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PROTECTING COMPANIES AND COMMUNITIES FROM PRIVATE EQUITY ABUSE

HEARING

BEFORE THE

SUBCOMMITTEE ON
ECONOMIC POLICY

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING WHAT PRIVATE EQUITY FIRMS ARE DOING TO OUR ECONOMY AND TO OUR COMMUNITIES

OCTOBER 20, 2021

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C O N T E N T S

WEDNESDAY, OCTOBER 20, 2021

WITNESSES

Additional Material Supplied for the Record

PROTECTING COMPANIES AND COMMUNITIES FROM PRIVATE EQUITY ABUSE

WEDNESDAY, OCTOBER 20, 2021

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON ECONOMIC POLICY,
Washington, DC.

The Subcommittee met at 2:14 p.m., via Webex and in room 538, Dirksen Senate Office Building, Hon. Elizabeth Warren, Chair of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIR ELIZABETH WARREN

Chair WARREN. This hearing will come to order. This hearing is in a hybrid format. A few reminders. As you begin, for our guests who are joining us virtually, once you start speaking there is a slight delay before you are displayed on the screen. To minimize background noise please click the Mute button until it is your turn to speak or to ask questions.

You should all have one box on your screen labeled “Clock” that will show you how much time is remaining. For witnesses, you will have 5 minutes for your opening statements. For all Senators, the 5-minute clock still applies for your questions. At 30 seconds remaining for your statements and questions you are going to hear a bell ring to remind you that your time is almost expired. It will ring again when your time has actually expired.

And to simplify the speaking order process, Senator Kennedy and I have just decided we will go by seniority as people come in.

What we are going to do is we are also in the middle of votes, just to add an extra layer of complication to all of this. So I am going to hand the gavel over to Senator Kennedy, who is going to get us started. I am going to run, and then I will come back and he can do the same.

So thank you all for being with us. Thank you. Thank you, Senator Kennedy. All yours.

OPENING STATEMENT OF SENATOR JOHN KENNEDY

Senator KENNEDY [presiding]. I do not have a very elaborate opening statement. I want to thank all of you for being here.

If there are problems in our private equity markets I would like to hear about them. I consider private equity—and we can talk about the definition today if you would like—to be an essential part of the free enterprise system. I mean, stripped to its bare essential, all private equity investment is is a decision by one willing buyer

and one willing seller, and that happens every day, billions of times every minute in the American economy.

Private equity, as we know it, as I know it, of course, is limited to accredited investors, very sophisticated investors. I am a former State Treasurer and sat on the boards of a number of retirement systems. I know, in the retirement systems with which I am familiar, private equity is a huge part of those retirements systems' investments. So put me in the corner of pro-private equity, and I say that because I am pro free enterprise. I am not real fond of neosocialism. I think neosocialism is just trickle-down poverty. And it bothers me that our store shelves are starting to look like the store shelves in Cuba and Venezuela. That concerns me a great deal.

So let us get started. I cannot see, without my glasses, and even with my glasses I cannot see that far.

OK. I am not going to introduce the panel. That will just take away from their time. I am just going to introduce the speaker. Well, maybe I should. I do not know. I do not want to get put on double secret probation here.

OK, first, I am going to read this. Joining us virtually we have Ms. Shirley Smith. Ms. Smith is a former employee of Art Van Furniture in Detroit, Michigan, and is a Leader with United For Respect. Next here, in person, we have Ms. Peggy Malone. Ms. Malone is a registered nurse at Crozer—did I say that right?—Chester Medical Center in Upland, Pennsylvania.

Joining us virtually we have also the Honorable Michael Frerichs. Did I say that, Mr. Treasurer, correctly?

Mr. FRERICHS. Senator, former treasurer, close enough. Michael Frerichs.

Senator KENNEDY. Yes, sir. Mr. Treasurer, welcome.

We also have Dr. Eileen Appelbaum here, who is the Codirector of the Center for Economic Policy and Research. And we have Dr. Doug Holtz-Eakin, President of American Action Forum, and last we have Mr. David Burton, Senior Fellow at The Heritage Foundation.

Let us start—well, let us start with our panel here.

How about Mr. Burton.

STATEMENT OF DAVID R. BURTON, SENIOR FELLOW IN ECONOMIC POLICY, ROE INSTITUTE FOR ECONOMIC POLICY STUDIES, INSTITUTE FOR ECONOMIC FREEDOM AND OPPORTUNITY, THE HERITAGE FOUNDATION

Mr. BURTON. Thank you. My name is David Burton. I am Senior Fellow in Economic Policy at The Heritage Foundation. I would like to thank you, Senator Kennedy, Senator Warren, and the other Members of the Committee for the opportunity to be here.

Entrepreneurship is vital to innovation, improved productivity, better products, better wages, and prosperity throughout the country. Private capital markets are, by far, the primary means by which entrepreneurs raise capital to launch and grow their business. Private equity, broadly defined, is absolutely vital to the economic future of the United States. Private offerings account for at least $2.9 trillion annually in capital raised. In contrast, registered or public offerings raise less than half of that amount, $1.4 trillion.

Regulation D is the most important means of raising private capital and accounts for approximately $1.7 trillion as of 2018.

Public capital markets are in decline due to regulatory overreach. Firms go public much later in their life cycle, fewer firms go public at all, and ordinary investors typically do not receive the returns from successful startups and entrepreneurial ventures because they go public so much later.

Being a public company has become extraordinarily expensive, both in terms of the initial public offering costs, the amount of money you have to spend on lawyers, investment bankers, accountants, and so on, but also the continuing compliance costs and the annual regulatory costs, not to mention regulatory risk, the threat of being sued.

The number of public companies has declined almost by half over the past quarter century, despite the real GDP growing by 80 percent and the population increasing by almost a quarter.

There is a major effort underway now to apply the policies that have harmed the public market to the private market, on a whole host of fronts, including ESG and what have you, and the legislation that is part of this hearing today would be part of that, the Stop Wall Street Looting Act.

Private equity funds, narrowly defined, are also an important aspect of our capital markets. They are one of the primary means of keeping incompetent management accountable. They also are one of the primary means by which companies are turned around, by an infusion of new equity capital.

The Stop Wall Street Looting Act would be more aptly named the Protecting Incompetent Management Act. It basically would erect a high wall and a moat around management of companies that are failing, to make it virtually impossible to mount a takeover that would be able to change the management and protect the continued existence of the company by replacing the management and also protecting the employees' jobs, who work there and will lose their jobs in the event the company fails.

Now this may be attractive to corporate elites and corporate management and their lobbyists but it certainly is not in the interest of shareholders, workers, or consumers.

One thing I wanted to bring to the attention of the Committee, if you read section by section there is a provision that imposes a 100 percent tax on fees paid by targeted companies to private equity funds, but the actual statutory language in that would, in effect, impose the 100 percent tax, which is really including State taxes, more than 100 percent, on all payments by firms to any fund. It is very poorly drafted language and not only would shut down, in effect, the private equity fund market but have much broader and extraordinarily adverse effects. I think that is a drafting error, but it is a really important drafting error.

Other things in the act that I think are deeply problematic, Title V would impose disclosure requirements on private equity funds that are roughly comparable to what Regulation SK and other aspects of securities law impose on publicly traded funds, and I think that is more or less by design. It would impose disclosure requirements on private equity firms that are roughly analogous to public companies, so no one would actually choose to be a private equity

fund anymore. Shutting down these private equity funds would have an adverse impact on millions of people.

And last, in my written remarks I include 14 specific suggestions on how to improve our private equity markets.

Thank you very much.

Senator KENNEDY. Thank you, sir. Dr. Holtz-Eakin.

STATEMENT OF DOUG HOLTZ-EAKIN, PRESIDENT, AMERICAN ACTION FORUM

Mr. HOLTZ-EAKIN. Thank you, Senator Kennedy, Senator Reed, Members of the Subcommittee for the chance to be here today. I also do not have an elaborate opening statement. Let me say a few things and then I would be happy to answer your questions.

Clearly, financial markets are an important part of the U.S. economy. They serve to provide many essential economic functions, channeling funds from savers to investors, allocating that capital as efficiently as possible, pricing risk and return, allowing individuals to diversify away from risk as they desire, and the list goes on. And in looking at those financial markets you like to have all sorts of business models compete to provide those services to the economy. We have insurance companies and banks and all sorts of things, including private equity.

My concern today is about the proposed legislation, and I am concerned not because I am a big fan of private equity. I am not. I also have no particular animus toward private equity. I am concerned because the legislation would tilt the legal, regulatory, and tax playing field quite strongly against private equity, and I think that the objective of policy should be that those legal, regulatory, and tax policies be as neutral as possible. This is clearly an attempt to tilt the playing field against private equity. And if there are problems with private equity I think those should be dealt with in other ways, identifying the harms and correcting the behaviors.

So its success in finding undervalued companies, reforming their operations, has delivered an enormous footprint. There are 11.7 million workers in private equity, earning about $900 billion in compensation. These are good-paying jobs. The average employee is getting $73,000 in 2020, and the private equity sector has produced $1.4 trillion in gross domestic product, our about 6.5 percent of GDP. That footprint is a testament to the success it has had in providing valuable economic function.

The flip side is that this legislation would undo that, and that would come at a tremendous cost. The Chamber of Commerce estimates that the loss would range from somewhere between 6.9 to 26.3 million jobs in the U.S. economy, and returns that are up to $3.5 billion a year for investors.

And so my hope is that the discussion can focus on what is good policy for private equity and others and where there are, in fact, identifiable hard to find remedies that are not so sweeping as to disrupt the level playing field from a policy perspective. Thank you.

Senator KENNEDY. I am going to turn the gavel back over to our Chairperson.

Chair WARREN [presiding]. So it looks like we have the Illinois State Treasurer next, the Honorable Michael Frerichs. Michael, are you there?

Mr. FRERICHS. I am. Can you hear me?

Chair WARREN. Thank you. Yes, we can.

STATEMENT OF MICHAEL FRERICHS, ILLINOIS STATE TREASURER

Mr. FRERICHS. Great. Well, good afternoon, Madam Chair and Ranking Member Kennedy, Members of the Subcommittee, and distinguished guests.

Now the clock I am looking at shows me a minute and 30 seconds.

Chair WARREN. No.

Mr. FRERICHS. Oh, there we go.

Chair WARREN. There you go.

Mr. FRERICHS. My name is Michael Frerichs. I am the Illinois State Treasurer, elected by the great people of the State of Illinois, and as Senator Kennedy knows from his time as State Treasurer, and my colleague in the National Association of State Treasurers, it is truly an honor being trusted with the people's money. It is an honor to be invited to speak with this Subcommittee today.

The Illinois State Treasurer performs many roles. I am the State's Chief Investment and Banking Officer. In that role, my team and I actually manage approximately $50 billion. This portfolio includes roughly $25 billion in State funds, $16 billion in retirement account savings plans, and $9 billion on behalf of local and State governments. Among those investments are $500 million in private equity and venture capital.

But I also serve as a trustee on the Illinois State Board of Investment, which manages approximately $31 billion in pension assets on behalf of over 226,000 beneficiaries. ISBI maintains approximately $1.7 billion of private equity investments.

My job is to prudently invest public funds and pension funds, a portion of which are managed by private equity firms. I also have responsibility to the long-term fiscal health of our State and local government institutions, which rely on a vibrant and sustainable economy. And I also have a duty to tend to the well-being of the communities I represent, including the economic security and dignity of millions of workers.

Unfortunately, some private equity firms engage in practices that harm these objectives. From my experience as an institutional investor there are several important challenges relating to private equity investments, in particular, the need for increased transparency and the need for reforms to ensure that workers, communities, and investors are protected from predatory practices.

Before I go into further details I want to say that private equity is an essential part of our capitalist system. The idea of the industry is simple: sometimes a company has room to grow and become more productive, but its current ownership is not in a position to capitalize on that opportunity.

In this situation, it makes sense for an investment vehicle, run by experts, to pool private capital, to buy the firm and take it to the next level, and then to sell it. This generates a profit for private equity firms and their investors, it helps the company to grow, and it creates more economic opportunity for society at large.

For investors like the Illinois Treasury, private equity provides an opportunity to further diversify our portfolios, to help drive economic development, to support small businesses, to expand the circle of opportunity to underutilized investment firms like those in downstate Illinois or those that are minority and women-owned, and to provide a competitive return within our overall portfolio.

Unfortunately, as private equity has continued to evolve and become a larger and larger portion of the economy it has continued to be regulated as though it was a boutique investment that only affected the ultra-wealthy. That means that predatory activities, like opaque fees and pillaging assets and strategically using bankruptcy without regard for the well-being of workers and their communities and their pensions remains perfectly legal. And as long as these practices are allowed, they will happen, and as long as they happen, our communities are at risk, and that is why sensible reforms are needed to rein in harmful behavior by bad actors in this space.

Let me talk for a little bit about fee transparency before I run out of time. There has been a significant increase in demand from public pensions to invest in private equity. It's no wonder. The asset class has had historic levels of fundraising and record amounts of distribution to investors. Private equity is unique in that it is rooted in a sense of long-term partnership where investments are designed to mature in 10 to 15 years, if not longer.

Fiduciary duty is the foundation of an effective partnership between general partners and limited partners in private equity funds, and this is especially important given that these investments are illiquid and currently require less transparency than other investment vehicles.

And that brings me to a crucial point. There is a dire need for increased transparency and disclosure to help provide investors the necessary information to make informed decisions, including data on fees, to make clear, complete, consistent, and in a not misleading manner, so that institutional investors, like myself, can better fill our fiduciary duties.

I see my 5 minutes is coming to an end, so I look forward to any questions you might have.

Chair WARREN. So thank you very much, Mr. Treasurer. I appreciate your comments here today.

And next we have joining us virtually Ms. Shirley Smith, who is a former employee of Art Van Furniture in Detroit, Michigan, and who is also a leader with United for Respect.

Ms. Smith, I would like to recognize you for 5 minutes, please.

STATEMENT OF SHIRLEY SMITH, FORMER SALES MANAGER, AT ART VAN FURNITURE, LEADER WITH UNITED FOR RESPECT

Ms. SMITH. Thank you, Senators. Thank you so much for having me here.

My name is Shirley Smith and I live in Detroit, Michigan. For 23 years, I worked for Art Van Furniture, the last 9 as a sales manager, and it was a job that I truly loved. Art Van was a family owned business, and the company culture was centered around

family. Employees were tight-knit, we had each other's backs, and there was a real sense of community.

I was a single mom and I am grateful for the support and flexibility I had at work, so I could be there for my son while juggling a successful career. I had the opportunity to build relationships with my customers and earn a good living, making it possible to buy my own home and provide a good education for my son. Working at Art Van was like my own little slice of the American Dream, until the private equity firm, T.H. Lee, came in and broke up our family.

Before T.H. Lee took over in 2017, Art Van was a successful company, reporting $800 million dollars in revenue that year. Up to then, most of my colleagues would have told you it was a company they loved working for, but those last 3 years were hell.

It was not obvious right away, but a lot started changing. We noticed our top company leaders were being pushed out the door. T.H. Lee brought in people who did not know the furniture business, and orders started coming in slower. In hindsight, that was a big red flag. Sales associates work on straight commission, which only gets paid when an order is delivered, and customer orders were not being filled.

Art Van's reputation was being destroyed right before our eyes. We had to start making up excuses to our customers, some of whom grew violent when they learned they would not be getting refunds. One of my colleagues even had a gun pulled on her during closing weekend. T.H. Lee made us feel like liars and thieves, taking people's hard-earned money when they knew they were never going to get their orders.

We stopped paying our bills on time and started cutting staff. For decades, Art Van had been a debt-free company that paid all its bills. Under T.H. Lee's ownership, Art Van racked up millions of dollars in debt to Wall Street banks and other deep-pocketed creditors. T.H. Lee even sold off Art Van's real estate to itself, forcing Art Van to pay rent on the same properties it once owned. By the end of 2019, under T.H. Lee's so-called leadership, Art Van was in the red, and it took just three short years for T.H. Lee to strip our company for parts.

Then the pandemic hit. We first received WARN Act notices about our layoffs before the COVID–19 emergency order was issued in Michigan, so the bankruptcy and layoffs had nothing to do with the pandemic. But then, a few weeks later, Art Van changed their original WARN Act notice, citing COVID–19 instead. As a result, we did not get any severance pay or benefits. Nothing. Robbing the American workforce like this, hurting the same people on the front lines who have been applauded as "heroes" for keeping our economy open, should be a crime.

When we were told we would be losing our jobs, we were promised a lot. We were promised health insurance after closing. We never got it. The only insurance I could afford charged me 10 times what I had been paying for prescriptions. I was unemployed for 5 months, and many times I had to choose between paying for my medication or paying other bills.

We were also promised a retention bonus that we never got. Since my unemployment did not kick in for 2 months, I had to take

out money from my 401 to make ends meet, which I am still paying taxes on today.

Sadly, my story is not unique. Private equity has quietly taken over nearly every facet of life, from retail and grocery store chains, to housing, health care, media, and more, turning the American Dream into nothing more than a pipe dream for millions of working families.

And T.H. Lee did not only destroy us, the individual workers who lost their jobs. Every community that had an Art Van store suffered too. We had a deep reach into our communities. We were one of the largest taxpayers in the city of Warren, where we were headquartered, and the biggest contributor to our food banks. When the company went under, there was a terrible ripple effect of harm felt throughout the State of Michigan.

I am here today to show you the human toll of Wall Street's greed. Our elected leaders, each of you here today, I have to ask you why billionaires should be allowed to do this and destroy the fiber of America. Why should this be legal? This is a sin, it is unconscionable, and something needs to change.

Thank you for giving me the opportunity to speak with you today.

With nearly 12 million people working for private equity-owned companies in the United States, private equity is a major employer. Given the industry's poor track record we must also take a closer look at how their cost cutting and greed impacts workers and the customers they serve across America.

Chair WARREN. Ms. Smith, thank you very much for being with us today. We really appreciate it.

And now we have, in person, Ms. Peggy Malone, who is a registered nurse at the Crozer-Chester Medical Center in Upland, Pennsylvania.

STATEMENT OF PEGGY MALONE, REGISTERED NURSE, CROZER-CHESTER MEDICAL CENTER

Ms. MALONE. Thank you, Senator Warren, and Members of the Subcommittee for having me here today. I am the Vice President of the Crozer-Chester Nurses Association, which is a local of PASNAP, and I am also on the executive board. I have been a registered nurse for 32 years at Crozer-Chester Medical Center.

Being a nurse, for me and my colleagues, is a calling. It is a profession that we are very proud of, and private equity has no business in health care. They have destroyed our hospital. They have destroyed the fiber of what we are as health care professionals.

Prospect Medical Holdings, which has 17 hospitals across the country, I can go on and on about the owners, Leonard Green, David Topper, Sam Lee, and what they have done. That is all public knowledge. You can find that out. You can get that information. You can see that it is wrong that our tax system should not be creating incentives for business practices and private equity firms. They should not be able to extract huge dividends from hospitals. They were given $173 million of COVID relief money, none of which we have seen in the hospitals. We take care of patients every day, and I understand some of you are very pro private equity. Well, I am going to tell you that families were not allowed in the

hospital. You did not see what was going on in there during this pandemic.

We served patients moldy bread during that pandemic. We were not able to give good-quality care to patients. Patients were dying. They had no family. They had no one in the rooms but us. It was the nurses. It was the respiratory therapists. We were the ones that had to go in. We were scrambling for iPads so that families could say goodbye to their loved ones, without having anyone in the room. We were their families. We were using poor-quality equipment. I would have to try to straddle a urinal to collect urine from a patient's bag, between my feet, with a gown and a mask and all the PPE. Number one, we were wearing trash bags at a certain point because we did not even have enough PPE.

And this is how we were taking care of patients, day in and day out. I left my family. I stayed at a house that the local college gave us, because I was afraid to take it home to my family. I had my children at home who were having graduations and everything taken away from them, as all of my colleagues. And we went in and we did this job every day, to the best of our ability, with no equipment, with no PPE. We were afraid for our lives, and we did this job, and we did it every day. For every single person in this country we thought we were doing good. And you know what? Now we are the bad guys, because we are speaking up, and we want to know where that money is, and we want to know how these private equity firms cannot take care of the patients that are in these hospitals.

We do not have enough staff. We do not have enough equipment. We are fighting every day to give good-quality care to patients, and we are not able to do it. We are not able to do it, and nobody was in there watching. There were no families in there. There was no one watching. It was just us, and we were watching people die.

And so I can give you the statistics. I can talk about Leonard Green, and I can talk about all the things that are going on, and all the tax credits and things that these companies are given. They were given pandemic money and we have not seen one bit of it being spent on the patients. That is our goal.

Private equity does not belong in health care. Our job. Our job is to do no harm. It is to do no harm. It is to care for our patients. That is why we got into this. And we will fight, and every nurse I know will fight. But what I see now, we are seeing the PTSD. We are seeing the nurses suffering. We are seeing the doctors struggle. What we saw was a war zone, for the last 20 months, and it is not over. And we have not gotten support. We have not gotten support from our administration. We have not gotten supplies that we need. We do not have the staff that we need.

Private equity has no business in health care.

Chair WARREN. So thank you, Ms. Malone, and thank you for the work that you have done. I lost my brother early in the pandemic, and he had no one with him except the nurses who showed up to hold his hand. I appreciate all that you have done and I know it has been hard.

We now have our final witness, and that is Dr. Appelbaum. Dr. Appelbaum, could you please talk with us a bit.

STATEMENT OF EILEEN APPELBAUM, CODIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Ms. APPELBAUM. Yes. Thank you, Senator Warren, Senator Kennedy, Members of the Subcommittee. I am very happy to be here to testify today.

Private equity is a largely unregulated financial actor, and it is playing a growing role in both the U.S. economy and in global economies. In 2020, global assets under management reached $4.5 trillion, and this is expected to double to $9 trillion by 2025, so it is a big and important player.

In the U.S., private equity owns or backs 8,000 companies in every nook and cranny of the economy, ranging from health care, as we just heard, to IT, to retail chains, to supermarkets, single-family rental homes, and payday lenders. They are in every part of the economy. The private equity industry and its companies employ nearly 12 million workers.

Pension funds and other limited partners have been pouring money into private equity funds, seemingly unaware that it is really hard for any private equity fund to beat a booming U.S. stock market, and they have not beaten it. Research has shown that the median private equity fund in every vintage since 2006, has just tracked the stock market. It has not actually beaten it.

Yet fundraising by the largest private equity firms has reached stratospheric levels. It is not that investors in private equity do not see a return on their money. They do see it. However, the point is that they could have gotten the same returns by investing in stock market index funds without all the risk. So they are not beating the stock market. The point is they could have done as well in the stock market.

The big private equity funds are just raking in money from institutional investors. In the last 5 years, Blackstone and KKR each raised more than $90 billion. This year, KKR was launching an $18.5 billion for its North America Fund, and Carlyle has announced plans to raise $27 billion for its next fund, in what would be the biggest private equity fund.

It is not possible to take that kind of money, they have just a few years to deploy it, and to invest it in small companies. They invest in really big companies which do not give you much opportunity for turning them around. We have just seen the $38 billion purchase of Medline, a family owned company, by private equity firms. You do not pay $38 billion for a company you think you have to turn around.

With all that cash on hand, private equity is poised to buy up large swaths of the U.S. economy, with no limit on how much debt they can leverage on the companies, with no limit on how much wealth they can take out, and no limit on how hard they can squeeze the employees.

A study examining private equity buyouts of public companies found that when private equity takes these public companies private employment declines by 13 percent in just the first 2 years. Another study that looked at private equity buyouts that used a lot of debt found that the bankruptcy rates were as high as 20 percent. For affected workers, their families, and communities, this is dev-

astating. But win or lose, the private equity firms always walk away with a profit.

Thank you.

Senator REED [presiding]. Well, I want to thank Chair Warren and Ranking Member Kennedy for allowing me to go first and ask question. Chair Warren will return promptly from the vote.

Dr. Appelbaum, what do you believe to be the primary gaps in the regulation and supervision of private equity?

Ms. APPELBAUM. I think that there is little recognition that while they once wanted to buy on leveraged buyouts, private equity firms have now really developed many, many avenues for making money and for participating in the economy. So it is not just leveraged buyouts. It is also the credit funds, which I think are playing a huge role in a shadow economy.

Back in 2013, the regulators provided guidance that essentially said to the banks, "Really, you should not put more debt on a company than six times earnings, because our research shows that when you go beyond that point the company is very likely to default on its debts, experience financial distress, and to even go bankrupt." So they put that out there.

And KKR came along, and it had difficulty raising the kind of money it wanted to put debt on a company that it was buying. And so it was not long before the private equity firms figured out they needed their own credit funds. And these credit funds act like investment bankers, but there is no banking regulation of them. So I think that is really a huge gap in our knowledge of what is going on.

Private equity now has real estate funds. These real estate investment funds move back and forth. Sometimes they are publicly traded. Sometimes they are privately held by the private equity firm. They are playing a role that I think is little understood in the economy .

I have been studying health care so I have seen their role there. When you say that a chain like Steward sold its real estate to a real estate investment trust, that would be something that operates without much regulation, and provides a lot of money to operators to go out and buy up, in this case, more hospitals. So we have seen a buying spree of hospitals, by private equity or formerly private equity-owned chains, funded by the real estate investment trusts.

Real estate investment trusts are in many aspects of the economy. We look to the SEC to say, shouldn't you be taking a look at them? But, in fact, it is not just the SEC that needs to be involved. Banking regulators regulate investment banks, and I think if these credit funds want to operate as investment banks, they should be regulated in the same way. And I think we need to know a lot more about the role of real estate investment trusts in the economy. They fly completely below the radar, but they fund a lot of the expansion that we see going on by private equity firms.

Senator REED. Thank you very much, Dr. Appelbaum.

Now if the Treasurer is still on Webex or Zoom, Treasurer Frerichs, I would like to ask if you could share your experience with private equity in terms of fee-and-expense arrangements, and

do you believe these arrangements are adequately disclosed and transparent?

Mr. FRERICHS. OK. So my office experience is similar to what other institutional investors are recognizing, and that is as private equity continues to evolve there is a growing need for improved disclosures around direct and indirect fees, expenses, and performance-based fees, such as carried interest in particular.

It is safe to say that investors such as ourselves or public pension plans would be greatly benefited with increased level of disclosure and transparency between general partners of private equity firms and investors. Given the fees charged by private equity managers are among the highest shouldered by institutional investors, a lack of transparency represents a meaningful risk factor.

It is necessary to ensure transparency for all investors and ensure investors can validate fees but also understand if there are any potential conflicts of interest around certain fees that may be passed through to companies that may negatively affect our investments.

Senator REED. Well, thank you very much, Treasurer, and thank you to the panel. I would happily yield back to my colleague from Louisiana. Then I am going to vote.

Thank you, John.

Senator KENNEDY [presiding]. Thank you. Thank you, Senator.

Mr. Treasurer, I am a little confused. As Treasurer you invest in private equity, do you not?

Mr. FRERICHS. That is correct.

Senator KENNEDY. And your concern, and a concern we should all share, is you say the fees are opaque and there is not enough transparency.

Mr. FRERICHS. Correct.

Senator KENNEDY. Are you telling me that you make private equity investments, as a fiduciary, without understanding the fees, and if so, whose fault is that?

Mr. FRERICHS. We put a lot of time and effort into understanding these fees and working, but that adds increased cost to us, and there are also smaller pension plans out there who do not have the resources.

Senator KENNEDY. Well, why don't you just do not make the investment?

Mr. FRERICHS. Oftentimes we do not, if they are not willing to work with us.

Senator KENNEDY. So what is the problem?

Mr. FRERICHS. Just as in other fields, in other investment classes, the transparency has been helpful in bringing down the cost of fees, in things like mutual funds. We think we would see improvements in fees with greater transparency.

Senator KENNEDY. But if I go to buy a car and the car salesman does not explain the details of the financing to me, I just walk away. I do not call for the Federal Government to take over every car salesman in America. What am I missing here?

Mr. FRERICHS. Well, I would say we are not——

Senator KENNEDY. I mean this——

Mr. FRERICHS. ——calling on the Federal Government to——

Senator KENNEDY. ——this is—these are two players in the financial market. You are not required to invest in private equity. In fact, you breach your fiduciary duty to invest in private equity if you do not understand the fees, do you not?

Mr. FRERICHS. As I said, we put a lot of effort and time into this. I am the first one to note that we at the Illinois Treasury have significantly increased our allocation to the private equity space, given the opportunities and our ability to manage risks.

Senator KENNEDY. Well, have you ever invested in private equity when you did not understand the fees?

Mr. FRERICHS. I never said we did not understand the fees. We are advocating for the elimination—not advocating for elimination of private equity. We are seeking reforms to make it easier for us to do our jobs, to stop abuses, to increase transparency, to help create more efficient markets, and provide basic protections——

Senator KENNEDY. I understand. Have you ever invested in a private equity deal, as a fiduciary, as the State Treasurer, without understanding the fees?

Mr. FRERICHS. We put a lot of effort into this, but that results in increased costs as well. And just as we saw public——

Senator KENNEDY. I understand that. I heard you the first time. But have you ever invested in a private equity deal without understanding the fees?

Mr. FRERICHS. No.

Senator KENNEDY. OK. Let me ask Dr. Holtz-Eakin, I have looked at this legislation. It will gut private equity like a fish.

Mr. HOLTZ-EAKIN. I think that is correct.

Senator KENNEDY. Now what will that impact have on workers of America?

Mr. HOLTZ-EAKIN. We know that, you know, the private equity markets are very large, as David Burton pointed out, that this is an important source of capital. Capital is how firms invest in skills for their workers, technologies, equipment, it raises productivity, and that productivity flows into higher real wages. So you are really affecting the standard of living——

Senator KENNEDY. Is it going to cause layoffs?

Mr. HOLTZ-EAKIN. Absolutely.

Senator KENNEDY. You get rid of private equity, whether you do it in the de facto or de jure way, you could abolish private equity. You could also regulate it half to death. No, regulate it completely to death. Now if you do that, I know it is in vogue to talk about rich billionaires around here, but they comprise a very small part of the American free enterprise system. We are going to have massive layoffs, are we not?

Mr. HOLTZ-EAKIN. Yes. I mean, you need the capital to run the economy.

Senator KENNEDY. In fact, is not that what free enterprise is, a marriage of capital and labor?

Mr. HOLTZ-EAKIN. Yes.

Senator KENNEDY. Some of my colleagues think it is a zero-sum game. They think that the American economy is like it was back in primitive times. To take a Marxist approach, some of my colleagues think that the only value in an economy is labor, and if you make money in an economy you have to make money. If you be-

come wealthy, you do it by exploiting labor. That is not an accurate description of the American economy today. Capital joins with labor, and today they both improve their value. That is how we grow our GDP, is it not?

Mr. HOLTZ-EAKIN. That is correct.

Senator KENNEDY. All right. Do you disagree with anything I said, Mr. Burton?

Mr. BURTON. No. The one thing that you did not really mention is it is not just capital and labor. It is also entrepreneurship and innovation, and it takes capital to innovate, to acquire new technologies, and that is how productivity improves, and that is how wages go up. If you do not become more productive through technological innovation or better management practices then you cannot see wages go up over any extended period of time.

I also think everything you said is absolutely true with respect to private capital markets. If we were to restrict private capital markets we would destroy the United States economy, because they are the most important means of raising capital for businesses, and particularly for entrepreneurship.

There is a more narrow case of these private equity funds that are basically engaged in acquiring failing public companies——

Senator KENNEDY. Can I stop you, because I am way over time.

Mr. BURTON. Yep. Yep. Yep.

Senator KENNEDY. Since Senator Warren is coming back. Do they have private equity in Cuba?

Mr. BURTON. No.

Senator KENNEDY. Do they have private equity in Venezuela?

Mr. BURTON. No.

Senator KENNEDY. If they have private equity in China it is State-owned, right?

Mr. BURTON. China is a little bit more ambiguous, but they are certainly restricting private enterprise——

Senator KENNEDY. So is that where we are headed here, to have government-run private equity, like President Xi does in China?

Mr. BURTON. Yes.

Senator KENNEDY. Would this bill move us toward that end?

Mr. BURTON. This bill would make private equity funds, narrowly defined, utterly uneconomic.

Senator KENNEDY. Now my understanding of private equity is that you have a company that goes out and says, "We are really good at investing money, and we ask you to invest your money, private investor, with us, the venture capital company. And in order to invest in that venture capital company you have got to be an accredited investor." I mean, you have got to have a net worth and show that you are a sophisticated investor.

Mr. BURTON. Generally, yes.

Senator KENNEDY. And then that private equity company goes and buys a private business. When it buys that private business, does it put a gun to the head of the owner of the private business and say you have to sell?

Mr. BURTON. No.

Senator KENNEDY. So it is usually a voluntary transaction.

Mr. BURTON. Yes.

Senator KENNEDY. And so now you have got a new owner of the business. Is that right?

Mr. BURTON. Yes.

Senator KENNEDY. And that new owner tries to increase the value of that business, because that new owner wants to make money. Am I right?

Mr. BURTON. Yes.

Senator KENNEDY. Does it always work?

Mr. BURTON. No.

Senator KENNEDY. If it does not work, who loses?

Mr. BURTON. There can be a lot of losers—the shareholders, the equity fund, the employees, customers, vendors.

Senator KENNEDY. But if it does work it is a beautiful thing.

Mr. BURTON. Yes.

Senator KENNEDY. And we call this free enterprise.

Mr. BURTON. Yes.

Senator KENNEDY. As opposed to the Government saying you cannot invest there but you have to invest there.

Mr. BURTON. Right.

Senator KENNEDY. OK. I went way over.

Chair WARREN [presiding]. That is OK.

Senator KENNEDY. But I had to stall.

Chair WARREN. Are you good?

Senator KENNEDY. I am done.

Chair WARREN. All right.

Senator KENNEDY. I am going to go vote. Thank you all for coming today.

Chair WARREN. And thank you again. Sorry about the confusion about all the things that are going on at once.

Let me start. I would like to talk about private equity and its impact on workers and communities. Ms. Smith, I think you are with us virtually. I want to thank you for being here today. Since you experienced it firsthand I would like your help in walking through how Art Van went under, so that we can better understand the private equity model.

So could you tell me, was Art Van profitable before it was acquired by THL in 2017?

Ms. SMITH. We were. We had about $8 million in sales that year, and we literally owned about 55 to 60 percent of the market share in the furniture sales industry.

Chair WARREN. OK. So this private equity company takes over this successful, profitable, I think you said 58-year-old company, saying they were going to make it more profitable.

Ms. SMITH. Exactly.

Chair WARREN. So let's talk about how they made it more profitable. Ms. Smith, once THL came in, what did they do first to supercharge Art Van's growth? Did they boost the marketing budget? Did they invest in retaining management? Did they start a staff training program? Did they build a new website? What did they do to help boost the profits? What did they do, straight out of the chalks?

Ms. SMITH. Straight out of the gate, the first thing they did was sell off all of the real estate. Art Van was a debt-free company. They owned the land that every building was on. The first thing

they did was sold the real estate, made back the money that they spent buying the company, and then they started destroying the company.

They got rid of all of our top leadership and brought in, as I said, people that did not know the furniture industry at all. They hired the worst CEO, something that was rated the worst CEO in the Nation, in 2016, to run the company, and some could say he did not do his job, but I will say that he did his job very well. He was hired to run his company out of business, and that is what he did.

Chair WARREN. OK. So let us talk through this. So this is a standard play out of the private equity book. THL put out very little of its own money. It took out a bunch of debt to buy Art Van, and then made Art Van responsible for that debt. Meanwhile, THL is collecting huge fees just for putting its own deal together. And then before the ink dries on that deal, Art Van, this once very profitable company, as you say, that had no debt, gets hit with now two big expenses—the new debt that THL put on the company and now, if they sell off all the real estate, it is not that they move out and shut down their business yet. It is that they have got to pay rent on all the buildings that they used to own.

THL, however—so Art Van is a whole lot worse off. THL, however, is a whole lot better off. They take some of that money from the buildings, they pay themselves back they money they had originally invested in the deal, and then they just keep collecting fees on everything that is happening, including managing the rental property here.

So now Art Van has its back against the wall. So let me ask you, Ms. Smith, at this point then how did Art Van meet these new expenses? Did these investments in the business help boost revenue so they could offset these new debts?

Ms. SMITH. There were no real investments into the company. T.H. Lee took money out of the company and never put anything back in. They started laying off workers. They kept advertising. The one thing they did was they kept the advertising budget up, but that was to keep customers coming in, spending money. But where the money was going, we do not know. They said that we were losing money. However, even though our actual intake might have dropped in dollar-volume wise, our profit margin went up.

Chair WARREN. Mm-hmm.

Ms. SMITH. So when you talk about $800 million, 6, 7 percent is a lot of money.

Chair WARREN. All right. OK. But I take it what happens is they keep cutting, they keep cutting the costs, and then Art Van gets into a situation, because they no longer own their real estate, they have now got to pay rent, they ultimately cannot pay their bills. And so Art Van files for bankruptcy. That destroys about 3,000 jobs. And you and your coworkers were left without health care during a pandemic. Do I have that about right?

Ms. SMITH. You have that right. They told us that we would have health care to the end of the month, and we did not. They did not give us the severance pay they told us. They told us that we did not get it because they did not close because they were going out of business. They closed because of COVID so, you know, let me

use this as a shield to change my attitude and change my dance so I do not have to pay.

Chair WARREN. Right. So, you know——

Ms. SMITH. Everything they did was to profit them and to hurt the people, and they did not care.

Chair WARREN. One of the things that we often hear about from the private equity industry is that it is not in their interest to drive companies into bankruptcy. I think that was kind of the point that Senator Kennedy was making. And that cases like yours are unfortunate, but they are just part of doing business. They say that most businesses survive after being taken over by private equity while only a few, like Art Van, actually fail. Do you find that a persuasive argument, Ms. Smith?

Ms. SMITH. So I do not find it a persuasive argument. I know that T.H. Lee did not intend for Art Van to go out of business. They intended to take us into debt, because that is the model. Let us take the company into debt. Let us suck everything out of it we can, take it into debt, and then sell it to somebody else.

However, Mr. Van's name was so golden that they were able to borrow so much against this company that they could not sell it. They took this company so deep into debt. And, you know, I keep hearing the Senators talk about capitalism, and this country was built on capitalism, and yes, it was. It was built on capitalism. But this is cannibalism. It is not capitalism. This is cannibalism. They are going in and they are stripping, destroying, and they do not care. They are plundering and leaving debt in their wake, and they do not care.

Chair WARREN. Well what really troubles me here is that private equity has worked out a business model that helps them get rich at the expense of workers like you and your families. You know, the model is pretty simple. They gamble with other people's money, they squeeze out what they can, they cram their pockets full, and then they bail, leaving workers and communities to deal with the fallout.

So let me ask you, Dr. Appelbaum, how would the Stop Wall Street Looting Act help address these market failures?

Ms. APPELBAUM. Thank you. So it is very clear that the Stop Wall Street Looting Act would play a role in these kinds of situations. It would require that the private equity firm keep some skin in the game. It would reduce incentives for them to load portfolio companies with excessive amounts of debt. Obviously reasonable amounts of debt are not a problem. As our speaker just described, the amounts of debt that they put on that company is what the problem was.

And so it protects companies from bankruptcy. The act includes protections for workers in the case of bankruptcy, severance pay and other protections. And it also increases transparency. The institutional investors in these private equity funds have little to no information about the companies that the fund has acquired, and this would provide them with some information, alter an asymmetrical information situation, and, in my opinion, it would stop the worst abuses and encourage private equity to do what it says it does and help companies to grow and be successful.

Chair WARREN. Thank you. Thank you very much, Dr. Appelbaum.

I am just going to go to another round of questions, since, like I said, we are in a little mix-and-match here.

What I would like to talk about now is what happens when companies buckle under the weight of private equity debt and mismanagement and go bankrupt and how workers and their families and communities have to deal with that fallout. We understand—and that is what happened in Art Van—that particular version of the problem, but even when companies do not go under, the consequences of the private equity playbook can still be devastating. In the worst cases, as we have seen with private equity's involvement in health care, people get sick and they die.

So Ms. Malone, you have been a registered nurse at Crozer for more than 30 years. Your hospital was acquired by Prospect Medical, which was owned by the private equity firm Leonard Green, in 2016. Did you notice a change when private equity took over?

Ms. MALONE. Yes, almost immediately. We immediately saw staff were cut. We were unable to get supplies. We were told by vendors that bills had not been paid and that is why we were not able to get supplies. I work in the substance abuse department. We were not able to have our acupuncturist come, our music therapist. They had not been paid in several months and they were going to be unable to continue to come and provide their services to our patients. And we saw that happen pretty quickly.

Staff was at a minimum, and the quality of the supplies—which, when you have poor quality it takes several more attempts to put an IV in, you are increasing your rate of infection. When you have poor quality Foley catheters your instance of infection goes up.

And so all of these things result in death. You have the potential every time you make cuts in staff, when you are giving nurses more patients than they are safely able to handle. We are constantly putting patients at risk. These are people's lives that we deal with. Workplace violence has increased. People who are waiting. When you have 20 people over and above what your emergency room holds, waiting to be seen, the staff, we are abused. We are physically abused. We are verbally abused.

I mean, the trickle-down of the cuts that this company made almost immediately, we are still feeling. And unfortunately, the pandemic happened, and so everything is being hidden under the guise of this pandemic. These things were happening long before the pandemic, and they are using the pandemic as an excuse that there is a nursing shortage, that we cannot get supplies, when the reality is they are not providing us with what we can have. There is not a nursing shortage.

There is a shortage of nurses who are willing to work at the bedside under these kinds of conditions. We take an oath to do no harm, and we are no longer able to do that. Nurses are fleeing. I can tell you of 20-plus nurses who have left Crozer in the last 2 weeks.

Chair WARREN. So you are saying here, just so I can get this together, with private equity, so they cut staffing, cut supplies. That reduces the quality of patient care, and, in fact, increases infections, ultimately mortality rates.

Talk to me just a little bit, though, about other parts out of the playbook. For example, what did they do with the real estate, in your case?

Ms. MALONE. So they did sell the real estate, and so, once again, they made a large profit. Leonard Green took $400 million out of Prospect Medical.

Chair WARREN. So they took how much money out of the——

Ms. MALONE. $400 million.

Chair WARREN. So they take $400 million out while they are laying off people, shortchanging you on supplies.

Ms. MALONE. Yes. Yes. They took all of that money, and they had made a commitment. They had made a commitment to make a $200 million investment in our hospital as part of the acquisition deal, and none of that has happened.

Chair WARREN. None of it happened. You know, this is not a business model. This is looting.

Ms. MALONE. It is.

Chair WARREN. And unfortunately, we are seeing it all around the health care sector, including, as COVID has made painfully clear, at nursing homes. Private equity firms have been buying up nursing homes, and the consequences have been deadly. Researchers have found that private equity ownership, quote, "increases the short-term mortality of Medicaid patients by 10 percent," end quote. That implies that more than 200,000 people died between 2000 and 2017, simply because they lived in a nursing home that was owned by a private equity firm.

So, Ms. Malone, from what you have experienced with private equity at your hospital, does the fact that private equity ownership has been found to kill people in nursing homes surprise you?

Ms. MALONE. No, it does not. It does not at all. Private equity firms are focused on making the biggest profit. They are not focused on providing the best care. And I do not ever see how their incentives could be aligned with patients and staff. It just does not work that way. These are people's lives.

Chair WARREN. I think I misspoke on the number of deaths. I think I looked down and said 200,000 instead of 20,000. One death is one death too many.

Ms. MALONE. It is too many.

Chair WARREN. Too many. So this is one of those things we need to act, and this is why I have introduced the Stop Wall Street Looting Act, so that we can better align incentives between private equity and the companies they take over by restricting the ability of private equity to buy a company and profit from running it straight into the ground. This is a bill that would ensure that private equity has skin in the game, as Dr. Appelbaum was talking about. Because if private equity has skin in the game, maybe they will think twice about their actions, especially when their looting leads to increased illness, suffering, and death among our most vulnerable people.

So thank you very much. Thank you for being here. I appreciate it, Ms. Malone.

Should I do another round of questions? All right. Right here. Here we go. This is what happens when you get out of order here. You guys just have to take me straight through on this.

So I want to talk about the returns. Let us talk about the financial part of this now, the returns from private equity investments. After all, private equity keeps scooping up money because they promise super-high returns, higher than more traditional investments like stocks and bonds. In fact, that is why giant private equity firms get the big fees. They supposedly deliver big returns.

Strong and steady returns are important. Public pension funds and retirement security of teachers and firefighters and local government employees across the country depend on these returns. So it is no wonder that pension funds and other institutional investors would find private equity's promises so very attractive and why they might be willing to tolerate the risks, and even the consequences that we have talked about today.

So let us start with the data. Dr. Appelbaum, you have studied market returns in detail. This is pretty much your specialty. So let me ask you, does private equity outperform the market?

Ms. APPELBAUM. No, no, it does not, and there are quite a few studies now that show that the returns basically—well, let us be clear. Since 2006, it is the median private equity firm in each vintage launched since then that has just about tracked the market, using the metric that the finance professors would use, which is the public market equivalent.

Nobody who studies private equity uses the internal rate of return, which is what is used in the industry and which is quite misleading. You never get the amount of money that the internal rate of return suggests to take to the bank. That is not money you can take to the bank. If we have time I can tell you all about what is wrong with the IRR.

But what the researchers use is the public market equivalent, and what they find is that since 2006, the median fund, the typical fund has not outperformed the market. That means half of the funds are underperforming the market. Right?

Chair WARREN. Right. But that means for 15 years now——

Ms. APPELBAUM. Yes.

Chair WARREN. ——I just want to be crystal clear on this—for 15 years the typical private equity fund has failed to outperform the stock market, which sounds a lot like private equity has been fooling everyone for the past 15 years.

So let me ask, Dr. Appelbaum, if the typical private equity fund is not generating the returns that the private equity industry claims it does, then what are the investors paying for?

Ms. APPELBAUM. Yes, that is a very good question, and, of course, as you know, they are paying billions of dollars in fees. I mean, those fees really add up. So I am just going to point to a study by Oxford University finance professor, Ludovic Phalippou. He calls private equity funds "billionaire factories." They produce little for investors but they make private equity firm partners billionaires.

Chair WARREN. Wow. So teachers and firefighters are being asked to take money out of their retirements to pad the pockets of private equity billionaires, and they are not even getting the above-average market returns that they thought that they were paying for. Is that a fair summary?

Ms. APPELBAUM. It is definitely a fair summary. And you have to remember that these are risky investments, and the idea at the

beginning was that they would get a return that was 3 percent above the market to reward them for the risk that they are taking. And now they get no premium whatsoever.

Chair WARREN. OK. So they are getting no premium but they are taking on more risk.

So we have a chance here now to talk with the Treasurer of the number one State employee pension fund, the fund that is doing better than any other public employee pension fund. I mean, hurrah, right? This is not the one in the middle. This is the one way down on the top-performing end.

Treasurer Frerichs, you have been doing very well with private equity. Is that a fair statement?

Mr. FRERICHS. Yes. That is correct.

Chair WARREN. Good. And you are an investor. That is, you manage a pension fund on behalf of your office. You are a trustee for a public pension plan that invests in private equity on behalf of teachers and firefighters and other public employees.

So the question I want to ask you, as an investor, you are on the side that is trying to make money out of this, are you satisfied with the current rules governing private equity or would you like to see some new rules in place requiring transparency about fees and aligning the interests of PE managers with their investors?

Mr. FRERICHS. I will say that PE has done well by us, but it would be beneficial to see new rules and sensible reforms. For example, standard reporting would ensure transparency for all investors and ensure investors can validate all fees charged by private equity to know that they conform with their negotiated agreements. That would be one good reform.

Our office does due diligence. Senator Kennedy asked if I had made any investments without that, no. We do our due diligence, but for us, and many of our public fund peers, there is difficulty receiving proper disclosure and transparency around direct and indirect fees in a clear and consistent manner. There has been characterization that we are heading toward socialism here. I believe in the market here, and I believe markets work well and efficiently with proper access to information.

This opaqueness makes it difficult to shop around and determine whether we are getting a competitive rate. He is right, if we are buying a car and someone would not disclose to us, we would not want to buy there, but sometimes they will just flood you in information and bury things in that sale document at that car dealer. You know, and we regulate car dealers to make sure there is proper disclosure.

Without proper disclosures, tracking the fees and expenses charged by a private equity firm is a cumbersome process, and markets should not be cumbersome. This can then potentially enable firms to hide and shift fees, potentially manipulate returns reporting, and avoid disclosing certain deals. Ultimately, I believe new rules would be valuable.

Chair WARREN. Yeah. So as I understand this, you are saying you like the market but it is very hard for you to be able to see what you are paying in fees, and if that is hard, that means it is very hard to make comparative judgments.

And I just want to emphasize here, you are not one of the little funds. Am I right on this? You have a pretty big shop there.

Mr. FRERICHS. Correct. We oversee tens of billions of dollars in investments, between ISBI and internal, billions of dollars in private equity. So we have the resources here, but still, in order to use those resources to try and sort through all of this, it costs us extra money, and smaller pension funds do not have the resources that we have.

Chair WARREN. Yeah. I think there is just a really important point about markets. If we want markets to work then people have to have consistently reported information so you can get comparisons across them, and the information has to be made available.

You know, I appreciate your testimony on this. My Stop Wall Street Looting Act would require private equity funds to clearly disclose their fees and returns so that public pensions and other investors have the information that they need in order to make informed decisions.

America faces a retirement crisis, but the solution is not to squeeze employees more or to cut retail jobs and wages or to undermine the health and safety of people in hospitals and nursing homes. The solution is to put stronger rules in place that investors and retirees and families do not get gouged by private equity firms that are trying to fleece them. So to me, that is what this hearing is about today.

Since I did not get to do an opening statement at the beginning I just want to do a kind of overview as we wrap this up and say thank you to everyone who has been here. You know, this is the first hearing that the Senate has held that has focused entirely on private equity, and it is about time that we do this. We need to get the facts on the table about what private equity firms are doing to our economy and to our communities.

Private equity firms have plenty of money to spend on lobbyists and PR campaigns. They have their own trade association, which I know has been making the rounds in Congress ahead of this hearing. They have worked hard to portray themselves as good actors that bring jobs and investments to communities in need, and they have no problem telling their version of the story.

But their version of the story glosses over a lot of what happens to local workers, to local businesses, to local communities when some private equity firm waltzes into town. Once private equity starts buying up local stores or hospitals or newspapers or prison commissaries or for-profit colleges or nursing homes or hospitals or any of dozens of other industries, the smiling private equity managers and their secret investors profit hugely while workers and local businesses and local communities too often come out as the losers.

In 2019, I opened a broad investigation of the role of private equity in the economy, and this investigation exposed how the industry is fundamentally broken. Private equity relies on a business model that pays managers to go after short-term profits, charging huge fees even as they destroy the long-term prospects of the businesses that they buy. It is bad for workers and bad for consumers when local retailers, or even large chains, are bought out by private equity. These firms load up the target company with debt, as we

have seen the examples here today, they strip out assets, and the next thing you know thousands of workers have lost their jobs and the stores are shut down.

It is also bad for seniors and their families when private equity firms buy up nursing homes and other health care providers. It is the same pattern: assets are stripped out, cost-cutting runs rampant, and the quality of care declines, with real consequences for people's health and for their lives.

It is bad for students when private equity firms buy up for-profit colleges. The industry already has a bad record of ripping off students, and private equity just makes it worse.

It is bad for communities when private equity firms buy up thousands of manufactured homes and the land that they sit on. Costs skyrocket, forcing residents to choose between paying the rent and paying for basic necessities like food and medicine, and meanwhile the investments in these communities decline and conditions get worse and worse.

And by the way, we will be hearing more about that particular abuse of private equity in the housing sector tomorrow at the Banking Committee hearing, and I am looking forward to joining Senator Brown on that.

What I see here is across the board. In industry after industry it is the same pattern. Private equity executives make off with massive short-term gains and they leave workers, consumers, communities, and ordinary investors with pretty much nothing to show for it. And all of this has been magnified during the COVID pandemic. The companies that are owned by private equity firms have received over $5 billion in taxpayer money from the CARES Act. I appreciate you pointing it out in your case, Ms. Malone.

Their record has only gotten worse. Private equity-owned nursing homes had a terrible safety record before the pandemic. Private equity-owned retails were weighed down with debt and shut their doors for good. Private equity landlords laid in wait for the eviction moratorium to end so they could make more money, even if meant kicking families out of their homes. What almost every American experienced as a crisis, private equity viewed as an opportunity.

And I know, we have heard from the private equity industry in response to this hearing. They say this is all for the best. We hear about the standard talking points that private equity firms employ millions of people and create big returns for pension funds for teachers and firefighters. But when you fact-check those claims, it just turns out they are not true. In fact, private equity investments often result in fewer jobs and lower wages, and despite how hard they squeeze the businesses they acquire, private equity does not offer an above-market return to investors.

So what are we doing to do about this? Well, I want to set some minds at ease. I do not want to eliminate private equity, but I do want to fix it, and that is why I have introduced the Stop Wall Street Looting Act, which is groundbreaking legislation to clean up this industry. My legislation aims to make the entire industry more transparent and to end the misaligned incentives that create private equity's "heads, I win, tails, you lose" business model.

So I appreciate all of the witnesses who joined us today. I very much appreciate the first-hand accounts you have given us about

what it is like to live through this on the receiving end, as an employee. I appreciate the academic perspective that is going on, and I very much appreciate the Treasurer joining us and telling us what it is like as an investor, even someone who has done well with private equity, how we could make improvements that make this market work better.

So thank you all for being here today. Thank you for providing testimony. Before we go I would also like to submit a statement for the record from the Private Equity Stakeholder Project.

For Senators who wish to submit questions for the record, those questions are due 1 week from today, which is Wednesday, October 27.

I also want to enter into the record a statement from my friend, Senator Baldwin, who has been a fighter for the workers and the communities of Wisconsin in the face of predatory private equity abuses. And so thank you, Senator Baldwin. We will make sure that is entered into the record.

And for our witnesses, you will have 45 days to respond to any questions.

Thank you all very much, and with that this hearing is adjourned. Thank you.

[Whereupon, at 3:34 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIR ELIZABETH WARREN

Good afternoon, and welcome to today's hearing on ensuring that companies and communities are not destroyed by private equity firms. This is the first hearing that the Senate has held focused solely on private equity, and it's about time. We need to get the facts on the table about what private equity firms are doing to our economy and to our communities.

Private equity firms have plenty of money to spend on lobbyists and PR campaigns. They have their own trade association, which I know has been making the rounds in Congress ahead of this hearing. They have worked hard to portray themselves as good actors that bring jobs and investments to communities in need, and they have no problem telling their own version of the story.

But the industry version glosses over what happens to the local workers, to the local businesses, and to the local communities when some private equity firm waltzes into town. Once private equity starts buying up local stores, or hospitals, or newspapers, or prison commissaries, or for-profit colleges, or nursing homes, or any of the dozens of industries, the smiling private equity managers and their secret investors pocket huge profits while local workers, local businesses, and local communities come out the losers.

In 2019, I opened a broad investigation of the role of private equity in the economy. This investigation exposed how the industry is fundamentally broken. Private equity relies on a business model that pays managers to go after short-term profits, charging huge fees even as they destroy the long-term prospects of the businesses they buy.

It's bad for workers and consumers when local retailers or even large chains are bought out by private equity firms. These firms load the target companies up with debt, strip out their assets, and next thing you know, thousands of workers have lost their jobs, and the stores are shut down.

It's bad for seniors and their families when private equity firms buy up nursing homes and other health care providers. It's the same pattern: assets are stripped out, cost-cutting runs rampant, and the quality of care declines—with real consequences for people's health and lives.

It's bad for students when private equity firms buy up for-profit colleges. The industry already has a bad record of ripping off students, and private equity makes it worse.

It's bad for communities when private equity firms buy up thousands of manufactured homes or the land they sit on. Costs skyrocket, forcing residents to choose between paying the rent and paying for basic necessities like food and medicine, meanwhile investments in these communities decline and conditions get worse and worse. By the way, we'll be hearing more about the abuses of private equity in the housing sector at tomorrow's Banking Committee hearing, and I'm looking forward to joining Chairman Brown there.

Across the board, in industry after industry, we see the same pattern: private equity executives make off with massive short-term gains, and leave workers, consumers, communities, and ordinary investors with nothing to show for it.

All of this has been magnified during the COVID pandemic. The companies that are owned by private equity firms have received over $5 billion in taxpayer money from the CARES Act, and their record has only gotten worse. Private equity-owned nursing homes had a terrible safety record during the pandemic. Private equity-owned retailers were weighed down with debt and shut their doors for good. Private equity landlords laid in wait for the eviction moratorium to end so they could make more money, even if it meant kicking families out of their homes. What almost every American experienced as a crisis, private equity viewed as an opportunity.

I know what we'll hear from the private equity industry in response to this hearing. They'll say that all this is for the best. We'll hear the standard talking points that private equity firms employ millions of people and create big returns for pension funds for teachers and firefighters. But it's time to fact-check those claims. In fact, private equity investments often result in fewer jobs and lower wages. And despite how hard they squeeze the businesses they acquire, private equity doesn't always offer a good return to pension funds. In fact, pension funds turn over millions in fees for these funds to manage, then they end up with no better returns than index funds in the stock market.

So what do we do about it? Well, let me set some minds at ease. I don't want to eliminate private equity. But I do want to fix it. And that's why I've introduced the Stop Wall Street Looting Act, my groundbreaking legislation to clean up the industry. My legislation aims to make the entire industry more transparent and to end misaligned incentives that create private equity's "heads I win, tails you lose" business model.

I appreciate our witnesses joining us today—I'm looking forward to hearing their first-hand accounts of what private equity meant for their jobs and their communities. It's long past time to reform this industry and end their most destructive practices.

PREPARED STATEMENT OF DAVID R. BURTON

SENIOR FELLOW IN ECONOMIC POLICY, ROE INSTITUTE FOR ECONOMIC POLICY STUDIES, INSTITUTE FOR ECONOMIC FREEDOM AND OPPORTUNITY, THE HERITAGE FOUNDATION

OCTOBER 20, 2021

My name is David R. Burton. I am Senior Fellow in Economic Policy at The Heritage Foundation. I would like to express my thanks to Subcommittee Chair Warren, Ranking Member Kennedy, and members of the committee for the opportunity to be here this afternoon. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

Summary of Key Points

1. Entrepreneurship is vital to innovation, improved productivity and better products. Entrepreneurship enhances wages, reduces price and improves the international competitiveness of U.S. businesses and workers.
2. Private capital markets are, by far, the primary means that entrepreneurs use to raise the capital necessary to launch and grow their businesses. Private equity, broadly defined, is absolutely vital to the economic future of the United States.
3. Public capital markets are in decline due to regulatory overreach. Firms go public later in their life-cycle and ordinary investors typically do not receive the returns generated by successful start-ups.
4. There is a major effort to apply the policies which have harmed the public market to the private market. If successful, this will have serious adverse consequences for investors, workers and consumers.
5. Private equity funds, narrowly defined, are the primary means of holding failing corporate management to account. They are the primary means by which troubled companies are acquired, management replaced and companies turned around.
6. The "Stop Wall Street Looting Act" (WSLA) would be more aptly named the "Protect Incompetent Management Act." The WSLA would erect a moat and high walls around failing companies so that it would become virtually impossible, and certainly economically unattractive, to take over failing companies and replace their management. While this may be attractive to corporate elites and their lobbyists, it is certainly not in the interests of shareholders, workers or consumers.
7. As drafted, the 100 percent tax in the WSLA on payments to private funds would be imposed on a host of businesses and payments far beyond what the authors of legislation say they intend (to wit, the confiscation of fees paid to private equity funds). There appears to be absolutely no limitation on this tax to private equity funds acquiring targets in the statutory definitions. It is monumentally poorly drafted.

The Importance of Entrepreneurship

Entrepreneurship matters. It fosters discovery and innovation.[1] Entrepreneurs also engage in the creative destruction of existing technologies, economic institutions and business production or

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[1] Israel M. Kirzner, *Competition and Entrepreneurship* (University of Chicago Press: 1973); Israel M. Kirzner, "Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach," *Journal of Economic Literature*, Vol. 35, No. 1 (1997); Randall Holcombe, *Entrepreneurship and Economic Progress* (Routledge: 2006); William J. Baumol, *The Microtheory of Innovative Entrepreneurship* (Princeton University Press: 2010).

management techniques by replacing them with new and better ones.[2] Entrepreneurs bear a high degree of uncertainty and are the source of much of the dynamism in our economy.[3] New, start-up businesses account for much, if not most, of the net job creation in the economy.[4] Entrepreneurs innovate, providing consumers with new or better products. They provide other businesses with innovative, lower cost production methods and are, therefore, one of the key factors in productivity improvement and real income growth.[5] The vast majority of economic gains from innovation and entrepreneurship accrue to the public at large rather than entrepreneurs.[6] Entrepreneurs are central to the dynamism, creativity and flexibility that enables market economies to consistently grow, adapt successfully to changing circumstances and create sustained prosperity.[7] Entrepreneurship promotes the common good, prosperity and a higher standard of living. Among the most important

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[2] See, e.g., Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (1942; Routledge: 1976), pp. 81-86 http://digamo.free.fr/capisoc.pdf; W. Michael Cox and Richard Alm, "Creative Destruction," *Concise Encyclopedia of Economics* (Liberty Fund: 2010) http://www.econlib.org/library/Enc/CreativeDestruction.html; Henry G. Manne, "The Entrepreneur in the Large Corporation," in *The Collected Works of Henry G. Manne*, Vol. 2 (Liberty Fund: 1996).

[3] Frank H. Knight, *Risk, Uncertainty, and Profit* (Houghton Mifflin: 1921) http://www.econlib.org/library/Knight/knRUP.html; Richard J. Cebula, Joshua C. Hall, Franklin G. Mixon Jr. and James E. Payne, *Economic Behavior, Economic Freedom, and Entrepreneurship* (Edward Elgar: 2015).

[4] Magnus Henrekson and Dan Johansson, "Gazelles as Job Creators: A Survey and Interpretation of the Evidence," *Small Business Economics*, Vol. 35 (2010), pp. 227–244 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1092938; Ryan Decker, John Haltiwanger, Ron Jarmin, and Javier Miranda, "The Role of Entrepreneurship in US Job Creation and Economic Dynamism," *Journal of Economic Perspectives*, Vol. 28, No. 3 (Summer 2014), pp. 3–24 http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.28.3.3; Salim Furth, "Research Review: Who Creates Jobs? Start-up Firms and New Businesses," Heritage Foundation Issue Brief No. 3891, April 4, 2013 http://www.heritage.org/research/reports/2013/04/who-creates-jobs-startup-firms-and-new-businesses. In terms of the neo-classical growth model, entrepreneurship is an important factor affecting the rate of technological change and the marginal productivity of capital. See, e.g., Robert M. Solow, *Growth Theory: An Exposition* (Oxford University Press: 2000). Legal institutions, human capital and other factors are also important determinants of economic growth. See N. Gregory Mankiw, David Romer and David N. Weil, "A Contribution to the Empirics of Economic Growth," *The Quarterly Journal of Economics*, Vol. 107, No. 2 (May, 1992), pp. 407-437 https://eml.berkeley.edu/~dromer/papers/MRW_QJE1992.pdf; Robert J. Barro, *Economic Growth*, 2nd edition (MIT Press: 2003).

[5] Ralph Landau, "Technology and Capital Formation," in *Technology and Capital Formation*, Dale W. Jorgenson and Ralph Landau, editors (MIT Press: 1989).

[6] Yale economist William Nordhaus has estimated that 98 percent of the economic gains from innovation and entrepreneurship are received by persons other than the innovator. See William D. Nordhaus, "Schumpeterian Profits in the American Economy: Theory and Measurement," NBER Working Paper No. 10433, April 2004 https://www.nber.org/papers/w10433.pdf.

[7] See, Decker *et al*, *supra*; C. Mirjam van Praag and Peter H. Versloot, "What is the Value of Entrepreneurship? A Review of Recent Research," *Small Business Economics*, Volume 29, Issue 4 (December 2007), pp 351-382 https://link.springer.com/content/pdf/10.1007%2Fs11187-007-9074-x.pdf; David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf; Deirdre N. McCloskey *Bourgeois Equality: How Ideas, Not Capital or Institutions, Enriched the World* (University of Chicago Press: 2016); Adam Thierer, *Permissionless Innovation: The Continuing Case for Comprehensive Technological Freedom* (Mercatus Center: 2016); David R. Burton, "Building an Opportunity Economy: The State of Small Business and Entrepreneurship," Testimony before the Committee on Small Business, United States House of Representatives, March 4, 2015 https://www.heritage.org/testimony/building-opportunity-economy-the-state-small-business-and-entrepreneurship; George Gilder, "Capitalism is an Information and Learning System," Remarks, November 15, 2018 https://www.heritage.org/markets-and-finance/event/capitalism-information-and-learning-system; Friedrich A. Hayek, "The Use of Knowledge in Society," *The American Economic Review*, Vol. 35, No. 4 (September, 1945), pp. 519-530 https://www.econlib.org/library/Essays/hykKnw.html.

factors impeding entrepreneurship are securities laws that restrict entrepreneurs' access to the capital needed to launch or grow their businesses.[8] After all, without capital to launch a business, other impediments to entrepreneurial success are moot.

Sometimes, an entrepreneur has sufficient capital to launch and grow his or her business from personal savings, including profits from previous entrepreneurial ventures, and retained earnings. Often, however, an entrepreneurial firm will need capital from outside investors or lenders.[9] Other than friends or family, outside investors are typically described as "angel investors" or "venture capitalists."[10] Typically, "angel investors" are individuals who invest at the early "seed stage" while "venture capitalists" are firms or funds that make investments later in the firms' life-cycle after "proof of concept." Firms seeking outside investors are often the most dynamic, high growth companies.[11] In principle, Regulation A and Regulation CF would allow ordinary investors to invest in young firms and for young firms to find a new source of capital. So far, they have been of relatively minor importance largely due to the regulatory and statutory structure of these exemptions. Regulation D and other private offerings remain the most important source of capital for young, dynamic firms.

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[8] Banking laws and practices are a contributing factor. For a short introduction to the problems, see SEC Commissioner Daniel M. Gallagher, "Whatever Happened to Promoting Small Business Capital Formation?," September 17, 2014 http://www.sec.gov/News/Speech/Detail/Speech/1370542976550#.VFfbI8mGklQ.

[9] See, e.g., "2013 State of Entrepreneurship Address: Financing Entrepreneurial Growth," Kauffman Foundation Research Paper, February 5, 2013 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212743; *The Oxford Handbook of Venture Capital*, Douglas Cumming, Editor (Oxford: 2012).

[10] See Angel Capital Association http://www.angelcapitalassociation.org/ and National Venture Capital Association http://www.nvca.org/. See also Ibrahim, Darian M., "Should Angel-Backed Start-ups Reject Venture Capital?," *Michigan Journal of Private Equity & Venture Capital Law*, Vol. 2, pp. 251-269 http://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=2734&context=facpubs; Abraham J.B. Cable, "Fending For Themselves: Why Securities Regulations Should Encourage Angel Groups," *University of Pennsylvania Journal of Business Law*, Vol. 13, No. 1, Fall 2010, pp. 107-172 https://www.law.upenn.edu/journals/jbl/articles/volume13/issue1/Cable13U.Pa.J.Bus.L.107%282010%29.pdf; Darian M. Ibrahim, "The (Not So) Puzzling Behavior of Angel Investors," *Vanderbilt Law Review*, Vol. 61, p. 1405-1452 (2008) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984899; Brent Goldfarb, Gerard Hoberg, David Kirsch and Alexander Triantis, "Does Angel Participation Matter? An Analysis of Early Venture Financing," Angel Capital Association, April 4, 2008 http://www.angelcapitalassociation.org/data/ACEF/ACEFDocuments/Does%20Angel%20Participation%20Matter%20-%20Analysis%20of%20Early%20Venture%20Financing.pdf.

[11] Sampsa Samila and Olav Sorenson, "Venture Capital, Entrepreneurship, and Economic Growth, *Review of Economics and Statistics*, February, 2011, Vol. 93, No. 1, pp. 338-349; Dane Stangler, "High-Growth Firms and the Future of the American Economy, Kauffman Foundation, March 9, 2010 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1568246.

The 2012 JOBS Act[12] was a bipartisan achievement of consequence.[13] It substantially improved the laws governing entrepreneurial capital formation.[14] Although the implementation of the JOBS Act by the Commission was unnecessarily heavy-handed, the SEC has made some improvements in the regulatory environment for entrepreneurial capital formation over the past several years. Much more needs to be done by Congress, the Commission and other regulators.

The Importance of Private Capital Markets to Innovation, Dynamism, Good Wages and Prosperity

Section 4(a)(2) of the Securities Act exempts "transactions by an issuer not involving any public offering."[15] Prior to the JOBS Act, the exemption was in §4(2). This exemption is typically called the "private placement" or "private offering" exemption.

Private offerings are the most important source of capital for American businesses, accounting for *at least* $2.9 trillion in raised capital annually.[16] By comparison, registered (public) offerings raised less than half of that amount ($1.4 trillion).[17] Regulation D is the most important means of raising private capital amounting to approximately $1.7 trillion in 2018.[18] Regulation D is lightly regulated and a tremendous success. The SEC adopted Regulation D in 1982 during the Reagan Administration.[19] It is not an overstatement to say that our economy would not be recognizable without Regulation D. Damaging Regulation D would harm the dynamism of our economy in incalculable ways and have an adverse impact on tens of millions of working men and women and consumers.

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[12] Jumpstart Our Business Startups Act, Public Law 112–106, April 5, 2012, http://www.gpo.gov/fdsys/pkg/PLAW-112publ106/pdf/PLAW-112publ106.pdf.

[13] H.R. 3606 (112th Cong.) passed the House with overwhelming support, 390 to 23: Final Vote Results for Roll Call 110, H.R. 3606, Recorded Vote, March 8, 2012, http://clerk.house.gov/evs/2012/roll110.xml, and passed the Senate by a wide margin, 73 to 26: U.S. Senate Roll Call Votes 112th Congress–2nd Session, H.R. 3606, March 22, 2012, http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=112&session=2&vote=00055.

[14] See, e.g., David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf; Thaya Brook Knight, "A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis," Cato Institute Policy Analysis 790, May 3, 2016 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2833877#.

[15] 15 U.S. Code § 77d(a)(2)

[16] SEC "Concept Release on Harmonization of Securities Offering Exemptions," *Federal Register*, Vol. 84, No. 123, June 26, 2019, p. 30466, Table 2 — Overview of Amounts Raised in the Exempt Market in 2018 https://www.govinfo.gov/content/pkg/FR-2019-06-26/pdf/2019-13255.pdf.

[17] SEC "Concept Release on Harmonization of Securities Offering Exemptions," *Federal Register*, Vol. 84, No. 123, June 26, 2019, p. 30465, Figure 1: Capital Raised in Exempt and Registered Capital Markets, 2009-2018 https://www.govinfo.gov/content/pkg/FR-2019-06-26/pdf/2019-13255.pdf.

[18] Ibid., p. 30466, Table 2. See also David R. Burton, "Don't Crush the Ability of Entrepreneurs and Small Businesses to Raise Capital," Heritage Foundation Backgrounder No. 2874, February 5, 2014 https://thf_media.s3.amazonaws.com/2014/pdf/BG2874.pdf.

[19] "Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers of Sales" (Release No. 33-6389), *Federal Register*, No. 47 (March 16, 1982), p. 11251. Regulation D is found at 17 C.F.R. §230.500 through §230.508. See "Revision of Certain Exemptions from the Registration Provisions of the Securities Act of 1993 for Transactions Involving Limited O ers of Sales" (Release No. 33-6339), *Federal Register*, No. 46 (August 18, 1981), p. 41791, for the original proposed rule.

The estimates for section 4(a)(2) below are almost certainly substantially lower than the actual amount because the SEC used Thomson Financial's SDC Platinum,[20] which uses information from underwriters, issuer websites, and issuer SEC filings, to quantify section 4(a)(2) raises. It will not capture the amounts raised by typical small businesses throughout the country from family, friends and angel investors. These small business owners raise capital using the section 4(a)(2) exemption – usually without knowing the exemption even exists. Also, while Regulation A and crowdfunding are "exempt offerings" in the sense that they are not "registered offerings" they are not really private offerings either. They are best thought of as quasi-public offerings.

Amounts Raised in the Exempt and Registered Market in 2018 ($ billions)

Offering Type	Amount Raised	Amount Raised (Subcategories)
Registered (Public)	$1,400	
Exempt (Private)	$2,912	
Rule 506(b) of Regulation D		$1,500
Rule 506(c) of Regulation D		$211
Regulation A: Tier 1		$0.061
Regulation A: Tier 2		$0.671
Regulation Crowdfunding		$0.055
Rule 504 of Regulation D		$0.002
Other exempt offerings (section 4(a)(2), Regulation S, and Rule 144A offerings)		$1,200

Source: Securities and Exchange Commission, *Concept Release on Harmonization of Securities Offering Exemptions*

There is no definition in the Securities Act or the Securities Exchange Act or, for that matter, in the securities regulations, of a "public offering" or, conversely, of what is not a public offering. Investors and their attorneys must rely on various court cases, SEC interpretive releases, SEC concept releases, SEC policy statements, SEC staff interpretations, SEC staff legal bulletins, and SEC "no action" letters to make judgments about what will be deemed a public offering. The leading Supreme Court case interpreting this statutory provision is *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953). In that 1953 case, the court held that "the applicability of §4(1) [now §4(a)(2)] should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" This "fend for themselves" formulation is highly suspect in that, whether or not an offering is "public" is analytically unrelated to whether or not the investors in the offering can "fend for themselves." For example, an offering to one utterly unsophisticated person wholly incapable of fending for himself with whom there is a substantial pre-existing relationship is not public in any meaningful sense. (For instance, when the CEO's never-employed son who was a poetry major in college is the sole offeree.) Conversely, an offering limited to those demonstrably able to "fend for themselves" (by whatever measure) conducted on national television and with whom there was no pre-existing relationship is certainly public in the ordinary sense of the term (and the authors of the Securities Act of 1933 undoubtedly intended for it to be treated as such).

[20] Ibid p. 30466, at footnote 41.

Although private offerings do not necessarily have to be in compliance with Regulation D, Regulation D provides a regulatory safe harbor such that if an issuer meets the requirements of Regulation D, the issuer will be treated as having made a private offering. Because it is a relatively easy, straight-forward means of ensuring that an offering will be deemed a private placement and because Rule 506 offerings do not need to comply with state blue sky registration and qualification rules, Regulation D Rule 506 offerings have become the most common choice for those raising significant amounts of private capital.

Public Capital Markets are in Decline Due to Regulatory Impediments

The market capitalization of U.S. public companies is on the order of $50 trillion.[21] These markets play a critical role in allocating capital in the U.S. economy, funding growth and funding the retirement of millions of Americans. Unfortunately, being a public company has become increasingly costly because of a vast array of costly regulations and regulatory risk. The number of public companies has declined by almost half over the past quarter century[22] despite the real GDP growing by about 80 percent[23] and the population increasing by about 26 percent.

A large number of poor regulatory decisions over many years have made companies go public later or not at all and many public companies have gone private. Regulators appear to think that they can pile ever-increasing regulatory burdens on firms without any adverse impact. This has an adverse impact on investors because the large gains from entrepreneurship now accrue to relatively wealthy accredited investors operating in private markets and has an adverse impact on young, dynamic and growing companies because they cannot access public capital markets cost-effectively. It also reduces economic growth and economic dynamism to the detriment of the broader public.

The core objective of securities law should be deterring and punishing fraud and fostering reasonable, limited, scaled disclosure by firms for the purpose of providing material information to investors. Statutory provision and regulations that do not meet these objectives should be discarded. Just because somebody somewhere or a small group of investors or non-investors wants free information at the expense of shareholders does not mean regulators should mandate it. And requirements to provide information that has a political purpose unrelated to investors' returns should be particularly suspect.

The Attack on Private Capital Markets

There are proposals to radically restrict access to Regulation D by raising the accredited investor thresholds. There are proposals to impose ESG requirements on private issuers. There is, of course, the "Stop Wall Street Looting Act" which is a direct attack on private equity funds. All of these would increase the cost of raising capital and of operating a business. They would harm the

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[21] Total Market Capitalization of Public U.S. Companies (USD, millions) as of December 31, 2020 https://siblisresearch.com/data/us-stock-market-value/.

[22] See, for example, Les Brorsen, "Looking Behind the Declining Number of Public Companies," *Harvard Law School Forum on Corporate Governance*, May 18, 2017 https://corpgov.law.harvard.edu/2017/05/18/looking-behind-the-declining-number-of-public-companies/; Craig Doidge, G. Andrew Karolyi and René M. Stulz, "The U.S. Listing Gap," NBER Working Paper 21181, May 2015 http://www.nber.org/papers/w21181.

[23] Real Gross Domestic Product, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/GDPC1.

dynamism of the U.S. economy. They would harm innovation. They would reduce productivity and reduce wages. They would cost jobs and reduce opportunity. They would make management of incumbent firms more entrenched and less accountable. They would disproportionately harm small and start-up businesses and lead to greater concentration and less competition.

The Meaning of the term "Private Equity"

The term private equity can mean several different things. It can mean an equity investment in securities that are not a registered, publicly traded securities. In other words, an equity investment in a private offering. It can mean private equity, as in equity investments made by any private fund (including venture capital funds, angel led groups, hedge funds, Small Business Investment Companies (SBICs), Business Development Companies (BDCs), private equity funds (narrowly defined), and a host of other private company investment. Or the term can be used more narrowly for private funds that specialize in acquiring troubled or failing firms or specialize in acquiring firms with a combination of equity and debt but relatively high levels of debt. The later are often called leveraged buy-outs or LBOs.

The Vital Importance of Private Equity Funds, Broadly Defined

As discussed above, private equity funds, broadly defined, are the primary means of raising entrepreneurial capital and absolutely vital to the economic future of the United States. Most successful new companies over the past four decades raised their capital in the private market. They did not do an initial public offering until relatively late in their life cycle (if at all). Neither Congress nor the SEC should do anything to harm this market.[24]

The Importance of Private Equity Funds, Narrowly Defined

Private equity funds, narrowly defined, play a critical economic role as well. They are one of the few remaining practical means of taking over failing public companies, replacing the failed management and turning the company around. But for these funds, the management of public companies would be effectively unassailable and accountable to nobody. Effectively protecting incumbent management from takeovers is undoubtedly attractive to corporate elites and their lobbyists, but it is certainly not in the interests of shareholders, workers or consumers. Congress should not protect failing incumbent managers.

Obviously, not every turnaround attempt is successful. Some fail. But Congress should not adopt legislation that would make it virtually impossible to even try. Doing so would be bad for those that work for these firms since they will all lose their jobs in the absence of a turn around attempt. It would be bad for existing investors since there will be few opportunities to salvage troubled

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[24] For a detailed discussion of these issues and citations to supporting data, academic research and proposals for reform, see David R. Burton and Norbert J. Michel, :Proposals to Foster Economic Growth and Capital Formation," March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf. See also David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf.

companies. It would be bad for customers since the firms from which they buy goods and services will fail.

Inevitably, adjustments necessary for a failing firm to survive can be painful. But the alternative is either bankruptcy -- because an equity infusion will not be forthcoming and banks or other lenders will stop lending to a failing firm – or government subsidies or bail-outs. It is not desirable to subsidize or bail-out failing firms, including financial institutions. Badly run, unprofitable firms should be allowed to fail. Bail-outs and subsidies make the market markedly less effective at providing goods and services, induce firms to take unwarranted risks, protect incompetent management, raise prices and reduce innovation, increase concentration and harm small competitors and cost taxpayers. Socializing loss and privatizing profit is also unethical.

The Likely Impact of the Proposed "Stop Wall Street Looting Act"

The "Stop Wall Street Looting Act" (WSLA)[25] would be more aptly named the "Protect Incompetent Management Act." The WSLA would erect a moat and high walls around failing companies so that it would become virtually impossible, and certainly economically unattractive, to take over failing companies and replace their management. While this legislation may be attractive to corporate elites and their lobbyists, it is certainly not in the interests of shareholders, workers or consumers. If enacted, WSLA would make it vastly more difficult for troubled firms to find equity investors and make it much more difficult to replace failing management to turn around a company.

Liability for Target Company Debts

The bill would make owners (other than limited partners), officers, directors and other "insiders" of private funds liable for the debts and other liabilities of target companies and prohibits indemnification by the target firm with respect to these liabilities. This provision alone will make it vastly less attractive to acquire an indebted and failing firm.

The definition of private fund is extremely broad. A private fund is generally defined as a company that "would be considered an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) but for the application of paragraph (1) or (7) of subsection (c) of such section 3"[26] and is "not a venture capital fund, as defined in section 275.203(l)–1 of title 17, Code of Federal Regulations." This definition of a venture capital fund goes on for approximately 1,000 words and would exclude many actual venture capital funds either because they acquire debt securities (including convertible bonds or notes), are insufficiently diversified or have more than a de minimis degree of leverage.

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[25] Note: The discussion in this section is based on a draft of the 2021 version of the Stop Wall Street Looting Act, provided by committee staff on October 18th, which is the version expected to be introduced this week. My written testimony had to be submitted by October 19th at 2:00 p.m. It is, of course, possible that the version actually introduced will be different. The 2019 version was introduced as S. 2155 (116th Congress). See also, The Stop Wall Street Looting Act of 2019, Section-by-Section https://www.warren.senate.gov/imo/media/doc/2019.7.17%20Stop%20Wall%20Street%20Looting%20Act%20Section%20by%20Section.pdf.

[26] In general, paragraphs (1) and (7) exclude funds that do not presently propose to make a public offering and are beneficially owned by not more than one hundred persons who are not qualified purchasers.

Fraudulent Transfers

Under current law, 11 U.S. Code §548 provides bankruptcy trustees the authority to police fraudulent transfers. The WSLA extends the lookback period after a change of control from two years to eight years and creates a presumption that any payments to the private fund by the debtor were fraudulent. This too will make acquiring a failing company substantially less attractive.

Confiscatory Taxation

The section-by-section description of the 2019 WSLA says that the bill "Applies a 100% tax on fees paid by target firms to private fund managers, often called "monitoring" or "transaction" fees, effectively ending this form of looting of portfolio companies by managers."[27] The 2021 statutory language amending the Internal Revenue Code, however, does not appear to be limited to just such fees. It states:

> The term 'applicable payment' means **any** amount paid or incurred by an applicable entity (or any person related within the meaning of section 267(b) or 707(b) to such entity) to **any** other person which, at the time such amount is paid or incurred, is an applicable controlling entity. (emphasis added)

An 'applicable entity' is probably *meant* to be a target firm but the statutory language would include just about any firm in the universe.

> The term 'applicable entity' means **any** person—
>
> "(A) which is engaged in the active conduct of a trade or business, and
>
> "(B) with respect to which **any** other person conducts activities in connection with an applicable trade or business. (emphasis added)

The term 'applicable trade or business' means **any** activity conducted on a regular, continuous, and substantial basis that consists of (1) raising or returning capital, and (2) investing in or disposing of specified assets (or identifying specified assets for such investing or disposition) or developing specified assets. Specified assets are securities and real estate "held for rental or investment."

The definition of 'applicable controlling entity' is also very, very broad and will include a host of businesses that presumably are far beyond what the authors of the legislation say they intend. It would include **any** entity which controls the applicable entity and is engaged in an applicable trade or business.

In short, as drafted, this bill would impose a confiscatory 100 percent tax on almost all payments from almost any firm to almost any investment fund indefinitely.[28] There appears to be absolutely

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[27] The Stop Wall Street Looting Act of 2019, Section-by-Section https://www.warren.senate.gov/imo/media/doc/2019.7.17%20Stop%20Wall%20Street%20Looting%20Act%20Section%20by%20Section.pdf.

[28] Once state taxes are considered, the tax rate will exceed 100 percent.

no limitation on this tax to private equity funds acquiring targets in the statutory definitions. It is monumentally poorly drafted.

Non-Deductibility of Interest

The limitation on the deductibility of interest would make a normal business expense non-deductible and is therefore a substantial move toward the discredited gross income or gross receipts tax.[29] Interest has generally been deductible for purposes of computing taxable income since the advent of the modern income tax.[30] It still *generally* is.[31]

There are two competing conceptions of income in public finance.[32] One is called the Haig-Simons definition of income.[33] The other is sometimes called the Fisher-Ture definition of income[34] although this concept has intellectual antecedents dating back to at least John Stuart Mill in the 19th century.[35] Although not universally the case, the Haig-Simons definition is most often

[29] Andrew Chamberlain and Patrick Fleenor, "Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes," Special Report No. 147, December, 2006 ("it is not possible for lawmakers to craft an economically neutral gross receipts tax") https://files.taxfoundation.org/legacy/docs/sr147.pdf; Nicole Kaeding and Erica Wilt, "Gross Receipts Taxes: Lessons from Previous State Experiences," Fiscal Fact No. 523, August 9, 2016 https://files.taxfoundation.org/20170209073111/TaxFoundation_FF523_0.pdf.

[30] See Revenue Act of 1913, section II.B. ("That in computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses; second, all interest paid within the year by a taxable person on indebtedness …")

[31] Internal Revenue Code §163(a) ("There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.").

[32] For a good collection of writing on the subject of measuring and defining income written primarily by authors outside of the field of public finance, see R.H. Parker and G.C. Harcourt, *Readings in the Concept and Measurement of Income* (Cambridge, U.K.: Cambridge University Press, 1969).

[33] Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938; Robert Murray Haig, "The Concept of Income – Economic and Legal Aspects," in *The Federal Income Tax*, Robert Murray Haig, Ed., (New York: Columbia University Press, 1921), pp. 1-28 reprinted in *American Economic Association Readings in the Economics of Taxation*, Vol. IX, Richard A. Musgrave and Carl S. Shoup, Eds., (Homewood, IL: Richard D. Irwin, 1959).

[34] Irving Fisher, *Elementary Principles of Economics* (New York: MacMillan, 1910, Chapter III ("A stock of wealth existing at a given instant of time is called capital; a flow of benefits from wealth through a period of time is called income."); Irving Fisher, "Income in Theory and Income Taxation in Practice," *Econometrica* (January 1937); Irving Fisher, "The Double Taxation of Savings," *American Economic Review*, Vol. 29 (March 1939), p. 1; Irving Fisher, "The Unperceived Double Taxation of Income, Answers to Those that Deny Its Existence," 1946, previously unpublished manuscript published in William J. Barber, ed., *The Works of Irving Fisher*, Vol. 12, "Contributions to the Theory and Practice of Public Finance" (London: Pickering and Chatto, 1997); Irving Fisher, "Paradoxes in Taxing Savings," *Econometrica* (April 1942); Irving Fisher and Herbert Fisher, *Constructive Income Taxation* (New York: Harper and Brothers, 1942); Norman B. Ture, "Supply Side Analysis and Public Policy," in David G. Raboy, ed., *Essays in Supply Side Economics* (Washington, DC: The Institute for Research on the Economics of Taxation, 1982), http://iret.org/pub/SupplySideBook.pdf; and Norman B. Ture, "The Inflow Outflow Tax—A Saving-Deferred Neutral Tax System," The Institute for Research on the Economics of Taxation, 1997, http://iret.org/pub/inflow_outflow.pdf .

[35] John Stuart Mill, *The Principles of Political Economy with Some of Their Applications to Social Philosophy* (1848), Book V: On the Influence of Government, Chapter III: Of Direct Taxes, § 5. [An Income Tax] ["all sums saved from income and invested, should be exempt from the tax"]. See also Chapter II: On the General Principles of Taxation
https://oll.libertyfund.org/title/mill-the-collected-works-of-john-stuart-mill-volume-iii-principles-of-political-economy-part-ii#lf0223-03_label_1165.

associated with liberal and progressive analysts while The Fisher-Ture definition of income is most often associated with conservative and libertarian analysts.[36] The Haig-Simons definition is what is most commonly seen in modern public finance textbooks. The Haig-Simons definition defines income as the sum of consumption plus changes in net wealth.[37] The Fisher-Ture definition defines income as gross receipts less any outlays or disbursements made to earn current or future income. In both cases, interest income increases income and interest expense reduces income.

A simple example may help better understand the difference between these two conceptions of income. Consider a farmer who bought a tractor for $100,000. The tractor has an expected useful life of ten years. In the first year, the farmer sells crops worth $25,000. Has the farmer made money? Proponents of the Haig-Simons definition of income would say yes, he has income of $15,000 in the first year. This is calculated by saying the tractor has depreciated or declined in value by $10,000,[38] so the farmer has a $10,000 depreciation expense to deduct against his $25,000 of gross receipts. Proponents of the Fisher-Ture definition of income would argue that the farmer has not made money until he has recovered the cost of the tractor. Thus, having spent $100,000 on the tractor and having only $25,000 in income, he has lost $75,000 in the first year. It is important to note that both result in a ten-year net income of $150,000, provided that the farmer *actually* earns $25,000 a year for ten years and then that the tractor is scrapped at the end of the tenth year and has no salvage value. This is because the farmer would have ten years of income at $25,000 per year (i.e. a total of $250,000) and $10,000 of annual depreciation times ten years equals the $100,000 cost of acquiring the tractor. Given the time value of money, however, the two methods are not economically equivalent and at times of high interest rates, this difference can be quite substantial.

Using the Haig-Simons definition of income, interest income either increases net wealth or funds consumption. Conversely, interest payments either reduce net wealth or reduce consumption. Using the Fisher-Ture definition of income, interest income is a gross receipt and should be

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[36] The reason for this is that the Haig-Simons definition implies a higher effective marginal tax rate on capital income which appeals to some progressives. The fact is, however, that graduated tax rates can be applied to a Fisher-Ture tax base and any distributional outcome sought can be obtained. For any given level of tax revenue, the Fisher-Ture tax base has a lower excess burden or deadweight loss. This is because factor incomes are taxed once and equally by a Fisher-Ture tax base and capital income is taxed twice under Haig-Simons. Fisher-Ture is less distortionary and has a lower excess burden.

[37] Simons' exact words were "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in value of the store of property rights between the beginning and end of the period in question." Simons, *Personal Income Taxation*), p. 50. Haig's formulation was "[i]ncome is the money value of the net accretion in economic power between two points in time." Haig, "The Concept of Income,' p. 27.

[38] This assumes that the tractor declines in value evenly over time and that straight-line depreciation method is used. Other methods are possible (e.g. double declining balance, sum of the years digits, production units, etc.). Economists often use geometric decay since it can be mathematically more tractable in certain models. For information on tax depreciation, see, "How to Depreciate Property," Internal Revenue Service, Publication 946 (2020) https://www.irs.gov/publications/p946. See also Charles R. Hulten, "The Measurement of Capital," in *Fifty Years of Economic Measurement: The Jubilee of the Conference on Research in Income and Wealth*, Ernst R. Berndt and Jack E. Triplett, eds. (Chicago: The University of Chicago Press for the National Bureau of Economic Research, 1990), pp. 119-152. Charles R. Hulten, "Getting Depreciation (Almost) Right," March, 2008 https://www.econ.umd.edu/sites/www.econ.umd.edu/files/pubs/Getting%20Economic%20Depreciation%20Almost%20Right.pdf.

included in income.[39] Similarly, interest expense should be deductible as a cost of acquiring capital.

Accounting conceptions of income lead to the same conclusion. Interest received is considered income and interest paid is considered an expense under generally accepted accounting principles (GAAP).[40] Both the Financial Accounting Standards Board (FASB)[41] and the Securities and Exchange Commission[42] require that interest income and expense be reflected on financial statements.[43]

Compensation Restrictions

In principle, I have no issue with well-considered restrictions on bonuses and other payments to management that drove their company into the dirt. The restrictions need to be carefully drafted to ensure that they do not impede the ability to hire new management in a turn around situation.

Carried Interest

The carried interest provisions in the bill are complex and generally counterproductive. There is, however, a need to draw the line between capital and labor income. But it need not be this complex. Raising the capital gains tax rate on true investments is both economically destructive and will reduce federal revenues.

Voluminous Disclosure Requirements

The Title V disclosure requirements are so voluminous that private fund disclosure would be a close cousin to public fund disclosure and be just as burdensome. This is probably the point. But, as discussed above, the private capital market is vital to the economic future of this country and we should be loath to damage it. Doing so will harm millions of ordinary people.

Private Equity Issues that Need to be Addressed

The SEC Division of Examinations has identified a number of issues relating to private equity funds, narrowly defined, that need to be addressed. There appears, however, to be an adequate statutory and regulatory framework to address the issues through examinations and enforcement.[44]

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[39] If the interest income is saved or invested, then there will be a countervailing deduction. If it is used to fund consumption, then there will be no countervailing deduction.
[40] See, for example, FASB's Accounting Standards Codification 835-20-20; *U.S. Mater GAAP Guide*, 2017 (Riverwoods, IL: CCH, 2016) Topic 835, Interest, p. 8137; Joanne M. Flood, *Wiley GAAP: Interpretation and Application of Generally Accepted Accounting Principles*, 2019 (Hoboken, NJ: John Wiley & Sons, 2019), chapter 55, p. 1070. Certain interest expense must be capitalized.
[41] Financial Accounting Standards Board https://www.fasb.org/home.
[42] The SEC is the primary regulator of companies that issue securities and their periodic financial disclosures. See Securities and Exchange Commission https://www.sec.gov/. See also David R. Burton, "Reforming the Securities and Exchange Commission," Heritage Foundation Backgrounder No. 3378, January 30, 2019 https://www.heritage.org/sites/default/files/2019-01/BG3378.pdf.
[43] See Securities and Exchange Commission Regulation S-X.
[44] "SEC Risk Alert, Observations from Examinations of Investment Advisers Managing Private Funds," Securities and Exchange Commission, June 23, 2020 https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf.

There are many issues that need to be addressed to improve private equity, broadly defined. A partial list would include:[45]

1. Establish a fundamentally reformed, simplified and rationalized securities disclosure system with three basic categories of firm (private firms, quasi-public or venture firms and public firms), reasonable, scaled disclosure requirements and specified secondary markets.
2. Enact legislation permitting finders and private placement brokers substantially along the lines of the "Unlocking Capital for Small Businesses Act."
3. Congress should require the Division of Economic and Risk Analysis at the SEC to conduct a study mapping and reporting accredited investor data by state and county but permitting the use of core-based statistical areas or metropolitan statistical areas if data masking by the Census Bureau or the IRS Statistics of Income effectively requires their use.
4. Congress should amend the Securities Act section 4 by adding a new subsection (f) to create a safe harbor under section 4(a)(2) for micro-offerings. Alternatively, Congress should create a new exemption for micro-offerings under section 4(a) of the Securities Act by enacting a new section 4(a)(8).
5. Congress should provide that a natural person is an accredited investor for purposes of Regulation D who has:
   (1) passed a test demonstrating the requisite knowledge, such as the General Securities Representative Examination (Series 7), the Securities Analysis Examination (Series 86), or the Uniform Investment Adviser Law Examination (Series 65) or a newly created accredited investor examination testing for substantive investment knowledge;
   (2) met relevant educational requirements, such as an advanced degree in finance, accounting, business, economics or entrepreneurship; or
   (3) acquired relevant professional certification, accreditation, or licensure, such as being a certified public accountant, chartered financial analyst, certified financial planner, registered representative or registered investment advisor representative.
6. Self-certification should be allowed for all Rule 506 offerings and obtaining an investor self-certification should be deemed to constitute taking "reasonable steps to verify that purchasers of the securities are accredited investors" as required by the JOBS Act for Rule 506(c) offerings.
7. The statutory crowdfunding offering limit should be conformed to the new limit in Regulation CF. Clarify funding portal liability for the misstatements of issuers. Clarify that the term "issuer" does not include any person who is a broker or funding portal except with respect to securities of the entity (or its parents, subsidiaries, affiliates or other related parties) operating the broker or funding portal. Congress should make it clear that funding portals need not comply with AML rules because they may not hold customer funds. Allow

[45] For a detailed discussion of each of these proposals and citations to supporting data, academic research and draft statutory language, see David R. Burton and Norbert J. Michel, :Proposals to Foster Economic Growth and Capital Formation," March 18th, 2021 https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

curation by funding portals by repeal restrictions on investment advice. Alternatively, allow "impersonal investment advice" by funding portals.

8. Amend Section 1361(c) of the Internal Revenue Code to disregard crowdfunding and Regulation A shareholders for purposes of the 100 shareholder limit for Subchapter S corporations.
9. Preempt blue sky registration and qualification requirements for all primary and secondary Regulation A offerings.
10. Require an annual SEC and one-time GAO study that collects and reports data from state regulators on the fees or taxes they collect from issuers. These studies should collect data from at least the years 2017-2020 and classify the fees and taxes collected from issuers by offering type.
11. Codify and broaden the exemption from the section 12(g) holder-of-record limitations for Regulation A securities. Eliminate the income and net worth limitations imposed by Regulation A (although not by Securities Act section 3(b)).
12. Exempt P2P lending from federal and state securities laws. Amend Title III of the JOBS Act to create a category of crowdfunding security called a "crowdfunding debt security" or "peer-to-peer debt security" with lesser continuing reporting obligations. Congress could adopt an alternative regulatory regime for P2P lending.
13. Exempt business brokers from the broker-dealer registration requirements. Alternatively, register and reasonably regulate business brokers.
14. Congress should require the SEC to publish better data on securities offerings, securities markets and securities law enforcement and to publish an annual data book of time series data on these matters (as outlined below). The Division of Economic and Risk Analysis (DERA) should publish annual data on:
    (1) the number of offerings and offering amounts by type (including type of issuer[46], type of security[47] and exemption used[48]);
    (2) ongoing and offering compliance costs by size and type of firm and by exemption used or registered status (e.g. emerging growth company, smaller reporting company, fully reporting company) including both offering costs and the cost of ongoing compliance;
    (3) enforcement (by the SEC, state regulators and SROs), including the type and number of violations,[49] the type and number of violators and the amount of money involved;

[46] By industry; by measures of size such as gross revenues, assets or employees; by age (i.e. years in existence); reporting status; and so on.

[47] Common stock, preferred stock, bond, (and whether the bond or preferred stock is convertible into common stock), other classes of security, whether options or warrants were attached; and so on.

[48] Regulation D (Rule 504 and 506 (including 506(b) and 506(c)); Regulation A (Tier 1 and Tier 2); Crowdfunding (Tiers 1, 2 & 3); non-Regulation D section 4(a)(2) offerings, Rule 144A and other exemptions.

[49] Civil or Criminal (referrals, convictions, settlements); with respect to broker-dealers (Breach of Fiduciary Duty, Suitability violations, Negligence, Failure to Supervise, Misrepresentation, Fraud, Breach of Contract, Omission of Facts, Violation of Blue Sky Laws, Unauthorized Trading, Manipulation, Churning); issuer violations by type of violation (e.g. fraud, non-compliance with Regulation S-K, Regulation S-X, failure to file an 8-K, Regulation A, Regulation CF, etc.) and type of issuer ((private issuer, Regulation A issuer, crowdfunding issuer, reporting company, investment company, registered investor advisor, broker-dealer, registered representative, etc.).

(4) basic market statistics such as market capitalization by type of issuer and type of security; the number of reporting companies, Regulation A issuers, crowdfunding issuers and the like; trading volumes by exchange or ATS; and

(5) market participants, including the number and, if relevant, size of broker-dealers, registered representatives, exchanges, alternative trading systems, investment companies, registered investment advisors and other information.

This data should be presented in time series over multiple years (including prior years to the extent possible) so that trends can be determined.

PREPARED STATEMENT OF DOUG HOLTZ-EAKIN

PRESIDENT, AMERICAN ACTION FORUM

OCTOBER 20, 2021

Introduction

Chairman Warren, Ranking Member Kennedy, and Members of the Subcommittee, thank you for the opportunity to discuss financial markets, in general, and, in particular, the role of private equity firms. In this testimony, I hope to make three main points:

- Financial markets serve key economic functions such as intermediation between savers and investors, allocation of capital, diversification of risk, separation of ownership and management, pricing return and risk, and others.
- Participants in financial markets have myriad business models—banks, insurance companies, pension funds, hedge funds, private equity, etc.—to undertake these functions; legal, regulatory, and tax policies should be as neutral as possible with respect to the choice of business models.
- The Stop Wall Street Looting Act violates this basic dictum, discriminating against public equity firms, damaging the outlook for the private equity industry and the economy as a whole.

Let me discuss each of these in greater detail.

Financial markets are a crucial component of developed economies. Well-functioning financial markets permit savers to provide their pooled savings to firms for investment in skills, technologies, and physical capital. They permit savers to diversify across risks and provide important price signals regarding the expected returns and risks of alternative investments. In the absence of financial markets, owners would be forced to also manage each firm and hold undiversifiable risk regarding its performance; financial markets permit specialization of management functions as well as diversification of risks.

These economic functions may be supplied by a variety of entities—banks, pension funds, insurance companies, mutual funds, and others offer various combinations of these desirable economic activities. In developing the legal, regulatory, and tax frameworks within which they operate, it is desirable to tilt the playing field as little as possible, allowing financial market participants to compete on the basis of performance. As noted by most economists and this Administration, healthy market competition leads to lower prices, higher quality goods and services, greater variety, and more innovation.

Background on Private Equity

Private-equity (PE) firms are a crucial part of capital allocation and the pricing of return and risk. PE firms invest in businesses they see as undervalued, provide additional capital and management services, and raising value. The vast majority (over 85 percent) of these investments are in small businesses (under 500 employees).

PE has been very successful. For example, the American Investment Council's 2021 Public Pension Study shows PE has the highest return of any asset class public pension portfolios. In 2020, PE had a median annualized return of 12.3 percent over a 10-year period.

Its success in raising value has resulted in a substantial economic footprint. According to E&Y, the PE sector directly employed 11.7 million workers earning $900 billion in employee compensation. The average employee earned roughly $73,000 in wages and fringe benefits in 2020, while the median worker received approximately $50,000 in wages and benefits in 2020. These workers helped the private equity sector produce $1.4 trillion of gross domestic product (GDP), or roughly 6.5 percent of total GDP.

The PE sector has substantial backward linkages. Suppliers generated $900 billion in GDP, employing another 7.5 million workers, and paying roughly $500 billion in wages and benefits.

In short, PE is a very successful sector of the economy and the fruits of its success are widely shared by the investors in PE and the economy as a whole. As a corollary, unwise policies that damage PE would impose widespread harm in the economy.

Economic Implications of the Stop Wall Street Looting Act

The proposed Stop Wall Street Looting Act (SWSLA) is one such potential policy misstep. The SWSLA would impose a separate set of tax, regulatory, and legal frameworks on the PE industry. Among other provisions, it would impose:

- A 100 percent surtax on fees received from portfolio companies,
- A tax increase on carried interest capital gains,
- Limitations on interest deductibility,
- Restrictions on dividends,
- Joint and several liability on holders of economic interests in a private fund for all liabilities of a portfolio companies, and
- Alternative rules for the treatment of worker claims in bankruptcy.

As a matter of logic, the net result would be to make investments in PE less attractive, pushing capital to less productive uses, and imposing a loss on the economy. The only question is how large the losses would be.

A 2019 study by the U.S. Chamber of Commerce found that the "imposition of increased risk, taxes, and restrictions . . . would likely cause some (and potentially all) of the private equity industry to cease to exist." As a result, the SWSLA would result in a loss in the range of 6.9 million to 26.3 million jobs, from $671 million to $3.36 billion per year in investor earnings (about half of which would be lost to pension fund retirees), and substantial tax revenue for local governments, State governments, and the Federal Government.

Thank you. I look forward to answering your questions.

PREPARED STATEMENT OF MICHAEL FRERICHS

ILLINOIS STATE TREASURER

OCTOBER 20, 2021

Good afternoon Chair Warren, Ranking Member Kennedy, and other distinguished Members of this Subcommittee and guests. My name is Michael Frerichs. I am the Illinois State Treasurer, and it is an honor to be invited to speak to you today to share my experience managing investments on behalf of the people of Illinois.

The Illinois State Treasurer is a constitutionally established, elected office in our State that performs a variety of roles. I am the State's Chief Investment and Banking Officer. In that role, my office manages approximately $50 billion, including $25 billion in State funds, $16 billion in retirement and college savings plans, and $9 billion on behalf of State and local government entities.[1] I also serve as a trustee on the Illinois State Board of Investment (ISBI),[2] which manages approximately $31 billion in assets on behalf of over 226,000 beneficiaries of a number of State retirement plans.[3]

As an elected steward of public funds, I have a responsibility to make prudent investment decisions, and I also have a responsibility to the long-term fiscal health of our State, which relies on a vibrant and sustainable economy. Furthermore, I have a responsibility to the communities that I represent to tend to their well-being and to be mindful of how the decisions that our office makes might impact the livelihoods of workers and their families.

As an active investor in the space, I view private equity as an essential part of our capitalist system. The idea of the industry is simple and reasonable: sometimes a company has room to grow and become more productive, but its current ownership is not in a position to capitalize on that opportunity. In this situation, it makes sense for an investment vehicle run by experts to pool private capital, buy the firm, take it to the next level, and then sell it. This generates a profit for private equity firms and their investors, it helps the company grow, and it creates more economic opportunity for society at large.

For investors like the Illinois Treasury and other institutional investors, private equity investments provide an opportunity to further diversify our portfolios, help drive economic development in Illinois and beyond, support small businesses, invest in qualified minority- and women-owned investment firms, and provide a competitive return that complements our investments in other asset classes such as public equities and fixed income.

The problem is that as private equity has continued to evolve as an asset class, becoming a larger and larger portion of our economy, it has remained dangerously

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[1] Illinois State Treasurer, Investments, available at *https://illinoistreasurer.gov/Office-of-the-Treasurer/Investments.*

[2] I am testifying today in my capacity as the Illinois State Treasurer and as an individual trustee of ISBI. These views are my own and are not intended to represent the views of ISBI.

[3] Illinois State Board of Investments, "About Us", available at *https://www.isbinvestment.com/.*

under-regulated. That means that predatory and destructive activities like pillaging assets, opaque fees, and strategically using bankruptcy without regard for the well-being of workers remain perfectly legal. As private equity continues to evolve, there is a need for sensible reforms that will enhance long-term outcomes for investors, including public pensions, and continue to focus private equity on what it does best, helping companies to grow and expanding economic opportunity for our communities.

As Treasurer, my office directly invests in private equity funds, and we intend to continue to do so in the future. Through the Illinois Growth and Innovation Fund (ILGIF), my office makes targeted investments with venture capital, growth equity, and private venture debt funds that invest in technology-enabled businesses that are either based in Illinois or possess a significant workforce in Illinois with the goal to attract, assist, and retain these quality technology-enabled businesses in Illinois.[4] As of March 31, 2021, we have $430 million invested in private equity and venture capital through this program. To date, these investments have been our highest performing asset class with a net internal rate of return of 21.3 percent since the inception of the program in 2016.[5] After evaluating this program, I saw great potential in these investments for Illinois, both in terms of the return on investment and the ability to stimulate growth in our economy, and that led me to advocate for a change in the State law to allow my office to increase the percentage of funds invested in ILGIF from 2 percent of the State investment portfolio to 5 percent.[6]

A core investment objective for ILGIF in addition to driving performance and economic development, is fostering a more diverse and inclusive manager and private equity ecosystem across Illinois. It is my core belief that a more inclusive private equity ecosystem means more opportunities for diverse founders which in the long term, has the opportunity to build generational wealth and advance equity, diversity, and inclusion in our communities. We know the importance of providing individuals with traditional and nontraditional backgrounds necessary opportunities to grow within the private equity space and the benefits a greater level of diversity adds to the ecosystem overall.

As of March 31, 2021, of the $430 million committed to Illinois venture capital firms under ILGIF, $183 million has been committed to minority-, women-, veteran-, and disabled-operated (MWVD) venture capital firms. That represents over 42 percent of committed capital to date.

Investments from ILGIF fund managers have supported more than 110 diverse-owned portfolio companies to receive funding. Through ILGIF, the Illinois Treasurer actively seeds and anchors new MWVD-operated venture capital and private equity funds furthering the investment objective to foster a more diverse and inclusive manager pool and entrepreneurial community across Illinois.

For example, our office continues to push toward increasing economic equity to broad swaths of Chicago, in which there has been decades of disinvestment and undercapitalization that has left entire communities vulnerable and marginalized. Entrepreneurship is a potent tool in closing longstanding wealth gaps. That is why in partnership with minority-owned and operated venture capital firm Cleveland Avenue, ILGIF anchored and helped launch the Cleveland Avenue State Treasurer's Urban Success Fund, a $70 million fund dedicated to investing in underrepresented founders within underserved communities on Chicago's South and West sides.

Likewise, as a trustee of ISBI, which maintains approximately 7 percent of its total portfolio in private equity investments, I have also given considerable thought to the role that these investments play in support of the long-term growth of our State pensions.

I have seen first-hand the benefits of private equity investment for our State, but also the ways in which the current lack of regulation allows for abuses that harm institutional investors, workers, and businesses. Specifically, I want to underscore the need for greater transparency to allow institutional investors, including ILGIF and our State pension programs, to fairly evaluate the prospective costs and benefits associated with a particular private equity investment, as well as the need for reforms targeting bad actors in this industry that allow workers and their families to become collateral damages when an investment goes awry. I see these reforms as a way to enhance this industry by aligning the goals of private equity firms, in-

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[4] See Illinois Growth and Innovation Fund, Mission, available at *http://www.ilgif.com.*

[5] See Illinois Growth and Innovation Fund, Impact, available at *https://www.ilgif.com.*

[6] See the Technology Development Act, 30 ILCS 265, available at *https://ilga.gov/legislation/ilcs/ilcs3.asp?ActID=502&ChapterID=7*; see also "Treasurer Frerichs Announces Increase in Venture Funding To Help Grow Technology Businesses in Illinois", Illinois Venture Capital Association, Aug. 29, 2020, available at *https://ivca.memberclicks.net/treasurer-frerichs-announces-increase-in-venture-fundingto-help-grow-technology-businesses-in-illinois.*

stitutional investors, and the people and communities that work every day to make their businesses a success.

Lack of Transparency

Regulators have recognized that the lack of transparency in this industry often operates to the detriment of institutional investors. Since 2014, the SEC has brought to light many cases where fees and expenses were improperly charged or insufficiently disclosed to investors in private funds.[7] In June 2020, the Office of Compliance Inspections and Examinations (OCIE) at the U.S. Securities and Exchange Commission (SEC) released a risk alert identifying numerous issues with allocation and disclosure of fees and expenses by private fund advisors that had arisen in recent compliance examinations.[8] OCIE noted that many of the deficiencies discussed in the Risk Alert may have caused investors in private funds "to pay more in fees and expenses than they should have or resulted in investors not being informed of relevant conflicts of interest concerning the private fund advisor and the fund."[9] Earlier this year, in testimony before the full Senate Banking Committee, SEC Chairman Gary Gensler stated that "[u]ltimately, every pension fund investing in these private funds would benefit if there were greater transparency and competition in this space."[10]

In my own experience, the lack of transparency surrounding private equity investments, specifically related to fee arrangements and the calculation of the internal rate of return creates significant challenges for institutional investors like my office and our State retirement plans. The fees and costs associated with a particular investment can significantly affect the longterm return on these investments. The fees charged by private equity managers are among the highest in the investment industry, thus, any lack of transparency represents a meaningful risk.

Private equity firms use different terms, different methodologies around calculating asset values, and different metrics to report on their performance, with some breaking out fees and expenses to investors while others make fee and expense information much harder to identify. This makes evaluation cumbersome and makes direct comparisons between funds nearly impossible.

Additionally, private equity firms are increasingly using bridge loans, known as subscription lines, to pay for assets, manage capital calls, and boost returns, adding more debt to already leveraged transactions without always accounting for their true impact on returns. In order to assess the value of these investments, institutional investors have to hire specialists who are expensive and drive up costs, or risk paying more for an investment than we should.

Clear and standardized fee and expense disclosures, similar to the template established by the Institutional Limited Partners Association, would allow institutional investors to streamline their analysis and will drive better decision making. These basic reforms would also reduce the compliance burden and cost, not only on Limited Partners, such as the programs my office manages, but also on General Partners being asked to report against a range of varying templates from investors. Investors would also be able to accurately understand and account for general partner fees, fee offsets, and fund expenses in order to verify what they are being charged against what was agreed upon in investment contracts.

While some might argue that access to more granular reporting can be achieved through negotiations between more sophisticated Limited Partners like large institutional investors and the private equity firms, this approach has yet to result in a change in market practice. As a larger institutional investor, my office attempts to negotiate an increased level of transparency by leveraging a reporting template that is modeled off of the Institutional Limited Partners Association's reporting template to ensure private equity firms demonstrate that they are allocating costs appropriately. However, basic market transparency should be available to all investors, including smaller institutional investors such as city or county pension funds,

[7] See Andrew J. Bowden, Director of OCIE, "Spreading Sunshine in Private Equity", May 4, 2014, available at *https://www.sec.gov/news/speech/2014-spch05062014ab.html*; see also Marc Wyatt, Acting Director of OCIE, "Private Equity: A Look Back and a Glimpse Ahead", May 13, 2015, available at *https://www.sec.gov/news/speech/private-equity-look-back-and-glimpse-ahead.html*.

[8] See U.S. Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Risk Alert, dated June 23, 2020, available at *https://www.sec.gov/files/Private%20Fund%20Risk%20Alert-0.pdf*.

[9] See OCIE Risk Alert, supra.

[10] Testimony of Gary Gensler before the United States Senate Committee on Banking, Housing, and Urban Affairs, September 14, 2021, available at *https://www.banking.senate.gov/imo/media/doc/Gensler%20Testimony%209-14-21.pdf*.

not just those with the buying power to negotiate a more favorable release of information.

Protection for Workers and Communities

In my role as an elected officer of the State of Illinois, I take my responsibility towards the communities in my State very seriously. As an investor of public funds, I also see it as my obligation to integrate sustainability factors into our investment decisions, including minimizing risks and negative impacts to what we call our human capital—the workers who drive our economy. While I see strong value in private equity investment, there are many examples of firms that have profited off a business model that allows them to buy companies, load them up with debt, pay themselves massive and often opaque fees with that borrowed money, and then leave the company in bankruptcy. Hundreds of thousands of workers have lost their jobs in private equity owned corporate bankruptcies,[11] tearing families and neighborhoods apart. To this end, Congress should consider reforms that prioritize worker pay in the bankruptcy process, create incentives for job retention so that workers can benefit from a company's second chance, and incentivize value-generating management and investment over asset-stripping.

Conclusion

Madam Chair, Ranking Member Kennedy, and other distinguished Members of this Subcommittee and guests, I ask for your help in strengthening private equity markets, which will help ensure the long-term success of the industry, establish market efficiencies, and lead to better outcomes for all stakeholders. I firmly believe that private equity can help unlock economic opportunity in ways that grow our communities, expand the circle of possibility, and provide excellent, long-term returns for investors like the Illinois Treasury. With your support, I know that a reformed private equity market can accomplish all this, and more.

PREPARED STATEMENT OF SHIRLEY SMITH

FORMER SALES MANAGER AT ART VAN FURNITURE AND LEADER WITH UNITED FOR RESPECT

OCTOBER 20, 2021

Good afternoon, Senators. My name is Shirley Smith and I live in Detroit, Michigan. For 23 years, I worked for Art Van Furniture as a sales manager—a job I truly loved. Art Van was a family owned business, and the company culture was centered around family. The employees were tight-knit and we had each other's backs; there was a real sense of community. I was a single mom and I'm grateful for the support and flexibility I had at work, so I could be there for my son while juggling a successful career. I had the opportunity to build relationships with my customers and earn a good living, making it possible to buy my own home and provide a good education for my son. Working at Art Van was like my own little slice of the American Dream—until the private equity firm Thomas H. Lee (THL) came in and broke up our family.

Before T.H. Lee took over in 2017, Art Van had been a successful company, reporting $800 million dollars in revenue[1] that year. Up to then, most of my colleagues would have told you it was a company they loved working for, but those last 3 years were hell.

It wasn't obvious right away, but a lot started changing. We noticed our top company leaders were being pushed out the door. T.H. Lee brought in people who didn't know the furniture business, and our orders started coming in slower. In hindsight, that was a big red flag—sales associates work on commission which only gets paid when an order is delivered—and customer orders weren't being filled. Art Van's reputation was being destroyed right before our eyes, and we had to start making up excuses to our customers, some of whom grew violent when they learned they wouldn't be getting refunds. One of my colleagues even had a gun pulled on her during closing weekend. T.H. Lee made us feel like liars and thieves, taking people's hard-earned money when they were never going to receive their orders.

We stopped paying our bills on time, and started cutting staff. For decades, Art Van had been a debt-free company that paid all its bills. Under T.H. Lee's ownership, Art Van racked up millions of dollars in debt to Wall Street banks and other

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[11] The Center for Popular Democracy, "Pirate Entity: How Wall Street Firms Are Pillaging American Retail, The Center", July 23, 2019, available at *https://www.populardemocracy.org/pirateequity.*

[1] *https://www.crainsdetroit.com/awards/40-art-van-furniture-inc*

deep-pocketed creditors. T.H. Lee even sold off Art Van's real estate to itself, forcing Art Van to pay rent on the same properties it once owned. By the end of 2019, under T.H. Lee's so-called leadership, Art Van was in the red. It took just 3 short years for T.H. Lee to strip our company for parts. Then the pandemic hit.

We first received WARN Act notices about our layoffs before the COVID–19 emergency order was issued in Michigan, so the bankruptcy and layoffs had nothing to do with the pandemic. But then, a few weeks later, Art Van changed their original WARN Act notice, citing COVID–19. As a result, we didn't get any severance pay or benefits. Nothing. Robbing the American workforce like this—hurting the same people on the front lines who've been applauded as "heroes" for keeping our economy open—should be a crime.

When we were told we'd be losing our jobs, we were promised a lot. We were promised health insurance after closing. We never got it. The only insurance I could afford charged me 10 times what I had been paying for prescriptions. I was unemployed for 5 months, and many times I had to choose between paying for my medication or paying other bills. We were also promised a retention bonus that we never got. Since my unemployment didn't kick in for 2 months, I had to take out money from my 401K to make ends meet, which I'm still paying taxes on today.

Sadly, my story is not unique—private equity has quietly taken over nearly every facet of life—from retail and grocery store chains, to housing, health care, media, and more—turning the American Dream into nothing more than a pipe dream for millions of working families. And T.H. Lee didn't only destroy us, the individual workers who lost their jobs; every community that had an Art Van store suffered too. We had a deep reach in our communities—we were the largest taxpayer in the city of Warren where we were headquartered, and the biggest contributor to the Food Bank. When the company went under, there was a terrible ripple effect of harm felt throughout the State of Michigan.

Art Van is not the only bankruptcy in T.H. Lee's portfolio. Between 2009 and 2019, T.H. Lee drove three other companies into bankruptcy. In each instance, T.H. Lee attempted to profit while paying down creditor interest by steadily decreasing the operational quality of these companies, destabilizing their real estate holdings, extracting their resources, and cutting jobs. While under T.H. Lee's ownership, over 6,000 people lost their jobs at four companies, including Art Van, that filed for bankruptcy in sectors spanning food processing, media, retail, and manufacturing. You can find more information about these bankruptcies in the attached research brief, Thomas H. Lee Partners Creates ESG Risk for Investors (Appendix III).

I'm here today to show you the human toll of Wall Street's greed. Our elected leaders—each of you here today—have the power to stop private equity firms from coming in and taking over our companies, leaving employees with nothing and gutting our local economies. Billionaires shouldn't be allowed to gamble with our livelihoods, driving thriving companies into bankruptcy just to make another buck.

When faced with private equity's abuses, we fought back. More than 500 of my former coworkers and I teamed up with United for Respect to demand that T.H. Lee create a hardship relief fund. We called, wrote letters and told our story of what happened at Art Van, and after a year, T.H. Lee relented and ultimately provided nearly $2 million dollars to the relief fund, with eligible employees who signed up receiving about $1,200 dollars each. Make no mistake, we're proud of this hard-fought victory—but $1,200 dollars falls far short of the fair severance each of us deserved.

With nearly 12 million people working for private equity-owned companies in the United States, private equity is a major employer. Given the industry's poor track record we must also take a closer look at how their cost cutting and greed impacts workers and the customers they serve across America.

One example I'd like to share with you is the ongoing efforts of PetSmart employees to sound the alarm about unsafe conditions in stores that hurt both workers and pets under their care. With 56,000 employers and 1,650 stores across the U.S. and Canada, PetSmart is the largest pet retailer in North America. PetSmart is also owned by London-based private equity firm BC Partners.

When BC Partners acquired PetSmart for $8.7 billion in March 2015, it was the largest private equity buyout of the year. In true private equity form, BC Partners took an $800 million dividend from PetSmart less than a year after taking over.[2]

Like me and my former Art Van coworkers, the people who worked at PetSmart before BC Partners took over started noticing alarming changes to store practices and policies after private equity took over. PetSmart workers who started after the

[2] *Forbes,* Feb 18, 2016, "PetSmart's $8.7 Billion LBO Is Already Paying Off for Consortium Led by BC Partners".

2015 acquisition report having to struggle to provide quality pet care while dealing with understaffing, stagnant wages, lack of supplies, and broken equipment.

In July 2020, over 500 current and former PetSmart employees wrote to BC Partners alerting them to these serious problems. It has been over a year since PetSmart employees reached out to BC Partners and workers are still waiting for a response. You can read more about BC Partners mismanagement of PetSmart in a recently published report, "Greed Unleashed: PetSmart, BC Partners, and what happens when private equity preys on workers and pets" (Appendix IV [In Additional Material section of this Hearing]).

Imagine the victories we could win for working families with the power of Congress behind us. I'm asking you, Senators, to summon the same courage we found to stand up to these Wall Street executives and corporate billionaires, because essential workers can no longer be treated as collateral damage. The Stop Wall Street Looting Act will finally close regulatory loopholes and change the rules that have only served the billionaire class while wreaking havoc in our communities. It's way past time to protect essential workers over wealthy corporate executives—Congress must pass the Stop Wall Street Looting Act and finally put essential workers first.

Thank you for inviting me to testify today, Senator Warren. I hope all the Senators on this Committee will join me in standing up to Wall Street.

PREPARED STATEMENT OF PEGGY MALONE

REGISTERED NURSE, CROZER-CHESTER MEDICAL CENTER

OCTOBER 20, 2021

Thank you Senator Warren and Members of the Subcommittee for having me here today. My name is Peggy Malone, RN, and I have provided care at the Crozer-Chester Medical Center for 32 years. I am the Vice President of the Crozer-Chester Nurses Association, which is a local of the Pennsylvania Association of Staff Nurses and Allied Professionals, or PASNAP. I am also a member of the PASNAP Board of Directors.

Being a nurse for me and my colleagues is more than a job. It is a calling. We are first and foremost, fierce patient advocates. That is why I am here today. Our patients are suffering due to the greed of a major private equity firm that has enriched itself and its owners at the expense of our patients.

Prospect Medical Holdings, which owns 17 hospitals across the country including mine, was majority-owned until June 2021 [1] by the major private equity firm Leonard Green & Partners. Leonard Green and Prospect's founders and current owners, Sam Lee and David Topper, extracted over $400 million from Prospect since taking ownership just a few short years ago. [2] Simply put, we were looted.

I am here to testify in support of Senator Warren's Stop Wall Street Looting Act, because Congress needs to take action now. We cannot have a health care system in this country that allows, even enables, this to happen.

Eighteen months ago, we were called upon to face a global pandemic head on. We had no idea what we were up against. We did not have enough PPE. We did not have enough staff. We were away from our families. It was the hardest work of our careers. But we showed up at every shift and took care of our patients. We took care of them like they were our own family. We had one goal: to do no harm and help save as many lives as we could. Were we scared? Sure. But we hid it behind our masks.

Eighteen long months later, we are still wearing masks, but we can't hide what we feel now. We are sad, frustrated, overworked and disrespected, but we still show up to work to take care of our patients every day.

We have done our jobs. Prospect has not done theirs. In fact, things have gotten progressively worse since our community hospital system was converted to for-profit status under Prospect's ownership in 2016. The quality of care has gone downhill, and our hospital is only kept from collapsing by the sheer will of the nurses and health care workers that keep the ball rolling.

We are now at a crisis point. Due to Prospect's misguided efforts to save money, we are now severely understaffed and without the supplies we need to do our job. There are many shifts when our nurses are overwhelmed with the number of pa-

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[1] "Rhode Island Regulator Approves Hospital Sale". Laura Cooper, *Wall Street Journal*. June 1, 2021.

[2] "Investors Extracted $400 Million From a Hospital Chain That Sometimes Couldn't Pay for Medical Supplies or Gas for Ambulances", Peter Elkind with Doris Burke, *Propublica*. September 30, 2020.

tients they have to care for—significantly higher than the safe maximum number of patients per nurse.

This decline comes as Prospect has received $173.8 million in COVID grants from the Federal Government.[3] Where has that money gone? We don't know. It certainly hasn't prevented conditions from getting worse at the bedside.

Senator Warren's Stop Wall Street Looting Act would have helped to prevent the worst abuses by Leonard Green, Sam Lee, and David Topper. The bill would "[p]rohibit interest on excessive debt obligations from being tax deductible by target companies," as pointed out by Senator Warren's office.[4] The increased interest rates that Prospect was charged for issuing the debt lowered the tax payments made by Prospect.

What was most of the debt issued for? Not to provide care at the bedside. Instead, the debt was issued to pay $400 million in dividends to Leonard Green, Sam Lee, and David Topper.

They took this money while leaving our patients at risk. At the same time they failed to fully fund our pension, leaving our families and retirement at risk as well.

This is wrong. Our tax system should not be creating incentives for bad business practices, and private equity firms should not be able to extract huge dividends while failing to fund employee pensions. Senator Warren's Stop Wall Street Looting Act would put an end to it.

Our calls to Prospect and its owners over the years have fallen on deaf ears. We now turn to you. The 1,300 nurses and health care professionals represented by PASNAP at Prospect are in full support of Senator Warren's bill, and we call on you, our elected officials, to support us, and support this bill.

Thank you so much.

PREPARED STATEMENT OF EILEEN APPELBAUM

CODIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

OCTOBER 20, 2021

Thank you, Senator Warren, Ranking Member Kennedy, and distinguished Members of the Subcommittee. I am pleased to be here today, at this important hearing, to discuss how the Stop Wall Street Looting Act will rein in excesses and end abuses by private equity firms, keep American companies strong, and protect the economic vitality of communities.

By way of background, I am currently the Codirector of the Center for Economic and Policy Research. Prior to joining CEPR, I held academic positions as Distinguished Professor of Labor Studies and Employment Relations 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 Ph.D. in economics at the University of Pennsylvania.

My coauthored 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] More recently, Professor Batt and I have studied the role of private equity in health care. Our publication, "Private Equity Buyouts in Health Care—Who Wins, Who Loses?" examines the private equity business model in health care. It focuses, among other topics, PE's acquisitions of physician practices and its growing role in the collection of medical debt—so-called revenue cycle management.[2]

Private Equity, Largely Unregulated, Plays a Growing Role in the U.S. Economy

By net asset value, global private equity assets under management have grown ten-fold since 2000. In 2020, global assets under management by private equity firms reached $4.5 trillion—and growing. There are about 5,000 private equity firms worldwide.[3] More than half of assets under management are held by U.S. PE firms.

[3] Covidstimuluswatch.org Query. October 18, 2021.

[4] "The Stop Wall Street Looting Act of 2019 Section-by-Section".

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

[2] *https://www.ineteconomics.org/research/research-papers/private-equity-buyouts-in-healthcare-who-wins-who-loses*

[3] *https://www.mckinsey.com/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/*

About 8,000 companies in the U.S. are currently owned by or have financial backing from private equity firms.[4] The cumulative number would be far larger. According to the website of the American Investment Council (AIC), the U.S. PE lobbying arm, employment in the private equity industry and private equity-backed companies combined numbers more than 11.7 million U.S. workers.[5] In the year 2019, AIC reports that PE firms in the U.S. invested $700 billion in 4,841 businesses (latest year).[6]

The industry is a sizable and growing financial player in the U.S. economy. Yet, it is largely unregulated. It is famous for loading companies with excessive amounts of debt, for selling off the real estate of companies it acquires, for its lack of transparency about fees it collects or the performance of the companies it owns, and fiercely protective of tax loopholes that allow PE partners to line their pockets with billions that should have gone to the Treasury. Private equity provides a newly acquired company with a game plan for its first 100 days and the metrics it is expected to meet. It selects the company's board members and freely fires its CEO if he doesn't get with the program. The "Stop Wall Street Looting Act" will establish guardrails that rein in behavior that undermines the viability of companies it owns to the detriment of workers, vendors, suppliers, creditors, and the communities where they are located.

The PE industry claims that it provides access to financing and to expertise on organizational improvements—upgrading accounting and IT systems, improving the company's digital and social media presence—and advising on business strategy. This is often the case when smaller PE firms buy out small to mid-sized companies for its portfolio and provides this support. The PE firm "turns these companies around" and sells them at a profit. Small and mid-sized companies have relatively few assets to be used as collateral for loans, so the amount of debt loaded on them is not excessive. By the same token, they have relatively few assets that could be stripped, and their cash flow will not support further borrowing in the junk bond market to pay their PE owners dividends. In this case, the PE firm relies on operational improvements to create value for the company and the economy in order to achieve a successful exit at a price much higher than it paid to acquire the company, often via a sale to a strategic buyer who sees value in the company's products or services.

Most private equity deals, by deal count, fall into this category and PE firms are able to provide small and mid-sized portfolio companies with operational and strategic improvements. The Stop Wall Street Looting Act will have little effect on the operations of these PE firms.

However, most of the capital committed to private equity by pension funds, endowments, sovereign wealth funds, and other institutional investors flows to PE firms that sponsor large PE funds. Mega funds—those with capital commitments of $5 billion or more—used to be rare. Now they are becoming increasingly common. Mature, successful companies with predictable cash flow make attractive acquisition targets for the portfolios of large funds. But the companies provide few, if any, opportunities for organizational or strategic improvements. They do, however, present many opportunities for the PE firm to make money for itself and its investors through financial engineering—that is, by using the assets of the company as collateral for the high levels of debt loaded onto it to finance its acquisition by the PE fund; restructuring the organization not for a productive purposes but to reduce the taxes it pays; using the revenue it generates to have the company take out junk bond loans in order to pay dividends to its PE owners; charging its portfolio companies monitoring and transaction fees that go straight to the coffers of the PE firm; and stripping the company of valuable assets and using the sale proceeds to line the pockets of the PE investors. The Stop Wall Street Looting Act will end the most extreme and abusive of these practices.

PE firms are playing with other people's money—capital committed by PE investors to the PE fund it sponsors and the loans advanced to it by creditors as it loads debt on the companies it acquires. Keeping up with payments on the debt often means the company must squeeze its workforce, cutting pay and benefits and even laying off workers. If despite these efforts, the company faces financial distress, it

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mckinseys%20private%20markets%20annual%20review/2021/mckinsey-global-private-markets-review-2021-v3.pdf, p.11, 12, and 18.

[4] *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*

[5] *https://www.investmentcouncil.org/*

[6] *https://www.investmentcouncil.org/aic-announces-top-states-and-districts-by-private-equity-investment/*

is the creditors who will lose money and, in extreme but not uncommon cases, force the liquidation of the company in order to recover as much of the money they lent as possible.

A veil of secrecy hides much of what private equity firms do, the fees and expenses they charge to their investors for managing their money, or the monitoring fees and transaction costs they charge to their portfolio companies. In particular, there is virtually no information about the financial condition or performance of portfolio companies available to the public or even to the PE investors that own the companies. Private equity is famously "private," requiring nondisclosure agreements and preventing even the investors in its funds from speaking to each other about the deal they cut with the PE firm.

The Stop Wall Street Looting Act will establish guard rails that will protect the interests of investors in PE funds and the creditors that provide the financing for leveraged buyouts. It will not mandate the level of debt that can be levered on portfolio companies, but it will discourage the excessive use of debt by holding the decisionmaking General Partner of the PE fund and the private equity firm jointly responsible with the portfolio company for repaying the debt in case of financial distress. It will tear back the veil of secrecy that surrounds the actions of private equity and hides the financial health of portfolio companies from public view. We—and the PE firm's investors and creditors—have to take the word of the PE firms for the value of companies in their portfolios.

The PE industry promotes the myth that if PE firms are making money, they must be creating value for the companies they own, the companies' investors and creditors, and for the economy. In my testimony today, I want to address that myth by describing how large PE firms can make money without creating value and even when they destroy it.

Leveraged Buyout Model

Private equity firms recruit institutional investors—pension funds, insurance companies, foundations, endowment, sovereign wealth funds—for funds that they sponsor. A committee consisting of partners and principals in the PE firm is called 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 equity firm), typically 2 percent annually of the money they have committed to the fund. The larger the fund, the larger are these 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 percent (but may be as high as 30 percent) of the fund's returns. And the PE firm typically contracts separately with the portfolio company for payment of monitoring fees and transaction expenses to the PE firm.

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 used to acquire the portfolio company 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 refinance it as it matures. In the case of an unanticipated development, however, the portfolio 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 monitoring fees the PE firm collects directly from the portfolio company or from the proceeds of the sale of the portfolio company's assets. The PE firm has little skin in the game; it's the company, its workers, suppliers, creditors, and customers whose livelihoods have been put at risk.

The Case of Retail Chains

Investments in large retail store chains provide private equity with rich opportunities for asset stripping, dividend payments, and monitoring fees; and 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 is room to load retail companies with lots of debt in the buyout. The real estate opens up the possibility of sale-leaseback transactions that benefit PE investors but leave the chain paying rent. And the high cash flow means the retail company is 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. It also facilitates the payment of dividends to the company's PE owners.

Overloading retail chains with debt or selling off their real estate and burdening them with rent payments has made them financially fragile. Any change in the company's prospects could lead to financial distress, bankruptcy, and even, in extreme cases, to liquidation and the shuttering of stores. 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, left vendors with unpaid invoices, and creditors facing steep haircuts. 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, Cerberus Capital Management-owned Mervyns Department Store and, most recently, the Michigan-based Art Van furniture store chain owned by Thomas H. Lee Partners.

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, its debt burden increased to $6.2 billion—a capital structure of 17 percent equity and 83 percent debt. Toys 'R Us 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 very rich payoff if they exited the company at a profit 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 company's debts.

Toys 'R Us would have been broadly profitable in the years following its takeover 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 as creditors reasoned that their best chance to recoup some of their money was to liquidate the business and sell off its assets. Nine-hundred communities lost an important retail anchor as the stores closed, 33,000 workers lost their jobs, vendors and landlords went unpaid, and creditors lost money they had loaned to the retail chain. 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.

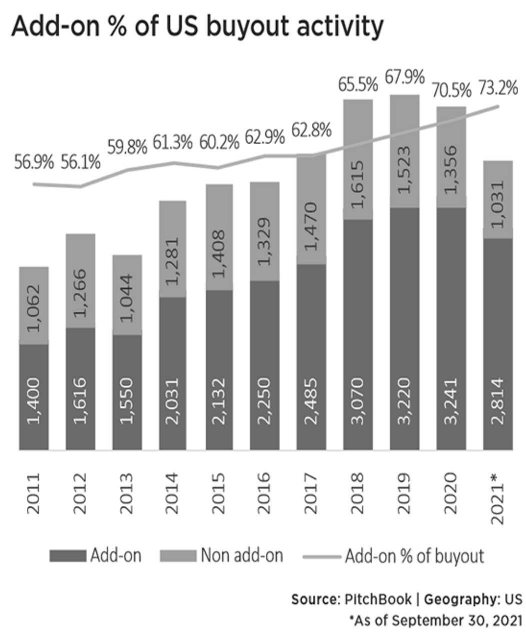
The bankruptcy protections for workers in the Stop Wall Street Looting Acy include mandatory severance payments for workers who lost their jobs in the bankruptcy, which would provide further protection not just for workers but for businesses that have a stake in the survival of companies like Toys. We cannot know whether Toys' creditors would have made a different decision if seniority-based severance payments to 33,000 workers, some with decades of service, had to be paid out in the case of liquidation. But it would definitely have altered the calculus.

As for the funds that owned the chain, they each put in $433 million in equity when Toys was purchased. Bain contributed 10 percent of the equity in its fund or $43 million. KKR put up $10 million (2.3 percent 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 percent 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, Toys 'R Us paid the firms that owned it $464 million. In addition, some of the chain's real estate was sold to Vornado and leased back by the stores, resulting in a total of $73 million paid to Vornado in rent (details and sources in Appendix A). Toys' PE firm owners made a profit despite recklessly endangering the toy store chain.

Buy and Build PE Model

"Buy and build" is another strategy that private equity uses to make money. In this strategy, the private equity firm acquires a company in a leveraged buyout and then expands the company—now called a platform company—through a series of debt-fueled horizontal mergers with its smaller rivals. The strategy has several advantages for the PE firm. It enables the PE firm to establish local monopolies and reduce competition. Its portfolio company can exploit its dominance in the market to increase its profits by raising prices and/or degrading the quality of its services without fear of competition for its customers. And adding-on smaller rivals is a faster path to revenue growth than investing in the original company. A growth strategy of using leveraged buyouts to add-on smaller competitors to the original portfolio company is more lucrative than investing in the original company and taking the time to allow it to grow organically.



The use of add-ons by PE firms has become a popular strategy. It has grown as a proportion of leveraged buyout activity across all segments of the economy, from 56.5 percent of buyouts in 2009 to 70.5 percent in 2020 and is on a path to reach 73.2 percent, an all-time high, in 2021.[7] The key to the strategy is to pursue healthy add-on acquisitions in highly fragmented markets and utilize the platform

[7] *https://files.pitchbook.com/website/files/pdf/PitchBook-Q3-2021-US-PE-Breakdown.pdf#page=1*

company's access to leveraged loans to expand into hundreds of smaller, local territories through multiple add-on acquisitions.

Physician Staffing Firms

A familiar example of how PE firms extract wealth and make money using the buy and build strategy comes from the world of physician staffing firms. Private equity-owned emergency room physician practices and the use of surprise billing to collect sometimes astronomical payments from patients who are treated by these doctors have raised concerns among consumers and patient advocates. These are patients who are treated at hospitals that are in their insurance networks by out of network emergency doctors on private equity-owned company payrolls. Private equity firms have been actively acquiring doctors' practices through leveraged buyouts and rolling them up into large, debt-burdened physician staffing firms, a form of Managed Services Provider (MSP). PE firms have consolidated these previously fragmented markets, and are now dominant players able to exploit the market power of their MSPs to increase prices paid by patients and private insurance payers. Many of the acquisitions have been too small to trigger antitrust oversight. But cumulatively, they have led to large, national consolidated doctors' practices able to exercise monopoly pricing power in local health markets.

In addition to increased market power in pricing emergency room procedures, the takeover of doctors' practices affects the practice of emergency medicine. Physicians are shielded from dealing with billing and collections. But on the flip side of this, the PE-owned staffing firms often inflate prices for treatment of patients, while doctors on PE payrolls do not have a right to see invoices sent out in their names. They are, thus, unable to serve as a check on fraud or exploitation of patients. From the point of view of the private equity firm, physicians are the major expense, and they would like to see revenue per physician increase or the cost of employing these doctors reduced. Pressure is on these emergency medicine doctors to use charting and documentation to maximize payments to the staffing firm, and to increase the number of patients they see per hour. PE firms also decrease the number of emergency medicine physicians on staff and increase the number of lower cost nonphysician practitioners (NPPS) in emergency rooms, increasing the length of time that patients in ERs wait to see a doctor. Not only do these practices reduce the employment of trained physicians in emergency rooms, but the number of NPPs that each physician is tasked with overseeing is increased. There are few complaints about working conditions or patient care from doctors on private equity payrolls. Doctors employed by PE-owned physician staffing firms put their jobs on the line if they speak up about their concerns. They can be fired on short notice and given no opportunity to contest the termination. When the focus is on making money, doctor staffing levels decline, the pressure on emergency medicine doctors increases, and the quality of patient care suffers.[8]

Most States require that physician practices be owned by doctors and make the corporate practice of medicine illegal. Private equity firms get around this requirement by having the physician practices nominally owned by a medical practitioner. In recent legal proceedings against an emergency medicine staffing firm, it was revealed that a single physician was on record as owning and managing 270 to 300 physician practices across 20 States.[9] This was clearly a sham arrangement to hide PE's role in the illegal corporate practice of medicine. While a physician nominally owns the doctor practices. all of the assets of the practices, from the chairs in the waiting room to accounts receivable, are owned by the physician staffing firm. The Stop Wall Street Looting Act would require that all entities receiving Federal money—so nearly all entities in health care—to reveal their ultimate owners.

The initial focus of private equity acquisitions was on hospital-based specialties like emergency medicine and anesthesiology. The largest physician staffing companies in these specialties are Envision Healthcare and TeamHealth, MSPs acquired respectively by funds of private equity firms KKR in 2018 for $9.9 billion and the Blackstone Group in 2016 for $6.1 billion. The two staffing companies have cornered 30 percent of the market[10] for outsourced emergency medicine doctors, and collectively employ almost 90,000 health care employees that fill a variety of roles. Debt-financed consolidation of emergency medicine practices has enabled these PE firms and their MSPs to dominate the physician staffing industry. Multiple rounds of pri-

[8] Robert M. McNamara, MD, and Professor of Emergency Medicine at Temple University's Medical School power point presentation at Take EM Back Summit, *https://www.youtube.com/channel/UCQqx7Ajl6uAudQAJTARcjew*; *https://www.medpagetoday.com/special-reports/exclusives/95022*.

[9] Ibid.

[10] *https://isps.yale.edu/sites/default/files/publication/2017/07/surpriseoutofnetwrokbilling-isps17-22.pdf*

vate equity ownership, punctuated by IPOs and a return to public markets, have left these companies with high debt loads. Envision's $5.45 billion loan is due in October 2025; TeamHealth's loan is due in January 2024. The companies have relied on high fees for doctor services and surprise medical bills to provide sufficient revenue to meet debt obligations.

Envision came under heavy scrutiny for the huge out-of-network surprise medical bills it sent 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 compared to the charges billed by previous physician groups. TeamHealth, the Yale University economists found, took a somewhat different tack. It used the threat of surprise billing to gain high reimbursements from insurance companies to keep its doctors in-network.

In a victory for patients and the health care system, Congress passed the No Surprises Act in December 2020. The act bans the practice of sending surprise medical bills to patients beginning on January 1, 2022. In a concession to the private equity-owned staffing companies, such bills can still be sent to insurance companies, and disputes over payment are subject to arbitration. But arbitrators are instructed to begin from what innetwork doctors are paid for procedures rather than from the often massively inflated charges from the PE-owned doctors' practices. PE-owned practices may still receive somewhat higher payments than other doctors, but the expectation is that these payments will be much more in line with what others receive, and a great savings to the health care system. The effects of these measures on the massive amounts of debt owed by TeamHealth and Envision coming due in 2024 and 2025 are currently not known. But default would surely throw the health care system into chaos.

More recently, the corporate practice of medicine has grown as private equity has turned its attention to specialties that are not hospital-based. Dermatology is the bleeding edge of this development, having been among the earliest to attract private equity's attention. But dermatology has been quickly followed by gastroenterology, orthopedics, ophthalmology, women's health, and other specialties that cater to patients with private insurance, assuring a more lucrative payer mix. The effects of COVID–19 proposed spending in President Biden's Build Back Better bill have further fueled private equity's already considerable interest in home health care, hospice services, and behavioral health—the latter to treat both victims of the opioid crisis and those suffering mental health problems caused by the isolation and disruption of the pandemic. Patient care is likely to suffer as the PE owners hold the medical specialists, now their employees, to metrics that increase revenue per patient and reduce costs. The substitution of less expensive Nonphysician Practitioners for physicians and an increase in the number of NPPs a physician is required to supervise are likely to affect patient care. Requiring these practices to identify private equity firms as their owners, as the Stop Wall Street Looting Act requires, will enable patients to make informed decisions about where they want to be treated.

A similar situation is emerging in the accounting industry. Like physician practices, accounting firms have legal requirements that require that certified public accounting firms be owned by certified public accountants (CPAs). An "attest" service—in which a CPA conducts an independent review of a company's financial statements and attests to their accuracy—can only be conducted by a CPA-owned firm. As with health care, the accounting business is largely recession proof. It's a predictable business with high cash flow and little volatility. So, it is not surprising that PE is looking for a work around that will let it take over large, successful accounting firms.

In mid-September 2021, PE firm Lightyear Capital announced that it is buying a large stake in Schellman & Co., a top CPA firm, ranked 65th in the country in the Accounting Today 2021 list. Schellman is being split into two entities—a CPA firm that will perform attest services and a new company, in which the PE firm is the majority owner, that that will provide tax and consulting services. A month later, PE firm TowerBrook Capital Partners announced it would take an ownership stake in top 20 accounting firm EisnerAmper. It again split the company into two entities and took a majority stake in the consulting business. [12] These large accounting firms with high cash flow can be loaded with debt that will be used to acquire smaller competitors. This has the potential to crush competition and establish the dominance of these accounting firms in local and national markets. Main Street

[11] *https://isps.yale.edu/sites/default/files/publication/2017/07/surpriseoutofnetwrokbillin-isps17-22.pdf*

[12] *https://www.journalofaccountancy.com/news/2021/oct/private-equity-push-into-accounting.html*

businesses are likely to suffer from a lack of alternatives when it comes to having tax and auditing work done. They might want to be informed about whether private equity has a stake in an accounting firm with which they do business.

The Paradox of Private Equity

The "paradox of private equity" [13] refers to the finding that smaller private equity funds often outperform mega funds and tend to deliver the best returns to investors, while the bulk of the money invested in private equity flows to large funds and mega funds. Better performance of smaller funds is actually not surprising. In our research, Rosemary 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 enterprises have relatively little in the way of assets that can be mortgaged, which rules out the excessive use of debt to acquire them. In addition to lower levels of debt, these PE funds provide access to 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. But while the large majority of PE deals are carried out by smallish funds buying out smallish companies, large or mega funds receive he lion's share of funds from PE investors. Limited partner investors have committed billions of dollars to massive funds sponsored by a relative handful of PE firms. In the 5 years ending in April of 2021, the top 300 PE firms worldwide raised a total of $2.25 trillion. This is an increase of 13 percent from the previous 5-year period. Blackstone retained its position as top fund raiser—its funds raised $93.2 billion over the 5 years, with KKR not far behind. [14] Eight of the top 10 (out of 300) funds are U.S. firms. [15] The flow of capital to the largest PE firms in the aftermath of the pandemic is even more extreme than when the Stop Wall Street Looting Act was first introduced, making its passage all the more urgent. Capital raised by individual funds in the first three-quarters of 2021 make clear that mega funds dominate fund raising. PE firm Hellman & Friedman raised $24.4 billion for its 10th fund while KKR is closing in on $18.5 billion for its North America fund and the Carlyle Group has announced plans to raise $27 billion for its next fund—the largest private equity fund ever if, as expected, they reach their goal. Silver Lake Partners whose latest fund closed this year at $20 billion, Clayton, Dubilier & Rice at $16 billion, and Bain Capital at nearly $12 billion are also among the mega funds at the top of the fund-raising pyramid. Twelve mega funds have closed through August, with a quarter of the year still left. [16] All of this money needs to be deployed in just a few years.

Mega funds have incentives to acquire large companies even if the returns are mediocre compared with smaller companies. A mega fund has a huge amount of capital it needs to deploy in a relatively short period of time. This is more easily done if the fund acquires a few very large companies. (The exception, as noted earlier, 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 3 to 5 years. This is too short a time horizon to "turn around" a struggling company. In contrast to the myth that PE funds buy troubled companies, it turns out that attractive acquisition targets tend to be successful businesses. Medline Industries, a family owned medical supply company, sold for $34 billion in June of 2021 in a club deal in which Blackstone, Carlyle, Hellman & Friedman, and GIC participating. Clearly, a company that sells for $34 billion to some of the biggest names in private equity offers few opportunities for improvement.

Large, successful companies present few opportunities for creating value by improving operations or business strategy. They nevertheless present opportunities for PE funds to load them with debt, extract wealth via financial engineering, and make PE partners rich. Millionaire and billionaire partners in private equity firms make money even when the funds they sponsor do not create value and even when they destroy it. Good jobs have been lost and inequality has worsened.

Meanwhile, private equity firms contend that their freewheeling behavior results in returns that beat the stock market by a wide margin and help fund retirees' pen-

[13] *https://www.institutionalinvestor.com/article/b1hx33sxljv1r0/The-Private-Equity-Paradox*

[14] *https://www.privateequityinternational.com/pei-300/*

[15] They are Blackstone, KKR, Carlyle, Thomas Bravo, Vista Equity Partners, TPG, Warburg Pincus, and Neuberger Berman Private Markets *https://www.privateequityinternational.com/database/#/pei-300*.

[16] *https://pitchbook.com/news/articles/mega-funds-private-equity-investing*

sions. They caution against killing the goose that lays the golden eggs. This is an argument that might once have made sense, but no longer. Studies by finance professors find that since 2006, the median private equity fund has just tracked the market.[17]

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, hollowing them out and leaving them bereft of the resources they need to invest in the technologies and worker skills required for success in the 21st century. PE firms view the companies their funds acquire for their portfolios as financial assets whose purpose is to provide returns to the fund and its private equity investors, not as operating companies that employ workers, produce valuable products for customers, and foster sustainable growth.

Private equity is poised to buy up key segments of the U.S. economy. The rising tide of capital flowing into PE funds has left them sitting on piles of dry powder. They are now ins a better position than ever to buy up and hollow out large parts of the U.S. and global economies. Estimates of how much global dry powder PE firms are sitting on varied from $1.5 to $2 trillion in August with 4 months to go in 2021. In September 2020, U.S. buyout funds had $746 billion in dry powder.[18] The figure below shows the amounts of dry powder that some of the largest PE firms are getting ready to deploy.

In the U.S. PE firms have set their eyes on everything from health care to single family homes, and are even trying to figure out how to make money from the chaos in fossil fuels as attention turns to combatting climate change.[19] We need the Stop Wall Street Looting Act now to provide incentives to PE funds sitting on many billions of dollars to use them in ways that create good jobs, high-quality goods and services, and help build a sustainable economy that supports the planet. No one will object if they also make an honest profit.

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[17] Eileen Appelbaum and Rosemary Batt. 2018. "Are Lower Private Equity Returns the New Normal?" in Michael Wright, et al. (editors), "The Routledge Companion to Management Buyouts", Routledge. Robert S. Harris, Tim Jenkinson, and Steven N. Kaplan. 2015. "How Do Private Equity Investments Perform Compared to Public Equity?" *Journal of Investment Management*. Darden Business School Working Paper No. 2597259, June 15. Available at *http://ssrn.com/abstract=2597259*; Jean-Francois L'Her, Rossitsa Stoyanova, Kathryn Shaw, William Scott, and Charissa Lai. 2016. "A Bottom-Up Approach to the Risk-Adjusted Performance of the Buyout Fund Market". *Financial Analysis Journal*, 73(4), July/August. *https://www.cfainstitute.org/en/research/financial-analysts-journal/2016/a-bottom-up-approach-to-the-risk-adjustedperformance-of-the-buyout-fund-market*; Ludovic Phalippou. 2020. "An Inconvenient Truth: Private Equity Returns and the Billionaire Factory". *Journal of Investing*, Volume 29, December. Available at *https://papers.ssrn.com/sol3/papers.cfm?abstract-id=3623820*.

[18] *https://www.investmentcouncil.org/wp-content/uploads/trends-2021q1.pdf* Figure 4.

[19] *https://www.nytimes.com/2021/10/13/climate/private-equity-funds-oil-gas-fossil-fuels.html?smid=tw-share*

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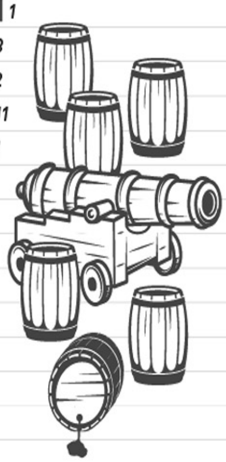
Largest private equity firms globally by dry powder

Entity name	Country	Private equity dry powder, estimated ($M)	Number of private equity funds in market (actual)
Blackstone Inc.	U.S.	43,202.3	11
KKR & Co. Inc.	U.S.	42,802.8	2
CVC Capital Partners Ltd.	U.K.	33,321.4	0
Ardian	France	29,964.2	0
JIC Capital Co. Ltd.	Japan	26,023.8	0
The Carlyle Group Inc.	U.S.	25,613.8	21
SoftBank Investment Advisers (UK) Ltd.	U.K.	22,420.8	0
Bain Capital Private Equity LP	U.S.	20,561.8	1
EQT AB (publ)	Sweden	20,246.8	1
TPG Capital LP	U.S.	20,132.3	7
China Reform Holdings Corp. Ltd.	China	19,626.3	1
Thoma Bravo LLC	U.S.	18,641.0	1
Hillhouse Capital Management Ltd.	Hong Kong	16,728.1	3
Apollo Global Management Inc.	U.S.	16,665.0	2
HarbourVest Partners LLC	U.S.	16,627.0	11
Silver Lake Management LLC	U.S.	16,571.8	1
Lexington Partners LP	U.S.	15,369.4	0
Clayton Dubilier & Rice LLC	U.S.	14,548.8	0
TA Associates Management LP	U.S.	14,519.2	0
Genstar Capital LLC	U.S.	14,432.2	0
Advent International Corp.	U.S.	12,756.3	2
AlpInvest Partners BV	Netherlands	12,482.8	0
Goldman Sachs AIMS Group	U.S.	12,441.8	5
Chengtong Fund Management Co. Ltd.	China	12,342.0	0
Polaris Capital Group Co. Ltd.	Japan	11,769.6	0



Data accessed as of Aug. 18, 2021.
Credit: Cat Weeks
Sources: S&P Capital IQ Pro; Preqin

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APPENDIX A: Toys 'R Us Financial Data

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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

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM EILEEN APPELBAUM

Q.1. Several private equity firms have recently announced acquisitions of life insurance companies. Please explain the primary conflicts of interest for investors and sources of harm to policyholders caused by these acquisitions.

A.1. Thank you, Senator Reed, for shining a light on private equity industry activities that are flying under the radar.

Private equity firms have had their eye on individual retirement savings since 2013, when they were first allowed to market directly to people. Pension funds already allocate workers' retirement savings to private equity firms that use these assets to fund a range of risky equity and debt investments. Access to personal retirement savings would open up a huge new source of capital for PE.

PE firms first attempted, unsuccessfully, to get a piece of the very large direct contribution assets (IRAs and 401(k)s) that individuals use to save for their own old age. More recently, they have succeeded in gaining control of life insurance and annuity assets. They use these assets to invest in high fee alternative investments, including in the PE firm's own buyout, real estate investment, and debt funds. These insurance assets provide PE firms with a form of "permanent capital." A private equity firm typically raises capital by recruiting investors and launching an investment fund with a life span of 10 years, after which all the capital in the fund is paid out and the fund is liquidated. PE firms launch these funds every few years. Individual retirement savings, unlike these sources of capital, do not need to be paid out at the end of 10 years and don't require the PE firm to recruit investors every couple of years.

For the public that owns these insurance and annuity policies, there is the danger that investments in risky assets may not provide them with the peace of mind and the assurance that the benefits will be there when they are needed. Investments in private debt and equity pay higher rates of interest than plain vanilla bonds and stocks of publicly traded companies. But they are illiquid, meaning that they will be difficult to sell in case cash is required to satisfy a spike in payouts on these insurance policies. In addition, the possibilities for corruption and self-dealing are very real as PE firms can use these insurance assets to bolster the performance of their own struggling funds. Even in the absence of patently illegal actions, PE control of life insurance assets raises basic conflict of interest questions: are PE firms looking out for the interests of insurance beneficiaries or are they more concerned with making a profit for themselves and their investors? Moreover, the claim that investing life insurance assets in risky alternative strategies increases benefits for policy holders may fail, either because the investment fails or because the high fees charged for managing complex investments eat up the higher performance associated with greater risk. For consumers who bought life insurance and annuity policies from stodgy insurance companies making plain vanilla investments, it may be disconcerting to learn that their policy has been sold to a private equity firm that will be making risky investments with their retirement savings.

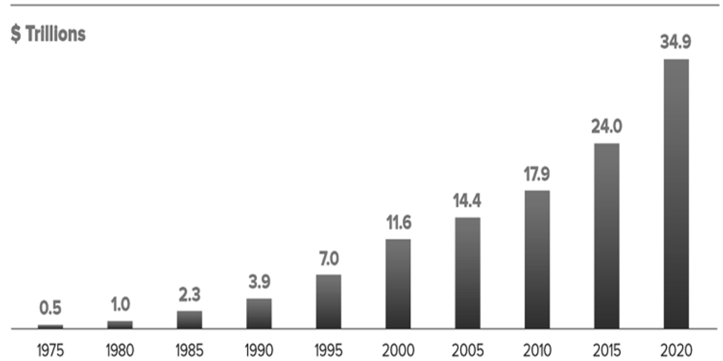
There is a clear need for regulations to protect the retirement savings of holders of life insurance and annuity policies. The opaqueness of private equity and the lack of transparency regarding its activities makes regulation difficult. Federal regulation to cap the fees that policy holders pay and to assure that PE firms that control insurance assets hold adequate reserves for their risky investments is important. Moving the headquarters of PE-owned insurance companies to Bermuda raises red flags because of the low reserve requirements in that country when insurance companies invest retirement savings of annuity holders in risky assets.

In what follows, I examine the size of retirement savings in the U.S; briefly review earlier, largely unsuccessful, attempts by PE firms to gain access to the savings of individuals; and discuss PE's foray into life insurance and annuities in recent years. Private equity's control of life insurance assets has greatly increased, with little to no regulatory oversight or protections for beneficiaries.

U.S. Retirement Assets

U.S. retirement savings have exploded in the last 30 years, reaching $35 trillion in 2020, nine times as much as in 1990. Pensions (direct benefit plans) have declined as a share of retirement savings, most dramatically in the private sector. Direct contribution plans (IRAs and 41(k)s) have grown in volume and importance. IRAs have seen the most dramatic growth, but 401(k) plans account for a large share of retirement assets. (see figures below) [1]

FIGURE 2. Total U.S. Retirement Assets

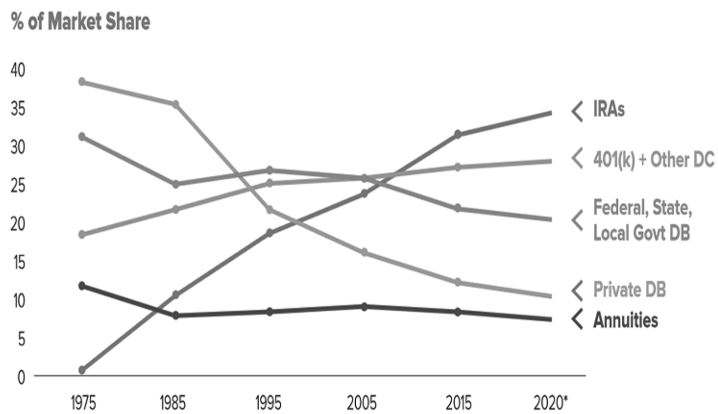


Source: Investment Company Institute.

EVOLVING FORCES OF CHANGE IN THE U.S. RETIREMENT MARKET

[1] SEI Investment Manager Services. 2021. "Evolving Forces: Convergence in the U.S. Retirement Market Place". SEI. *https://seic.com/sites/default/files/SEI-IMS-Evolving-Forces-Retirement-2021-Whitepaper-US.pdf*

FIGURE 3. Historical Share of U.S. Retirement Market by Plan Type



*Data reflects year-end figures for all periods except 2020 which reflects data as of September 30.
Source: Investment Company Institute.

PE Tries (Unsuccessfully) To Tap Individual Retirement Savings of Workers' Pensions

Workers' pensions have been at the center of the equity contributions to private equity investment funds. Public pension funds have provided about a quarter of the equity in PE investment funds and private pension funds have provided about 10 percent. But pension funds' share of retirement savings has been declining over the last decade and longer. Private Equity firms have had their eye on workers' individual retirement nest eggs—401(k) and IRA accounts—since late 2013 when rules on advertising to individuals were relaxed. But PE firms have had only limited success tapping into IRA and 401(k) accounts. They were stymied by the Obama Labor Department, which held the line against letting risky private equity and hedge fund products into workers' individual retirement accounts.[2] Private equity had some success during the Trump administration as the Labor Department approved some private equity and hedge fund products for these accounts.[3] But brokers who manage workers' defined contribution accounts were slow to include them, because they lacked the experience and the confidence to recommend them and because of the high fees attached to these

[2] Eileen Appelbaum. 2015. "As Public Pensions Shift From Hedge Funds, Hedge Funds Look to Main Street". *The Hill*, November 30. *https://thehill.com/blogs/pundits-blog/finance/261455-as-public-pensions-shift-from-hedge-funds-hedge-funds-look-to-main*

[3] Eileen Appelbaum. 2020. "CEPR Statement on New Labor Department Guidance Allowing Risky Private Equity Investments in Workers' 401(k) Accounts". Center for Economic and Policy Research, June 4. *https://cepr.net/cepr-statement-on-new-labor-department-guidance-allowing-risky-private-equity-investments-in-workers-401k-accounts/*

products. They were concerned that poor performance of these assets could expose them to litigation and liability claims.

Private equity firms have long included very wealthy individuals among the investors in their funds. But since 2015 have tried to develop new products for the merely very rich.[4] These efforts continue to the present time, but with only limited success. Most of these "retail" investors are effectively excluded from private equity and hedge fund investments. The Trump administration's SEC chair, Jay Clayton, pushed to open these funds to more investors. And in September 2021, an SEC panel formed in 2019—the Asset Management Advisory Committee—recommended letting ordinary investors into these funds.[5] But current SEC chair Gary Gensler's remarks indicating that the agency will take a tougher stance for greater transparency on fees and expenses and against conflicts of interest may undermine PE's efforts to attract money from retail investors.[6]

PE Is Eating up Life Insurance and Annuities Companies

Recruiting limited partner investors for the PE funds that private equity firms raise every few years has become increasingly burdensome. Tapping into retirement savings creates a source of "permanent capital" as savings flow into retirement assets, creating a pool of assets that can fund PE investment activities. Despite the lack of success penetrating workers' IRAs and 401(k)s, retirement savings remain an enticing source of capital for PE investment funds. And PE firms have found another way to get their hands on people's retirement savings. Private equity firms are taking a leaf out of Warren Buffet's playbook. For decades Buffett has funded investments in publicly traded companies from his $360 billion insurance arm.[7] Accumulated life insurance and retirement assets and ongoing premium payments for annuities and death benefits are an attractive, permanent source of investment capital. In the last few years, private equity firms have looked to the management or acquisition of life insurance assets as a source of permanent capital that can fund a wide range of activities and reduce the need to raise new investment funds every couple of years. Private equity firms have found a way to get rich from the retirement savings and bequests of individuals. In just a few years, insurance assets have become a major component of assets under management of PE firms.

Some PE firms are buying up entire life insurance companies and annuity businesses. Others are taking a minority stake in them and then managing all of their assets. Only the largest PE firms have the financial wherewithal to afford deals to manage or

[4] Eileen Appelbaum. 2015. "Private Equity Is Going Retail". *Huffington Post*, March 11, *https://www.huffpost.com/entry/private-equity-is-going-r-b-6842394.*

[5] Chris Cumming. 2021. "SEC Panel Backs Letting Ordinary Investors Into Private Equity", *WSJ*, September 28. *https://www.wsj.com/articles/sec-panel-backs-letting-ordinary-investors-into-private-equity-11632778962*

[6] Paul J. Davies. 2021. "Gary Gensler's Everything Crackdown Reaches Privat Equity". *Bloomberg*, November 17. *https://www.washingtonpost.com/business/gary-genslerseverything-crackdown-reachesprivate-equity/2021/11/16/591d740a-46d1-11ec-beca-3cc7103bd814-story.html*

[7] Paul J. Davies. 2021. "Apollo Wants To Be a Bit Like Buffett, But It's Complicated". *Bloomberg*, October 29. *https://www.bloomberg.com/opinion/articles/2021-10-29/apollo-wants-to-be-a-bit-like-warren-buffett-but-it-s-complicated*

own the life insurance and annuity businesses of major, old line insurance companies. But even smaller PE firms have gotten into the game, buying up smaller life insurance businesses and selling indexed annuities, a line of business they view as an extension of their investment experience. At the end of 2020, aggregate holdings of cash and invested assets of U.S. life insurance companies was $4.9 trillion. Private equity firms controlled 9.6 percent of these assets—a total of $471 billion. Of the slightly more than 400 U.S. life insurance companies, 50 are owned or controlled by more than 24 private equity firms. These include well-known PE firms such as Blackstone, Apollo, and KKR. But also, many that most people have never heard of. [8]

Apollo is probably the most advanced. It has had a stake in life insurance company Athene since 2015; in 2021, it acquired the entire company and now owns Athene's insurance assets worth about $194 billion. Apollo says it plans to invest about 5 percent of Athene's funds in riskier, fee-paying alternative assets, including its own private equity and debt funds. [9] This kind of self-dealing is rife with conflicts of interest. Will Apollo's insurance units look out for its beneficiaries or for its investors and shareholders?

Unlike Apollo, Blackstone prefers to take minority stakes in life insurance companies and take over management and control of most or all of their assets. It invests them in alternative strategies in search of higher yield. In 2021, Blackstone paid $2.2 billion to American International Group (AIG) for a 9.9 percent stake in its life insurance and annuities unit. Initially, Blackstone will manage $50 billion of AIG's life insurance assets. In the coming years, this will rise to nearly $100 billion. Blackstone also struck a deal in 2021 to buy a life insurance unit of Allstate Corporation. With these transactions, Blackstone's insurance assets under management will reach $150 million by the end of 2021. The insurance assets it controls account for a third of Blackstone's overall assets. [10]

In July 2020, KKR announced it was buying life insurance and retirement income company Global Atlantic Financial Group for $4.4 billion and taking over management of about $70 billion of Global Atlantic's assets. The deal raised KKR's assets managed on behalf of insurance companies from about $26 billion to more than $96 billion. It increased KKR's total assets under management by 30 percent, from $207 billion to more than $277 billion. And it increased the share of permanent capital—capital that does not need to be replenished by fund raising—from 9 percent to 33 percent. [11]

[8] Allison Best. 2021. "Private Equity Firms Keep Eating U.S. Life Insurers". *ThinkAdvisor*, July 20. *https://www.thinkadvisor.com/2021/07/20/private-equity-firms-keep-eating-u-s-life-insurers/?slreturn=20211028142207*; Leslie Scism. 2021. "Who Owns Your Life Insurance Policy? It Might Be a Private Equity Firm". *WSJ*, September 21. *https://www.wsj.com/articles/insurance-policy-private-equity-11632236526.*

[9] Paul J. Davies. 2021. "Apollo Wants To Be a Bit Like Buffett, But It's Complicated". *Bloomberg*, October 29. *https://www.bloomberg.com/opinion/articles/2021-10-29/apollo-wants-to-be-a-bit-like-warren-buffett-but-it-s-complicated*

[10] Miriam Gottfried and Leslie Scism. 2021. "Blackstone Enters Deal To Manage AIG Life and Retirement Assets". *WSJ*, July 14. *https://www.wsj.com/articles/blackstone-near-deal-to-manage-aig-life-and-retirement-assets-11626294156?mod=markets-lead-pos2*; Antoine Gara. 2021. "Blackstone Braces for Higher Inflation as Earnings Hit Record". *Financial Times*, October 21. *https://www.ft.com/content/10de97da-30e9-4c92-a3a7-5da251706c3e*

[11] Miriam Gottfried and Dave Sebastien. 2020. "KKR To Buy Global Atlantic Financial Group for $4.4 Billion". *WSJ*, July 8. *https://www.wsj.com/articles/kkr-to-buy-global-atlantic-financial-group-for-around-4-billion-11594207178?mod=article-inline*

Dangers Facing Policy Holders and the Challenges of Regulating PE Control of Insurance Assets

Regulating private equity investments is difficult because there is little public information on how these firms invest insurance assets, making it difficult to gauge risk. But clearly, they are moving some of the assets out of plain vanilla corporate bonds and into private debt and asset-backed securities where they can earn high fees for managing the assets. Returns on private debt are usually higher than for the plain vanilla bonds. However, investments in private debt are riskier—they are less transparent and more difficult to trade, making them difficult to sell to meet death benefit and annuity obligations in case of an economic slowdown and cash crunch. This may endanger policy holders. The Fed has expressed concern that investments in difficult-to-sell debt and equity holdings may mean that insurers will lack cash in an economic crisis to pay a surge of claims. Not only do the assets lack liquidity, they may also go down in value in these circumstances. [12] Insurance regulators should require PE firms to hold higher reserves against these riskier investments. But assessing whether they are doing so will be hampered by the secrecy that shrouds PE firm activities.

Opportunities for corrupt self-dealing are widely available as PE firms can use the insurance assets to shore up the finances of failing or struggling funds they own. Such activities are difficult to detect, since there is no requirement for public disclosure of transactions. Banning the practice of PE firms investing insurance assets they control in their own debt and buyout funds would prohibit this activity. At a minimum, rules to prevent corrupt self-dealing by PE firms need to be put in place. Recent statements by SEC Chair Gensler indicating that the SEC will act to increase transparency of PE's financial dealings are welcome in this context as well.

Caps on fees paid for investment in alternatives such as buyout or debt funds should be put in place so that fees paid to PE firms do not eat up higher earnings on these risky assets.

National standards for reserves against more risky investments for any company managing life insurance and retirement benefits in the U.S. regardless of where the company is headquartered are needed to thwart moves to jurisdictions with lax reserve requirements.

In general, steps need to be taken to prevent the possibility that billionaire PE firm partners will further enrich themselves at the expense of holders of life insurance and annuity policies.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VAN HOLLEN FROM EILEEN APPELBAUM

Q.1. The Atlantic recently published an article on October 14th that examines Alden Global Capital and its handling of the news outlets it owns. The author, McKay Coppins, summarizes Alden's corporate model as: "Gut the staff, sell the real estate, jack up subscription prices, and wring as much cash as possible out of the en-

[12] Alwin Scott. 2021. "Chasing Yield, U.S. Private Equity Firms Nudge Up Risk on Insurers". *Reuters*, June 1. *https://www.reuters.com/business/finance/chasing-yield-us-private-equity-firms-nudge-up-risk-insurers-2021-06-01/*

terprise until eventually enough readers cancel their subscriptions that the paper folds, or is reduced to a desiccated husk of its former self."

Are you familiar with Alden's corporate model and, if so, do you agree with McKay Coppins's characterization of it?

What kind of conditions can be set to prevent private equity from engaging in such predatory ownership?

Dr. Appelbaum, your testimony points to the size and influence of private equity in the United States. Many of the funds are registered offshore in the Cayman Islands, Bermuda, and other countries.

What are the practical effects of foreign ownership in terms of accountability for these funds, and do you anticipate national security implications?

A.1. Thank you, Senator Van Hollen, for this very timely question about Alden Global Capital's ownership of newspapers. On Monday, September 22, Alden-owned Digital First/Tribune—the second largest owner of newspapers in the U.S.—announced its intention to acquire Lee/BH Media, the third largest. Gannett, formerly backed by private equity firm Fortress Investment Group which is thought to continue to have a stake in the company since it became publicly traded, is the largest owner of newspapers since its 2019 merger with Gatehouse. Gannett/Gatehouse owns 613 newspapers, Digital Media/Tribune owns 207, LEE/BH Media owns 170 for a total of just under 1,000 newspapers. The next seven largest newspaper companies together own a total of 500 newspapers. When the deal goes through, Gannett/Gatehouse and Alden will create a duopoly with an ownership between them of two-thirds of U.S. newspapers.[1]

This is very concerning from the point of view of workers at the newspapers Alden Global Capital owns and from the perspective of residents in the communities the papers serve. McKay Coppins description of Alden's business model is correct. Alden views the newspaper industry as already in decline with many newspapers in distress. The investment firm sees an opportunity in buying up newspapers and consolidating the industry that will allow it to extract the still sizable ad revenue while cutting positions and costs to maximize profits in the short run before discarding what is left of the papers over a longer time horizon.

At a general level, Congress may need to grapple with the question of whether there are industries where it does not make sense for investment funds to own companies. The key role that newspapers play in a democracy suggests that ownership by investment funds, with their short time horizons and single-minded drive for profits, make them unsuitable owners. Ownership of health care providers is another questionable situation: the drive for profits by investment funds may conflict with the health care mission of providers.

In the short-run, passage of legislation proposed by Senator Ron Wyden to provided an economic lifeline to the newspapers not already owned by Digital First/Tribune and LEE/BH Media can be

[1] Penelope Muse Abernathy. 2021. "News Deserts and Ghost Newspapers: Will Local News Survive". University of North Carolina—Chapel Hill, Center for Innovation and Sustainability in Local Media. Cislm.org.

very useful in enabling some community newspapers to resist the siren call of investment firms. But this is not a permanent solution.

Perhaps the most promising answer is to rethink the current application of antitrust regulations. Under the current application of antitrust regulations, there is nothing to stop Alden from acquiring LEE/BH Media. The newspapers acquired in this way are likely to be approved by regulators because they don't compete with other Alden-owned papers in local markets. Current interpretation of antitrust has allowed private equity and hedge fund investors to build national powerhouses in a variety of fragmented industries because of the focus of regulators on competition and prices in local markets. This interpretation was established by antitrust regulators during the Reagan administration, when they chose to abandon the measure of market share as a red flag in mergers and acquisitions. A new reinterpretation by the Biden administration's Department of Justice might be able to restore market share as a factor to be considered before approving a merger such as the one Alden proposes between Digital First/Tribune and LEE/BH Media. The merger will give the combined company ownership of one-quarter of all newspapers and likely would not pass muster if market share is a factor to be considered.

Your second question about the implications of PE investment funds locating their headquarters in the Cayman Islands and similar offshore locations is also an important one. You have put your finger on the main issue—lack of transparency and accountability. They are tax havens that allow PE firms and their investors to avoid some U.S. taxes. Financial regulation also tends to be more lax. In the latest twist, PE firms are buying up life insurance companies that provide annuities. Insurance regulations in some offshore locations have more lenient reserve requirements, making them a preferred location for the headquarters of these investment funds. But the implications beyond these observations, and national security implications in particular, are not my area of expertise.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

STATEMENTS SUBMITTED IN SUPPORT OF THE STOP WALL STREET LOOTING ACT

Private Equity Stakeholder Project

Private Equity Stakeholder Project (PESP) – Statement for the Record

October 20, 2021 Hearing of the Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Economic Policy

Protecting Companies and Communities from Private Equity Abuse

Chairman Warren, Ranking Member Kennedy, and Members of the Subcommittee, thank you for the opportunity to provide a statement for the October 20, 2021 hearing "Protecting Companies and Communities from Private Equity Abuse" by the Subcommittee on Economic Policy.

My name is Jim Baker and I am the executive director of the Private Equity Stakeholder Project. The Private Equity Stakeholder Project is a non-profit organization whose mission is to identify, engage, and connect stakeholders affected by private equity with the goal of engaging investors and empowering communities, working families, and others impacted by private equity investments.

This hearing could not come at a more critical time. The private equity industry has grown dramatically in recent years. Private equity and other private funds firms had less than $1 trillion in assets under management in 2004. They now manage more than $7.5 trillion, and are growing quickly.[1]

While the world and the global economy continue to struggle with the COVID-19 pandemic, private equity firms have taken advantage of the flood of cheap debt that the US Federal Reserve's and other central banks' stimulus efforts have made available to buy companies at a record pace and to extract debt-funded dividends from companies they currently own.[2]

In the first half of 2021, private equity firms had their busiest six months ever, announcing 6,298 deals worth $513 billion, according to the *Financial Times*.[3]

As private equity firms and deals have grown, they have come to impact growing numbers of people. In the past year, private equity firms have acquired companies with hundreds of thousands of workers such as G4S (530,000)[4] and Dunkin Brands (250,000).[5] A private equity-owned rural hospital company, LifePoint Health, is in the process of trying to acquire competitor Kindred Healthcare. The combined company will have 77,000 employees in 34 states and will be the largest private-equity-owned healthcare company in the US.[6]

Based on reports by the private equity industry's main lobbying group, the number of US employees at private equity-owned companies has increased substantially in recent years – from 8.8 million in 2018 to 11.7 million in 2020, a 33% increase.[7] This increase is striking as overall US employment dropped by 4.5% over the same period.[8]

Based on academic studies showing that private equity takeovers typically result in job losses at acquired companies,[9] this increase appears to be largely driven by private equity firms acquiring more and larger companies – putting the jobs of millions more US workers at risk.

The private equity buying spree that we have seen over the past year is certain to continue. As of mid 2021, private funds managers had amassed a record $3.3 trillion of unspent capital.[10]

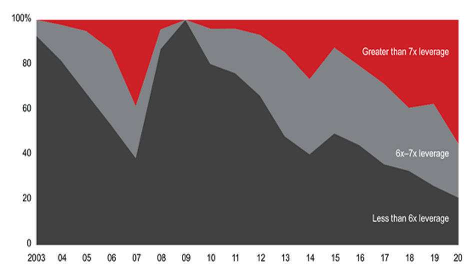
The house always wins – and workers, patients, communities and the planet often lose

Private equity firms almost always use debt, often very significant amounts of debt, to buy companies. This debt ends up on the balance sheets of the companies that are acquired, rather than the private equity firms themselves. Debt levels at private equity-owned companies have grown in recent years.

Consulting firm Bain & Co. reported earlier this year that for around half of 2020 buyouts, private equity firms utilized leverage greater than seven times the portfolio company's Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA), a proxy for cash flow.[11]

"Despite the deep uncertainty surrounding the Covid-19 economy, debt multiples shot up in 2020, with almost 80% of deals leveraged at more than 6 times EBITDA—traditionally the level at which federal regulators start to raise eyebrows," Bain & Co. added.[12]

Share of US leveraged buyout market, by leverage level



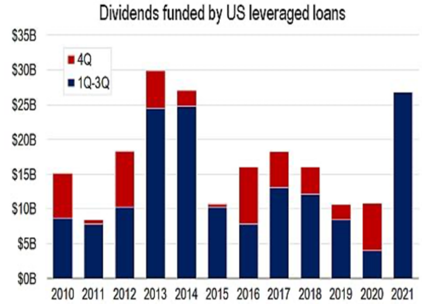
Source: Refinitiv LPC

Debt-funded dividends

In addition to using record levels of debt to acquire new companies, in the past year private equity firms have also added record amounts of debt to the balance sheets of portfolio companies they already own to finance dividend recapitalizations, or debt-funded dividends.[13]

Dividend recapitalizations do nothing to grow private equity-owned businesses but instead are a way for private equity firms to extract cash from these companies. Instead, debt-funded dividends leave portfolio companies with more debt, making defaults and bankruptcies more likely. Credit rating

Dividends funded by US leveraged loans



Data through Sept. 22, 2021.
Data covers borrowers owned by private equity sponsors.
Source: LCD, an offering of S&P Global Market Intelligence

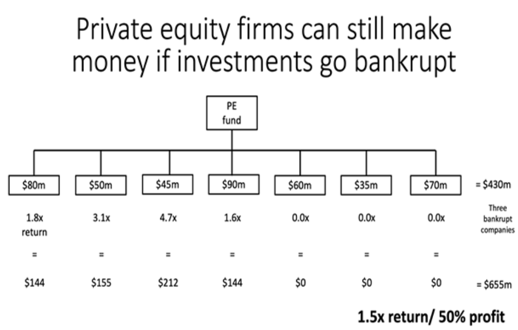
agency Moody's noted in September that "The surge of dividend recapitalizations lays bare private equity firms' intentions to recoup their investments after paying high acquisition multiples."[14]

Heads I win, tails you lose

Private equity firms' heavy use of debt at portfolio companies (and limited investment of their own money), growing extraction of cash from portfolio companies through debt-funded dividends, and limitation on their own liability increasingly set up a "heads I win, tails you lose" structure where private equity firms can make substantial profits for themselves even as the companies they own struggle, default on debt, or go bankrupt.

Private equity firms typically invest in companies through funds that may acquire 20-30 companies, holding each of those companies for around 4-7 years. Private equity firms have a large incentive to identify and invest in companies in which they can dramatically grow cash flow over 4-7 years, either by growing revenue or cutting costs. Private equity firms are typically judged, and private equity executives paid, based on fund-level returns – i.e., the combined returns of all of the companies that a private equity fund has invested in.

As the hypothetical example at the right demonstrates, a private equity fund that invests in several companies and generates strong returns on some may still generate a profit for the private equity firm even if multiple portfolio companies go bankrupt and the private equity fund's stakes in those companies are wiped out. In this case even though three of seven companies went bankrupt, the private equity fund still generated a 1.5x gross return – i.e., a 50% profit.



Even when portfolio companies go bankrupt, private equity firms cannot lose any more than the limited capital they put in. On the other hand, when things go well, private equity firms' potential upside is unlimited and is magnified by high debt.

This structure means private equity firms' interests are often not aligned with those of portfolio company stakeholders such as workers, consumers, communities in which the companies operate, tenants, government payors, and others. Rather than being focused on the long-term sustainability of these businesses, private equity firms may instead be focused on how to grow cash flow as quickly as possible in a few years for their own benefit, regardless of the consequences to others.

We have seen these consequences in examining impacts of private equity investments on workers, climate change, healthcare, and civil rights, among other areas.

Private equity's impact on workers and jobs

The main US private equity lobbying group, the American Investment Council (AIC), has touted private equity's contributions to the US economy by employing millions of workers.[15] However, since private equity firms acquire companies with existing workers, they often do not create new jobs. Indeed, as economists have documented, when private equity firms take over a company, the total number of workers usually goes down.[16]

Job losses at private equity-owned companies

A 2019 study by researchers at Harvard Business School and the University of Chicago found that private equity takeovers result in significant job losses. The report found average job losses of 4.4% in the two years after a company was bought by private equity, relative to control companies.[17]

A 2019 report by the Private Equity Stakeholder Project, United for Respect, and Americans for Financial Reform found that in the prior decade, 597,000 people working at private equity and hedge fund-owned retail companies lost their jobs after their Wall Street-managed retailers went bankrupt or liquidated.[18]

These retail layoffs are especially troubling because they occurred while the retail industry added over one million additional jobs during the same period.[19] Over the same period, private equity and hedge fund-owned retailers added only around 76,000 jobs—creating only one job for every eight jobs that were eliminated — meaning that private equity cost the retail sector over half a million (521,000) in net job losses. These job losses spanned over 25 retailers, including household names like Sears, Toys "R" Us, Payless, Sports Authority, Claire's, and RadioShack.[20]

These job losses devastate local economies and ultimately ripple throughout the national economy as suppliers and local small businesses feel the downstream effects. Not only have private equity and hedge fund-owned retailers laid off hundreds of thousands of workers, the Wall Street-driven retail bankruptcies also have effects that are felt far beyond those retailers and their former employees. Businesses and their workers, including in the retail sector, not only provide direct jobs but also have multiplier effects on indirect jobs; in other words, their economic activity supports workers in other industries, such as those who manufacture and deliver the products sold at retailers and businesses where retail employees spend their income, like grocery stores or gas stations.

Private equity-owned retailers' suppliers and their employees suffer when the retailers go bankrupt, close stores, or shut down completely. For example, in July 2018, just months after Toys "R" Us shut down, Mattel, the maker of Barbie and Hot Wheels, announced it was laying off 2,200 workers after its sales dropped by 14 percent.[21] Then, in October 2018, toymaker Hasbro — which produces Play Doh, Transformers, and My Little Pony toys — announced it would lay off up to 10% of its employees. Hasbro's sales fell 12% in the third quarter 2018, a drop the company attributed primarily to the loss of Toys "R" Us.[22]

A January 2019 study by the Economic Policy Institute noted that for every 100 direct jobs lost at retailers, approximately 122 additional indirect jobs are lost.[23] Based on this multiplier, over the decade to 2019, the 597,000 documented direct retail job losses at private equity-owned retailers would have caused an estimated additional 728,000 indirect job losses, meaning Wall Street's gamble in retail has likely cost more than 1.3 million total job losses.

A 2011 National Bureau of Economic Research analysis of over 3,000 private equity acquisitions found that retail companies acquired by private equity experienced a 12 percent drop in employment over the subsequent five years.[24]

Job losses at private equity-owned companies are not limited to retailers, but extend to virtually every industry.

Case study: OpenGate Capital and HUFCOR

Private equity firm OpenGate Capital serves as a clear example of the private equity destroying, rather than createing, jobs. In 2017, OpenGate, a Los Angeles-based private equity firm bought HUFCOR, which manufactures portable room partitions for hotels and convention centers and has been operating in Janesville, Wisconsin for 120 years. This past summer, OpenGate announced that it would close the factory and shift its operations to Mexico, permanently laying off 166 workers, many of whom had spent their entire adult lives working for the company.[25]

HUFCOR was just the latest casualty in OpenGate's history of buying viable businesses and then running those companies into the ground, throwing employees out of work, sometimes without advance notice, and harming communities. In a span of less than four years, OpenGate Capital ran at least five companies out of business, putting more than 1,300 US workers out of their jobs.[26]

Poverty wages

In addition, the largest numbers of workers employed by private equity-owned companies appear to be concentrated in industries where employers typically pay low wages such as food service and hospitality (at least 1.8 million workers), retail (at least 1.1 million workers), security (1 million+ workers), healthcare (800,000+ workers), and call centers (500,000+ workers).[27]

Case study: Roark Capital

There are at least 1.5 million workers at food service companies owned by private equity firms. Roark Capital is the largest private equity owner of food service companies. In December 2020, Roark acquired Dunkin' Donuts, bringing the total number of people working at Roark Capital-owned food service companies or their franchisees to over 750,000. Many of the jobs at these Roark Capital-owned companies pay low wages with minimal benefits.

Sample wages at Roark Capital-owned food service companies

Company	Position	Average Wage[28]
Dunkin' Donuts	Crew Member	$11.07/hr
Arby's	Team Member	$10.98/hr
Culver's	Crew Member	$10.54/hr
Sonic Drive-In	Cook	$10.58/hr
Hardee's	Crew Member	$10.20/hr

The wages at these companies are so low that some of these companies' workers must turn to public assistance in order to afford health care, food, and other basic necessities. A report last year from the US Government Accounting Office (GAO) found that some of Roark Capital's chains (such as Sonic, Dunkin' Donuts, and Arby's) were among the companies with the most workers relying on public assistance.[29]
In March 2021, Roark Capital-owned Inspire Brands sent employees and franchisees a report of its government lobbying activity that bragged about its success in helping to kill the federal Raise the Wage Act, which would have raised the minimum wage to $15 per hour.[30]

In contrast to Roark Capital, many other large restaurant chains have realized that they could continue to operate profitably with a $15 minimum wage and decided they would no longer support the National Restaurant Association's (NRA) opposition to raising the minimum wage. For instance, in 2019,

McDonalds sent a letter to the NRA stating that the company would "not use our resources, including lobbyists or staff, to oppose minimum wage increases," at any level, and that it would not "participate in association advocacy efforts designed expressly to defeat wage increase."[31]

Over 230 large employers, including Amazon, Best Buy, Costco, Target, CVS, and Walgreens have announced they will pay their workers $15 per hour or more. Yet only one of these companies is owned by a private equity firm and employs fewer than 1,000 workers.[32]

Nonetheless, Roark Capital's Inspire Brands has continued to oppose increases to the federal minimum wage, telling NBC News in October 2021 that "we don't support a one-size-fits-all approach to the minimum wage."[33]

Private equity and healthcare

Private equity increasingly makes up a substantial portion of investment in US healthcare companies, touching virtually every sector, and is expected to continue to grow. Asset managers have record levels of available capital earmarked for health care investment; as of 2019, private equity firms had $29.2 billion in capital waiting to be invested in health care.[34] These firms benefit from trillions of dollars of government health care spending.

As private equity ownership of health care companies grows and continues to benefit from taxpayer funded health care spending, it is essential for lawmakers to understand the risks associated with private equity investment in the industry and create policy that protects patients and supports health care workers.

Private equity and nursing homes

Concerns surrounding private equity ownership of nursing homes echo critiques of private equity in the broader health care industry. Private equity investors' outsized return expectations over short time horizons may lead to profit-seeking tactics that hurt patient care. High levels of debt left over from leveraged buyouts can leave nursing homes with less capital available for operations as more money is diverted to interest payments. Sale-leaseback transactions, where a company is made to sell its real estate to a third party and lease it back, can leave nursing homes with fewer assets and increased liabilities in the form of rent payments. Management fees and shareholder dividends can further bleed nursing home companies of money that could be invested into patient care.

A 2020 paper published in the National Bureau of Economic Research (NBER) made waves for its disquieting findings on how private equity ownership of nursing homes impacts operations and patient care, including increasing the mortality of Medicare patients by 10%. The study, "Does Private Equity Investment in Healthcare Benefit Patients? Evidence from Nursing Homes," analyzed data reported by Centers for Medicare and Medicaid Services by US nursing facilities between 2005 and 2017.[35]

Key findings from the study are summarized below:[36]

- Private equity ownership increases the short-term mortality of Medicare patients by 10%, implying 20,150 lives lost due to private equity ownership between 2005 and 2017.
- Taxpayer spending over a short-term Medicare patient stay at a private equity-owned nursing home increases by 11%.

- Average staffing decreases at private equity-owned nursing homes. After a private equity buyout, the number of hours provided by frontline nursing assistants decreases on average by 3% and overall staffing declines by 1.4%. The vast majority of time spent by frontline nursing assistants is used provide mobility assistance, personal interaction, and cleaning to minimize infection risk and ensure sanitary conditions.
- After a private equity firm buyout, patient mobility declines and pain intensity increases.
- Going to a private equity-owned nursing home increases the probability of taking antipsychotic medications – discouraged in the elderly due to their association with greater mortality – by 50%. Elevated antipsychotic use could also be partly explained as a substitution response to lower nurse availability.
- After a private equity buyout: management fees increase by 7.7%, lease payments increase by 75%, and interest payments increase by about 325%. Cash on hand decreases by about 38%.

The complex business structures used by many nursing home companies can obfuscate ownership and make it difficult to track quality and compliance across nursing homes with the same owner. These structures also allow owners to reap excessive profits while limiting financial transparency, primarily through use of related party services.

Nursing home companies often contract with third party entities that have the same owner to provide services and goods, such as management services, staffing, supplies, and lease agreements. These structures legally allow nursing home owners to siphon money out of nursing facilities and hide profits. Nursing home owners can further boost profits by overpaying related parties. Third-party arrangements are not unique to private equity – more than 70% of US nursing homes use operating funds to pay related parties – but many of the private equity-owned nursing homes studied by PESP appear to operate with these structures.

See our report: "Pulling Back the Veil on Today's Private Equity Ownership of Nursing Homes"

Case study: Private equity ownership of a safety net hospital system

Between 2010 and 2021, private equity firm Leonard Green & Partners owned Prospect Medical Holdings, a safety net hospital company with 17 hospitals in Pennsylvania, New Jersey, Connecticut, Rhode Island, and California.[37]

After Leonard Green acquired Prospect in 2010, it used the hospital chain as a platform to raise debt so it could siphon off hundreds of millions of dollars in dividends and fees. According to Prospect's own financial statements, the owners collected at least $658 million from the hospitals—despite dramatic operating challenges, substantially underfunded pensions, and increasing regulatory scrutiny.[38]
The largest dividend that Prospect's owners collected in 2018 directly contradicted a commitment Prospect made to state regulators. When it bought hospitals in Rhode Island in 2014, Prospect told regulators It wouldn't pay out any more dividends. Just four years later, the Leonard Green & Partners-led ownership collected an almost $460 million dividend. That same year, Prospect generated a $244 million net loss.[39]

As a result of that dividend, Prospect ran out of cash by early 2019, forcing the owners to provide emergency cash infusion.

Prospect was eventually able to pay off the existing $1.1 billion in debt it had accrued in part to fund dividends, but only by selling off the bulk of Prospect's real estate to a REIT. The transaction replaced debt with lease liabilities and left Prospect with fewer assets and greater liabilities.[40]

- Prospect's hospitals have some of the lowest quality ratings from the Centers for Medicare and Medicaid Services.[41]
- Prospect completely shut down all of its facilities in San Antonio in late 2020 — laying off nearly 1,000 workers — and sold its hospital building to a hotel developer.[42]
- Last year, the California Attorney General formally charged Prospect executives with "gross negligence" related to persistent mold contamination of a hospital pharmacy, including in equipment used to mix patient medications. The pending Attorney General proceedings could revoke or suspend the hospital's pharmacy permit.[43]

These kinds of problems are magnified in the COVID-19 era. A 2020 ProPublica investigation found that in in Rhode Island, poor infection control led to COVID-19 infection of 19 of the 21 geriatric psychiatric ward residents: six of them died. Six housekeeping staff also got COVID in part due to limited access to PPE. The head of the department died.[44]

Leonard Green currently owns at least 11 other health care companies.[45]

Private equity and dental care

In recent years, private equity firms have increasingly carved out a substantial portion of the US dental industry, primary through ownership of Dental Services Organizations (DSOs). DSOs are companies that handle the business side of dental practices, such as administrative, marketing, bookkeeping, and financial services.

While DSO-affiliated practices currently make up a relatively small portion of the broader dental industry, the number is rapidly increasing. Today, private equity firms have near-complete control of the DSO market. Nine of the top 10 DSOs are owned by private equity firms, and 27 of the top 30 DSOs are private equity-owned. This amounts to approximately 84% of practice locations that contract with the top 30 DSOs.[46]

Private equity's dominance of the dental services industry raises concern. The high returns typically targeted by private equity investors over short time horizons may create perverse incentives that are harmful to patients, including cost-cutting tactics, high financial leverage, and a focus on profit-maximizing procedures.

Of critical concern is how the DSO structure may emphasize "quantity of care over quality of care." DSO proponents often claim that DSOs have no impact on clinical operations, and focus entirely on business management services. However, investigations by regulators have found that the relationship between DSOs and dentists is murkier than represented. In some cases, the owners of DSOs, i.e., private equity firms, exert undue influence over practices to increase profits.

A 2013 joint investigation by the U.S. Senate Finance and Judiciary committees into DSOs and corporate dentistry affirmed these concerns. The investigation, "Joint Staff Report on the Corporate Practice of Dentistry in the Medicaid Program," found "a failure to meet quality and compliance standards, including unnecessary treatment on children; improper administration of anesthesia; providing care without proper consent; and overcharging the Medicaid program."[47]

Pressure to meet revenue targets has been shown to lead to over-booking and understaffing or rushing through treatments to maximize the volume of patients. It can also lead dentists and hygienists to push unnecessary or expensive procedures, such as drilling into healthy teeth, conducting unnecessary and costly x-rays or screenings, and performing medically unnecessary root canals.[48]

The potentially harmful impact on patients especially raises concern given that a significant portion of patients receiving care at DSO-affiliated practices are Medicaid eligible, which may exacerbate problems of inequity in oral health for low-income people. While DSOs' scale may allow for expanded access for underserved communities, it is critical that access does not come at the expense of quality for these communities in the service of maximizing profit for private equity investors.

See our report: "Deceptive Marketing, Medicaid Fraud, and Unnecessary Root Canals on Babies: Private Equity Drills into the Dental Care Industry"

Private equity in dentistry case study: Benevis/Kool Smiles – FFL Partners

Georgia-based Benevis, formerly known as Kool Smiles, has been owned by various private equity firms since 2004. Benevis has had a troubled history including Medicaid fraud and significant medical malpractice suits, leading to the company's bankruptcy and subsequent restructuring in 2020. Today, Benevis has 150 affiliates in 17 states and has 3,500 employees.[49]

In January 2018, Benevis paid $23.9 million to settle a federal lawsuit alleging that it performed and billed for medically unnecessary dental services performed on children insured by Medicaid.[50] The alleged activity took place under the ownership of private equity firm Friedman Fleischer & Lowe (FFL), which first invested in Benevis in 2004.[51] The settlement was the second largest False Claims Act dental settlement in history.[52]

The US Department of Justice (DOJ) alleged that Benevis facilities submitted claims for performing medically unnecessary tooth extractions and root canals on babies, and sought payments for baby root canals that were never performed. The DOJ also alleged that Benevis "routinely pressured and incentivized dentists to meet production goals through a system that disciplined 'unproductive' dentists and awarded 'productive' dentists with substantial cash bonuses based on the revenue generated by the procedures they performed."[53]

The DOJ found that the alleged fraudulent activity took place at 130 of Benevis-affiliated clinics, which submitted false claims to 17 different state Medicaid programs.[54]

FFL's high return expectations allegedly played a key role in incentivizing fraud. In particular, the DOJ amended complaint alleged that FFL sought to boost returns in order to attract investors to subsequent private equity funds:

> "Not only did FFL's interest in the profits of portfolio companies provide a significant incentive to maximize those profits, FFL also intended to sponsor additional private equity funds, and its success in attracting investors in subsequent funds would depend greatly on the returns earned by investors in existing funds managed by it."[55]

The complaint further alleges that FFL's requirements pressured staff to commit Medicaid fraud:

> "FFL…established the business requirements necessary to attain the desired rate of return from the Kool Smiles clinics and directed [Benevis] to undertake these steps necessary to achieve those returns knowing that those returns would and did include the submission of false Medicaid claims. Accordingly, FFL and Capital Partners II are liable for the submission of those false claims as detailed herein."[56]

Two months after settling the federal lawsuit, FFL sold Benevis to private equity firms Littlejohn & Co and Tailwind Capital.[57] Littlejohn and Tailwind held on to Benevis for less than 2.5 years before taking the company into bankruptcy in August 2020.[58]

Private equity in behavioral health

Private equity investors have shown substantial interest in the behavioral health sector, and this trend is expected to continue.

In 2018, behavioral health acquisitions and mergers reached a historic high at 97 known transactions, representing a 59% year-over-year increase from 2017. Private equity-driven transactions made up a substantial portion of deal activity; between 2017 and 2018, private equity buyers went from accounting for 48% of acquisitions in behavioral health to 69% of acquisitions.[59]

Private equity interest in behavioral health has focused on a few key areas: autism, eating disorders, and addiction treatment.[60] Firms employ a familiar model in behavioral health: they typically buy or create a platform investment, such as a large treatment center, and then acquire add-on investments to expand the company. Consolidation and improvements to tech and administrative functions are expected to drive value creation.[61]

However, private equity's tendency to demand outsized returns in a sector that is already vastly underfunded, and serves vulnerable populations, raises serious concerns about its potential impact on patient care.

For example, health researchers who surveyed former owners of companies sold to private equity firms found expectations of "meeting your numbers" post-sale and, as a result, the eagerness to fill beds even without adequate staffing.[62] These kinds of behaviors may be especially harmful where having adequate staffing and training is vital both to providing safe and effective treatment as well safe working conditions for staff.

Case study: Sequel Youth & Family Services – Altamont Capital

Sequel Youth and Family Services runs teen residential treatment facilities, therapeutic group homes, community-based programs, and alternative education programs for youth. The company serves 10,000 people at 50 locations in 21 states.[63] It is owned by Altamont Capital Partners, Palo Alto-based private equity firm with $2.5 billion assets under management.[64]

In the last several years, Sequel has come under immense scrutiny for the death of a teenager and numerous instances of child abuse, neglect, and poor quality of care at its facilities in multiple states.

Altamont acquired Sequel in August 2017 through a leveraged buyout from Canadian private equity firm Alaris Royalty.[65] Alaris reported generating $71 million profit, or 23% annual return, on its investment in Sequel.[66]

Both Altamont and Alaris added substantial debt to Sequel over the course of their ownership; In August 2016, Alaris completed a dividend recapitalization of Sequel in part to pay itself a dividend. After Altamont acquired sequel in a leveraged buyout, it took out debt financing at least two more times, in 2017 and 2018, totaling at least $94 million.[67]

The litany of horrific conditions at Sequel facilities includes:

- Michigan: In May 2020, a Black teenager living at Sequel-operated Lakeside Academy in Michigan, died after being restrained by seven staffers. The state of Michigan had substantiated 56 violations at Lakeside Academy since 2018, including multiple instances of inappropriate physical restraints.[68]
- Alabama: In February and March 2020, Alabama Disabilities Advocacy Program (ADAP) conducted an investigation of a Sequel facility in Courtland, Alabama. In its report in the investigation, ADAP wrote that the facility had "unsafe, squalid living conditions and a disturbing cultural and programmatic environment that further traumatizes extremely vulnerable children."[69]
- Utah: A June 2019 report had found that police were called to the Sequel-owned Red Rock Canyon School 72 times since 2017. During the same period, 23 staff members were investigated for child abuse, nine were charged, and four more were referred for charges.[70]
- Ohio: In September 2020, children housed at Sequel Pomegranate were removed from the facility after multiple incidents of improper restraints, sexual abuse and violence. The facility's license was revoked.[71]
- Iowa: Sequel's Clarinda Academy shut down in February 2021 following numerous allegations of excessive restraint, assault, and rape.[72]

For more information, see our report: "Understaffed, Unlicensed, and Untrained: Behavioral Health Under Private Equity"

How private equity has defrauded government health care programs

There is substantial overlap between the risks associated with private equity ownership of health care companies and the activities targeted by the False Claims Act (FCA), a federal law that establishes liability for individuals or companies that defraud governmental programs.

The FCA is commonly used to prosecute health care companies that defraud Medicaid, Medicare, and related programs by submitting false claims for a variety of activities. Fraudulent activities may include providing substandard care, providing medically unnecessary services, receiving kick-backs for services provided, filing claims for services not provided, and providing services by unlicensed or improperly licensed providers.[73]

In an effort to achieve the high returns often expected by private equity investors, companies' aggressive profit-seeking may result in fraudulent activity.

Since 2013, at least 25 private equity-owned health care companies have paid a total of at least $570 million to settle false claims act suits related to alleged billing fraud that took place under private equity ownership. Altogether, the private equity firms that owned those companies currently own nearly 200 other health care companies, many of which also bill Medicare, Medicaid, and other government health programs.

The alleged fraud in these suits included providing medically unnecessary procedures and substandard care, engaging in kickback schemes, and hiring unlicensed licensed providers.

Many of the private equity firms that paid settlements are frequent health care investors, suggesting that there are substantial due diligence and operational failures that have enabled the alleged fraudulent behavior. This raises questions about what steps investors are taking to ensure that other health care portfolio companies are in compliance with applicable laws and regulations.

For more information, see our report: "Money for Nothing: How Private Equity has Defrauded Medicare, Medicaid, and Other Government Health Programs, and How that Might Change"

Dividend recapitalizations at healthcare companies

As discussed earlier in this testimony, dividend recapitalizations are transactions by which private equity firms add debt to their portfolio companies' balance sheets in order to collect dividends for themselves. By saddling their companies with debt to extract cash, private equity firms put those companies at risk for restructuring, bankruptcy, or cost cutting to make up the interest payments and pay off debt.[74]

Given the concerns over the impact of dividend recapitalizations on the viability of companies, it is especially troubling that private equity investors would reap debt-funded dividends from their health care portfolio companies. Siphoning cash from providers of critical health services, such as hospitals, nursing homes, dental offices, mental health clinics, and others, may negatively impact affordability, quality, staffing, and access to care.[75]

Many health care companies draw a substantial portion of their revenue from publicly funded programs such as Medicare and Medicaid. Now, billions more dollars are flowing into the industry through stimulus funding aimed to address the COVID-19 pandemic.[76]

Private equity-backed health care companies are taking full advantage of the stimulus funding. An analysis by Bloomberg found that $2.5 billion in COVID-19 aid has gone to just three private equity-backed hospital companies—LifePoint Health (Apollo Global Management), Steward Health Care (Cerberus Capital Management), and Prospect Medical Holdings (Leonard Green & Partners).[77]

In February 2021, private equity firm Ares Management paid itself a $209 million debt-funded dividend from its physicians' practice DuPage Medical Group (DPMG)[78] after DPMG had collected almost $80 million in CARES Act dollars.[79]

As taxpayer-funded programs continue to provide valuable resources to the health care industry, it is essential to examine the role of private equity-backed dividend recapitalizations to ensure that that money goes where it is intended—and not primarily to benefit wealthy investors.

Case study: The Mentor Network – Centerbridge Capital

Private equity firm Centerbridge Partners owns behavioral health company The Mentor Network (Mentor). Mentor is a national network that provides residential and other services to adults and children with intellectual and developmental disabilities and brain and spinal cord injuries, and to youth with emotional, behavioral and medically complex challenges. It is one of the largest for-profit foster care companies in the US.[80]

In February 2021, Centerbridge took out debt on Mentor in part to pay itself a $375 million dividend.[81] This is the second debt-funded dividend Centerbridge has extracted from Mentor. In October 2019, just six months after it acquired Mentor, Centerbridge paid itself a $100 million debt-funded dividend from the company. In all, Centerbridge has collected almost half a billion dollars in debt-funded dividends from Mentor over the course of its two-year ownership.[82]

Mentor has come under fire for allegations of widespread abuse, neglect, and deaths in its foster care and group home programs. A 2017 investigation by the US Senate Committee on Finance found that at least 86 children died in a 10-year period while in the custody of Mentor. In only 13 of those deaths did the company conduct an internal investigation.[83]

The Senate committee released its final reports on Mentor in December 2020.[84] While the majority of the investigation covered the period prior to Centerbridge's ownership,[85] the reports found that problems have persisted since its acquisition. For example, just weeks before the final report was completed, state regulators in Oregon discovered so many violations at a Mentor home that they shut the facility down for good.[86]

Given the ongoing problems with Mentor facilities and services, it is appalling that Centerbridge would add substantial debt to Mentor in order to pay itself dividends rather than investing in operations to improve patient care.

For more information, see our report: "Dividend Recapitalizations in Health Care: How Private Equity Raids Critical Health Care Infrastructure for Short Term Profit"

Private equity and climate change

The private equity industry has pumped hundreds of billions of dollars into fossil fuel companies—buying up offshore drilling in the Gulf of Mexico, propping up fracking operations, expanding infrastructure through pipelines and export terminals, spewing pollution from gas and coal power plants—with minimal public scrutiny.

Unlike publicly-traded oil companies, the private equity industry has investments in fossil fuel assets that are—by definition—private and exempted from most public disclosure rules. There are no comprehensive disclosures of their holdings, let alone of their environmental and community impacts.

An analysis of deals tracked by data provider Pitchbook showed that private equity firms have invested around $1.1 trillion dollars into energy assets since 2010.[87] That is double the market value of Exxon, Chevron, and Royal Dutch Shell combined.[88]

Private equity's energy investments are dominated by fossil fuel holdings that are contributing to the climate crisis through emissions of methane, carbon dioxide and other greenhouse gases (GHG). These investments and operations have significant and long-lasting impacts on the planet and its people, with communities of color shouldering a disproportionate share of the harms of fossil fuels including compromised health[89] and damage from extreme weather tied to climate change.[90]

Scientists convened by the United Nations warned in August that steep cuts in emissions are crucial, requiring immediate action to shift away from fossil fuels.[91] As publicly listed oil majors face growing pressure from shareholders[92] and courts[93] to cut emissions, many are seeking to demonstrate progress by selling fossil fuel assets. However, private equity firms have repeatedly stepped up as buyers of those assets, negating progress on climate impacts.[94]

Thus, investors may find fossil fuel assets shifting from their portfolios' public market investments over to the private markets, where fossil fuel extraction and operations continue in the shadows. Simultaneously, fundraising by private equity firms has accelerated, with $460 billion in commitments in the first half of 2021, giving firms plentiful capital to deploy.[95]

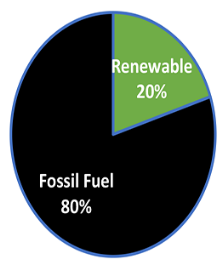
The Private Equity Stakeholder Project recently released a report entitled "Private Equity Propels the Climate Crisis" that explores the energy holdings for ten of the world's largest private equity managers which combined manage $3 trillion in assets:[96] Ares Management, Apollo Global Management, The Blackstone Group, Brookfield Asset Management/Oaktree Capital, The Carlyle Group/NGP Energy Capital, CVC Capital, KKR, Kayne Anderson, TPG Capital and Warburg Pincus.[97]

The private equity industry must take responsibility for its role in the climate crisis. Firms should disclose all energy holdings and impacts, a plan to swiftly transition to clean energy, and ensure investment practices align with a 1.5 degree Celsius scenario. Investors, regulators and policymakers must compel private equity firms to provide full transparency on their fossil fuel holdings and impacts and act now to ensure a livable future for all.

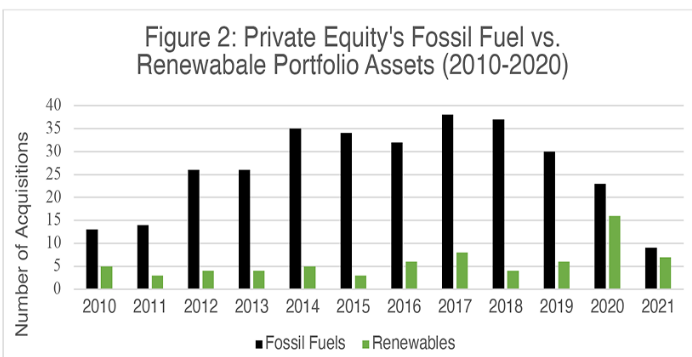
Fossil fuel investments eclipse clean energy

The ten private equity firms examined collectively own over 300 portfolio companies across the energy sector, with the vast majority related to oil, gas and coal.[98] Eighty percent of the energy assets held by these ten private equity firms reviewed are in fossil fuels, while only 20 percent are in renewables.

FIGURE 1: PRIVATE EQUITY ENERGY PORTFOLIO ASSET BREAKDOWN RENEWABLE VS FOSSIL FUEL



Fossil fuels continue to dominate energy investments by private equity despite the efforts of individual firms touting their Environmental, Social, Governance (ESG) investment strategies and appetite for renewables and the private equity industry trade group highlighting sustainable investments.[99]



A review of acquisitions by these firms year by year over the past decade illustrates the persistent focus on fossil fuel assets, as seen in the figure below. In 2020, the economic and fuel demand disruptions from the COVID-19 pandemic resulted in fewer fossil fuel deals for the ten firms examined, the smallest

number of deals since 2011. By comparison, the number of acquisitions of renewable firms was higher than prior years – but was still behind the number of fossil fuel deals. So far in 2021, private equity managers continue to pursue new fossil fuel acquisitions to add to their existing oil and gas portfolios, in addition to renewable deals, which means their negative environmental impacts will be ongoing.

Beyond the number of deals executed, another measure of private equity's interest in fossil fuels is in the amount of capital deployed. In line with the lack of transparency across the industry, private equity firms do not consistently disclose the size of transactions. Based on the deal information available for the acquisitions examined, over the past decade the average fossil fuel deal was around $880 million, compared to the average for renewable deals of around $397 million.[100] In other words, on average, fossil fuel deals pursued by these ten firms were more than double the size of renewable deals.

Larger deals are heavily weighted toward fossil fuels; the ten private equity managers secured 83 deals over $500 million for companies in the oil and gas industry. Transactions in renewable energy trend toward smaller deals, with only 15 surpassing $500 million.

The combination of pursuing vastly more fossil fuel companies and transactions that are substantially larger indicates that private equity has pumped considerably more capital into dirty energy. Even with the recent uptick in renewable deals in 2020, private equity has directed a far smaller amount of money into climate solutions.

Fossil fuel holdings pose serious risks, provide low returns

Private equity firms' clients—institutional investors like pension funds—face risks from exposure to fossil fuels in their portfolios because of the mounting impacts of the climate crisis.[101] Institutional investors face the prospect of substantial losses through climate change risks including physical risks to assets from flooding, drought or fire; transition risks for investments in conventional energy with diminishing demand or stranded assets; and liability risk for failing to meet fiduciary obligations or duty of care by insufficiently accounting for climate change.[102]

Companies with extensive fossil fuel holdings are vulnerable in the transition to clean energy as fossil fuel consumption inevitably declines due to regulatory mandates and public demand.[103] Even the oil majors are acknowledging a permanent shift, with Royal Dutch Shell joining other oil majors in saying earlier this year that the world had reached peak oil production in 2019, and that going forward it expects annual declines.[104] Last September, British oil giant BP came to the same conclusion that oil demand peaked in 2019.[105]

Private equity's bets on energy have generally failed to deliver strong returns to investors over the past decade, despite hundreds of billions invested in the sector. Oil- and gas-focused funds have been among the lowest-yielding strategies for private capital over the past decade, lagging buyout firms by about five percentage points, according to a 2020 *Bloomberg* analysis of Preqin data.[106] An analysis of nearly 200 energy funds by *Cambridge Associates* also concluded in 2020 that returns trailed broader private equity returns.[107] The energy funds sponsored by many of the largest buyout firms, including Ares, Apollo, KKR and Carlyle, have posted negative returns.[108]

Private equity-backed oil and gas companies may be more susceptible to financial risks due to higher debt loads and volatility. In 2020, the disruptions to demand and price triggered by the pandemic resulted in an unusually high number of bankruptcies in the oil and gas sector, the majority of which were filed by companies owned by private equity firms—which also carried a higher debt burden.[109]

Code Red for communities of color and the climate

The climate crisis is accelerating with real time economic and social impacts, underscoring the urgency of immediate and meaningful action by corporations and governments. The summer of 2021 has clearly illustrated the crisis with a distressing number of events linked to climate change. A heat dome in the Pacific Northwest and Western Canada killed hundreds of people,[110] warped roadways[111] and left forecasters stunned.[112] At the same time, flooding in the Midwest overwhelmed infrastructure.[113] The parched Western U.S. is experiencing the worst drought conditions in two decades.[114] Intense wildfires on the West Coast sent smoke thousands of miles to contaminate air on the East Coast.[115] In Europe, catastrophic flooding killed hundreds in Germany and Belgium.[116]

The United Nations Intergovernmental Panel on Climate Change (IPCC) report published in August warned that sharp reductions in greenhouse gasses are urgently required. A 1.5 degree Celsius rise in global temperatures has become nearly unavoidable, due to decades of inaction and continued emissions from fossil fuel usage. The hazards unleashed by extreme weather and sea-level rise will accelerate in the coming decades, the report found, but even more devastating impacts could be ameliorated by an immediate shift away from fossil fuels.[117] UN Secretary General António Guterres said, "This report must sound a death knell for coal and fossil fuels, before they destroy our planet."[118]

The world's largest private equity firms contribute to the continued expansion of fossil fuel infrastructure and its associated harm towards marginalized communities. For instance, 64 percent of the total population living near the Blackstone Group's greenhouse gas (GHG) emitting facilities are people of color.[119] Similarly, 66 percent of the communities living around Arclight Capital's facilities are communities of color.[120] And 60 percent of the communities living around Ares Management's environmentally harmfully facilities are racially marginalized communities.[121]

From our sample of about 125 private equity-owned companies with domestic fossil fuel operations, communities in Oklahoma, Louisiana, New Mexico, and Texas each contend with substantial fossil fuel exposure. Low income and minority communities in south Texas bear the brunt of private equity's environmental and public health harms,[122] with over 70 private equity owned companies primarily operating in the extraction and production hotbeds of the Permian Basin and the Eagle Ford Shale (see Figure 3).[123]

The majority of people living near gas flaring in these two drilling regions are people of color.[124] Latina women in the Eagle Ford shale face significantly higher risk of giving birth prematurely.[125] Other studies have found similar results in Colorado,[126] Pennsylvania,[127] and Oklahoma.[128] Moreover, fracking wastewater contains potentially harmful chemicals and metals and has been tied to contamination of surface and groundwater. A 2016 study published in the *American Journal of Public Health* found the that although fracking activity was slightly more prevalent in white communities, fracking wastewater wells were more frequent in communities of color. [129]

Together, the Permian Basin in Texas and New Mexico, the Eagle Ford Shale in Texas and the Bakken Shale in North Dakota and Montana account for 83 percent of the gas flaring activity in the country. Half a million people living in those basins reside within three miles of a flare, with 39 percent living close to more than 100 flares.[130]

As nations prepare for the UN Climate Change Conference (COP26) in November, public and private sector actors must make strong commitments to cut their own emissions.[131] The IPCC report's "code red for humanity" brings increased urgency.[132] Seeking to restore its global leadership, the United States aims to cut its emissions by half within a decade.[133]

Adding to the urgency, the International Energy Agency released a Net Zero by 2050 roadmap, declaring that the pathway to achieve net-zero emissions is "narrow but achievable" and requires "nothing short of a

complete transformation of the global energy system." The narrow pathway calls for no new oil, gas or coal projects to be developed, and for all existing operations to focus on emissions reduction.[134]

Given their massive fossil fuel exposure, private equity firms have an urgent responsibility to address the significant role they play in propelling the climate crisis, and must start being transparent about the financial and social risks of their continued exposure to the fossil fuel sector.

From sunlight to darkness – private equity shifts dirty energy into the shadows

Private equity firms continue to hold, build and buy more fossil fuel assets despite demands to urgently reduce emissions in order to forestall the worst of the climate crisis.

For example, Oaktree Capital has expanded its fossil fuel exposure, with at least three upstream acquisitions in 2020 including a $900 million commitment to FourPass Energy drilling company in Colorado,[135] a $700 million commitment to Banpu Kalnin Ventures to pursue upstream natural gas,[136] and a $1 billion deal with Diversified Energy & Gas to fund joint acquisitions to expand the company's footprint,[137] which in July 2021 acquired assets in Louisiana and Texas.[138]

Blackstone recently acquired midstream pipeline company Tallgrass Energy, which is developing a new oil export terminal in Louisiana that would emit more than 500,000 tons of greenhouse gasses annually and would be built over a historic graveyard for enslaved people, according to the *Times-Picayune*.[139]

Private equity firms have also shown a sizeable appetite for acquiring assets from publicly-traded oil majors that are looking to shed segments of their operations in response to public pressure and to reduce exposure to climate risks.[140] For example, the Carlyle Group recently acquired Occidental Petroleum's oil fields in Colombia and was in talks to acquire the company's oil fields in Ghana as well.[141] KKR's Contango Oil & Gas expanded its fracking operations by buying up all of ConocoPhillips' drilling assets in Wyoming in July 2021.[142]

Private equity firms are also acquiring fossil fuel assets from some of the world's largest producers, Abu Dhabi and Saudi Arabia, which are planning to expand production.[143] The *Financial Times* recently reported that pressure on publicly listed oil companies "in short-term production could shift to private or state-owned companies which face much less scrutiny over their activities."[144] Examples of such transactions include:

- In 2021, Brookfield bid $6.8 billion for Inter Pipeline, a major petroleum transportation and natural gas liquids processing business operating in Western Canada.[145]
- Private energy specialist EIG led a consortium in a $12 billion deal to buy a 49 percent stake in Saudi Arabia's pipelines in June 2021.[146]
- Several private equity firms have inked deals with the Abu Dhabi National Oil Company as well, including a $10 billion deal in 2020 by a consortium that included Brookfield Asset Management.[147]
- KKR participated in a $4 billion deal with the Abu Dhabi National Oil Company to buy a 40 percent stake in its pipelines in 2019.[148]
- In 2016, Brookfield invested in Brazil's NTS 2,000-kilometer (1,243-mile) gas pipeline network. Earlier this year, it increased its stake to 100 percent ownership.[149] This network is responsible for approximately 50 percent of gas consumption in Brazil.[150]

Stakeholders must act now to push private equity to exit fossil fuels

The accelerating climate emergency calls for dramatic action to reduce fossil fuels now. The private equity industry's energy investments contribute substantially to climate change, and thus, these asset managers must provide transparency to the public and investors about their fossil fuel holdings, emissions, and impacts on communities.

Based on the IPCC Climate Report, UN Secretary-General Guterres said, "The climate crisis poses enormous financial risk to investment managers, asset owners and businesses. These risks should be measured, disclosed and mitigated." He noted that corporations must align their portfolios with the Paris Agreement and that, "The public and private sector must work together to ensure a just and rapid transformation to a net-zero global economy."[151]

To date, the private equity industry has not adequately addressed its role in propelling climate change, which underscores the importance of engagement by stakeholders to press the industry to pivot away from fossil fuels.

Institutional investors whose capital is at risk must demand that their private market partners use their capital responsibly through investing in adherence to a 1.5 degree future. Investors should insist that private equity managers:

- Develop and disclose a plan with clear incremental benchmarks to shift energy portfolios to be pollution free
- Commit to no expansion of fossil fuel development or operations, in alignment with the IEA Net Zero 2050 roadmap[152]
- Provide a risk management strategy under a 1.5 degree warming scenario consistent with science-based emissions targets, as well as scenarios above 1.5 degrees
- Disclose all direct and indirect emissions (Scope 1, 2, and 3)[153] as well as other climate impacts such as spills, accidents, explosions, citations for environmental violations
- Engage with impacted communities to develop a just transition program both for the workforce and for communities impacted by current fossil fuel holdings
- Provide transparency on political spending and how it aligns with the UN PRI's Investor Expectations on Corporate Climate Lobbying[154] including:
  - Corporate and executive political spending – lobbying and campaign contributions
  - Political spending by portfolio companies and their executives
  - Membership in trade associations and how those trade associations' lobbying positions align with the goals of the Paris Agreement

Regulators like the Securities Exchange Commission (SEC) that oversee the stability of markets for investors have an important role to play as well. Under the current lax regulatory structure, private equity firms have produced subjective and vague reports of their efforts on environmental issues. For members of the public and investors, there is no way to discern which companies have greater climate impacts, which are engaged in greenwashing through misleading ESG policies, or which may be genuinely working to disclose and mitigate climate impacts and emissions.[155] The SEC is commencing a process to update climate disclosure requirements and received hundreds of comments in response to a request for public input in June 2021.[156]

Investors, regulators and policymakers must enact policies obliging private equity firms to provide full transparency on their fossil fuel holdings and the impacts of those holdings on the environment and on

communities. The private equity industry must take responsibility for its role in the climate crisis and detail the steps it will take to transition to clean energy and certify that investment practices align with a 1.5-degree scenario, to ensure a livable future for investors and impacted communities alike.

For more information on the specific energy holdings of the largest private equity managers, please see the Private Equity Stakeholder Project's recent report, "Private Equity Propels the Climate Crisis."

Private equity and civil rights

A handful of private equity firms have invested heavily in companies providing services to prisons, jails, and detention facilities around the United States and the more than two million people housed at those facilities. Private equity-owned companies profiting from incarceration and detention include Securus and Global Tel Link (phone and communications), Wellpath and Corizon (healthcare), TKC Holdings (commissary), and Attenti (electronic monitoring).

The United States incarcerates more people than any other country in the world, both in terms of the number of individuals incarcerated and by percentage of population. In 2020, there were roughly 2.3 million people in the country's prisons and jails,[157] and about 1 in 113 adults in the U.S. were incarcerated;[158] if the number of imprisoned individuals in the U.S. were a city, it would be the fifth-largest in the country.[159]

Mass incarceration is overwhelmingly and discriminatorily aimed at communities of color**.** More than 60 percent of the U.S. incarcerated population are people of color, and according to the NAACP, "If African Americans and Hispanics were incarcerated at the same rates as whites, prison and jail populations would decline by almost 40%."[160]

While public and investor debate around the privatization of prisons, jails, and detention facilities has largely focused on publicly-traded companies such as CoreCivic and GEO Group, the largely private equity-owned firms that provide phone services, commissary services, healthcare, bail bonds and other services are more ubiquitous, serving thousands of prison, jail, and immigrant detention facilities around the country.

In addition, some of the same companies have been heavy political contributors opposing sentencing reform, bail reform, and other measures intended to reduce the incarceration rates. For example, just three days after California passed bail reform legislation in August 2018, an affiliate of private equity firm Endeavour Capital, then owner or Aladdin Bail Bonds, contributed $800,000 to become one of the largest funders of the successful effort to roll back the law.[161]

Most recently, private equity firm Warburg Pincus earlier this year acquired G4S, a gigantic security company with 530,000 employees globally.[162] Among other things, G4S runs a number of private prisons, jails, and immigration detention centers in the US, UK, South Africa, and elsewhere.[163]

Partial list of private equity-owned firms providing services to prisons, jails, and detention facilities:

Company	Industry/ Services	Scope	PE Owner(s)	Acquired
Securus/ Jpay	Telephone/ Communications	Serves more than 3,400 public safety, law enforcement and corrections agencies and over 1.2 million inmates across North America.[164]	Platinum Equity[165]	2017
GTL (Global Tel Link)	Telephone/ Communications	Serves approximately 2,300 facilities and 1.8 million inmates in 50 states, the District of Columbia and Puerto Rico.[166]	American Securities[167]	2011
TKC Holdings (Keefe Group/ Trinity Services Group/ Swanson Svcs/ ICSolutions)	Commissary/ Food/ Telephone/ Communications	Keefe Commissary Network serves more than 650,000 people weekly and 14 out of 17 outsourced state departments of corrections.[168] Telecommunications provider ICSolutions serves 300,000 people housed in over 400 correctional facilities nationwide.[169]	H.I.G. Capital[170]	2012
G4S	Private prisons, Detainee transportation	G4S runs private prisons, jails, and immigration detention centers in the US, UK, South Africa, and elsewhere.[171]	Warburg Pincus[172]	2021
Corizon Health	Healthcare	Corizon Health provides quality healthcare services to our clients at 220 facilities serving over 180,000 patients in 17 states.[173]	Flacks Group[174]	2020
Wellpath (Formerly Correct Care Solutions/ Correctional Medical Group Companies)	Healthcare/ Probation	Provides medical and behavioral health services for nearly 300,000 patients located in local, state and federal correctional facilities, as well as state hospitals and other facilities.[175]	H.I.G. Capital[176]	2013/ 2018
Comprehensive Health Services/ Caliburn	Detention Center Operations	Operated the Homestead child detention center in Florida as well as facilities in Texas[177]	DC Capital[178]	2018
Attenti	Electronic Monitoring	Global provider of electronic monitoring technologies to national, federal state and local correctional and law enforcement agencies around the world.[179]	Apax Partners[180]	2017
Sentinel Offender Services	Probation	Sentinel Offender Services is a private probation company that partners with community corrections, courts and law enforcement.[181]	Bison Capital Asset Management[182]	2012

Private equity firms' heavy use of debt at portfolio companies (and limited investment of their own money), growing extraction of cash from portfolio companies through debt-funded dividends, and limitation on their own liability increasingly set up a "heads I win, tails you lose" structure where private equity firms can make substantial profits for themselves even as the companies they own struggle, default on debt, or go bankrupt.

Even when portfolio companies go bankrupt, private equity firms cannot lose any more than the limited capital they put in. On the other hand, when things go well, private equity firms' potential upside is unlimited and is magnified by high debt.

This structure means private equity firms' interests are often not aligned with those of portfolio company stakeholders such as workers, consumers, communities in which the companies operate, tenants, government payors, and others. Rather than being focused on the long-term sustainability of these businesses, private equity firms may instead be focused on how to grow cash flow as quickly as possible in a few years for their own benefit, regardless of the consequences to others.

There is a critical need for reforms to address the growing impacts of private equity firms.

Thank you,

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Written Testimony of Senator Baldwin
Wednesday, October 20, 2021 at 2pm
Senate Banking Committee -- Economic Policy Subcommittee

Thank you to Chair Warren and Ranking Member Kennedy for inviting me here to the committee today.

I am here to testify before this committee as someone with firsthand knowledge of the impact of the private equity business model on workers and their communities in Wisconsin.

Several historic Wisconsin companies have been driven into bankruptcy or had their facilities moved overseas by private equity funds.

The first company I want to talk about today is ShopKo—a retailer founded in 1961 in Ashwaubenon, Wisconsin. ShopKo was bought by a private equity firm in 2005 called Sun Capital Partners. Sun Capital immediately executed a "sale-leaseback"—a textbook private equity maneuver—in which the fund sells the company's real estate out from under it. ShopKo's 351 locations—worth hundreds of millions—were sold to a company that would lease the land and buildings back to ShopKo.

Sun Capital promised to reinvest the proceeds of the sale into the company, but instead it paid the cash to itself in the form of dividends and management fees. Not only was ShopKo prevented from using its cash to reinvest, it was loaded up with $200 million more in additional debt to fund even more payouts to Sun Capital executives.

After years of being starved of investment, ShopKo was forced into bankruptcy and liquidation in 2019. The three-thousand Wisconsin workers were promised severance pay in exchange for working through the company's final days, but when the time came to pay the workers—Sun Capital said it didn't have the money.

When I traveled to Wisconsin to meet with ShopKo workers, I heard from Kristi Van Beckum, who told me: “I always felt proud to work at ShopKo because it was a Wisconsin-based company and it invested a lot in the community. But I saw how Sun Capital sold off ShopKo’s properties and destroyed the company, all for their own benefit. They made millions while I didn’t even get the severance I was promised. Sun Capital ran a company we loved into the ground.”

More recently, I visited with workers at Hufcor, which had operated in Janesville, Wisconsin for over 120 years. In 2017, the manufacturer was acquired by a private equity fund called OpenGate Capital.

Wisconsinites are sadly familiar with OpenGate. The LA-based private equity fund bankrupted Golden Guernsey Dairy in 2013, only two years after acquiring it, laying off hundreds of workers in Waukesha, Wisconsin. Dairy workers showed up one day to find the doors locked. They were given no notice of their layoff and had to fight OpenGate to get their back pay for eight years.

This past summer, OpenGate notified the 166 workers at Hufcor that their jobs would be terminated and the manufacturing operations would be moved to Monterrey, Mexico.

When I visited with workers this summer, I heard from Michelle who worked at Hufcor for 23 years. She is anxious about what training she might need to get another job that will pay what she earned at Hufcor.

I also heard from Jesse, who was diagnosed with cancer two years ago and depends on the health benefit provided by Hufcor for his treatment.

These workers had great benefits because of their representation by the Communication Workers of America and their employment at Hufcor. But they were left with an uncertain future because OpenGate decided to move their jobs to Mexico.

These stories illustrate the devastation that the private equity business model has wrought on my state.

These workers deserve better. We need to rip up private equity's predatory playbook that enriches looters, but leaves workers with nothing but pink slips.

I was proud to work with Senator Warren to introduce the aptly-named Stop Wall Street Looting Act. This legislation will prevent private equity firms from enriching themselves by starving businesses of investment and running them into bankruptcy or shipping jobs overseas.

This bold reform will help rewrite the rules of our economy and protect workers from predatory practices so that we can start rewarding hard work and not just wealth.

Thank you Senator Warren for the opportunity to share the stories from my state with your Committee and I look forward to working with you to pass this important legislation.

APPENDIX I

Happy Allen (Tullahoma, TN)
Happy Allen worked at PetSmart for five years as a dog trainer in three stores and has six dogs of his own right now. He loved working at Petsmart and thought he had finally found a job he could retire from. He says it felt like a big family. Unfortunately, about a year into his time there, PetSmart was bought by BC Partners and Happy has seen PetSmart workers and innocent pets suffer as a result. After the change in ownership, Petsmart eliminated middle management, cut full-time positions and slashed hours. BC Partners seemed to want to put as much work on as few people as possible. As a result, Happy was doing training at three stores 85 miles apart, from Chattanooga to Nashville, and often had to help in stocking, petcare, and on the register on top of that. He felt like he was working four jobs instead of one. Happy and his coworkers went from having a workplace that they loved, to feeling stressed and overworked. There simply wasn't enough staff, unfortunately, many times Happy and his coworkers did not have enough supplies to provide proper care for the pets in their care.

Adrian Valdés (Savannah, GA)
Adrian Valdés has been a part-time stylist apprentice in a PetSmart grooming salon for almost a year. Adrian just completed PetSmart's training academy as part of the trajectory to become a Pet Stylist. Unfortunately, in his salon, employees lack the proper supplies and equipment to do their jobs well. Adrian has also been concerned about the safety of pets they have worked with in the salon because Petsmart's grooming training was so rushed and minimal. Adrian has also been concerned for their own health and safety at work when pandemic precautions were not enforced in the salon. The salon does not have doors or windows to the outside and masks have not been enforced for employees throughout the pandemic. Adrian's wage is $11 an hour and they cannot afford to move out of their parents' home despite working 40 hours per week. Before attending the grooming academy, Adrian was denied full-time hours and therefore also did not have access to health insurance.

Kaede Montooth (Savannah, GA)
Kaede Montooth started working at Petsmart nearly two and a half years ago because he loves animals. Ever since BC Partners took over, his hours have been cut, staff eliminated, and he is now expected to juggle many different jobs at once - from covering the register, to caring for animals, to stocking shelves, to cleaning, unloading inventory shipments and helping customers on the sales floor. The exhaustion and stress have negatively impacted his mental health - and things only got worse when the pandemic hit. For several months, Kaede had to pick up two other jobs in order to make ends meet and still relied on food stamps to survive. Despite working throughout the pandemic, mask-wearing was not consistent among employees in his store, social distancing was not adequately enforced and Petsmart never offered hazard pay to employees risking their health at work every day. Because Kaede received no health insurance as a part-time employee, he has often feared that if he contracted COVID-19 at work, he would not have been able to afford treatment.

Isabela Burrows (Grand Blanc, Michigan)
Isabela Burrows is an Associate Lead at PetSmart, and she lives with family and 8 pets. She has worked at Petsmart for a year and lives in Grand Blanc, MI. Isabela. In August, she was promoted

to the low level manager position but was still responsible for petcare and cashier tasks. She often feels overwhelmed and exhausted being expected to work 3 jobs instead of one. Isabela has seen coworkers overheat on the job when her store's air conditioning broke down, oftentimes so hot in the store that they had to remove their masks just to breathe. She has often felt unsafe going into work during the pandemic,because Petsmart does not offer paid sick time to part-time associates, she has had coworkers come to work sick during the pandemic. She feared bringing COVID-19 home to her mother who is high risk. When her brother passed away unexpectedly from health conditions, her manager told her to "get over it" and that her home life shouldn't impact her while at work. Isabella doesn't want others to go through the disrespect and lack of empathy she has experienced at Petsmart.

Sheena Simmons (Grand Rapids, MI)

Sheena Simmons was employed by Art Van for 11 years as a Sales Manager. She started in the electronics department and made her way to sales where she earned enough in commission to pay off her car. She enjoyed the family atmosphere and interacting with customers at Art Van. When she lost her job with no warning, that meant she lost her health insurance for her and her son. She applied for unemployment for the first time ever, struggled with finding a new job during the COVID-19 pandemic and had many sleepless nights not knowing if she could pay rent. When private-equity firm Thomas H. Lee Partners (THL) bankrupted and liquidated Art Van Furniture early last year, it shut down all 97 locations in Michigan and abruptly destroyed thousands of family-sustaining jobs — leaving workers like her without pay or health insurance at the onset of the COVID-19 pandemic.

APPENDIX II
Previously Submitted to

U.S. House of Representatives, Committee on Financial Services

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

November 19, 2019

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.

APPENDIX III

Statement by

Melody Crawford

United for Respect Leader

Testimony before the Senate Banking, Housing, and Urban Affairs Committee

Congressional Briefing for Members and Staff on
"Dignity of Work: Workers whose daily lives are affected by the financial system"

April 27, 2020

Good morning, Senator. My name is Melody Crawford. I live in Detroit, Michigan. Until March of 2020, I was an assistant buyer for the mid-west regional retailer, Art Van Furniture. I am also now a leader with United for Respect.

Art Van was a good employer, where you could build your own financial stability. Art Van paid people well, with great benefits. And it was really a leader of our community. Not only did I work for Art Van, but my daughter, son-in-law, and niece worked there too. Art Van supported many local charities, like the food bank. I was there for 13 years, and proud of my company.

When private equity firm TH Lee took over Art Van in 2017, everything changed. Under TH Lee's ownership, Art Van came to owe millions of dollars to Wall Street executives, and creditors. One of the reasons for this was because TH Lee sold the properties to itself, including the Warren Michigan headquarters, and then made Art Van pay back an expensive lease!

Art Van had been a growing business, reporting $800 million in revenue in 2017. But by the end of 2019, Art Van was in the red. We got a WARN Act notice about the layoffs before the COVID-19 pandemic emergency order in Michigan, so the bankruptcy and layoffs originally had nothing to do with the pandemic. Then, a few weeks later, Art Van, under THL's ownership, changed their original WARN Act notice, citing the COVID-19 pandemic. We didn't get any severance pay or benefits as the employees. This meant we got *nothing*.

I received an email that everyone had to report to the office, then we were told on a conference call that all stores would be closed, and we were all laid off. The customers who had ordered furniture, paid for furniture, were told they wouldn't be getting it -- and wouldn't be getting their money back. It was chaos.

We were fired with no notice at all. And we all lost our health insurance. This was probably the most terrifying part for me, personally. I have underlying conditions that require medicines, and I could no longer afford to buy them. I had just bought a new car and then couldn't make payments.

The destruction of this once thriving company blew a giant hole through my entire family, my community, and the state of Michigan. It was really one of the worst things that has ever happened to me, and I wouldn't wish this on anybody. Working for a company for 13 years, and just - tossed out overnight, into the pandemic, while TH Lee executives pocketed millions on the deal.

That's why I am here today to ask you to stop allowing Wall Street to loot retailers like Art Van and Toys R Us, and treat American workers like collateral damage, while they get rich. It's not right, it has to end. I am here today to ask you to pass laws to protect workers from Wall Street greed in the US Senate as soon as possible.

Over 500 of my former coworkers and I worked with United for Respect, and called on TH Lee to provide health insurance to all employees for 90 days, and to create a hardship fund. We had never sat down with Wall Street executives before, but at that point - what did we have to lose? We'd lost everything, they'd taken it, and it was time to take action.

Last month, after a year of campaigning and publicity, they finally said they would provide nearly $2 million to a fund, and now all eligible employees who signed up will receive about $1,200.

It was former workers, myself and others who organized with United for Respect, who spoke up for ourselves, who brought this Wall Street private equity firm to the table. But $1,200 falls far short of the fair severance each of us deserves.

Elected officials need to stop private equity firms from coming in and taking over, leaving employees with nothing. That's what I'm here to fight for, and Senator -- I'm facing down Wall Street and demanding better for workers. It's time this committee of our US Senate does the same.

Companies owned by private equity firms accounted for 8.8 million jobs in the U.S. in 2018. 10 of the 14 largest retail bankruptcies since 2012 have been at stores owned by private equity, including Toys 'R' Us, Shopko, and Art Van. There are millions of people like me who have already been laid off by Wall Street owned retail companies, or are at risk of losing everything like we did.

I'm willing to fight to the end. We need laws in place so this doesn't happen to anyone else. I'm here. I'm ready. I hope you are too. Thank you for hearing my testimony today.

APPENDIX IV

Thomas H. Lee Partners Creates Material ESG Risk for Investors

United for Respect, March 2021

Thomas H. Lee Partners ("THL") poses potentially significant risks to investors because of its mismanagement of companies within its portfolio. The recent and controversial bankruptcy of Art Van, a 60-year-old Midwest furniture retailer, represents a broader, unsustainable trend in THL's strategy that threatens investors with operational, reputational, and competitive risk. Investors should encourage THL to change course to effectively mitigate these risks for the long-term.

THL acquired Art Van in 2017. At that time, Art Van was a successful and growing family-owned company with 117 stores and 3,500 employees.[3] In three short years THL drove Art Van into bankruptcy, forcing the once vibrant company to default on its obligations to creditors and customers and leaving thousands of employees unemployed and without health care at the start of the COVID-19 crisis.[4] In response, former Art Van workers waged a public advocacy campaign to compel THL to provide a hardship relief fund to compensate them for their lost health insurance benefits.

After months of public pressure, in March 2021, THL finally increased its financial contribution to the fund after initially only committing to $400 per employee for the limited number of employees who received notice from the firm to sign up for the hardship fund. Nevertheless, in yielding to public pressure, THL ostensibly sought to mitigate the considerable reputational harm created from its generally anemic response to the Art Van bankruptcy.[5] However, Art Van's bankruptcy remains emblematic of a strategy that continues to expose THL investors to significant long-term Environmental, Social, and Corporate Governance (ESG) risks.

THL'S HISTORY OF RECKLESS MANAGEMENT AND HIGH-RISK LBOS

Although Art Van's bankruptcy is the firm's most recent bankruptcy to date, it is not the only one in THL's portfolio. Within the span of just ten years (2009-2019), THL drove three other companies into bankruptcy. As was the case with Art Van, these companies were saddled with excessive debt obligations. In each instance, THL attempted to profit while paying down creditor interest by steadily decreasing the operational quality of these companies, destabilizing their real estate holdings, extracting their resources, and cavalierly cutting jobs. However, in each instance, when the credit bills ultimately came due in full, rather than rescue these pillaged companies, THL allowed them to go bankrupt and left workers with nothing.

[3] https://www.furnituretoday.com/business-news/art-van-sold-private-equity/

[4] https://www.bloomberg.com/news/features/2021-02-10/private-equity-art-van-workers-fight-for-severance-insurance-after-bankruptcy

[5] https://www.crainsdetroit.com/retail/art-van-workers-claim-victory-after-private-equity-firm-owner-boosts-bankruptcy-payouts

While under THL ownership, over 6,000 employees lost their jobs at four companies, including Art Van, that filed for bankruptcy in sectors spanning food processing, media, retail, and manufacturing.

- ***CTI Foods 2019 bankruptcy***
  CTI Foods was acquired by THL in 2013 and closed its Long Beach facility just over a year later, laying off 315 workers.[6] The closure and subsequent job loss attracted the attention of the United Food and Commercial Workers and in 2016 CTI workers in Pennsylvania successfully ratified a union contract.[7] THL would continue to saddle CTI Foods with debt, including a $25 million loan that CTI Foods would take on for its 2016 acquisition of Liguria Foods.[8] Moody's then downgraded its rating of CTI Foods' debt in 2018, citing "very high financial leverage well in excess of 10 times on a Moody's-adjusted Debt-to-EBITDA basis."[9] When CTI Foods finally filed for bankruptcy in 2019, chief restructuring officer Kent Percy named debt as a significant driver of the company's financial woes, along with "declining sales ... and increased competition." He also pointed to the Liguria acquisition."[10]

- ***iHeartMedia 2018 bankruptcy***
  THL acquired radio broadcaster iHeartMedia (formerly Clear Channel) in 2008 in a heavily leveraged buyout, where THL and Bain Capital contributed only $2 billion of the $17.9 billion purchase price.[11] This subsequently brought iHeartMedia to the point where it was obligated to $1.4 billion in annual interest payments by 2017.[12] These financial burdens ultimately weighed down otherwise seemingly healthy revenues and operating incomes, driving the largest radio broadcaster in the country to bankruptcy in 2018.[13] Workers paid the price in the form of persistent layoffs, which climbed as high as about 1,500 dismissals in a 20,000-strong workforce in 2009,[14] and hundreds of DJs in 2011.[15]

- ***Simmons Bedding Company 2009 bankruptcy***
  Not even 133-year old Simmons Bedding Company could survive THL's poor stewardship. THL's ownership of the mattress manufacturer concluded with Simmons' filing for bankruptcy in 2009, just six years after THL's acquisition. THL set investors on a dangerous course by paying a "lofty" $1.1 billion for Simmons, a debt-burdened transaction that provoked a warning to investors from Moody's analysts.[16] The purchase price had already been inflated by a string of previous private equity buyouts, such that THL was gambling investor money on the prospect of more risky short-term profits. The

[6] https://www.edd.ca.gov/Jobs_and_Training/warn/WARNReportfor7-1-2014to06-30-2015.pdf
[7] https://www.ufcw.org/cti-workers-ratify-first-union-contract/
[8] https://www.wsj.com/articles/cti-foods-files-406-million-debt-cutting-bankruptcy-11552317991
[9] https://www.moodys.com/research/Moodys-downgrades-CTI-Foods-ratings-CFR-to-Caa2-Outlook-negative--PR_383301
[10] https://www.pehub.com/thl-goldman-to-lose-equity-with-cti-foods-restructuring/
[11] https://pitchbook.com/news/articles/bain-capital-back-under-the-microscope-with-iheartmedia-toys-r-us-bankruptcies
[12] Ibid.
[13] https://www.npr.org/sections/thetwo-way/2018/03/15/593868390/iheartmedia-turns-the-dial-to-bankruptcy
[14] https://www.reuters.com/article/industry-us-clearchannel/radio-ad-company-clear-channel-cutting-1500-jobs-report-idUSTRE50G0G720090117
[15] https://www.cbsnews.com/news/is-romney-to-blame-for-hundreds-of-layoffs-at-clear-channel-radio/
[16] https://www.nytimes.com/2009/10/05/business/economy/05simmons.html

> scale of debt THL had loaded onto Simmons made it almost impossible to sustain operations in the long term, and executives' efforts to boost revenues fell far short of these new debt obligations. Even after the acquisition was complete, THL took out still more loans against Simmons, to the point that the manufacturer's 2009 debt burden of $1.3 billion exceeded its original purchase price.[17] Despite the debt load THL collected millions of dollars in profits while driving Simmons into the ground. The resulting bankruptcy made THL the face of private equity's two reckless decades at Simmons and left Simmons bondholders' with an estimated $575 million in losses and 1,000 employees (over a quarter of Simmons' workforce) laid off in the preceding year.[18] Prior to the layoffs, 56% of Simmons employees were represented by a union and collective bargaining agreement.[19]

Reputational Risk

While private equity-driven bankruptcies have long been scrutinized, the global pandemic and concomitant economic downturn have renewed public attention to the extractive nature of private equity acquisitions that leads to store closures and job loss. THL's bankruptcy of Art Van generated critical coverage from outlets like Bloomberg[20], Retail Dive,[21] and Crain's Business.[22] In addition, THL's financial malfeasance garnered the attention and outrage of both state and federal elected officials.[23]

As noted earlier, former Art Van employees fought for and won the creation of a hardship fund, but called THL's initial contribution, which averaged out to about $400 per person, "grossly inadequate."[24] Former employees called on THL to take fiduciary responsibility for the negative impact their investment decisions have had on former Art Van employees and provide no less than $1,500 per employee to help them cover health care expenses incurred after they lost their jobs and health care. After a year of pressure, THL ultimately doubled their contribution to the fund.

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[17] https://www.nytimes.com/2009/10/05/business/economy/05simmons.html
[18] Ibid.
[19] https://sec.report/Document/0001275211-09-000023/
[20] https://www.bloomberg.com/news/articles/2020-09-29/art-van-workers-demand-t-h-lee-pay-back-lost-benefit-accounts
https://www.bloomberg.com/news/features/2021-02-10/private-equity-art-van-workers-fight-for-severance-insurance-after-bankruptcy
https://www.bloomberg.com/news/articles/2020-06-10/t-h-lee-s-1-million-for-ex-workers-called-grossly-inadequate
https://www.bloomberg.com/news/articles/2020-04-22/tlaib-asks-thomas-h-lee-to-cover-insurance-for-art-van-workers
https://www.bloomberg.com/news/articles/2020-04-21/bankrupt-retailer-s-workers-beseech-thomas-h-lee-for-benefits
[21] https://www.retaildive.com/news/former-art-van-employees-win-2m-hardship-fund-from-private-equity-firm/596538/
[22] https://www.chicagobusiness.com/joe-cahill-business/what-went-wrong-art-van-furniture
https://www.crainsdetroit.com/retail/how-art-van-went-retail-juggernaut-house-afire
https://www.chicagobusiness.com/retail/art-van-workers-demand-owner-pay-back-benefit-accounts-lost-bankruptcy
[23] https://www.freep.com/story/money/business/2020/03/05/art-van-furniture-jim-fouts-warren/4964627002/
https://www.bloomberg.com/news/articles/2020-04-22/tlaib-asks-thomas-h-lee-to-cover-insurance-for-art-van-workers
[24] https://www.bloomberg.com/news/articles/2020-06-10/t-h-lee-s-1-million-for-ex-workers-called-grossly-inadequate?sref=AuDcg4aq

Former Art Van employees are still dismayed that THL's hardship fund, managed by a third party, **failed to reach nearly half of the former Art Van employees**. Despite the real social cost of THL's mismanagement of Art Van and the accompanying public relations nightmare, the firm still does not appear to have long-term fiduciary and risk management policies in place for its portfolio that can mitigate the risks and harms of such negative reputational events in the future.

According to THL's ESG principles statement, THL purports to follow specific "guidelines for responsible investment" that include a commitment to "consider environmental, public health, safety, and social issues associated with portfolio companies..."[25]
By failing to live up to its own purported ESG commitments, THL risks becoming like its peers Bain Capital[26] KKR,[27] ESL Investments,[28] and Sun Capital whose business practices have garnered unwanted notoriety,[29] lawsuits, and activist campaigns.

Operational Risk
THL's public ESG commitment also states that THL will "..grow and improve portfolio companies for long-term sustainability" however THL's failure to chart a course for long-term growth at Art Van, or to prioritize workforce issues associated with managing the firm, before and after the bankruptcy, bears closer examination as these factors create risk for investors, as well as for the people and communities who depended on Art Van as an employer and retailer.

- *Increased debt and operating costs*: The factors that contributed to Art Van's demise started with THL's acquisition of the company. THL's $612.5 million buyout was financed by selling real estate owned by Art Van then having the company pay rent on more than 100 stores it used to own:[30] According to one report, the "...new rental payments weakened the retailer's finances…"[31]. Under THL's stewardship, Art Van acquired Levin Furniture and Wolf Furniture. Both of these purchases were financed by sale-leaseback transactions which saddled Art Van with new financial obligations and additional debt.[32] Prior to THL's acquisition, Art Van's revenue had grown an impressive 29% from 2014 to 2017,[33] but Art Van's bankruptcy filings revealed that revenue had since fallen a cumulative 27% on a same-store basis compared to fiscal year 2016; [34] By the end of 2019, net income had fallen into the negative.

- *Forced and voluntary exodus of experienced executives:* The first two years of THL's ownership of Art Van were marked by dramatic executive turnover. Twenty-two Art Van executives resigned or were terminated, including eight of the top 9 executives. Among

[25] https://thl.com/home/esg/
[26] https://www.wsj.com/articles/vulture-investors-swoop-into-china-to-feast-on-soured-loans-11579602603
[27] https://www.theatlantic.com/magazine/archive/2018/07/toys-r-us-bankruptcy-private-equity/561758/
[28] https://www.reuters.com/article/us-sears-lawsuit/sears-sues-lampert-claiming-he-looted-assets-and-drove-it-into-bankruptcy-idUSKCN1RU1V3
[29] https://www.bloomberg.com/news/articles/2019-06-20/senator-rebukes-buyout-firm-sun-capital-on-shopko-severance-pay
[30] https://www.chicagobusiness.com/joe-cahill-business/what-went-wrong-art-van-furniture
[31] https://www.bloomberg.com/news/features/2021-02-10/private-equity-art-van-workers-fight-for-severance-insurance-after-bankruptcy?sref=AuDcg4ag
[32] https://www.detroitnews.com/story/news/local/macomb-county/2020/03/09/art-van-files-bankruptcy-delaware/4998571002/
[33] https://www.crainsdetroit.com/awards/40-art-van-furniture-inc
[34] https://www.retaildive.com/news/art-van-furniture-files-for-chapter-11/573728/

them were longtime CEO Kim Yost, who was replaced by Ronald Borie, the former CEO of Barnes & Noble, who was ranked as the worst executive of 2016 by Yahoo! Finance.[35]

- *Failure to move Art Van into online shopping:* According to press reports, Art Van "bungled it's digital strategy" under THL's oversight. According to former THL executives, "the website became a standalone business, with separate merchandise, management, even office space. Rather than generating new revenue, this two-tiered system cannibalized the chain's retail sales".[36] This failure is all the more stunning as THL bills itself as a leader in "using technology to improve productivity in business processes"[37] and has a distinct "THL Automation Fund" that has raised $900 million.[38]

- *A failed investment*: THL is reported to have lost their entire investment in Art Van Furniture three years after they purchased the company.[39]

When Art Van declared bankruptcy, THL initially walked away from former Art Van employees, largely ignoring the socioeconomic impacts that resulted from their failure. THL's backtracking of these missteps appears to have been the result of an ad hoc decision, not governed by a robust ESG policy. As such, there is little to prevent THL from responding to future crises with the same mistakes that exposed investors to considerable risk in the Art Van bankruptcy:

- When Art Van declared bankruptcy on March 8, 2020, workers were promised "continued work and health coverage until it finished shutting down stores in May;" instead, using the pandemic as an excuse, Art Van stores were closed abruptly, halting "all the pay, severance, and health insurance employees were expecting."[40]

- After over 500 former Art Van employees publicly called on THL to establish a hardship fund for former employees, THL initially committed $1million or about $400 per person,[41] far below the $1,500 per employee that workers had called for.

- THL committed to raise additional monies for the fund and committed to provide $1 million in matching funds but had come up with only another hundred thousand dollars by the end of January, 2021.[42] **THL's poor administration of the hardship fund compounded the damage done by the inadequacy of the fund, as many eligible employees were unable to enroll because outreach efforts were woefully inadequate.**

[35] https://www.crainsdetroit.com/retail/how-art-van-went-retail-juggernaut-house-afire
[36] https://www.bloomberg.com/news/features/2021-02-10/private-equity-art-van-workers-fight-for-severance-insurance-after-bankruptcy?sref=AuDcg4ag
[37] https://thl.com/automation/
[38] https://www.businesswire.com/news/home/20201116005722/en/Thomas-H.-Lee-Partners-Raises-900-Million-for-Automation-Focused-Private-Equity-Fund
[39] https://www.bloomberg.com/news/articles/2020-06-10/t-h-lee-s-1-million-for-ex-workers-called-grossly-inadequate?sref=AuDcg4ag
[40] https://www.bloomberg.com/news/features/2021-02-10/private-equity-art-van-workers-fight-for-severance-insurance-after-bankruptcy?sref=AuDcg4ag
[41] https://www.bloomberg.com/news/articles/2020-04-21/bankrupt-retailer-s-workers-beseech-thomas-h-lee-for-benefits?sref=AuDcg4ag
[42] https://www.bloomberg.com/news/features/2021-02-10/private-equity-art-van-workers-fight-for-severance-insurance-after-bankruptcy?sref=AuDcg4ag

Competitive Risk
Industry peers have realized that maintaining positive public relations are of great material and social concern:

- In April 2020, Robert Levin voluntarily contributed $1,500 to each of his former employees, who also lost their jobs and healthcare when Art Van filed for bankruptcy and closed stores.[43]

- THL's commitment is also proportionately below the $20 million fund that employees at Toys R Us received from the company's former private equity owners, after declaring bankruptcy in November 2018.[44]

In neither of the aforementioned instances were the companies required by law to provide payments to their displaced workers, but it appears that they did so to maintain their industry competitiveness and to generate public goodwill. As such, these gestures were likely of material benefit to investors as well. Lorna Friedman, senior partner in the global health business at Mercer consultancy, told the Society for Human Resource Management, "People will remember the goodwill and reputational value of trying to do the right thing."[45]

Responsible Investment and Labor Policies Can Protect THL Investors and Workers
THL has an opportunity to adopt sound long-term investment and labor policies across its portfolio that will protect the interests of both investors and workers. Investors have a fiduciary responsibility and a compelling self-interest to ensure these ends are met.

For example, THL must develop sound worker-centric risk management protocols for bankruptcies to ensure the firm is adequately prepared to manage the social impacts and reputational harms stemming from such crises. THL's ESG commitment cannot end when a portfolio company files for bankruptcy. Refining THL's governance model to include these risk management protocols will ensure the firm's continued financial vitality and sustainability. To this end, it is incumbent upon investors to encourage THL to bring its governance policies into synchronization with existing and pending national and local legislation by advocating for the following:

[43] https://pittsburgh.cbslocal.com/2020/04/28/robert-levin-furniture-checks/
[44] https://www.washingtonpost.com/business/2018/11/20/million-fund-set-aside-laid-off-toys-r-us-workers/
[45] https://www.shrm.org/resourcesandtools/hr-topics/employee-relations/pages/these-companies-put-employees-first-during-pandemic.aspx

1. A commitment to prioritize and pay out severance to employees who are displaced from their jobs as the result of mass layoffs, site relocations, or site closings[46]; equal to one week's pay for each year of employment.[47]
2. A payment that extends or replaces employees' health care plan coverage for a minimum of 90 days' after a portfolio company files for bankruptcy protection.
3. Implementing an advance notice of at least 90 days for mass layoffs, site closings, and other qualifying adverse employment actions.[48]
4. Working with third-party administrators to ensure any and all monies an employee has paid into a health savings account or flexible spending account is returned to the employee within a reasonable amount of time following bankruptcy, mass layoffs, or site closures.
5. A public commitment to quality jobs at portfolio companies, including base wage of at least $15 an hour, adequate paid leave, fair and predictable scheduling, freedom of association with protections against retaliation, and worker representation on corporate boards of directors.[49]

Further, investors should encourage THL to implement controls to protect investors and workers against reckless leveraging and acquisitions by adhering to the following minimum standards as outlined in the Stop Wall Street Looting Act of 2019:

6. Prohibiting any special compensation for executives if the employer has not paid severance or employee benefits to employees.[50]
7. Requiring detailed transparency and reporting on fees, returns, and other financial information.[51]

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[46] Mass layoffs, plant relocations, and plant closings are defined by the federal Worker Adjustment and Retraining ("WARN") Act (29 U.S.C. ch 23). The federal WARN Act should be thought of as merely a baseline definition for what legally-defines terms such as mass layoff, plant relocation, and plant closure, inter alia, as well as the exemptions to the requisite notice that employers must give employers and state governments. Such terms and exemptions should be considered baselines because states maintain and, have in some cases, exercised the prerogative in their respective jurisdictions to lower the employer-size threshold for coverage, lower the affected employee threshold, and mandate employers pay severance to employees adversely affected by qualifying adverse employment events, among other policy changes.

[47] New Jersey recently passed legislation that mandates this severance standard. Setting aside a liability fund for liquidated damages accounting for no less than 60 days of back pay for all employees and benefits under an employee benefit plan described in section 3(3) of the Employee Retirement Income Security Act of 1974, including the cost of medical expenses incurred during the employment loss which would have been covered under an employee benefit plan if the employment loss had not occurred. This liquidated damages liability fund should not be construed or interpreted as a substitute or replacement for severance pay.

[48] As outlined in the Fair Warning Act of 2019. https://www.congress.gov/116/bills/s2938/BILLS-116s2938is.pdf

[49] UFR Principles for Quality Jobs https://united4respect.org/principles/

[50] https://www.congress.gov/bill/116th-congress/house-bill/3848/text (See Title III, Section 305)

[51] Ibid.(Title V, Section 501)


GREED UNLEASHED:
PetSmart, BC Partners, and what happens when private equity preys on workers and pets
SEPTEMBER 2021
UNITED for RESPECT

EXECUTIVE SUMMARY

Private equity is a particularly predatory industry within the financial sector that has grown exponentially over the last decade thanks to legal loopholes and massive capital investment by public and private pension funds, endowments, and high net worth individuals. The typical private equity playbook includes imposing high-debt loads on companies acquired via leveraged buyouts, extracting additional fees and dividends from the acquired companies, and stripping companies of core assets needed to remain competitive.

While private equity-driven bankruptcies and job losses have made headlines and garnered public outcry, private equity-owned companies currently employ 11.7 million workers[1], making the industry a major employer in the United States. Assets held by private equity firms have grown from $1 trillion prior to the 2008 financial crisis to nearly $4.5 trillion today.[2]

From housing to health care, private equity has its tentacles in nearly every sector of our economy and the $100 billion US pet store industry[3] is no exception. The top three pet specialty retailers in the United States[4] - PetSmart, Petco, and Pet Retail Brands - were all private equity owned until CVC Capital Partners took Petco public in January 2021.[5] Atlanta based Roark Capital created Pet Retail Brands, the third largest pet retailer in North America, in 2019 by merging Pet Valu and Pet Supermarkets.[6] A consortium led by London-based BC Partners acquired PetSmart for $8.7 billion[7] in March 2015 and retains ownership of the company today.[8]

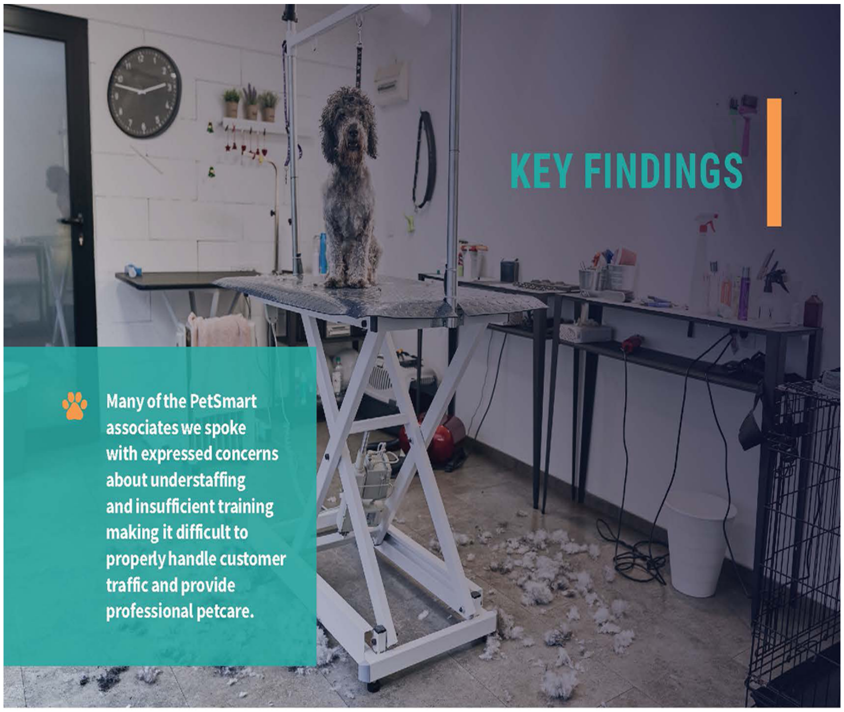
These pet speciality retailers are competing to capture a bigger piece of the growing "pet parent" market by offering high-touch, high priced services[9] like grooming, boarding, and training. Services whose provision depends on well-trained, well-compensated employees. Yet, PetSmart, the largest among them, is cutting corners on the staffing, training, supplies, and equipment needed to provide quality petcare. Sadly, it is PetSmart associates, customers, and pets who pay the price for BC Partners' extractive ownership practices.

United for Respect conducted original research and interviews with PetSmart employees between April 2020 and July 2021. Our findings reveal how the harmful impacts of private equity ownership coupled with a laissez-faire regulatory environment degrades working conditions and the quality of petcare at the largest pet specialty retailer in the country, particularly during the COVID-19 pandemic.

Our findings also underscore the need for company executives to tap the expertise of frontline employees in corporate policy making and implementation to ensure the provision of exceptional pet care, long-term industry competitiveness, and to safeguard employee and pet health and safety.

The PetSmart employees who agreed to be quoted in this report did so out of a sincere desire to make PetSmart a high-road employer and a safe place for animals, big and small.

Report Images: All images throughout report are stock photos.



PetSmart failed to adequately protect frontline workers during the COVID-19 pandemic.

Many of the PetSmart associates we spoke to recounted working during the pandemic pet boom[10] under conditions they feared put workers and animal welfare in jeopardy. In July 2020, hundreds of current and former PetSmart employees wrote to BC Partners asking them to provide proper personal protective equipment, hazard pay, and to ensure store management effectively implemented recommended protocols in stores, like social distancing and mask mandates.[11] As of the publication of this report, employees have yet to receive a response from BC Partners.

BC Partners' operational mismanagement degrades working conditions and puts animals at risk.

Many of the PetSmart associates we spoke with expressed concerns about understaffing and insufficient training making it difficult to properly handle customer traffic and provide professional petcare. Employees also reported ongoing supply shortages and frequent malfunction of proprietary equipment that further undercut their ability to care for animals.

Dog deaths have more than doubled since BC Partners acquired PetSmart in 2015.

At least 36 dogs have died since 2015 while receiving care at PetSmart or shortly thereafter. Between 2008 and 2014, only 15 dogs died under PetSmart's care.[12] In addition, PetSmart has been cited for animal neglect and abuse in Colorado[13], North Carolina[14], and Tennessee[15] while under BC Partners' ownership.

Minimal federal and state oversight of pet retailers and pet grooming further jeopardizes employees and pets.

Regulatory oversight of pet retailers is minimal across the 50 states and there are no federal regulations requiring training or certification of pet groomers.[16] Minimal state and federal oversight of the pet industry - pet grooming in particular - further jeopardizes employees and animal welfare by leaving the pet industry and its private equity owners to define standards of care. Six states have attempted unsuccessfully to regulate pet grooming over the last decade. Nearly all proposed legislation was prompted by instances of pet injury or death during grooming sessions.[17]

KEY RECOMMENDATIONS

Private equity owners of pet specialty retailers have a responsibility to protect employees and public health, create quality jobs, and ensure the provision of exceptional pet care.

To protect frontline employees and pets, BC Partners must guarantee:

- **Quality Jobs for All Frontline Employees**
  Guaranteed $15 minimum wage, fair scheduling, access to full-time hours, a safe work environment, and a $5/hour essential worker pay increase.

- **Healthcare for All**
  Provide quality employer-paid healthcare and cover premiums for all employees, including part-timers.

- **Prioritize Pet Safety**
  Provide employees with functioning equipment, proper supplies, and adequate staffing and training that allows employees to safely give animals the caring services they deserve.

- **Job Protections**
  Establish a severance policy for all employees in the event of bankruptcy or change of ownership that would result in layoffs, with at least one week of pay per year of employment, two weeks minimum. Any layoffs should be done in order of reverse seniority and employees should get at least 90 days notice.

- **Worker Representation on the Board of Directors**
  Frontline employees should have input into corporate policies that directly impact them and the pets they care for. Pet care professionals bring unique knowledge and perspectives that are essential to the provision of exceptional pet care and customer service as well as the long-term competitiveness of PetSmart.

Federal policy makers must reign in private equity excess and protect employees who organize to improve their working conditions:

- Pass the **Stop Wall Street Looting Act (SWSLA)** to protect workers, communities, and businesses from private equity extraction and excess. Private equity executives pay themselves fees for nonexistent services and quickly convert the assets of acquired companies into dividends for the private equity firm. This leaves the companies without resources to invest in sustaining and growing their businesses, or paying workers fairly.

- Pass the **Protecting the Right to Organize (PRO) Act** to remove obstacles that impede workers from exercising their rights to improve their livelihoods and working conditions. Defending these rights is crucial in lessening the plight of economic inequality, as it allows workers to come together and fight for safe working conditions, enhanced wages and benefits, and equalizes the power imbalance between workers and their employers.

State policy makers must protect pet store workers and regulate pet specialty retailers:

- Ensure pet service workers have access to **rigorous training and certification programs** that prepare them to provide safe, quality pet care.

- Require pet speciality stores to **report instances of pet death and injury,** empower a State Agency to investigate these incidents, and **prohibit** pet speciality retailers from entering into **non-disclosure agreements** with customers.

- Encourage pet service workers to **report unsafe working conditions** and company practices and policies that can seriously injure animals under their care.

INTRODUCTION

Private equity's role in retail bankruptcies and massive job losses has been well documented.[18] Less talked about are the significant number of people employed by companies owned by private equity. Nearly every sector of our economy has come under private equity control, from retail and media to grocery, health care, and housing.

The industry has grown exponentially over the past decade thanks to legal loopholes and massive capital investment by public and private pension funds, endowments, and high net worth individuals. Assets held by private equity firms have grown from $1 trillion prior to the 2008 financial crisis to nearly $4.5 trillion today.[19] Private equity-owned companies currently employ 11.7 million workers[20], making private equity a major employer in the United States.

The growing $100 billion US pet store industry[21] has not escaped private equity's grasp. The top three pet specialty retailers in the United States[22] - PetSmart, Petco, and Pet Retail Brands - were all private equity owned until CVC Capital Partners took Petco public in January 2021.[23] Atlanta based Roark Capital created Pet Retail Brands, the third largest pet retailer in North America, in 2019 by merging Pet Valu and Pet Supermarkets.[24] PetSmart, owned by a consortium led by London-based BC Partners, employs 55,000 people across 1,650 stores in the US, Canada, and Puerto Rico including over 200 in-store PetHotels facilities.[25]

When BC Partners acquired PetSmart for $8.7 billion[26] in March 2015 it was the largest private equity buyout of the year.[27] Within 10 months of the takeover, PetSmart paid a whopping $800 million dividend to its new owners (about 38% of total acquisition cost).[28]

A year into its tenure over PetSmart, BC Partners acquired its e-commerce competitor Chewy.[29] The purchase was scrutinized by lenders for saddling an additional $2 billion onto PetSmart's existing $6 billion debt load[30] and despite PetSmart's relatively weak e-commerce position, BC Partners chose to keep Chewy and PetSmart operations separate, minimizing the companies'

ability to realize synergies.[31] BC Partners then relinquished PetSmart's entire stake in Chewy through a recapitalization initiated in 2020.[32] While the spilt substantially reduced PetSmart's debt, much of which was the result of BC Partners' leveraged buyout,[33] it left the company vulnerable to e-commerce competition and enhanced the need for PetSmart to deliver exceptional, personalized services to customers and their pets to remain the industry leader.[34]

In the face of mounting competition from supermarkets, mass merchandisers, and online retailers that offer similar products at competitive prices, PetSmart - and its now public competitor Petco - has positioned itself as the exclusive provider of high-quality food and service offerings like grooming, training, and boarding.[35] In fact, PetSmart's investment in services is credited with bringing to a near-halt a long sales decline at the company.[36] While other retailers have slowed or halted new store openings, PetSmart continues to open brick and mortar stores. New PetSmart stores were opened in North Carolina, West Virginia, Louisiana, and Wisconsin in 2021 demonstrating the company's continued investment and commitment to in-store services.[37]

By every measure, 2020 was a wildly successful year for the pet industry. Sales surpassed $100 billion for the first time[38] and analysts predict the post-pandemic pet industry will be even bigger and more consolidated.[39] PetSmart reported increased sales and foot traffic in the Spring of 2020[40] and stands to benefit from continued growth and consolidation.

As the largest pet retailer in North America, PetSmart is well-positioned to raise industry standards. Yet, BC Partners seems to be taking a page out of the private equity playbook by underinvesting in critical elements of PetSmart's operation and core business which impacts employees, pets, and the company's long term competitiveness.

We hope the findings in this report spur pet parents and policy makers to join PetSmart employees in their effort to make PetSmart a better place to work and a safer place for animals, big and small.

PETSMART FAILED TO ADEQUATELY PROTECT EMPLOYEES DURING THE COVID-19 PANDEMIC

When state and local governments began issuing stay-at-home orders forcing non-essential businesses to shutter their doors, PetSmart successfully lobbied to secure an "essential business" designation[41] and continued to operate in every state in which it was not legally barred from doing so.

> ***"PetSmart didn't care if we got COVID-19 and died. We could be replaced as if we meant nothing. We were tools to be used until we couldn't anymore."***
> — Joy, Petcare Associate in Tennessee

PetSmart employees described a palpable uptick in customer traffic during the Spring of 2020 and expressed concern about the failure of store management to effectively implement and enforce policies and procedures recommended by the CDC to protect employees and customers from COVID-19 exposure.

Nearly 30% of Americans adopted a new furry friend during the pandemic.[42] Animal shelters across the United States faced a unique problem for the first time; the high demand for animal adoptions meant shelters were running low on supply.[43] According to the American Pet Products Association (APPA), Americans spent $103.6 billion on their pets in 2020 - over $30 billion of which was spent on pet supplies, over-the-counter medications, and pet services such as pet boarding, grooming, insurance, training, pet sitting, and walking services.[44]

PetSmart cut corners while profiting from the pandemic pet boom. Between March and April of 2020 the pet retailer saw a 36% increase in sales and in-store foot traffic growth of 6%.[45] Despite this spike in demand, PetSmart temporarily furloughed and then permanently laid off employees across multiple stores in April and May 2020[46] resulting in an abrupt loss of income and health insurance. The company did not provide severance pay to laid-off employees, even though the job losses came during an economically crippling pandemic.

PetSmart associates who continued to work did so with fewer staff than before and without hazard pay. Major retailers, some of them direct competitors of PetSmart — Amazon[47], Target[48], Costco[49], and RiteAid[50] — boosted hourly wages in recognition of the increased risk to frontline employees. In contrast to many other companies, PetSmart also did not voluntarily provide paid COVID-19 leave to employees.

"Our shift leader was supposed to text us and ask if we were having any symptoms of COVID-19. They were supposed to ask in person, in the store every day, and I never got asked that. Never."
— Crista, Pet Bather in Texas

As the magnitude of the COVID-19 crisis began to crystalize, current and former PetSmart associates began to speak out about unsafe conditions, insufficient paid leave, and loss of their livelihoods. In July 2020, over 500 current and former PetSmart employees wrote to BC Partners alerting them to ongoing hazardous conditions in stores including insufficient personal protective equipment, lax enforcement of social distancing protocols, and a refusal to provide severance pay to laid off employees or hazard pay to employees who continued to work at great risk to themselves and their families[51].

It has been over a year since PetSmart employees reached out to BC Partners. As of the publication of this report, BC Partners has yet to respond to any of the people who signed onto that letter.

PetSmart's ineffective health and safety protocols inspired Crista, a former pet bather in Texas, to abruptly quit their job in January 2021 after two months of anxiety over contracting the disease at work. In an interview with *VOX*, Crista stated, "I was weighing the risk of, do I potentially bring COVID home to myself and my family for what amounts to basically poverty wages?"[52]

"They don't even tell anyone when people get COVID-19. They just bring in a cleaning crew, then someone is gone for two weeks and they'll tell us that person is on vacation."
— Michelle, Retail Sales Associate in California

PetSmart's lax COVID-19 protocols also prompted complaints with the Occupational Safety and Health Administration (OSHA) in March and April of 2020:[53]

- **March 2020:** A complaint was filed against a **PetSmart store in Staten Island, NY after a PetSmart associate tested positive for COVID-19 and it was reported that only the back of the pet hospital was sanitized, not the entirety of shared common areas.** The complaint detailed how other employees did not feel safe working there.

- **March 2020:** A complaint was filed in Salem, NH for **not enforcing CDC guidelines for COVID-19.**

- **April 2020:** A complaint was filed against a PetSmart store in Virginia for **not protecting employees from contracting and spreading COVID-19** in the workplace. It was noted in the complaint that employees in grooming salons cannot social distance, nor could employees properly distance themselves from customers.

- **April 2020:** A complaint was filed against a PetSmart in Tacoma, WA for **failing to enforce social distancing guidelines, not providing hand sanitizer to customers and employees, and not limiting the number of customers inside the store.**

- **April 2020:** A complaint was filed in Daytona, FL for **failure to implement CDC/OSHA guidelines for workplace protections against COVID-19.**

- **April 2020:** A complaint was filed in Denver, CO against PetSmart for failing to implement COVID-19 precautions such as access to PPE, social distancing, limiting the amount of customers inside of the store at one time, or training workers about the hazards of COVID-19. **The complaint also stated that employees who were sick were required to report to work.**

- **April 2020:** A complaint was filed against a PetSmart store in Waterbury, Connecticut after **a worker tested positive for COVID-19 and risked exposing other workers in the store.**

While PetSmart clearly fell short in its attempts to safeguard stores from coronavirus, the company was grappling with health and safety issues well before the COVID-19 pandemic.

The federal OSHA and state occupational health agencies have conducted multiple inspections of stores across the country every year between 2015 and 2021, several of which resulted in violations and fines against PetSmart:

- **April 2015:** A PetSmart in Hermitage, TN was fined $1,000 for multiple safety violations,[54] including **violation of hazard communication program requirements,** which require employers to provide employees with effective warnings, information, and training about hazardous chemicals.[55]

- **March 2016:** PetSmart was fined $2,459 for a serious health and safety violation at a store in Traverse City, MI.[56]

- **August 2017:** A PetSmart in Vero Beach, FL was fined $5,432[57] for violating vermin control requirements.[58]

- **February 2018:** OSHA fined a PetSmart in Hyannis, MA $11,034[59] for **failure to provide a workplace free from recognized hazards that were causing or likely to cause death or serious physical harm where employees were exposed to hazards associated with dog attacks.**[60]

- **June 2019:** A PetSmart in Bangor, Maine was fined $41,676 for multiple, serious and repeat safety violations[61] including **violations of medical first aid requirements.**[62]

- **November 2020:** PetSmart was fined $9,535[63] for **not complying with Virginia's COVID-19 emergency temporary standard**[64] at a store in Woodbridge, VA.

- **February 2021:** PetSmart was fined $14,348 for multiple serious OSHA violations at a store in Williston, VT[65] including **improper hazard communications**[66] **and failure to keep records of workplace injuries, illnesses, and fatalities.**[67] This case is still open and fines are not final.

Many of the PetSmart associates we spoke to recounted working during the pandemic under conditions they feared put workers and animal welfare in jeopardy and expressed frustration that BC Partners has not addressed many of the problems employees raised in July 2020. In addition, the number of OSHA inspections conducted and complaints filed against PetSmart for violations of workplace safety standards[68] underscores the need for PetSmart to strengthen internal protocols and policies during the COVID-19 crisis and beyond. With the rise of new, more aggressive coronavirus variants, PetSmart associates have renewed concerns about their well-being at work and the health and safety of customers and pets under their care. As PetSmart's owner, BC Partners has a responsibility to ensure CDC and OSHA rules and recommendations are properly implemented and enforced across PetSmart's fleet of stores and that employees are provided compensation commensurate with the level of risk associated with working a public-facing job during a global pandemic.

Many of the PetSmart associates we spoke to recounted working during the pandemic under conditions they feared put workers and animal welfare in jeopardy and expressed frustration that BC Partners has not addressed many of the problems employees raised in July 2020.

OPERATIONAL MISMANAGEMENT IS COMPROMISING JOB QUALITY, PET & CUSTOMER CARE

As animal adoptions skyrocketed during the pandemic[69] PetSmart associates were faced with a surge in customer demand. Customers needed advice on how to care and provide for their new animals as well as a host of supplies and services. Instead of investing in the workforce by hiring more staff, increasing pay, or offering flexible emergency leave, BC Partners cut staffing positions as demand for pet adoptions and supplies was soaring.[70] PetSmart associates also faced a number of operational issues that made providing quality pet care and customer service challenging. Under staffing, supply shortages, broken or improperly repaired equipment, and other operational troubles made day to day work at PetSmart unnecessarily difficult for frontline employees.

Zoe, a pet stylist-in-training, who performs grooming services in Massachusetts, had to deal with ongoing flooding in their PetSmart salon. According to Zoe, "there was a straight month going back and forth between either the salon [where dogs are bathed] was flooding or the bathroom was flooding." To make matters worse Zoe's store had parasitic worms growing in the flooded drains.

In addition to flooding, Zoe's location had difficulties keeping temperatures in the salon within PetSmart's own temperature guidelines, which state that heat in salons should not exceed 80 degrees. Zoe reported working in strenuous conditions at temperatures above 80 degrees.

> ***"PetSmart is making huge profits and still doesn't want to put in the money to make needed repairs. They just do little band-aid fixes so the problems don't go away and we're stuck working in conditions that are not safe for us or the pets."***
> — Zoe, Pet Bather in Massachusetts

Additionally, Zoe said that PetSmart frequently ran out of specific shampoos and conditioners that were necessary to adequately perform their job. Malfunctioning equipment was rampant. The "Hydrosurge" bathing system at Zoe's location was

defective for months at a time, which meant bathers had to spend more time manually washing pets with their hands without the assistance of the expensive equipment customers had paid for.

Adrian, the bather who is training to become a groomer in Georgia, echoed Zoe's experiences. Adrian recounted how when they started working for PetSmart in late November 2020, their store location went without FURminator®'s dog shampoo and FURminator® deshedding solution for the entirety of the holiday season. PetSmart offers a specialized service for an additional charge that helps reduce the shedding of animals with specific coats utilizing FURminator®, but when their store ran out for several months PetSmart did not stop offering the service and associates were told to use a cheaper alternative because they "smelled similar."

> ***"With my morals, I would have told the customer that we are out of the FURminator® deshedding solution. Don't spend your money on it because it's so much more expensive to get a FURminator® bath than just a basic bath. People were paying for FURminator® baths but weren't getting what they were paying for because PetSmart was out of the product for months."*** — Adrian, Pet Bather in Georgia

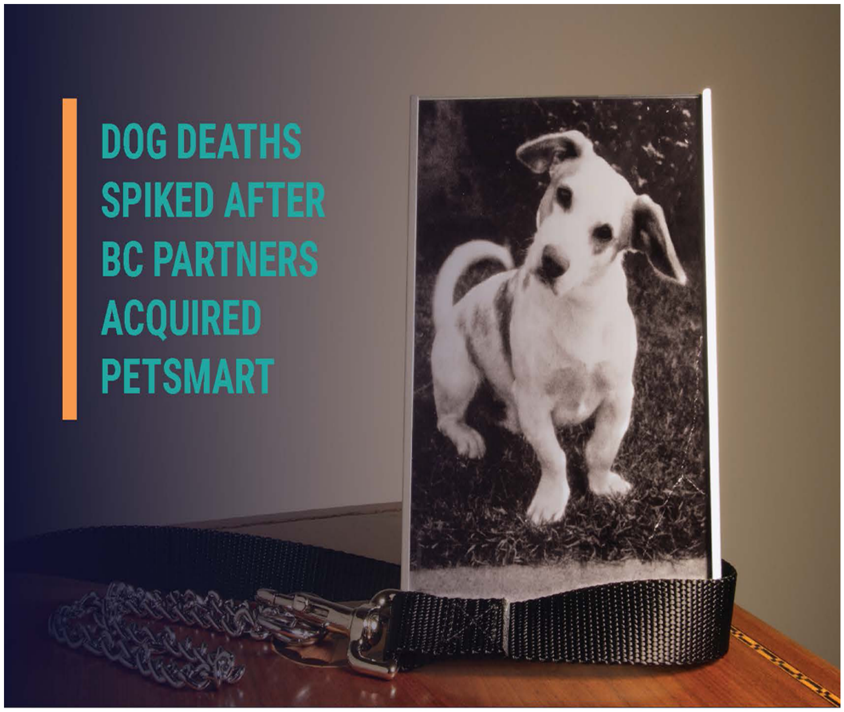
PetSmart associates in Crista's store in Texas have had to constantly deal with equipment that would go out of service for long periods without being repaired and a lack of basic supplies. In an interview, Crista shared how when specialty pet shampoos and conditioners ran out groomers were forced to resort to whatever supplies they had on hand - even if it was not the expensive product pet parents thought was being used.

In addition to supply shortages, Crista's store had clogged drains in the dog bathing area, which would cause a terrible odor and floors in the room where dogs were groomed had a persistent algae growth issue.

Adrian, Zoe, and Crista's experiences indicate that PetSmart customers may be paying for a service they did not receive.

PetSmart associates continue to express concern about the impact these operational issues have on customers and pets. As frontline employees they have a unique understanding of what is and is not working in their stores. Yet, BC Partners continues to ignore PetSmart associates' call for needed changes in stores across the country.

"With my morals, I would have told the customer that we are out of the FURminator® deshedding solution. Don't spend your money on it because it's so much more expensive to get a FURminator® bath than just a basic bath. People were paying for FURminator® baths but weren't getting what they were paying for because PetSmart was out of the product for months." — **Adrian, Pet Bather in Georgia**

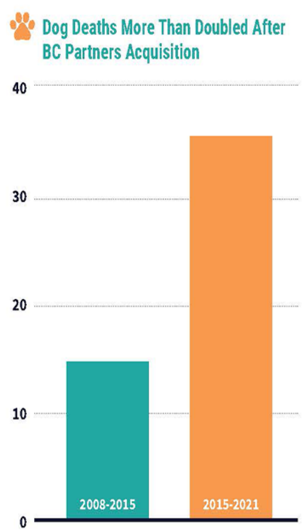


DOG DEATHS SPIKED AFTER BC PARTNERS ACQUIRED PETSMART

Since BC Partners acquired PetSmart in 2015, press reports show that dog deaths in PetSmart's care have more than doubled. A groundbreaking 6-month investigation entitled *"Groomed, then Gone: Dogs are dying after PetSmart visits and families struggle to understand why"* by **NJ Advance Media**, found that the deaths, which typically occur during or immediately after grooming services at PetSmart, *surged after private equity took possession of the firm in 2015.*

From 2008 to 2014 there were only 15 pet deaths nationally for the company, but from 2015 to 2018 in the first three years that BC Partners owned the retailer, that number surged to over 30 deaths.[71] In less than three years since the investigation, press reports show that an additional five dogs have died while in PetSmart custody or shortly thereafter, including a poodle that was **allegedly strangled while being groomed** and a bulldog that was **crushed under a PetSmart grooming table**.

PetSmart did not admit to wrongdoing in any of the deaths covered in the NJ Advance Media study, but the corporation has not been transparent and has refused to disclose the number of dog deaths in their custody - the true number of



dog deaths at PetSmart may actually be higher than those uncovered during the investigation.

Is Understaffing and Inadequate Training to Blame?

At the time of the NJ Advance Media report, they found that understaffing and under training might be factors that explain the high number of dog deaths in PetSmart's care:

> ***"Some former employees allege PetSmart's groomer training — which the company touts as the industry's very best — can fall short of what's advertised. They say they have seen unprepared trainees rushed into stores because of short-staffing, putting dogs at greater risk of injury." And, "...many [PetSmart employees] felt either ignored or retaliated against when they spoke up about safety concerns or wrongdoing by colleagues."***

More recently, in a 2020 incident, PetSmart admitted that inadequate training as the reason a Maltese-shih tzu mix named Winter nearly died. What began as a routine trip to the groomer for Winter, ended with the dog being rushed into emergency surgery to save her life.[72] In July 2020, Sherrilyn Miller took Winter to PetSmart for a run-of-the-mill bathing and grooming service, Miller then paid extra to have bows placed on her 2-year-old emotional support dog. The next day, Miller noticed Winter's behavior change, Winter was sluggish and liquid was oozing from her ears. Miller said, "her ears looked like black coal," in an interview with *Mercury News*. The pup was then rushed to emergency surgery in which a veterinarian would apply multiple punctures with an 18-gauge needle to the dog's ear. As stated by the vet, if another four hours passed, Winter could have lost her ears and in 24 hours, the dog could have been dead.

According to a press report inadequate training is to blame in the near-death of Winter: "A managing agent at PetSmart immediately admitted wrongdoing, saying that the employee was new and had undergone "expedited" training."[73]

In a separate May 2020 incident where a poodle by the name of Kobe was killed, a video surfaced showing the dog being asphyxiated by two leashes as he was having a routine nail clipping. "They used two separate leashes. One directly above the grooming table at a vertical angle, and the other leash was horizontal. So he's tethered in two different directions. They begin to clip his nails, and there's two of them and they're lifting him up in a way that he can't put his paws down on the table at all," Kobe's owner, AJ Ross, told *People Magazine*.[74] "It's horrific to watch and [after a minute] he goes limp. They never put his feet down until after he goes limp."

PetSmart terminated the employees involved in the incident, and in a statement said that the corporation's investigation found an *"...unintended failure to adhere to our pet safety processes"*[75] raising questions about the adequacy of training procedures. After her dog's death, Kobe's owner Ross asked to view PetSmart's grooming regulations, but according to press reports, PetSmart would only do so if she agreed to sign a nondisclosure agreement, which she refused to do.[76]

When lawmakers have sought to standardize groomer training by requiring licensing, they have often faced stiff opposition. According to New Jersey Assemblywoman Valerie Huttle: "So I think the pushback is about the profits ... I would think all of us that have pets would say pets over profits."[77]

PetSmart employees continue to describe the need to improve employee training. Happy, a Retail Sales Associate in Tennessee who worked his way up to become a Pet Training Associate and started working at PetSmart before the acquisition by BC Partners, said he has witnessed how training standards have deteriorated over time since the private equity firm acquired the company. According to Happy, "new [PetSmart] leadership seems to value its bottom

"Some former employees allege PetSmart's groomer training — which the company touts as the industry's very best — can fall short of what's advertised. They say they have seen unprepared trainees rushed into stores because of short-staffing, putting dogs at greater risk of injury." And, "...many [PetSmart employees] felt either ignored or retaliated against when they spoke up about safety concerns or wrongdoing by colleagues." **— NJ Advance Media report**

line over pet training and pet care." When he first started working at PetSmart prior to BC Partners' involvement, he underwent a meticulous training program that has since been "dumbed down" and he has seen older, experienced workers replaced by younger people who are paid a lower rate.

Adrian, a bather from Georgia who was recently accepted into PetSmart's Grooming Academy, also expressed concerns about PetSmart training protocols, stating that they didn't feel as "safety certified" as they could be because the initial training was so rushed and minimal. Oscar, a retail sales associate in Arizona, shared similar sentiment regarding lack of training, declaring, "they [PetSmart] never trained me how to properly deep clean the small animal enclosure. They just threw me at small animals because someone called out."

> ***"They [PetSmart after BC Partners' acquisition] dumbed down the curriculum and got rid of all of the older, more experienced, career-trained workers and hired young people at their new really low commission rate. I almost felt like a lot of what we were doing with dogs and their clients wasn't even relevant and certainly not considered best industry practices."***
> — Happy, Pet Training Associate in Tennessee

In addition to mistreatment of dogs, allegations of animal abuse have continued to add up since BC Partners acquired PetSmart:

- **Between January 2019 and March 2020, PetSmart was cited for more than 70 violations of Colorado's Pet Animal Care Facilities Act (PACFA),** "which requires the bare minimum standards of animal care," according to a review of state records by People for the Ethical Treatment of Animals (PETA). The violations occurred at 16 different PetSmart stores throughout the state.[78]

- **In 2018, police raided a PetSmart in Bellevue, TN** after allegations of animal neglect. According to a **Nashville news station**, "... Metro Health Department and Metro Animal Care and Control received information, photos and video detailing an alleged "lack of care" for animals at the store."

- **20 PetSmart stores in North Carolina were ordered to "improve conditions for animals in order to comply with the state's Animal Welfare Act"** according to **a review of records** from the North Carolina Department of Agriculture and Consumer Services (NCDA&CS) between June 2018 and February 2020 by PETA.

The 2018 NJ Advance Media investigative report highlighted a spike in dog deaths at PetSmart in the years following BC Partners' 2015 acquisition of the company. Since that report was published, more dogs have died under PetSmart's care and citations for animal neglect and abuse have piled up. PetSmart employees report many of the issues exposed in 2018 - understaffing, inadequate training, and poor in-store management- persist today. Ironically, in-store services like grooming and boarding are PetSmart's best hope for accessing the high-spend "pet parent" market currently driving the pet industry,[79] but these services can only be delivered by well-trained, well-paid employees working in safe, healthy conditions.

"They [PetSmart after BC Partners' acquisition] dumbed down the curriculum and got rid of all of the older, more experienced, career-trained workers and hired young people at their new really low commission rate. I almost felt like a lot of what we were doing with dogs and their clients wasn't even relevant and certainly not considered best industry practices."
— Happy, Pet Training Associate in Tennessee

MINIMAL FEDERAL & STATE OVERSIGHT OF THE PET INDUSTRY FURTHER JEOPARDIZES THE QUALITY OF PET CARE

A review of the federal and state legislative landscape for pet groomers and pet stores found no federal regulation or oversight of the industry, significant variation in the regulation of pet stores across the fifty states, and a complete absence of laws governing the licensing or certification of individual pet groomers.[80] *(See Appendix I for summary of state licensing regulations)*

State oversight and regulations that are in place vary widely. In some states the licensure required of pet stores amounts to little more than registration and a means of fee-collection, with no requirements for standards of care. For example, in Alabama and Alaska pet retailer licensing requirements are housed within the tax code. Pet stores are lumped together with other "miscellaneous store retailers" like florists, novelty, art, and tobacco retailers, and licensure comes with no regulation specific to the pet industry.[81] Delaware only regulates the boarding and selling of dogs. The states of Florida, Indiana, Montana, Washington, and Maryland devolve oversight of the pet industry to municipal governments.

Even states whose laws impose some standards of care on pet stores fail to regulate the services provided to pets - training, grooming, and boarding. Across the board, training and certification of individual pet groomers is an indication of technical skill that might make a groomer a more attractive hire, but not subject to any aptitude test or legal requirement. There is no regulation stopping a pet store from employing an untrained groomer or one whose grooming training took place entirely online without oversight.[82]

In the last decade, only six states - California, Massachusetts, New Jersey, New York, Pennsylvania, and Rhode Island - have attempted to regulate pet grooming. Nearly all proposed legislation was prompted by instances of pet injury or death during or shortly after grooming sessions.[83] All of the proposed legislation failed to become law.

The harmful impacts of private equity ownership are compounded by minimal oversight of the pet industry and the services pet retailers provide. Without stronger regulation of private equity and the pet industry as a whole, the responsibility for protecting animal welfare will be left to the pet industry's private equity owners who seem more interested in short-term gain than protecting the pets under their care.

> ***"So I think the pushback is about the profits … I would think all of us that have pets would say pets over profits." — NJ Assemblywoman Valerie Huttle***

CONCLUSION

Private equity ownership of PetSmart degrades working conditions and negatively impacts the quality of animal care at the largest pet retailer in the country. Sadly, it is PetSmart associates, customers, and pets who pay the price for BC Partners' extractive ownership practices.

As detailed above, under BC Partners' stewardship, PetSmart has not done enough to protect employees during the coronavirus pandemic, resulting in numerous occupational health and safety complaints. With the rise of new, more aggressive coronavirus variants PetSmart associates are once again concerned about their well-being at work and the health and safety of customers and pets under their care.

The operational management of PetSmart's fleet of stores has also suffered under BC Partners' ownership. Associates shared the difficulties and challenges of working without rigorous training, functioning equipment, or sufficient supplies. Those who had worked at PetSmart before private equity took over reported a marked deterioration of job quality and pet care standards.

Since BC Partners' 2015 acquisition, at least 36 dogs have died under PetSmart's care and citations for animal neglect and abuse have piled up. Despite several high-profile cases linked to poor or rushed training of new hires, PetSmart employees continue to report operational issues that hinder their ability to provide loving, professional pet care. According to the associates we spoke to, problems of understaffing, inadequate training, and poor in-store management persist today.

Minimal state and federal oversight of the pet industry - pet grooming in particular - further jeopardizes employees and animal welfare by leaving the pet industry and its private equity owners to define standards of care.

While the problems outlined in this report are serious, there is a path to making PetSmart a better place to work and a safer place for animals.

State policy makers can ensure pet service workers have access to rigorous training and certification programs that prepare them to provide safe, quality pet care. They can also impose reporting requirements on pet specialty retailers, empower state agencies to investigate pet deaths and injuries, and prohibit pet specialty retailers from entering into non-disclosure agreements with customers.

Federal policy makers have an opportunity to reign in private equity mismanagement and excess, and to support frontline employees who speak out about animal neglect and unsafe working conditions. The Stop Wall Street Looting Act will restrict private equity's ability to saddle acquired companies with debt and extract fees and dividends which deprives companies of assets needed to remain competitive.[84] The Protecting the Right to Organize Act will ensure workers can push for workplace changes without fear of retaliation.[85]

Ultimately the responsibility to protect employees, create quality jobs, and ensure the provision of exceptional animal care at PetSmart falls to BC Partners. As the owners of the largest pet specialty retailer in the United States, BC Partners must prioritize petcare and the people working in their stores over short-term profits.

This report offers a series of recommendations for BC Partners and public policy makers.

KEY RECOMMENDATIONS

Private equity owners of pet specialty retailers have a responsibility to protect employees and public health, create quality jobs, and ensure the provision of exceptional pet care.

To protect frontline employees and pets, BC Partners must guarantee:

- **Quality Jobs for All Frontline Employees**
  Guaranteed $15 minimum wage, fair scheduling, access to full-time hours, a safe work environment, and a $5/hour essential pay increase.

- **Healthcare for All**
  Provide quality employer-paid healthcare and cover premiums for all employees, including part-timers.

- **Pet Care Over Profit**
  Provide employees with functioning equipment, proper supplies, and adequate staffing and training that prepares employees to give animals the caring services they deserve.

- **Job Protections**
  Establish a severance policy for all employees in the event of bankruptcy or change of ownership that would result in layoffs, with at least one week of pay per year of employment and two weeks minimum. Any layoffs should be done in order of reverse seniority and employees should get at least 90 days' notice.

- **Worker Representation on the Board of Directors**
  Frontline employees should have input into corporate policies that directly impact them and the pets they care for. Pet care professionals bring unique knowledge and perspectives that are essential to the provision of exceptional pet care and customer service as well as the long-term competitiveness of PetSmart.

Federal policy makers must reign in private equity excess and protect employees who organize to improve their working conditions:

- Pass the **Stop Wall Street Looting Act** to protect workers, communities, and businesses from private equity extraction and excess. Private equity executives pay themselves fees for nonexistent services and quickly convert the assets of acquired companies into dividends for the private equity firm. This leaves the companies without resources to invest in sustaining and growing their businesses, or paying workers fairly.

- Pass the **Protecting the Right to Organize Act** to remove obstacles that impede workers from exercising their rights to improve their livelihoods and working conditions. Defending these rights is crucial to lessening the plight of economic inequality, as it allows workers to collectively come together and fight for dignified wages, adequate benefits, proper health and safety on the job, and balancing the power between workers and their employers.

State policy makers must protect pet store workers and regulate pet specialty retailers:

- Ensure pet service workers have access to **rigorous training and certification programs** that prepare them to provide safe, quality pet care.

- Require pet speciality stores to **report instances of pet death and injury**, empower a State Agency to **investigate these incidents,** and **prohibit** pet speciality retailers from entering into **non-disclosure agreements with customers.**

- Encourage pet service workers to **report unsafe working conditions** and company practices and policies that can seriously injure animals under their care.

NOTES ON METHODOLOGY

In July 2020, 550 current and former PetSmart employees wrote to BC Partners about unsafe conditions in stores including insufficient personal protective equipment, lax enforcement of social distancing protocols, and a refusal to provide severance pay to laid off employees or hazard pay to those who continued to work.

United for Respect interviewed 25 current and former PetSmart employees between April 2020 and July 2021 about their experiences and concerns while working at PetSmart. Tenure with PetSmart varied from between 4 months to over 10 years among associates whose experiences are highlighted in this report.

Associates we spoke to represented varied job classifications including:

- **Pet Stylist (groomer):** responsible for helping customers select grooming packages, cleaning the pet's teeth, trimming the pet's nails, and cutting the pet's hair.[86] Pet Stylists work in close proximity to bathers in the salons.

- **Pet Stylist Apprentice (bather):** prepare pets for bathing, nail trimming, teeth brushing, and perform assessments of pets (HOP) before their service.[87] Pet Stylist Apprentices work in close proximity to Pet Stylists (groomers) in the salons as this is the first of 4 steps to becoming a fully certified groomer within PetSmart's internal structure.[88]

- **Petcare Associate:** oversee and care for all living pets in stores (fish, reptiles, birds, small animals). They help clean, feed, and keep pets healthy.[89]

- **Retail Sales Associate:** provide numerous services to PetSmart including expediting the check out process as a cashier, providing pet care to all living pets in stores (fish, reptiles, birds, and other small animals), and are responsible for merchandising, inventory, and stocking goods.[90]

- **Pet Hotel Associate:** interact directly with the pets - playing with them during Doggie Day Camp and ensuring they get exercise and food. Night shift associates take care of pets throughout their overnight stay — providing food and medication, and, occasionally, a bedtime story.[91]

We calculated the number of pet deaths at PetSmart post BC Partners acquisition by using the NJ Advance Media investigative report[92] findings (32) as a base but subtracted the Danielle DiNapoli/Scruffles incident due to an ultimately successful defamation lawsuit brought by PetSmart and Ms. DiNapoli's subsequent retraction, bringing the total number of deaths between 2015 and 2108 to thirty-one (31).[93] We then conducted a Lexis-Nexis news and litigation search to identify any instances that occurred after September 2018 and found documentation of five additional deaths of dogs while under PetSmart's care or shortly after the service was provided, bringing the updated total to thirty-six (36). Note, PetSmart has refused to disclose the number of dogs that have died in their care, the true number may be much higher.

The five additional deaths we identified are listed below:

- 10/29/18 - A mastiff broke free from its kennel in the grooming salon and attacked and killed another dog in Illinois.[94]
- 11/25/18 - Thomas Cunningham brought his English Bulldog, Trinity, into PetSmart and shortly after her grooming service she passed away.[95]
- 2/14/19 - Darren Harris lost his English Bulldog, Enzo, shortly after a grooming service.[96]
- 12/26/19 - Vikki Seifert lost her Bulldog, Minnie, who was crushed under a table during a grooming service.[97]
- 5/13/21 - Aj Ross lost her toy poodle, Kobe, after a grooming service went wrong.[98]

Similarly, our analysis of the federal and state regulatory landscape for pet grooming and pet speciality stores is based on Lexis-Nexis and other research conducted in July 2021 that captured federal and state legislation.

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APPENDIX I: DETAILED SUMMARY OF STATE REGULATION OF PET RETAILERS AND GROOMERS

State	Individual Groomer Legal Requirements		Retailer Legal Requirements		Proposed Legislation
	License Required?	Certification?	Pet Store-Specific License Required?	Standards Imposed	
AL	None	None	No, only for tax **AL Code 11-51-90.2 (Section 453)**	None	-
AK	-	-	No, only for tax **AS 43.70.020(a)**	-	-
AZ	-	-	Yes	**AZ ST §44-1799**. Defines a pet dealer as one who owns a pet store, and regulates pet dealers' responsibility to provide sanitary housing conditions, water and nutrition, adequate space, decent flooring, veterinary care where necessary. Prevents sale of cats/dogs younger than 8 weeks.	-
AK	-	-	Yes	**AK Code 4.97.104-109**. Retailers must register with the State Board of Health. Any authorized person is entitled to inspect the premises, failure to make premises or records available to an authorized person is a Class A misdemeanor. Every retail pet store required to be registered shall post a public notice on each of its premises, failure to post notice is a Class A misdemeanor. It is unlawful for a retail pet store to knowingly give, sell, exchange, barter, or otherwise transfer an animal to any other person if the ultimate destination of the animal is research or killing for dissection punishable as a Class A misdemeanor.	-
CA	-	-	Yes	**CA Health and Safety Code Section 122125 - 122220** (Lockyer-Polanco-Farr Pet Protection Act). Retailers are to examine dogs and cats received for sickness and cage contagious animals separately. Encourages pet dealers to offer customers incentives to use spaying and neutering services. Retailers must give customers a standardized receipt on sale including information on their pet's breeding, immunizations, health statement signed by a veterinarian, etc. Pet dealers must maintain a written record on status and health of pet for one year after sale. Violation of any of the above is subject to a civil penalty of up to $1000 per violation. Must provide animals with adequate sanitation, water, nutrition, shelter, comfort, exercise, and socialization. Provides for consumer protection in the event that a customer discovers that their purchased animal was already sick before the sale.	2012: **SB 969 Pet Grooming Act (Failed)** Would have required groomers to complete 900 hours of training for a voluntary state certification.

State	Individual Groomer Legal Requirements		Retailer Legal Requirements		Proposed Legislation
	License Required?	Certification?	Pet Store-Specific License Required?	Standards Imposed	
CO	-	-	Yes	Individual groomers do not need a license, but many pet service facilities require a license, including pet grooming facilities, under Code of Colorado Regulations 8 CCR 1202-15 ($320 for Pet Grooming facility). **PACFA, the Pet and Animal Care Facilities Act**, extensively governs all facilities that provide pet services, including pet retailers. Persons providing any of the following services exclusively do not require licensure with PACFA: dog and cat nail trims, pet animal oral hygiene, pet animal ear cleaning, or pet animal anal gland expression. Licensure involves a fee and application, but licensed businesses are subject to inspection and disciplinary measures should they violate any PACFA clauses. Complaints against pet facilities can be submitted to PACFA by the public.	-
CT	-	-	Yes	**The General Statutes of Connecticut Chapter 435 Section 22-344c** govern all pet facilities, which must be licensed, including pet stores/ retailers. The standards to which pet stores are held are listed in the Department of Agriculture's Regulations **Section 22-344-16a to 25c**, covering structural standards, standards for enclosures, temperature, animal health, lighting, prohibited sales, and recordkeeping.	-
DE	-	-	Yes, for sale of dogs specifically	Under **Title 16 Chapter 30F Subtitle IV** of the Delaware Code, retail dog outlet owners must apply for a license from the state on an annual basis. Section § 3044F also stipulates the standards to which these stores will be held, including standards for housing, tethering, feeding, and compatible grouping.	-
FL	-	-	No	Florida Statute **FL ST §828.28** devolves responsibility for licensure to county/ municipality level. **FL ST §828.29** governs the sale and transport of dogs and cats specifically. The regulations work to provide a health guarantee of the pets sold, and protections in the event that a customer is sold an unhealthy pet.	-
GA	-	-	Yes	Animal facilities are governed by Georgia's **Animal Protection Act** and its **attached regulations**. These regulations include standards for the operator's premises, disease control. Pet dealers must receive a license to operate, with the attached fee varying from $100 to $400 with volume of sales. Once licensed, dealers are subject to inspection at any time, and disciplinary penalties in the case of violation of the act.	-
HI	-	-	No	-	-
IL	-	-	Yes	Under Illinois' **Animal Welfare Act**, pet care facilities, including pet stores, must apply for a license from the state. The act governs the recordkeeping practices, sanitary conditions, ventilation, nutrition, and disease prevention requirements for licensees. The specific standards for premises and care are found in sections **25.20** and **25.30**.	-

State	Individual Groomer Legal Requirements		Retailer Legal Requirements		Proposed Legislation
	License Required?	Certification?	Pet Store-Specific License Required?	Standards Imposed	
ID	-	-	No	-	-
IN	-	-	No	None. **Regulation of pet stores falls under local city/county law.**	-
IA	-	-	Yes	Pet shops require a $175 license to operate in Iowa. Iowa Code **Chapter 162** the standard of care for pets, inspection of licensees, and disciplinary actions for pet stores (and other commercial establishments that deal in pets). Under IA ST §552B.1-8, an animal broker must be registered with the States. A broker may not sell an animal unless the animal has been examined by a licensed veterinarian. Brokers must also display a statement of buyer's rights in their establishment. Violations of this Act punishable as a civil penalty of up to $1,000.	-
KS	-	-	Yes	The **Pet Animal Act** requires pet stores to have a state license to operate, and also requires licensees to adhere to **Article 18's** regulations on animal facilities, which cover license fees ($600 for a pet store), recordkeeping, inspections of premises, housing and enclosure standards, sanitation, feeding, exercise, and grouping.	-
KY	-	-	No	-	-
LA	-	-	No	Louisiana **Revised Statute 3:2511** regulate retail stores' sourcing of pets from breeders, the minimum age of cats/dogs sold, and the recordkeeping/presentation of information on the breed of the animals for sale.	-
ME	-	-	Yes	Maine **Revised Statute Chapter 745 §4163** requires pet stores to apply for a vendor's license ($150). Chapter 745 generally governs the sale of dogs and cats, and Chapter 739 generally governs animal welfare and the conditions of housing, sustenance, etc for owned/confined animals, but there is no specific law governing the conditions in a pet store.	-
MD	-	-	No	There is no state-level licensing of pet retailers, and it appears to be devolved to the **municipal level**.	-
MA	-	-	Yes	**Chapter 129, Section 39A** of Massachusetts General Law requires every pet store to be licensed by the state. The specific regulations on animal care, facilities, quarantine, isolation, and recordkeeping are stipulated in **330 CMR 12**	State Representative Carlos Gonzalez plans to draft new legislation **this December** that builds on former State House Representative Cheryl Coakley-Rivera's 2013 bill. Coakley-Rivera pushed for regulatory controls over the pet grooming industry **in 2013**. Coakley-Rivera's bill included a list of more than 50 regulations that included licensing requirements, yearly inspections of grooming facilities, and restrictions of the use of cage or box dryers, where heaters are used to dry a dog's coat while crated.

State	Individual Groomer Legal Requirements		Retailer Legal Requirements		Proposed Legislation
	License Required?	Certification?	Pet Store-Specific License Required?	Standards Imposed	
MI	Depending on the type of product used, pet groomers must have a **domestic animal pest management license** if they provide flea baths for clients.	-	Yes	**MCL 287.334** requires pet stores to be licensed, and **287.355** requires the director of agriculture to inspect the premises before approving the license, with **287.355a** stipulating the prohibited conduct for a pet store.	-
MN	-	-		Minnesota Statutes **ST §346.35-44** govern animal welfare in commercial animal facilities. Pet retailers would fall under their **definition of a kennel**. Following application for a license, the kennel **must be inspected** by the Board of Animal Health, to ensure that they conform to the regulations for animal health laid out in **Chapter 1721** of the Minnesota Administrative Rules.	-
MS	-	-	No	-	**MS SB 2206** was introduced in 2017 but died in committee. It would created a license requirement for kennels, stables, and animal shelters.
MO	-	-	Yes	**Missouri Statute 273.327** requires pet stores to apply for licensure. Licensees are then required to adhere to the stipulations of the **Rules of Department of Agriculture 2 CSR 30-9.010 to 9.030.**	-
MT	-	-	No	**Local city and county offices provide all business licensing in Montana.**	-
NE	-	-	Yes	**Nebraska Revised Statute 54-627** requires pet stores to be licensed by the state, which will only be approved with a qualifying inspection, and all licensees will be inspected at least once in a 24-month period. The full regulations governing these inspections and standards are stipulated in the Nebraska Administrative **Code Title 23, Chapter 18** (Commercial Dog and Cat Operator Inspection Regulations).	-
NV	-	-	Yes	Nevada Revised Statutes Chapter **NRS 574.450-510** governs pet retailers, and **NRS 574.360-440** govern the duties of all pet facility operators to maintain acceptable standards on their premises.	-
NH	-	-	Yes	New Hampshire Revised Statutes **Chapter 437:1-10** governs pet stores, and requires that they be licensed with the state. License applications will only be approved with a satisfactory qualifying inspection. The **specific regulations governing the inspection** are stipulated in the New Hampshire Administrative Rules **Agr 1704**.	**NH HB376** was introduced and died in chamber in 2020. It would have established a committee to study best practices for companion animal groomers.
NJ	-	-	Yes	New Jersey Statutes **4:19-15.8 and 9** require that pet shops be licensed ($10 annually). The specific regulations around the operation of animal facilities are stipulated in **Chapter 23A** of the New Jersey Administrative Code.	**NJ A3044** was introduced and died in committee in 2018. It would have provided and required a system for licensing pet groomers.

State	Individual Groomer Legal Requirements		Retailer Legal Requirements		Proposed Legislation
	License Required?	Certification?	Pet Store-Specific License Required?	Standards Imposed	
NM	-	-	No	New Mexico title **19:30.9.6** established eligibility and application requirements for vendors specializing in the sale of wildlife. Commercial pet stores are required to submit an **importation application** and pay a specific fee depending on the amount of non-domesticated animals sold.	-
NY	-	-	Yes	**Article 26-A** of the New York's Consolidated Laws governs the care of animals by pet dealers, which includes pet stores. Section 403 mandates that pet stores must be licensed, and the other sections of 26-A stipulate the standards of care required of pet stores. Section **403 point 6** explicitly states that a satisfactory inspection must precede the issuance of a license.	**S1569A** was introduced in 2017 and was referred to consumer protection. It would require the registration and certification of pet groomers.
NC	-	-	Yes	North Carolina General Statute **§ 19A-27** requires pet shops to be licensed for $75. The standards of care for pet shops are stipulated in the North Carolina **Animal Welfare Administrative Code**.	-
ND	-	-	No	**North Dakota Century Code Chapter 36-21.2** governs the treatment of animals generally, but the state does not appear to have any specific regulation on pet stores.	-
OH	-	-	Yes	Ohio Revised Code **Title 9 Section 956.21** requires pet stores to be licensed. Ohio Administrative Code **901:1-8** stipulates recordkeeping, licensing, and identification requirements for these licensees, but there does not appear to be any requirements for standards of care in these facilities	-
OK	-	-	No	Regulation and licensure of pet stores appears to be devolved to the municipal level, as in the example of **Okmulgee**.	-
PA	-	-	Yes	Pet stores are defined as kennels in Pennsylvania, and are therefore **required to be licensed** by Act 119, passed in 2008. **Act 119** also specifies the standards of care that kennels must maintain to retain their license.	**HB 2194** was introduced and referred to professional licensure in 2005. It would have provided a board for the licensure and regulation of pet groomers.
RI	-	-	Yes	Rhode Island statute **4-19** governs animal care, and **4-19-5** specifically requires that pet shops be licensed. Rhode Island's **Rules and Regulations Governing Animal Care Facilities** specify the standards of care that kennels must maintain to retain their license.	**HB 7609** was introduced and **died in committee** in 2018. It would have established the registration of pet groomers and grooming facilities. **HB 6504** was introduced in 2017. It would have required pet grooming facilities to be licensed by the state.
SC	-	-	No	-	-
SD	-	-	No	-	-
TN	-	-	Yes	Tennessee Code defines pet stores that sell dogs/cats as dog and cat dealers, which are governed by **Tennessee Code 44-17-101 to 122**. As such, they must be licensed by the state. The **Rules of the Tennessee Department of Agriculture** provide more detail on requirements of licensees, who must pass an inspection before a license can be issued. For the specific standards of care expected of dog dealers, the Rules defer to federal standards stipulated in **9 CFR part 3**.	-

State	Individual Groomer Legal Requirements		Retailer Legal Requirements		Proposed Legislation
	License Required?	Certification?	Pet Store-Specific License Required?	Standards Imposed	
TX	-	-	No	Regulation and licensure of pet stores appears to be devolved to the municipal level, as in the example of **Harris County**.	-
UT	-	-	No	-	-
VT	-	-	Yes	Vermont Statute 2**0 V.S.A. § 3906** requires pet stores to be licensed by the state for $175. Vermont's **Animal Welfare Regulations** specify the standards of care that kennels must maintain to retain their license.	-
VA	-	-	Yes	**SB 891**, just signed in 2020, requires pet shops to be registered with the state, and requires at least one annual, unannounced inspection of each pet shop. Code of Virginia Chapter 65 **Article § 3.2-6511** requires that pet shops provide adequate care.	-
WA	-	-	No	Regulation and licensure of pet stores appears to be devolved to the municipal level, as in the example of **Thurston County**.	-
WV	-	-	No	West Virginia Code **§19-20-3** requires every kennel (wherein dogs are bred, kept, boarded or sold as a commercial venture for profit) to be registered with the state. Code does not appear to stipulate any standards or responsibilities of care for kennels.	-
WI	-	-	Yes	Pet stores that offer to sell at least 25 dogs must be licensed according to Wisconsin Statute **173.41**. The regulations that apply to licensees are stipulated in Administrative Code Chapter **ATCP 16**.	-
WY	-	-	No	-	-

UNITED for RESPECT

united4respect.org
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LETTERS SUBMITTED IN OPPOSITION TO THE STOP WALL STREET LOOTING ACT

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE VICE PRESIDENT

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October 20, 2021

The Honorable Sherrod Brown
Chair
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Brown and Ranking Member Toomey:

The U.S. Chamber of Commerce strongly opposes the "Stop Wall Street Looting Act," which may be subject to discussion during an October 20 subcommittee hearing. This legislation would punitively target the private equity segment of the financial services sector that we believe is vital to the American economy.

Private equity firms make long-term investments in companies poised for growth as well as undervalued or underperforming businesses, and the private equity funds created by such firms invest in various companies throughout the economy are often backed by capital from institutional investors, including public pension funds. Private equity 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.

The "Stop Wall Street Looting Act" would make it extremely difficult, if not impossible, for private equity to continue its productive contributions to the American economy via their investments in main street businesses. The legislation would require investors to assume new financial liabilities, ban dividends to investors, change bankruptcy law, and institute other restrictions such as increasing taxes on carried interest capital gains that would prevent private equity funds from investing in job creation.[1]

The Chamber released a report in 2019 entitled, "Economic Impact Analysis of the Stop Wall Street Looting Act,"[2] which found that if this legislation were enacted it would result in:

- The loss of between 6.2 million to 26.3 million jobs across the U.S.

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[1] Swenson, C. (Fall 2021). The U.S. Chamber of Commerce. https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/09/CCMC_-Impact-On-Jobs-Tax-Revenue-And-Economic-Growth-Of-Proposed-Tax-Increase-On-Carried-Interest-9.5.21.pdf

[2] Swenson, C. (November 12, 2019). Economic Impact Analysis of the Stop Wall Street Looting Act. The U.S. Chamber of Commerce. https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/11/Swenson-Chamber-Economic-Impact-Analysis-Report-Stop-Wall-Street-Looting-Act-FINAL-002.pdf

- The loss of a combined $109 billion to $475 billion annually in tax revenues across federal, state, and local governments.
- The loss by public pension funds of at least $329 million (and possibly up to $1.65 billion) annually that would be caused by switching to lower-yielding investments.
- The loss for investors of $671 million to $3.36 billion per year.
- The potential elimination of the private equity industry as a result of increased risk, taxes, and restrictions.
- The failure or downsizing of many firms which normally seek private equity financing that would now be unable to find financing.

Legislation like the "Stop Wall Street Looting Act," and the various restrictions on investments it proposes, would undoubtedly be extremely damaging to main street businesses. We thank you for considering our views and look forward to working with the Committee on issues regarding the contributions of private funds to the U.S. economy.

Sincerely,

Tom Quaadman

cc: Members of the Senate Committee on Banking, Housing, and Urban Affairs

October 19, 2021

The Honorable Elizabeth Warren
United States Senate
309 Hart Senate Office Building
Washington, DC 20510

The Honorable John Kennedy
United States Senate
416 Russell Senate Office Building
Washington, DC 20510

Dear Senators Warren & Kennedy,

We are writing to express our concern about the upcoming hearing in the Senate Banking Economic Policy Subcommittee titled "Protecting Companies and Communities from Private Equity." More specifically, we are strongly opposed to legislation like Senator Warren's *Stop Wall Street Looting Act*, which would increase taxes, stifle private investment, eliminate jobs, and threaten the life savings of Americans across the country. We urge the Committee to reject this legislation and any similar legislation that would harm workers, retirees, and pensioners.

It appears that Senator Warren is using this subcommittee hearing as an opportunity to reintroduce and highlight her *Stop Wall Street Looting Act,* a dangerous bill that could crush thousands of businesses at a time when the economy is still trying to recover from the COVID-19 pandemic. The bill is concerning for a number of reasons:

- **Tax increases on investment**: By sharply raising taxes on long-term capital gains, the bill would dampen returns of universities, startup ventures, and pensioners. Raising taxes on carried interest is part of a long-running campaign by some to raise taxes on all capital gains investment. A recent study found that raising taxes on carried interest could eliminate up to 4.9 million jobs and cost pension funds up to $3 billion per year. The bill also creates a 100% surtax on certain fees and denies legitimate interest deductions for disfavored private companies.

- **Imposes new mandates:** The bill penalizes private investment based entirely on the ownership structure of the underlying businesses. The legislation would impose new and onerous legal liabilities on private investors and managers that do not exist for other investors, including through a radical rewrite of the bankruptcy code. These liabilities would make it exceedingly difficult to invest in struggling businesses.

- **Penalizes workers & retirees:** These new regulations would make it harder for pension funds to generate stronger returns for the teachers, fire fighters and public-sector workers whose retirements depend on the performance of these investments. The bill could also cost investors as much as $3.36 billion each year, with almost half of the loss accruing to pension fund retirees.

- **Eliminates jobs:** Senator Warren's legislation would erase anywhere from 6 to 26 million jobs from the American economy and reduce federal, state and local tax revenue by as much as $475 billion each year, according to a study by the United States Chamber of Commerce.

As we have seen time and time again throughout history, when you tax and overregulate an activity, you get less of it. Unfortunately for workers and retirees across the country, the result of the Stop Wall Street Looting Act would hurt the livelihoods of the 11.7 million workers directly employed by private equity-backed companies.

In 2019, when Senator Warren introduced the *Stop Wall Street Looting Act,* the Wall Street Journal noted that "every policy she proposes would increase government control over the private economy." Unfortunately, the newest version of the bill stays the course. Instead of attacking private sector employers with legislation like the *Stop Wall Street Looting Act*, we urge the Subcommittee to focus on solutions that will empower workers.

Sincerely,

Grover Norquist
President, Americans for Tax Reform

Phil Kerpen
President, American Commitment

Krisztina Pusok, Ph. D.
Director, American Consumer Institute

Brent Wm. Gardner
Chief Government Affairs Officer, Americans for Prosperity

Ryan Ellis
President, Center for a Free Economy

Andrew F. Quinlan
President, Center for Freedom and Prosperity

Jeffrey Mazzella
President, Center for Individual Freedom

Tom Schatz
President, Council for Citizens Against Government Waste

Iain Murray
Vice President, Competitive Enterprise Institute

Matthew Kandrach
President, Consumer Action for a Strong Economy

Adam Brandon
President, FreedomWorks

Garrett Bess
Vice President, Heritage Action for America

George Landrith
President, Frontiers of Freedom

Andrew Langer
President, Institute for Liberty

Seton Motley
President, Less Government

Tom Hebert
Executive Director, Open Competition Center

Bryan Bashur
Executive Director, Shareholder Advocacy Forum

Saulius "Saul" Anuzis
President, 60 Plus Association

Jim Martin
Founder/Chairman, 60 Plus Association

Karen Kerrigan
President & CEO, Small Business & Entrepreneurship Council

David Williams
President, Taxpayers Protection Alliance

CC: Full Senate Banking Committee

NATIONAL TAXPAYERS UNION

October 19, 2021

The Honorable Elizabeth Warren
Chair, Subcommittee on Economic Policy
Senate Banking Committee
Washington, DC 20510

The Honorable John Kennedy
Ranking Member, Subcommittee on Economic Policy
Senate Banking Committee
Washington, DC 20510

Dear Chair Warren, Ranking Member Kennedy, and Members of the Subcommittee,

On behalf of the National Taxpayers Union, the nation's oldest taxpayer advocacy organization, I write to express our views ahead of an October 20 hearing titled "Protecting Companies and Communities from Private Equity Abuse" that will be before your subcommittee. NTU is concerned that this hearing will be used to push a big government agenda that could have significant consequences on the American economy and target a specific industry with punitive measures. As will be mentioned below, there are many reasons to resist the opportunity to impose additional regulatory and tax burdens onto American businesses and investors. We therefore urge you to stand with taxpayers by supporting free market policies that create wealth and prosperity for all.

Reports indicate that this hearing could be used as a platform for the reintroduction of the deeply-flawed "Stop Wall Street Looting Act." While the final details of this year's version of the legislation are not certain, it is expected to be similar to the previous iteration. Based on the last version of the bill, its introduction would be problematic for taxpayers and the American economy as it is likely to retain provisions to increase taxes and add more regulations onto private equity companies. We fear passage of this legislation would suppress private sector investment, hurt workers, and threaten the ability of companies to save businesses on the brink of failure. Together these effects would have negative consequences and could stunt America's economic recovery from the COVID-19 pandemic, which is already in an uncertain position.

As it relates to federal tax policy, this bill includes many dubious sections that would harm our overall competitiveness. Most problematic is the modification of the long-standing tax treatment of carried interest, which is the share of long-term profits that flow to investment managers who partner with investors. For over a century, the federal government has recognized carried interest as investment income, rather than wage income. As a result of this differing classification, any income derived from carried interest is treated as a capital gain instead of being taxed at ordinary income tax rates. Like other sources of investment income, carried interest is subject to more favorable tax treatment, with a top rate of 20 percent, compared to the top individual income tax rate of 37 percent.

Yet, the Stop Wall Street Looting Act would treat carried interest as ordinary income, which for some, could be a near doubling of their tax liability. As NTU noted in May, "this tax structure has allowed partnerships of entrepreneurs and investors to funnel capital into startups and construction. Those seeking to raise taxes claim this legislation would 'close a tax loophole.' This is false. As a 2017 letter from 22 Members of Congress aptly points out, "the classification of carried interest as capital gains is the correct one."

Additionally, the bill applies a 100 percent surtax on certain fees paid by target firms to private fund managers. A 100 percent tax rate is punitive and confiscatory. Separate provisions amend the amount of interest some funds are permitted to deduct on their tax liability. Certainly, the ideal tax structure would have a low rate and include no special provisions, but this legislation is an overall net tax increase without commensurate reductions to the capital gains tax rate.

On the regulatory side, the bill would hold private equity firms liable for all debts, legal judgments, and pension obligations of their portfolio companies - a concerning and unprecedented step. Further, it would effectively rewrite bankruptcy law with new rules and regulations when a private equity-owned company goes bankrupt. Section 302 adjusts the priority structure for creditor payments by reclassifying severance and employee benefit plans as administrative expenses.

While the aim of the bill is to force "Wall Street bigs" to pay a higher rate, the tax increase would ultimately be passed on to middle-class investors. Funds would simply pass along these higher expenses in the form of higher service charges to their clients, which could suppress realized returns. In some cases, the additional regulatory burdens would make it prohibitive for private equity to invest in solutions to turn businesses around. The irony is that without cash injections from private equity companies, many businesses would fail sooner, leaving employees out in the cold.

Supporters of the Stop Wall Street Looting Act may characterize private equity investments into failing companies as "legal looting," but these legitimate investments are a key part of a free functioning society. Private equity can help Main Street companies return to profitability and retain as many employees as possible. In fact, a 2019 piece by the *Wall Street Journal* Editorial Board sums up the role of private equity perfectly, they write, "private-equity firms make long-term investments in underperforming companies and aim to create value - and turn a profit - by fixing inefficiencies."

Thank you for considering our viewpoints on this critical issue. Should you have any questions, we stand ready to work with you.

Sincerely,

Thomas Aiello
Director of Federal Affairs