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Group exercise
RFK Compass, June 2023
Applying ESG in the Meat Processing Industry

Private equity investing has grown significantly in the last decade. In 2010 (the year of the first Compass conference), private equity investment firms managed about $1.8 trillion in assets. By the end of last year, that number had more than quadrupled to $7.6 trillion. According to the American Investment Council, which represents the interests of private equity firms, "private equity builds better businesses across America, directly employs millions of workers, and delivers the strongest returns to support the retirements of millions of workers." At the same time, there are well-publicized examples of negative social and environmental impacts linked to private equity firms, and regulation is sparse. Increasingly, private equity firms are being called on to scrutinize their business models in light of their ESG, and especially social, impact.

Some of these challenges are tied to the increased size of the workforce of these firms. Today private equity firms employ about 20 million workers globally, with a high concentration in low-wage sectors like food services and private security. In 2021, Warburg Pincus expanded its holdings in the security sector to employ 800,000 workers worldwide. Its security arm is now the third largest US-based private employer behind Walmart and Amazon. Fast-food franchisees held by Roark Capital employ over a million workers worldwide. Other PE firms like KKR (with over 800,000 employees), Carlyle (650,000), and Blackstone (550,000) all employ more people than FedEx, even though FedEx is generally listed as the fifth-largest US-based employer. Many of those who are employed by companies owned by private equity firms work outside of the US.

The nature of some of the work being done by companies owned by private equity firms poses significant human rights risks to those working in their labor supply chains. While the most dramatic examples occur in global supply chains, there also are some issues that are gaining greater attention in the United States. Some of these cases involve the exploitation of migrant children in US factories. Two cases from the meatpacking and food processing sectors in the US recently have come to light.

The first involves a cleaning contractor called Packers Sanitation Services. It is a contractor for slaughterhouses that are owned by giant food processing firms like JBS and Tyson Foods. There are a range of safety issues in slaughterhouses, including high injury rates including amputations. In 2017, Bloomberg Businessweek deemed Packers to be the nation's most dangerous employer. At the start of this school year, an eighth-grade girl reported to her Nebraska middle school with acid burns on her hands and knees. The US Labor Department launched an investigation. In

December, the agency won a nationwide injunction in Nebraska federal court against what the judge called “oppressive child labor” at Packers.

In February, the Labor Department found that Packers had employed at least 102 children – mostly undocumented migrants – across eight states, from Texas to Minnesota. The owners of Packers, through Blackstone Core Equity Partners I, are Canada Pension Plan ($1 billion invested in the fund), New York State Common Retirement Fund ($300 million), North Carolina Retirement Systems ($250 million), Finnish Local Government Pensions Institution (€226 million), National Pension Service of Korea, PensionDanmark, State Oil Fund of the Republic of Azerbaijan, and Houston Firefighters’ Relief and Retirement Fund.

That same month, an investigative report in the New York Times focused on the prevalence of child labor among unaccompanied child migrants in the US. It described a factory in Michigan operated by Hearthside Food Solutions where many child workers were employed. Owned by Charlesbank Capital and Switzerland’s Partners Group, Hearthside is the largest US firm manufacturing food on a contract basis for household brands. Its business partners include brands like Cheerios for General Mills and the Quaker Oats and Frito-Lay divisions of PepsiCo.

In both of these instances, private equity firms offered brand-name clients a layer of distance from “S” risks, by outsourcing a part of their business process that involves large-scale low-wage labor under dangerous conditions, while promising to reduce costs. Hearthside, the provider of outsourced services in Michigan, took the deniability of labor abuses one step further, by suggesting to the Times that the staffing agency it used was to blame.

In reviewing the Times findings, General Mills stated that it recognizes “the seriousness of the situation.” PepsiCo later stated: "We are deeply concerned about the allegations of labor violations by one of our manufacturing partners. While we neither own nor operate these facilities, we hold our suppliers to the highest standards and require compliance with all laws and regulations as well as with our Global Supplier Code of Conduct, which specifically prohibits the hiring of underage workers."

In 2022, Hearthside’s revenues totaled $4.24 billion, according to Chicago Crain’s Business. To date, the company has not been fined in connection with the firm’s hiring of children. A Labor Department investigation is in progress, but as an article in Fortune by two legal experts at the National Employment Law Project notes: “Although corporations that outsource labor to staffing agencies are legally responsible as joint employers…they are rarely held responsible in practice.”

While some argue that it is the responsibility of the US government to address these problems, in practice, the government has very limited resources available to do so. The US Department of Labor has only one occupational safety officer for every 70,000 US workers. Even when the department investigates abuses and finds a company responsible, the fines are extremely low.

In the case of Packers, the government was able to document 102 cases of child workers in 8 states. These findings resulted in civil fines totaling $1.5 million, based on the maximum fine of $15,000 per child for violations of the 1938 Fair Labor Standards Act not resulting in death or serious injury. Packers revenues in fiscal year 2021 were $579 million. Congress is now considering a bill that would raise the maximum fine to $700,000 per child in cases of serious death or injury, with up to 10 years in prison for repeat offenders.

Today's group exercise focuses on Packers Sanitation Services and Blackstone Core Equity Partners. The question we are exploring is what accountability measures should be in place to address the exploitation of child labor. The specific question on which each group will focus is whether private equity firms should have direct responsibility for labor rights violations involving companies they own. If so, how and by whom? And if they are not responsible, then who should be? You will be divided into five groups to explore these questions from different perspective

Group 1 – ESG team at Blackstone

Stung by the negative publicity generated by the January court decision against Packers, senior leaders of the firm have asked you to develop an ESG plan, consistent with the firm's business model, that will demonstrate Blackstone's commitment to combatting child labor. You are exploring different options. Some on your team think the firm should make charitable contributions to organizations like the Children's Defense Fund. Others on your team want to go further. They argue that the company should build stronger due diligence systems, requiring it to take greater responsibility for the actions of Packers and other high-risk companies it owns. Advocates of this more ambitious option argue that Blackstone has human rights responsibilities that go beyond its legal obligations, stressing the need to maintain the firm's reputation among limited partners and the public at large, and the imperative of staving off increased government regulation.

Group 2 – Blackstone's C-Suite

Your role is to balance the arguments made by your firm's ESG team and your general counsel and others in the firm who favor a stay the course alternative. Because Blackstone is 88% privately held, it does not face the same level of shareholder pressure as a typical publicly-traded firm. It also has been very successful historically in insulating itself from legal liability claims relating to companies in which it invests. It has done so with Packers Sanitation Service, avoiding the assumption of any liability in connection with the cases where the court found unlawful child labor. You will consider these different internal perspectives as well as what you are hearing from limited partners like Yale's investment office and from other commentators like the conservative American Compass think tank.

Group 3 – Investment office at Yale

The Yale investment office is considering placing some of its endowment funds into a new Blackstone ESG investment fund. You have been told that student activists at Yale are planning a fall campaign to protest the university's relationship with Blackstone as a portfolio manager for any part of the university's $42 billion endowment. They are singling out Blackstone because of the Packers case. You have been asked by the President's office how the university should respond, especially in light of the Labor Department's findings on the use of child labor by Packers.

Group 4 – Canada Pension Plan

You are the trustees of Canada Pension Plan Investments Board, which holds the largest stake in the Blackstone Core Equity Partners fund that owns Packers. Should you engage with Blackstone, and if so what will you tell them? You hear that Blackstone is raising a new fund that you are worried may invest in sectors prone to labor and human rights risk. Should you invest in the new fund? Would your responses be the same if you were the trustee of an LP that is not a public pension plan?

Group 5 – American Compass Think Tank

Launched in 2019 American Compass is a conservative think-tank in Washington headed by Oren Cass, a former senior staffer to Senator Mitch Romney (R-Utah). Its mission is to persuade pro-business Republicans that they should cast a more skeptical eye on Wall Street's private equity firms and hedge funds.

American Compass is working to "re-direct Republican policies to support businesses that make things and contribute to the real economy." The organization has been critical of financial firms that are engaging in what they call "Coin-Flip Capitalism." According to American Compass, these firms employ "complicated, high-fee investment strategies [that] gobble up money and business talent while generally performing worse than basic market indexes. That enriches fund managers but does little to benefit society."

The leaders of American Compass have turned their attention to the Packers case. It is considering using this case as a catalyst for strengthening US law and regulatory policies that will protect vulnerable workers and increase transparency and greater accountability for private equity firms.