American Federation of Labor and Congress of Industrial Organizations

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Dear Investor:

The $4 billion initial public offering of The Blackstone Group L.P. ("Blackstone LP") is scheduled to open as early as June 22.[1] What could be the largest U.S. initial public offering in more than five years has received a lot of attention from Congress and the press because it could also open the door for other private equity companies and hedge fund advisers to go public.

In preparation for the IPO, Blackstone LP filed several drafts of its offering documents ("Prospectus") with the United States Securities and Exchange Commission ("SEC"). If you are thinking about buying shares in the IPO, you might be tempted to skip the daunting task of wading through several hundred pages of legalese in the Prospectus. After all, Blackstone LP will be the public version of The Blackstone Group (Blackstone Group) and CEO Stephen Schwarzman made nearly $400 million last year.[2] Who wouldn't want a piece of those profits?

But this is a situation where it pays to read the fine print. A June 16 column in *The Wall Street Journal*, "Read the 'Risk Factors' – Far From Empty Boilerplate, IPO Prospectuses Lay Out Debutant Firms' Red Flags," stated, "[Blackstone]'s prospectus has 62 separate risk factors listed over 34 pages. Some of these sound distinctly alarming."

Here is a quick summary of the major risks you should consider before calling your broker to add Blackstone LP to your portfolio:

- Unlike most public companies, Blackstone LP proposes to curtail or eliminate altogether its responsibility to act in investors' interests.
- Shareholders will not have voting or other traditional rights that shareholders in public companies have.
- Management will exclusively set executive compensation without any input or oversight from unitholders.
- It is nearly impossible to determine what Blackstone LP's assets actually are and what they are truly worth. This may give public investors an unreliable and potentially misleading view of the value of their investment.

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[1] "Blackstone IPO in June," *The New York Times*; by Reuters (June 13, 2007).
[2] Amended Prospectus filed June 15, 2007; pages 197-198.

- This offering may be a way for Blackstone LP's partners to cash-out their stakes in the firm at the expense of public shareholders.

- Congress recently proposed legislation that would tax Blackstone LP's future income at a much higher rate. This means lower returns for investors.

- It appears that Blackstone LP was structured in an attempt to avoid being regulated as an investment company. The regulations Blackstone LP is trying to evade, by and large, address the specific concerns referenced above. The AFL-CIO has asked the SEC to require Blackstone LP to register as an investment company.

I. Governance and Shareholder Rights

A. Diminution of Fiduciary Responsibility

Perhaps the most fundamental issue for investors considering the Blackstone LP offering is the firm's attempt to limit or eliminate its obligations to protect the interests of its "common unitholders," the investors in the publicly-traded Blackstone LP. Like most limited partnerships, Blackstone LP will be managed by its general partner. The partnership agreement contains provisions that will "reduce or eliminate duties (including fiduciary duties) of our general partner and limit remedies available to common unitholders for actions that might otherwise constitute a breach of duty."[3] The Prospectus spells out that the management of the entity going public will not be required to act in shareholders' interests. This effectively eliminates the fiduciary duties that lie at the heart of our system of corporate governance.[4]

But the lack of fiduciary duties is not the only corporate governance problem with the Blackstone IPO. In a number of other ways, common unitholders of Blackstone LP will not have the basic rights Congress and the courts have determined are essential to protect investors in publicly-traded companies.

B. No Right to Elect Directors or Vote on Many Other Matters of Concern to Shareholders

Investors will not have the opportunity to elect directors or raise issues related to the governance of the partnership since Blackstone LP will not hold annual meetings.[5] In addition, Blackstone Group's founders, who will have no economic interest in Blackstone LP, will have full authority to determine how much senior executives are paid.[6] The practice of executives setting their own pay without shareholder

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[3] Amended Prospectus filed June 15, 2007; page 56.
[4] Amended Prospectus filed June 15, 2007; page 219. "Given the significant flexibility afforded our general partner to resolve conflicts of interest—including that our general partner has the right to determine not to seek the approval of the common unitholders with respect to the resolution of such conflicts—the general partner may resolve conflicts of interests pursuant to the partnership agreement in a manner that common unitholders may not believe to be in their or in our best interests. Neither our common unitholders nor we will have any recourse against our general partner if our general partner satisfies one of the standards described in the four bullet points [on page 219 of the Amended Prospectus filed June 15, 2007]."
[5] "Unlike the holders of common stock in a corporation, our common unitholders will have only limited voting rights and will have no right to elect our general partner or its directors, which will be elected by our founders." Amended Prospectus filed June 15, 2007; page 18.
[6] "Our founders, Messrs. Schwarzman and Peterson, have historically made all final determinations regarding executive officer compensation. The board of directors of our general partner has determined that maintaining as closely as possible our current compensation practices following this offering is desirable and intends that these practices will continue. Accordingly, the board of directors of our general partner does not intend to establish a compensation committee." Amended Prospectus filed June 15, 2007; page 196.

involvement is at odds with the current efforts in Congress and among investor groups to provide shareholders a meaningful voice in executive compensation matters.[7]

Blackstone Group's founders—Stephen A. Schwarzman and Peter G. Peterson—will effectively control 78 percent of the vote on any matters that may be submitted to common unitholders for a vote.[8] This highlights the major question potential investors in Blackstone LP should be asking: If I give my money to Blackstone LP, who will really control what happens to it? Who, on the inside, will look out for me?

C. Little Accountability with Structure

Investors in the IPO will purchase common units in Blackstone LP but will not have a direct interest in Blackstone Group's portfolio of investment funds. This type of structure is analogous to a "fund of funds" where investors buy shares of a mutual fund that holds shares of other investment companies. Fund of funds arrangements are a particular concern to regulators because they make it difficult for investors to see who really controls their money or to properly determine the value of their investments. Without proper regulation, investors in fund of funds also face the risk that the manager is buying shares of affiliated funds in order to advance personal interests instead of creating long-term shareholder value.[9]

D. The Relationship with China

Beijing Wonderful Investments Ltd. ("Beijing Investments"), a state foreign exchange investment company that will report directly to the Chinese government, has agreed to buy a 44.2 percent economic interest in Blackstone LP.

According to Blackstone LP's Prospectus, the partnership anticipates a quid-pro-quo relationship with the Chinese.[10] "Industry players widely expect Blackstone to pour billions of dollars into the Chinese market."[11] In return, China will help Blackstone Group identify investment opportunities and participate as a co-investor.[12] CEO Stephen Schwarzman told Reuters that he hopes this deal will also spur the Chinese government to invest directly in Blackstone Group's private equity, real estate, debt products and hedge funds.[13]

China holds more than $1.2 trillion in foreign exchange reserves and has demonstrated its intention to diversify these holdings into alternative investments. China's extraordinary potential to invest more of its reserves with Blackstone Group combined with its direct equity investment in Blackstone LP will undoubtedly give Beijing Investments considerable leverage with Blackstone Group's managing partners who will also manage the entity going public. This is particularly important because investors who purchase common units in the IPO will have no real authority to influence management's

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[7] On April 20, 2007, the House of Representatives passed, with a 269 to 134 vote, the "say on pay" bill sponsored by Representative Barney Frank of Massachusetts, which seeks to provide an advisory shareholder vote on CEO pay. Senator Barack Obama of Illinois has introduced an identical bill in the Senate.

[8] Amended Prospectus filed June 15, 2007; page 18.

[9] Fund of Funds Investments: 17 CFR Parts 239, 274, and 275. [Release Nos. 33-8297; IC-26198; File No. S7-18-03] (October 8, 2003).

[10] Amended Prospectus filed June 15, 2007; page 5.

[11] Tamora Vidaillet, "Blackstone hopes China will bet on its funds," Reuters http://www.reuters.com/articlePrint?articleId=USPEK21474820070521 (May 21, 2007).

[12] Amended Prospectus filed June 15, 2007; page 5.

[13] Tamora Vidaillet, "Blackstone hopes China will bet on its funds," Reuters http://www.reuters.com/articlePrint?articleId=USPEK21474820070521 (May 21, 2007).

decisions regarding Blackstone LP's activities or the activities of the Blackstone funds. Nor will Beijing Investments owe fiduciary duties to the common unitholders. Typically, an investor with a controlling interest in a public company owes fiduciary duties to other investors.

II. Accounting Treatment and Disclosure

According to a *Financial Times* editorial referencing Blackstone LP's June 4 filing with the SEC, "[Blackstone LP's] initial public offering is already challenging enough for investors to understand without the added debate over its accounting. They need to get comfortable with the relative novelty of a listed private equity management company. It will rely heavily on potentially volatile profits from carried interest and looks set for a high valuation. In spite of the long prospectus, it will remain unclear which investments are generating the returns and how risky they are."[14]

Blackstone LP has released several drafts of its offering documents. These filings present dramatically different impressions of the firm's assets. In the June 4 filing, Blackstone LP reported that its assets were worth $9.4 billion. The June 11 filing reported that its assets were worth $17.2 billion.

Subsequent filings have done nothing to clarify this issue. Even astute investors will find it difficult—if not impossible—to determine what assets are being offered to the public through this IPO.

Consider the following:

- Blackstone Group has estimated the fair value of most of its assets. Valuations of these assets are inherently difficult to make, requiring significant personal judgment.

- Contrary to industry practice, Blackstone LP did not use an independent firm to value its assets for the financial disclosures. Investors are being asked to trust management to make an objective assessment.[15]

- Blackstone LP reveals very little about the assets it manages. The Prospectus provides only a list of representative holdings. Detailed financial profiles of the holdings, even at the asset-class level, are entirely lacking.

As a result, Blackstone LP intends to issue a security to the public without providing the financial disclosure that investors rely on to make informed investment decisions.

III. Selling Out At the Top

Blackstone LP announced June 11 that the IPO will allow its founders, Stephen A. Schwarzman and Peter G. Peterson, to walk away with around $2.33 billion. Even after the big payout, Schwarzman's holdings will be worth around $7.73 billion and Peterson will hold $1.31 billion of shares.

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[14] "Blackstone's accounts," *Financial Times* (June 6, 2007).

[15] "There are no readily ascertainable market prices for a very large number of illiquid investments of our corporate private equity, real estate opportunity and mezzanine funds. We determine the value of the investments of each of our corporate private equity, real estate opportunity and mezzanine funds on a periodic basis based on the fair value of such investments. The fair value of investments of a corporate private equity, real estate opportunity or mezzanine fund is determined using a number of methodologies described in the investment funds' valuation policies. We have made valuation determinations historically without the assistance of an independent valuation firm, although an independent valuation firm will participate in valuation determinations following this offering." Amended Prospectus filed June 15, 2007; page 43.

In a June 13 column, “The Takeover Boom, About to Go Bust,” *Washington Post* business columnist Steven Pearlstein explained that private equity’s continued ability to generate such high returns depends on the ability to borrow money at low interest rates. This allows firms to buy public companies and take them private. “It is impossible to predict when the magic moment will be reached and everyone finally realizes that the prices being paid for these companies, and the debt taken on to support the acquisitions, are unsustainable. When that happens, it won't be pretty. Across the board, stock prices and company valuations will fall. Banks will announce painful write-offs, some hedge funds will close their doors, and private-equity funds will report disappointing returns. Some companies will be forced into bankruptcy or restructuring,” he wrote.

It seems as if Blackstone Group’s partners recognize that the private equity industry is at or near its peak. This IPO provides management a timely opportunity to cash out.[16]

Martin Mayer, a visiting scholar at the Brookings Institution, said, “I don’t think there’s any benefit to anybody except the people who are partners in [Blackstone] who’ll be able to cash out.”[17]

IV. Tax Treatment

A big reason that Blackstone Group produced such large returns for its investors is that it relied on a tax loophole so that most of its revenue was taxed at the capital gains tax rate of 15 percent, instead of the standard 35 percent rate paid by corporations. According to the Prospectus, if Blackstone LP cannot maintain this tax treatment, “distributions to [investors] would be substantially reduced and the value of our common units would be adversely affected.”[18]

On June 14, Senators Max Baucus (D-Mont.), chairman of the Senate Finance Committee, and Chuck Grassley (R-Iowa), the ranking member, introduced legislation that would tax publicly-traded partnerships, such as Blackstone LP, at the standard 35 percent corporate tax rate. The proposed legislation would not apply to Blackstone LP until June 14, 2012. However, there are several unresolved issues that could result in Blackstone LP being subject to the higher tax rate sooner.

Senators Baucus and Grassley have also stated that, even under current tax law, they believe Blackstone LP should be taxed at the standard corporate rate. In a letter to Treasury Secretary Henry Paulson, released in conjunction with the legislation mentioned above, they asked the Department of Treasury to review the Blackstone LP public offering. Specifically, they asked “what guidance Treasury intends to issue to make investors or potential investors aware of how Treasury will enforce the law.” The Department of Treasury’s decision would have an immediate impact on Blackstone LP’s tax treatment.

Even if these issues are resolved in Blackstone LP’s favor, investors shouldn’t necessarily expect this favorable tax treatment to continue. A large portion of the income generated by Blackstone Group’s investment funds is in the form of “carried interest.” Carried interest entitles the investment manager to a portion, generally 20 percent, of the investment returns of the Blackstone funds. Congress is considering whether to close the loophole that allows carried interest to be treated as capital gains. Like the legislation recently proposed by Senators Grassley and Baucus, this could cause a large portion of

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[16] Potential risks that could materially impact Blackstone’s current investments include rising interest rates, overvaluation of assets, antitrust concerns, and government regulation.
[17] “Blackstone Workers Produce Nine Times More Profit Than Goldman,” Bloomberg News; by Elizabeth Hester and Jason Kelly (March 23, 2007).
[18] Amended Prospectus filed June 15, 2007; page 63.

Blackstone LP's profits to be treated as ordinary income (like most companies), which is taxed at more than twice the rate.

V. The Investment Company Act of 1940

The AFL-CIO believes that Blackstone LP is an investment company and should be required by the Securities and Exchange Commission to register as such under the Investment Company Act of 1940. The AFL-CIO has sent two detailed letters to the SEC explaining our concerns.[19] Compliance with the Investment Company Act would resolve many of the concerns we address in these letters, including the lack of transparency about the actual assets of Blackstone LP and the absence of basic corporate governance protections.

The Investment Company Act of 1940 was created to protect the investing public from theft, self-dealing, fraud, excessive fees and breach of fiduciary duty. Blackstone LP seems to be structured in an attempt to avoid regulation as an investment company by inserting several layers of corporate entities between the Blackstone's investment funds, which hold the vast majority of Blackstone Group's assets, and the publicly-offered Blackstone LP.[20]

By and large, Blackstone's investment funds do not sell to the general public because they use investment strategies considered too risky for people who do not have a lot of money to lose if a deal goes bad. By only selling shares to very wealthy individuals or institutional investors, such as pension funds, Blackstone Group can operate would-be investment companies without complying with the Investment Company Act of 1940. These exemptions from regulation do not apply, however, to the current situation.

Investors should be concerned that this IPO not only allows Blackstone LP to evade regulation, but it would set a dangerous precedent. If Blackstone LP can avoid SEC regulation, it is only a matter of time before mutual funds, hedge funds and other investment companies that sell to the general public can use similar strategies to escape regulation.[21]

It is equally important to recognize that the regulatory compliance requirements of registered investment companies were implemented to address many of the concerns discussed above regarding the Blackstone LP public offering. These protections include corporate governance provisions intended to prevent conflicts of interest, limits to the amount of debt the company may take on, provisions that guide fair value determinations, disclosure requirements, mandatory shareholder voting on key issues and limits on the fees charged to shareholders.

VI. Conclusion

Investors in the Blackstone LP public offering should be on notice that they are being asked to trade away basic pro-shareholder rights and safeguards in exchange for the opportunity to participate in the IPO. This is not an opportunity for the common person to invest alongside the bigwigs in the private equity world, but a way for Blackstone Group's partners to cash out while they are ahead of the game.

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[19] You can find these letters at: http://www.aflcio.org/corporatewatch/capital/corporategovernance.cfm#blackstone.
[20] According to Delaware Division of Corporations, Blackstone LP and its general partner, Blackstone Management LLC, were organized March 12, 2007. *See Delaware Division of Corporations—Online Services* at: https://sos-res.state.de.us/tin/controller; accessed May 10, 2007.
[21] For a copy of the letter, go to: http://www.aflcio.org/corporatewatch/capital/upload/Blackstone.

The overarching theme of Blackstone LP's disclosures is "governance for ransom." Investors in the IPO will have no voice in management decisions and management has no duty or economic interest to protect investors' rights. Moreover, Blackstone LP is trying to avoid fulfilling its regulatory and legal obligations to protect investors.

Investors in the IPO will be completely at the mercy of the company's managers. This strategy, if successful, will likely be duplicated by other private equity firms, hedge funds and mutual funds to the detriment of public investors.

The AFL-CIO is concerned that this particular offering does not meet basic standards of disclosure, corporate governance and legal compliance that investors expect. Moreover, if this offering goes forward in its current form, it will set an example that will lead to a dramatic erosion of the standards that public offerings are held to by regulators and investors.

We would be happy to discuss our concerns with any interested investors. If you would like to contact us, please call the AFL-CIO's Office of Investment at 202-637-3900. Thank you for your attention to this important matter.

Sincerely,

Daniel F. Pedrotty
Director
Office of Investment

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cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Kathleen L. Casey
Commissioner Annette L. Nazareth
Director John White, Division of Corporation Finance
Director Andrew Donohue, Division of Investment Management
Stephen A. Schwarzman, Chairman and CEO, The Blackstone Group