**Senate Committee on Finance Hearing**
**July 31, 2007**

*"Carried Interest, Part II"*

**Testimony of:**
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Good morning. My name is John Frank and I am the Managing Principal of Oaktree Capital Management, L.P. I'm here to address the merits of the proposed PTP legislation (S.1624) and the adverse impact it has had on our unitholders, such as mutual funds managed by Fidelity, Lord Abbett and Marsico, and the many individual American savers who invest through these intermediaries.

As an initial matter, allow me to observe that there are thousands of investment firms managing perhaps as much as $2 or $3 trillion that are loosely referred to by many as "private equity" and "hedge" funds. As I am sure the Committee appreciates, the investment strategies pursued by those firms, and the business principles they observe, range from conservative to aggressive. We think we fall on the conservative end of the spectrum.

Oaktree is a leading global investment firm focused on non-mainstream and alternative markets. Unlike mutual funds, which traditionally invest only in publicly-traded equities or investment grade bonds, our investments are concentrated in less well-known "alternative" asset classes or strategies. We invest about $47 billion in a wide range of strategies, including high yield bonds, distressed debt, private equity (including power infrastructure), convertible securities, real estate, emerging market equities, mezzanine finance, and Japanese equities. No one strategy predominates among our offerings. Private equity, as of June 30, 2007, constituted about $8.5 billion, or 18% of our assets under management. As best we know, no client has ever lost money investing with Oaktree.

We believe that our investment success stems from our focus on the avoidance of loss rather than the pursuit of outsized gains. Thus our overriding belief is that "if we avoid the losers, the winners will take care of themselves."

What we do – and do well – is invest money on our own behalf and on behalf of our clients and the beneficiaries and the investors they represent. Our clients include 128 corporate pension plans; the pension plans of 28 of the 50 states; 225 college, university, cultural or charitable endowments or foundations; and 38 insurance companies. We are not an investment bank – that is, we do not offer financial advisory services, we do not help companies buy or sell other companies, we do not trade or underwrite securities as a

business, nor do we offer mutual funds. Our competitors are other investment managers, including hedge and private equity funds.

Unlike many of our competitors, our firm has benefited from broad-based employee ownership virtually since its inception. We now have about 85 employee-owners. Other owners include a state pension plan and several charitable endowments.

In May of this year, we sold a 16% interest in Oaktree to a large group of institutional investors – mostly mutual funds and other investment funds – through an offering underwritten by Goldman, Sachs & Co. As a result, our equity now trades on an over-the-counter market developed by Goldman Sachs for qualified institutional buyers – institutions with at least $100 million of investment assets. We limited our offering to sophisticated investors for a number of reasons, including a concern that the average retail investor might not be well-equipped to analyze appropriately and understand the long-term focus and the inherent volatility of our business.

All of our employee-owners, together with our outside owners, sold a portion of their interests on a pro rata basis in the offering. We believed having tradable equity would provide a valuation mechanism and liquidity that will help us succeed in the intense competition for talented investment professionals and facilitate an orderly transition from the current owners of Oaktree to our future leaders. Although we raised some new equity capital in the offering, raising capital was not a major motivation for us, given that our firm, like other substantial investment advisors, generates surplus capital.

Historically, our business, like that of almost all of our competitors, was structured as a partnership. As such, all the income was taxable to the partners, and not to Oaktree. Consistent with that historical practice, when we decided to undertake the offering, we sought to continue our business as a partnership by relying on the statutory exception for publicly traded partnerships or "PTPs," that permits an entity to continue to be taxed as a partnership if it has sufficient "qualifying" income. Our decision to structure ourselves as a PTP did not represent any "stretching" of the tax law – a conclusion that I believe is consistent with Treasury testimony before this Committee.

Guided by prominent accounting and law firms, we carefully reviewed each of our investments and activities to identify those that clearly satisfied the qualifying income definition under the PTP rules and those that did not. We arranged our affairs to satisfy the statutory requirements by ensuring that any non-qualifying income – including all of our management fees and the income generated by our mezzanine finance and real estate strategies – flows into a corporate subsidiary and is subject to corporate tax. At no time was there any suggestion that anything we were doing was beyond the letter, or even the spirit, of the law.

I think it's worth emphasizing that, as a result of our offering, we have now subjected a substantial portion of our income – including the management fees that have historically represented between one-third and one-half of our income – to a corporate level tax. As a private partnership, Oaktree did not pay tax on any of its income, only its partners did.

Even though we were raising the tax burden on the business and thus placing ourselves at a competitive disadvantage vis-à-vis the vast majority of our thousands of competitors (who continue to operate as private partnerships), we believed that the benefits of our offering and public ownership would exceed the additional tax burden.

In making that judgment, however, we had no reason to believe that legislation would be proposed just weeks after we offered our units for sale that would subject all of our income to corporate tax and our distributions to a second level of tax. If we had understood that a bill like this would be proposed, and retroactively applied to transactions consummated before the change in law was even proposed, we might well have pursued a different route to establish a valuation mechanism and to provide liquidity for our equity.

While we think fair tax policy requires greater transition relief if the Committee changes the PTP rules as proposed, we first and foremost urge the Committee not to adopt the proposed legislation. We believe passing the PTP legislation will discourage the salutary trend of alternative investment firms going public, will increase the relative attractiveness of non-U.S. capital markets, and will target unfairly a single industry.

While a small number of our competitors announced an intention to go public after the legislation was proposed, we believe that this legislation will generally discourage other firms from doing so. Our business tends to generate surplus capital, meaning that firms like ours do not need to access public markets to raise capital. If Congress adopts legislation that in effect imposes a penalty on going public, we believe that many firms like ours will conclude that the burden exceeds the benefit.

In my judgment, that would be unfortunate. If we could turn the clock back just a few short months, we would find that primary concerns about private equity and hedge funds were that their private operation shielded the funds from public scrutiny and that the ordinary investor had no access to ownership of the companies doing business in this asset class – leaving it to the wealthy who have historically benefited from the diversification it offers. If this legislation were to go forward, it would discourage public offerings of firms like Oaktree, the industry would continue to operate largely out of the public eye, and the average investor would lose the ability to participate in these investment opportunities.

Imposing a corporate tax on investment PTPs, like Oaktree, also raises larger questions regarding the competitiveness of the United States capital markets. Historically, the United States has been the preferred location to raise capital. But our capital markets no longer hold the allure they once did. Many other nations are moving aggressively to cut tax rates and take other steps to attract capital. At the same time, many investment managers believe that the most attractive investment opportunities are disproportionately abroad. As a result, many investment firms are already locating or expanding their operations and employment abroad – a trend that will only increase if multiple levels of tax are imposed upon our industry.

Moreover, I do not know of any principled justification for disallowing PTP status for qualifying investment management firms, while continuing to permit such status for firms in other sectors of the economy. It strikes me as unfair and inconsistent that the proposed legislation would impose a corporate tax on the *passive* income of PTPs (dividends, interest, and capital gains) in our sector, which would result in some cases in triple taxation of income, while continuing to shield from the corporate tax the *active* income of PTPs in certain other favored sectors. For these reasons and others, we believe policy considerations favor preserving the current tax treatment of PTPs.

If, however, the Committee adopts this legislation, equity and fairness require that Oaktree, and any other PTP trading before the introduction of the proposed legislation, should receive transition relief for a period of at least ten years. As you know, when Congress adopted the PTP rules in 1987, it provided a ten-year transition period. At the end of that period, in 1997, Congress went further and provided for permanent relief for grandfathered PTPs. A ten-year transition period would be consistent with past precedent and reduce the economic harm suffered by the outside investors from the introduction of the PTP legislation.

And that is the reason I am here today. In connection with our offering, I traveled with my colleagues all over the country speaking with potential investors about Oaktree and our business. In those meetings, we emphasized that we were seeking long-term investors comfortable with our management approach and long-term focus and with the staying power to ride through the inevitable ups and downs of our business. We met with a warm reception and our offering, which was oversubscribed, began to trade on May 22, 2007.

When S. 1624 was introduced on June 14, 2007, our unit price plummeted almost ten percent overnight – representing a loss of over $500 million in our market capitalization and close to $100 million for our new investors – notwithstanding the proposed five-year grandfather provision. The market had not anticipated the change in law contemplated by the bill. After a subsequent House bill was introduced with no grandfather provision (H.R. 2875), and a House bill changing the treatment of carried interests was introduced (H.R. 2843, by Representative Levin and Chairman Rangel on June 22, 2007), our unit price slipped an additional five percent. A chart showing the decline in value resulting from the proposed legislation is attached.

As a result, our outside investors – pension funds, mutual funds and other investment funds managing the personal savings and retirement funds of working Americans – have lost close to 15% of their investment. Although I had no idea this legislation might be proposed, I feel an obligation to do everything I can to see that the losses suffered by these investors are recovered.

In that connection, it's important to note that our investors, and the investors in the PTPs that preceded us, are the only outside investors that were adversely affected by the proposed legislation. While our investors were aware, of course, that our nation's laws are subject to change, they had no reason to anticipate a fundamental change to the

taxation of PTPs just a few weeks after their purchase. In this respect, the position of our outside investors is quite different from those that may invest in a PTP subsequent to the introduction of the proposed legislation. Those investors, unlike ours, were on notice that the tax regime might change, and the price they paid for their investment presumably reflected that uncertainty.

Some have suggested – mistakenly in my view – that transition relief for our outside investors would provide Oaktree some unfair competitive advantage. While transition relief would ameliorate the loss suffered by our outside investors, it would not afford Oaktree a competitive advantage in the areas crucial to its continuing business operations – attracting capital for its funds or bidding on assets for investment. Whether an investment firm structured as a PTP is taxed as a partnership or corporation is irrelevant to the competition for client capital – which is the main source of capital for investment and the main area of competition among firms in our business. A transition rule that protects the investment expectations of the outside investors who invested in Oaktree will not give Oaktree an advantage in the competition for investment clients or enhance its investment opportunities.

Thank you for allowing me this opportunity to speak with you today. I would be happy to address any questions that you may have.