Congress of the United States
Washington, DC 20510

November 18, 2019

Carmine Di Sibio
Global Chairman and Chief Executive Officer
Ernst & Young AG
5 Times Square
New York, NY 10036

Dear Mr. Di Sibio:

We write to inquire about the report that Ernst & Young AG (EY) recently released in partnership with the American Investment Council (AIC), a trade group for the private equity industry, about the scope of private equity's influence in the economy.

This new report appears to have been prepared as part of the response to our new private equity legislation, the *Stop Wall Street Looting Act of 2019*. This legislation would close the legal, tax, and regulatory loopholes that have long allowed private equity firms to capture rewards of their investments while passing the risk on to target companies, investors, workers, and consumers.[1] It would require firms to share the responsibility for the liabilities of companies under their control to better align their incentives with the performance of the company by encourage more responsible use of debt. It would ban dividends for investors for two years after a firm acquires a company and end the looting of companies through excessive fees to give target firms a chance to succeed. It would ensure that workers are protected in case a target firm does not succeed and hold private equity firms accountable if they cut corners or break the law. Finally, the *Stop Wall Street Looting Act of 2019* would empower investors by increasing the transparency behind private equity funds' fees, returns, and political expenditures.

We are not surprised that the private equity industry is fighting this legislation at every turn – and we have questions about the role your firm is playing in providing rigged reports and conclusions as part of this effort.

We are concerned about corruption and corporate capture of the legislative and regulatory process. All too often, wealthy interests are able to buy influence and rig the system through campaign contributions, lobbying, and revolving door hiring practices that allow insiders and lobbyists to become government policymakers – and then return to their lucrative corporate gigs.

There are a myriad of other ways that corporate interests can wield their influence. One way they do so is by funding sham research – by consultants and researchers who receive big bucks for their work – to back up their views. These studies are distorted and biased and misused

[1] Office of Senator Warren, "Warren, Baldwin, Brown, Pocan, Jayapal, Colleagues Unveil Bold Legislation to Fundamentally Reform the Private Equity Industry," July 18, 2019, https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-unveil-bold-legislation-to-fundamentally-reform-the-private-equity-industry.

in the regulatory and legislative and regulatory process, lending an air of legitimacy to corporate special pleading. The new EY report, prepared with and for a trade group for the private equity industry, appears to be a picture-perfect example of such sham study.

EY purports to be a company whose "insights and quality services ... help build trust and confidence in the capital markets,"[2] but the new report fails to live up to that standard: it employs analytical tricks and slights of hand and omits key facts and context, painting a dishonest picture of the effect of the industry on the American economy.

The AIC report's central premise is troubling in and of itself: private equity's explosive growth over the last decade means that it controls the fate of millions of workers, their communities and families, and potentially the entire U.S. economy. According to the report, "in 2018, the US private equity sector directly employed 8.8 million [workers]," and "5% of US GDP is supported by the US private equity sector."[3] These staggering numbers underscore the vulnerability of millions of workers and the economy to a business model where the private equity funds' incentives are fundamentally misaligned with investors, target companies, workers, consumers, and the communities they serve. This is particularly pronounced in certain industries where private equity investment has been especially dominant. For example, according to a new report, private equity investments in the retail industry have led to 1.3 million jobs lost over the last decade while the non-private equity-owned retail sector added more than one million jobs.[4]

AIC has claimed that the industry earns high returns for investors by using their capital to buy companies, using funds' management expertise to make the companies' operations more efficient, and then selling the companies at a profit.[5] While there are certainly funds that fulfill that promise, in reality, most private equity funds often load up debt on the companies they buy, strip them of their assets, and extract exorbitant fees, guaranteeing payouts for themselves regardless of how the investment performs, and walking away from workers, consumers, communities, and investors if the bets go bad. The report comes to the opposite conclusion – but a close analysis reveals a number of misleading conclusions and glaring flaws in the analysis. These include:

Misleading Claims on Wages and Employment

Your report attempts to show that private equity buyouts are beneficial for a typical affected workers work by asserting that, "[t]he average US private equity sector worker earned

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[2] EY, "Who we are," Accessed November 12, 2019, https://www.ey.com/en_gl/who-we-are.
[3] EY, "Economic contribution of the US private equity sector in 2018," October 2019 https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.
[4] Center for Popular Democracy, Americans for Financial Reform Education Fund, Strong Economy for All Coalition, United for Respect, Hedge Clippers, and Private Equity Stakeholder Project, "Pirate Equity: How Wall Street Firms are Pillaging American Retail," July 2019, https://united4respect.org/wp-content/uploads/2019/08/Pirate-Equity-How-Wall-Street-Firms-are-Pillaging-American-Retail.pdf.
[5] American Investment Council, "Private Equity FAQs," Accessed November 5, 2019, https://www.investmentcouncil.org/private-equity-faqs/.

approximately $71,000 in wages and benefits in 2018."[6] But this claim is misleading: the $71,000 figure is an average of the wages and benefits of all workers employed by private equity owned firms, including the highly paid corporate executives, and those employed by the private equity firms themselves.[7] If, for example, this type of calculation were done for Toys 'R' Us before its private equity owners took it into bankruptcy, it would average the earnings of sales associates who made approximately $9 per hour[8] (an annual full-time salary of $18,720) with its C-suite executives who made millions annually even as they drove the company into the ground.[9] These calculations would also include, for example, the pay for the two leading executives of the private equity firm KKR, whose co-CEOs' compensation was more than $56.5 million, respectively, in 2018 alone.[10]

The average wage calculation is even less useful because it ignores the full range of the target companies owned by private equity companies. Private equity employs retail workers[11] (median annual wage of $24,200 in 2018[12]), property managers[13] (median annual wage of $58,340[14]), and physicians[15] (median annual wage of $208,000[16]) who each have different wage expectations. To honestly demonstrate that private equity investment had a positive wage effect, EY would have had to show that in each of the discrete industries it identifies, wages remain stable or grow following private equity investment or that wages are consistent with those at non-private equity-owned competitors. That it demonstrated neither suggests that EY found no evidence of a positive relationship between private equity investment and stable or growing

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[6] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.

[7] Forbes, "Private Equity Firms Have Caused Painful Job Losses And More Are Coming," Mayra Rodriguez Valladares, October 30, 2019, https://www.forbes.com/sites/mayrarodriguezvalladares/2019/10/30/private-equity-firms-have-caused-painful-job-losses-and-more-are-coming/.

[8] CNBC, "Target just gave employees a raise – here's what 19 other major retailers pay," Marguerite Ward, September 25, 2017, https://www.cnbc.com/2017/09/25/what-the-20-largest-retailers-in-america-pay-their-employees.html.

[9] New York Business Journal, "Bankrupt Toys 'R' Us thanks CEO with millions in incentive bonuses," Anthony Noto, November 22, 2017, https://www.bizjournals.com/newyork/news/2017/11/22/bankrupt-toys-r-us-pays-ceo-bonuses.html.

[10] Securities and Exchange Commission, "KKR & Co. Inc.," Form 10-K For the Year Ended December 31, 2018, February 15, 2019, https://ir.kkr.com/static-files/0d7d5a49-9e6d-4d92-bb8a-9490184f76e7.

[11] Center for Popular Democracy, Americans for Financial Reform Education Fund, Strong Economy for All Coalition, United for Respect, Hedge Clippers, and Private Equity Stakeholder Project, "Pirate Equity: How Wall Street Firms are Pillaging American Retail," July 2019, https://united4respect.org/wp-content/uploads/2019/08/Pirate-Equity-How-Wall-Street-Firms-are-Pillaging-American-Retail.pdf.

[12] Bureau of Labor Statistics, "Occupational Employment and Wages, May 2018," March 29, 2019, https://www.bls.gov/oes/current/oes412031.htm.

[13] Office of Senator Warren, "Warren, Loebsack Question Private Firms' Predatory Management of Manufactured Housing Communities," May 28, 2019, https://www.warren.senate.gov/oversight/letters/warren-loebsack-question-private-firms-predatory-management-of-manufactured-housing-communities.

[14] Bureau of Labor Statistics, "Occupational Outlook Handbook, May 2018: 11-9141 Property, Real Estate, and Community Association Managers," March 29, 2019, https://www.bls.gov/oes/current/oes119141.htm.

[15] Office of Senator Warren, "Warren, Pocan, and Doggett Examine Role of Private Equity in Rise of Surprise Medical Billing," October 21, 2019, https://www.warren.senate.gov/newsroom/press-releases/warren-pocan-and-doggett-examine-role-of-private-equity-in-rise-of-surprise-medical-billing.

[16] Bureau of Labor Statistics, "Occupational Outlook Handbook: Physicians and Surgeons: Pay," September 10, 2019, https://www.bls.gov/ooh/healthcare/physicians-and-surgeons.htm#tab-5.

wages. In fact, a recent analysis of private equity buyouts from 1980 to 2013 found that average earnings per worker fell by nearly 2 percent, compared to similar companies not owned by private equity.[17]

Finally, the EY report appears to ignore the evidence that private equity results in job losses: new research has found that two years after a private equity buyout of publicly listed firms, employment at target firms fall by 13 percent, and while there is also a 13 percent increase in employment for privately-held companies, this is likely not due to expansion of those businesses but rather is part of the acquisition of new companies.[18] [19]

Methodological Flaws and Missing Baselines

The report also asserts that the industry "generated $1.1 trillion of value added" to the U.S. economy in 2018, and the "5% of US GDP is supported by the US private equity sector"[20] – dubious claims backed up by no hard evidence. The report is vague about how that $1.1 trillion number is calculated, other than specifying that it includes the "related economic activity of: suppliers to the US private equity sector, and (2) related consumer spending" of workers in the private equity industry[21] – a broad interpretation that ascribes vast multifold benefits to the industry.

More basically, although the report asserts that $1.1 trillion was "value added," by private equity, it provides no baseline to establish the value of private equity in comparison to a baseline without private equity investments. Private equity has bankrupted hundreds of formerly profitable companies by loading them with debt, charging excessive and unnecessary fees, and stripping them of wealth, and prevented them from making the long-term investments in their businesses and workers that would make them sustainable in the future.[22]

Investments by private equity firms also often diminish the quality of the goods or services at their target companies. For example, private equity landlords often raise rents while cutting back on maintenance;[23] for-profit colleges owned by private equity raise tuition while

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[17] Harvard Business School, "The Economic Effects of Private Equity Buyouts," working paper, Steven Davis, John Haltiwanger, Kyle Handley, Ben Lipsuis, Josh Lerner, and Javier Miranda, October 7, 2019, https://www.hbs.edu/faculty/Pages/item.aspx?num=56942.
[18] Harvard Business School, "The Economic Effects of Private Equity Buyouts," working paper, Steven Davis, John Haltiwanger, Kyle Handley, Ben Lipsuis, Josh Lerner, and Javier Miranda, October 7, 2019, https://www.hbs.edu/faculty/Pages/item.aspx?num=56942.
[19] Forbes, "New Study Shows Adverse Economic Effects of Private Equity Buyouts," Mayra Rodriguez Valladares, October 7, 2019, https://www.forbes.com/sites/mayrarodriguezvalladares/2019/10/07/new-study-shows-adverse-economic-effects-of-private-equity-buyouts/.
[20] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.
[21] *Id.*
[22] Letter from Eileen Appelbaum to Senator Elizabeth Warren, July 18, 2019, https://www.warren.senate.gov/imo/media/doc/2019.7.17%20Stop%20Wall%20Street%20Looting%20Act%20Analysis.pdf.
[23] Office of Senator Warren, "Warren, Loebsack Question Private Firms' Predatory Management of Manufactured Housing Communities," May 28, 2019, https://www.warren.senate.gov/oversight/letters/warren-loebsack-question-private-firms-predatory-management-of-manufactured-housing-communities.

cutting back on student services;[24] prison services companies owned by private equity gouge incarcerated people and their families on food, phone calls, and hygienic products while providing deficient services;[25] and emergency services providers owned by private equity often leave patients with exorbitant surprise bills.[26]

Misleading Findings on Tax and Spending Effects of Private Equity

Your report also asserts that, "[i]n 2018, the US private equity sector paid $174 billion of federal, state, and local taxes."[27] But the implication of this assertion – that taxpayers benefit from the expansion of private equity – is, at best, unproven given the tax benefits and loopholes that private equity firms use and abuse. Firms are able to deduct the debt used in their acquisition, drastically lowering their tax burdens when compared with their pre-acquisition tax bill. The private equity business model also makes it more likely that any profits from target companies are taxed at low carried interest rates rather than higher income tax rates. The carried interest loophole in the tax code allows private equity managers to pay a significantly lower tax rate by taxing large amounts of their profits as capital gains, rather than income.[28] Additionally, the report states that "estimates of federal, state, and local taxes paid are based on the historical relationship between federal, state, and local tax collections (by tax type) to economic activity."[29] Since these relationships are based on past tax payments that predate the 2017 enactment of the *Tax Cuts and Jobs Act of 2017*, which cut the corporate tax rate and other business taxes, the report's tax figures substantially overestimate the private equity industry's tax contributions.[30]

Moreover, the report does not account for the increase in government expenditures due to private equity. Massive layoffs caused by private equity bankruptcies cause significant unemployment and could thus swell the rolls of government-funded unemployment insurance and other social programs.[31] In addition, private equity has invested in industries where the government is a large customer like higher education and health care. When the firms raise

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[24] Office of Senator Warren, "Warren, Pocan Investigate How Private Equity Buyouts Exacerbate Problems Plaguing For-Profit Colleges, September 17, 2019, https://www.warren.senate.gov/oversight/letters/warren-pocan-investigate-how-private-equity-buyouts-exacerbate-problems-plaguing-for-profit-colleges.

[25] Office of Senator Warren, "Warren, Pocan, and Ocasio-Cortez Investigate Private Equity Firms Profiteering Off Incarcerated People and Their Families," October 1, 2019, https://www.warren.senate.gov/oversight/letters/warren-pocan-and-ocasio-cortez-investigate-private-equity-firms-profiteering-off-incarcerated-people-and-their-families.

[26] Office of Senator Warren, "Warren, Pocan, and Doggett Examine Role of Private Equity in Rise of Surprise Medical Billing," October 21, 2019, https://www.warren.senate.gov/newsroom/press-releases/warren-pocan-and-doggett-examine-role-of-private-equity-in-rise-of-surprise-medical-billing.

[27] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.

[28] ProPublica, "Carried Interest Reform Is a Sham," Allan Sloan, December 1, 2017, https://www.propublica.org/article/carried-interest-reform-is-a-sham.

[29] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.

[30] Brookings Institution, "A fixable mistake: The Tax Cuts and Jobs Act," William Gale, September 25, 2019, https://www.brookings.edu/blog/up-front/2019/09/25/a-fixable-mistake-the-tax-cuts-and-jobs-act/.

[31] Forbes, "Private Equity Firms Have Caused Painful Job Losses And More Are Coming," Mayra Rodriguez Valladares, October 30, 2019, https://www.forbes.com/sites/mayrarodriguezvalladares/2019/10/30/private-equity-firms-have-caused-painful-job-losses-and-more-are-coming/.

prices or cut services, the government pays more. For example, a recent National Bureau of Economic Research paper found that when private equity buys a for-profit college it results in "higher tuition… [and] lower education inputs, graduation rates, [student] repayment rates, and earnings."[32] Since the federal government is the main student lender, the higher tuition coupled with the lower repayment rates translates into higher government expenditures.

The report's description of the private equity business model and its supposed benefits mislead what appear to be simple facts. According to the report, private equity investments become profitable by "transforming the target company to operate more efficiently and effectively generates returns for the private equity fund, the private equity firm that sponsors the fund, and the fund's limited partner investors."[33] In reality, however, since the financial crisis, the median private equity funds no longer beat the public market when accounting for the exorbitant fees and length of investments.[34] [35] Instead, fund managers benefit from years of cost cutting and underinvestment in the target firms' competitiveness through fees and dividends – hurting taxpayers, the economies, and the companies they take over.

It is unfortunate and troubling that your report on the private equity industry cherry-picks estimates, distorts context, and omits key facts and basic analyses. The substandard quality of this analysis raises more questions than it answers – about the private equity industry and about your consulting work with the American Investment Council.

In order to better understand your methodology and findings, we ask that you answer the following questions by December 6, 2019:

1. The report your company wrote stated, "The average US private equity sector worker earned approximately $71,000 in wages and benefits in 2018."[36] While the report misleadingly reports these figures as aggregate averages, it also breaks down private equity investments by industry in Figure 3: Economic activity related to the US private equity sector, 2018.[37]

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[32] National Bureau of Economic Research, "When Investor Incentives and Consumer Interests Diverge: Private Equity in Higher Education," Charlie Eaton, Sabrina Howell, and Constantine Yannelis, April 2019, https://www.nber.org/papers/w24976.
[33] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.
[34] Center for Economic and Policy Research, "Are Lower Private Equity Returns the New Normal?," Eileen Appelbaum and Rosemary Batt, June 2016, http://cepr.net/images/stories/reports/private-equity-performance-2016-06.pdf.
[35] Letter from Eileen Appelbaum to Senator Elizabeth Warren, July 18, 2019, https://www.warren.senate.gov/imo/media/doc/2019.7.17%20Stop%20Wall%20Street%20Looting%20Act%20Analysis.pdf.
[36] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.
[37] *Id.*

a. What was the median wage and benefits of workers in private equity-owned companies in each of the industries identified in Figure 3 in 2018? How did these change after private equity takeovers?

b. What was the median wage and benefits of workers in non- private equity-owned companies in the each of the industries identified in Figure 3 private equity sector in 2018?

c. What were the average and median wages and benefits of workers in private equity-owned companies in the each of the industries identified in Figure 3 in 2018, removing compensation for corporate executives and senior managers? How did these change after private equity takeovers?

d. What were the average and median wages and benefits of workers in non-private equity-owned companies in the each of the industries identified in Figure 3 private equity sector in 2018, removing compensation for corporate executives and senior managers?

2. The report your company wrote stated, "The US private equity sector directly generated $1.1 trillion of value added in the United States in 2018," "transforming [target companies] to operate more efficiently and effectively generates returns for the private equity fund, the private equity firm that sponsors the fund, and the fund's limited partner investors," and "[private equity funds generate] returns on its investment by maximizing profits net of interest expenses and payments of the debt principal."[38]

    a. Please describe all inputs to the $1.1 trillion figure in detail.

    b. What baseline was used to determine that the private equity industry created $1.1 trillion in "value added?"

    c. How much money did the private equity industry collect in fees from target companies and limited partners in 2018?

    d. How many jobs were created or lost in private equity-owned companies in each of the industries described in Figure 3 of the report? Please provide a breakdown by state.

    e. You wrote the report in partnership with AIC. For of the funds managed by each of AIC's members, please provide returns in terms of public market equivalent.

[38] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.

3. The report your company wrote stated, "In 2018, the US private equity sector paid $174 billion of federal, state, and local taxes," with $113 billion of this figure being federal taxes.[39]

    a. For each AIC member, please provide how the value of the carry earned by each general partner in each of its firms.

    b. When accounting for store and location closures associated with private equity buyouts and management, what were the associated reductions in tax bases of states and localities?

    c. What percent of the $113 billion were capital gains taxes? Absent the carried interest loophole, how much would these tax payments increase?

4. What were the terms and conditions of the contract between EY and AIC?

    a. What was the specific charge given to EY with regard to the report and its conclusions?

    b. How much was EY paid for this report?

    c. Did AIC officials obtain copies of drafts or previews of the report prior to its publication?

        i. If so, did AIC officials or individuals representing AIC or private equity firms provide editorial comments or suggestions?

        ii. If so, were any of these editorial comments or suggestions included in the final report?

Sincerely,

Elizabeth Warren
United States Senator

Mark Pocan
Member of Congress

[39] EY, "Economic contribution of the US private equity sector in 2018," October 2019, https://thisisprivateequity.com/wp-content/uploads/2019/10/EY-AIC-PE-economic-contribution-report-10-16-2019.pdf.

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