Private Investment Fund Team Compensation Arrangements: Structuring and Terms

A Practical Guidance® Practice Note by Nathaniel Marrs, Jessica McKinney, Aalok Virmani, Richard Ashley, and Thomas Geraghty, DLA Piper LLP

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This practice note addresses the legal aspects of private investment fund compensation arrangements for their investment teams, with a particular focus on special industry-specific structuring, certain tax, and other considerations.

The private fund industry continues to grow at a record pace, with $9.2 trillion under management as of March 2021, according to the 2022 Preqin Private Capital Compensation and Employment Review. As the industry has grown, private fund principals and employees have become increasingly well compensated through a variety of sources, including salary, bonus, long-term incentive plan (LTIP) compensation, fund co-investment participation, and carried interest awards. In order to retain and recruit talented individuals, private fund sponsors are well served by ensuring their team members are appropriately compensated. Likewise, as the marketplace has become ever more competitive for top talent, private fund sponsors must consider appropriate conditions and restrictions to protect their interests in connection with departures.

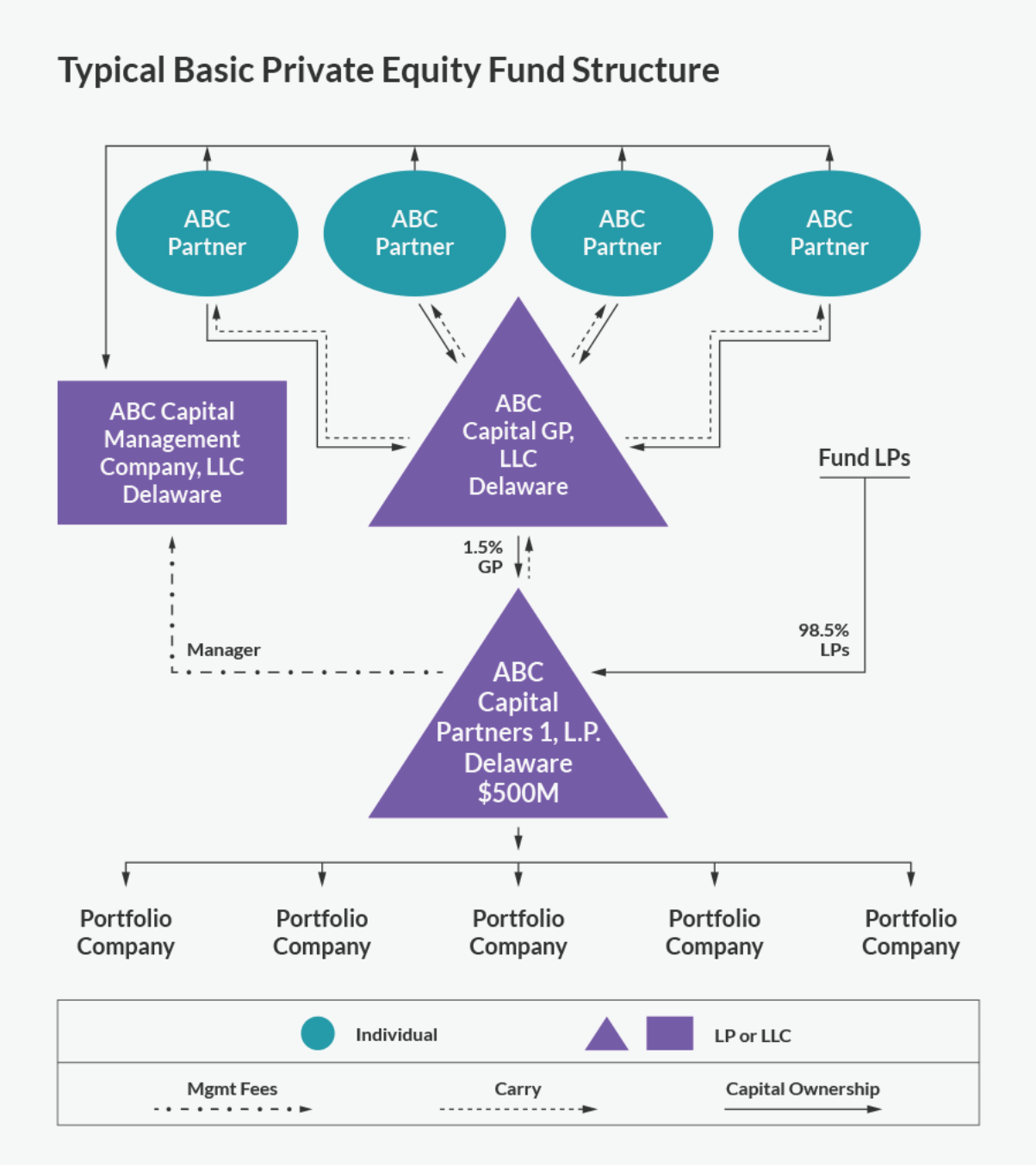
This practice note will address the legal aspects of these arrangements. It is not intended to provide a market overview of current levels of employee compensation or focus on the more general elements of employment arrangements. Certain federal income tax issues associated with the taxation of carried interests, and the various nuances associated with such rules regarding the characterization of gains as short-term or long-term capital gains, are beyond the scope of this practice note. It will also not focus on employment tax considerations or any

state-specific legal considerations, such as state-specific tax implications or state-specific limitations on employee non-compete restrictions.

For the second part of this practice note that deals with continuity considerations that arise when structuring private fund team compensation, see Private Investment Fund Team Compensation Arrangements: Continuity Considerations.

General Partner and Management Company Structures

Setting aside special considerations applicable to private fund sponsors affiliated with a public company, a private fund sponsor will typically be comprised of one or more series of general partner (GP) entities and one or more management company (ManCo) entities. A very basic example of such a structure is depicted below.



Although a variety of entity types may be used in different parts of a private fund structure, the main fund vehicle is almost always formed as a limited partnership or limited liability company treated as a partnership for federal income tax purposes. Classification as a partnership for federal income tax purposes allows the fund to not be subject to entity-level federal income taxes, and instead subject (taxable) fund investors to federal income taxes on their share of the fund's income and deductions per their own income tax returns. Most commonly, the main fund vehicle is a Delaware limited partnership, with almost all management authority vested in a single GP, and the GP delegating all or a portion of that management authority to a single ManCo pursuant to a management agreement that permits the ManCo to manage the fund and its investments in exchange for a management fee. All or a portion of the sponsor's required fund co-invest capital is typically invested through the GP, and the GP almost invariably receives any carried interest payable by the fund.

GP Structure

The GP may be formed as a single limited liability company in which the sponsor's principals and employees participate as members, or as part of a two-tier structure with the immediate GP (Direct GP) formed as a limited partnership, with the general partner of the Direct GP formed as a limited liability company (the Ultimate GP). In this two-tier structure, more junior employees may participate as limited partners of the Direct GP, while more senior employees and principals may participate as members of the Ultimate GP. As an alternative, such junior employees may participate indirectly in the Direct GP through a limited partnership or limited liability company formed to act as a holding company for such employees. This approach has the administrative benefit of permitting the sponsor to interact with such employees as a class through a holding entity outside of the Direct GP, thus facilitating new admissions, departures and other events involving such employees without the participation of other parties.

Similar to the fund, the GP is typically classified as a partnership for federal income tax purposes, which allows the sponsor's principals and employees to enjoy long-term capital gain treatment on capital gains allocated to their capital and carried interests—partnership classification also avoids double taxation resulting from corporate income taxes assessed at the GP level if treated as a corporation. Choice of entity for the GP may be important for other reasons including how such entity may be treated under non-U.S. tax laws—limited liability companies are often treated as corporations (or "opaque") in foreign jurisdictions, which could impact whether GP employees and principals can benefit from certain tax treaty benefits arising from income and gains generated from the fund's non-U.S. investments.

ManCo Structure

Similarly, the ManCo may be formed as a limited liability company or as a limited partnership, perhaps with the Ultimate GP acting as the general partner of that entity as well. A ManCo structured as a limited partnership permits the sponsor's principals and employees to participate as limited partners of a limited partnership as opposed to members of a limited liability company, which can have certain federal tax benefits in certain circumstances. Finally, although not illustrated in the structure chart, the ManCo will often act as employer with respect to the sponsor's employees, either directly or through a separate subsidiary entity that is structured as a partnership. Such an indirect employment structure may be established if the employees will participate in the ownership of the ManCo—employees in that scenario are thus able to avoid being treated as employees of the same vehicle in which they own interests, which can create certain federal employment tax problems for them as well as the ManCo.

Ultimately, these different entities and their affiliates provide private fund principals and employees a variety of potential forms of economic consideration—salary, bonus, LTIP compensation, fund co-investment, carried interest, and ownership of the management company (i.e., the net fee income generated by fund investments). Each of these forms of consideration is discussed in more detail below.

Salary and Bonus

A sponsor's employees are typically entitled to an annual salary and bonus, with the bonus often paid without conditions so long as the employee is still employed by the firm when the bonus is paid. The basic bonus structure is often used to focus on individual performance with individual benchmarking, although a portion can be designed based upon organizational performance. The standard bonus is paid annually and is usually designed so that the individual must remain employed through the payment date in order to avoid deferred compensation concerns. Alternatively, bonuses can be earned based upon employment through the annual performance period, but payment should then be structured so that payments are made within two and one-half months of the close of the performance period in order to avoid the creation of deferred compensation. As mentioned above, if an employee will also be entitled to participate in the ownership of the ManCo, then the employee should not be

directly employed by the ManCo (and a separate employer entity should be used to employ the employee).

Long-Term Incentive Plans (LTIPs)

In addition to an annual salary and bonus, an employee may be entitled to certain LTIP compensation, which can facilitate participation in the economics of the sponsor's larger enterprise beyond a particular fund upon the achievement of certain performance targets. If the sponsor is affiliated with a public company, that participation could take the form of stock options or restricted shares of the public company. According to the 2022 Preqin Private Capital Compensation and Employment Review, more than 90% of the executive management, and an ever-increasing share of lower-level employees, of the sponsor's participating in that survey are eligible to receive some form of LTIP. Since smaller, principal-led sponsors do not typically offer LTIPs as part of their employee compensation packages, this growing prevalence could be explained in part by the continued consolidation of sponsors through M&A transactions and the more rapid growth of larger, more established sponsors in recent years. As a general matter, LTIPs are designed to provide compensation over a longer performance period (e.g., three years), with payment based upon the achievement of relevant business results over the period. LTIP structures can be implemented as a fixed program, or, alternatively, created in a fashion so that a new award and a new LTIP cycle is created each year on a rolling basis. An LTIP may be established as a deferred compensation program subject to the applicable requirements of Code Section 409A of the Internal Revenue Code of 1986, as amended (the Code), or designed in a fashion that requires payment shortly after vesting in a manner that qualifies for an exemption from Code Section 409A.

Fund Co-investment

The GP is almost invariably required to make a meaningful commitment to a fund (the GP Commitment), typically ranging from 1%–2% of the fund's total commitments from third-party investors. The GP Commitment, in turn, is funded by the sponsor and its principals and employees as direct or indirect members or limited partners of the GP. Senior principals and other senior employees of the GP are usually required by to participate in the GP Commitment, while less senior employees may be provided an option to participate, without being obligated to do so. The interest in the GP that represents each participant's funded amount of the GP Commitment is called a "Capital Interest." Federal income tax law regarding the taxation of carried interest (the "Carried Interest Tax Rules") provides an important exception for Capital Interests to the rule's three-year holding period requirement for long-term capital gain treatment (the "Capital Interest Exception"). The Capital Interest Exception generally provides that allocations of capital gains attributable to a sponsor participant's capital contributions will enjoy long-term capital gain treatment (and correspondingly be subject to lower capital gains tax rates) if the underlying investment was held for more than one year. Given their affiliation with the sponsor, participant's GP Commitments are not typically charged sponsor carried interest, management, or other fees with respect to their Capital Interest by the fund.

Sponsor Participants

From a federal securities law perspective, the GP Commitment must fall within an exemption from registration under Securities Act of 1933 (33 Act). This often means that individuals participating in the GP Commitment either (1) qualify as "accredited investors" under the 33 Act—often by meeting certain wealth thresholds or having certain professional credentials—or (2) participate through a 701 "compensatory plan" established by the sponsor. In addition, the GP Commitment must fit within the underlying private fund's applicable exclusion from the definition of "investment company" under the Investment Company Act of 1940 (40 Act)—often referred to as either 3(c)(1) (no more than 100 beneficial owners) or 3(c)(7) (limited to qualified purchasers). For example, if the fund relies on the exclusion found in Section 3(c)(7) of the 40 Act, each participating individual must qualify as a "knowledgeable employee" or "qualified purchaser"; similarly, if the fund relies on the exclusion found in Section 3(c)(1) of the 40 Act, the number of participating individuals must not cause the fund to exceed the one hundred investor limit. Since sponsors do not typically charge participating individuals carried interest, management, or other fees, sponsor's registered with the SEC as investment advisers do not typically need to concern themselves with whether such individuals are "qualified clients" under the Investment Advisers Act of 1940 (IAA). However, if carried interest or any such fees will be charged, then such individuals must also qualify as "qualified clients" under the IAA.

The amount of the GP Commitment allocated to sponsor principals and employees often correlates with seniority, with founding principals and other senior employees being allocated larger percentages, and more junior employees being granted a smaller portion. Most often, this allocation is fixed for the duration of the term of the fund and

does not change from investment to investment. Thus, whenever the GP is required to fund its GP Commitment, each participant is also required to fund such participant's pro rata share of the GP Commitment. If the sponsor desires to permit certain principals and employees to have a larger participation in certain investments, it might establish one or more employee co-investment vehicles that invest alongside the main fund in all or a subset of investments. In addition to the initial amount of the GP Commitment, the GP, like any other fund investor, may be required to re-contribute certain amounts of distributions made with respect to its Capital Interest, such as when the GP exercises its right to recall such distributions (typically only during the fund's investment period) to make new investments or pay fund expenses or to permit the fund to pay a fund liability. When this occurs, the individual sponsor participants in the GP Commitment should also be contractually obligated to fund their share of such amounts.

Technically, if the GP recalls distributions to pay a fund liability, the GP may be required to return a portion of prior carried interest distributions it previously received, in addition to prior distributions made with respect to the GP's Capital Interest. As such, as addressed in more detail below, sponsor participants receiving carry points should be obligated to fund their portion of such recalled amounts of carried interest. In addition, sponsor participants may still be allocated taxable income from their share of the fund's gains that generated such distributions. The requirement to re-contribute recalled amounts may necessitate tax distributions to the sponsor participants so that sponsor participants can pay their income tax obligations notwithstanding their recall obligations.

Funding the GP Commitment

There are three principal ways in which individuals participating in the GP Commitment may fund their portion of this commitment: (1) contribute cash, (2) utilize a capital loan, and (3) participate in the sponsor's management fee waiver program.

A participant may fund all or a portion of the contribution via a capital loan. Sometimes such capital loan programs are facilitated by the sponsor with a financial institution that will then work directly with a participant to implement the loan. Oftentimes, however, a sponsor may be involved in more directly making or backing such a loan program, thereby allowing participants to leverage the sponsor's balance sheet to obtain more favorable loan terms. The Carried Interest Tax Rules should be carefully considered with these loan arrangements. Such loan arrangements can cause a sponsor participant's Capital Interest funded by a loan to no longer be subject to the Capital Interest Exception—resulting in short-term capital gain treatment from the sale of investments that do not satisfy a three-year holding period.

Lastly, a participant may fund all a portion of the contribution via participation in the sponsor's management fee waiver program. If a management fee waiver arrangement is in place for a fund, the fund's GP will be permitted to fund all or a portion of the GP Commitment by waiving an amount of the ManCo's management fee in exchange for a deemed profits interest that functions in a manner similar to a Capital Interest (funded by the third-party investors) in the same amount. From a federal income tax perspective, as discussed in more detail below, it is critically important that the deemed interest be treated as a true "profits interest" for tax purposes. Thus, while the interest may occupy the same position in the fund's waterfall as a GP's capital interest, if sufficient fund profits are not generated after the creation of the deemed interest, the interest will be worth less than a capital interest created as part of an actual contribution of capital (e.g., cash) at the same time.

If implemented appropriately, such an arrangement can provide federal income tax deferral, potential conversion of income that would otherwise be treated as ordinary into capital income (note that the profits interest attributable to a fee waiver arrangement is subject to the Carried Interest Tax Rules, which generally require capital gains arising from a disposition of an investment to satisfy a three-year holding period in order for an individual sponsor participant to enjoy long-term capital gain treatment), and other benefits to the GP and the sponsor individuals who are permitted to participate in the waiver arrangement. Most often, only more senior principals and employees have the right to participate in the benefits of such a program as there is often a correlation between ownership of the ManCo (where the fund management fees are paid in the first instance) and participation in such programs. In addition, more senior principals and employees may have more financial freedom to forgo a portion of their annual compensation in order to participate in the program. However, at times the benefits of such programs are shared more broadly by permitting more junior principals and employees to waive a portion of their salary or annual bonus. Such fee waiver programs are not without some drawbacks, including some complexity of administration (as participants are required to make a determination of the amount of management fee-derived income they want to waive, which can require careful planning) and the conversion of what would otherwise be more certain income (in the form of annual fund management fees) into less certain income (in the form of a profits interest

in the fund, which may be worth less than the amount of the waived management fees upon realization). The fundamental economic risk of the arrangement, which is critical to achieving the desired federal income tax result, is that if the fund never generates the expected positive returns for which the management fees have been reduced, the sponsor will be left with lower aggregate cash proceeds as a result of the arrangement. In fact, the IRS proposed regulations in 2015 that made the "entrepreneurial risk" associated with such programs the key factor in determining whether such arrangements will be respected. In recent years, such programs have begun to attract more attention from fund investors who may be concerned that they can undercut the requirement that sponsor principals and employees have real "skin in the game" from a psychological perspective (although it could certainly be argued that such participants still have "skin in the game" by virtue of waiving the right to receive income to which they would otherwise be entitled). Indeed, the most recent form of due diligence questionnaire published by the Institutional Limited Partner Association (the ILPA DDQ 2.0) contains a number of questions concerning a sponsor's fee waiver program and how the applicable sponsor's GP Commitment is funded in general (such as whether any type of sponsor financing is utilized). As a result, some sponsors have responded by limiting the amount of management fees that can be waived as part of their fee waiver programs (e.g., 50% of a fund's total management fees).

GP / Carried Interest

Many private funds distribute their net proceeds from dispositions of investments and any ongoing net cash generated by investments through a "distribution waterfall." A fund's distribution waterfall dictates the order in which the fund's net distributable cash is paid out to the fund's investors, to the GP in respect of the GP's Capital Interest, and to the GP in respect of a disproportionate profit percentage (typically 20%) in excess of investor capital (such profit percentage, the "Carried Interest").

Types of Carried Interest

At a high level, there are two typical formulations of a fund's distribution waterfall—an "American" waterfall and a "European" waterfall. In the "American" waterfall, Carried Interest may be distributed, at least to some extent, on a deal-by-deal basis. In contrast, in the "European" waterfall, Carried Interest is only distributed with respect to any given investor after that investor has received a full return of that investor's invested capital plus, typically, a preferred return on that invested capital. For most private funds, Carried Interest is only payable with respect to cash actually paid by the fund to investors, but in some circumstances, such as in certain open-end real estate funds and hedge funds, Carried Interest may be distributed with respect to unrealized appreciation in fund investments as well. Carried Interest is often awarded to participating individuals on the basis of "carry points." As with the GP Commitment, the number of carry points awarded to sponsor principals and employees is often correlated with the seniority of such individuals, with more senior participants receiving a larger number of carry points than more junior participants.

Regardless of the type of distribution waterfall employed by the fund and whether cash distributions are made to the GP, the GP may often find its Carried Interest being allocated a share of the fund's annual taxable income. To ensure the GP members have the wherewithal to pay their income tax obligations, fund agreements typically have tax distribution provisions allowing cash distributions to the GP in the event the GP's share of taxable income exceeds its cash distributions during an applicable tax period. Tax distributions are generally considered advances to the GP that reduce future distributions that would be made to the GP under the fund's waterfall.

Methods of Allocation

Different GPs apply different methodologies for allocating carry points to individual participants, with three methodologies being the most common. First, most frequently, a fixed number of carry points may be allocated over the life of the fund. Under this approach, participants will be entitled to the same percentage of the Carried Interest from each fund investment, irrespective of whether a participant worked on the investment and irrespective of their increasing seniority during the life of the fund. Second, carry points may be allocated on an annual basis so that a participant's share of the Carried Interest will be determined based on the "vintage year" of a fund investment. Under this approach, a participant will be entitled to the same percentage of the Carried Interest from each fund investment consummated in a given year but may be entitled to a different percentage for investments consummated in other years. Third, carry points may be allocated on an investment-by-investment basis, typically determined on the basis of whether a participant is actively involved with a particular investment. This approach can lead to a number of administrative and incentive difficulties and is thus somewhat less frequently employed than the other methods.

In some cases, a combination of two or more of these methodologies may be employed. For example, a sponsor may apply the first approach (fixed number of carry points over the life of the fund) to 50% of the awarded

carry points and the third approach (investment-by-investment allocation) with respect to the remaining 50% of the awarded carry points. From an investor perspective, investors are most interested in ensuring that the interests of the sponsor individuals actively working on a fund's investments are properly aligned with those of the investors. Thus, investors may seek comfort that the carry points are allocated in a manner to minimize the risk of departure for the most critical members of the fund's management team (particularly any named key people).

Future Allocations

After carry points are initially allocated to a set of individuals, sponsors must determine how future allocations are made and the effect of those allocations on prior participants. In terms of the dilutive effect on prior participants, the most common approach is to provide some type of dilution protection (usually absolute) for junior participants receiving the least number of carry points, with dilution borne exclusively by some set of the most senior participants. In some cases, there may be a cap on the percentage of dilution borne by the most senior participants, particularly in relation to junior principals who still receive a relatively large number of carry points. Care must be taken to ensure that carry points awarded in the future are not awarded at a point in time when the underlying Carried Interest is "in the money" if a liquidation of the fund were to occur at that time. If that is the case, a sponsor may apply a "distribution threshold" concept to the applicable carry points or incorporate a "clawback" requirement to the granted interest in order to ensure that such carry points will still be treated as "profits interests" for federal income tax purposes. If that step (or steps having a similar effect) are not taken, there will likely be adverse federal income tax consequences for both the prior and the new participants. Without delving too deeply into the details, there are a number of options that can be applied to such "distribution thresholds" concept, including a full or partial "catch-up" feature that would permit the later recipients of carry points with a distribution threshold to be fully caught up with distributions made to prior recipients if sufficient distributions are available. Such a carried interest "clawback" requirement can allow a grantee to participate in the fund's returns alongside existing carried interest holders but require a "clawback" payment from the grantee to the fund (and the existing carried interest holders) in situations in which the fund does not generate sufficient returns after the grant date to fully offset the dilution to the existing carried interest holders at the time of the grant.

Vesting

Most sponsors impose some type of vesting methodology to carry points, regardless of the manner of allocation, tied to the continuing employment or provision of services by the applicable participant. However, vesting, like other financial benefits, may not be applied equally to all participants, with a shorter vesting schedule (or no vesting at all) applied to more senior participants. Vesting periods can range from three to eight years, often commencing with a participant's date of hire or, if later, the initial closing date for the fund. In some cases, vesting is applied on an investment-by-investment basis, with vesting commencing with the acquisition of an investment and ending (perhaps via full acceleration) on the disposition of an investment. This can be the case even when the underlying carry points have not been allocated on an investment-by-investment basis. Vesting may apply on a "cliff vesting" basis, such that the entire amount of the applicable percentage is only vested at the end of that period, or on a "prorated" basis so that a participant is credited for time spent during a partial period if the participant departs before the end of that period. Vesting may incorporate a holdback component, meaning that a percentage (e.g., 70%–80%) of a participant's carry points vest over an initial period of years and the remainder (i.e., 20%–30%) of the carry points are held back to vest upon the occurrence of a future event, such as the termination date of the fund's investment period, the dissolution of the Fund or, in the case of an investment-by-investment allocation or vesting, the disposition of the investment to which the carry points are tied.

Finally, vesting may be applied on a prospective basis, in the sense that a participant receives distributions relating to their carry points only as they vest, or vesting may be applied on a retrospective basis, in the sense a participant receives distributions relating to all of their carry points until a departure event occurs, at which point the participant is only entitled to distributions relating to their vested carry points. If such retrospective vesting is utilized, a departing participant will usually be required to give back any distributions in excess of the amount the participant would have received had the participant only been entitled to distributions with respect to such vested carry points during the entire period prior to departure. In the case of prospective vesting, when distributions of Carried Interest are made, participants will only be entitled to receive that amount of distributions representing their then-vested share of carry points, with the remainder being held back and released over time on subsequent vesting dates. If

a participant departs prior to full vesting, any remaining amount will typically be transferred to the parties entitled to receive forfeited unvested carry points in the first instance (and allocated between such parties in the same relative amounts as the parties' relative entitlements to such forfeiture benefit).

As a result of changes in vested and unvested carry points due to departures and the admission of new participants, it is possible that participants may receive Carried Interest distributions from time to time in excess of their then-vested carry points. In order to avoid this result, participants will often be required to give back any distributions of Carried Interest in respect of such "over-vested" amounts. Of course, this can be a particularly acute issue when retrospective vesting is used. As with the allocation of carry points, investors want to ensure that the sponsor individuals actively working on a fund's investments are incentivized to remain with the sponsor for as long as possible, or at least through liquidation of the fund in which they have invested. As such, investors generally prefer longer vesting periods and material holdbacks.

From a federal income tax perspective, participants receiving carry points subject to vesting of any type should generally seek to make an 83(b) election (pursuant to Section 83(b) of the Code) upon receipt. In addition, because such recipients may be allocated taxable income with respect to carry points in circumstances where distributions would not otherwise be made with respect to such carry points, such recipients should seek the right to obtain special distributions to pay such taxes to the extent distributions are already being made. In most cases, such tax distributions are provided to carry point recipients of right (and are thus mandatory, subject to the availability of distributable cash); less frequently, a sponsor may only agree to provide such distributions at its option. In either case, any such distributions that are made will offset future distributions to which the recipients would otherwise be entitled.

Clawback

As part of a fund's limited partnership agreement or other constituent documents, a GP is usually contractually obligated to repay Carried Interest to the fund's investors if they do not receive a full return of their capital contributions plus their preferred return in an amount required to cover the lesser of that shortfall or the amount of Carried Interest distributions actually received by the GP (typically on an after-tax basis) (such amount, the "Clawback Amount"). Because the GP may be obligated to repay a Clawback Amount to fund investors, each sponsor participant allocated carry points should also be contractually obligated to repay to the GP its share of the Clawback Amount. In addition, as noted above, each sponsor participant should be obligated to repay to the GP its share of any prior distributions of Carried Interest that the GP is required to re-contribute as part of the GP's recall of fund distributions to pay a fund liability. The GP usually will also be obligated to return any amount of Carried Interest the GP may have received in excess of the maximum specified percentage of Carried Interest (e.g., 20%) the GP should have been entitled to receive in the first instance. However, while this is mathematically possible in certain circumstance, it is less frequently a problem in practice.

The Clawback Amount is usually net of federal and state income taxes paid or accrued on taxable income allocated to the Carried Interest over the life of the fund. In recent years, investors have focused on ensuring that the amount of "taxes" deducted from a GP's clawback obligation represents the actual amount of taxes ultimately paid by the individuals allocated taxes with respect to Carried Interest, taking into account any deductions received by such individuals as a result of the repayment of Carried Interest as a result of a clawback (versus, for example, estimated tax amounts, calculated on the basis of certain assumptions, that are typically utilized in a GP's tax distribution provision).

Clawback of Carried Interest can be a particular challenge for evergreen funds, such as hedge funds and open-end funds, due to the perpetual terms of these vehicles, the change in composition of investors over time, and the potential calculation of Carried Interest on unrealized appreciation. In response, some evergreen funds may impose an ongoing holdback requirement where only a portion (e.g., 50%) of Carried Interest is payable at the end of a specified period (e.g., three years), with the remainder payable at the end of the next period only if the fund has achieved certain performance metrics through the end of that next period.

In order to ensure sponsor participants allocated carry points do not avoid their obligation to fund their portion of a Clawback Amount, fund investors may require each sponsor participant allocated carry points to sign a personal guaranty in favor of the fund or require that a specified percentage of any Carried Interest otherwise distributable to the GP be placed into escrow (and not be paid to the sponsor participants otherwise entitled to it) until the achievement of a performance test or some other threshold. In some cases, any such guarantees may be backstopped by the GP, ManCo or another other credit-worthy affiliate of such parties. When an escrow is employed, it is particularly important for the sponsor

participants receiving carry points to be entitled to tax distributions until the escrowed cash is distributed to such participants.

For the second part of this practice note that deals with continuity considerations that arise when structuring private fund team compensation, see Private Investment Fund Team Compensation Arrangements: Continuity Considerations.

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Nathaniel Marrs is a Partner in the Chicago office of DLA Piper and Co-Head of the Firm's Investment Funds Practice.

His practice is focused on the structuring and formation of private funds and their management companies, with a particular focus on real estate, infrastructure and energy firms. He also represents such firms in a variety of corporate transactions, including roll-ups, joint ventures, co-investments, the formation of portfolio and other operating companies, and investment management M&A transactions.

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Jessica McKinney advises investment fund managers in connection with private fund formation and ongoing operations. Jessica helps managers navigate applicable regulatory and securities laws compliance. Jessica has experience working with established fund managers as well as first-time and emerging fund managers across a variety of asset classes and investment strategies, such as private equity, venture capital, real estate and other alternative investment strategies. Jessica also has experience representing high-net worth individuals, family offices and other institutional investors in the course of investing in private investment funds.

In addition, Jessica advises investment advisers on regulatory compliance matters, including SEC registration requirements and available exemptions, Form ADV and other regulatory filings, and SEC examinations.

Prior to joining the firm, Jessica served as Special Counsel in the US Securities and Exchange Commission's Office of the Advocate for Small Business Capital Formation. During her time at the SEC Jessica worked to advocate for small businesses and their investors from startup to small cap, with a focus on issues facing investors who pool capital through venture and other funds.

Aalok Virmani, Partner, DLA Piper LLP

Aalok Virmani has more than 20 years of experience advising fund sponsors and investors on federal income tax matters.

Aalok represents US and non-US fund sponsors on the tax aspects of forming, organizing and operating private equity funds, private equity real estate funds, venture capital funds, hedge funds, debt funds and secondary funds. Aalok's practice includes counseling family offices with respect to establishing investment platforms and management incentive arrangements. He also regularly advises on GP-led fund restructurings, US and non-US investor representations, secondary transactions and minority investments in fund sponsors.

Aalok spent significant time in-house as a principal at Equity International, a private equity firm that invests in non-US real estate companies. He was responsible for all tax aspects of the firm's portfolio-level transactions, fund formations, sponsor-level tax planning, tax compliance and financial statement reporting. Aalok also held board and audit committee positions at various portfolio companies to help Equity International support and oversee its investments.

Richard Ashley, Partner, DLA Piper LLP

Rich Ashley's practice includes advising both public and private companies on the design, implementation and administration of qualified retirement plans, nonqualified retirement plans, welfare benefit plans, equity incentive programs and executive compensation arrangements.

Rich's practice includes advising professional asset managers, registered investment advisors, plan fiduciaries, and service providers with respect to fiduciary obligations, reporting and disclosure obligations, recordkeeping, and compliance with the prohibited transaction rules under ERISA and the Code. Rich regularly advises private funds and hedge fund sponsors with respect to ERISA Title I matters, and regularly consults with clients with respect to managing plan assets and structuring venture capital and real estate operating companies

Rich regularly works with plan administrators on benefit plan compliance and testing issues. Rich has experience with IRS and DOL correction procedures and has represented clients on a variety of compliance issues in connection with government audits.

Rich has extensive experience in the benefits and compensation issues that arise in connection with the transactions, including Code Sections 162(m), 280G and 409A compliance. Rich regularly advises Plan fiduciaries with respect to their duties, best practices, matters relating to the ERISA plan assets regulations and ERISA issues arising under credit agreements. Rich also works with Section 16 officers with respect to their legal obligations.

Rich regularly represents public companies, executive officers, and management teams in connection with potential mergers and acquisitions. Rich also designs and assists in the implementation of Change in Control Agreements and executive continuity and protection programs. Rich has represented professional athletes and executives of professional sports' organizations with respect to employment and compensation matters.

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Tom advises clients on structuring and tax aspects of complex domestic and cross-border business transactions, including mergers and acquisitions (including SPAC and up-C structures), joint ventures, public and private offerings of securities, debt and equity restructurings, real estate transactions, the organization and operation of investment funds, and investments in cryptocurrency and digital assets.