

**Ballard Spahr**  
LLP

*Structuring and Implementing Executive Compensation  
Strategies in Private Equity Portfolio Companies: Trends,  
Tips and Techniques*

February 28, 2019

**Ballard Spahr**  
LLP

## Presenters

**Craig O'Donnell**

Principal, People & Organizations Practice, PwC  
Tel.: (617) 530-5400 | E-Mail: craig.odonnell@pwc.com

**Nicole Strait**

Chief of Organization Strategy, Norwest Equity Partners  
Tel.: (612) 215-1640 | E-Mail: nstrait@nep.com

**Brian Pinheiro**

Partner and Practice Group Leader, Employee Benefits and Executive Compensation, Ballard Spahr  
Tel.: (215) 864-8511 | E-Mail: pinheiro@ballardspahr.com

**Josh Natzel**

Partner, Employee Benefits and Executive Compensation, Ballard Spahr  
Tel.: (612) 752-1041 | E-Mail: natzelj@ballardspahr.com

**Meredith Dante**

Partner, Employment and Labor, Ballard Spahr  
Tel.: (215) 864-8132 | E-Mail: dantem@ballardspahr.com

2 |

**Ballard Spahr**  
LLP

## Agenda

1. Trends in Private Equity Portfolio Company Executive Compensation
2. Strategic and Collaborative Compensation Design
3. Equity and Cash Compensation Alternatives in Private Equity Portfolio Companies
4. Common Employment Law Issues Facing Private Equity Funds and Their Portfolio Companies

3 |

**Ballard Spahr**  
LLP

**Ballard Spahr**  
LLP

*Trends in Private Equity Portfolio Company Executive Compensation*

Craig O'Donnell | PwC

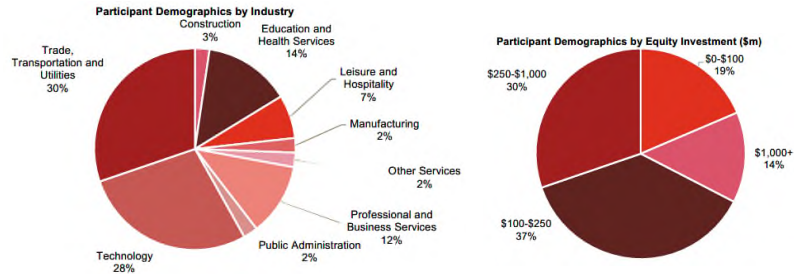
[www.pwc.com](http://www.pwc.com)

**2018 Private Equity  
Portfolio Company  
Management  
Compensation Survey**

4 |

**Ballard Spahr**  
LLP

## Survey Participant Demographics

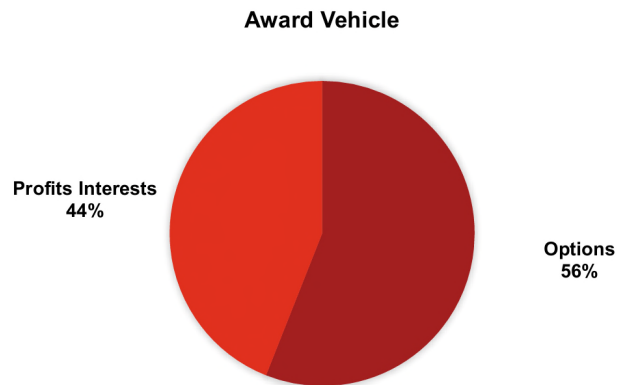


5 |

Ballard Spahr  
LLP

## Award Vehicles

- Growth-based vehicles (options and profits interests) are the rule for PE portfolio companies
- Use of profits interests has increased

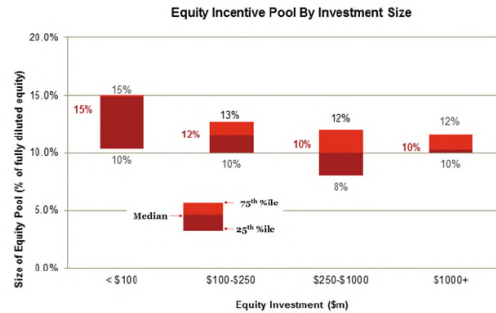


6 |

Ballard Spahr  
LLP

## Management Equity Pool Size

- At the median, sponsors are reserving 11% of fully-diluted shares for issuance under management incentive plans
- Pool sizes of 15%+ generally only reserved among investments of less than \$100 million



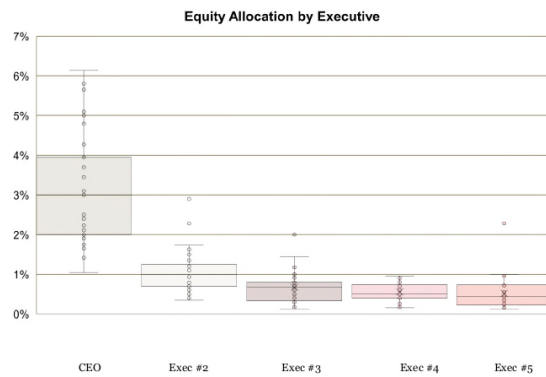
Figures above rounded for illustrative purposes

7 |

Ballard Spahr  
LLP

## Executive Allocations

- Allocations of fully-diluted shares to the CEO has increased
- Grants to top five executives comprise approximately 55% of equity pool

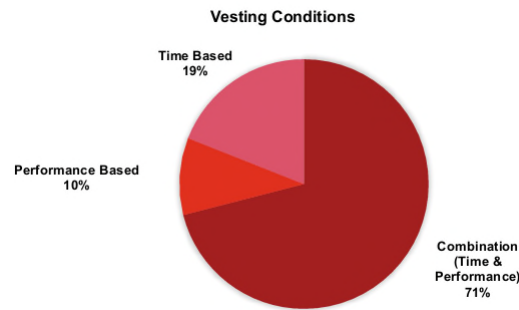


8 |

Ballard Spahr  
LLP

## Award Vesting

- Sponsors continue to tie award vesting to challenging performance metrics (typically ties to the sponsor's return)
- There is an overwhelming tendency to include MOIC in performance objectives (generally requiring a 3.0x return for full vesting)
- Time-based awards typically vest ratably over five years. Most common split is 50% (time)/50% (performance)

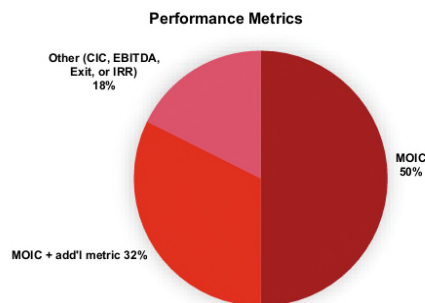


9 |

Ballard Spahr  
LLP

## Performance-Based Vesting Metrics

- Where performance-based vesting criteria are used, they are increasingly tied to investment returns
- Sponsors are far more frequently tying vesting to MOIC than IRR (generally due to longer holding periods face by sponsors which make it more difficult to achieve IRR goals)

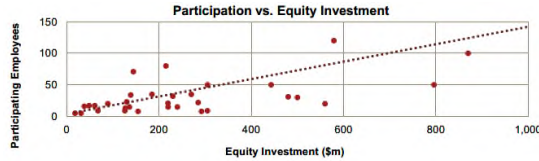


10 |

Ballard Spahr  
LLP

# Participation

- Sponsors are increasing the depth of participation in management equity plans for larger investments
- There is a direct correlation between investment size and participation with investments of \$300+ million. Technology companies include the largest percentage of workforce in the plans.



Note: Certain data points have been excluded from the exhibit for illustrative purposes

Overall Sample by Industry (Investment >\$100m)

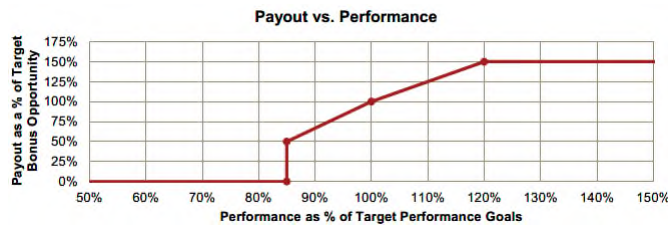
Industry	# of Records	Median Participation (%)	Median Participation (#)
Information & Technology	8	10.1%	75
Professional & Business Services	5	3.8%	34
Trade, Transportation & Utilities	9	4.1%	21
Education & Health Services	5	0.8%	35
Other	5	0.9%	22
<b>Grand Total</b>	<b>37</b>	<b>3.6%</b>	<b>32</b>

11 |

Ballard Spahr  
LLP

# Annual Incentive Plans

- Sponsors are thinking more strategically about the use of annual incentives plans by identifying the key enterprise, functional and individual performance indicators that complement the company's operating plan
- EBITDA remains most prevalent metric for determining annual incentives, however, over half of programs include additional performance metric(s) to determine bonus payment



Executive Bonus Targets

	PortCo Mgmt Comp Survey	Published Comp Survey (public)
Chief Executive Officer	88%	95%
Chief Financial Officer	59%	65%
Chief Operating Officer	61%	70%

12 |

Ballard Spahr  
LLP

## Historical Trends

		2009	2013	2016	2018
Equity Award Vehicles	Stock Options:	78%	70%	75%	56%
	Profits Interests:	19%	23%	18%	44%
	Other:	3%	7%	9%	
Share Reserve Pools	50 <sup>th</sup> Percentile	9%	10%	12%	11%
Top 3 Grants (Median)	CEO:	1.8%	2.0%	2.1%	3.0%
	#2 Executive:	0.8%	1.0%	1.0%	1.0%
	#3 Executive:	0.5%	0.7%	0.5%	0.7%
Vesting	Time – Only	16%	18%	23%	19%
	Performance – Only	9%	9%	8%	10%
	Combination – Time & Performance	75%	74%	70%	71%
Participation	50 <sup>th</sup> Percentile	1.8%	27 (3.5%)	27 (3.7%)	32 (3.6%)
Sample Size	# Portfolio Companies	32	30	34	43

13 |

Ballard Spahr  
LLP

## The KKR Industrials “Experiment”

Kohlberg Kravis Roberts (KKR) has implemented a broad-based equity incentive and employee ownership program in portfolio companies within its Industrials Group, which is principally made up of manufacturing companies with numerous hourly workers

Designed to address what KKR views as a misalignment of incentives between hourly employees and employers:

- Employers focus on quality, cost and on-time delivery
- Employees focus on hours, because how much they get paid depends on how many hours they work (if an employer falls behind on a job, it may be bad for the business, but it is good for the employees because they receive overtime pay to catch up)

Three principal elements to model:

1. Invest in the workforce
2. Make everyone an owner
3. Community involvement

14 |

Ballard Spahr  
LLP

## KKR – Making Everyone an Owner

1. Create a very large option pool
2. All employees receive free options
3. All employees given the opportunity to invest up to \$5,000 alongside KKR
4. Make the equity feel “real” to employees
  - Educate employees about what it means to own equity
  - Show employees how each of them contributes to financial performance
  - Issue physical stock certificates
  - Pay a small early dividend (even several thousand dollars can be significant to hourly workers) and let employees know there is more to come if the business succeeds

15 |

**Ballard Spahr**  
LLP

**Ballard Spahr**  
LLP

*Strategic and Collaborative Compensation Design*

Nicole Strait | Norwest Equity Partners

Partnering with management teams.  
Investing capital to create long-term value.  
Building companies since 1961.

**N|E|P**

16 |

**Ballard Spahr**  
LLP

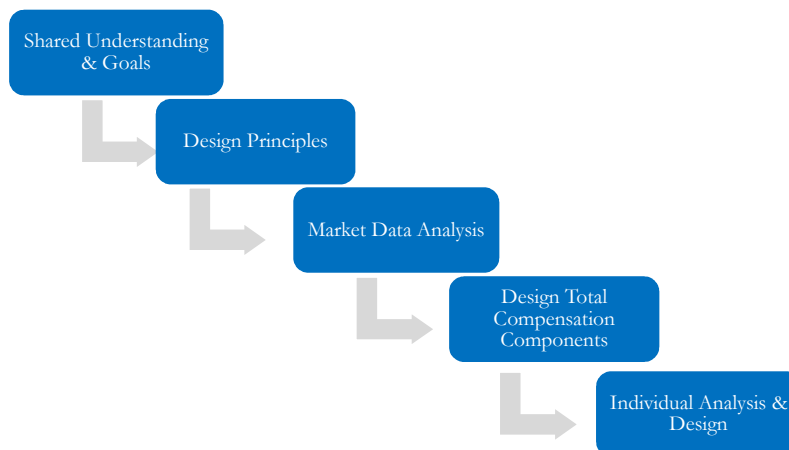


## A Strategic Management Tool

Total Compensation is an important management tool requiring thoughtful, collaborative and strategic design intended to:

- Create focus in areas that lead to desired outcomes
- Attract and retain the talent needed
- Create a high performance, results-oriented culture
- Balanced short and long-term focus
- Align the organization
- Align management and investors
- Strengthen partnership with CEO through a collaborative design process

## Strategic & Collaborative Design



Example

## Total Compensation Elements

---

Compensation	Benefits	Work Environment
<ul style="list-style-type: none"> <li>–Base Salary</li> <li>–Short-term Incentives</li> <li>–Long-term Incentives</li> </ul>	<ul style="list-style-type: none"> <li>–Health Plan</li> <li>–401(k) &amp; Match</li> <li>–Dental</li> <li>–Disability</li> <li>–Life</li> <li>–PTO</li> <li>–Holidays</li> </ul>	<ul style="list-style-type: none"> <li>–Flexibility</li> <li>–Summer Hours</li> <li>–Casual Dress</li> <li>–Values &amp; Culture</li> <li>–Talented Colleagues</li> <li>–Workspace &amp; tools</li> <li>–Location, no parking fee</li> <li>–Stocked Fridge</li> <li>–Training &amp; development</li> <li>–Discounted product</li> <li>–Leadership effectiveness</li> <li>–Communication</li> <li>–Employee involvement</li> </ul>

19 | NORWEST EQUITY PARTNERS | BUILDING COMPANIES SINCE 1961

Ballard Spahr  
LLP

Example

## Total Compensation Strategy

---

We strive to provide a total compensation program that:

- Attracts experienced, capable industry and functional experts
- Recognizes and retains collaborative, results-oriented, strong contributors
- Provides market competitive base & variable pay opportunities considering the position scope, responsibilities, location, skill and experience
- Aligns the organization through an incentive pay plan that rewards strong business performance with strong payout opportunity
- Provides key employees and executives with a long-term incentive opportunity aligned to shareholder interests
- Offers a market-leading health plan that supports our employees and their families in their efforts to live healthy lives
- Encourages retirement savings by providing a competitive 401k match
- Includes a unique, casual, and flexible work environment
- Drives focus on the objectives that drive and balance both short-term and long-term business performance
- Is accurately administered and effectively communicated

20 | NORWEST EQUITY PARTNERS | BUILDING COMPANIES SINCE 1961

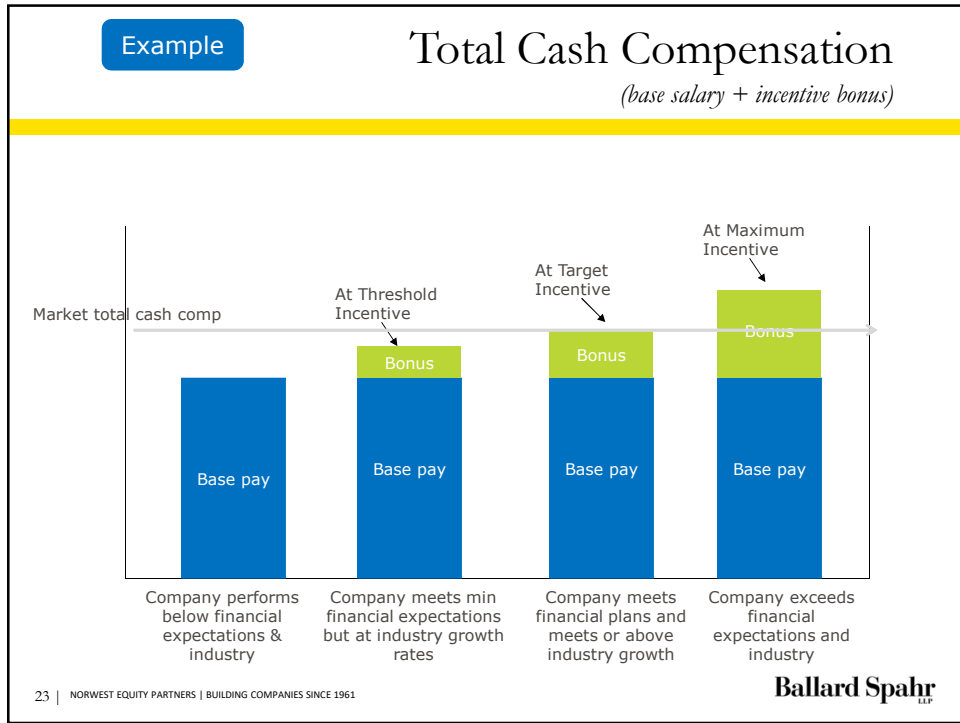
Ballard Spahr  
LLP

## Short-Term Incentive Plan – Design Considerations

- **Purpose:** What do we generally want to drive/reward/create focus through variable pay? How will this plan help us attract, retain, motivate and reward?
- **Participation Philosophy:**
  - **Eligibility:** Management, salaried, hourly, or all?
  - **One or more plans:** All employees on same plan, different plans/metrics for different groups or levels, facility specific plans, some combo?
  - **Sales incentive:** Will there be a different plan on top of or in lieu of co plan? Will the sales plan utilize incentive targets or be commission based?
- **Payout frequency:** Monthly, Quarterly, Annually, or combination?
- **Incentive Metrics:** Where do we want to focus the organization and what outcomes are we trying to drive this year? Focus may change over time.
  - **Business metrics:** EBITDA, Revenue, Net Sales, Business Unit or Dept. metrics (operations, sales, etc.), Individual objectives/performance, Non-financial business plan objectives (i.e. innovation pipeline, large initiatives), discretionary, etc.
  - **Weighting:** Needed if more than one metric
  - **Goals:** Set payout level goals for each metric - based on internal improvement % YOY, vs. budget, and/or performance versus market/competition? (i.e. consider that budgeted performance can be above-market performance in a growth company)

## Short-Term Incentive Plan – Design Considerations

- **Funding:** Self-funding or not; circuit breaker to begin paying at threshold; % of EBITDA funds pool and then allocated based on performance in metric areas or no pool concept – set performance /payout levels that make sense as % of EBITDA
- **Share to employees:** Is there a % of EBITDA share to employees that the company is trying to achieve? Will this vary from year to year based on strategic focus (i.e. investment year, new execs added, etc.) or size of company (% of EBITDA share to employee typically declines over time with growth & mgmt. cost leverages).
- **Individual Opportunity Level:**
  - **Target:** Standard payout target as % of salary (starting/ending) or “eligible earnings” for each job level? Determine if market data driven, past practice driven, or varies/discretionary by individual? Consider internal peer level equity.
  - **Cut-in / Threshold as % of Target opportunity:** at \$1 , 50%, other. Will all have same structure as % of their individual target or is the range different by role or individual?
  - **Maximum as % of Target opportunity:** 125%, 150%, 200% , other. Will all have same max as % of their individual target?
- **Adjusted EBITDA:** What items will be considered adjustments to EBITDA for the purpose of incentive plan calculations. The eligible adjustments should be determined up front and approved as part of the plan approval.
- **Administration Guidelines:** Document important plan admin policies



**Example** **F'18 Annual Incentive Plan**

(\$000)	Weight	FY18 Budget	2018 payout levels		
			Threshold	Target	Max
Net Sales					
% Growth vs. PY					
EBITDA					
% Growth vs. PY					
% of Net Sales					
Pre-Bonus EBITDA					
Payout % of Target					
Payout Amount					
EBITDA Share to EE					

24 | NORWEST EQUITY PARTNERS | BUILDING COMPANIES SINCE 1961 **Ballard Spahr LLP**

Example

## Annual Incentive Plan Targets

---

Position Level	As a % of Eligible Earnings		
	Threshold (50% of target)	Target	Max (150% of target)
- All other employees			
-Managers	5%	10%	15%
-Sales Team			
-Directors			
-Vice President			
- SVP/C-level			
- CEO			

25 | NORWEST EQUITY PARTNERS | BUILDING COMPANIES SINCE 1961

- Example

## Administration Guidelines

---

  1. All full-time and part-time employees are eligible to participate in the annual incentive plan. Temporary, intern or contract employees are not eligible.
  2. Incentive bonus target and opportunity levels are set as a percentage of eligible earnings.
  3. Eligible earnings include base pay, overtime, holiday or vacation pay during the incentive period. Eligible earnings exclude commission, sales incentive, prerequisites, relocation benefits, car allowance, signing bonus, incentive payments or any other one-time lump sum payment or benefits.
  4. No payments under this plan shall occur unless the threshold goal(s) is achieved. EBITDA must exceed prior year results before any bonus will be paid on non-EBITDA metrics.
  5. Straight-line calculations will be applied for performance between payout levels above the threshold.
  6. Maximum payout under this plan is 150% of target.
  7. Employees must be employed as of the payout date to be eligible for this incentive plan payment unless otherwise stated in an individual agreement.
  8. In the case employment is ended due to the employee's death or permanent disability, a prorated portion of any earned incentive payment would be paid out following the completion of the fiscal year and calculated based on eligible earnings during the incentive period.
  9. The amount, criteria, plan provisions, rules and conditions of the annual incentive plan shall be solely within the discretion of the Board of Directors and may be modified, amended or canceled at any time unless otherwise stated in an individual employment agreement.

26 | NORWEST EQUITY PARTNERS | BUILDING COMPANIES SINCE 1961

## Long-Term Incentive Plan – Design Considerations

- **Purpose:** What do we want to drive/reward through variable LTI?
- **Pool size & Type of Plan/Units**
- **Participation Philosophy:** Executive only, Management, Key Employees, all? Forecasted future hiring/promotion/retention needs?
- **Vesting & metrics:** Time, performance, type of performance metrics
- **Individual opportunity level:** Same for all in peer group or varies by individual? Market data used? Ranges by level or set amounts by level?
- **Allocation timing and planning:** All up front (upon hire, transaction or after close, promotional increases), annual grants, or varies/discretionary?. Fully allocate up front, allocate as needed, intentional dry powder/reserve based on forecasted needs, handling of unallocated at/before exit.
- **Design and allocation involvement:** CEO, Sponsor Deal team, Board, Comp Committee, HR leader or CFO
- **Communication Tools Needed & Document Management Responsibilities**

### Example

## Long-Term Incentive Plan Design

### Purpose:

The purpose of Company X's long-term incentive program is to:

- Attract an experienced and talented management team and key employees and encourage their long-term commitment and performance.
- Align the compensation of key employees with shareholder interests to enhance shareholder value and share in the future success of our long term performance.

### Allocation Guidelines:

Title	% of Total Pool	% of Fully Diluted	Ann. Equity Value - Expectation*	Ann. Equity Value - High End*
CEO				
Senior Executive (SVP/C-level)				
Function Exec (VP)				
VP/Dir – below Exec Team				
Manager				
Sr. Indiv Contr / Key Employee				

\* Expectation assumed to be a \_\_x return and High End assumed to be a \_\_x return, over a 5-year investment period.

Example

Allocation Forecast

---

Current Option Holder	Title	Total Options	Current	
			% of Option Pool	Total FD Units %
	CEO			
	President			
	CFO			
	VP Operations			
	SVP Marketing & Sales			
	VP HR			
	Sales Director			
	VP R&D			
	Key Manager			
	Proj Manager			
	Board Advisor			
	Board Advisor			
	Unallocated Options			
	Forfeited Options			
	<b>Total Options</b>		<b>100.0%</b>	
	<b>Forecasted Future Needs</b>		<b>Forecasted Need</b>	
	Flex - Dry Powder			
	Director FP&A			
	Director Product Line			
	Director Product Line			
	VP IT			
	Sales Director			
	Director level / Sr. Indiv Contributor			
	Director level / Sr. Indiv Contributor			
	Director level			
	Director level			
	Total Available			

29 | NORWEST EQUITY PARTNERS | BUILDING COMPANIES SINCE 1961

*Equity and Cash Compensation Alternatives in Private Equity Portfolio Companies*

Brian Pinheiro and Josh Natzel | Ballard Spahr

30 |

## Agenda

- Cash v. Equity Compensation
- Types of Cash Compensation Arrangements
  - Phantom Units
  - Unit Appreciation Rights
  - Bonus Programs
- Types of Equity Compensation Arrangements
  - Profits Interests
  - Capital Interests
  - Options
  - Management Aggregator Structure

31 |

Ballard Spahr  
LLP

## Cash vs. Equity Compensation

- Cash Compensation
  - Advantages:
    - Can be designed to mimic equity interest, and align interests of equity owners with portfolio company management without diluting equity
    - Compensation deduction for portfolio company
    - Simplicity
  - Disadvantages:
    - Ordinary income tax treatment for portfolio company management
      - No opportunity for capital gains treatment
    - Management employees may not have the same sense of equity ownership
    - Additional Code Section 409A considerations

32 |

Ballard Spahr  
LLP



## Cash vs. Equity Compensation

- Equity Compensation
  - Advantages:
    - Aligns interests of equity owners with portfolio company management
    - Promotes sense of equity investment among management employees
    - Capital gains opportunity for management employees
  - Disadvantages:
    - More complicated than cash compensation
    - Equity ownership rights (*e.g.*, voting, transfer, tax distribution) must be addressed
    - Management employees treated as partners for tax purposes
      - May be addressed by Management Aggregator structure

33 |

Ballard Spahr  
LLP

## Cash Compensation

- Phantom Units
  - Provides cash payment at a specified time equal to the full value of a specified number of company units
- Unit Appreciation Rights (UARs)
  - Similar to Phantom Units, but provides cash payment equal only to the increased value of a specified number of company units over a future period of time

34 |

Ballard Spahr  
LLP

## Cash Compensation

- Phantom Units and UARs
  - Designed to look like equity compensation, but does not provide equity interests
    - No voting or other equity holder rights
    - Only ordinary income for the holder; no opportunity for capital gains treatment
      - Could consider a tax gross-up to make up for the difference between ordinary income and capital gains tax treatment

35 |

Ballard Spahr  
LLP

## Cash Compensation

- Phantom Unit and UAR Plan Considerations
  - Pool of units
  - Code Section 409A
    - Exempt from or compliant with
  - Unit valuation
  - Vesting
    - Time and/or performance based
    - Acceleration, forfeiture and clawback events
  - Payment events
    - Fixed date, separation of service, death, disability, change in control

36 |

Ballard Spahr  
LLP

## Cash Compensation

- Phantom Unit and UAR Plan Considerations
  - Payment terms
    - Lump sum or installments
    - Immediately upon a change in control or if, as and when payments are received by equity holders
  - Tax compliance
    - Income and employment tax
    - Company deduction

37 |

Ballard Spahr  
LLP

## Cash Compensation

- Phantom Units and UAR Trends:
  - UARs more commonly used
  - Performance-based vesting
    - Over a period of years based on EBITDA targets
    - Multiple of return upon change in control
  - Change in control payments paid if, as and when equity holders are paid

38 |

Ballard Spahr  
LLP

## Cash Compensation

- Bonus Programs
  - Common forms:
    - Annual and long-term performance based
    - Change in control
    - Retention
  - 409A considerations
    - Generally exempt as short-term deferral
  - Simplicity

39 |

Ballard Spahr  
LLP

## Equity Compensation

- Profits Interests
  - Equity interest in a partnership or an LLC that entitles the holder to a share of the increase in the value of the entity over time, beginning on the grant date
    - Similar to a stock appreciation right (SAR) in a corporation
  - May be subject to a vesting schedule at grant
    - Time-based or performance-based

40 |

Ballard Spahr  
LLP

## Equity Compensation

- Profits Interests
  - Typically, profits interests have no value at grant
  - If safe harbor is satisfied, all future appreciation treated as capital gain
    - Received in exchange for performance of services
    - Must not relate to a substantially certain and predictable stream of income from partnership or LLC assets
    - Holder must not dispose of profits interest for 2 years
  - Holders file a protective section 83(b) election in case safe harbor not satisfied

41 |

Ballard Spahr  
LLP

## Equity Compensation

- Profits Interests
  - Holder of a profits interest is treated as a partner, rather than an employee
    - Would receive a Form K-1, rather than a Form W-2
    - Subject to self-employment tax and estimated taxes
    - Check benefit plans to confirm that partners can participate
  - May be able to avoid partner treatment by issuing profits interests under a “Management Aggregator” structure

42 |

Ballard Spahr  
LLP

## Equity Compensation

- Capital Interests
  - Equity interest in a partnership or an LLC that entitles the holder to a share of the full value of the entity
    - Similar to restricted stock in a corporation
    - If the entity were liquidated the day after grant, and the capital interest were fully vested, the holder would receive a share of the liquidation value of the entity

43 |

Ballard Spahr  
LLP

## Equity Compensation

- Capital Interests
  - May be subject to a vesting schedule at grant
    - Typically, the holder would make a section 83(b) election within 30 days of grant to close out the ordinary income element of the capital interest at grant
    - Otherwise, holder is subject to ordinary income equal to value of capital interest at vesting
    - Holder has opportunity to receive capital gains treatment upon subsequent disposition of the capital interest, if capital gains holding period is satisfied

44 |

Ballard Spahr  
LLP

## Equity Compensation

- Capital Interests
  - Holder of a capital interest is treated as a partner, rather than an employee
    - May be able to avoid partner treatment by issuing profits interests under a “Management Aggregator” structure
  - Capital interests are rarely granted to employees in partnerships and LLCs due to potentially adverse tax consequences for the entity and other equity holders

45 |

Ballard Spahr  
LLP

## Equity Compensation

- Options
  - Partnership or LLC may grant a management employee an option to purchase either a capital interest or a profits interest at some point in the future
    - Similar to a nonqualified stock option in a corporation
  - Holder would have to pay an exercise price to exercise the option
    - Exercise price must be at least equal to fair market value of underlying equity interest on date of grant

46 |

Ballard Spahr  
LLP

## Equity Compensation

- Options
  - Holder will be subject to ordinary income at exercise, equal to the spread between the fair market value of the underlying equity interest at exercise, and the exercise price
  - If holding period is satisfied, holder will be subject to capital gain on all subsequent appreciation upon the sale of the equity interest

47 |

Ballard Spahr  
LLP

## Equity Compensation

- Options
  - Partnerships and LLCs tend to prefer profits interests to options because they are simpler to administer
    - No tax at the grant date of a profits interest, unlike a capital interest

48 |

Ballard Spahr  
LLP



## Equity Compensation

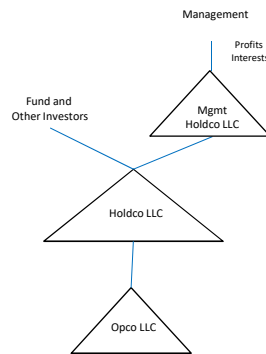
- Management Aggregator Structure
  - Issuance of profits interest to a management employee will cause that employee to be treated as a partner for tax purposes
    - Will receive a Form K-1, rather than a Form W-2
    - Will be subject to self-employment taxes and estimated taxes
  - In 2016, U.S. Treasury Department issued temporary regulations to confirm that holders of profits interests are treated as partners and not employees

49 |

Ballard Spahr  
LLP

## Equity Compensation

- Management Aggregator Structure
  - A Management Aggregator structure can avoid this result



50 |

Ballard Spahr  
LLP

## Equity Compensation

- Management Aggregator Structure
  - A new entity (Mgmt Holdco, LLC) is created to hold profits interests in the entity that serves as the holding company (HoldCo, LLC)
  - Management employees of the subsidiary portfolio company (Opco, LLC) are issued non-voting profits interests in Mgmt Holdco, LLC
    - Mgmt HoldCo, LLC profits interests mimic the HoldCo, LLC profits interests

51 |

Ballard Spahr  
LLP

## Equity Compensation

- Management Aggregator Structure
  - Management employees in OpCo, LLC can remain as employees of OpCo, LLC
    - Will receive a Form W-2, rather than a Form K-1
    - Will be subject to normal employment taxes; no estimated taxes

52 |

Ballard Spahr  
LLP

## Equity Compensation

- Management Aggregator Structure
  - Typically, an entity controlled by the PR Fund would exercise all voting rights with respect to Mgmt Holdco, LLC
    - Creates ancillary benefits, such as:
      - Greater Fund control over the exit process
      - Less visibility for management employees into HoldCo, LLC

53 |

**Ballard Spahr**  
LLP**Ballard Spahr**  
LLP

*Common Employment Law Issues Facing Private Equity Funds  
and Their Portfolio Companies*

Meredith Dante | Ballard Spahr

54 |

**Ballard Spahr**  
LLP

## Agenda

---

- Three Main Hot Topics
  1. Salary History Inquiries
  2. Joint Employer Jumble
  3. Transactional Potpourri

55 |

**Ballard Spahr**  
LLP

## Salary History Inquiries

56 |

**Ballard Spahr**  
LLP

## Salary History Inquiries

- Several state and local governments now prohibit questions regarding wage history during hiring and prohibit the use of this information in setting new hire compensation

Advocates	Critics
Salary history perpetuates past wage inequity	Restrictions impede First Amendment free speech rights

57 |

**Ballard Spahr**  
LLP

## Salary History Bans: Where?

- Questions regarding an applicant's salary history are not allowed in:

Statewide Bans		Local Bans
CA	NJ	Chicago, IL
CT	NY	Louisville, KY
DE	OR	New Orleans, LA
HI	PR	New York City, NY
IL	VT	Philadelphia, PA
MA		Pittsburgh, PA
		Kansas City, MO

58 |

**Ballard Spahr**  
LLP

## Salary History Bans: Where?

- WI and MI, by contrast, have laws that prohibit local governments from passing salary history bans



59 |

Ballard Spahr  
LLP

## Joint Employer Jumble

The Joint Employment Relationship



Bob was a bit confused during his I-9 onboarding process

60 |

Ballard Spahr  
LLP

## Joint Employer Defined

- Not defined, but the definition of “employer,” “employ” and “employee” are generally very broad under labor and employment laws!
- Joint employment arises where 1 worker can claim that 2 or more entities both employ her for the same work
  - Potential even where two entities are entirely separate in a corporate sense
- No single joint employer test from DOL or the Courts

61 |

Ballard Spahr  
LLP

## Joint Employer Risks for PE Funds

- As PE funds become more involved in the daily operations of their portfolio companies, they are increasingly at risk of being deemed a joint employer
- Employees of PE funds may provide services to a portfolio company
- Either scenario raises potential liability under numerous labor and employment statutes
- Employees are looking for deep pockets to sue
- Employees are increasingly filing class actions over wage and hour claims

62 |

Ballard Spahr  
LLP

## Joint Employer Factors

- Most courts rely on the **Economic Realities**:
  - Degree of control employer has over manner in which work is performed
  - Worker opportunity for profit or loss
  - Worker investment in equipment or material for employer
  - Degree of skill
  - Permanence of working relationship
  - Degree to which services rendered are integral to employer's business

63 |

Ballard Spahr  
LLP

## Joint Employer Strategies

- Observe corporate formalities
- Board members should stay out of the weeds
- Review insurance policies re: employment liability and ensure that D&O insurance provisions cover joint employer claims
- Proper due diligence
- Indemnification clause

64 |

Ballard Spahr  
LLP



## Joint Employer Strategies

- Sample excerpt of indemnification language – note that this language depends on the facts and circumstances of the arrangement and this is offered only as an example of what might be appropriate:

**[Insert definition of the company]** (the “*Indemnifying Parties*”) will indemnify and hold harmless Management Company, its affiliates, subsidiaries and related entities, and each of its and their respective employees, officers, directors and agents (each an “*Indemnified Party*”) from, and defend and indemnify them against, any and all losses, damages, costs, and expenses, including but not limited to professional and attorneys’ fees and costs, whether suit is brought or not and including any fees and costs incurred in all appellate, bankruptcy and probate proceedings, resulting from claims that an Indemnified Party is a joint employer, single employer, successor or alter ego with **[insert company entities]**, or their respective shareholders, members, employees, subcontractors or agents.”

65 |

Ballard Spahr  
LLP

## Transactional Potpourri



66 |

Ballard Spahr  
LLP

## What is Pay Equity?

- Goal: Eliminate sex, race and other forms of discrimination in the wage-setting system
- Recent focus (socially and legally) toward eliminating the pay gap
- In the third quarter of 2016, the U.S. Bureau of Labor Statistics determined that full-time female employees earned 81.8% of what their full-time male counterparts earned
- Race and National Origin also play a role: African American women earn approximately 63 cents and Hispanic women earn 54 cents for every dollar earned by a white non-Hispanic man

67 |

**Ballard Spahr**  
LLP

## Pay Equity and Private Equity

- Increasing legislation regarding potential reporting requirements - portfolio companies will have to comply
- Growing trend toward regulating gender pay gap and penalizing non-compliance
- PE firms want to retain and motivate key employees through the M&A process. Can accomplish this by offering equal base pay, other forms of compensation and benefits to all employees in the same group

68 |

**Ballard Spahr**  
LLP



## Overtime Exemptions Misclassification

- As PE funds increasingly participate in the affairs of their portfolio companies, funds may face greater exposure to liability for a portfolio company's obligations
- Misclassification of Employees creates the potential for significant penalties
- Red Flags
  - Independent contractors
  - Hourly employees who never receive overtime
  - Everyone in a single department as "Exempt"
  - Very few non-exempt employees

71 |

Ballard Spahr  
LLP

## Independent Contractor Classification

- Independent contractor misclassification can be difficult to identify in M&A diligence, as it is not immediately obvious on the surface. Further digging, normally beyond the documents initially provided, may be required.
- Investigation is necessary in light of the:
  - Federal and state crackdown on misclassification
  - An increase in legislation regarding independent contractors, and
  - Stream of class action lawsuits

72 |

Ballard Spahr  
LLP

## Independent Contractor Classification

- Test is in Flux
  - the extent to which the work performed is an integral part of the employer's business;
  - the worker's opportunity for profit or loss;
  - the nature and extent of the worker's investment in his/her business;
  - whether the work performed requires special skills and initiative;
  - the permanency of the relationship; and
  - the degree of control exercised or retained by the employer.
- Potential Penalties for Misclassification

73 |

**Ballard Spahr**  
LLP

**Ballard Spahr**  
LLP

Q&A

74 |

**Ballard Spahr**  
LLP