in healthcare is one of low risk, as third-party government and private insurers guarantee payments. It is one of high returns due to the extensive use of debt. In 2018, the median or typical debt leveraged in a PE healthcare buyout was 7 times earnings, a debt level that increases the risk of bankruptcy of the acquired company. In the case of hospitals – rural hospitals in particular, this can be destabilizing to the community and deprive rural residents of badly needed health care. Servicing this debt and also achieving outsized returns for PE investors means that prices of healthcare services must rise.
- Surprise medical bills from emergency room (ER) visits and ambulance services have become a major concern in recent years. Patients who go to the ER believe that their insurance will cover the costs for ER services in the hospital that accepts their insurance; but they often later find that the ER doctors bill them directly because, in fact, the hospital has outsourced the ER to a physician staffing company that is not covered by their insurance.
- In fact, the leading national physician staffing firms responsible for hitting patients with surprise medical bills or using the threat of surprise medical bills to bully insurance companies to pay higher reimbursement rates to their doctors are owned by private equity firms: Envision Healthcare (with 69,000 employees), owned by KKR, and TeamHealth (with

20,000 employees), owned by Blackstone. Together these two companies supply 30 percent of the market for outsourced physicians. These national chains of medical specialists are the result of PE's strategy of buying up small specialty practices and rolling them into national chains with substantial market power to raise prices.

- Dentist practices have also been an attractive target for private equity firms. PE firm Abry Partners has been a major player in this highly fragmented segment of the medical industry. It has bought up dental practices and rolled them up into a platform company – the North American Dental Group.
- Doctors and dentists employed by staffing companies owned by private equity firms often have incentives to raise revenue by over-treating patients – calling for more diagnostic tests, admitting more patients from the ER to in-patient beds in the hospital, or performing unnecessary procedures. They may also face incentives to reduce costs if there are productivity benchmarks in their contracts with the firm that owns their practice – benchmarks related to the number of patients to be seen, for example, that may interfere with providing patients with the best quality of care, or to the ratio of costs generated by a doctor or dentist to the revenue that medical practitioner generates.
- Air and ground ambulances are another major source of surprise medical billing. The average cost for an air ambulance was over $36,000 in 2018, and 69 percent of bills were out-of-network – meaning that insured patients in these cases, were billed directly for the services. Two of the three largest ambulance transport companies are owned by private equity firms. KKR merged American Medical Resources (AMR) and Air Medical Group Holdings (AMGH) to create the largest provider of ground services and one of the largest for air transport services. Air Methods, also owned by private equity, reports that it accounts for nearly 30 percent of total air ambulance revenue in the US.In 2019, Congressional committees introduced legislation to curb surprise medical bills. This legislation, while badly needed by patients is a threat to the private equity business model which relies on these high, out-of-network charges to be able to repay the huge debt loads that Envision Healthcare and TeamHealth are carrying. The threat of legislation to rein in these practices has led players in credit markets to re-evaluate the ability of these companies to repay the debt. The value of Envision's leveraged debt fell from 97 cents on the dollar in May 2019 to 73 cents on the dollar in August 2019 before recovering somewhat to 81 cents on the dollar in November 2019. TeamHealth's leveraged debt was still trading below 80 cents on the dollar in November 2019 – that is, below the threshold for distressed debt.
- Private equity firms also have bought up and rolled up revenue cycle management companies – those responsible for hounding patients to pay their bills – including those accumulated as a result of the surprise medical billing by PE owned physician staffing companies. Medical debt is a major contributor to almost 60 percent of personal bankruptcies, and has grown in recent years due in part to increased deductibles in health insurance plans.
- Hospitals are increasingly outsourcing bill collection to revenue cycle management companies. PE firms have developed platforms to acquire a series of small RCM companies

and roll them into national chains providing 'one-stop shopping' for a range of RCM activities. PE firms active in this segment include Blackstone, The Gores Group, Thomas H. Partners, Vista Equity, Waud Capital Partners, and Warburg Pincus, among others.

- RCM companies are under scrutiny by the Federal Communications Commission (FCC) for aggressive tactics. Complaints to the FCC have increased; and lawsuits claiming violations of the Telephone Consumer Protection Act (TCPA) by RCM and other bill collections companies increased by 560 percent between 2010 and 2014. In August 2015, the FCC ruled that the decades-old Telephone Consumer Protection Act (TCPA) applies to cell phone calls by bill collectors, including revenue cycle management companies hired to collect medical debt from patients. PE firms are on the forefront of the outsourced RCM segment in healthcare, pushing it toward consolidation and involved in aggressive billing collection practices, including violating debt collection laws, suing low-income patients, and offering potentially exploitive medical loans.

18. Dr. Appelbaum: Since 2015, seven major grocery stores employing more than 125,000 workers have filed for bankruptcy.[12] The media has blamed low-cost competitors and high-end markets, but many fail to note that every one of these stores was owned by private equity. Further, no comparable publicly traded grocery chains went bankrupt during that period.[13] A study compared the publicly-traded Kroger with the comparable private-equity owned Albertsons and found that private-equity owners had saddled their grocery stores with almost twice as much debt as Krogers.[14] Why do you think this is the case? What's different about private equity ownership? Why might private equity owners be more likely than a public company to declare bankruptcy or risk it by assuming a lot of debt?

As I discussed earlier, private equity owners often saddle their portfolio companies with excessive amounts of debt. This is a high-risk strategy for the company, but a low risk strategy for the PE firm. Excessive debt means less equity is used in the deal. When the company is resold just a few years later, the return on the equity invested will be higher the lower the amount of equity used to acquire it.

This is a business strategy that is not available to publicly-traded companies. A publicly-traded company that acquires another company is responsible for repaying any debt used to purchase it; the debt is not loaded onto the acquired company. The amount of debt used in these transactions is generally reasonable. Public shareholders would be concerned and sell their shares if a publicly-traded company loaded itself with the amount of debt that Toys R Us struggled to service, and that ultimately drove it into bankruptcy.

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[12] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[13] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[14] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.

Another consideration is that private equity owners intend to resell a company they acquire in three to five years. If the company cannot make all the necessary improvements to be competitive because of the resources its private equity owners have extracted from them, the private equity owners intend to be long gone when the resulting problems emerge. A publicly traded company that acquires another business does so because they see a long-term strategic value to the acquisition. Engaging in financial engineering practices that hollow out an acquired company makes no sense if your intention is to retain that company as a division or subsidiary for the foreseeable future.

19. Dr. Appelbaum: As you know, many private equity firms use leveraged buyouts to purchase companies. In a leveraged buyout, a PE fund takes over a company by purchasing the company's existing or newly issued equity shares, worth only a portion of the company (usually less than 40%) and then buying the rest of company with debt backed by the acquired company's assets.[15] Even after the initial purchase saddles a company with debt, private equity firms will force companies to take out additional loans to pay investors dividends and create profits.[16] In order to address this practice, the Stop Wall Street Looting Act would prohibit companies from making a capital distribution during the 2 years following a leveraged buyout transaction. Currently, regulations in the European Union prevent private equity firms from making a capital distribution within 2 years of an acquisition.[17] Can you talk about how this rule affected the European private equity markets?

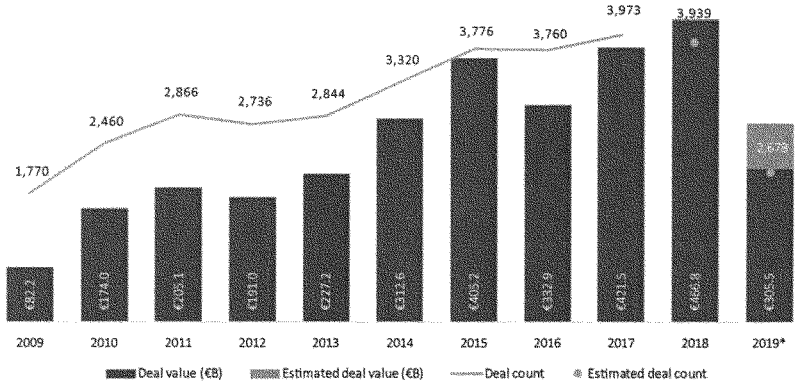
Despite this European regulation that prevents a PE firm from taking a capital distribution in the first two years, private equity funds in Europe have increased their fund raising and deal making over the last decade. This graph from PitchBook, a highly regarded firm that collects data on PE

[15] Miriam Gottfried & Ryan Tracy, *Risky Deals Return to Leveraged-Buyout Market*, Wall Street Journal (October 24,2018), https://www.wsj.com/articles/risk-returns-to-leveraged-buyout-market-1540373400.
[16] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[17] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, OJ L 174, 1.7.2011, §57

PitchBook

Overview

PE deal activity



Source: PitchBook | Geography: Europe
*As of September 30, 2019

firm transactions, tells the story of the growth of PE deal activity in Europe for full years 2009 to 2018. Data are current through the end of the third quarter of 2019 – not the full 2019 year.

20. Dr. Appelbaum: There is some concern that the provisions outlined in the Stop Wall Street Looting Act would be overly burdensome for small or medium private equity funds. As you know, although the bulk of the money in the private equity industry is raised by large funds, the majority of the deals are carried out by small and medium funds. How will these smaller funds be affected by the Stop Wall Street Looting Act?

Small and medium-sized PE funds invest in small to medium-sized companies. As discussed earlier, these companies typically have a limited amount of assets that can be 'mortgaged,' thus limiting the amount of debt that can be loaded onto these portfolio companies. They are also generally unable to sell junk bonds and use the proceeds to make capital distributions to their PE owners. Thus, the debt burden on these companies is not excessive, and the probability that debt will drive these companies into bankruptcy is very low. At the same time, small to medium-sized portfolio companies often can benefit from improvements in their IT or accounting systems or from guidance in creating national or international marketing channels – guidance PE firms are equipped to provide. The operations of small and medium-sized PE funds and the PE firms that sponsor them will not be affected by the Stop Wall Street Looting Act. These acquisitions, it should be noted, account for the overwhelming number of private equity deals.

21. Dr. Appelbaum: In 2017, the National Association of Investment Companies, which mostly includes diverse-owned private equity firms, reported that on a capital-weighted internal rate of return basis, private equity funds managed by their diverse members returned more than seven percentage points above the benchmark for all U.S. private equity funds. Despite this evidence, the number of diverse private equity funds, and the percentage of assets under management they control, remains low.

    a. What can be done to address the biases against diverse private equity firms? What has research shown about why these firms continue to have limited access to capital and what can be done to change the tide for well-performing diverse firms?

    b. Given the impact on performance, investors have an interest in the extent to which companies include diverse perspectives and people in their board rooms. Recently, the House passed bipartisan legislation that would require corporations to disclose the gender, racial, and ethnic composition of their boards to ensure consumers have the information they need to make informed investment decisions about a company's governance. General partners of private funds determine the board members of the portfolio companies they own, but have not been required to disclose the board demographic data in a similar manner to their investors. Do you agree that private fund investors would similarly benefit from information about the board composition of companies in the fund portfolios? What other measures by investors, general partners and others could be implemented to push for more board diversity?

You are correct that there is a large literature that documents the superior performance of companies with more diverse boards. Yet most boards continue to be composed of all, or nearly all, straight white men. This is part of the more general problems surrounding diversity in American society. That said, there are some initiatives that can be taken.

National legislation that requires the general partners of private funds to disclose demographic data about the board members of companies they own is a good idea that would serve two purposes. It would encourage GPs to more actively work to make sure these boards are more diverse in order to not be publicly embarrassed by a lack of diversity. And it would provide investors in future funds of a PE firm with information they can use in deciding where to put their investment dollars. This may be especially important to PE investors that seek to serve a social purpose – university endowments or public pension funds, for example. Currently, California, Massachusetts, Pennsylvania and Illinois have enacted board diversity legislation for publicly-traded companies. The California law mandates only the minimum number of women publicly traded companies in that state must have. Michigan and New Jersey are also considering

legislation to increase the number of women on corporate boards. Progress on race and ethnic diversity on corporate boards lags behind.

Private initiatives may also help. On January 23, Goldman Sachs announced that it would not help take public any company with an all-white male board. Blackrock, the world's largest asset manager, has called on companies in which it invests to have a minimum of two women on its board. Actions like these can be helpful, but more attention to demographic diversity in addition to gender diversity is necessary.

Questions for the Record
Full Committee hearing entitled, "America for Sale? An Examination of the Practices of Private Funds"
November 19, 2019

Wayne Moore

1. Mr. Moore: Investors have been calling for greater transparency from private equity firms for years about fees, investment decisions, and governance practices, but firms have widely resisted disclosing additional information, citing additional regulatory costs. However, in a letter to Chairman Clayton at the Securities and Exchange Commission, the Institutional Limited Partnership Association, representing over 500 PE investors, noted that in most cases the private equity fund investors or "LPs ultimately pay the cost of the Adviser's compliance with the SEC rules, and that LPs are often pleased to do so for the protection (benefit) such regulations provide."[1] In light of investors' willingness to shoulder any financial burdens imposed by additional regulations, why do you think the private equity industry is so resistant to increasing transparency?

   I believe there are several reasons private equity funds resist additional financial disclosures. First, if LP's have access to more information, they will be able to ask more questions about the GP's operations, actions and decision making. Even if LP's are willing to accept the cost of additional reporting, the GP's will still be expending time and energy answering these queries. More importantly, considering how to respond to more scrutiny and prospective queries during their decision making processes adds another layer of uncertainty in decision making which might lead to either less risk taking and less returns and profits. PE investors are not long term investors. Their investment horizon is 7-10 years. LP's have longer investment horizons and typically are more risk averse. This inherent conflict in investment philosophy would only be amplified by the increased oversight generated by more timely and accurate information about fees, expenses, leverage, risk taking and portfolio construction.

   Secondly, disclosure of the actual total fees and expenses paid to GPs and others by LP's juxtaposed with the actual returns distributed to LP's and GP's could be a critical analytical tool in negotiating management fees and carried interest. LP's typically provide 97 – 100% of the capital for investments. The returns from these investments covers all fees and expenses before any profits are distributed. Thereafter, the distribution of profit, i.e. carried interest, could be more fairly and accurately allocated based on factors such as capital contributions, market momentum, financial engineering and other factors in addition to GP performance. These more quantitative

[1] Institutional Limited Partners Association, *Letter to the SEC on Strengthening the Private Equity Market Through Balanced Oversight*, (April 30, 2018), https://ilpa.org/wp-content/uploads/2018/04/ILPA-Letter-to-Chairman-Clayton-on-PE-Regulation-4.30.18.pdf.

analyses might put at risk maintenance of the current fee structures that are very generous for GPs.

Finally, as risk takers, PE investors have set high expectations for returns and in a low return investment environment. The added pressure for high returns might lead to GP's to engage in financial engineering activities that undermine long term growth in favor of shorter term returns and profits. While some losses are sustainable to LP portfolios, the same may not be true for GP's and therefore may encourage GP's to place their interests above that of the partnership and the longer term goals of pension funds.

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2. Mr. Moore: Traditionally, private equity funds operate with a "2-and-20" fee structure in which firms earn an annual management fee of 2% of the fund's assets, along with 20% of the profits. However, there is a current trend towards private equity investors advocating for an alternative "1-or-30" fee arrangement in which funds collects the higher of either 1% of the assets or 30% of the fund's performance.[2]
    a. Why do you think this change is happening? Why is this new arrangement preferable to the current, "2-and-20" model?
    b. What types of investors are able to negotiate for this preferential arrangement? Why are other investors unable to negotiate for this?

To my knowledge, private equity funds have not been moving toward the "1 or 30" fee structure. This structure has been adopted by some hedge fund managers in an effort to preserve their revenue models as hedge fund returns have fallen significantly since 2008. The thesis promoted by the "1 or 30" model reserves 70% of returns for the investor and makes 30% of returns available to the hedge fund managers. Both hedge fund and private equity fee structures are based on assets under management. Fees based on assets have no correlation to the management services provided to investors or the performance of the funds. I do not believe asset based fee structures are in the best interests of pension funds. I believe a fairer fees system would include reimbursement of the cost of direct services, reimbursement for a limited and equitable portion of indirect and overhead expenses and a reasonable profit based on performance attributable to fund managers i.e. not performance attributable to other factors not controlled by the fund managers.

3. Mr. Moore: While management fees charged by fund managers at venture capital funds, hedge funds, and across the investment industry have been declining, this trend is not true for

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[2] Christine Williamson, *Texas pension fund taking bold step on fees*, Pensions & Investments (Dec. 26, 2016), https://www.pionline.com/article/20161226/PRINT/312269978/texas-pension-fund-taking-bold-step-on-fees.

private equity fund managers.[3] Even where private equity funds are reporting lower base management fees, changes in fee structures have led to higher overall costs for investors. Why do you think private equity is the only industry who has not reduced its fees?

Private equity has been the best performing long term asset for institutional investors over the past few decades, consistently providing double digit net of fees investment returns through cash distributions over the life of the fund. The cash distributions are critical factors for public pension funds who have demands for cash to pay monthly retirement benefits. In the current low return environment, private market investments in general are in high demand as institutional investors seek higher returns and regular cash distributions to meet their monthly cash needs. Private equity investments meet that need, consequently the demand for their investment services give private equity firms little or no incentive to lower or modify the 2 and 20 structure.

4. Mr. Moore: Currently, the national total student debt is over $1.5 trillion, and that number continues to grow.[4] More than 3 million senior citizens in the US are still paying off their student loans.[5] Recently, private equity has started acquiring debt servicing companies and pursuing old, sometimes nonexistent student debts. One company received over 4,500 complaints from consumers in the first four years of being managed by private equity.[6] Do you think investors would want to know if as part of its management of an acquisition, a private equity fund was pursuing aggressive, even illegal debt collect practices? Do investors have the ability to find out this information today?

My view as a fiduciary for an institutional investor is that this is the type of information that increased transparency could yield. We do not have that level of transparency today. It would certainly influence my decision making. Other fiduciaries may hide behind ERISA guidance and interpretations that lead fiduciaries to consider only investment returns and not consider the impacts of investment strategies. I should note that ERISA legislations has been heavily influenced by the financial services industry since its inception the 1970"s.

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[3] Mark Cobley, *Fund managers' fees are falling — but private equity holds out*, Financial News (Oct. 7, 2019), https://www.fnlondon.com/articles/fund-managers-fees-are-falling-but-private-equity-holds-out-20191007.

[4] Maggie McGrath, *Student Debt As An Asset Class: A $1 Trillion Opportunity?*, Forbes (Dec. 29, 2014) https://www.forbes.com/sites/maggiemcgrath/2014/12/10/student-debt-as-an-asset-class-a-1-trillion-opportunity/#c80c6720e948.

[5] Kelly McLaughlin, *3 million senior citizens in the US are still paying off their student loans*, Insider News (May 3, 2019), https://www.insider.com/americans-over-60-paying-student-loans-2019-5.

[6] *Platinum Equity-Owned Transworld Systems Fined $2.5 Million for Illegal Student Debt Collection Lawsuits, Draws Thousands of Consumer Complaints*, Private Equity Stakeholder Project (July 2019), https://pestakeholder.org/wp-content/uploads/2019/07/Platinum-Equity-Owned-Transworld-Systems-Fined-2.5-Million-PESP-071619.pdf.

5. Mr. Moore: In 2017, the National Association of Investment Companies, which mostly includes diverse-owned private equity firms, reported that on a capital-weighted internal rate of return basis, private equity funds managed by their diverse members returned more than seven percentage points above the benchmark for all U.S. private equity funds. Despite this evidence, the number of diverse private equity funds, and the percentage of assets under management they control, remains low. Given the impact on performance, investors have an interest in the extent to which companies include diverse perspectives and people in their board rooms. Recently, the House passed bipartisan legislation that would require corporations to disclose the gender, racial, and ethnic composition of their boards to ensure consumers have the information they need to make informed investment decisions about a company's governance. General partners of private funds determine the board members of the portfolio companies they own, but have not been required to disclose the board demographic data in a similar manner to their investors. Do you agree that private fund investors would similarly benefit from information about the board composition of companies in the fund portfolios? What other measures by investors, general partners and others could be implemented to push for more board diversity?

   Yes, I believe investors would benefit from having board demographic data of portfolio companies. There have been many studies over the past 25 years that confirm more diverse teams perform better in all aspects of business operations, finance and administration than their more homogeneous peers. Let's be candid and logical. No one demographic group has a monopoly on entrepreneurialism, innovation and analytical skills. More diverse organizations have the benefit of accessing the very best talent from a larger talent pool. The smaller more homogeneous talent pool whether by race, gender, educational background or geography will trend towards including team members based on attributes unrelated to the skills required for high level performance. In making investment decisions, diversity and inclusion are critical success factors that investors need to be knowledgeable about. McKinsey & Company's January 2018 report "Delivering through Diversity" made two major finding:

   a) **Companies in the top-quartile for ethnic/cultural diversity on executive teams were 33% more likely to have industry-leading profitability, and**
   b) **Companies in the top-quartile for gender diversity on executive teams were 21% more likely to outperform on profitability and 27% more likely to have superior value creation.**

   It stands to reason that more diverse boards will lead to more diverse executive teams as the boards are responsible for the long term success of their organiztions.

6. Mr. Moore: As you know in California, public pensions are required to publicly disclose the fees and expenses paid to private equity funds. Why do you think this disclosure is necessary or helpful to investors? Should this be applied to all funds in the U.S.?

   The disclosures required by California's AB2833 are a first step towards a comprehensible industrywide database of cost information from the alternative investment sector. The law became effective January 1, 2017 and therefore only two

years of data has been collected and reported so far. This data collection is important as I discussed in my written testimony because investors, especially public pension funds, need this information to effectively analyze fees and other costs of investing alongside risks, volatility, liquidity and performance in making their asset allocation decisions. California public pension funds have almost 20% of the defined benefit public pension fund assets in the country and consequently a large number of asset managers doing business in California are already in compliance with AB 2833. Extending the California model nationwide through congressional action will allow all investors, public and private, access to the same information and begin leveling the playing field with the asset management industry when it comes to controlling and lowering the costs of investing. Such action should not have a significant implementation impact on the asset management industry as the size of the California market already requires AB 2833 compliance from a large number of asset managers. , The benefit to the rest of institutional investors however, would be significant.

7. Mr. Moore: Because the relationship between investors and private equity funds is contractual, investors can waive their fiduciary duties and in many instances are expected to do so in connection with private equity investments.[7] Both the Stop Wall Street Looting Act and the Investment Adviser Alignment Act limit the ability of private equity funds to waive their fiduciary duties. How are investors affected when these duties are waived?

   My perspective is that of a public pension fund fiduciary. Acting on behalf of 170,000 beneficiaries is significantly different from acting on my own behalf. Without respect to the contractual relationship between private investors and private equity funds, waiving fiduciary duties for private equity fund managers with public pension fund contracts opens the door for added risk taking on the part of these managers who already have discretionary authority to invest however they choose. By relieving them of any duty of care and prudence in exercising their discretionary authority, investors are creating an unacceptable risky environment that bad actors are likely to infiltrate to the detriment of the beneficiaries of public pension funds.

8. Mr. Moore: At the hearing, Congressman Sherman advised limited partners to simply not invest in private equity firms that don't provide sufficient disclosures. California law of course mandates that, as a public pension fund, LACERA obtain certain disclosures from investments, but that wasn't always the case, and in the overwhelming majority of states these disclosures are not mandatory. Why are investors outside of California unable to base their decision to invest in private equity on the available disclosures?

   California has been a progressive state since the early twentieth century, leading the nation in creating legislative processes and local governance structures that included

[7] Jeffery E. Horvitz, *Fiduciary duty waivers of LPs may expose sponsors*, Pensions & Investments (October 14, 2013)

pathways for citizens to be more engaged and influential in public policy making. Stronger legislative authority relative to executive authority, the initiative process, citizen commissions, neighborhood councils, special purpose and enterprise fund service delivery organizations all play important roles in distributing political power in the state of California. This rather fluid and diffuse distribution of political power leads to more diverse sets of policy options for problem solving at the state and local government levels. Other states as well as Congress should look at California as a laboratory of ideas for solving national problems.

Eileen Appelbaum

9. Dr. Appelbaum: A key finding of a report conducted by the American Investment Council and Ernst and Young states, "The US private equity sector provides employment and earnings for millions of workers."[8] However, economists at Harvard University and the University of Chicago found in a recent 2019 study that when private equity firms buy out large publicly traded companies with numerous employees there is about a 13% decrease in jobs in the first two years.[9] If a private equity acquires a struggling company, or even a company that has already filed for bankruptcy, how are employees' benefits, wages, and severance packages typically affected? Are there examples of employees' receiving increased benefits and wages as a result of a private equity acquisition of a bankrupt company?

10. Dr. Appelbaum, can you explain why acquisitions by small and medium private equity funds have a lower rate of bankruptcy and why these funds tend to outperform the larger, Wall Street megafunds?

    Dr. Appelbaum: In his written testimony, Leo Hindery, who has run 7 private equity funds, noted that in 2017, there were around 8,000 private-equity owned businesses in the U.S., which is nearly double the number of publicly listed firms. He also argues that because many private equity fund managers are generalists with little to no experience in the industries or companies they are investing in, they have to engage in predatory practices such as loading an acquired company with debt, and slashing jobs and worker benefits in order to generate returns to pay their investors, rather than focusing on creating long-term value for the acquired company. Can you please discuss how, as Mr. Hindery has labeled it, this has

[8] [8] *Economic contribution of the US private equity sector in 2018*, EY (October 2019), https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.

[9] Stephen Davis et at, *The Economic Effects of Private Equity Buyouts*, (October 7, 2019) at 21.

become the "much-discredited playbook" that many private equity firms are engaging in instead of creating long-term company value?

11. Dr. Appelbaum: As you know, a company's bankruptcy can be devastating for workers, consumers, and communities. Is a private equity fund just as devastated if one of their portfolio companies goes bankrupt? Can a private equity fund make a profit despite, or even because of a company's bankruptcy proceedings?

12. Dr. Appelbaum: During its ownership of Southeastern Grocers, one of the largest supermarket portfolio companies in the country, which includes Winn-Dixie and Harveys and employs approximately 45,000 people,[10] the private equity firm Lone Star ran the company into bankruptcy twice. Even after the company emerged from the first bankruptcy in 2010, Lone Star continued to saddle the company with more debt. Over the next 8 years, Lone Star would collect a total of $980 million in dividends in addition to spending over $860 million acquiring the company's competitors.[11] By 2018, the company was once again unable to service its loans and forced into bankruptcy. Why do you think Lone Star chose to continue taking out loans on behalf of Southeastern Grocers?

13. Dr. Appelbaum: A recently released report by accounting and consulting firmEY about private equity lauded their contribution to the tax base. And yet, state and local governments have also been left unpaid when private equity drives a company into bankruptcy. For example, after being acquired by private equity firm Sun Capital Partners and paying tens of millions of dollars to its private equity investors in dividends and consulting fees, Shopko was forced into bankruptcy, closed 360 stores, terminated 14,000 employees, and left taxpayers holding the bag with over $13.5 million owed in unpaid taxes and penalties to the state of Wisconsin.[12] Do you think private equity companies should be responsible for paying back the taxpayers?

14. Dr. Appelbaum: United for Respect issued a report that found that 1.3 million Americans, including 600,000 retail employees, have lost their jobs as a result of private equity over the last decade alone.[13] The report further found that women and people of color have been disproportionately affected by these practices.
    a. Can you please discuss how the currently regulatory regime surrounding private equity can incentivize private equity firms to engage in extractive, reckless behavior at the expense of workers and acquired companies?

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[10] Southeastern Grocer, Forbes (accessed 11/17/2019) (available at https://www.forbes.com/companies/southeastern-grocer/#75fa7618757d).
[11] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[12] Jeff Bollier, *Shopko used borrowed money to pay dividends; owes Wisconsin $13 million in taxes, fees*, Green Bay Press Gazette (Mar. 1, 2019), https://www.greenbaypressgazette.com/story/money/2019/03/01/shopko-dividends-under-investigation-also-owes-wisconsin-13-5-million/2906336002/.
[13] Jim Baker, et al., *Private Equity: How Wall Street Firms are Pillaging American Retail*, at 8, (July 2019).

b. What should Congress do to stop these predatory practices while letting good private equity actors continue to do their work?

15. Dr. Appelbaum: Many are warning that private equity firms are beginning to cause serious problems in housing by forcing traditional mom-and-pop landlords out of the single-family housing market in favor of large corporate buyers, in addition to buying up hundreds of thousands of homes formerly available for would be homeowners.[14] Indeed, large PE buyers such as Blackstone Group, the largest PE firm in the United States whose CEO has become known as "America's landlord," purchased hundreds of thousands of foreclosed single-family homes in working-class neighborhoods with high percentages of minority residents and converted them into rental properties.[15] Can you please discuss the impact this has had on housing prices and tenants, particularly in vulnerable and low-income communities?

16. Dr. Appelbaum: The United States' criminal justice system disproportionately targets Black and Latinx Americans and has allowed private prisons and companies providing support services to correctional facilities to rake in billions of dollars at the expense of incarcerated individuals, their families, and taxpayers for decades. Government agencies spend $80 billion annually on vendors to support this system and private equity vendors are a specific part of this market.[16] Private equity firms are one of the owners of such companies, and often charge exorbitant rates and fees for simple services like phone calls and providing over-priced, subpar food and healthcare services. Can you explain how these companies are able to take advantage of the noncompetitive marketplace to take advantage of incarcerated individuals and their families through our criminal justice system?

17. Dr. Appelbaum: Just last year, a Washington Post investigative report found that after being acquired by private equity firm Carlyle, ManorCare, the second-largest nursing home chain in the United States exposed tens of thousands of patients to health risks such as medication errors, failure to treat bed sores, and failure to provide special care for patients needing special services like colostomies and prostheses. Additionally, ManorCare realized an astonishing 26% increase in annual health code violations after being acquired by Carlyle. Many have argued that there are certain sectors, especially industries related to public health, that are just too sensitive in nature for private equity to be operating in. Would you agree with that?

18. Dr. Appelbaum: Since 2015, seven major grocery stores employing more than 125,000 workers have filed for bankruptcy.[17] The media has blamed low-cost competitors and high-

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[14] Sarah Edelman, et al., *When Wall Street Buys Main Street*, Center for American Progress (Feb. 27, 2014), https://www.americanprogress.org/issues/economy/reports/2014/02/27/84750/when-wall-street-buys-main-street-2/.
[15] Alana Semuels, *When Wall Street Is Your Landlord*, The Atlantic (Feb. 13, 2019), https://www.theatlantic.com/technology/archive/2019/02/single-family-landlords-wall-street/582394/
[16] Tim Requart, How Private Equity Is Turning Public Prisons Into Big Profits, The Nation (May 13 2019), https://www.thenation.com/article/prison-privatization-private-equity-hig/.
[17] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.

end markets, but many fail to note that every one of these stores was owned by private equity. Further, no comparable publicly traded grocery chains went bankrupt during that period.[18] A study compared the publicly-traded Kroger with the comparable private-equity owned Albertsons and found that private-equity owners had saddled their grocery stores with almost twice as much debt as Krogers.[19] Why do you think this is the case? What's different about private equity ownership? Why might private equity owners be more likely than a public company to declare bankruptcy or risk it by assuming a lot of debt?

19. Dr. Appelbaum: As you know, many private equity firms use leveraged buyouts to purchase companies. In a leveraged buyout, a PE fund takes over a company by purchasing the company's existing or newly issued equity shares, worth only a portion of the company (usually less than 40%) and then buying the rest of company with debt backed by the acquired company's assets.[20] Even after the initial purchase saddles a company with debt, private equity firms will force companies to take out additional loans to pay investors dividends and create profits.[21] In order to address this practice, the Stop Wall Street Looting Act would prohibit companies from making a capital distribution during the 2 years following a leveraged buyout transaction. Currently, regulations in the European Union prevent private equity firms from making a capital distribution within 2 years of an acquisition.[22] Can you talk about how this rule affected the European private equity markets?

20. Dr. Appelbaum: There is some concern that the provisions outlined in the Stop Wall Street Looting Act would be overly burdensome for small or medium private equity funds. As you know, although the bulk of the money in the private equity industry is raised by large funds, the majority of the deals are carried out by small and medium funds. How will these smaller funds be affected by the Stop Wall Street Looting Act?

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[18] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[19] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[20] Miriam Gottfried & Ryan Tracy, *Risky Deals Return to Leveraged-Buyout Market*, Wall Street Journal (October 24,2018), https://www.wsj.com/articles/risk-returns-to-leveraged-buyout-market-1540373400.
[21] Eileen Appelbaum & Rosemary Batt, *Private Equity Pillage: Grocery Stores and Workers At Risk*, The American Prospect (October 26, 2018), https://prospect.org/power/private-equity-pillage-grocery-stores-workers-risk/.
[22] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, OJ L 174, 1.7.2011, §57

a. What can be done to address the biases against diverse private equity firms? What has research shown about why these firms continue to have limited access to capital and what can be done to change the tide for well-performing diverse firms?

b. Given the impact on performance, investors have an interest in the extent to which companies include diverse perspectives and people in their board rooms. Recently, the House passed bipartisan legislation that would require corporations to disclose the gender, racial, and ethnic composition of their boards to ensure consumers have the information they need to make informed investment decisions about a company's governance. General partners of private funds determine the board members of the portfolio companies they own, but have not been required to disclose the board demographic data in a similar manner to their investors. Do you agree that private fund investors would similarly benefit from information about the board composition of companies in the fund portfolios? What other measures by investors, general partners and others could be implemented to push for more board diversity?

Giovanna De La Rosa

22. Ms. De La Rosa, after acquiring Toys "R" Us, private equity firms Bain, KKR, and Vornado, tripled Toys "R" Us' debt from $1.86 billion to over $5 billion, forcing Toys "R" Us to spend as much as 97% of its operating profits to service this debt.[23] As a result, Toys "R" Us was forced to lay off tens of thousands of employees and was left with little resources to modernize its stores to compete with competitors like Amazon and Target. Can you please talk about how these drastic cuts affected your ability to do your job and Toys "R" Us' ability to serve its customers?

23. Ms. De La Rosa, Toys "R" Us was forced to declare bankruptcy, terminate all 33,000 employees, and close every single one of its stores.[24] And yet, the private equity owners of Toys "R" Us still squeezed out an estimated $470 million dollars to pay themselves.[25] Given your experience, do you believe that Bain, KKR, or Vornado had any interest in saving Toys "R" Us? Why?

24. Ms. De La Rosa: At the hearing, some Members speculated that it was competitive pressures from online retailers Amazon, rather than private equity that drove Toys R Us out of business. But in your experience, Toys "R" Us provided more to a community than just a

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[23] Bryce Covert, *The Demise of Toys R Us Is a Warning*, The Atlantic (July/August 2018), https://www.theatlantic.com/magazine/archive/2018/07/toys-r-us-bankruptcy-private-equity/561758/.
[24] Kate Gibson, *Toys "R" Us employees demand severance for 33,000*, CBS News (May 9, 2018), https://www.cbsnews.com/news/toys-r-us-employees-demand-severance-pay-for-33000/.
[25] Susan Berfield et al., *Tears R Us: The World's Biggest Toy Store Didn't Have to Die*, Bloomberg Businessweek (June 6, 2018), https://www.bloomberg.com/news/features/2018-06-06/toys-r-us-the-world-s-biggest-toy-store-didn-t-have-to-die.

place to buy toys. Can you talk about the role Toys "R" Us played in your community and how Toys "R" Us was unique from other retailers?

25. Ms. De La Rosa: At the hearing, Congressman Vargas asked you about how life at Toys "R" Us changed after the company was acquired by Bail, KKR, and Vornado and you said workers were expected to do the jobs of three or four people. Can you talk more about how the culture of the store changed after the acquisition?

Drew Maloney

26. Mr. Maloney: The American Investment Council has offered a wide range of estimates for the number of jobs at private equity owned firms. In 2015, AIC estimated there were 11.3 million people working for PE-owned companies; in 2017, it reported 4.8 million jobs at PE-owned firms; in mid-2019, it reported 5.8 million jobs; and in the Fall of 2019, the AIC-commissioned Ernst & Young study reported 8.8 million jobs. The volatility in the job estimates at PE-owned firms do not align with the changes in assets under management, which have grown steadily over the past decade.
    a. How does AIC explain its own widely variable and volatile job numbers while U.S. private equity assets under management have grown steadily?
    b. Describe the methodological differences for AIC's job numbers in 2015, 2017, and the two estimates in 2019.
    c. How did private equity create 3 million jobs in only a few months during 2019?

27. Mr. Maloney: The AIC sponsored Ernst & Young study estimated 8.8 million jobs at U.S. private-equity owned businesses based on Pitchbook data, but the study offers little methodological detail as to how the total estimate was derived. Pitchbook's employee numbers are self-reported by the company and many firms choose not to disclose the employee numbers.
    a. To what extent did E&Y include employees at PE-owned firms that went bankrupt during the course of 2018? To what extent did E&Y's job estimate include firms that have had 2017 or 2018 bankruptcy driven layoffs? Did E&Y estimate the employment prior to bankruptcy-driven layoffs or subsequent to the layoffs? How many firms are in E&Y's dataset that have been liquidated and no longer exist, and thus cannot have any employees at all?
    b. How did E&Y account for foreign-based employees at U.S. based, PE-owned companies?
    c. To what extent does the E&Y job estimate include firms where private equity held a minority, non-controlling stake in the U.S. firm? How would E&Y's job estimate change if only private equity-owned or private equity-controlled firms were counted? To what extent can E&Y estimate U.S.-based employment only at private equity-owned U.S. firms?
    d. What percentage of the job estimate was modeled and what percent was directly from Pitchbook employment numbers? What percentage of the workers in the

E&Y estimate were provided by Pitchbook and what percentage were modeled by E&Y?

e. How much would E&Y's job estimate change if it were solely full-time equivalent (FTE) employees/jobs instead of total worker headcount? How much lower does E&Y estimate the total FTE jobs might be than its total workforce headcount estimate?
f. Given private equity's focus on short-term yield growth, how and how appropriate is it for E&Y to impute employment numbers at firms based on revenue, EBIDTA and sector? What percentage of the total E&Y estimate were "imputed" from revenue and EBIDTA? Since Pitchbook does not use North American Industrial Classification System (NAICS), describe how E&Y matched Pitchbook sector/industry codes to NAICS codes. Did E&Y purely apply the national, sectoral averages (based on revenue and EBIDTA) to the private equity-owned firms that did not disclose employment numbers, or were those figures adjusted downwards in any way to reflect private equity's impact on employment? Given that the revenues and EBITDA figures were self-reported by the PE-owners, describe E&Y's confidence of modeling employment based on self-reported financial performance numbers that the private equity firm has an incentive to present in the most favorable (i.e. profitable) manner?

28. Mr. Maloney: The E&Y study reports that average compensation (both wages and benefits) for workers at PE-owned firms was $71,000 annually or $36 per hour. However, the E&Y figure is not based on any wage or compensation information from the private equity industry or other reported data by the private-equity-backed firms; it is entirely modeled from national industry averages.
    a. Why didn't E&Y report a median wage/compensation figure that would reflect something closer to what typical workers at PE-backed firms earn? Please provide the median wage/compensation for workers at PE-backed firms, or explain why you cannot.

Brett Palmer

29. Mr. Palmer: In what has been labeled as the private equity "paradox," although the majority of private equity money is invested in large mega funds, research has shown that small private equity funds, which typically acquire small- and medium-sized companies, outperform mega funds and tend to deliver better returns for investors and are able to do so using relatively low levels of debt. As you understand it, do smaller and medium sized private equity funds employ different management strategies than the large mega funds? Why might a company would prefer an investment from a small- or medium-sized fund over a large mega fund?

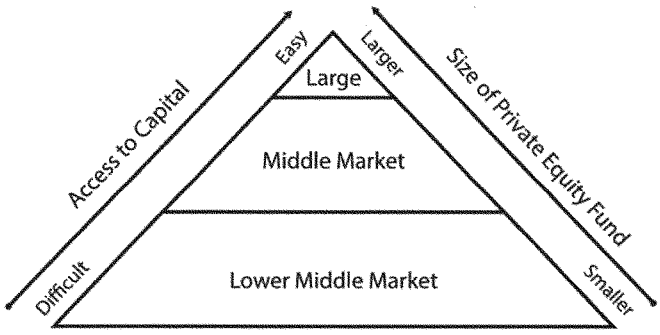
Answer to Questions for the Record

The size of the private equity fund has a meaningful impact on how a fund invests; the size of the company it invests in; its capacity to absorb regulatory costs; the number of jobs created; how difficult it is to raise capital from institutional investors to form the fund; the type of direct management assistance and "hands on" help portfolio companies need; the number of investing options; and the risks associated with investing in businesses. It is true that, in general, private equity funds investing in small and medium-sized domestic businesses significantly outperform their larger private equity brethren.[1] It is also true, according to Dr. Eileen Appelbaum, another hearing witness who stated for the record that, according to her research:

> ... [S]maller PE funds typically acquire small and medium-sized enterprises that can benefit from the access to financing and improvements in operations and business strategy that private equity firms can provide. These PE funds use relatively low levels of debt, provide financing to upgrade operations, advise on implementation of modern IT, accounting, and management systems, and appoint board members that can assist with business strategies. These improvements in governance, operations, and strategy *create value* for the companies and the economy.[2] *(italics added)*

There are no specific, absolute, easily-defined metrics for what is "small", "medium", "large", or "mega" funds – it is all a continuum. There are clearer differentiations between the early and later stage businesses, but that too is a continuum. To have a robust economy, the whole continuum must be healthy, starting with the small businesses.

Private Equity Paradox



[1] https://www.institutionalinvestor.com/article/b1hx33sxljv1r0/The-Private-Equity-Paradox (Nov. 5, 2019)
[2] Testimony of Dr. Eileen Appelbaum, Center for Economic and Policy Research, before the House Financial Services Committee at 3 (Nov. 19, 2019).

Given that it is true that small business investing and medium-sized business investing produces better returns and creates jobs, why is it so much harder for these small business private equity funds to attract capital from institutional investors like pension funds? The answer is scale of the institutional investors, commonly pension funds. If a pension fund has allocated $5 Billion dollars for private equity investment and for risk concentration purposes does not want to be more than 10% of any private equity fund, then the choice they face is investing in at least 500 small funds ($100 Million PE funds with investments from limited partners of $10 Million each) or 10 mega funds ($5 Billion funds with investments from Limited Partners of $500 Million each) or some mix of the two. Performing diligence and managing 500 funds is significantly more challenging (nearly impossible) than doing so for 10 larger funds. It takes just as much work for a pension fund to diligence a single small fund as it does to diligence a single mega fund. The better returns would benefit the pension funds, but they are not able to scale down enough to invest in American small businesses. It is worth noting that because it is so much harder for smaller funds to attract institutional investor capital, small funds will stretch to great lengths on transparency, fees, and other aspects of their fund's structure to be as accommodating to limited partners as possible. This is an area where policymakers, at the state and federal level, should consider making changes to enable pension funds to invest in more smaller funds and thereby get better returns and empower more small business growth.

Further, because of the scale differences, new law and new regulations are not needed for small and medium-sized funds' as it relates to their relationships with their limited partners. Limited Partners generally only need to ask for additional reasonable accommodations, and they will receive them from fund managers.

Choice of Capital Providers

What are the benefits to a company accessing capital from a larger private equity fund versus accessing capital from a smaller fund? Every small business would like a $100 Million dollar investment, but the truth is most smaller businesses could not really use that much money. It would be too big of an investment to use effectively. Larger funds invest in larger amounts and therefore have great difficulty scaling their investments down to a size that smaller businesses can effectively use all the money. Smaller funds cannot invest in big enough sizes to be capital providers to large businesses. Thus, the size of the business correlates with the size of the private equity fund providing capital. Big needs big and smaller needs smaller.

Similarities and Differences in Investing Opportunities

Choice of investments varies by scale too. There are millions of small businesses to choose between when investing. There are only several thousand publicly traded companies. Despite there being millions more small businesses to choose from, small business investing is harder to source deals and to execute deals. Small businesses are infinitely varied in what they do, how they operate, and what type of information is available on their financials and their market. Publicly traded companies generally have GAAP financials, public SEC filings, professional analyst reports, and other critical information readily available.

To be successful, smaller private equity funds must do a lot of work to make a small portfolio company successful and enable growth. These smaller private equity funds must be more "hands on" with companies; must do more work to "professionalize" the management of the companies; must apply new technologies; must apply better information systems and quality controls; and must hire new employees

to enable expansion and growth. Larger private equity funds are investing in companies where most, sometimes all, of these foundational improvements have already been made. Thus, larger private equity funds are maximizing value by considering different growth and business optimization models than smaller funds are able to do. In choosing between private equity funds from whom to draw investments, a company should be focused on which fund can provide the type of help the company needs to be successful and less on the size of the fund.

There are differences in the type of investments that smaller and bigger funds make. Smaller funds invest nearly exclusively in private businesses with no access to the liquidity of the public markets for equity and with limited access to debt. Given this illiquidity and more difficult access to capital, investing in these smaller businesses requires patient investors because there is nearly no path to a quick exit from the investment for a gain or to minimize a loss. Again, successful investing in smaller businesses requires a private equity fund to grow and modernize those businesses.

There are fewer big businesses to invest in, but there is greater competition from private equity funds, mutual funds, and hedge funds to invest in those larger businesses. The larger a business is, the easier it is for it to quickly access debt. If the company is publicly traded, then it can also very quickly access equity capital. Investing in larger companies creates more opportunities in ways to invest and in ways to exit an investment in a business. Investments into and out of publicly traded businesses can happen quickly.

Larger businesses can grow in ways that make them less nimble and adaptable to change. Further, over time larger companies with different divisions and platforms can grow in ways that lose alignment of those businesses. Unlike smaller businesses, larger businesses can sometimes benefit from separating out divisions that have grown too different and are therefore not helping each other. (For example, Hewlett Packard separated their printer business from their industrial grade server business because they were not aligned anymore[3].) Breaking through internal bureaucracies that stifle innovation, reduce global competitiveness, and ultimately reduce the long-term viability of a company is needed for an employer to survive. It is these transformational investments in bigger companies, which may be well-known themselves, that can harm the public image of private equity, regardless of the fact that without these investments and improvements, these businesses (aka employers) would potentially fail and thereby lose all of their employees.

[3] HP Inc.: The HP Split Worked https://finance.yahoo.com/news/hp-inc-hp-split-worked-121242257.html

STATE BOARD OF ADMINISTRATION
OF FLORIDA

1801 HERMITAGE BOULEVARD, SUITE 100
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

RON DESANTIS
GOVERNOR
CHAIR

JIMMY PATRONIS
CHIEF FINANCIAL OFFICER

ASHLEY MOODY
ATTORNEY GENERAL

ASH WILLIAMS
EXECUTIVE DIRECTOR & CIO

November 19, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairwoman Waters and Ranking Member McHenry:

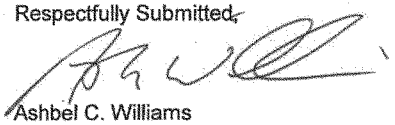
The State Board of Administration of Florida acting on behalf of the Florida Retirement System Trust Fund (the "SBA") writes regarding the hearing planned for November 19, 2019, titled **"America for Sale, An Examination of the Practices of Private Funds."** We strongly support the provisions in the *Investment Adviser Alignment Act,* which will ensure greater alignment of interest and improved transparency and governance in the private equity asset class.

The SBA acts as the fiduciary for the retirement assets of over 1 million current or former public employees. We are also active members of the Institutional Limited Partners Association ("ILPA"), and support their efforts to improve the private equity industry. The Florida Retirement System has $166.96 billion of assets under management, with an asset allocation to private equity of 7.2 percent. Private equity provides necessary returns and asset diversification that the SBA requires to meet our fiduciary obligations to our beneficiaries. The SBA is supportive of targeted reforms, such as those in the *Investment Adviser Alignment Act*, that seek to improve the asset class.

The SBA is concerned about recent trends in the private equity industry that seek to reduce the fiduciary obligations owed to limited partners. We also actively seek fee and expense reporting from the private equity managers we invest with and find it critical to ensure the investment contract we signed with the GP is complied with. Finally, we support efforts to ensure LPs are informed of who their partners are, and that prevent limitations on communications among investors in a private equity fund. Each of these items are addressed in the *Investment Adviser Alignment Act*, which is supported by ILPA.

The SBA appreciates the opportunity to comment on this important topic and encourages the Committee to move forward with the reforms in the *Investment Adviser Alignment Act* to ensure the long-term health of the private equity industry.

Respectfully Submitted,



Ashbel C. Williams
Executive Director & CIO
State Board of Administration of Florida

recordonline.com
TIMES HERALD-RECORD

New Windsor mobile home park residents protest upcoming rent hike

By Michael Randall / Times Herald-Record
Posted at 7:01 PM

NEW WINDSOR — Residents of the Silver Stream Village mobile home park marched Thursday afternoon to protest a pending increase in their lot rents that they say exceeds what state law allows.

They were joined at a news conference and rally before the march by state Sen. James Skoufis, who said if park owner RHP Properties won't withdraw the increase on its own, the state Division of Housing and Community Renewal should intervene and negotiate an increase that is fair and lawful.

Residents said they don't want to be forced out of their homes by excessive rent.

"I really like it here," said resident Michele Tucci. "But I'm not going to be able to afford to stay here."

RHP, based in Michigan, acquired Silver Stream from a previous owner late in 2017.

Skoufis said that under the Housing Stability and Tenant Protection Act passed earlier this year, lot rent increases in mobile home parks are capped at 3 percent annually.

But residents say the increases they will pay next year are closer to 6 percent.

Yvonnne Maldonado, a resident who helped organize Thursday afternoon's protest, said she was paying $695 a month in lot rent when she moved to Silver Stream in August 2016.

Her rent is now $880, and it is slated to rise to $927 next year — a 5.34 percent increase.

"I'm afraid I might have to sell my home and move on," Maldonado said. "But would anyone buy it (under these circumstances)?"

Exceptions are allowed to the 3 percent cap in cases of substantial increases in property taxes or capital expenses.

In a statement released Thursday through a public relations firm, RHP President Joel Brown said the increases "are within the law."

Noting the exceptions allowed for taxes or capital expenses, Brown said in the statement, "Unfortunately the community has been impacted by these increased expenses."

But Skoufis said town and county property taxes for the park decreased in the past year, and school taxes only increased 1 percent.

Brown's statement did not specify what, if any, capital expenses would contribute to a rent increase above the cap, and Skoufis quoted from a letter sent to residents about the increase that also offered no justification for the size of the increase.

After the rally, about two dozen residents marched along Bivona Lane to the park's management and sales office near the park entrance on Route 207.

Maldonado, using a megaphone, called on someone inside to come out and address the group.

She even knocked on the door, but no one appeared.

mrandall@th-record.com



A bold voice for transportation workers

November 26, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Waters and Ranking Member McHenry:

On behalf of the Transportation Trades Department, AFL-CIO, I want to applaud the Committee on Financial Services for convening its hearing last week on the impact and role Private Equity has on front-line workers and our national economy.

As the Committee considers these issues and further examines concerns posed by Wall Street investors seeking short-term and unstainable profits at the expense of workers, customers and communities, I want to share the recent experiences of our unions who represent tens of thousands of workers in the freight rail industry.[1] As explained more fully in the attached policy statement adopted by TTD's Executive Committee, major segments of the freight rail industry have adopted a number of changes in the way they operate trains, interact with shippers and maintain their tracks and rolling stock. These changes are not based on what is best from a railroad business perspective, but instead are being dictated by, and will benefit, those that have a short-term financial interest in these companies.

[1] TTD consists of 33 affiliated unions that represent workers in all modes and areas of transportation. Attached is a list of our Rail Labor Division Unions.

Transportation Trades Department, AFL-CIO
815 16th Street NW / 4th Floor / Washington DC 20006
Tel: 202.628.9262 / Fax: 202.628.0391 / www.ttd.org
Larry I. Willis, President / Greg Regan, Secretary-Treasurer

Freight railroads are already generating record revenue and steady profits, and operating at high levels of efficiency. But for hedge fund managers, equity investors and others with a short-term interest in this sector, these operating returns are not enough. To satisfy their outsized needs, this investor class has forced railroads to adopt a strategy misnamed as "Precision Scheduled Railroading (PSR)." The hallmarks of this model should sound familiar—reduced headcount, hollowed-out operations, and degradation of service. In the freight rail industry this not only harms its workforce, it has a direct negative impact on safety. The result is more injuries and accidents in a sector where moving thousands of tons of hazardous, explosive, and radioactive material is all in a day's work.

Like most of the witnesses at your hearing, we are deeply concerned with the consequences of allowing investors to extract every bit of profit from an organization or industry before moving on to more profit-rich territory. We look forward to working with the Committee as it continues to focus on this problem and to craft legislation that will hold Wall Street accountable, protect front-line workers and allow responsible businesses to flourish.

Sincerely,

Larry Willis

Larry I. Willis
President

RLD MEMBER UNIONS

The following labor organizations are members of and represented by the Rail Labor Division of the Transportation Trades Dept, AFL-CIO

Brotherhood of Railroad Signalmen (BRS)

International Association of Machinists and Aerospace Workers (IAM)

International Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers and Helpers (IBB)

International Brotherhood of Electrical Workers (IBEW)

National Conference of Firemen and Oilers, SEIU (NCFO, SEIU)

Sheet Metal, Air, Rail and Transportation Workers (SMART)

SMART-Transportation Division

Transportation Communications Union /IAM (TCU)

Transport Workers Union of America (TWU)

UNITE HERE!



PRECISION SCHEDULED RAILROADING THREATENS TO GUT AMERICA'S FREIGHT RAIL SYSTEM

Since the first U.S. freight trains departed from Baltimore nearly 200 years ago, the freight rail industry has served as the backbone of domestic commerce, providing reliable, safe and responsive service and in the process creating and sustaining good union jobs. The success of the rail industry is premised on the fair treatment and utilization of its frontline workforce, balanced economic regulations and an expectation that railroads will meet their service obligations. Unfortunately, the introduction of an operating model known as Precision Scheduled Railroading (PSR) threatens to weaken these conditions and undermines our freight rail industry.

Freight railroads today are generating record revenues and operating at high levels of efficiency. But for some, these profits are not enough. To satisfy their outsized needs, short-term investors and hedge fund managers have forced PSR on large segments of the freight rail industry. This decision is not based on what is best for customers, workers, or even the long-term needs of the industry—it is about satisfying what Transportation and Infrastructure Committee Chairman Peter DeFazio described as the "Wall Street Jackals" who now dominate this sector.

Whereas carriers once sought to accommodate shippers' unique requirements and schedules, PSR dictates that rail cars operate on a set and often arbitrary schedule, arriving and departing at specific times regardless of the needs of its customers. PSR proponents claim that this improves train velocity—how quickly they can move trains from one location to another. However, we know the ultimate goal of PSR is to cut every possible corner and to slash every penny out of a capital-intensive industry that needs a long-term perspective to survive.

Mass layoffs have been a disturbing and central component of PSR operations. In just the first two years after CSX implemented this model, the carrier fired 22% of its equipment maintenance workers, 16% of its train crews and 11% of its maintenance-of-way employees. In a 2018 interview, Union Pacific's CEO proudly stated that, "We're in the process of eliminating about 500 jobs [and] there's more of that to come." Railroads may want us to believe these workers are extraneous, but it has become clear that reductions are simply about cutting costs, even if those cuts result in the degradation of safety. Workers who remain have been forced to do more with less, and are faced with discipline or dismissal if they refuse to comply. The consequences of these choices are no longer hypothetical.

As carriers that have prescribed to PSR run fewer trains, understaffed shop craft facilities are reporting increasingly idle locomotives and equipment, but lack the workforce to keep the equipment in a state of good repair. In some cases, carriers are closing facilities entirely, increasing the workload for employees elsewhere who are already overwhelmed.

Carriers are also compensating for reduced staffing by requiring remaining employees to perform work outside their craft in addition to fulfilling their regular duties. At best, this may involve employees performing tasks with which they are not experienced. At worst, employees may be forced to do work for which they are not qualified. Furthermore, rather than maintaining appropriate staffing levels, carriers are mandating overtime for workers who are already stretched thin. In an industry where fatigue is a constant risk factor, exposing employees to additional fatigue by asking them to work longer and faster while performing multiple jobs is a recipe for disaster.

When TCU and IAM conducted a survey of their members on the impacts of PSR, the answers painted a deeply disturbing picture of day-to-day operations. One responding machinist reported being sent, by himself, to work with dangerous and heavy equipment that once required two workers, and expressing fear that no one would know to call for help if he was injured. A carman wrote that at his yard, management now demands brake inspections be performed at the extraordinary and unsafe pace of just 60 seconds per car. Employees of both crafts say critical safety rules designed to protect employees from being hit by equipment are being ignored in the name of speed. Numerous employees stated that re-shift safety briefings—a common industry practice—are being eliminated in order to better utilize man-hours. And commonly, carmen are being forced to ignore FRA defects. One consistent theme emerged throughout the responses: railroads value getting trains moving and moving quickly above all else, including safety.

Rail carriers are also increasingly turning to longer and heavier "PSR-optimized" trains to increase efficiency. A recent GAO report found average train length has increased by approximately 25 percent since 2008, and carriers are regularly operating trains up to three miles long. Frontline workers told GAO they are not receiving adequate training on how to safely operate these longer trains. And current rail networks are simply not designed for trains of this magnitude, which risks delays to both freight and passenger service. Furthermore, local communities are not included in discussions about the use of longer trains in their jurisdictions that often block grade crossings and can make it difficult for emergency personnel to respond if an incident does occur. The FRA has failed to address the substantial safety challenges these operations present.

In fact, the FRA has done nothing at all to address PSR's effect on safety. Recently, on a private conference call to FRA employees, a senior staff member dismissed PSR issues as mere "hiccups." Yet, FRA's own data shows far more than just a hiccup. Derailments, fatalities, and collisions have all increased over the last several years. Accidents involving injuries to Class I carrier employees will increase across most railroads in 2019. The total number of employees injured at Kansas City Southern and Union Pacific have already surpassed these carriers' employee injury totals from 2018. The Class I carrier slated to do better in 2019 is BNSF. Not so coincidentally, BNSF is the only carrier who has not moved to PSR.

Between reports from frontline employees and the FRA's own data, it is clear that PSR puts rail workers and the public at real and unacceptable risk. The FRA must take aggressive action to address these concerns before conditions further erode. The agency should start by not ignoring safety violation reports filed by frontline workers that describe a culture on PSR carriers that is

not conducive to safe operations. More broadly, the FRA needs to conduct detailed analysis of modern rail operations—even when the letter of the law or regulation is not being explicitly violated—in order to prioritize safe operations.

We are also deeply concerned with the impacts of PSR on the future viability of freight rail and existing networks. At a recent hearing on the subject, witnesses discussed a Tennessee Pringles factory nearly driven out of business due to delays in shipments, a Kellogg plant that had to suspend production entirely, and federal intervention that was required to get grain moving to Florida farms. Even while providing substandard service, railroads are padding their pockets with fees they assess when shippers cannot comply with the carrier's demanding schedule. In 2018 alone, Class I's levied a record $1.2 billion in fines against shippers. The lack of compatibility between PSR and customers' needs has even led to questions of whether carriers who have adopted PSR are abiding by their common carrier obligations. While Wall Street may enjoy the fruits of this model now, it presents long and short-term risks of pushing away customers whose business models rely on freight rail service.

Impacts to shippers will have far-reaching economic effects. In 2017, freight rail networks moved approximately $174 billion worth of goods. Disrupting the flow of commerce by degrading service or cutting off rail shipping options entirely will have cascading effects throughout sectors that directly or indirectly rely on freight rail to move their goods.

Precision Scheduled Railroading works for the few—wealthy investors who have little concern for anything other than their bottom lines. These investors are fickle, and when they have extracted every last cent out of the railroad industry, they will move on to the next sector. Meanwhile, we will be left with a hollowed-out system that does not serve its customers, has abandoned safety, and has pushed out thousands of skilled workers who may never return. This trajectory can be changed, but doing so will require active engagement from Congress and federal safety and economic regulators, as well as a serious rethinking of operational strategy from freight rail carriers. TTD calls on them to reverse the damage caused by PSR before it becomes too late.

Policy Statement No. F19-03
Adopted October 29, 2019

Truthout

OP-ED | ECONOMY & LABOR

Let's Stop Wall Street Predators From Banking on Displacement



A protester holds a sign during a demonstration outside of the Wells Fargo headquarters on April 23, 2013, in San

Francisco, California.

JUSTIN SULLIVAN / GETTY IMAGES

BY

Paulina Gonzalez-Brito (https://truthout.org/authors/paulina-gonzalez-brito/) & Sharon Kinlaw (https://truthout.org/authors/sharon-kinlaw/), TRUTHOUT

PUBLISHED

November 8, 2019

Investigative reporter Aaron Glantz's new book, ***Homewreckers: How a Gang of Wall Street Kingpins, Hedge Fund Magnates, Crooked Banks, and Vulture Capitalists Suckered Millions Out of Their Homes and Demolished the American Dream*** **(https://www.harpercollins.com/9780062869531/homewreckers/)**, gets into some of Treasury Secretary Steven Mnuchin's legacy in Southern California, demonstrating how he struck it rich while ramping up foreclosures.

Glantz unveils Mnuchin and other Wall Street titans as modern robber barons. He introduces Trump associates, like Colony Capital, Inc. founder Tom Barrack, as a new

type of corporate landlord preying upon all of us.

Following the foreclosure crisis after the 2008 housing bust, Wall Street speculators bought up foreclosed properties, seeing an opportunity to make big profits off the suffering of others. Private equity firms like the Blackstone Group and Barrack's Colony Capital purchased tens of thousands of foreclosed properties that had been previously owned and lived in by families. What were once opportunities for people to own homes and build wealth, have become rental empires for the wealthy to squeeze profits from working families.

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The California Reinvestment Coalition has over 300 organizational members across the state and advocates for public and corporate policy change to advance economic justice and equity. We and other community

organizations played a central role in uncovering a troubling housing trend that is still with us: As corporations become your landlord, working families and households of color have been either priced out of the housing market or evicted.

There is a new financialization craze, and it has tipped the scales far in favor of Wall Street.

The volume of these investor purchases of property is unprecedented. Since 2012, large investment companies, mainly private equity firms, have raised and/or invested **$25 billion (http://calreinvest.org/wp-content/uploads/2018/08/REO-to-Rental-in-California-CRC-June-2015.pdf)** to purchase as many as 150,000 single-family homes throughout the United States.

From 2013 onwards, Wall Street has **issued (http://calreinvest.org/wp-content/uploads/2018/08/REO-to-Rental-in-California-CRC-June-2015.pdf)** more than $8 billion of securities tied to almost 60,000 homes owned by companies such as Blackstone, Colony and American Homes 4 Rent. These securities are similar to the Wall Street subprime securities that fueled the housing crisis.

Nine large Wall Street firms together are the absentee

landlords of more than 200,000 (https://d3n8a8pro7vhmx.cloudfront.net/acceinstitute/pages/100/attachments/original/1516206780/CorporateLandlordsFinalReport.pdf?1516206780) single family homes in 13 states. In Sacramento County, California, Invitation Homes is the single largest private landlord in the county, and the second-largest property owner after the county of Sacramento itself.

It is now more difficult than ever to buy a home as these corporate landlords swoop in, and it follows disturbing trends that disproportionately impact low-income communities and neighborhoods of color. We already know that the scales are tipped against people of color. Redlining is still alive and well, as Aaron Glantz reported in *Reveal* (*https://www.revealnews.org/article/for-people-of-color-banks-are-shutting-the-door-to-homeownership/*): Black applicants were denied home loans at significantly higher rates than whites in 48 cities, Latinos were denied at higher rates in 25 cities, Asians in nine cities and Native Americans in three.

Nine large Wall Street firms together are the absentee landlords of more than 200,000 single family homes in 13 states.

Home ownership remains a gateway for the middle class and working people to build wealth over time. To do that, we need to tip the scales back away from favoring corporations, and we need to do more than level the playing field going forward, we need to provide redress to, and tip the scales in favor of, working class Americans and communities of color that have long been unfairly denied access.

We need massive reinvestment into homeownership by the private and public sector, in the form of subsidy programs by banks, financial corporations and the federal government that allow families to buy their first home, as well as those that allow homeowners to re-enter homeownership after losing their homes in the financial crisis, as well as subsidy programs to make communities of color whole after generations of redlining and discrimination.

Lastly, we need to hold Wall Street companies and titans accountable for their actions and to pay their fair share. This includes speculation and vacancy taxes for homes

that remain in the hands of corporations, yet sit empty in our neighborhoods. And we need rent control for single family rental properties.

We know it's unrealistic to expect corrective action coming out of Trump's Washington. This administration has chosen to go in the other direction — proposing to make it even harder to prove discrimination in **housing and lending (https://www.chicagotribune.com/sns-tns-bc-housing-discrimination-20191029-story.html)**. As Glantz notes, President Trump's real estate cronies — from Steve Mnuchin to Secretary of Commerce Wilbur Ross to bank regulator Joseph Otting — occupy important positions in his administration, overseeing much of our economy that's tilted to benefit the wealthy few responsible for displacing our communities and throwing people out of their homes over the last 15 years.

And yet despite headwinds for positive change, tenant and affordable housing advocates are dogged in the fight to stem the tide of housing displacement. In one form or another, change is coming. Grassroots advocates are winning the right to stay in their homes. Last month in Sacramento, advocates **secured a cap on rental surges (https://www.latimes.com/california**

/story/2019-10-08/california-rent-cap-tenant-protections-signed) happening in California. We are successfully urging leading California financial institutions to sign (http://calreinvest.org/wp-content/uploads/2018/11/Anti-displacement-best-practices-5.21.19-Updated.pdf) a "code of conduct" agreement and adhere to best practices that don't displace residents and fuel neighborhood gentrification. Nationwide, our partners are mounting successful state and local campaigns to keep people in their communities.

This year our fair housing complaint against Mnuchin's former bank, OneWest/CIT led to a recent settlement (http://calreinvest.org/press-release/over-100-million-to-go-to-southern-california-communities-as-a-result-of-advocacy-groups-anti-redlining-complaint-against-bank-formerly-chaired-by-trump-official/) agreement which will enhance the number of home loans for households living in Southern California neighborhoods of color. In this settlement, OneWest/CIT Bank committed to provide $5 million in subsidies to eligible borrowers and $100 million in home lending to borrowers in majority people of color census tracts. Similarly, our members negotiated a $8 billion Community Benefits Agreement with OneWest/CIT

(http://calreinvest.org/wp-content/uploads/2019/11/Community-Benefits-Plan-20191030-Rev-4.0.pdf) that includes further commitments from the bank to open bank branches in communities of color and homeownership assistance programs for people of color.

Change may be slow, but possible.

California, like the rest of the country, is in the middle of an affordable housing crisis. These modern-day robber barons have tipped the scales in their favor at the expense of working families; it's time to tip them back. We must halt Wall Street predation on families struggling to keep a roof over their head.

The stakes have never been higher

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Paulina Gonzalez-Brito(https://truthout.org/authors/paulina-gonzalez-brito/)

Paulina Gonzalez-Brito is the **California Reinvestment Coalition (http://calreinvest.org/)**'s executive director.

Sharon Kinlaw (https://truthout.org/authors/sharon-kinlaw/)

Sharon Kinlaw is the **Fair Housing Council of the San Fernando Valley (https://www.ccrcca.org/resources/family-resource-directory/item/fair-housing-council-of-the-san-fernando-valley)**'s executive director and a **California Reinvestment Coalition (http://calreinvest.org/)** board member.

The Washington Post
Democracy Dies in Darkness

A billion-dollar empire made of mobile homes

By **Peter Whoriskey**

Feb. 14, 2019 at 1:10 p.m. EST

SMYRNA, Tenn. — It's not fancy. But in the exurbs of Nashville stands part of a billion-dollar real estate empire.

The Florence Commons community consists of about 300 mobile homes of varying vintages, mostly single-wide, many valued at less than $30,000 apiece, set 20 feet apart from one another. The occupants of some will tell you: The floors buckle. The ceilings crack. The doors don't shut right. Their homes are sinking.

"Okay — it's a trailer park, not a fancy gated community," said Jessica Boudreaux, 33, who lives there with her two daughters. "If people could, they'd live somewhere else."

Yet Florence Commons, along with more than 200 other mobile-home parks around the United States, has produced hefty returns for Stockbridge Capital, a $13 billion private-equity firm, and its major investors.

AD

Their company for mobile-home parks has produced tens of millions for investors in recent years and saw a return on investment of more than 30 percent between late 2016 and the end of 2017, according to documents.

Those ample returns arise in part from their willingness to boost the rents of residents of mobile homes. As one investor's report on the company put it: The "senior management team has a demonstrated track record of increasing home rental rates."

It has received $1.3 billion in financing through government-sponsored lender Fannie Mae, which says mobile homes are "inherently affordable." The money helped them buy existing mobile-home parks.

AD

As large financial firms buy more and more U.S. homes, both conventional and mobile, the question of whether such investments benefit tenants or merely exploit them is a matter of dispute.

"They prey on people who can't afford land, people who can't move," said David Barrett, 62, an excavation equipment operator who lives in Florence Commons. "They're taking advantage of — I wouldn't say poor people — but working people. Where do you think their profits come from?"

Yes Communities, the investors company that owns Florence Commons, says it is helping to meet the nation's need for affordable housing.

Much of the investors' revenue comes from residents who, while they often own their homes, must pay rent for the home lot. At Florence Commons, rent has risen by 4 percent or more a year, residents said. Most have little choice but to pay up because of a practical reason: They can't move. The dwellings are called "mobile," but they are costly to transport and sometimes owners are contractually forbidden to move them.

AD

The residents at Florence Commons must pay in other ways, too. Rent checks that are six days late incur a 10 percent fee and a threat of quick eviction. If residents fail to cut the grass, the park managers threaten them with fees of $100 or more, residents said. An aggressive towing service has forced some residents to pay $200 or more to recover their cars.

The median income for families that live in mobile homes is about $30,000 a year. Adult residents of mobile homes also have lower levels of formal education, according to surveys. About two-thirds of them lack education beyond high school.

"The owners just seem to want to get every dime from us," Boudreaux said.

AD

Officials with Stockbridge Capital, a firm led by Terry Fancher and Sol Raso, released a statement: "Stockbridge is proud of its association with YES Communities, which has met the affordable housing needs of its residents nationwide for the past 11 years."

Vanessa Jasinski, vice president of marketing for Yes Communities, said the rents at Florence Commons have risen at 4 percent a year on average over the past six years — slightly higher than the average lot rate in the area last year, according to figures from Datacomp, an industry analyst.

Jasinski also said the rules — and fees — for lawn and parking violations are intended to create pleasant surroundings. No park residents were required to pay for grass-cutting last year, she said. In the past five years, 46 home renters at Florence Commons have purchased homes in the community, she noted.

AD

As for the damage caused by mobile homes settling, she said "it is not uncommon for manufactured homes to settle and experience issues like these. This is true also of site-built homes."

'Chained to their booths'

Over the past three years, some of the biggest private-equity firms — the Carlyle Group, Apollo Global Management and TPG Capital — have taken stakes in mobile-home parks, according to a forthcoming report by the nonprofit groups Private Equity Stakeholder Project, MHAction and Americans for Financial Reform. The mobile-home parks owned by private-equity firms have more than 100,000 home sites, according to the report.

"The firms made these investments seeking to double or triple their money in the space of a few years," said Jim Baker, director of the Private Equity Stakeholder Project, an organization that has been critical of the private-equity industry. "That doesn't lead to affordable housing."

AD

He said residents of these mobile-home communities are reporting substantial rent increases, aggressive fees for small infractions and escalating evictions.

Critics of large investors' role in mobile-home parks point to the remarks of Frank Rolfe, an investor who has owned thousands of mobile-home lots. Referring to the steady stream of revenue, he said that a mobile-home park "is like a Waffle House where the customers are chained to their booths."

In fact, the money that investors can see from mobile-home parks is remarkably steady — and growing fast. Between 2004 and 2018, operating income from such parks rose 87 percent, according to Green Street Advisors, a global real estate research firm. The income never declined, even during the recession, the research firm said.

AD

In the case of Yes Communities, government help supports the investors' returns.

In August 2016, Fannie Mae, the government sponsored lender, said it was helping finance Yes Communities. It has helped, through two banks, to provide about $1.3 billion for Yes Communities. Those loans enable Yes Communities to buy up mobile-home parks.

The Yes Communities loan "will preserve affordable housing in communities across the nation," Fannie Mae said in a news release at the time.

"Providing investors with attractive returns helps YES to invest into new communities and markets and meet the affordable housing needs of both existing and new residents," Jasinski said.

AD

The terms of the loan to Yes Communities, however, do not limit the rent hikes that face residents. A Fannie Mae spokesman said rent limits are not in their purview.

"We believe the federal government should be preserving affordable housing, but as far as we can tell, that's not the case with these loans" said Elisabeth Voigt, co-director of MHAction, an organization of mobile-home residents. "If it were, there would be requirements to keep the rents affordable. These loans should be helping residents buy and run their own communities, not private-equity groups that earn huge profits."

'It's really gone downhill'

Stockbridge Capital, which is based in San Francisco and specializes in real estate investments, invested in the mobile-home park operator in 2008. In August 2016, it sold 71 percent of Yes Communities to a fund whose investors include the government of Singapore and a pension fund for public school employees in Pennsylvania. Stockbridge continues to manage the mobile-home park operator.

It is difficult to know how much private-equity firms are making, but the Pennsylvania pension fund does issue some figures. Between September 2016 and December 2017, the value of Stockbridge's $179 million investment rose more than 30 percent, according to the firm's public disclosures.

But while Yes Communities is producing ample returns for investors, some residents say the parks have suffered.

"It's really gone downhill," said Kris Wilkin, 47, a state corrections officer who bought a 2003 double-wide home in Florence Commons seven years ago.

One year, residents said, the community swimming pool didn't open for the summer. Residents also pointed to couches and other trash laying in the park.

Boudreaux, a medical assistant for a neurologist, agreed. She and her two daughters moved there in 2011.

Florence Commons, she said, was appealing to her because it welcomes people with imperfect credit. At the sales office, where salespeople encourage customers to buy homes in the park, they tell visitors that they can buy a home even if their credit records include a bankruptcy or home foreclosure. Credit scores need be no higher than 550.

"Yes! It Feels Good to be a Homeowner!" the company brochures say. "Contact our homeownership specialist today!"

Boudreaux had come from a mobile-home park in South Dakota that was family owned. There, she said, "if there was an issue, they'd fix it." She expected it would be the same at Florence Commons.

"They said they'd work with us," Boudreaux said.

She bought a double-wide home for $34,000.

But there are aspects of the park she likes. For one thing, it's conveniently located and there are enough kids in the neighborhood that she's rarely had to drive them to a play date.

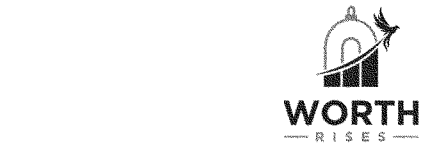
But the company, she says, doesn't respond to basic requests for maintenance: requests for better drainage, streetlights or potholes. The park managers seem unimpressed, she said, by her complaint that uneven settling of her lot has created a crack in her ceiling where the two sides of her double-wide home are separating.

Meanwhile, the rents are rising.

The loan payments for home, she said, have dropped. But over the past six years, her lot rent has risen from $338 to $437, or almost 30 percent.

"They're almost like slumlords," she said. "If you point something out, they're just like . . . whatever. They just want the rent."

Peter Whoriskey
Peter Whoriskey is a staff writer for The Washington Post whose investigative work focuses on American business and the economy. Previously, he worked at the Miami Herald, where he contributed to the paper's coverage of Hurricane Andrew, which was awarded a Pulitzer Prize for public service. Follow



Bianca Tylek
(973 650-4277
btylek@worthrises.org

168 Canal Street, 6th Fl
New York, NY 10013
www.worthrises.org
@worthrises

November 18, 2019

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Re: November 19, Hearing: America for Sale? An Examination of the Practices of Private Funds

Worth Rises thanks the Committee for calling a hearing to investigate the practices of private equity firms, and we appreciate the opportunity to comment on the matter. We also thank Senator Elizabeth Warren (D-MA) for introducing the Stop Wall Street Looting Act, a bill that if passed would force private equity firms into transparency about their financial information and hold them accountable for the debts of the corporations under their control.[1] Finally, we thank Sen. Warren, Representative Mark Pocan (D-WI), and Representative Alexandria Ocasio-Cortez (D-NY) for challenging private equity firms engaged in the prison industry in their October 1, 2019 letter.[2]

Worth Rises is a national, nonprofit, criminal justice advocacy organization committed to dismantling the prison industrial complex and ending the exploitation of those it touches. We write to share our concerns about the prominent and harmful role that private equity plays within the prison industry.

Across industries, private equity has drawn much criticism for the unscrupulous ways it maximizes returns. Within the prison industry, private equity firms have quietly but aggressively consolidated market players and used the resulting corporate nesting dolls to exploit disenfranchised communities with dangerously poor service quality and predatory pricing practices. Private equity-backed corporations have driven families into debt over the cost to

[1] https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-unveil-bold-legislation-to-fundamentally-reform-the-private-equity-industry
[2] https://www.warren.senate.gov/oversight/letters/warren-pocan-and-ocasio-cortez-investigate-private-equity-firms-profiteering-off-incarcerated-people-and-their-families

maintain contact,[3] killed patients under their care,[4] served maggot-contaminated food,[5] and generally stripped incarcerated people and their families of their dignity.

Just a handful of private equity firms own the majority of the largest prison service corporations with little oversight. We have highlighted these private equity firms, their holdings, and their problematic practices in the prison service industry below.

Platinum Equity
Aventiv Technologies (Securus Technologies, Jpay, AllPaid)

In 2017, Platinum Equity acquired Securus Technologies for $1.6 billion,[6] becoming the owner of one of the nation's two largest correctional telecom companies. Securus provides telecom services, including voice calling, video conferencing, voice biometrics, tablets, money transfers, debit release cards, and electronic monitoring, to prison, jails, and youth detentions centers. Securus owns roughly 40% of the more than $1.2 billion correctional telecom market; it's largest competitor Global Tel Link (GTL) owns another 40% and ICSolutions another 10%, both of which are owned by private equity.[7]

Securus extracts nearly $700 million[8] from the 1.2 million incarcerated people[9] and their loved ones forced to use its services through its exorbitant pricing. In various jurisdictions, Securus and its subsidiaries charge: $25 for a 15-minute phone call, $4 for a 5 second voicemail, $46 for a music album, $7 for a $20 money transfer, and $10 to close a debit card. They often share the profits from these sales with their government partners through legalized corporate kickbacks. Securus has also been sued for surveilling privileged calls and unlawfully turning over recordings to law enforcement and prosecutors,[10] fined for lying to the Federal Communications Committee (FCC) regarding its transfer of control to Platinum Equity,[11] and condemned for using voice biometric technology on both incarcerated people and their loved ones to create voice databases.[12]

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[3] https://ellabakercenter.org/sites/default/files/downloads/who-pays.pdf
[4] https://www.huffpost.com/entry/correct-care-solutions-detention-center-lawsuits_n_5bd755fce4b07427610a0ccf
[5] https://www.freep.com/story/news/local/michigan/2017/11/06/maggots-food-cotton-prison-jackson-michigan-trinity-services/825834001/
[6] https://www.latimes.com/business/story/2019-09-05/la-fi-tom-gores-securus-prison-phone-mass-incarceration
[7] Market share is based on a proprietary analysis of current prison and jail telecom contracts conducted by Worth Rises with the help, in part, of 2015-2018 data collected by the Prison Policy Initiative, Human Rights Defense Center, and Vera Institute. Please note, that we believe the industry has grown and diversified since Bloomberg Businessweek reported an industry size of $1.2 billion in 2012, but no more current estimate exists; https://www.prisonpolicy.org/graphs/phone_fees_national.html.
[8] https://www.prisonpolicy.org/phones/financials/2018/Securus_Preliminary_Consolidated_Balance_Sheet_2018.pdf
[9] https://securustech.net/about-us/
[10] https://theintercept.com/2016/03/16/securus-settles-lawsuit-alleging-improper-recording-of-privileged-inmate-calls/
[11] https://docs.fcc.gov/public/attachments/FCC-17-140A1.pdf
[12] https://theintercept.com/2019/01/30/prison-voice-prints-databases-securus/

Rather than address the grave concerns presented by Securus' existing business practices, upon acquiring the corporation, Platinum Equity instead immediately sought to grow Securus' reach and make it an even more prominent player in the market. Within just the first month of its ownership of Securus, Platinum Equity acquired Government Payment Services and Jobview and rolled them into Securus. A few months later, in May 2018, Platinum Equity made its most aggressive move in petitioning the FCC to acquire ICSolutions (owned by HIG Capital),[13] an acquisition that would grow its share of the correctional telecom market to 50%.

In July 2018, Worth Rises urged the FCC to oppose the merger which would only further consolidate and empower the effective duopoly in the correctional telecom industry.[14] In response to our submissions and those of our allies, the FCC demanded documents from Securus and ICSolutions.[15] After reviewing roughly one million documents, in April 2019, the FCC ruled against Securus and ICSolutions and their private-equity owners, concluding that the merge was against the public interest as explained by Worth Rises and other advocates.[16] Platinum Equity and Securus were forced to abandon the deal, and we are glad they did because it saved families from their predatory reach.

Worth Rises has also been challenging pension boards to stop investing in Platinum Equity and other private equity firms invested in the prison industry. Due to our success at the FCC and outreach to its largest investors, Platinum Equity agreed to conversation. In March 2019, we issued Platinum Equity a set of demands and by September,[17] Platinum Equity had not met a single demand. Consequently, backed by ample media accounts,[18] that month, we moved the Pennsylvania State Employee Retirement Systems to unanimously decline a $150 million proposed investment in Platinum Equity.[19]

Trying to get out from under bad press, Platinum Equity recently restructured Securus by creating a new holding company under a new name: Aventiv Technologies.[20] But we are not fooled, nothing has changed about the predatory practices of the corporation. We continue to discuss our demands with executives at the firm, but we have still not seen any changes in their practices that we have not relentlessly forced.

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[13] https://www.prisonlegalnews.org/media/publications/NY_petition_for_approval_to_transfer_control_of_Inmate_Calling_Solutions_LLC_dba_ICSolutions_to_Securus_Technologies_Inc._2018.pdf

[14] https://ecfsapi.fcc.gov/file/10717225630127/2018.07.16%20-%20Corrections%20Accountability%20Project%2018-193%20Comment%20.pdf

[15] https://ecfsapi.fcc.gov/file/0911205749656/DA-18-939A1.pdf

[16] https://www.fcc.gov/document/chairman-pai-statement-withdrawal-inmate-calling-merger

[17] See attached, along with report card against what changes Platinum Equity claims Securus has made.

[18] https://www.latimes.com/business/story/2019-09-05/la-fi-hom-gores-securus-prison-phone-mass-incarceration

[19] https://www.inquirer.com/business/phillydeals/psers-sers-pension-investment-prison-securus-fillman-20191001.html

[20] https://www.prnewswire.com/news-releases/securus-technologies-realigns-business-units-diversifies-product-offerings-under-new-corporate-parent-aventiv-technologies-300936504.html

Tom Gores, Chief Executive Officer at Platinum Equity, has agreed to meet with Worth Rises and families directly impacted by Securus' predatory practices. While we would like to believe Mr. Gores' concern for the harm Securus causes is sincere, we cannot ignore that his brother's firm, The Gores Group, which he helped found, owned its largest competitor, GTL, from 2004[21] to 2009 when they sold the company to Goldman Sachs and Veritas.[22]

H.I.G. Capital

Wellpath (formerly Correct Care Solutions and Correctional Medical Group Companies)
TKC Holdings (Trinity Service Group, Keefe Group, Access Corrections, and ICSolutions)

H.I.G. Capital is one of the most notoriously awful private equity firms engaged in the prison industry. The firm has played a role in the formation or growth of many of the major corporations in this space. In 2004, H.I.G. merged T-Netix and Evercom to create Securus,[23] one the largest correctional telecom corporations that traded hands between private equity firms multiple times between landing most recently with Platinum Equity.

In 2012, H.I.G. acquired Trinity Services Group,[24] a correctional food service provider, that it folded under TKC Holdings in 2016 when it acquired Keefe Group,[25] a leading commissary corporation that also owns Inmate Calling Solutions, the last major player in the correctional telecom market. Interestingly, H.I.G. fails to list TKC, Trinity Services, or Keefe on its list of portfolio companies.

Trinity Services has been fined millions of dollars for serving food tainted with mold, dirt, and maggots to incarcerated people who have little other options to turn to inside.[26] But sadly Trinity Services' failures in the mess hall can often benefit H.I.G. by driving incarcerated people to commissary, where its other portfolio company, Keefe, dominates the market.[27] Keefe charges egregious prices for low-quality products, and when it operates the commissary store outright, Keefe often pays its government partners corporate kickbacks.

In 2013, H.I.G. acquired California Forensic Medical Group (CFMC)[28] and began its foray into correctional healthcare. Over the next few years, it acquired a series of smaller correctional healthcare companies and rolled them under a new holding company: Correctional Medical Group Companies (CMGC). In 2019, H.I.G. acquired Correct Care

[21] https://www.gores.com/profiles/globaHellink/
[22] https://nypost.com/2011/08/19/prison-phone-profit/
[23] https://higcapital.com/news/release/31
[24] https://www.pehub.com/2012/04/hi-g-capital-seals-trinity-deal/
[25] https://www.ftc.gov/enforcement/premerger-notification-program/early-termination-notices/20161194
[26] https://www.michiganradio.org/post/maggots-meals-state-responds-latest-prison-food-service-issues
[27] https://www.thenation.com/article/prison-privatization-private-equity-hig/
[28] https://higcapital.com/news/release/621

Solutions and merged it with CMGC to form Wellpath, the largest correctional healthcare corporation with an estimated $1.5 billion in annual revenues.[29]

Wellpath and its corporate predecessors have been sued nearly 1,400 times for providing inadequate healthcare and wrongful death.[30] Under the care of Wellpath medical professionals or lack thereof, patients have died of pneumonia in pools of their own blood and vomit,[31] suffered 17 consecutive and untreated seizures,[32] and given birth alone in a cell.[33] People have suffered unimaginable harm at the hands of Wellpath and its private equity backers: H.I.G., its executives must be held accountable.

American Securities
Global Tel Link (Telmate, TouchPay)

GTL was acquired in 2011 by American Securities for $1 billion from Goldman Sachs and Veritas, which bought the business for $345 million in 2009. GTL is one of the largest correctional telecom corporations, splitting 80% of the market with Securus, discussed above.[34] In 2016, the last year for which we have publicly available data, GTL reported annual revenues of $536 million.

GTL engages in many of the same abuses as Securus, including exorbitant call rates. It preys on the relationships between incarcerated people and their families and inculpates government agencies in its predatory schemes. GTL charges as much as up to $17 for a 15-minute phone call.[35] And not only has GTL similarly paid government partners corporate kickbacks for the ability to do so, but it has also in some cases outright bribed correctional officials for contracts. In Mississippi, GTL recently paid $2.5 million to settle a lawsuit alleging that the corporation bribed the Mississippi Department of Corrections Commissioner to retain its contract with his agency.[36] Last year, GTL also paid $8.8 million to settle a lawsuit that alleged it violated the federal Telephone Consumer Protection Act by making robocalls to request billing information to enable calls from a correctional facility previously failed.[37]

GTL and its private equity owner, H.I.G., treat these fines and settlements as part of the price of doing business. They do not respect regulations or the law in the regular course of their operation.

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[29] https://higcapital.com/news/release/1128
[30] https://www.adn.com/alaska-news/anchorage/2019/02/17/private-company-hired-to-run-api-has-a-mixed-record/
[31] https://www.cnn.com/interactive/2019/06/us/jail-health-care-ccs-invs/
[32] https://www.woodtv.com/news/target-8/jail-death-when-a-nurse-is-not-a-nurse/
[33] https://www.sun-sentinel.com/local/broward/fl-ne-broward-pregnant-inmate-ignored-controversy-20190604-ohshqjtww5ee3charq6tr34iv4-story.html
[34] See Footnote 5.
[35] https://www.prisonpolicy.org/phones/appendix_table_2.html
[36] https://www.clarionledger.com/story/news/2017/08/15/epps-lawsuit-settled-2-5-m/568119001/
[37] https://www.gtltcpasettlement.com/

Endeavour Capital
Triton Holding (Seaview Insurance Company, Aladdin Bail Bonds)

Endeavour Capital acquired Seaview Insurance Company[38] and Two Jinn (DBA Aladdin Bail Bonds)[39] in 2012 and merged them under Triton Holdings[40] to obfuscate their visibility in the firm's portfolio. Seaview is the surety behind Aladdin Bail Bonds, one the largest bail bond agencies on the west coast. Bail bond agencies force economic disenfranchisement families to pay outsized fees and agree to unwieldly conditions to free their loved ones from jail. Their services often saddle families with debt that carries well-beyond court proceedings have finished.

With the support of Endeavour, Triton has routinely thrown capital around to stop substantive, non-carceral reforms to the criminal legal system, particularly bail reforms, which would reduce the need for or entirely eliminate the bail bonds industry. In Oregon, between 2009 and 2015, Triton and Two Jinn spent $420,000 lobbying to re-establish the long abolished for-profit bail system.[41] In 2018, Triton spent $800,000 to repeal new legislation in California that would eliminate the bail bonds industry.[42] Endeavour and its portfolio companies are essentially lobbying to send people to jail so that they can turn a profit getting them out.

Apax Partners
Attenti

In 2017, Apax Partners purchased Attenti, one of the nation's largest electronic monitoring corporations, for $200 million. Apax attempts to differentiate itself from the other private equity firms that own prison service companies by claiming that Attenti's electronic monitoring is an alternative to incarceration, but this distinction is woefully dubious.[43] Electronic monitoring is often not an alternative to incarceration but rather additive condition of community supervision that creates more opportunity to violate people and send them to jail or prison.[44] Not to mention it also has a net widening impact on our criminal legal system.

Moreover, faulty wiring in Attenti's electronic monitoring shackles has led to nearly 3,000 faulty warrants to violate people on supervision who in fact had committed no violation. But importantly, whether an alternative or not, Attenti charges exorbitant fees to people forced to use its electronic monitors or their families, often as much as $500 per month for supervision and nearly $1,000 if the tracker is lost or stolen.[45] And like others corporations in the prison

[38] http://www.insurance.ca.gov/0250-insurers/0300-insurers/0400-reports-examination/upload/SeaviewInsCo12.pdf
[39] https://www.sheppardmullin.com/assets/htmldocuments/2012%20Corporate%20Transactions%202-13.pdf
[40] https://endeavourcapital.com/ec/the-aladdin-group/
[41] https://pestakeholder.org/wp-content/uploads/2018/08/2018.07.31.-ACLU-follow-up-letter-to-Endeavour-re-Aladdin-Bail-Bonds.pdf
[42] https://www.latimes.com/business/la-fi-california-cash-bail-20181029-story.html?
[43] https://pitchbook.com/newsletter/apax-pushes-back-on-elizabeth-warren-prison-letter-IIG
[44] https://mediajustice.org/nomoreshackles-reports/
[45] https://pestakeholder.org/wp-content/uploads/2019/10/Continuing-Incarceration-Apax-Partners-PESP-100319.pdf

industry, Apax's Attenti has lobbied in Florida, Michigan, and Mississippi for legislation, regulation, and policies that increase the use of electronic monitoring and the number of people in our society under this invasive form of supervision,[46] hardly supporting the argument that they are supporting criminal justice reform.

We provide this information to clearly illustrate how pervasive private equity is in the prison industry and the remarkable harm these firms have caused to disproportionately poor and black and brown communities. Advocates and Congressional members alike have made significant strides to raise public awareness around the influence that private equity holds within the prison industrial complex.
This year, we have seen an uptick in interest from media outlets starting to cover the role of private equity in the prison industry. Below is just a selection of articles published on the topic in the last six months.

- "How the Fight for 'Prison Phone Justice' Scored a Major Victory," Bianca Tylek, *The Crime Report* (April 23, 2019), https://thecrimereport.org/2019/04/23/how-the-fight-for-prison-phone-justice-scored-a-major-victory/.
- "How Private Equity is Turning Public Prisons into Big Profits," Tim Requarth, *The Nation* (April 30, 2019), https://www.thenation.com/article/prison-privatization-private-equity-hig/.
- "'Please help me before its too late'," Blake Ellis & Melanie Hicken, CNN (June 2019), https://www.cnn.com/interactive/2019/06/us/jail-health-care-ccs-invs/.
- "NYC Pensions to Expand Prison Investment Ban with Platinum Equity," Davide Scigliuzzo, *Bloomberg* (June 18, 2019), https://www.bloomberg.com/news/articles/2019-06-18/nyc-pensions-to-expand-prison-investment-ban-with-platinum.
- "Opinion: PSERS Latest Investments Don't Align with What Union Members Want," Nicole Hunt, *The Philadelphia Inquirer*, (August 14, 2019), https://www.inquirer.com/opinion/commentary/psers-pension-retirement-platinum-equity-securus-prison-phone-20190814.html.
- "Troubled Companies Made Him Billions. A Prison Phone Investment Made Him Enemies," Laurence Darmiento, *Los Angeles Times* (September 5, 2019), https://www.latimes.com/business/story/2019-09-05/la-fi-tom-gores-securus-prison-phone-mass-incarceration.
- "The Private Option: Private Equity's Grip on Jail Health Care," Marsha McLeod, *The Atlantic* (September 12, 2019), https://www.theatlantic.com/politics/archive/2019/09/private-equitys-grip-on-jail-health-care/597871/.

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[46] https://pestakeholder.org/wp-content/uploads/2019/10/Continuing-Incarceration-Apax-Partners-PESP-100319.pdf

- "Pennsylvania Pension Passes on Platinum Equity Investment Amid Prison-Phone Controversy," Chris Cumming, *Wall Street Journal* (September 24, 2019), https://www.wsj.com/articles/pennsylvania-pension-passes-on-platinum-equity-investment-amid-prison-phone-controversy-11569361404.
- "PA's Millions: Pensions Split on Private-Prison Protest," Joseph N. DiStefano, *The Philadelphia Inquirer* (October 1, 2019), https://www.inquirer.com/business/phillydeals/psers-sers-pension-investment-prison-securus-fillman-20191001.html.
- "Platinum Equity Reorganizes Prison-Phone Company Targeted by Elizabeth Warren," Chris Cumming, *Wall Street Journal* (October 10, 2019), https://www.wsj.com/articles/platinum-equity-reorganizes-prison-phone-company-targeted-by-elizabeth-warren-11570745317.
- "Prison Industry Deal Drags L.A. Billionaire into Elizabeth Warren's Campaign," Laurence Darmiento, *Los Angeles Times* (October 11, 2019), https://www.latimes.com/business/story/2019-10-11/tom-gores-elizabeth-warren-securus-technologies.

Given the expansive influence that private equity has in the prison industrial complex, we ask that the Committee dedicate time in the questioning of Mr. Drew Maloney, who will represent the private equity industry, to discuss the role of private equity in the prison industry during the hearing. We ask the you ask him to reckon with private equity's harmful impact on the 2.2 million people who are incarcerated and their families and ask him to commit to push his members to exit the industry and stop contributing to our nation's carceral crisis.

Thank you for your attention and consideration ahead of the Committee hearing. We welcome the opportunity to share more of our expertise in this field with the Committee and any of its members. We are committed to exposing and dismantling the ways that the private equity industry exploits incarcerated people and their loved ones and restoring equity and dignity to those most affected.

Sincerely,

Bianca Tylek
Executive Director



Bianca Tylek
(973 650-4277
btylek@worthrises.org

168 Canal Street, 6th Fl
New York, NY 10013
www.worthrises.org
@worthrises

March 19, 2019

Platinum Equity
360 North Crescent Drive
Los Angeles, CA 90210

Dear Mr. Mark Barnhill,

We have shared our grave concerns about Platinum Equity's ownership of Securus Technologies (hereafter "Securus"). Following up on our conversations that included the American Federation of Teachers, Color of Change, the Action Center on Race and the Economy, and the Private Equity Stakeholder, we mandate that, with regard to its investment in Securus, Platinum Equity contractually commit to its investors to:

- Not investing in any other correctional assets in any future funds
- Meeting the Operational Reforms outlined below with regards to Securus
- Exiting the Securus investment by year end 2020

Operational Reforms

- As it relates to telephone services:
  - Provide free phone calls to juveniles for all agency clients
  - Create one flat rate across all call types (e.g. local, intrastate, long distance) as done contractually for many agency clients
  - Offer every agency client an agency-paid option with a fixed rate contract for unlimited calls
  - Move to a standardized per minute rate structure for all calls that eliminates upcharges for the first minute of call
  - Cap the price of 15-minute phone call at $0.75, including transaction costs, for all billing methods
  - Allow account customers to deposit as much as $300 in a single transaction and cap deposit fee at 3%
- As it relates to video calling services:
  - Rebrand this service as video calling (rather than video visitation), which has inappropriately sought to synonymize video calls with visits
  - Work with agency clients that removed in-person visits as required by contract or suggested in negotiations to return in-person visits
  - Move to a standardized per minute rate structure as is employed with telephone calls instead of a flat rate for a specified period
  - Provide all incarcerated people in the custody of agency clients with video calling services with at least one free internet video call per week

  - Offer every agency client an agency-paid option with a fixed rate contract for unlimited video calls
  - Cap the price of a 30-minute video call at $5.00, including transaction costs, for all billing methods
- As it relates to services provided by Securus' subsidiary JPay:
  - *Money Transfers.* Change cost structure to a simple percentage fee no higher than 3% of deposit amount from the tiered structure that over taxes smaller deposits
  - *Email.* Make email services resemble email services outside correctional facilities to the extent possible (e.g. remove the max word count, allow attachments without the need for additional stamps, etc.) and cap the cost of a stamp at $0.15
  - *Tablet Content.* Ensure that there are free options for all content (e.g. e-books, music, games, etc.) in every contractual agreement with an agency client and that pricing is commensurate with correctional wages
  - *Parole/Probation Processing Fees.* Cap the additive fees associated with paying a parole or probation supervision fee to an agency client to 3%
  - *Debit Release Cards.* Eliminate all fees aside from currency conversion fees for international purchases and a max $2.00 monthly service charge after the first month
- As it relates to other services provided by Securus or any of its subsidiaries:
  - *Voicemail.* Cap the price of a voicemail at $0.50
  - *Voice Biometrics.* Contractually commit to never selling voice print data to law enforcement agencies, protecting against the release of voice print data to prosecutors, erasing the voice print data of anyone who has been released from incarceration, and never using voice biometrics to monitor people who are not incarcerated in any way
  - *Electronic Monitoring.* Encourage agency clients to assume cost of electronic monitoring and, where bore by the person wearing the electronic monitor, cap the cost of such surveillance to $5.00 per month
- As it relates to any other practices of Securus and the related practices of Platinum Equity:
  - Commit to never challenging legislation that regulates the cost of or operational practices associated with Securus' services or products through litigation or lobbying
  - Commit to not using the fulfillment of any of the above demands until all have been met in marketing or fundraising or with media

We may share this mandate with your existing and potential investors and encourage them to contractually obligate Platinum Equity to these commitments.

While we believe that making these reforms to the cost and service model employed by Securus would be transformative in the lives of those its services and products touch, we reiterate our disapproval of its business and any business that preys on vulnerable communities for its revenue. Accordingly, we continue to implore Platinum Equity to plan for a swift exit from its investment in Securus.

Regards,

Bianca Tylek
Executive Director

WORTH

Platinum Equity's Report Card (as of August 11, 2019)

Platinum Equity's Claim	The Truth
1. Overhauled the management team	Platinum Equity removed existing management staff just to promote existing junior staff. This newly promoted staff was responsible for lobbying against bills that would make phone calls more accessible in Connecticut.
2. Lowering rates to customers with increase rate transparency	Securus has never voluntarily reduced rates. Securus's rates have only fallen because advocates have successfully fought for more affordable phone calls. These reductions should not be attributed to Platinum Equity. Platinum Equity is also looking for credit for telling call recipients the price of a call before asking whether they would like to accept the call. However, transparency of predatory rates is hardly relevant when families have no other options to be in communication with their incarcerated loved ones and must accept such rates.
3. Provided over 785,000 free phone calls last year	Again, Securus has never voluntarily offered free phone calls to any population. There are many agencies that require free phone calls for certain populations, particularly for the first call when someone is arrested. This figure amounts to 40 seconds per person per year in a facility served by Securus.
4. Supporting the co-existence of both in-person visitation and video conferencing	Securus is responsible for the elimination of in-person visits in hundreds of facilities across the country. When Securus introduced video calls, it contractually required facilities to eliminate in-person visits. While the company has since stopped these predatory practices, the harm has been done. It's much easier to eliminate in-person visits than it is to return them. Securus has done nothing of support facilities through the reintroduction of in-person visits.
5. Required 0% site commission option	Securus, and Platinum Equity, typically blame agency customers for their high call rates due to commissions. Not only would their rates be high without commissions, but they also *created* the commission model that they are looking to scapegoat. Without the commission model, prison telecom would've never become its own industry. These companies should receive no credit for offering the least predatory product version.

6. First conversion of a major corrections facility to a fully tax-payer funded model	Neither Securus nor Platinum Equity are responsible for free communications out of New York City jails. More than a dozen advocacy organizations fought hard and long with the City Council to pass legislation that would make phone calls free. Securus had a very clear option: renegotiate the contract or see your contract terminated. There were limited alternatives.
7. Created the Securus Foundation to reduce recidivism	The Securus Foundation reappropriates funds from the most impoverished communities for charitable giving, and then wants credit. The impoverished communities that must pay for the communities are expected to be gracious because Securus uses their own money to reinvest in them. It's perverse.
8. Substantially increase investments in privacy and cybersecurity	Over the years, Securus has been routinely exposed for (1) breaches of recorded calls and (2) recording and handing over privileged calls (i.e. attorney calls). These are strict violations for which protections should have always existed.

JOSH GOTTHEIMER
5TH DISTRICT, NEW JERSEY

WASHINGTON OFFICE:
213 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-4465
FAX: (202) 225-9048

HTTP://GOTTHEIMER.HOUSE.GOV
TWITTER: @REPJOSHG
FACEBOOK: FACEBOOK.COM/REPJOSHG

Congress of the United States
House of Representatives
Washington, DC 20515–3005

COMMITTEE
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PROBLEM SOLVERS CAUCUS
CO-CHAIRMAN

November 14, 2019

Mr. Kenneth R. Feinberg
Feinberg Law Offices
1455 Pennsylvania Avenue, NW
Suite 390
Washington, D.C. 20004

Dear Mr. Feinberg:

I am writing today in regards to the $20 million TRU Financial Assistance Fund. The bankruptcy and subsequent liquidation of Toys "R" Us (TRU) deeply affected my constituents and my state, and I joined with other leaders in New Jersey in supporting severance pay for TRU workers. Your expertise on managing compensation funds, including the September 11th Victim Compensation Fund and this one, has provided needed financial relief to thousands of Americans.

In March 2005, a partnership between Bain Capital Partners LLC, Kohlberg Kravis Roberts (KKR), and Vornado Realty Trust reached an agreement with the TRU Board of Directors and announced a $6.6 billion leveraged buyout of the company.

While TRU grew for several years following the buyout, the company ultimately succumbed to e-commerce competition that has decimated much of the toy industry and filed for Chapter 11 bankruptcy in September 2017. They closed all of their American locations shortly thereafter, laying off thousands of workers. In November 2018, Bain Capital and KKR announced that they would each contribute $10 million to a fund for former employees. Their choice to do this was entirely voluntary, as it is not required under statutes governing the bankruptcy process.

As you may be aware, the U.S. House Committee on Financial Services, which I serve on, is planning on holding a hearing entitled "America for Sale? An Examination of the Practices of Private Funds" on Tuesday, November 19, 2019. A testifying witness includes a former TRU employee. To help inform my work on the Committee, I request additional information about the fund including:

- The process and cost of establishing the fund, including who developed the protocol and whether interested members of the public had an opportunity to participate;
- The methodology behind forming the payment protocol, including how former employees qualify for compensation and how much they receive;

GLEN ROCK
65 HARRISTOWN ROAD
SUITE 104
GLEN ROCK, NJ 07452
PHONE (201) 389-1100

HACKENSACK
65 CENTRAL AVENUE
HACKENSACK, NJ 07601
PHONE (201) 389-1100

NEWTON
93 SPRING STREET
SUITE 406
NEWTON, NJ 07860
PHONE (973) 940-1117

RINGWOOD
60 MARGARET KING AVENUE
RINGWOOD, NJ 07456
PHONE (201) 389-1100

VERNON
21 CHURCH STREET
VERNON, NJ 07462
PHONE (201) 389-1100

WASHINGTON BOROUGH
100 BELVEDERE AVENUE
WASHINGTON BOROUGH, NJ 07882
PHONE (201) 389-1100

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- The median payout to former employees;
- The current status of payments, the fund, and its effectiveness;
- What lessons we can learn from the fund's establishment and disbursements;
- Other corporations that may have established similar funds;
- And any other information about the fund that you think is relevant and the value of other companies taking similar steps in like situations.

Thank you for your prompt attention to this matter. I look forward to your response.

Sincerely,

Josh Gottheimer
MEMBER OF CONGRESS

THE LAW OFFICES OF
KENNETH R. FEINBERG PC

THE WILLARD OFFICE BUILDING
1455 PENNSYLVANIA AVENUE, N.W.
SUITE 390
WASHINGTON, D.C. 20004-1008

(202) 371-1110 (TELEPHONE)
(202) 962-9290 (FAX)

November 22, 2019

WRITER'S DIRECT DIAL NUMBER
202-962-9280
kfeinberg@feinberglawoffices.com

The Honorable Joshua S. Gottheimer
Congress of the United States
House of Representatives
US House Committee on Financial Services
213 Cannon House Office Building
Washington, DC 20515-3005

Dear Congressman Gottheimer:

We are in receipt of your letter of November 14, 2019 in connection with today's hearing conducted by the U.S. House Committee on Financial Services pertaining to "America for Sale? An Examination of the Practices of Private Funds." In your letter, you request information concerning the design, implementation and administration of the $20 million Financial Assistance Fund arising out of the bankruptcy and subsequent liquidation of Toys "R" Us (TRU). We were retained by both Bain Capital Partners LLC and Kohlberg Kravis Roberts (KKR) to perform these multiple tasks in the effort to distribute badly needed financial assistance to former employees of TRU.

As you mention in your letter, we have had great success in the past in designing and managing discrete compensation programs -- such as the September 11th Victim Compensation Fund, the Gulf Coast Claims Facility arising out of the BP rig explosion and oil spill in the Gulf of Mexico in 2010, OneFund Boston arising out of the Boston marathon bombings, and OneFund Orlando -- with the aim of compensating innocent citizens. We were also asked by the Department of the Treasury to determine compensation packages for those private corporate officials of major American corporations who received federal TARP financial assistance following the financial crisis of 2009 (12 U.S. Code § 5221 et seq.).

As you mention, in September 2017 TRU filed for bankruptcy laying off thousands of workers. In November 2018, both Bain and KKR voluntarily established a $20 million fund to compensate former employees of TRU. They retained us to design and manage this unique, unprecedented fund which, it is our understanding, was in no way required by governing federal bankruptcy statutes or any other law.

We immediately began our work. First, we met with representatives of Bain and KKR to determine the goals and objectives of this unique fund. Second, we enlisted the help of a small group of former TRU employees who, together with the Bain and KKR officials, helped us draft a compensation protocol detailing the criteria, compensation formula and other requirements for determining former TRU employee eligibility to participate in the fund, and the amount of compensation that would be made available to each such employee. Thereafter, we reached out to the TRU employee community itself through a series of telephone conference call town hall

meetings, explaining the Program and responding to former TRU employee questions and comments. Only after hearing from all interested parties, did we finalize the Protocol and begin processing individual claims and compensating eligible TRU employees. (A copy of the final Protocol is attached.)

The administrative costs associated with all aspects of finalizing the compensation protocol and distributing payments to eligible claimants were $2.6 million, paid entirely by Bain and KKR separate and apart from the $20 million fund.

The drafting process, and the outreach to all interested parties, resulted in a compensation formula that took into account a number of variables as noted in Attachment A to the Fund Protocol (attached). The range of individual payments made pursuant to the final Protocol ranged from $200.00 to $12,434.00. The median payout to former TRU employees eligible to participate in the fund was $489.00.

The $20 million fund became operational on December 12, 2018 and is currently in the process of a third and final distribution of the remaining balance in the Fund to those individuals already deemed eligible. See the attached Summary of Payments Made.

We deem the $20 million fund to have been a success. Although, as already indicated, not required by any federal or state law, the fund provided badly needed financial assistance to former TRU employees suddenly confronting an uncertain financial future following the bankruptcy filing of TRU. The fund was efficiently and effectively administered, with a minimum of bureaucracy. It is also, very important to note that 100% of the $20 million set aside by Bain and KKR was allocated to eligible former TRU employees; none of the $20 million was diverted to pay for administrative costs.

The establishment of similar funds, voluntarily created by private corporations in the United States, is a rare occurrence. BP voluntarily established a fund after the Deepwater Horizon oil rig explosion and oil leak in the Gulf of Mexico; GM voluntarily created a similar fund to deal with individual automobile accident claims allegedly caused by a defective GM ignition switch on certain GM models. But the number of similar funds are few and far between. And the TRU fund was unique in our experience in compensating terminated employees.

Finally, we believe that the TRU fund ought to be studied and considered not only by the Congress, but also private corporate America. It is a creative and viable option that might be considered in alleviating the financial pain and uncertainty of employees that suddenly confront a dark financial future. The TRU fund worked as intended. It was an efficient and effective mechanism to compensate innocent victims of financial trauma. We deem it a model of its kind.

We would be pleased to answer any questions that you and/or your Committee staff might pose. And we ask that this letter be made a permanent part of the Hearing Record.

Sincerely,

Kenneth R. Feinberg
Co-Administrator

Camille S. Biros
Co-Administrator

Enclosures

TRU FINANCIAL ASSISTANCE FUND

FINAL PROTOCOL

for

Participation in the TRU Financial Assistance Fund for Eligible Former Employees of Toys R Us

December 12, 2018

Please read this Protocol carefully and in its entirety.
You may be eligible for a payment from the TRU Financial Assistance Fund.
This Final Protocol contains important information regarding the above referenced fund.

I. PROTOCOL

This Final Protocol (the "Protocol") outlines the eligibility criteria and process requirements to determine whether certain individual former employees of Toys R Us (the "Company") can participate in the TRU Financial Assistance Fund (the "Trust") designed to allocate funds among these former employees ("Eligible Beneficiaries"). The purpose of this Protocol is to inform all Eligible Beneficiaries that they may be eligible to apply for a payment from the Trust as described below. The purpose of the Trust is to help alleviate some of the financial uncertainty following the liquidation of the Company's U.S. operations. This Protocol describes the steps individuals must take to receive a payment.

II. BACKGROUND

On September 18, 2017, the Company filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. In March 2018 all U.S. operations were liquidated resulting in the loss of most U.S. employees' jobs.

A $20 million Trust has been created and funded by Bain Capital Private Equity, LP ("Bain") and Kohlberg Kravis Roberts & Co. L.P. ("KKR") for the benefit of Eligible Beneficiaries, as more fully described in this Protocol. The Trust encourages additional contributions from entities and persons other than Bain and KKR.

The distribution of funds from the Trust is subject to certain eligibility requirements in order to maximize the effectiveness and impact of the Trust. Former employees do not have any automatic right to receive payments hereunder. Only certain eligible individuals who previously worked for the Company – as defined in this Protocol – may qualify to receive payments. Payments allocated pursuant to this Protocol do not require that Eligible Beneficiaries sign a waiver or release or surrender any rights they may have in connection with the Company's bankruptcy.

A. Administrators

Independent program administrators Kenneth R. Feinberg and Camille S. Biros (together, the "Independent Program Administrators") have been engaged to develop, design and administer an allocation methodology and process for the submission and review of applications for payments and the distribution of those payments from the Trust to Eligible Beneficiaries. This Protocol creates a Financial Assistance Fund under which the Independent Program Administrators will process, evaluate and determine amounts to be paid to Eligible Beneficiaries and will distribute funds in accordance with the eligibility requirements of this Protocol. Bain and KKR will not be involved in this process.

B. Approach

- The Program is administered by the Independent Program Administrators, who are responsible for all decisions relating to the administration, processing, and evaluation of Forms (described below) submitted pursuant to the Program.

- The Independent Program Administrators are authorized to process and distribute funds, based upon the formula described below, only to Eligible Beneficiaries as defined in this Protocol. No claims for economic injury or other allegations of damage or hardship are subject to this Protocol. Participation in the Program is completely voluntary and does not affect any independent rights that an individual may possess.

III. ELIGIBLE BENEFICIARIES and ELIGIBILITY REQUIREMENTS

Eligible Beneficiaries under this Protocol are limited to former employees of the Company who meet the following criteria (determined using available information):

1) Individuals must have been employed by the Company for a minimum of one year on or after September 18, 2017, the date of the Company filed for Bankruptcy under Chapter 11.

2) Individuals must have been employees in one of the following departmental categories:
   a. Global Resource Center Employees
   b. Stores and Regional Office Employees
   c. District Center Management and Full-time Hourly Employees

Employees with less than one year of service with the Company and seasonal workers are not eligible for a payment under the terms of this Protocol. Individuals with annual income over $110,000 or below $5,000 per year are also not eligible for payment from the Trust. See Attachment A for details and the Eligible Beneficiaries Payment Matrix.

IV. METHODOLOGIES FOR CALCULATING PAYMENTS

The Trust funding will be distributed in its entirety to Eligible Beneficiaries pursuant to this Protocol. No portion of the Trust will be used to pay overhead costs or other administrative fees pursuant to this Protocol. To determine the amount to be paid to each Eligible Beneficiary, the Administrators will use the following calculation methodology:

Each Eligible Beneficiary will receive an allocated amount based upon a simple methodology developed using the Company data and information: (See Attachment A to this Protocol.)

- Available Company data including
  - historic income for each individual,
  - regular hours worked,
  - tenure using hire/termination dates
- TRU termination/severance policies
- Input from Beneficiary Representatives

Titles and other individual job characteristics will not be considered in this calculation. If additional amounts are contributed to the Trust pursuant to Section II above, these amounts will be distributed using the same methodology governing this Protocol.

V. PROCESS AND PARTICIPATION REQUIREMENTS

Participation in the Trust is completely voluntary and limited to Eligible Beneficiaries as defined in this Protocol.

Eligible Beneficiaries will receive an Allocation/Acceptance Form (the "Form"). The Form will contain:

1) A unique Identifying number assigned to each Eligible Beneficiary,

2) The Eligible Beneficiary's Name and Address, and

3) The amount of the offered payment based on the formula applied.

Each Eligible Beneficiary must complete the information required on the Form, sign the Form, have their signature notarized and return it to the Independent Program Administrators with the required supporting documentation.

If an Eligible Beneficiary is deceased, incapacitated or otherwise unable to complete the process, the Legal Representative of the Eligible Beneficiary will be responsible for submitting the necessary documentation. A Legal Representative must supply proof of representative capacity – such as a Retainer Agreement signed by the Eligible Beneficiary and the Legal Representative, a power of attorney, guardianship (appointed as guardian or attorney ad litem, custodial parent) or the equivalent – as is required to establish authority to act in a representative capacity under the law of the resident state of the decedent, minor or incompetent or legally incapacitated Eligible Beneficiary.

All determinations of the Independent Program Administrators made in accordance with the provisions of this Protocol are final and not subject to appeal. These decisions have been made based upon data provided to the Administrators by the Company.

Participation in this Program is completely voluntary and does not affect any independent rights that an individual may possess.

VI. FILING FOR PAYMENT

A. Process and Procedures

Each Eligible Beneficiary will receive a "Trust Packet" which will include a copy of this Protocol, the Eligible Beneficiary's Allocation/Acceptance Form and a series of Frequently Asked Questions.

Eligible Beneficiaries must complete the Allocation/Acceptance Form and return it to the Independent Program Administrators in order to participate in this program. Upon receipt and review of the Allocation/Acceptance Form, the Independent Program Administrators will authorize payment of the allocated amount. Forms submitted to the Independent Program Administrators without the Unique

Identifier or with an unmatched Unique Identifier or without the required supporting documentation will not be processed and will be notified that the submission is deficient.

Completed Allocation/Acceptance Forms and supporting documentation may be submitted to the Independent Program Administrators either electronically by registering on the Trust website address at www.TRUFinancialAssistanceFund.com or via US mail to the following address:

TRU Financial Assistance Fund
P.O. Box 65800
Washington, DC 20035

The signed and completed Allocation/Acceptance Form must be received by the Independent Program Administrators with a postmark on or before **March 31, 2019**. Where possible, a representative of the Independent Program Administrators will work directly with Eligible Beneficiaries to help them properly complete their Allocation/Acceptance Forms and submit the necessary documentation.

B. Incomplete or Deficient Allocation/Acceptance Forms

If an Eligible Beneficiary submits an incomplete or deficient Allocation/Acceptance Form, e.g., the Eligible Beneficiary fails to sign the Allocation/Acceptance Form, a "Deficiency Notice" will be sent to the Eligible Beneficiary by the Independent Program Administrators within 30 days after receipt of the Eligible Beneficiary's package. A representative of the Independent Program Administrators will informally work with the Eligible Beneficiary in an effort to resolve any such deficiencies. Any Eligible Beneficiary who receives a Deficiency Notice shall have 30 days from the date of the Deficiency Notice to cure any deficiencies.

C. Notification of Program Decision

The Independent Program Administrators will send each Eligible Beneficiary an Allocation/Acceptance Form which will include the following:

1) The Eligible Beneficiary's Approved Payment Amount to be made pursuant to this Protocol; and

2) A Payment Option Form (whether the Eligible Beneficiary wishes to be paid by check or electronic bank wire).

Offers of payments approved pursuant to this Protocol shall be valid for 60 days, after which they are null and void if the Eligible Beneficiary does not satisfy any information or filing requirements necessary to receive the payment. All determinations of the Independent Program Administrators made in accordance with the provisions of this Protocol are final and not subject to appeal.

D. Payment

Payments will be issued following the final processing of an Eligible Beneficiary's Allocation/Acceptance Form. The Trust will authorize payment by check or electronic bank wire to each Eligible Beneficiary entitled to payment. If payment by check is elected, the check will be sent to Eligible Beneficiary by the Independent Program Administrators via regular mail.

VII. PRIVACY

Information submitted by an Eligible Beneficiary to the Trust will be used and disclosed only for the following purposes:

1) Processing the Eligible Beneficiary's request for payment.

2) Legitimate business use associated with administering the Program, including the prevention of fraud; and/or

3) As required by law, regulation or judicial process.

VIII. QUALITY CONTROL AND PROCEDURES TO PREVENT AND DETECT FRAUD

A. Verification Procedures

For the purpose of detecting and preventing the payment on fraudulent submissions, and for the purpose of accurate and appropriate payments to Eligible Beneficiaries, the Trust will implement procedures to:

1) Verify and authenticate submissions.

2) Analyze Allocation/Acceptance Form submissions to detect inconsistencies, irregularities, and duplication.

3) Ensure the quality control of Form review procedures.

B. Quality Control

The Independent Program Administrators shall institute all necessary measures designed to evaluate the accuracy of submissions and the accuracy of payments.

C. False or Fraudulent Submissions

Each Eligible Beneficiary will sign the Allocation/Acceptance Form at the time of submission, stating that he/she certifies that the information provided in the Allocation/Acceptance Form is true and accurate to the best of his/her knowledge, and that he/she understands that false statements made in connection with such submission may result in fines and/or any other remedy available by law. Suspicious Allocation/Acceptance Forms may be forwarded to federal, state and local law enforcement agencies for possible investigation and prosecution. Allocation/Acceptance Forms filed via the Internet will require an electronic signature, which shall be equally as binding upon the Eligible Beneficiary as a physical signature.

[redacted] Attachment A

TRU FINANCIAL ASSISTANCE FUND

Eligible Beneficiaries Payment Tables

Final Eligibility and Payment Criteria

To qualify for payment under this draft protocol, individuals must:

1. Have been employed by the Company for a minimum of one year on or after September 18, 2017.
2. Have terminated employment after September 18, 2017 because of the corporate shut-down/downsizing process.
3. Have annual income above $5,000 and below $110,000.
   a) For Salaried Employees – Income is the salary that the employee was being paid at the time of termination.
   b) For Hourly Employees – Income is the last hourly rate that the employee was being paid at the time of termination multiplied by the average number of hours that the employee worked per week in 2017 or 2018, whichever was higher.
4. Seasonal Employees are not eligible for payment.
5. Individuals who received severance or termination pay are not eligible for payment.
6. Individuals who are within 30 days of their next Year of Service will be rounded up.
7. Individuals terminated and re-hired during the bankruptcy period will receive credit for their prior tenure.
8. Individuals who were demoted in the bankruptcy period are credited with their prior pay rate.

The minimum payment will be $200.

ELIGIBLE BENEFICIARIES PAYMENT MATRIX

Yrs of Service	Wks of Pay	Between $0 - $5K	Between $5K - $10K	Between $10K - $15K	Between $15K - $20K	Between $20K - $25K	Between $25K - $30K	Between $30K - $35K	Between $35K - $40K	Between $40K - $45K	Between $45K - $50K	Between $50K - $55K
0 - 5	2.0	$0	$200	$222	$311	$400	$489	$578	$667	$756	$866	$934
5	2.5	$0	$200	$278	$389	$500	$612	$723	$834	$945	$1,057	$1,168
6	3.0	$0	$200	$334	$467	$601	$734	$867	$1,001	$1,134	$1,268	$1,401
7	3.5	$0	$234	$389	$545	$701	$856	$1,012	$1,168	$1,323	$1,479	$1,635
8	4.0	$0	$267	$445	$623	$801	$979	$1,157	$1,335	$1,513	$1,690	$1,868
9	4.5	$0	$300	$500	$701	$901	$1,101	$1,301	$1,501	$1,702	$1,902	$2,102
10	5.0	$0	$334	$556	$779	$1,001	$1,223	$1,446	$1,668	$1,891	$2,113	$2,336
11	5.5	$0	$367	$612	$856	$1,101	$1,346	$1,590	$1,835	$2,080	$2,324	$2,569
12	6.0	$0	$400	$667	$934	$1,201	$1,468	$1,735	$2,002	$2,269	$2,536	$2,803
13	6.5	$0	$434	$723	$1,012	$1,301	$1,590	$1,880	$2,169	$2,458	$2,747	$3,036
14	7.0	$0	$467	$778	$1,090	$1,401	$1,713	$2,024	$2,336	$2,647	$2,958	$3,270
15	7.5	$0	$500	$834	$1,168	$1,501	$1,835	$2,169	$2,502	$2,836	$3,170	$3,503
16	8.0	$0	$534	$890	$1,246	$1,602	$1,957	$2,313	$2,669	$3,025	$3,381	$3,737
17	8.5	$0	$567	$945	$1,323	$1,702	$2,080	$2,458	$2,836	$3,214	$3,592	$3,970
18	9.0	$0	$601	$1,001	$1,401	$1,802	$2,202	$2,602	$3,003	$3,403	$3,804	$4,204
19	9.5	$0	$634	$1,057	$1,479	$1,902	$2,324	$2,747	$3,170	$3,592	$4,015	$4,438
20	10.0	$0	$667	$1,112	$1,557	$2,002	$2,447	$2,892	$3,337	$3,781	$4,226	$4,671
21	10.5	$0	$701	$1,168	$1,635	$2,102	$2,569	$3,036	$3,503	$3,970	$4,438	$4,905
22	11.0	$0	$734	$1,223	$1,713	$2,202	$2,691	$3,181	$3,670	$4,160	$4,649	$5,138
23	11.5	$0	$767	$1,279	$1,791	$2,302	$2,814	$3,325	$3,837	$4,349	$4,860	$5,372
24	12.0	$0	$801	$1,335	$1,868	$2,402	$2,936	$3,470	$4,004	$4,538	$5,071	$5,605
25	12.5	$0	$834	$1,390	$1,946	$2,502	$3,058	$3,615	$4,171	$4,727	$5,283	$5,839
26 or more	13.0	$0	$867	$1,446	$2,024	$2,602	$3,181	$3,759	$4,337	$4,916	$5,494	$6,072

Yrs of Service	Wks of Pay	Between $55K - $60K	Between $60K - $65K	Between $65K - $70K	Between $70K - $75K	Between $75K - $80K	Between $80K - $85K	Between $85K - $90K	Between $90K - $95K	Between $95K - $100K	Between $100K - $105K	Between $105K - $110K
0 - 5	2.0	$1,023	$1,112	$1,201	$1,290	$1,379	$1,468	$1,557	$1,646	$1,735	$1,824	$1,913
5	2.5	$1,279	$1,390	$1,501	$1,613	$1,724	$1,835	$1,946	$2,058	$2,169	$2,280	$2,391
6	3.0	$1,535	$1,668	$1,802	$1,935	$2,069	$2,202	$2,336	$2,469	$2,602	$2,736	$2,869
7	3.5	$1,791	$1,946	$2,102	$2,258	$2,413	$2,569	$2,725	$2,881	$3,036	$3,192	$3,348
8	4.0	$2,046	$2,224	$2,402	$2,580	$2,758	$2,936	$3,114	$3,292	$3,470	$3,648	$3,826
9	4.5	$2,302	$2,502	$2,703	$2,903	$3,103	$3,303	$3,503	$3,704	$3,904	$4,104	$4,304
10	5.0	$2,558	$2,780	$3,003	$3,225	$3,448	$3,670	$3,893	$4,115	$4,337	$4,560	$4,782
11	5.5	$2,814	$3,058	$3,303	$3,548	$3,792	$4,037	$4,282	$4,527	$4,771	$5,016	$5,261
12	6.0	$3,070	$3,337	$3,603	$3,870	$4,137	$4,404	$4,671	$4,938	$5,205	$5,472	$5,739
13	6.5	$3,325	$3,615	$3,904	$4,193	$4,482	$4,771	$5,060	$5,350	$5,639	$5,928	$6,217
14	7.0	$3,581	$3,893	$4,204	$4,515	$4,827	$5,138	$5,450	$5,761	$6,072	$6,384	$6,695
15	7.5	$3,837	$4,171	$4,504	$4,838	$5,172	$5,505	$5,839	$6,173	$6,506	$6,840	$7,173
16	8.0	$4,093	$4,449	$4,805	$5,160	$5,516	$5,872	$6,228	$6,584	$6,940	$7,296	$7,652
17	8.5	$4,348	$4,727	$5,105	$5,483	$5,861	$6,239	$6,617	$6,996	$7,374	$7,752	$8,130
18	9.0	$4,604	$5,005	$5,405	$5,806	$6,206	$6,606	$7,007	$7,407	$7,807	$8,208	$8,608
19	9.5	$4,860	$5,283	$5,705	$6,128	$6,551	$6,973	$7,396	$7,819	$8,241	$8,664	$9,086
20	10.0	$5,116	$5,561	$6,006	$6,451	$6,895	$7,340	$7,785	$8,230	$8,675	$9,120	$9,565
21	10.5	$5,372	$5,839	$6,306	$6,773	$7,240	$7,707	$8,174	$8,642	$9,109	$9,576	$10,043
22	11.0	$5,628	$6,117	$6,606	$7,096	$7,585	$8,074	$8,564	$9,053	$9,542	$10,032	$10,521
23	11.5	$5,883	$6,395	$6,907	$7,418	$7,930	$8,441	$8,953	$9,465	$9,976	$10,488	$10,999
24	12.0	$6,139	$6,673	$7,207	$7,741	$8,275	$8,808	$9,342	$9,876	$10,410	$10,944	$11,478
25	12.5	$6,395	$6,951	$7,507	$8,063	$8,619	$9,175	$9,731	$10,288	$10,844	$11,400	$11,956
26 or more	13.0	$6,651	$7,229	$7,807	$8,386	$8,964	$9,542	$10,121	$10,699	$11,277	$11,856	$12,434

Summary of Payments to Date
ToysRUs Financial Assistance Fund

SUMMARY OF PAYMENTS MADE

ToysRUs Financial Assistance Fund
As of 11/19/19

Participant Group	Total Participants	Total Number Paid	Total Amount Paid	Average Payment	Median Payment
Original Group	19,020	15,764	$18,779,229	$1,191.27	$500.00
Expanded Group	2,468	977	$569,902	$583.32	$311.00
TOTAL	21,488	16,741	$19,349,131	$1,155.79	$489.00
Supplemental Group*	4,864		$738,640		

* The Supplemental Group will be allocated the Balance Remaining in the Fund. The Supplemental Payment Program is underway with an expected completion in January 2020.



December 2, 2019

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
2302 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
2371 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Waters and Ranking Member McHenry:

On behalf of the International Franchise Association (IFA), the oldest and largest association representing franchising worldwide, I would like to thank you for convening the November 19, 2019, Committee on Financial Services hearing titled "America for Sale? An Examination of the Practices of Private Funds." The role of private equity in the franchise sector is increasingly important as franchised brands explore private equity investments as a growth vehicle. According to the research firm FRANdata, the number of franchise brands acquired by private equity firms nearly tripled from twenty-four in 2012 to sixty in 2018. Franchisees have also gained the attention of the private equity firms which are attracted by the potential for organic and rapid growth along with the goodwill and strength of an established brand that franchised systems can provide.

Private capital providers invest in some of the most valuable and recognizable brands in America, including FASTSIGNS International, Auntie Anne's, Corner Bakery, Giordano's, Anytime Fitness, It's Just Lunch, Take 5 Oil Change, and hundreds of other reputable and well-known products and services. More importantly, together, private capital-backed franchises are an engine for job growth, and according to Pitchbook, employ more than a half million employees throughout the United States.

The operational expertise that is brought by private capital professionals to the franchising model provides an important growth vehicle for small entrepreneurs, generating wealth for individuals and their families, particularly women, minorities, and veterans. Owning a franchise provides these entrepreneurs with a level of independence where they can operate their business with an established product or service which may already enjoy widespread brand-name recognition, providing them with the benefit of a customer base that would ordinarily take years to establish. When private capital invests in franchising, the local community and societal benefits are pronounced.

IFA is concerned that the legislative proposals that were the subject of the November 19th hearing, particularly the *Stop Wall Street Looting Act*, would create unintended consequences for the small business economy. IFA urges Congress to reject such policies that make it more challenging for small business brands and franchise owners to access capital, which provide entrepreneurs with an important mechanism for building generational wealth.

1900 K Street, N.W., Suite 700 Washington DC 20006 USA
Phone: +1 202/628-8000 Fax: +1 202/628-0812 www.franchise.org



On behalf of the nation's 733,000 franchised small businesses, we appreciate your leadership on this issue of great importance. Thank you for considering our views, and please consider us a resource as you analyze the role of private equity in small business investing and the economy.

Sincerely,

Matt Haller
Senior Vice President of Government Relations & Public Affairs
International Franchise Association

1900 K Street, N.W., Suite 700 Washington DC 20006 USA
Phone: +1 202/628-8000 Fax: +1 202/628-0812 www.franchise.org

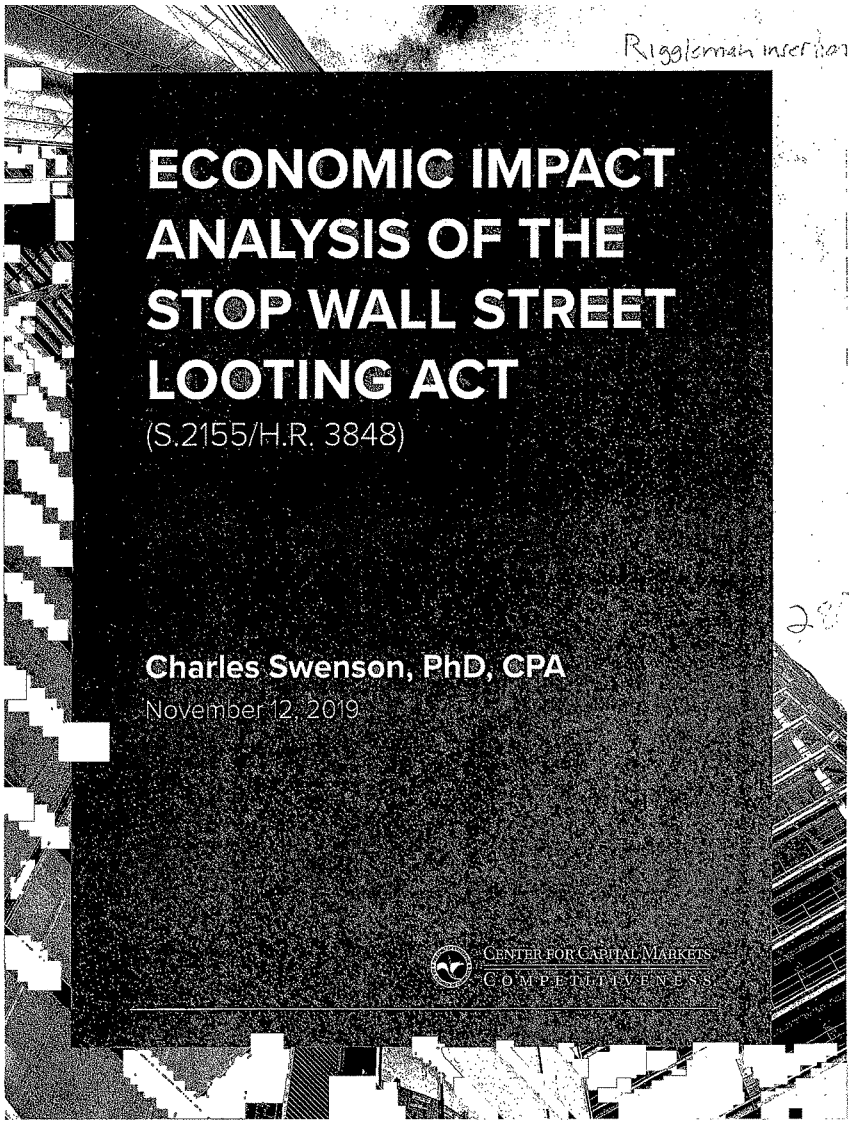

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ECONOMIC IMPACT ANALYSIS OF THE STOP WALL STREET LOOTING ACT
(S.2155/H.R. 3848)
Charles Swenson, PhD, CPA
November 12, 2019
Center for Capital Markets Competitiveness

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Executive Summary

Private equity (PE) firms make long-term investments in companies poised for growth as well as undervalued or underperforming businesses. The private equity funds created by private equity firms to invest in various companies throughout the economy are often backed by capital from institutional investors, including public pension funds. PE funds have long played a major role in the development of a broad range of companies, which employ 8.8 million people across the United States, including several hundred thousand people across every state, such as Hilton Hotels, Popeyes, Uber, Airbnb, Dollar General, Dunkin Donuts, Jiffy Lube, LA Fitness, Tate's Bake Shop, Beats Electronics, The Nature's Bounty, and McGraw-Hill Education.

All told, the private funds industry drives a significant amount of economic growth in the United States and supports millions of jobs across the country. After multiplier effects on the economy, such PE-backed companies and the PE firms themselves support over 26 million jobs and contribute over $475 billion in annual Federal and state/local tax revenues.

Private equity fund investments also provide significant assistance to pensions and public retirement systems, including the three largest funds (California Public Employees' Retirement System, California State Teachers' Retirement System, and the New York State Common Retirement Fund) as well as other significant funds (the Massachusetts Pension Reserve Investment Management Board and the School Employees Retirement System of Ohio). Private equity firms contribute over $6.4 billion annually to federal tax revenues and over $2.6 billion to state and local tax revenues.

However, proposed legislation in the current congress, the Stop Wall Street Looting Act (S. 2155/H.R. 3848), would impose significant restrictions, liabilities, and tax increases on the industry. Specifically, the legislation would seek additional caps on leverage for private equity, would tax profits at ordinary tax rates rather than as capital gains, and would hold private equity firms liable for all debts, legal judgements, and pension obligations of their portfolio companies. Additionally, the legislation would reorder bankruptcy law by having courts consider workers' interests above other financial considerations in the bankruptcy process.

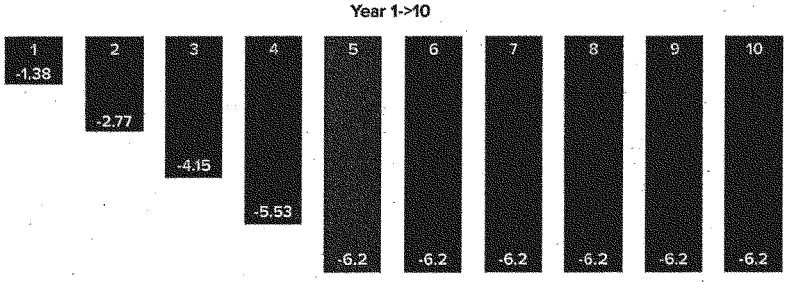
As a result, this study finds that these restrictions and taxes would be so impactful that, if enacted, even in a modest-case scenario, the country's workforce would be reduced by approximately 6 million jobs, and combined federal, state, and local tax revenues would drop by approximately $109 billion per year in the long run.

THIS STUDY'S MAIN FINDINGS ARE THAT ENACTMENT OF THE STOP WALL STREET LOOTING ACT (S. 2155/H.R. 3848)

- Would result in a loss in the range of 6.2 million to 26.3 million jobs across the United States;
- Would result in federal, state, and local governments losing a combined $109 billion annually in tax revenues in a modest-case scenario or $475 billion annually in a worst-case scenario;
- Public pension funds, which support retirees, would lose at least $329 million (and possibly $1.65 billion) annually since they would need to switch some (or all) of their investments into lower-yielding investments;
- Investors could lose anywhere from $671 million to $3.36 billion per year (about half of which would be lost to pension fund retirees);
- Imposition of increased risk, taxes, and restrictions contained in S.2155/H.R. 3848 would likely cause some (and potentially all) of the private equity industry to cease to exist;
- Many firms which normally seek PE financing would be unable to find financing and fail (or downsize);
- If even 1% of the industry exited, and an equivalent percent of PE portfolio companies failed, the federal governments would lose money.

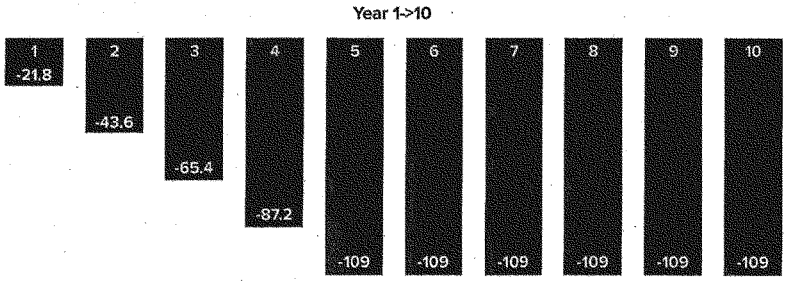
JOB AND TAX REVENUE LOSSES UNDER THE MODEST-CASE SCENARIO ARE SHOWN GRAPHICALLY BELOW:

Job Losses in Millions: Years 1->10 After S.2155/H.R. 3848 Enacted (modest-case scenario)



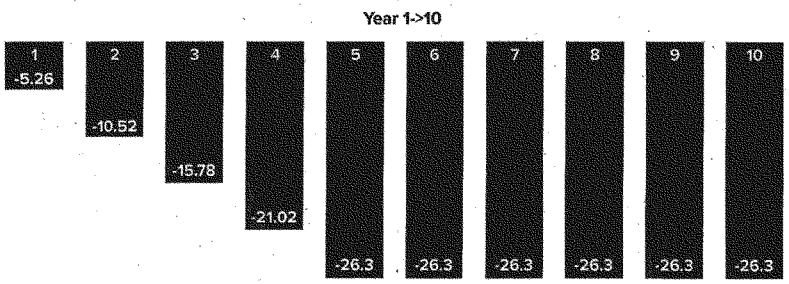
The Stop Wall Street Looting Act could reduce America's workforce by approximately 6 million – decreasing combined federal, state and local tax revenues by approximately $109 billion per year.

Tax Revenue Losses: Years 1->10 After S.2155/H.R. 3848 Enacted (modest-case scenario, $billions)

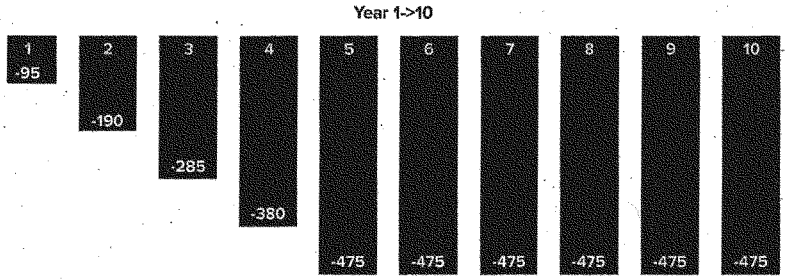


JOB AND TAX REVENUE LOSSES UNDER THE WORST-CASE SCENARIO ARE SHOWN GRAPHICALLY BELOW:

Job Losses in Millions: Years 1->10 After S.2155/H.R. 3848 Enacted (worst-case scenario)

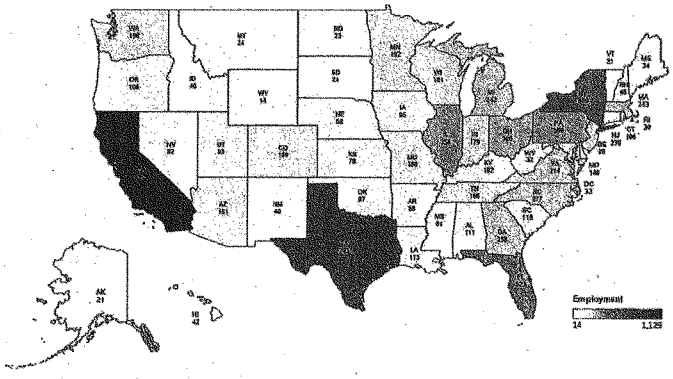


Tax Revenue Losses: Years 1->10 After S.2155/H.R. 3848 Enacted (worst-case scenario, $billions)



PE EMPLOYMENT IN THOUSANDS, FOR STATES THAT HAVE THE MOST PRIVATE EQUITY INVESTMENT, WHICH WOULD BE MOST NEGATIVELY IMPACTED BY THE LEGISLATION, ARE SHOWN BELOW[1]

Employment by State for PE Backed Companies (thousands)



[1]Data provided by EY, LLP 2018 report prepared for American Investment Council (AIC).

Sensitivity analyses indicate that if even 1% of the industry exited and an equivalent percent of PE portfolio companies failed the federal governments would lose money. In the worst-case scenario, the significant risk, regulation, and tax increases would cause the industry to cease to exist, companies normally backed by PE would fail, and the national workforce would drop by 26.3 million jobs (over 15% of the country's workforce), resulting in a loss of $475 billion annually in combined federal, state and local revenues. Investors could lose anywhere from $671 million to $3.36 billion per year (about half of which would be lost to pension fund retirees). In either the modest- or worst-case scenarios, there would also be negative impact on other firms in the private funds space, although quantification of such impacts is more difficult.

In the worst-case scenario, the industry would cease to exist, companies normally backed by PE would fail, and the national workforce would drop by 26.3 million jobs (over 15% of the country's workforce).

The increased restrictions and taxes in this legislation have a disincentive effect on labor supply as well as business formation and growth. The essentially unlimited liability exposure the legislation would create would impose significant risks for managers and investors in PEs, discouraging investments in companies throughout the economy, which in turn would result in higher business failures and lower returns to such PE investors as pension funds, university endowments, and charitable foundations. Although the private funds industry is composed of businesses, such businesses are mostly partnerships or limited liability companies, which means that their taxes are paid by owners (partners) of the business on their individual tax returns. Thus, increased taxes under the legislation are in a large sense a tax on the entrepreneurial efforts of the owners of PE firms who help grow businesses. It is important to note that many of the tax increases under the legislation are discriminatory insofar as the carried interest tax increase applies to only a subset of entrepreneurs investing in "specified assets" (including but not limited to securities, real estate, etc.). Nor do the 100% taxes on distributions from investments apply to other industries. Similarly, the bill's proposed restrictions on interest deductions would be hurtful to PE funds and their portfolio companies, which rely on debt financing. In addition, the bill's joint and several liability provisions and bankruptcy provisions would have costly negative implications for most if not all economic participants, not just private equity or the companies in which PE funds invest.

When private equity is combined with other private funds, which would also be affected by the legislation reviewed in this economic analysis, including venture capital and hedge funds, the private funds industry contributes over $37 billion annually to federal tax revenues and over $11 billion to state and local tax revenues. Private equity firms also directly employ approximately 124,000 people, and an additional 270,000 people are employed via the industry's "ripple-through" effect on the rest of the U.S. economy. When we look at the total private funds industry, it provides 472,000 jobs directly and over 1.5 million jobs after the "ripple-through" effect. The average annual wage in this industry is more than $199,000 (i.e., these are "good paying" jobs). When we add PE portfolio firms, there are 8.8 million people employed (26.3 million after multiplier effects on the economy), earning average wages of $71,000 per year.

Economic Impact of Private Funds

EMPLOYMENT AND TAX REVENUE IMPACTS OF PRIVATE EQUITY FUNDS

According to the Bureau of Labor Statistics, private equity firms directly employ over 124,000 people in the U.S.[2] When we add PE portfolio companies, there are 8.8 million people employed, and more than 26 million after multiplier effects on the economy. **Exhibit 1** shows the economic footprints of the private equity sector (composed of private equity firms, funds and the portfolio companies they support).

EXHIBIT 1

Estimated Employment, Income, and Output Effects of Private Equity Sector in U.S. (dollar values in millions)[3]

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	8,800,000	$600,000	$1,100,000	$1,700,000
Indirect Effect	7,200,000	$500,000	$900,000	$1,400,000
Induced Effect	10,300,000	$600,000	$1,000,000	$1,600,000
Total Effect	**26,300,000**	**$1,700,000**	**$2,900,000**	**$4,700,000**

"Direct Effect" refers to actual employment, labor income (wages), value added (added profit to owners in the local economy), and output (revenues generated in the U.S. economy).

"Indirect Effects" (often referred to as "type I multiplier effects") are similar effects but are measured as the impact on all of the U.S. economy, beyond the new business itself, as a result of business-related purchases rippling through the U.S. economy.

"Induced Effects" (often referred to as "type II multiplier effects") are similar effects but are measured based on the result of direct and indirect effects on employees, who then spend in the U.S. economy.

The **"Total Effect"** is the total of direct, indirect, and induced effects. All values are expressed in today's U.S. dollars.

As shown above, using multipliers across numerous industries, the "ripple through" impact of these companies is an estimated 26.3 million jobs, with an average wage of $71,000. There are an estimated 35,000 PE-backed companies from a very broad cross-section of industries.[4] As shown in **Appendix B**, such companies are scattered across all 50 states and all congressional districts.

Employment, income, and output effects of just the private equity industry itself (not including portfolio companies), both before and after multiplier effects, are shown in **Exhibit 2** below. After such multiplier effects, the industry accounts for more than 414,000 jobs and more than $30 billion in wages paid.[5] The average annual wage in this industry is more than $94,000, i.e., these are "good paying" jobs.

[2] Data from Bureau of Labor Statistics and Census.
[3] Source: Ernst &Young analysis done for AIC (2019).
[4] Employment by broad industry group (as percents) is as follows: consumer products and services (36%); business products and services (29%); healthcare (13%); information technology (9%); financial services (7%); materials and resources (2%); and energy (2%). Source: Ernst &Young analysis done for AIC (2019).
[5] For a discussion of multiplier analysis in a tax setting, see Swenson, C., and M. Moore. "Use of Input-Output Analysis in Tax Research." Advances in Taxation 1 (1987): 49-83.

EXHIBIT 2

Estimated Employment, Income, and Output Effects of Private Equity Firms in U.S. (dollar values in millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	124,207	$11,751	$7,882	$24,233
Indirect Effect	145,651	$10,625	$15,420	$27,168
Induced Effect	144,456	$7,776	$13,696	$24,243
Total Effect	**414,314**	**$30,152**	**$36,998**	**$75,644**

The above are calculated using IMPLAN[6], a widely accepted general equilibrium software. Value added is proprietor's income. Employees in PE firms include portfolio managers, research analysts, investor relations personnel, compliance specialists, legal counsel, tax specialists, information technology professionals, human resources staff, office support staff, etc. The industry also has a significant "ripple-through" or multiplier effect on the national economy as a whole. That is, the industry creates additional jobs and value added through indirect and induced effects. These include, for example, such firms paying accountants, attorneys, investments banks, consultants, real estate entities (for leases, etc.), and the monies spent in the U.S. economy by the industry's employees and investors. The multiplier effect is reflected in the 414,000 jobs shown in **Exhibit 2.**

The private equity sector (comprised of private equity firms and the portfolio companies in which private equity funds invest) accounts for a significant amount of federal taxes paid. Such taxes include income (individual and corporate for other industries), employment taxes, excise taxes, import taxes, and numerous other taxes and fees. Annual tax revenues to federal, state, and local governments contributed by the overall private equity sector is reported in **Exhibit 3.** We see that this sector contributes over $174 billion and $475 billion after multiplier effects.

[6] See www.IMPLAN.com. Multipliers are blends of the NAICS groups.

EXHIBIT 3

Estimated Annual Federal Taxes and Fees Generated by the Private Equity Sector
*** After Multiplier Effects[7] (in $billions)**

US private equity sector					
	Business Taxes	**Employee Taxes**	**Total**	**Suppliers to US Private Equity**	**Related Consumer Spending**
Federal taxes	**$36**	**$77**	**$113**	**$93**	**$102**
Individual income taxes	$7	$52	$59	$49	$53
Payroll taxes	$21	$21	$42	$34	$37
Corporate income taxes	$7	$0	$7	$6	$7
Excise taxes	$1	$2	$3	$3	$3
Customs duties and fees	$0	$1	$1	$1	$1
State and local taxes	**$26**	**$35**	**$61**	**$50**	**$55**
Property taxes	$11	$9	$19	$16	$17
Sales taxes	$6	$9	$15	$12	$13
Individual income	$2	$13	$14	$12	$13
Excise, license, other taxes	$6	$5	$11	$9	$10
Corporate income taxes	$2	$0	$2	$2	$2
Total taxes	*$63	*$112	*$174	*$144	*$157

*Totals reflect some rounding.

For the private equity industry itself (excluding PE portfolio companies), annually there are $6.4 billion in federal tax revenues generated (after multiplier effects) and $2.6 billion in state and local tax revenues generated (after multiplier effects) giving a total tax revenue contribution of $9 billion.

DATA ON INVESTORS IN PRIVATE EQUITY FUNDS (INCLUDING PENSIONS)

Numerous investors have stakes as limited partners in the PE funds that own portfolio companies. **Exhibit 4** shows types of investors and their relative investments in PEs.

[7] Ibid. Includes private equity firms, hedge fund firms, and venture capital firms. Calculations performed by EY for AIC. Individual taxes include taxes on capital gains.

EXHIBIT 4
Investors in PE Funds[8]

Investor Type	Ownership
Pension Funds	49%
Investment and Family Offices	14%
Insurance Companies	11%
Foundations and Endowments	11%
Sovereign Wealth Funds and Development Funds	10%
Banks	4%
Corporate Investors	1%
	100%

PE funds typically outperform other investments in terms of rates of return. Although there is incomplete public data on PE investors' alternative investments, there is such data for public pension funds. Over the last decade (2008–2018), such funds have earned a 9.7% return on their PE investments on average.[9] This is 2.25% higher than the 7.45% average rates of return on the largest pension funds. Since there is at least $149.33 billion of pension funds' money in PEs[10], this implies that as much as $3.36 billion (or $149.33 billion*2.25%) would be lost aggregate returns for pension funds if these pensions instead put their money in non-PE investments. Since the majority of such investors may be tax-exempt, tax impacts here are not estimated.

EMPLOYMENT AND TAX IMPACTS OF ALL PRIVATE FUNDS

Although the legislation is targeted largely at private equity firms, the liability exposure, tax increases, and other parts of this bill potentially apply to the entire private funds industry and in some cases even beyond it. Thus, it is instructive to examine the economic contribution of the industry as a whole. Exhibit 5 reports such data. Here, we see that after "ripple through" effects, the industry employs over 1.5 million people and has more than $163 billion in wages paid.[11]

[8] Source: American Investment Council (2018)
[9] Internal rates of return for US buyout firms; see Global Private Equity Report 2018 (Bain and Company)
[10] For 10 largest pension fund investors in PEs. See Public Pension Study (2019), American Investment Council.
[11] Data from Bureau of Labor Statistics and Census. Since this is 2017—the most recent data-employment in 2019 may be higher than this.

EXHIBIT 5

Estimated Employment, Income, and Output Effects of Private Funds* Firms in U.S. (employment in thousands; dollar values in millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	471.99	$93,937.5	$29,950.1	$92,083.9
Indirect Effect	553.47	$40,375.1	$58,597.8	$103,240.9
Induced Effect	548.93	$29,551.3	$52,045.1	$92,122.5
Total Effect	**1,574.39**	**$163,864.0**	**$140,592.9**	**$287,447.3**

*Includes private equity firms, hedge funds, and venture capital firms.

The private funds industry annually accounts for $37.1 billion in federal taxes paid and $11.3 billion in state and local taxes paid for a total of over $48 billion. **Tables A1 and A3 in Appendix A** report employment data for two of the states with the largest employments in the private funds industry, California and New York. We see that these two states employ over 70,000 and 250,000 people, respectively (after multiplier effects) and pay average wages of over $112,000 and $200,000, respectively. Not shown in such tables are employment impacts in other states such as Massachusetts and Texas which have hundreds of thousands of PE industry employees.

OTHER ECONOMIC IMPACTS: PRIVATE EQUITY FIRMS AND FUNDS[12]

Private equity firms invest in a number of companies via their funds. Such investments are typically over a number of years, during which time the PE fund aims to grow and strengthen the acquired company and make it more profitable for its investors. According to the American Investment Council (AIC), U.S. PE companies invested $3.4 trillion in U.S. companies over the 2013–2018 period. As noted previously, these companies contributed over 26.3 million jobs to the U.S. economy (after multiplier effects). **Exhibit 6** shows some of the more prominent PE-backed U.S. firms.

> **Private equity companies invested $3.4 trillion in U.S. companies between 2013-2018.**

[12] Sources include Pitchbook (various issues) and industry representatives.

EXHIBIT 6
Examples of U.S. PE-Backed Businesses



This impact is quite significant in such states as California, Texas, Illinois, Florida, and New York. According to the American Investment Council, PE funds invested $343.11 billion in New York companies over the 2008–2018 period. These companies had over 600,000 employees. In California, the AIC reports that California PE companies invested $85.61 billion in 659 California companies in 2018 alone. Private equity backed companies in California employ over 1 million people. Data on investments for other states include: Massachusetts, with 234,000 jobs and $18 billion in wages and benefits; Texas, with 703,000 jobs and $55 billion in wages and benefits; and Florida, with 523,000 jobs and $33 billion in wages and benefits.

As noted previously, almost half of PE investors are pension funds. For example, in New York, the New York State Common Retirement Fund has invested approximately $17.5 billion in PE funds.[13] In California, two of the state's largest pension funds—the California Public Employees' Retirement System and the California State Teachers' Retirement System—have invested approximately $43 billion in PE funds. Since historically, returns on private equity investment substantially exceed those of investments in public markets, fixed income, and real estate, *PE funds contribute significantly to the well-being of retirees.*

Economic Impact of the Legislation

SECTION-BY-SECTION DISCUSSION: DISINCENTIVE EFFECTS AND OVERALL ECONOMIC EFFECTS

Section 101: Joint and Several Liability for Controlling Private Funds

This section holds private funds that are control persons jointly and severally liable for all debt incurred by a target firm, including for legal judgments, liabilities in connection with violations of the Worker Adjustment and Retraining Notification (WARN) Act, and pension-related obligations.

Section 102: Joint and Several Liability for Holders of Economic Interests in Controlling Private Funds[14]

This section holds holders of an economic interest, or with a right to participate in the governance of, private funds that are control persons jointly and severally liable for all debt incurred by a target firm, including for legal judgments, liabilities in connection with violations of the WARN Act, and pension-related obligations.

Discussion. Section 101 effectively eliminates corporate separateness between a PE fund and its portfolio companies by making the PE fund jointly and severally liable for all liabilities of its portfolio companies, including any debt incurred as part of the acquisition of that portfolio company and employee/pension liabilities. Minority investments of at least 20% of the company's voting securities would trigger this joint and several liability if the PE fund participates in the direction of the management or policy of the company.

[13] Public Pension Study, American Investment Council (May 2018).
[14] Section 103, "Indemnification Void as Against Public Policy" holds that any indemnification of a private fund that is a control person or affiliate for the liabilities of the target firm and its affiliates is void against public policy. While this Section is not separately addressed above, it essentially prevents private funds from avoiding Section 101 and 102 risk though indemnifications.

Section 102 extends the joint and several liability of Section 101 to individuals who have an economic interest in or the right to participate in the governance of the PE fund. This proposal is the equivalent of requiring PE funds and their principals to guarantee the performance of their portfolio companies to all of their creditors, which would just end PE investing altogether and is contrary to a fundamental principle of American business, which is to respect the corporate form. This provision, and others in the bill, may increase financial stability/contagion risk. For example, this section imposes joint and several liability on any "holder of an economic interest in a private fund" for all liabilities of a portfolio company controlled by the private fund. Thus, under certain circumstances, liability could be shared by pension plans and others that currently have limited liability by virtue of the nature of their investment. And since Section 501 of the legislation would require the disclosure of a PE fund's limited partners (information that is currently available to the Securities Exchange Commission [SEC]), the markets would understand that pension plans or insurance companies that own interests in a private equity fund could be liable for "all liabilities" of each of the portfolio companies controlled by the private fund. In case of financial distress or bankruptcy of the target, creditors of the target may turn to such large financial companies (as "deep pockets") for payment and/or the market may lose confidence in the financial companies because of such losses.

Incentive Effects and Economic Impacts: Private Funds. These sections significantly increase risk of any company invested in. One bankrupt portfolio company could result in sufficient liability claims such that other assets of the PE fund complex, including limited partner investors such as pensions, might be needed to pay for such debts. If such assets are insufficient to pay the debts, creditors could then take personal assets of PE general partners and investment assets of PE investors (such as pension funds). At an extreme, PE funds would cease to exist since long-standing protection against joint and several liability in the investment context is essential to enable PE funds and other entrepreneurs to invest in startups and other businesses, and defaults could lead to personal bankruptcy of PE general partners and other economic hardship for employees and even pension plan investors. In this extreme case, it would be difficult to attract investors due to the potential of losing other assets in the case of the failure of a portfolio company. Less extreme results would be that PE firms would significantly curtail investments, focusing only on investments with very high probabilities of success. Although quantifying the percent of PE deals which would be avoided in this more modest scenario is difficult, a reasonable estimate is as follows. Since approximately 19% of companies backed by PEs have debt which is very risky, this implies that PEs would on average avoid about one-fifth of their typical investments in such a more modest scenario.[15]

In either case, the PE industry would decline and jobs in that sector would be lost, and related federal, state and local tax revenues would decline accordingly.[16]

Incentive Effects and Economic Impacts: Investors in PE funds. Since liability also extends to investors, this increases risk to such investors, including in certain circumstances, pension plans, charitable foundations and university endowments. In a moderate scenario, investors would demand a risk premium for their investments, requiring higher rates of return to compensate for higher risk. This in turn could cause PEs to reject investments in companies which would not offer such a potentially higher rate of return; here, there would be fewer PE investment opportunities and investors would thus shift portfolios to less profitable financial instruments. As noted above, this would suggest that approximately 19% of PE deals would be rejected in the more modest outcome, implying a 19% reduction in PE investment. In either case, overall returns to PE investors would decline as they shifted investments into less profitable investments.[17] This would negatively affect pensions (thus retirees), which hold almost half of PE investments. At an extreme, investors would no longer invest in PE funds and would instead shift investments to other financial instruments. Such instruments would have lower rates of return than those of PE investments.

[15] See "Leveraged Finance -- US: Tracking the largest private equity sponsors LBO credit quality is weak, bodes ill for next downturn" (Moody's, Oct. 18 2018). The 19% figure is the percent of PE-backed firms having debt rated as B3N ("distressed"). This is not to be confused with actual defaults of PE-backed companies, which was 6%, lower than the market average of 6.4% (see Announcement: Post-Crisis Default Rates of PE-Sponsored and Non-Sponsored Companies Similar (Moody's, June 18 2014).

[16] Although PEs have in the past experienced "dry powder" scenarios (that is, there were insufficient profitable investments), the permanent change in investment opportunities here suggest that the PE industry would downsize to match the lower number of opportunities.

[17] Pension managers are subject to fiduciary responsibilities (see "Reclaiming Fiduciary Duty Balance" by James Hawley, Keith Johnson, and Ed Waitzer, Rotman, International Journal of Pension Management, Volume 4, Issue 2 (Fall 2011)). Accordingly, they may avoid investments which put overall pension assets at risk.

Incentive Effects and Economic Impacts: Companies normally invested in. Companies seeking PE investments are often declining and have lower (or too costly) access to other forms of finance. Investment by PEs also provide valuable operating and financial expertise, increasing their odds of survival. To the extent PE investments become unavailable, some of these firms will fail and jobs (with related tax revenues) will be lost. Others will continue to decline, with more protracted job and tax revenue losses. Even with a modest outcome, approximately 19% of PE supported businesses would fail (see above discussion). At an extreme, eventually all PE supported firms would fail.

Overall Economic Impact. These sections will have a negative impact on PE firms and funds, their investors, and companies needing PE investments. In a modest-case scenario, there would be a 19% reduction in the PE industry, up to a 19% failure rate of PE-backed companies, and up to a 19% reduction in returns to PE investors (such as pensions). In a worst-case scenario, PEs would disappear, PE investors (such as pensions) would have lower profitability due to shifting into other investments, and companies seeking PE funding would be unable to survive.

Section 201: Limitations on Post-Acquisition Dividends, Distributions, Redemptions, and Buybacks

This section prohibits target firms from making a capital distribution during the 24 months following a buyout transaction. It also holds related parties that aid or abet any violation of this section jointly liable for such violations. Finally, the section provides a private right of action for any employee or creditor to enforce this section.

Incentive Effects and Economic Impacts: Private funds. The inability to make distributions before the company is sold by the PE fund decreases the rate of return on that investment, due to the time value of money (that is, a return of investment earlier in time is worth more than a later return). There is also increased risk on the investment if (despite the best efforts of the PE) the company fails or is sold for no profit. Both of these would cause some projects not to be undertaken, if the expected return were already low, or the risk of failure is relatively high.

Incentive Effects and Economic Impacts: Investors in PE funds. Perhaps most importantly, many limited partner investors, including pensions, would be harmed by the arbitrary prohibition on dividend recapitalizations. To the extent that fewer companies are invested in (per the above discussion), investors (such as pensions) would shift some of their investments to other investments, which would provide lower rates of return, and in the case of pensions would hurt retirees.

Incentive Effects and Economic Impacts: Companies normally invested in. As noted above, fewer companies would receive PE funding due to potentially lower rates of return and increased risk.

Overall Economic Impact. It is difficult to quantify the impact of the above. Here we assume that the 19% risky investments which would be avoided (discussed above) would be from the same group with no additive downsizing from this provision per se.

Section 202: Prevention of Fraudulent Transfers

This section allows the claw back of money transferred out of portfolio companies by removing existing safe harbors in fraudulent transfer laws for certain kinds of transactions in cases where such transfers are connected to a change in control transaction. It also creates a positive presumption of fraudulent transfer for transactions connected to a change in control and for affiliated transactions involving portfolio companies for eight years following a leveraged buyout (LBO). This section also extends the statute of limitations for fraudulent transfers when the U.S. government is a claimant to at least eight years after the transfer was made, if it was connected to a change in control.

Discussion. This section will make it easier to challenge buyouts and affiliated transactions as fraudulent conveyances, thereby increasing the risk of fraudulent conveyance litigation for distressed PE-owned companies. In turn, this will make it more difficult for those companies to restructure and more likely for them to liquidate.[18]

Incentive Effects and Economic Impacts: Private funds. PE funds may avoid riskier acquisitions (i.e., those with higher potential for bankruptcy). In the absence of any empirical evidence, it is assumed here that the same 19% of firms which are riskier (as discussed above) would not be invested in, implying an equivalent downsizing of PE firms with attendant reductions in employment and tax revenues.

Incentive Effects and Economic Impacts: Investors in PE funds. To the extent such riskier transactions are avoided, more investment would switch from PE to other financial investments. See above for the 19% percent of firms avoided as investments, with equivalent lowered investments by investors and resultant lower returns due to investments in other non-PE investments.

Incentive Effects and Economic Impacts: Companies normally invested in. To the extent that riskier companies are not financed by PEs, a number of them may fail, causing loss of employment and tax revenues. Alternatively, Section 202 will make it easier to challenge LBOs and affiliated transactions as fraudulent conveyances, thereby increasing the risk of fraudulent conveyance litigation for distressed PE-owned companies. In turn, this will make it more difficult for those companies to restructure and more likely for them to liquidate, causing job and tax revenue losses.

Overall Economic Impact. The economic impact here is expected to be part of the that covered in the Section 101 analysis above, noting that the provisions in Sections 201 and 202 would not be expected (by themselves) to cause a complete exodus of the PE industry and failure of PE-backed firms.

Section 203: Confiscatory Surtax on Certain Amounts Received by Investment Firms from Controlled Target Firms

This section applies a 100% tax on fees paid by portfolio companies to private fund managers, including "monitoring" or "transaction" fees. An "applicable payment" is any amount paid or incurred by an "applicable entity" to an "applicable controlling entity." Interest and dividend payments are excluded. An applicable entity generally is any person conducting an active trade or business (e.g., a portfolio company). An applicable controlling entity generally is any person (e.g., an investment fund) that controls (or is related to a person controlling) the applicable entity and is engaged in an "applicable trade or business," some of the activities of which relate to the applicable entity.[19] An "applicable trade or business" is any "activity" that consists (in whole or in part) of: (i) raising or returning capital, and (ii) either (a) investing in or disposing of specified assets (or identifying specified assets for investing or disposition), or (b) developing specified assets. A specified asset generally refers to any security, partnership interest, and real estate held for rental or investment.[20]

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[18] It is also worth noting that creditors are already protected by the combination of potential fraudulent conveyance claims under the bankruptcy code and under state laws (which have longer lookback periods than the bankruptcy code). From this viewpoint, Sec. 202 may be superfluous.

[19] Control means at least 50 percent of vote or value in the case of a corporation, or at least 50 percent of the capital, profits or other beneficial interests in the case of a person other than a corporation.

[20] The constructive ownership rules of section 318 would generally apply in determining whether persons are related. The tax generally could not be offset with credits. The tax would be imposed on nonresident aliens and foreign corporations if the payments are effectively connected with a U.S. trade or business. The Treasury Secretary would be given regulatory authority to: (i) prevent avoidance of the surtax, including through the use of unrelated persons and conduit transactions; and (ii) modify the section 318 constructive ownership rules to apply them to capital, profits, and other beneficial interests. This Section would be effective for payments paid or accrued on or after the date of enactment.

Discussion. Although described as "looting" by the authors of the Act, such payments are instead a means by which the PE manager is compensated for bona fide services that it provides to the portfolio company--to the extent that it receives these fees. These fees are generally shared with investors in the private equity fund through management fee offsets. As such, this tax stands to harm limited partner investors most, including pension plans, by effectively increasing the net amount of fees they pay to the PE fund manager.

Incentive Effects and Economic Impacts: Private funds. The 100% tax makes it economically untenable for the PE to perform such services. Accordingly, the incentive would be to outsource the services. Thus, part of the fee revenue normally shared with investors such as pension funds would disappear. The costs to PE portfolio companies might be higher, as outsourced monitoring companies may have lower familiarity with the PE portfolio company and its operations.

Incentive Effects and Economic Impacts: Investors in PE funds. As noted above, this tax would harm limited partner investors most, including pension plans, by effectively increasing the net amount of fees paid to the PE fund manager.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. This is difficult to quantify, although the efficiency loss and extra cost to the industry of outsourcing monitoring services could be non-trivial.

Section 204: Limitation on Deduction for Business Interest of Certain Businesses Owned by Private Funds

This section imposes a stricter (albeit currently unspecified) limit under Section 163(j) of the internal revenue code on the deduction of interest by portfolio companies and other entities controlled by investment funds. Any applicable entity owned by an applicable controlling entity (or any related person) with a debt-to-equity ratio greater than one will be subject to a stricter limitation on the deduction for interest under Section 163(j) than the current 30% of EBITDA limitation. The bill does not specify, yet, how much stricter the percentage limitation will be. The definition of applicable entity and applicable controlling entity is the same as described above in connection with the surtax on fees. Also, the constructive ownership rules of Section 318 would apply similarly. The debt-to-equity ratio is: (i) the taxpayer's total indebtedness, over (ii) the net cash and other assets held by the taxpayer (reduced by the total indebtedness). The amount of an asset taken into account for this purpose is equal to its adjusted basis for purposes of determining gain. Note that because of the availability of 100% expensing, the amount of many assets taken into account will be zero, making it even more likely that large numbers of businesses will be subject to the stricter limitation. The amount of debt taken into account includes the amount of any original issue discount previously accrued.[21] This section is effective generally for taxable years beginning on or after the date of enactment.

[21] The constructive ownership rules of Section 318 would generally apply in determining whether persons are related. The tax generally could not be offset with credits. The tax would be imposed on nonresident aliens and foreign corporations if the payments are effectively connected with a U.S. trade or business. The Treasury Secretary would be given regulatory authority to: (i) prevent avoidance of the surtax, including through the use of unrelated persons and conduit transactions; and (ii) modify the Section 318 constructive ownership rules to apply them to capital, profits, and other beneficial interests. This section would be effective for payments paid or accrued on or after the date of enactment.

Incentive Effects and Economic Impacts: Private funds. PE acquisitions are financed through a combination of debt and equity investments. Thus, reducing the tax deductibility of interest payments increases the after-tax cost of debt. The costs here are difficult to quantify and are estimated to reduce after-tax rates of return by 0.6%. [22]When multiplied by average aggregate PE equity investments of $300 billion, this translates into an annual cost to the industry of $1.8 billion.

Incentive Effects and Economic Impacts: Investors in PE funds. Because of the above effects at the PE level, PE investors can expect lower returns on PE funds using the above estimate.[23]

Incentive Effects and Economic Impacts: Companies normally invested in. Because interest deductions would also be limited on target firms' borrowings after being acquired by a PE, the after-tax costs of debt increase, which case lower rates of return on PE investments. At the margin, target companies with lower potential of success (i.e., those with "borderline" expected rates of return) may not receive PE investments and potentially downsize or fail if they could not secure other investors.

Overall Economic Impact. This section will likely cause negative economic effects, the most likely of which is lower returns to PEs and PE investors, including pension funds. Additionally, since this provision potentially applies to other industries with higher debt ratios, there may be harm to the broader economy.

Section 301: Increased Priority for Wages in Bankruptcy

This section raises the 507(a)(4) priority claim for unpaid wages and severance from $10,000 to $20,000 per worker and eliminates the 180-day time restriction. It also raises the 507(a)(5) priority claim for employee benefit contributions from $10,000 to $20,000 per worker and eliminates the 180-day time restriction.

Section 302: Priority for Severance Pay and Contributions to Employee Benefit Plans

This section classifies severance pay owed to employees ("under a plan, program or policy generally applicable to employees . . . [or] pursuant to a collective bargaining agreement") as administrative expenses for the purposes of the priority of claims in Chapter 11 bankruptcy. It also classifies unsecured claims for contributions to an employee benefit plan due on or after the bankruptcy filing as administrative expenses for the purposes of the priority of claims in bankruptcy.

Section 303: Priority for Violations of Federal and State Laws

This section increases the priority of back pay or damages arising from any violation of federal or state labor and employment law (including the WARN Act) to the level of administrative expenses.

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[22] Increasing the after-tax cost of debt decreases the relative cost of equity financing for funds received from PE investors). In finance theory, capital structure can either follow the pecking order concept (where a constant debt/equity ratio is sought), or the opportunistic approach, where managers react to changes in borrowing rates and taxes in picking debt/equity ratios. Here we assume the pecking order theory on the idea that it would be difficult for PE managers to ask investors to contribute more equity for the same amount of total return (which implies a lower rate of return for each dollar of equity invested). Accordingly, a very rough estimate of the impact of Section 204 is as follows. Assuming 70% of a deal is financed through debt on average, this rule would limit interest deductibility to that on 50% debt, or a loss of deductibility of interest on 20% of debt. Thus, the after-tax cost of capital would increase by .2*(Debt)*r*t, where r is the interest rate and t is the tax rate. Assuming an 8% borrowing rate and a tax rate of .3 (a blend of the top corporate and individual top rates), this implies an increased after-tax cost of debt of .2*.3*.08=.0048 or about half a "basis point." This would also be the extra amount paid in U.S. taxes, and assuming an average state income tax rate of 6% (and non-deductibility of state tax) we have a tax-reduced rate of return of .006. Using an example of a $500 million acquisition with 70% debt and an 8% interest rate, the loss in cash flows would be .2(to get to the 1:1 debt ratio limit)*$350 million in debt*8%*38%, or $2.13 million per year. This would also be the increase in overall US, state and local taxes on such an investment.

[23] Using the above estimates, a .6% decrease in returns would not appear to be significant enough for PE investors to shift away from PEs and into other investments. Thus the .6% loss would be absorbed by PE investors as well as PE general partners.

Discussion. Sections 301, 302 and 303 will increase the costs of Chapter 11 bankruptcy cases involving companies with large employee/pension obligations. This could make it prohibitively expensive to reorganize certain businesses and force liquidations, which would hurt employees of those businesses even more.

Incentive Effects and Economic Impacts: Private funds. Because of increased costs of Chapter 11 bankruptcy cases involving companies with large employee/pension obligations, it could make it prohibitively expensive to reorganize certain businesses and force liquidations. PE funds may thus avoid acquiring riskier firms (with high risk of bankruptcy), which will harm the most vulnerable businesses that need PE investment by making them less attractive investment opportunities. Quantification of the negative effects on PE funds here is difficult.

Incentive Effects and Economic Impacts: Investors in PE funds. Because of fewer investment opportunities at the PE level, investors will shift some investments away from PE funds and into other types of investments.

Incentive Effects and Economic Impacts: Companies normally invested in. If there are forced liquidations, job losses will occur. Also, if PE funds avoid investment in riskier firms (which might go bankrupt), such risky firms (if unable to obtain other forms of financing) may go bankrupt with potential job losses. Quantification of potential costs to such firms here is difficult.

Overall Economic Impact. As noted above, the negative consequences here are difficult to quantify.

Section 304: Limitation on Executive Compensation Enhancements

This section expands the 503(c) restriction against executive payments to include any incentive compensation, bonus, or severance payment to senior executives, any of the next 20 most highly compensated employees, consultants of the company, and department or division managers of the company.

Section 305: Prohibition Against Special Compensation Payments

This section prohibits bankruptcy courts from approving any payments to an insider, senior executive, highly compensated employee, or consultant of the company if the company has not paid promised severance pay to employees or has reduced employee benefits within the year before declaring bankruptcy.

Section 306: Executive Compensation Upon Exit From Bankruptcy[24]

This section prohibits bankruptcy courts from approving a company's reorganization plan if an insider, senior executive, highly compensated employee, or consultant of the company will receive payments that are not generally applicable to the company's employees when the company exits bankruptcy or that the court determines are excessive or disproportionate compared to payments to the company's non-management workforce.

Discussion. Sections 304, 305 and 306 will limit debtors' ability to hire and retain management during bankruptcy cases and upon exit from bankruptcy, which may translate to lower recoveries/value for creditors and shareholders of these companies.

[24] Related to this is Section 308,"Voidability of Preferential Compensation Transfers". This Section allows the trustee to void any payment made in violation of executive compensation provisions and allows any party of interest to apply to void any payment made in violation of those provisions.

Incentive Effects and Economic Impacts: PE funds. Historically, approximately 6% of PE-funded firms experience bankruptcy. The potential costs for these 6% of PE-funded companies is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 307: Collateral Surcharge for Employee Obligations

This section deems all unpaid wages and benefits for services rendered on and after bankruptcy to be necessary costs and expenses of preserving, or disposing of, property securing an allowed secured claim and therefore recoverable even if the trustee has otherwise waived certain provisions.

Discussion. Section 307 may increase financing costs for PE sponsors and other companies. In addition, to the extent that the employees' services benefitted the secured creditor, the bankruptcy code already provides that the costs of those services can be recovered from the secured creditor's collateral (although this can be waived by the trustee with court approval).

Incentive Effects and Economic Impacts: Private funds. The potential costs for the roughly 6% of PE-funded companies which undergo bankruptcy is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 309: Protection for Employees in a Sale of Assets

This section requires that in cases where there are multiple offers to purchase the property of a company in Chapter 11 bankruptcy, bankruptcy courts are directed to approve the offer that best preserves the company's jobs and maintains the terms and conditions of employment for its workers. The section also requires that in approving the sale of property by a company in bankruptcy, courts are directed to give substantial weight to the extent to which the purchase would preserve jobs and maintain the terms and conditions of employment for the company's employees.

Discussion. To approve a sale of assets under the bankruptcy code, a court must find that the sale is in the best interest of the debtor and its creditors and that the debtor obtained the highest or best price for the assets. Bankruptcy judges attempt to balance the interests of different stakeholders, including employees and other creditors, which in practice generally favor transactions that preserve jobs when possible. This section directs courts to give more weight to job preservation at the expense of other creditors. This may depress creditor recoveries (including unsecured creditors such as employees and retirees whose claims are not assumed as part of a sale) and ultimately increase financing costs for companies.

Incentive Effects and Economic Impacts: Private funds. The potential costs for the roughly 6% of PE-funded companies which undergo bankruptcy is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 310: Protection of Gift Card Purchasers

This section creates a new priority in Chapter 11 bankruptcy (behind employee wages and benefits) for claims by individuals arising from: the purchase, lease, or rental of property; the purchase of services that were not delivered; and the purchase of gift cards that have not been redeemed.

Incentive Effects and Economic Impacts. Uncertain and difficult to quantify.

Section 311: Commercial Real Estate

This section eliminates the time limit on retailers for deciding whether to assume or reject a commercial real estate lease, easing restrictions on seasonal retailers seeking to reorganize.

Incentive Effects and Economic Impacts. Uncertain and difficult to quantify.

Section 402: Partnership Interests Transferred in Connection with Performance of Services[25]

Under this section, the recipient of a partnership interest in connection with the performance of services generally would be treated as having made an election under Section 83(b) to include the liquidation value of the interest in income at the time the interest is transferred. The recipient would be allowed to affirmatively elect out of Section 83(b) treatment. This section would be effective with respect to interests in partnerships transferred after the date of enactment.

Incentive Effects and Economic Impacts. Uncertain and difficult to quantify.

[25] Section 401 is not discussed here since it only allows subsequent sections to amend the 1986 Internal Revenue Code.

Section 403: Special Rules for Partners Providing Investment Management Services to Partnerships

This section taxes carried interest, currently taxed at the preferential capital gains rate at the higher earned income rates. The bill would repeal Section 1061, added by the Tax Cuts and Jobs Act, which generally requires a three-year holding period for long-term capital gain treatment of gains attributable to a carried interest. Technical details of this section are in **Appendix C.**

Discussion. Carried interest is a profit-sharing mechanism which rewards investors for the long-term "sweat equity" investments they make in businesses. Carried interest is used in real estate businesses, the financial services industry, oil and gas ventures, and many other types of business partnerships. The concept is that general partners (or managing members of LLCs) invest sweat equity, money and expertise in such ventures along with limited partner investors who invest money in the ventures. If the venture is successful, the general partners are entitled to a portion of the net profits from the sale of such ventures, typically 20% only after the limited partner investors are returned their capital plus a hurdle rate of return of 8%.

In the private funds industry, companies having carried interest are typically in the private equity, venture capital and hedge fund fields. In this structure, the general partners or managing members of a fund manage the operations of the fund while limited partners are passive investors. General partners or managing members are compensated for their services via a management fee (similar to a salary as a payment for services rendered and taxed at ordinary income rates), often at 2% of assets under management.[26] In addition, the general partners retain a share of profits, which is not a fee. The profits' interest is typically set at 20% of gains earned by the fund once invested capital is returned and a hurdle rate of return for limited partner investors (typically 8%) has been fulfilled. Limited partners receive the other 80% of the remaining profits.

In private equity, general partners only realize carried interest if gains exceed a certain hurdle rate of return.

For federal tax purposes, since the start of the Federal Income Tax in 1913, carried interest capital gains have always been taxed as capital gains income even though the capital gains rates have varied over time. Indeed, carried interest tax treatment is consistent with the tax treatment afforded to other long-term investments in capital assets and is founded on two sound and settled tax policies. The first is that capital gains are designed to reward entrepreneurial risk-taking. The second is that partnership profits should be taxed on a "pass-through" basis. As recognized by the Joint Committee on Taxation in its description of the tax treatment of carried interest, "The character of partnership items passes through to the partners, as if the items were realized directly by the partners. Thus, for example, long-term capital gain of the partnership is treated as long-term capital gain in the hands of the partners."[27]

Starting in 2018, however, the new federal tax law imposes differential treatment for some long-term carried interest capital gains by changing the time window it takes for a long-term carried interest capital gain to be realized from one year to three years. Under this new law, a general partner's carried interest capital gains is only taxed at the lower long-term rates after three years. A general partner's carried interest capital gains on an asset held for less than three years are short-term capital gains, taxed at the same rates as ordinary income. Limited partners' share of profits, on the other hand, can be fully taxed like all other long-term capital gains at lower rates after one year.[28]

[26] Typically, it is 2% of committed capital and then it transitions into 2% of invested capital over the life of a fund.
[27] See https://www.cbo.gov/budget-options/2018/54795
[28] Note that limited partners that are non-taxable entities, for example pension plans, endowments and charitable foundations are not taxed on these gains.

Because there are no revenue estimates provided to accompany the legislation, this report provides a rough estimate of the potential tax revenues generated by a tax on carried interest using federal estimates of carried interest. The Joint Committee on Taxation (as reported by the Congressional Budget Office) estimated in 2018 that making carried interest taxable at regular rates would generate an average of $1.4 billion in additional federal tax revenues per year[29] assuming no behavioral adjustments such as tax avoidance, switching business forms, etc.[30] Since this would involve taxing carried interest generally at the top U.S. rate of 40.8% instead of the capital gains rate of 23.8%, an estimate of total carried interest nationally is $8.2 billion.[31] This also implies a 71.4% increase in federal taxes on PE general partners.[32]

Incentive Effects and Economic Impacts: Private funds. Increased taxes have a disincentive effect on labor supply as well as business formation and growth. Although the private funds industry is composed of businesses, such businesses are mostly partnerships or limited liability companies, which means that their taxes are paid by owners (partners) of the business on their individual tax returns. Thus, increased taxes are in a large sense a tax on the entrepreneurial efforts of the owners of financial services businesses. A considerable body of research indicates that increased taxes on individuals have an especially high "elasticity" response for individuals with higher incomes. That is, there is a significant percent decrease in taxable income to percent changes in tax rates. For wealthier individuals, such responses can include moving to tax-favored jurisdictions, increasing tax deductions, changing forms of business organization, increasing substitution of wages for tax-free perquisites, increased use of retirement plans, and switching to lower-skilled labor to perform tasks.[33]

Longer-run elasticities for high-income individuals have in the past been estimated at .57%; i.e., each 1% increase in the tax rate results in a .57% decrease in pre-tax income.[34] Since taxing carried interest at ordinary rates implies a 71.4% tax increase on PE general partners (see above discussion), *this suggests a 40.7 % reduction in pretax income would result for PE general partners. Since PE general partners generally share in 20% of overall PE profits, this implies an 8.1% reduction in overall PE pretax income (or 40.7%*20%). Note that while this 8.1% results in a reduction in tax revenues to the government, this figure represents a combination in lost labor supply (effort to business, and/or switching professions) and other tax avoidance methods. In the absence of any empirical guidance here, it is assumed that half of this, or 4%, represents an actual downsizing of the PE industry due to such effects.*

Incentive Effects and Economic Impacts: Investors in PE funds. As discussed above, it is assumed that the PE industry shrinks by 4%, thus overall returns to investors would decline by the same amount.

Incentive Effects and Economic Impacts: Companies normally invested in. Assuming the above 4% decline, there would be a similar 4% decline in PE firms invested in.

Overall Economic Impacts. There would be an 8% decline in tax revenues from PEs, a 4% decline in industry size (including employment), 4% decline in returns to investors (including pensions), and a 4% decline in PE portfolio firms (both employment and tax revenues generated from them).

[29] https://www.cbo.gov/budget-options/2018/54795
[30] Similar effects are not reflected in the $2 billion number at the federal level.
[31] Computed as $1.4 billion/(40.8%–23.8%). Over the 2019-2028 period total federal estimated revenues from taxing carried interest as ordinary income are $14 billion; the $1.4 billion noted above is annua
[32] Since most states already tax capital gains at ordinary tax rates, the state tax increase to PE general partners here would be modest.
[33] See for example Saez, E., J. Slemrod, and S. Giertz. "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review." Journal of Economic Literature 50, no. 1 (2012): 3–50.
[34] See, for example Gruber, J., and E. Saez. "The Elasticity of Taxable Income: Evidence and Implications." Journal of Public Economics 84, no. 1 (2002): 1–32.

Section 501: Disclosure of Fees and Returns

This section defines a private equity fund. It also requires the SEC to issue rules requiring each private equity fund to make certain annual disclosures, including the identities of those with interests in the fund and their ownership interests, the debt held by the fund and its portfolio companies, the performance of the portfolio companies, and fees and payments collected by the firm. This section also requires the SEC to review these rules once every five years to ensure that they reflect contemporary trends. Finally, this section requires the SEC to make the information disclosed under these rules available to the public.

Discussion. This section adds additional costs to PEs due to increased regulatory compliance costs. Much of this disclosure appears redundant, since Form PF and Form ADV filed with the SEC, provide responsible regulators with much of this disclosure. PEs also have other disclosures to investors.[35]

Incentive Effects and Economic Impacts: Private funds. The increased regulatory compliance costs here are difficult to quantify. An additional cost difficult to quantify may include confidential information regarding investors or confidential information regarding the private fund's investment strategy, trade secrets, or other aspects of its business that may be damaging (to both PE managers and investors in private funds) if publicly disclosed.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 502: Fiduciary Obligations

This section amends the Employee Retirement Income Security Act of 1974 (ERISA) to clearly require private fund managers to have a fiduciary duty to pension plans whose assets they manage. It also prohibits investment advisers, including private fund managers, from requiring investors (including pension plans) to waive any fiduciary duty. It also prohibits preferential side letters between a fund and any one of its limited partners that is not offered to them all.

Discussion. For purposes of ERISA, this section would treat a pension plan's interest in a private fund in the same manner as an interest in a mutual fund and would prohibit waivers of fiduciary duty under state and other laws. In practice, fiduciary duties present costs and benefits that PE managers and investors may decide to modify and tailor to the particular expectations and needs of the particular transaction or investment. For example, PE managers and investors may agree to modify the duties owed with respect to affiliate transactions to benefit the private fund as the PE manager's affiliates may be able to offer the highest quality service at the most reasonable price. This section removes such flexibility.

Incentive Effects and Economic Impacts: PE funds. The negative impact here is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. The negative impact here is difficult to quantify.

Incentive Effects and Economic Impacts: Companies normally invested in. The negative impact here is difficult to quantify.

Overall Economic Impact. The negative impact here is difficult to quantify.

[35] These include extensive information over the life of their investment including, typically, quarterly reports and annual audited financial statements. Investors also have the ability to request access to the current list of investors and information regarding the affairs of the private fund (e.g., financial statements), subject to reasonable conditions which investors have an opportunity to negotiate. Note also that regulators (e.g., the SEC, and monitoring under the Financial Stability Oversight Council) have existing oversight tools, including provisions of the Dodd-Frank Act.

Section 503: Disclosure Relating to the Marketing of Private Equity Funds

This section requires the SEC to issue rules requiring each private equity firm to make extremely detailed disclosures of their marketing related to the performance of their previous funds and the target firms they controlled.

Discussion. The required disclosures go beyond the types of disclosures that are required for retail investors; current disclosure requirements under Form ADV already require that PE managers disclose affiliations and other information with respect to their employees and investments. An argument against these types of disclosures is that highly sophisticated investors are in the best position to determine the type of information they need in order to make investment decisions.

Incentive Effects and Economic Impacts: Private funds. There would be additional accounting and legal costs, quantification of which is difficult.

Incentive Effects and Economic Impacts: Investors in PE funds. Additional disclosures may be of use to such investors. Much of the additional accounting/legal expenses could be passed onto such investors. Quantification here is difficult.

Incentive Effects and Economic Impacts: Companies normally invested in. The potential negative impact here is difficult to quantify.

Overall Economic Impact. The overall potential negative impact here is difficult to quantify.

Section 601: Risk Retention Requirements for Securitization of Corporate Debt[36]

This section requires arrangers of corporate loan securitizations to retain a share of the risk of those securitizations by clarifying that managers of collateralized debt obligations are subject to the risk retention requirements established in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Incentive Effects and Economic Impacts on Private Funds, PE investors, Companies, and Overall Economy. The potentially negative impact here is difficult to quantify.

[36] The Act also contains Sections 701 and 702 which are not analyzed here. Section 701, "Anti-Evasion" prohibits activities, such as entering into agreements, contracts, and transactions, and structuring entities, to willfully evade or attempt to evade any provision of this bill. Section 702, "Severability", requires that in the event that any provision of this bill is held to be invalid or unconstitutional, the remainder of the bill and its application shall not be affected.

Overall Economic Impacts of the Stop Wall Street Looting Act

MODEST-CASE SCENARIO

In the modest-case scenario, the Stop Wall Street Looting Act would result in over 23% of the PE industry ceasing to exist over time, and that 19% of firms normally financed and managed by PEs would be unable to find other financing and management, and fail. This and other negative effects of the legislation in this modest-case scenario are shown by Section in **Exhibit 7.**

EXHIBIT 7

Modest-Case Scenario: Estimated Direct Impact of S.2155/H.R. 3848[37] by Section

S.2155/H.R. 3848 Section	Direct Impact on PE Firms	Direct Impact on PE Investors (including pensions)	Direct Impact on PE Portfolio Companies	Direct Impact on Other Private Funds Firms
101 and 102	19% downsizing (long run)	Annual loss of $638 million (long run)	19% failure rate (long run)	Negative**
201,202, and 203	Negative*	Negative*	Negative*	Negative*
204	.6% decrease in profits	.6% decrease in profits, or $20.2 million	Potential failure of some marginal firms*	Negative*
301 though 311	Negative*	Negative*	Negative*	Negative*
401 and 402	Negative*	Negative*	Negative*	Negative*
403	4% down-sizing (long run)	Annual loss of $13.4 million due to downsizing (long run)	Failure rate increase of 4% rate (long run)	Negative*
501,502, and 503	Negative*	Negative*	Negative*	Negative*
601	Negative*	Negative*	Negative*	Negative*
701 and 702	Negative*	Negative*	Negative*	Negative*
Net Result	**23.6% downsizing**	**Annual loss of $671.1 million (long run)**	**23% increase in failure rate**	**Negative***

*difficult to quantify ** hedge funds

* Long run impacts would be the 5th year after implementation of S.2155/H.R. 3848. PE firms hold a portfolio company on average approximately 5 years. Thus, after 5 years, existing PE companies (pre-S.2155/H.R. 3848) will have been sold and there would be no new PE investments by this time.

Exhibit 8 shows the impacts of the above after multiplier effects. There is a loss of 97.7 thousand jobs (related to the PE industry, after multipliers) assuming all PE firms exit the market, and an additional 6.1 million lost jobs (after multipliers) due to PE-backed firms failing (i.e., unable to find suitable financing which also provides PE-type management skills), for a total long run job loss, in the modest-case scenario, of approximately 6.2 million jobs. Although not shown in **Exhibit 8**, investors in PEs would experience an annual (long-run) loss of over $671 million in earnings (about half of which would be pension funds). Also not shown in **Exhibit 8** is the effects of the legislationon other private funds firms (hedge funds and venture capital firms), who would also experience some negative effects, which are difficult to quantify.

EXHIBIT 8

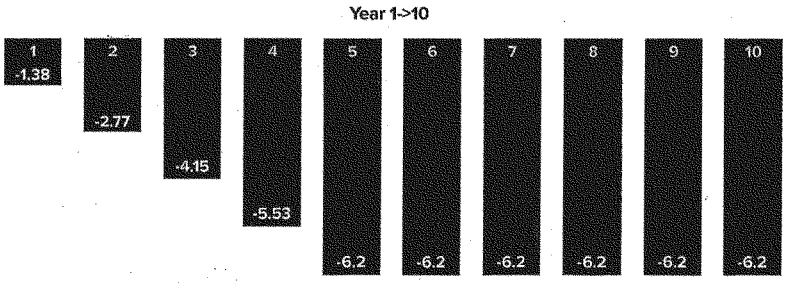
Modest-Case Scenario: Estimated Long-Run Loss in Employment and Tax Revenues (after multiplier effects) Due to S.2155/H.R. 3848[38]

	PE Firms	Portfolio Companies	Combined
Job Losses	97,704	6,109,096	6,206,800
Loss in Federal Tax Revenues	$400,000,000	$69,850,000,000	$70,250,000,000
Loss in State/Local Tax Revenues	$790,000,000	$38,040,000,000	$38,830,000,000
Total Loss in Tax Revenues	**$1,190,000,000**	**$107,890,000,000**	**$109,080,000,000**

Exhibit 9 shows the ten year, post S.2155/H.R. 3848 trajectory of such job losses.[39]

EXHIBIT 9

Modest-Case Scenario: Years 1->10 Trajectory in Job Losses After S.2155/H.R. 3848 (after multiplier effects, in millions)

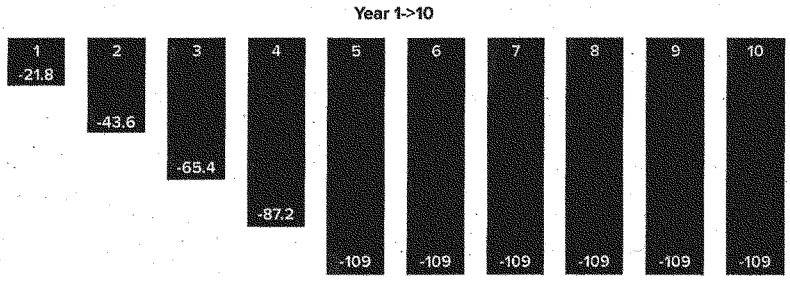


[38] Both employment and tax revenue losses are in the 5th year after implementation. Calculations use IMPLAN.
[39] PE firms hold a portfolio company on average approximately 5 years. Thus, after 5 years existing PE companies (pre-S.2155/H.R. 3848) will have been sold and there would be no new PE investments by this time.

Exhibit 8 also shows that there would be over $109 billion in combined lost federal, state and local tax revenues in this modest-case scenario, after multiplier effects and adding together the effects on the PE industry and the failure of PE-backed companies. Note that the downsized PE industry, in this modest-case scenario, would yield some additional potential taxes on carried interest, management fee payments, and interest expense deduction limitations for the remaining PE sector, which would add a small offset to other tax revenues lost. The ten-year trajectory of such tax revenue losses is shown graphically in **Exhibit 10.**

EXHIBIT 10

Modest-Case Scenario: Years 1->10 Trajectory in Federal, and State and Local Tax Revenue Losses After S.2155/H.R.3848 (in $billions, after multiplier effects)



WORST-CASE SCENARIO

As a result of the above disincentives, it is possible that the entire PE industry would cease to exist over time, and that firms normally financed and managed by PEs would be unable to find other financing and management and fail. **Exhibit 11** shows the predicted negative impact of the Stop Wall Street Looting Act by section in this worst-case scenario.

*The estimate includes increased tax revenues on carried interest and reduced deductibility of interest expense for surviving PE and portfolio companies. Note that most states already tax carried intere ordinary income, so this provision would have little impact on state revenues. Since most PE investors are tax exempt, no tax effects for them are estimated here.

EXHIBIT 11

Worst-Case Scenario: Estimated Direct Impact of S2155/H.R. 3848[41] by Section

S.2155/H.R. 3848 Section	Direct Impact On PE Firms	Direct Impact On PE Investors (including pensions)	Direct Impact On PE Portfolio Companies	Direct Impact On Other Private Funds Firms
101 and 102	100% industry exit (long run)	Annual loss of $3.36 billion (long run)	100% failure rate (long run)	Negative**
201,202, and 203	Negative*	Negative*	Negative*	Negative*
204				
301 though 311	Negative*	Negative*	Negative*	Negative*
401 and 402	Negative*	Negative*	Negative*	Negative*
403	4% down-sizing (long run)	Annual loss of 4% due to downsizing (long run)	4% failure rate increase of (long run)	Negative*
501,502, and 503	Negative*	Negative*	Negative*	Negative*
601	Negative*	Negative*	Negative*	Negative*
701 and 702	Negative*	Negative*	Negative*	Negative*
Net Result	100% industry exit	Annual loss of $3.36 billion	100% failure rate	Negative*

*difficult to quantify ** hedge funds

Exhibit 12 shows the impacts of the above after multiplier effects. There is a loss of 414 thousand jobs (related to the PE industry, after multipliers) assuming all PE firms exit the market, and an additional 26 million lost jobs (after multipliers) due to PE-backed firms failing (i.e., unable to find suitable financing which also provides PE-type management skills), for a total long run job loss, in the worst-case scenario, of 26.3 million jobs. In this setting there, would be a combined federal and state/total tax revenue loss of $475 billion. **Exhibit 12,** investors in PEs would shift $149.3 billion into lower-yield investments, resulting in an annual (long-run) loss of $3.36 billion in earnings (about half of which would be pension funds). Also not shown in **Exhibit 12** is the effects of S.2155 on other private funds firms (hedge funds and venture capital firms), which would also experience negative effects that are difficult to quantify.

[41] Long run impacts would be 5th year after implementation of S.2155/H.R. 3848.

EXHIBIT 12

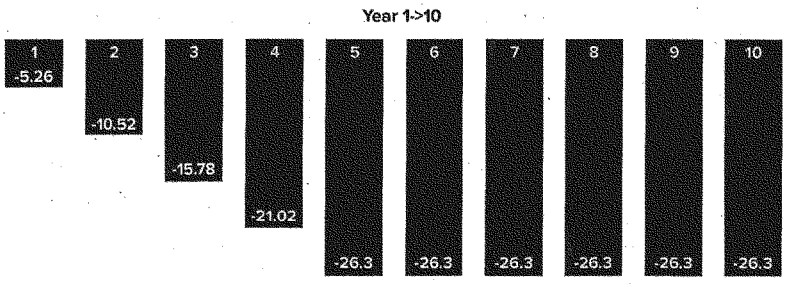
Worst-Case Scenario: Estimated Long-Run Loss in Employment and Tax Revenues (after multiplier effects) Due to S.2155/H.R. 3848[42]

	PE Firms	Portfolio Companies	Combined
Job Losses	414,000	25,866,000	26,300,000
Loss in Federal Tax Revenues	$6,400,000,000	$302,600,000,000	$309,000,000,000
Loss in State/Local Tax Revenues	$2,600,000,000	$163,400,000,000	$166,000,000,000
Total Loss in Tax Revenues	**$9,000,000,000**	**$466,000,000,000**	**$475,000,000,000**

The ten-year trajectory of such job losses is shown in **Exhibit 13**.[43]

EXHIBIT 13

Worst-Case Scenario: Years 1->10 Trajectory in Job Losses After S.2155/H.R. 3848 (after multiplier effects)

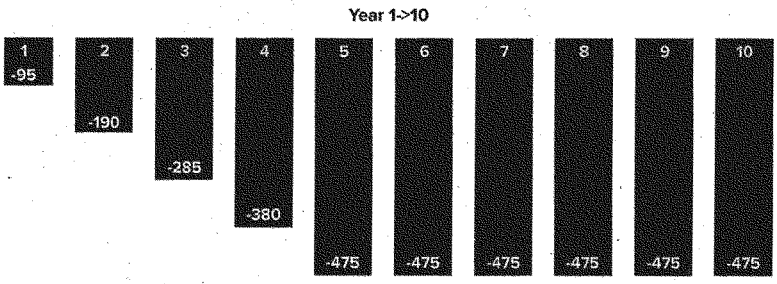


[42] Both employment and tax revenue losses are in the 5th year after implementation. Calculations use IMPLAN.
[43] PE firms hold a portfolio company on average approximately 5 years. Thus, after 5 years, existing PE companies (pre-S.2155/H.R. 3848) will have been sold and there would be no new PE investments by this time

Exhibit 12 also shows that there would be roughly $475 billion in lost federal, state and local tax revenues in this worst-case scenario, after multiplier effects and adding together the loss of the PE industry and the failure of PE-backed companies. Note that the disappearance of the PE industry, in this worst-case scenario, would yield no additional taxes on carried interest, management fee payments, and interest expense deduction limitations due to the disappearance of the tax base (PE industry). The ten-year trajectory of such tax revenue losses is shown graphically in **Exhibit 14**.[44]

EXHIBIT 14

Worst-Case Scenario: Years 1->10 Trajectory in Federal and State/Local Tax Revenue Losses After the Stop Wall Street Looting Act (in $billions, after multiplier effects)



We see that under every scenario, the governments would lose hundreds of millions of dollars of revenue under S.2155/H.R. 3848, which suggests that unless revenues are raised from other sources programs may need to be cut.

SENSITIVITY OF RESULTS TO ASSUMPTIONS

Appendix D performs sensitivity analyses to assumptions used in the foregoing analyses. Calculations show that if as little as 1% of private funds companies exit the market and an equivalent percent of PE-sponsored firms fail, the federal government will "lose money."

[44] Since many PE investors are tax free entities, tax revenue losses here are based on losses related to the PE industry itself, and related portfolio companies, both after multiplier effects.

OTHER NEGATIVE IMPACTS OF THE STOP WALL STREET LOOTING ACT

Retail Sector

One significant negative effect would be on the struggling retail sector. PEs have invested significantly in such companies. To the extent that such companies cannot get financing due to the downsizing of PEs or PEs increased risk exposure, many retailers may fail with resultant losses of jobs in many states.

Other Firms

While the focus of S.2155/H.R. 3848 is on private equity firms, a number of its section can apply beyond PEs. For example, Sections 301 through 310 apply to all companies. Additionally, the tax increasing provisions of S.2155/H.R. 3848 (dealing with carried interest and interest expense deduction limitations) in principle apply to venture capital funds, real estate funds, hedge funds, and other private funds as well. Since quantification of these costs related to these other firms is difficult, the impact here is simply noted aas "negative" in exhibits under both the worst-case and modest-case scenarios.

Markets in General

The risk assumption provisions of Sections 101 and 102 may spill over to other markets. If a number of PE-funded companies happen to fail, and liabilities of these companies exceed asset values, creditors will pursue investors (such as pensions) who in turn may be connected to other financial markets, causing potential financial contagion risk.

About the Author

Charles (Chuck) Swenson, PhD, CPA, is professor and Leventhal Research Fellow at the Marshall School of Business at the University of Southern California, where he has taught since 1987. Chuck has previously served as a visiting professor at UCLA and Caltech. Author of more than 50 academic research and professional articles on taxation which have appeared in such economics journals as the *National Tax Journal, the Journal of Public Economics, and the Journal of Law and Economics,* Dr. Swenson has won the Tax Manuscript Award from the American Taxation Association three times. He is author of two tax texts and is the general editor of the treatise *Bender's State Taxation: Principles and Practice* (LexisNexis, 2009, updated quarterly). His economics-based research has been presented before the New York Senate Revenue and Taxation Committee, the New York Assembly Committee on Jobs, the California State Assembly, and the City of Los Angeles. He is on the editorial boards of the Journal of *Accounting and Public Policy and the Asia Pacific Journal of Taxation.* His bio and curriculum vitae can be found at: https://www.marshall.usc.edu/personnel/charles-swenson

About the U.S. Chamber of Commerce Center for Capital Markets Competitiveness

The Center for Capital Markets Competitiveness's (CCMC) mission is to advance America's global leadership in capital formation by supporting diverse capital markets that are the most fair, transparent, efficient, and innovative in the world. CCMC advocates on behalf of American businesses to ensure that legislation and regulation strengthen our capital markets allowing businesses—from the local flower shop to a multinational manufacturer—to mitigate risks, manage liquidity, access credit, and raise capital.

Appendices

APPENDIX A: ECONOMIC IMPACTS AND TAX REVENUES OF PRIVATE FUNDS INDUSTRY – SELECT STATES

NEW YORK:

EXHIBIT A1

Estimated Employment, Income, and Output Effects of Private Funds in New York (employment in thousands; dollar values in $millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	133.6	$26,726.7	$25,748.0	$41,625.9
Indirect Effect	79.2	$8,698.0	$12,398.5	$18,420.9
Induced Effect	157.2	$9,629.6	$16,927.9	$25,802.5
Total Effect	**370.0**	**$45,054.3**	**$55,074.4**	**$85,849.3**

EXHIBIT A2

Estimated Annual State and Local Taxes and Fees Generated by the Private Funds Industry in New York After Multiplier Effects[45]

Description	Employee Compensation	Tax on Production and Imports	Households	Corporations
Dividends				$6,259,832
Social Insurance Tax- Employee Contribution Employer Contribution	 $46,275,106 $92,583,976			
Sales Tax		$951,294,220		
Property Tax		$1,214,472,638		
Motor Vehicle License		$13,071,943		
Severance Tax		$528,621		
Other Taxes		$160,636,633		
Other Fees		$3,677,187		
Corporate Profits Tax				$172,832,405
Personal Tax: Income Tax			$1,530,740,622	
Personal Tax: Fines-Fees			$210,565,748	
Personal Tax: Motor Vehicle License			$29,126,076	
Personal Tax: Property Taxes			$26,754,027	
Personal Tax: Other Taxes/Licenses			$4,151,986	
Total State and Local Tax	$138,859,082	$2,343,153,622	$1,801,338,189	$179,092,237
	$4,462,443,130			

[45] Ibid. Taxes on proprietors' incomes excluded since tax losses are reported by the pass-through entities.

CALIFORNIA:

EXHIBIT A3

Estimated Employment, Income, and Output Effects of Private Funds Financial Services in California (employment in thousands; dollar values in $millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	102.6	$11,557.8	$384.6	$18,283.2
Indirect Effect	63.6	$2,889.4	$211.5	$10,557.4
Induced Effect	87.2	$3,005.0	$57.7	$13,712.4
Total Effect	**253.4**	**$17,452.2**	**$653.8**	**$42,553.0**

EXHIBIT A4

Estimated Annual California State and Local Taxes and Fees Generated by the Private Funds Financial Services Industry After Multiplier Effects[46]

Description	Employee Compensation	Tax on Production and Imports	Households	Corporations
Dividends				$2,232,681
Social Insurance Tax- Employee Contribution Employer Contribution	 $36,985,620 $77,474,310			
Sales Tax		$490,418,718		
Property Tax		$404,119,112		
Motor Vehicle License		$11,120,826		
Severance Tax		$528,621		
Other Taxes		$72,707,102		
Other Fees		$13,733,836		
Corporate Profits Tax				$40,159,411
Personal Tax: Income Tax			$683,121,188	
Personal Tax: Fines-Fees			$112,336,897	
Personal Tax: Motor Vehicle License			$23,410,431	
Personal Tax: Property Taxes			$8,252,651	
Personal Tax: Other Taxes/Licenses			$4,638,125	
Total State and Local Tax	$114,459,931	$992,628,215	$831,759,292	$42,392,092

[46] Ibid. Taxes on proprietors' incomes excluded since tax losses are reported by the pass-through entities.

APPENDIX B: PE DEALS BY YEAR AND STATE (IN $BILLIONS, 2010–2018)*

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Alabama	$2.26	$1.75	$2.44	$2.26	$3.40	$4.84	$2.90	$4.06	$3.12
Alaska	$0.08	$0.01	$0.05	$0.20	$0.70	$0.46	$0.23	$0.37	$0.52
Arizona	$4.41	$7.19	$7.32	$4.37	$6.12	$27.22	$6.74	$8.49	$10.45
Arkansas	$0.19	$0.79	$0.39	$0.20	$1.44	$1.92	$1.55	$1.07	$1.73
California	$32.68	$43.01	$46.95	$44.35	$61.13	$65.37	$72.22	$67.34	$85.61
Colorado	$11.92	$7.38	$7.40	$10.04	$18.28	$10.79	$18.02	$24.09	$16.49
Connecticut	$8.96	$5.65	$6.45	$7.09	$6.71	$8.52	$7.96	$7.55	$8.39
Delaware	$0.70	$0.52	$1.15	$0.55	$3.00	$0.85	$0.64	$1.06	$0.83
District of Columbia	$0.91	$2.24	$0.63	$0.95	$0.70	$1.46	$0.57	$1.34	$2.75
Florida	$13.67	$18.96	$19.31	$15.77	$34.72	$24.66	$18.04	$32.30	$29.13
Georgia	$12.41	$9.99	$19.36	$14.11	$23.12	$15.85	$19.73	$14.59	$22.33
Guam		$0.10						$0.13	
Hawaii	$0.33	$0.36	$0.34	$1.17	$0.83	$0.27	$0.79	$0.78	$2.27
Idaho	$0.46	$0.30	$0.81	$1.18	$0.80	$0.71	$1.29	$0.87	$1.87
Illinois	$21.53	$15.57	$18.47	$46.82	$33.02	$85.02	$26.81	$34.14	$25.05
Indiana	$4.04	$3.94	$3.69	$4.18	$4.59	$11.70	$8.89	$9.45	$6.08
Iowa	$0.56	$0.16	$1.07	$1.91	$2.92	$1.45	$1.21	$4.00	$3.03
Kansas	$2.80	$1.42	$4.11	$2.95	$3.51	$2.69	$5.28	$3.27	$5.06
Kentucky	$2.38	$1.74	$2.87	$1.51	$3.42	$4.62	$5.82	$4.33	$13.24
Louisiana	$1.71	$1.69	$3.71	$3.93	$6.02	$3.11	$9.06	$5.67	$3.78
Maine	$0.93	$0.78	$0.91	$0.79	$0.95	$0.84	$1.43	$1.63	$0.96
Maryland	$4.07	$4.12	$3.17	$8.08	$10.73	$5.56	$6.74	$8.43	$9.85
Massachusetts	$12.93	$10.31	$9.11	$11.68	$13.70	$12.06	$99.34	$35.86	$26.24
Michigan	$5.30	$4.98	$8.49	$5.46	$14.91	$6.78	$12.19	$13.72	$16.63
Minnesota	$5.36	$6.95	$6.61	$5.02	$8.05	$11.76	$7.74	$7.77	$30.75
Mississippi	$0.23	$0.90	$2.24	$0.30	$1.85	$0.73	$0.65	$0.76	$1.49
Missouri	$3.22	$2.82	$4.09	$3.72	$6.44	$5.60	$7.40	$15.28	$9.27
Montana	$0.24	$0.20		$0.52	$1.09	$0.28	$0.27	$1.12	$0.55
Nebraska	$1.44	$0.97	$0.73	$0.55	$2.03	$1.46	$1.67	$9.47	$1.09
Nevada	$2.36	$1.92	$1.13	$1.35	$1.64	$2.45	$7.77	$2.30	$1.59
New Hampshire	$0.46	$1.71	$2.33	$0.80	$3.74	$1.70	$1.68	$3.05	$2.17
New Jersey	$7.60	$8.77	$12.76	$9.23	$20.26	$13.58	$12.07	$13.17	$14.91
New Mexico	$0.44	$0.32	$0.75	$0.70	$1.09	$0.51	$1.29	$2.21	$0.99
New York	$20.50	$24.93	$27.21	$28.32	$34.50	$46.60	$35.11	$50.03	$43.63
North Carolina	$9.41	$16.57	$12.46	$7.75	$12.53	$15.37	$11.17	$24.44	$20.58
North Dakota	$0.34	$0.93	$0.30	$0.93	$1.13	$2.82	$0.59	$0.46	$0.24
Ohio	$11.40	$13.12	$9.31	$10.84	$19.16	$15.11	$15.73	$13.02	$18.82
Oklahoma	$3.84	$11.04	$6.80	$8.34	$10.27	$6.30	$3.72	$7.52	$8.73
Oregon	$1.23	$1.37	$3.37	$3.13	$3.68	$3.51	$4.18	$3.22	$6.66
Other US Territory	$0.09		$0.02	$0.43	$0.20				
Pennsylvania	$9.16	$14.98	$16.21	$21.26	$19.27	$21.39	$31.68	$24.48	$27.12
Puerto Rico	$0.94	$1.66	$0.20	$0.09	$0.63	$0.33	$0.23	$0.48	$1.39
Rhode Island	$0.71	$0.48	$0.47	$0.75	$0.49	$0.89	$0.84	$0.81	$0.77
South Carolina	$1.71	$1.63	$2.01	$2.88	$2.56	$3.05	$5.53	$3.48	$5.49
South Dakota	$0.19	$0.19	$0.20	$0.51	$1.01	$0.63	$0.42	$0.22	$0.28
Tennessee	$10.31	$10.25	$5.42	$7.09	$10.87	$7.65	$10.82	$18.94	$32.97
Texas	$30.49	$51.42	$54.95	$90.16	$70.29	$54.42	$63.40	$72.25	$110.62
Utah	$2.84	$4.13	$9.28	$3.87	$5.26	$4.66	$3.58	$6.72	$4.57
Vermont	$0.45	$0.78	$0.40	$0.44	$0.57	$0.29	$0.44	$0.10	$1.48
Virgin Islands						$0.01	$0.23		$1.25
Virginia	$7.61	$12.09	$6.89	$19.34	$7.99	$15.44	$14.45	$17.29	$8.21
Washington	$2.57	$3.11	$10.44	$4.92	$9.24	$8.22	$9.72	$7.12	$16.30
West Virginia	$1.01	$0.62	$0.82	$0.06	$0.96	$0.35	$0.50	$1.07	$0.51
Wisconsin	$2.31	$4.98	$7.76	$8.88	$8.83	$8.73	$5.20	$8.39	$11.67
Wyoming	$0.27	$0.30	$0.14	$0.73	$2.11	$0.89	$0.52	$1.32	$0.44
Unknown	$1.10	$0.53	$0.77	$2.56	$2.60	$0.93	$1.49	$6.56	$4.07
Total	$284.74	$343.53	$374.89	$433.53	$527.05	$551.77	$605.28	$630.07	$687.17

*Source: Pitchbook

APPENDIX C: DETAILED EXPLANATIONS OF SECTION 403 OF S.2155/H.R. 3848

Undert his section, net capital gain from an "investment services partnership interest" (ISPI) is treated as ordinary income and is taken into account in determining the partner's net earnings from self-employment. The amount treated as ordinary income (or ordinary loss) is allocated ratably to the items of long-term capital gain (or loss) taken into account in determining net capital gain (or net capital loss). Net long-term capital gain (and loss) is determined under Section 1222, but (i) by only taking into account items of gain (or loss) taken into account by such partner under section 702, and (ii) treating any section 1231 property as held for more than one year.

Gain from the disposition of an ISPI is treated as ordinary income and is taken into account in determining the partner's net earnings from self-employment. The holder generally would be required to recognize such gain without regard to any other income tax provision.[47] Similar recharacterization rules apply to income or gain derived from other "disqualified interests" (e.g., convertible debt, options, or derivatives) held by a person who performs substantial investment management services for any investment entity. The rule generally does not apply to a partnership interest or to taxable C corporations and S corporations, except to the extent provided in regulations. The rule would apply to foreign corporations if substantially all of their income is not effectively connected income (ECI) or subject to a comprehensive foreign income tax.

If any built-in gain property is distributed with respect to an ISPI, the partner receiving such property will recognize gain equal to the FMV of such property over the partner's adjusted basis in the property. Gain recognized due to a distribution will be treated as ordinary to the extent gain on such partner's distributive share would have been treated as ordinary if the distributed property had been sold by the partnership at FMV immediately before the distribution and all of the gain had been allocated to the distributee partner. The basis of the distributed property will be FMV in the hands of the distributee partner. Qualified dividend income and the qualified small business stock rules will not apply to dividends or gain allocated to an ISPI. An ISPI will be treated as a "hot asset" in applying Section 751, and any gain that arises by reason thereof must be recognized without regard to any other income tax provision. Adjustments are made to exclude the amount attributable to a qualified capital interest. An exception to this rule applies to exchanges of interests in publicly traded partnerships that hold ISPIs, except to the extent provided by regulations.

This section also treats net capital loss from an ISPI as ordinary loss but such recharacterization is limited to the amount by which (i) the amount of net income recharacterized from such interest for all preceding partnership taxable years, exceeds (ii) the amount of net loss recharacterized from such interest for all preceding partnership taxable years. Loss from the disposition of an ISPI is treated as ordinary loss, but such recharacterization is limited to the amount by which (i) the amount of net income recharacterized from such interest for all partnership taxable years, exceeds (ii) the amount of net loss recharacterized from such interest for all partnership taxable years.

This section defines an ISPI generally as any interest in an investment partnership acquired or held by a person in connection with the conduct of a trade or business by such person (or a related person), which primarily involves the performance of any of the following services with respect to assets held (directly or indirectly) by one or more such investment partnerships: Providing advice regarding the advisability of investing, purchasing or selling of any "specified asset"; managing, acquiring, or disposing of any "specified asset"; arranging financing with respect to acquisition of "specified assets"; and/or performing any activity in support of the above-listed services. If an ISPI is acquired from a related person, it continues to be treated as an ISPI. Also, an interest does not cease being treated as an ISPI merely because such person holds such interest other than in connection with the described trades or businesses.

[47] An exception is provided for contributions of an ISPI to a partnership in exchange for an interest in such partnership provided the taxpayer elects to treat the partnership interest received as an ISP and to comply with certain reporting and recordkeeping requirements. Similar rules apply to certain partnership mergers, divisions and technical terminations subject to Section 708(b). Also, the bi would allow transfers of ISPIs by gift or death not to be treated as a disposition triggering ordinary income treatment. However, the transferee or heir must treat the obtained interest as an ISPI. Als any inchoate income (that would have been recharacterized had the decedent sold the ISPI at the time of death) shall be treated as income in respect of a decedent (IRD).

The term "investment partnership" means any partnership if, at the end of any two consecutive calendar quarters, (i) substantially all of the assets of the partnership are specified assets (determined without regard to any Section 197 intangible), and (ii) "less than 75 percent of the capital of the partnership is attributable to qualified capital interests which constitute property held in connection with a trade or business of the owner of such interest." For this purpose, a specified asset generally includes securities, real estate held for rental or investment, interests in partnerships, commodities, cash (or cash equivalents), or options or derivatives with respect to any such assets. Special look-through rules apply for certain wholly owned entities.

None of the foregoing rules apply to items of income, gain, loss, or deduction to the extent allocable to a qualified capital interest if a "significant" amount of allocations are made in the same manner with respect to other qualified capital interests held by unrelated partners who do not provide investment management services to the partnership. These rules may be applied separately by regulation to a portion of a "qualified capital interest."[48]

A "qualified capital interest" refers to the portion of a partner's interest in the capital of a partnership attributable to (i) the fair market value of money or other property contributed to the partnership in exchange for the interest; (ii) any amount included in gross income under Section 83; and (iii) any partnership amounts previously taken into account as net income or gain. The qualified capital interest shall be reduced by partnership distributions to the partner (after the effective date) or by allocations of net losses or deductions.

A transferee of an ISPI generally will succeed to the qualified capital interest of the transferor. Also, a qualified capital interest generally does not include any contribution of capital that is attributable to any loan or advance made or guaranteed (directly or indirectly) by another partner or the partnership (or a related person to another partner or the partnership). Loans and advances to the partnership made or guaranteed (directly or indirectly) by another partner that does not provide services to the partnership shall be taken into account in determining qualified capital interests of the partners.

The recharacterization rules under the bill (in subsections [a] and [b]) do not apply to items allocated to a domestic C corporation with respect to an ISPI and subsection (e) with respect to disqualified interests does not apply to domestic C corporations, except to the extent provided by regulations. Also, a new 40% penalty is imposed on underpayments resulting from avoidance of the purposes of the provision (as prescribed by regulations) or failure to treat income derived from other ownership interests as ordinary income.[49] Also, income treated as ordinary income from an ISPI generally would not be treated as qualifying income for purposes of determining whether a publicly traded partnership (PTP) can be treated as a partnership.[50]

Treasury is provided broad regulatory authority under the bill to prescribe guidance necessary or appropriate to carry out the purposes of the proposal, including: separate reporting and recordkeeping of income related to an ISPI; modifications consistent with the purposes of the proposal; rules to prevent avoidance of the proposal (including through the use of qualified family partnerships); and coordinate the proposal with other tax provisions. The bill generally would apply to taxable years ending after the date of enactment, but would apply only to dispositions and distributions after the date of enactment.

[48] In situations where there are no significant allocations to non-service providers, Treasury would have regulatory authority to treat partnership items as "properly allocable" to a qualified capital interest. Allocations to a partner in certain qualified family partnerships will be treated as meeting this test even though there is no unrelated qualified capital interest to use as a benchmark for such allocations.
[49] The reasonable cause exception under Section 6664(d) would only apply if the tax treatment has been adequately disclosed, there was substantial authority for the position, and the taxpayer reasonal believed the treatment was more likely than not proper.
[50] This rule would not apply to certain partnerships substantially all of whose assets are interests in PTPs or certain partnerships whose interests are convertible into interests in publicly traded real estate investment trusts (i.e., UP-REIT structures). This rule is not applicable to existing PTPs until taxable years beginning on or after the date that is 10 years after date of enactment.

APPENDIX D: SENSITIVITY ANALYSIS

We can solve for the minimum response rate to S.2155/H.R. 3848 before governments start to lose tax revenues. For the federal case, we solve:

$6.43 billion *(1-x) -$2.45 billion=0, (C1) where x=% response rate to taxation, $2.43 billion is the presumed gain to the federal government on the new taxes from S.2155/H.R. 3848 (without behavioral responses), and $6.43 billion is the total federal tax revenue generated by the industry (after multipliers, and before behavioral responses). The above yields approximately 38%. So, if as little as 38% of PE firms exited the market, the federal government would lose money. When we add in federal tax revenues lost from PE portfolio companies, we see that if as little as 1% of PE firms exited the market, and an equivalent percent of portfolio companies failed, the federal government would lose money.