

Opinion Leaders

JUNE 2008

N°3

In this month's issue:

EDITO 1

Legal and Tax Watch 2

Recent Legal Advice & Key
Deals – Upcoming
Conferences 9

Olivier Dumas
Partner

Corporate / Private Equity / Financing

Editorial

Certain summarize mankind's confusion to the following precept: "God moves in mysterious ways".

The same goes for the legislation regarding FCPRs which has, over the years, incessantly evolved and been modified.

Venture capital professionals can only be overjoyed by the Law on the Modernization of French Economy (*Loi de Modernisation de l'Economie Française*) introducing of the contractual risk fund (*fonds à risques contractuel*).

However, it is unfortunate that a new category of investment fund bestowed with its own legal regime had to be created in order to allow a French venture capital fund to function properly, that is, according to the international standards which govern such type of fund.

Could modernization be incompatible with simplification?

Should this not be the case, let us hope that all the efforts will be made to ensure that this new type of fund will be as successful as the previous one, the FCPR subject to the simplified procedure (*FCPR à procédure allégée*) and its specific fiscal status, product of a long legislative and doctrinal process.

Let us hope that the Paris market will find the appropriate means of selling this fund to foreign investors! Or else, the other markets will continue to develop their expertise (Luxemburg, London, Dublin, etc.).

Moreover, only part of the way to modernization has been covered and there is still a long way to go.

Thus, there still remain many projects: the clarification of commercialization rules of foreign funds in France, the regulation of funds of funds, the simplification of the legal and tax regime for preferred shares, or the implementation of a genuine French style limited partnership, endowed or not with a legal status and benefiting from an efficient tax regime.

We do not need to be ashamed of our market practices but need to notice and recognize the progress that has been made outside of our boundaries, and, if need be, accept to learn from these experiences.

Legal and Tax Watch

The “LME” bill on the modernization of the economy

The National Assembly worked late into the night of June 12 to complete its consideration of the bill on the modernization of the economy. After two weeks of thorough and constructive debate, the bill will be sent back to the Senate on June 30 for a second reading.

The government has declared this to be an urgent matter, so that a joint commission (made up of seven senators and seven National Assembly members) could be convened following consideration by the Senate of the new version. The bill could therefore be adopted and enacted into law by mid-July.

As amended by the National Assembly, the bill now includes the following changes in the law.

*** In the area of corporate law**

- Concerning corporations (*société anonyme – SA*), it loosens rules requiring that directors and supervisory board members of privately-held companies hold a certain number of shares, while preserving the double voting rights attached to certain shares held by an entity that is merged, spun off or whose assets are transferred (art. 13 bis).
- Concerning “simplified corporations” (*société par actions simplifiée – SAS*) it eases registration formalities for those with a sole shareholder and allows the performance of work to qualify as capital contributions in kind. In certain instances, an SAS would no longer be required to have an independent auditor, raise a minimum amount of capital or file annual statements of voting rights (art. 14).
- Concerning limited liability companies (*société à responsabilité limitée – SARL*), it provides model articles of incorporation and bylaws, simplifies their public notice requirements and allows their shareholders to meet by teleconference (art. 13).

The Committee on Laws also added an amendment to the effect that corporations issuing additional preferred stock will no longer have to appoint an official appraiser (*commissaire aux avantages particuliers*) (art. 13 bis). In addition, preferred shares with restricted financial rights will no longer be subject to preemptive subscription rights by existing shareholders, unless this is provided for in the articles of incorporation and bylaws.

Companies whose annual financial statements are certified by an independent auditor will have to disclose information on the length of supplier and customer payment periods (art. 6 bis).

Lastly, the National Assembly adopted an amendment proposed by the Finance Committee aimed at improving regulations governing new company stock warrants (BSPCE), including making the notion of ownership by individuals of 25% of the issuing company’s shares more flexible and facilitating the issuance of warrants by companies with a market capitalization of more than 150 million euros (art. 9 bis).

- * **In the commercial sphere**, in addition to reforms concerning the relationship between producers and retailers and rules on the location of supermarkets, the bill:
 - facilitates access by innovative small businesses to public procurement markets in the case of requests for proposals (art. 7),
 - creates a Competition Office (art. 23), an independent administrative agency formed as a result of the transformation of the current Competition Council, that will be in charge of regulating industry concentration and anti-competitive practices and will issue opinions on competition issues.

- * **In the area of bankruptcy law**, the LME will make it possible for the government to make changes in protective measures (art. 19) by
 - facilitating voluntary pre-bankruptcy proceedings (*mandat ad hoc*) and conciliation and eliminating some of the formalities for initiating them, bringing the benefits of conciliation in line with those of court-approved conciliation (*conciliation homologuée*) and giving added powers to the public prosecutor's office;
 - making protection proceedings (*sauvegarde*) more attractive by giving the courts jurisdiction over interim measures designed to avoid insolvency and keep companies in business, keeping debtors actively involved and improving procedures (simplifying the conditions for initiating proceedings, focusing the role of proceeding participants on their essential functions and simplifying consultations with bondholders);
 - reforming bankruptcy proceedings to ensure greater continuity from the preliminary stage through reorganization proceedings, as well as more effective coordination between court-ordered liquidations and simplified liquidation procedures.

- * **In the financial sphere**, the LME:
 - broadens the scope of market-making agreements with financial intermediaries, so that not only companies whose stock is traded on a regulated market may avail themselves of such agreements, but also those with shares listed on organized multilateral trading systems (art. 10 bis);
 - ratifies the announced reform of the “*Livret A*” savings accounts, which all banks will now be permitted to offer (art. 39);
 - determines how banks may use sums deposited in *Livret A* accounts and so-called “sustainable development” accounts (formerly *Codevi*) (art. 39);
 - contains certain provisions applicable to the savings bank system (art. 40bis) and the *Caisse des Dépôts et Consignations* public financial institution (art. 41);
 - strengthens the internal control systems of banks and financial institutions (art. 42 bis).

The LME contains several provisions that concern the specific area of investment funds.

- It changes the definition of “innovative companies” eligible for inclusion in the investment ratio of “innovation investment funds” (*fonds communs de placement dans l’innovation – FCPI*) (art. 7). While it continues to recognize the classification by Oséo Innovation, it modifies the criterion for research and development expenditures. Companies would be considered innovative if their research budget for the previous year accounted for at least 15 percent of their tax-deductible expenses (or 10 percent in the case of manufacturing companies).
- It permits “local investment funds” (*fonds d’investissement de proximité – FIP*) calculating their investment ratio to include investments in up to four adjacent regions as opposed to only three, as required at the present time (art. 10). By expanding the geographical scope of these investments, the new act will make it possible to provide more financing for less-favored regions in terms of per capita GDP and to increase the size of those funds.
- It does away with certain restrictions placed on “simplified” venture capital funds (*fonds communs de placement à risques – FCPR*) (art. 10). Their assets could now include up to 15% of shareholder advances to companies in which the funds hold an equity interest, for the duration of that investment. The funds would also be permitted to invest in companies, located in an OECD country or elsewhere, whose principal business consists of investing either directly or indirectly in privately-held companies.
- It provides for the establishment of “contractual venture capital funds” (*FCPR contractuels*) (art. 10). In order to give more leeway to the parties (in all instances qualified investors), investment and commitment rules as well as redemption terms and conditions are to be set forth in a contract between the parties, in this instance the fund’s bylaws.
- It provides for the setting up of endowment funds to finance non-profit institutions such as hospitals, universities and museums (art. 37). The funds would receive donations from corporations or individuals wishing to contribute to public-interest projects; as in the case of their US counterparts, contributors would be entitled to certain tax benefits (similar to those for philanthropic contributions). Thus, individuals would be entitled to an income-tax exemption on 66% percent of any sum donated, provided it does not exceed 20% of taxable income, while corporations and other business entities would be entitled to exemptions of 60% of their contributions not in excess of 5% of their annual revenue.

The LME also authorizes the government to issue orders aimed at making Paris more attractive as a financial center (art. 42). In this connection, the government can be expected to reform the laws governing mutual funds and investment companies, including real estate investment funds (OPCI), closed-end investment companies (SICAF) and closed-end funds. Regulations governing ARIA funds (*OPCVM Agréés à Règles d'Investissement Allégées*) will be updated to allow their managers to place a ceiling on redemptions on each withdrawal date; rights to carried interest will be extended to include additional managers; funds will be permitted to issue a prospectus in a single language version (not necessarily French) and regulations governing real estate investment funds restricted to certain investors will be revised.

The authorization would also provide for a reform of SICAV open-end investment companies, and most of all of SICAF closed-end companies, in order to promote the growth of closed-end funds in France. The long-term objective is to make Paris a financial center for listing French and foreign closed-end funds.

* **Concerning tax matters**, the LME also makes several changes.

- Corporations in existence for less than five years will have the option, subject to certain conditions, to elect to be taxed as partnerships or so-called “pass-through” or “partial pass-through” companies (art. 9). The system, which draws on the rules governing “Subchapter S” corporations in the United States, will allow shareholders to deduct corporate losses while keeping their liability limited to their investments as in the case of regular corporations (*sociétés anonymes*), simplified corporations (*sociétés par actions simplifiées*) or limited liability companies (*sociétés à responsabilité limitée*).

- The sole-owner venture capital company (*société unipersonnelle d'investissement à risques - SUIR*) is eliminated.

- A single transfer-tax rate of 3 percent will be applicable to transfers of shares of corporations and limited liability companies (SARL), with a ceiling of € 5,000 (art.15).

On the other hand, the deputies rejected amendments that sought to:

- raise the cap on the so-called “Madelin” tax benefit for investors in small businesses;

- make investments in venture-capital funds investing in start-ups (*sociétés d'investissement de business angels – SIBA*) eligible for wealth-tax deductions on investments in small businesses (as provided for by the “TEPA” Act on labor, employment and purchasing power).

Legal News

Publication of Government Order 2008-556 of June 13, 2008 transposing the European Parliament and Council Directive 2005/68/EC of November 16, 2005 on reinsurance and revising the legal framework of debt mutual funds (*fonds communs de créances*) (Journal Officiel of June 14, 2008)

Government Order of June 13, 2008 defines reinsurance and finite reinsurance and sets forth the conditions on which institutions (insurance companies, provident associations, mutual societies and associations of mutual societies) may be authorized by the CEA insurance industry commission (*Comité des Entreprises d'Assurance*) to provide such services. It also specifies the legal framework applicable to debt securitization institutions, companies and mutual funds.

Recommendation of the CCSF on financial services advertising

The Advisory Committee for the Financial Sector (*Comité Consultatif du Secteur Financier* – CCSF) has endorsed a series of recommendations concerning the advertising of savings and insurance products. The recommendations, which are intended for the financial industry (banks, insurance companies and investment firms), aim to improve consumer protection and confidence. They can be found on the Banque de France website.

Bill on mandatory and voluntary employee profit sharing

The bill, which is to be considered by the Council of Ministers before the summer break, will be debated in Parliament in the fall.

Concerning profit-sharing plans, the proposed legislation would do away with the automatic freezing of accounts. However, shares of profits that employees decide to withdraw could be subject to income tax.

As far as voluntary incentive plans are concerned, the bill seeks to increase this form of profit sharing twofold in four years by means of a tax credit (which would vary depending on whether or not the plan is a company's first) and to penalize small and medium-size businesses with fewer than 50 employees that fail to set up plans by 2010.

Once enacted, the new law is expected to become applicable in 2009.

Industry News

Publication of the 2007 AMF Annual Report

The AMF released its 2007 annual report on June 11 of this year. The publication provides an opportunity to take stock of how various areas of asset management have grown in France.

In terms of industry participants, 52 management companies were registered in 2007 (compared with 42 in 2006):

- 11 in traditional asset management,
- 29 in specialized management (17 in private equity, 11 in real-estate investment, 1 in employee savings),
- 12 in technical management (8 in contractual funds, 2 in ARIA funds, etc.)

In terms of products, 1,360 investment funds and companies were started up in 2007 (compared with 1,458 in 2006), of which:

- 1,124 were registered: 63 SICAV investment companies, 768 general FCP mutual funds, 58 FCPR venture capital funds (mainly FCPI innovation funds and FIP regional funds), 231 FCPE company mutual funds and 4 FCIMT “derivative” funds;
- 236 announced their formation: 119 contractual funds (129 in 2006) and 117 “simplified” FCPR venture capital funds (82 in 2006).

Publication of a report on sovereign funds

Economy Minister Christine Lagarde has received a report on sovereign funds prepared by Alain Demarolle. The report can be downloaded from the Ministry’s website. It suggests a number of ways to attract long-term investments by those funds.

A report on private equity investing to be issued by the Economic Analysis Council (*Conseil d’analyse économique*)

As of today, the Private Equity and French Capitalism report ("Private equity et capitalisme français") is available on the CAE's website.

Tax News

Close-up on a tax issue

Under certain conditions, investors in FCPI “innovation” funds may be entitled a tax exemption on income from the fund and on gains from the sale or redemption of fund shares. In order to be eligible for these benefits, they must agree to hold their shares for five years or longer and to immediately reinvest all of the proceeds generated by their fund shares during that period.

Since January 1, 2007, FCPI funds no longer have had to comply with the special tax regulations governing venture capital funds (FCPR) in order for their unit holders to qualify for exemption from “exit” taxes.

Accordingly, those funds will not longer have to comply with article 163(5)B of the General Tax Code (*Code général des impôts* – CGI), which requires them to have a 50-percent quota of their assets invested in shares of European companies subject to corporate income tax and active in sectors listed in article 34 of CGI. These same criteria are also included in article 214-41 of CMF Financial Markets Board regulations, where the ratio is 60 percent.

That clarification has come about as a result of a rule change introduced by the 2007 Finance Act, according to which there is no ceiling on investments by FCPI funds in shares of listed companies with a market capitalization of less than 150 million euros, traded on organized exchanges such as the Alternext market. The 20-percent ceiling of article L. 214-36(3) still in effect for those funds concerns shares of companies with a market capitalization of less than 150 million euros, traded on regulated markets, and applies to their legal ratio under rules governing venture capital funds and to their tax ratio for the purpose of personal income taxes.

For this reason, holders of units in FCPI funds that comply with the 60-percent ratio will henceforth be entitled to a tax reduction upon both entry and exit.

It is to be hoped that Parliament will now follow the same line of reasoning for FIP “regional” funds and for “wealth-tax” funds and amend article 163(5)B of the CGI.

Latest tax directives

7 G-1-08 no. 61 of June 9, 2008: Transfers without consideration. Applicability of transfer duties. Exemption of gifts for the purpose of calculating the ISF wealth-tax reduction provided for in article 885-0 Vbis of the General Tax Code.

7 S-5-08 no. 61 of June 9, 2008: Wealth tax. Calculation of tax. Tax reduction for donations to certain public-interest institutions.

5 C-4-08 no. 61 of June 9, 2008: Capital gains by individuals on sales of securities. Donations of shares traded on regulated markets to certain public-interest institutions. Interpretation of article 16 (VI and VII) of the “TEPA” Act on labor, employment and purchasing power.

Important dates

- **September 15, 2008:** Deadline for taxpayers to file individual statements and supporting documents, if any, required by articles 299(7) and 299(8) of the General Tax Code (wealth-tax exemption for investments in small businesses)
- **September 30, 2008:** Deadline for investment service providers offering investment advisory services to file their special 2008 report on investment advisory services with the AMF.

Recent Legal Advice and Key Deals – Upcoming Conferences

Recent legal advice and key deals:

- Audit of an infrastructure fund based in the Cayman Islands
- Advice provided to an American client on the risks linked to the *conditions de potestas* figuring in license agreement governed by French law
- Consultation concerning a deed of gift project along with the stripping of carried interest shares to descendants.
- Updating of the anti money laundering procedure manual applying to a French subsidiary of a foreign bank
- Consultation regarding the commercialization to French institutional investors of shares in foreign investment vehicles which can eventually be listed on non regulated European markets
- Review of the French and European regulatory scope applying to the commercialization of a service provided by an American entity linked to the optimization of derivative portfolios to European regulated entities
- Advising of an English group in the buying of French companies and businesses in the security and real estate sectors
- Drafting of services agreements and commercial agent agreements in view of the reorganization of the distribution of a client's food products.

Upcoming conferences:

- **"Capital Investissement et Actualité du back-office" ("Private equity and back-office developments")** symposium organized by AFIC on June 27, 2008 at Pavillon Ledoyen, with presentations by Daniel Schmidt, Partner, and Florence Moulin, Associate, Proskauer Rose LLP.

- « **CCAG Travaux: où en est-on?** » (“**CCAG Travaux: where do things stand?**”), symposium organized by Le Moniteur on July 1 with presentations by François Muller, Associate, Proskauer Rose LLP.
- « **La Procédure Civile et la Réforme de la Prescription : principes de base et premiers réflexes** » (“**Civil Procedure and the Reform of the Prescription: basic principles and preliminary reflexes**”), breakfast and debate organized with the European American Chamber of Commerce, on July 8, à 9am at Proskauer Rose, with presentations from Valérie Lafarge-Sarkozy, Partners et Rozenn Guillouzo, Associate, Proskauer Rose LLP.
- « **Club RH : Actualité du droit social - panorama jurisprudentiel** » (“**Club RH: actualization of labor law – jurisprudential panorama**”), organized with the AEF on July 10, at Proskauer Rose, with presentations from Béatrice Pola, Partner, Proskauer Rose LLP.
- “**Private Placement**”, first annual European Union Cross-Border Private Placement Conference, October 16 and 17, 2008, Kikuoka Golf Club, Luxembourg, with a presentation by Daniel Schmidt, Partner, Proskauer Rose LLP.

Corporate, Private Equity, Financing

For more information about this practice area, contact:

Daniel Schmidt 33.1.53.05.68.30 – dschmidt@proskauer.com

Florence Moulin 33.1.53.05.68.19 – fmoulin@proskauer.com

Others practice areas - Paris office : **Administrative / Antitrust and Competition / Commercial Liability and Litigation / Corporate Litigation / Healthcare / International Arbitration and International Litigation / Labor and Employment / Real Estate and Construction / Tax / White Collar Crime**

Publication E-mail: leaders.dopinion@proskauer.com

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice or render a legal opinion.

BOCA RATON | BOSTON | CHICAGO | LONDON | LOS ANGELES | NEW ORLEANS | NEW YORK | NEWARK | PARIS | SÃO PAULO | WASHINGTON, D.C.
www.proskauer.com

© 2008 PROSKAUER ROSE LLP. All Rights Reserved. Attorney Advertising.