



UNITE THE UNION EVIDENCE TO THE TREASURY SELECT COMMITTEE RESUMED INQUIRY INTO PRIVATE EQUITY

Unite the Union welcomes the Treasury Select Committee's resumed inquiry and the opportunity to submit evidence. Unite represents 2 million members employed throughout all sectors of the economy, including the food and drink industry, manufacturing, banking and finance, transport, commercial and contract services as well as the public and voluntary sectors. Unite was formed by the merger of Amicus the Union and the Transport and General Workers Union to form the UK's largest trade union.

Unite has previously expressed strong concerns about the need for legislation and regulation regarding many aspects of private equity. Unite remains very concerned about levels of leverage, advantageous tax regimes and the lack of transparency. Unite welcomes Sir David Walker's recognition that the private equity industry is too secretive in its dealings and opaque in its communication with other stakeholders. Unite acknowledges the clear recommendation from Sir David that this must change. Unite believes that workers' rights are at the heart of the remedies required and this is the main focus of this submission.

1. Executive Summary

- 1.1. Unite believes the private equity business model increases the risk for employees in terms of job security, terms and conditions, wage rates and pension provision.
- 1.2. The private equity model exploits workers and there is no industrial or legal provision for the protection of workers employment rights under this business model.
- 1.3. Unite believes the Walker report has failed to acknowledge issues around workers rights, high levels of leverage and unfair taxation. The report also fails to offer any pragmatic industrial solutions to issues raised in previous Unite submissions.

- 1.4. Unite believes that the remit asking for Sir David Walker to supply a set of voluntary guidelines is disingenuous, in that the report precludes any consideration of mandatory guidelines for the sector.
- 1.5. Unite would recommend a strengthening of the existing information and consultation regulations to accommodate the private equity business model. In doing so Unite believes this could go some way to mitigating some of the worst excesses of bad employment practices currently in operation in the sector.
- 1.6. Unite believes a voluntary Code of Conduct, monitored by the BVCA is unacceptable. Experience has shown that self – regulation does not work.
- 1.7. Unite believes that private equity companies should be subject to the same legal requirement for disclosure and transparency as public listed companies.
- 1.8. Unite is concerned to see that the Walker report undermines the proposal for a facility to provide comprehensive industry wide data on the private equity sector. Workers deserve the right to know what is happening to the company they work for and how the decision making process will affect them.
- 1.9. Unite believes there needs to be a review of the existing TUPE provision which currently does not include protecting the rights of those workers transferred through share purchase, including the right to request an injunction for non-compliance.
- 1.10. Unite would argue most strongly for a legal requirement for any pension provision or benefits to be protected and ring – fenced when a private equity group is looking at buying a company out.
- 1.11. Unite believes there is a significant argument in favour of supporting the introduction of a government levy on private equity profits to establish and finance a special fund to provide enhanced redundancy payments if a company bought out by a private equity group goes into liquidation or administration.
- 1.12. Unite would like to see the Danish model of taxation reviewed by government to see whether it would work in the UK economy.
- 1.13. Unite believes that the present advantageous tax regime for private equity companies and partners is wrong. This is a clear case of discrimination. Private equity partners should be subject to the same 40% personal taxation rate as other UK workers.

2. Private equity increases risk for workers

2.1. Private equity increases risk for workers. Unite’s belief on the need for worker rights is predicated on the clear, uncontested fact that the private equity business model based, as it is, on a high degree of leverage, increases the risk for employees in terms of firstly, keeping their jobs and secondly, being detrimental to their wages, benefits

especially pensions and other terms and conditions. Unite believes workers are being systematically exploited by the private equity business model and, at present, have absolutely no form of legal redress. Private equity does not share the benefits of its financial success with the workforce in terms of improved pay and conditions. A negative change in the risk of a business makes stakeholders worse off; an increased risk of default of a business makes workers worse off.

3. The Walker Report proposals

3.1 Having recognised that increased leverage increases risk for employees and private equity's implicit contractual obligations over and above its explicit contractual obligations with employees¹, the Walker report fails to prescribe solutions. The Walker report is narrow in scope ignoring worker's rights, leverage and tax. It considers only a very limited part of transparency, effectively ignoring the most important transparency for workers namely the right to be informed and consulted on the finance and business plan prior to acquisition/substantial share purchase resulting in a change of control. The value attribution proposal is weaker than in the consultation. The voluntary proposals for implementing even the inadequate recommendations are ineffective. The report also includes spurious assertions such as private equity is a force for good.

3.2 The Code of Conduct ignores the key issue for workers – workers rights and we elaborate on these in the section below. The notion that compliance with a Code should be voluntary, monitored by BVCA is unacceptable. The proposal for voluntary self regulation by the industry is inappropriate. It cannot work. The report fails to explain how self regulation in the Cayman Islands would work. With a track record for making claims about the private equity industry in relation to creating jobs which have been proven to be 'worthless'², regulation of the standard of reporting by the industry is a must. Unite suggests that the government investigates further the merits of regulation equivalent to that of the Securities and Exchange Commission who scrutinise prior to publication. The Walker report undermines the proposal for a respected capability for providing comprehensive industry wide data on the private equity industry by making the spurious assertion that private equity is a force for good, yet then acknowledges that there is inadequate information available about the industry.

3.3 The Walker proposals fall far short of the necessary disclosure and transparency requirements. The level and type of disclosure for workers in private equity owned businesses should be strengthened by regulation. Workers should not be kept in the dark. Workers need to know what the future might hold for them and that their jobs, wages and conditions and pensions are safe.

3.4 The report focuses on financial reporting and a narrow view of transparency, stressing communication about company values and 'covering attentiveness to interests of employees and communications'. This reflects the unsubstantiated claim on which the report is predicated, namely that private equity is a force for good in the economy. There is no evidence that this claim is true. What is true is that available data shows that workers do not benefit under private equity ownership. Existing research shows that

¹ Unite (T&G section) evidence to the Treasury Select Committee Inquiry, para 4.7.

² David Hall, Methodological issues in estimating the impact of private equity buyouts in employment, May 2007.

private equity reduces wages³ and completely ignores the evidence that workers do not benefit from private equity ownership.

3.5 Transparency alone will not meet employees' needs. Taking on debt is a risk to workers in terms of jobs, wages and conditions so workers should have the automatic right for protection and compensation for this risk.

4. Workers rights

4.1 Just as the banks and pension funds can secure their interests in leveraged buyouts so too should workers. In private equity transactions, banks are able to charge risk adjusted rates of interest; pension trustees exercise the right to demand greater up-front funding to compensate for added risk. Regulation should ensure that workers are similarly consulted, protected and compensated. There should not be two standards of protection and compensation in the economy.

4.2 Workers need rights prior to buyout. Workers and their representatives deserve the right to be both informed and consulted on the finance and business plan of any takeover/significant stake prior to acquisition/significant share ownership so that workers' pay and conditions are safeguarded and they are compensated regarding the additional risk. Pre-acquisition (any acquisition)/significant share purchase TUPE rights should apply. The Transfer of Undertakings (Protection of Employment Regulations) should be amended to cover transfer through share purchase, including the right to an injunction for non compliance⁴. Unite believes the case for an amendment of TUPE has been greatly strengthened by the decision in Millam⁵. The Court of Appeal has highlighted how share sales may lead to changes of control of a business, with consequences for employees, justifying extending to them the same protection available on transfer of an undertaking.

4.3 The repeated claims of private equity taking over companies, of their intention to exercise close control reinforces the case for regarding share sales to private equity as falling within the scope of TUPE as defined in Millam. Private equity openly declares its mission to exercise control and vaunts this as a positive advantage. With this should come responsibility towards employees, legally enshrined in TUPE.

4.4 The rule that transfers through share sales do not fall within TUPE was established by the Employment Appeal Tribunal in *Brookes v Borough Care Services*. A recent Court of Appeal decision in *Richard Millam v The Print Factory (London) 1991 Ltd*, while upholding the rule in *Brookes*, states that a change in legal control as a matter of law by way of share sales of itself may not suffice to constitute a transfer within TUPE. The implication is that a change in control as a matter of fact, apart from the share sale, may be a transfer within TUPE.

4.5 The absence of a change in legal control (no new employer in law) is not conclusive where there is a change in control in fact of the business. Lord Justice Buxton

³ Opcit

⁴ *ibid*

⁵ Court of Appeal decision, *Richard Millam v The Print factory (London) 1991 Ltd*.

concluded: “The legal structure is of course important, but it cannot be conclusive in deciding the issue of whether, within that legal structure, control of the business has been transferred as a matter of fact”. The Court of Appeal’s emphasis in Millam is on the question of fact: not legal control, but control in fact. A finding that there is no transfer, based on the sole fact of a share sale, is inconsistent with this approach. Thus TUPE should be amended.

4.6 TUPE rights need to embody the presumption that a substantial increase in debt as a consequence of a takeover or change in control is a detrimental change to workers terms and conditions. This gives workers the right to demand and receive compensation for the risk to which they are being exposed.

4.7 Through their trade unions, workers should have the right to seek fair compensation and protection should substantially greater levels of leverage be part of a private equity (or any other) takeover. Being consulted over any business financial plan is crucial because of the risk to workers. A buyout may mean management would want to change the financial structure of the firm from a ratio of 80:20 equity and debt to 10:90 equity and debt. It might be said that this is unacceptable but reluctantly accept more debt, providing guarantees are given.

4.8 Rights should thus include the right to be at the negotiating table choosing the preferred buyer, to secure the future for workplaces and plants, seek guarantees regarding suppliers and jobs, 5 year guarantees for wages and terms and conditions especially pensions. Finally, the government should enforce a levy on private equity to establish and finance a special fund for enhanced redundancy payments in case of administration⁶.

4.9 It is clear that the global economic outlook has now worsened significantly. Unite remains concerned that this will magnify the negative impact on jobs and pay as a result of private equity buyouts. Private equity funds may well keep and manage a portfolio company for longer and this will intensify attempts to increase profits and cut costs rather than relying on realising cash from IPO’s or secondary buyouts. Our concern is that this will result in more pressure on jobs, more capping or closure of pension funds, reduction in wages, investment, R&D and training, increased pressure on collective bargaining (including using USA anti trade union approaches); pressure on health and safety, as well as growing consumer safety problems.

4.10 A recent report⁷ showed the ratio of companies’ interest payments to operating surplus is at its highest for 15 years. This is at the peak of an economic cycle which is potentially about to enter a downturn. Debt should be at a minimum as the industry has been through the good times. Our earlier submission pointed out private equity buyouts had taken place in the context of an unprecedented stable economic environment. The credit crunch and the risks of less favourable economic circumstances means that if profitability declines many companies will find themselves with unattainable levels of

⁶ Opcit

⁷ 20 20 vision, boom, bang or bust – Twenty years of global, technological and financial innovation, Kroll, October 2007.

debt and this could increase the risk of wage freezes, wage cuts and benefit reductions, with further risk of job loss and increases in administration .

4.11 Many employees work for firms already under private equity ownership or control. Through their trade unions they should have the right to be consulted regarding new high leverage to fund dividend recapitalisations on the financial and business plan. Because the risk of private equity/highly leveraged ownership has only relatively recently been acknowledged, there are many employees currently working in businesses where no compensation or guarantees have been secured.

4.11 Workers should have the right to know how much the private equity partners are paid. If private equity ownership means value and wealth are being created, workers should have the right to know how it is being shared out and if that is fair. Details of management bonus schemes and the basis thereof (i.e. its basis in value creation or simply cost cutting such as job and plant cuts) should also be available. Workers should also have the right to know who are the ultimate owners (equivalent to shareholders in a public company) of the firm that they work for.

5. The implications of private equity funded takeovers for company pension funds.

5.1 Pension Funds in a company bought out by private equity has protections and compensations for the additional risk of leveraged buyouts which Unite believes should similarly apply to workers. However, despite these, there are many pension funds in firms bought out by private equity which have not had compensatory payments because awareness about the additional risk is a relatively recent development.

5.2 Up until a few years ago, private equity avoided buying companies with a material final salary pension scheme. The risks involved in operating such a scheme i.e., small changes in interest rates, stock market returns, mortality, could add meaningfully to the size of a pension deficit. While publicly held firms who could take a long term view and ride out any short term volatility could deal with this, it was anathema to private equity firms who bought companies with the intention of selling them on again in the short term. Firstly, any negative change in the net deficit position of a company's pension fund would directly impact what the private equity firm would obtain upon resale. Secondly, an increase in the pension fund deficit could also require the company to make greater contributions to the scheme, adversely affecting the cash flow so important to private equity firms and, in the worst case, requiring the private equity partners to inject additional funds into the company which adversely affects the IRR (internal rate of return) so important to private firms. For these reasons, up until a few years ago, having a sizeable final salary scheme was effectively a "poison pill" for companies against private equity firms.

5.3 However, as the size of the private equity funds grew and easy financing became readily available, it became more and more difficult for private equity firms to avoid companies who had final salary pension schemes. Thus, in the last several years, private equity firms have started taking over companies with material final salary schemes. Due to the duties placed on pension fund trustees in the 2006 Pension Act, private equity companies have to negotiate with pension trustees prior to any takeover.

The trustees now have the power to demand quicker repayment of any scheme deficit should the company's risk profile change. The risk profile inevitably changes because the private equity firm intends to load the company up with substantially greater debt than before.

5.4 However, the trustees only have a duty to protect benefits already accrued (i.e. for pensionable service rendered up to the date of takeover) and generally have no power to protect future pension benefit levels. As a consequence, Unite is concerned that companies taken over by private equity firms have closed their schemes to new entrants almost as a matter of course and many are going further, closing the schemes to existing employees. In their place, Unite is concerned that the private equity firms are instituting inferior money purchase schemes which transfers all the investment and mortality risk to employees and into which the private equity owned firms contribute substantially less money for their employees' retirement in the first place. Thus, in recent years, private equity firms have become a major agent in destroying the final salary pension arrangements which have provided a decent retirement for so many workers in Britain. Unite believes that the government should commission independent research on the impact of private equity on occupational pension schemes.

5.6 Because the pension trustees have no power to protect future benefit entitlements, it is essential that workers and their representatives have a power, similar to pension trustees, to sit down with private equity firms prior to takeover, and secure commitments from the private equity firms as to what will happen to their pensions (and all other terms and conditions) post acquisition. It is this right and the recognition that the extra debt by itself is a detriment to workers terms and conditions that Unite believes is necessary for workers to have in order to level the playing field with private equity firms. This can only be achieved by changing the law.

5.7 Unite would like to make two comments specifically about pension fund investments in private equity funds. Firstly, given the cartel like nature of the private equity industry, with no competition amongst GPs for the fees charged to pension funds Unite urges that fees charged by the GPs are investigated by the Competition Commission. Even though some of the private equity funds have increased in size, we understand that fees have remained the same even though costs have not increased in line with the size of the Fund.

5.8 Secondly, the statement that returns are higher than equity markets is not proven. Indeed evidence shows that claims about private equity funds performance has been overstated as a result of biased samples and misleading valuations⁸. In a rising market private equity returns ought to be higher than equity returns because there is less equity. Even that is not proven due to the extraction of value by the GPs fees. Moreover in a rising market private equity would be expected to do better than equity. What is yet to be tested is if private equity returns performance over a full economic cycle is higher than equity markets over an economic cycle. This is what we are about to see. Moreover as stated above Unite is concerned that high leverage in less favorable financial circumstances will lead to additional pressure for returns which will be met by value

⁸ David Hall, Unhappy returns to investors in private equity, PSIRU, Business School, University of Greenwich.

extraction from workers in terms of jobs, pay, less investment rather than value creation.

6. Transparency

6.1 Even within the Walker report's narrow consideration of transparency, the benchmark used for comparison with the private equity industry is wrong. Transparency is at the core of the pact between business and society, and significant progress has been made on the accountability of public companies. The appropriate transparency benchmark should be the same transparency requirement on public companies not with the current standard of zero requirements for transparency from the private equity firm itself. There should not be two standards of transparency. Private equity should have the same obligations to disclose as if it were a public company.

6.2 The private equity firms (the partnerships) should also have to disclose the same information as if they were a public company. This would mean that they should have to disclose the remuneration of general partners (just as directors pay is disclosed in a public company). They would also have to disclose significant shareholders and the size of their investments. There should be a register of limited partners shareholders available (just as shareholders in a public company are). Finally, the private equity firm should produce group accounts of their holdings just as a public company would. This obligation should apply to all private companies including sovereign wealth funds.

7. Taxation

7.1 Private equity deals are structured so that they reduce or eliminate the payment of tax. For reasons of public acceptability and accountability as well as revenue protection private equity should be fully taxed.

7.2 In relation to the tax treatment of debt and equity, tax relief on interest on debt should be abolished. In Denmark, the tax relief on interest payments has been eliminated with offsets elsewhere. Unite believes this model is worthy of consideration. The tax relief on interest on debt means that the portfolio firms acquired by private equity pay much reduced corporation tax. There is no reason why debt should be given more favourable treatment over equity; this is particularly so when debt is used for buyout purposes, and to fund dividend recapitalisation. Tax relief on interest on debt is an anomaly in Capital Markets theory (CMT). A purist approach to CMT would say there should be no difference between the treatment of debt and equity.

7.3 Arguably debt should be given less favourable tax treatment than equity given that leverage increases the financial risk of the firm and risk of default, shifting risk on to other stakeholders particularly workers, in terms of redundancy, erosion of pay and conditions including pensions. Leveraged buy-outs put new, additional financial costs and demands on the portfolio company and sources of finance have to be found to meet them. Unite is concerned that debt for acquisition and dividend recapitalisations also means less money for investment in fixed assets and training. Moreover highly leveraged buy-outs put pressure on public companies with a more traditional financial structure. In order to avoid being taken over, these firms close or sell off productive operations rather than invest and issue dividends or buy back shares. The knock on

effect of debt may well squeeze investment and long term planning across the economy. This is hardly something that should be encouraged by tax relief.

7.4 Equity investors contributing part of their capital as shareholder debt can exacerbate the issue of tax reduction and should be addressed.

7.5 Unite agrees with Nick Ferguson that it is wrong that private equity executives pay less tax than their cleaner. Given that employees on a modest income bear marginal tax rates, including social security taxes, private equity partners should be taxed at the full 40% income tax rate.

7.6 The recent change to capital gains tax is a move in the right direction. It is important that taper relief on carried interest be withdrawn, as the government is proposing. Dealing with tax loopholes, which either deprive the public purse or means higher taxes on those citizens who cannot avoid tax, is necessary but far from sufficient in relation to capital gains or in relation to the whole set of tax issues which are pertinent to private equity. It is the actual rate of tax that matters not the increase – which is why Unite believes that the 18% capital gains tax rate for private equity partners is insufficient and to address the discrimination against other tax payers, private equity partners should pay the full 40% income tax rate.

8. Private equity owned companies and public companies

8.1 Private equity leveraged buyouts puts huge pressure on other companies who wish to avoid being taken over, this pressure can result in aversion tactics that can include increasing debt, spending money on share buy backs or issuing dividends and focussing on short term cash flow all to the detriment of jobs, pay, productive capacity and investment in training and staff development. Thus, private equity may well be reducing not only investment of companies they own but of the entire UK economy.

8.2 The Walker report also asserts that public companies may be under borrowing rather than agree that the level of leverage in private equity is high. Unite believes this has not been proven, especially over the course of an entire business cycle. High levels of leverage shifts risk onto other stakeholders, particularly the workforce.

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January 2008

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