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U.S. House of Representatives Committee on Financial Services

“America for Sale? An Examination of the Practices of Public Funds.”

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*In the way of introduction, I am co-chair of the Task Force on Jobs Creation and a member of the Council on Foreign Relations. Formerly the CEO of AT&T Broadband and its predecessor, Tele-Communications, Inc. (TCI), I am currently an investor in media properties and the Chairman and CEO of a NYSE-traded SPAC. In the course of my career I have started and overseen seven private equity (PE) funds.*

If you look at our economy only from 30,000 feet, it’s easy to believe that we’re living in boom times.

But if you get closer to the ground, where too many good jobs are being replaced by precarious ones, where large-scale employers waver at the brink of going under, and where profits overwhelmingly go to the wealthy, you can see a practice escalating across the economy, a practice that has already had disastrous effects on workers generally and that has the potential to take down hundreds of thousands more jobs and put investors and consumers alike in jeopardy.

That practice is the unchecked and reckless overuse of heavy burdens of debt, and then of bankruptcy laws, by some PE firms and hedge funds to the overwhelming detriment of employees and retirees.

Particularly devastated has been America’s retail sector where “hedge funds and retailers don’t mix” (*Wall Street Journal*, August 7, 2019, <https://www.wsj.com/articles/riches-to-rags-hedge-funds-and-retailers-dont-mix-11565175602?mod=searchresults&page=3&pos=9>). According to the *Washington Post* (July 24, 2019, <https://www.washingtonpost.com/business/2019/07/24/private-equitys-role-retail-has-decimated-million-jobs-study-says/> ), “More than 1.3 million Americans have lost their jobs in the past decade as a result of private equity ownership in retail. That includes 600,000 retail workers, as well as 728,000 employees in related industries…Women and people of color have been disproportionately affected by the layoffs as debt-ridden retailers closed thousands of stores, according to the report by six progressive nonprofit organizations and workers’ advocacy groups, including Americans for Financial Reform and the Center for Popular Democracy.”

All of this is why we need to pay attention to proposals in Congress that would curtail the threat which financial predators pose and remove the incentives for them to further harm our economy and American workers. These proposals would also eliminate a tax abuse I have written against numerous times, namely, the pernicious ‘carried interest tax loophole’.

Though the existence of private equity firms and hedge funds is taken for granted today, I’m long enough in my career to remember when the PE boom took off in the mid-1980s.

Before the fictional Gordon Gekko and his maxim that “greed is good,” things worked differently. Private equity investors had a specialization that they focused on, and when they invested, they invested for the long term usually with reasonable amounts of debt leverage.

It was a different time.

It was before hundreds of thousands of workers across the retail sector lost their jobs as retailer after storied retailer closed their doors, crushed by the debt that some PE firms and hedge funds imposed on them.

It was before some PE firms and hedge funds began taking over nursing homes and major hospital systems and cutting costs to in order to turn a quick buck, sparing nary a thought for the patients and senior citizens who would lose quality care.

It was before some PE firms took over and privatized the water systems of a growing list of cities, spiking costs for a resource that’s critical to life.

As of 2017, there were around 8,000 private-equity owned businesses in the U.S., which is nearly twice as many as there were publicly listed firms. Today, too many PE fund managers are generalists, with little or no experience in the industry they’re investing in. And we’re seeing them use a much-discredited playbook: raise debt, take out cash for their own short-term benefit, add little genuine competitive value, and then slash jobs and worker benefits in a desperate bid for greater operating cash flow.

According to the *Financial Times*(July 29, 2019, <https://on.ft.com/2YoSukC>) this “stems from the way that private equity deals are structured. When buyout firms acquire a business, they fund the transaction primarily with borrowed money. This is then pushed down on to the portfolio company, which has to service those heavy debts.”

“The result is a company that may be leaner because of the so-called ‘discipline of debt’. Remember, financial engineering is a core skill for private equity. But it’s also far less resilient to business downturns or idiosyncratic problems. Its main recourse when these strike is simply to sell assets, cut back on staff numbers or squeeze the amount the business invests.” (*FT*, stet)

“By raising debt levels, buyout insiders increase the gearing on the call option that equity ownership of any company represents. This gives them an incentive to shuffle collateral out of the reach of creditors, whether by taking fat fees for such marginal activities as ‘monitoring’ or extracting assets in the form of leveraged dividends. If the deal ultimately flourishes; great. But if it doesn’t, well, they’re fine too.” (*FT*, stet)

Congress should hold predatory private equity firms and hedge funds liable for the damage they cause, it should close the tax loopholes which encourage excessive debt and which also let executives avoid paying their fair share of taxes, and it should limit the debt that predatory firms can access in order to seize control of companies.  And, tremendously importantly, any such bill should protect workers when employers go bankrupt, giving them added recourse to pursue the severance that is currently denied them.

These solutions don’t come out of nowhere. They are what workers, consumers and pension fund investors have been calling for across the country. But they shouldn’t have to fight for them. Adequate severance – and other protections for workers – should be the bare minimum provided in a bankruptcy.

Private equity isn’t going away, nor should it, as in the right hands and with the right target companies, it can bring great value to investors and employees alike. But we must restore appropriate balance among these funds, their investors and employees.

The legislative actions being considered are not perfect in every respect. But they are an excellent start to bring about very needed changes to abuses that have demonstrably harmed entire classes and groups of employees, and which if not fixed will continue to ravage ever greater numbers of employees.

Fundamentally, “private equity must show more transparency, and politicians are right to shine the light on the industry’s practices. The PE industry owns assets in every sector, from critical infrastructure to retailers. Persistent low interest rates have helped funds raise large sums of money; recent figures show they have up to $2.5 trillion to spend.” (*Financial Times*, October 15, 2019, <https://www.ft.com/content/e5efa950-ec17-11e9-85f4-d00e5018f061>)

With this greater power should come greater accountability. As it is, some private equity-controlled companies have deliberately and unfairly exploited the limited liability company regime to pay big dividends from increased debt just before investment collapsed.

Another appropriate response would be to whip away the most harmful PE industry incentives, specifically by withdrawing the privilege of limited liability for private equity investments and making the acquiring PE firm appropriately liable for the debts of its portfolio companies. If a private equity-controlled business goes bust, certain creditors (such as employee pension funds) should in some circumstances be able to go after as well the assets of the PE fund, and transfers, including monitoring fees and special dividends, which shifted collateral out of the reach of lenders should be deemed fraudulent unless proven otherwise.