

Opinion Leaders

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Editorial

Why the title "Opinion Leaders"?

One, because Proskauer Rose is a law firm that reaches beyond the traditional role of attorneys. As legal advisers, we of course consult and keep abreast of court decisions and new legislation. But Proskauer Rose goes further and seeks to actively participate in the evolution of laws and regulations. We contribute to the shaping of laws, in particular in the areas of private equity and labor legislation. Only experts like us have the ability to do so.

Second, because Proskauer Rose is eager to develop a critical mind. Commenting on obsolete statutes, regulatory inflexibility or barriers towards innovation. "Opinion Leaders" offers criticism aimed at creating discussions and opening the debate. *It is not a one-way street. Its objective is to serve as a forum to exchange with our readers.*

Finally, because we think our readers are all Opinion Leaders and we are proud to share our views with them.

Opinion Leaders is published twice a month and is divided into three sections:

- An editorial on a current hot topic,
- A legal and tax watch to use as a reference,
- An overview of the legal advice the firm provides as well as a few words on the firm's recent key deals.

Legal and Tax Watch

The Proposed Act on the Modernization of the Economy and its Impact on Business

A "Grab-bag" Bill...

The proposed statute is a "grab-bag" bill that covers a wide range of issues, from the building of shopping centers to corporate and financial law. As far as corporate law is

concerned, it seeks to ease the incorporation and operation of limited liability companies (sociétés à responsabilité limitée – SARL) by providing standardized articles of incorporation and bylaws (statuts), simplifying public notice requirements in connection with registration, allowing shareholders to hold meetings by teleconference, etc. and those of "simplified corporations" (sociétés par actions simplifiée – SAS) by reducing the need for statutory auditors, eliminating the minimum capital requirement and repealing rules applicable to the annual reporting of voting rights, and by authorizing capital contributions in kind in the form of work. Under the new law, transfers of ownership interests would be subject to a 3 percent tax, with a maximum of €5.000, regardless of the legal form of the business concerned (limited liability companies or corporations).

.....Aimed at De-Criminalising Certain Business Practices and Bankruptcy Law Reform...

The proposed law would also authorize the government to issue Orders aimed at

- De-criminalising certain prohibited business practices, including some offenses currently punishable by the loss of the right to engage in commercial and industrial activities for ten years,
- Revising the Act of July 26, 2005 on bankruptcy proceedings, primarily to facilitate the use of conservation proceedings (procédure de sauvegarde) by making conditions more flexible, giving corporate officers more authority for the administration and reorganization of their business, revising the operation of creditors' committees, etc.

...Far-reaching Changes for the Financial Sector...

The bill would also authorize the government to issue orders, within a six-month period, to make the decisions:

- To improve the competitiveness of the Paris financial centre,
- To provide a uniform framework for insurance products and their distribution,
- To transpose certain European Directives into law¹.

The first objective is in three parts and aims at:

¹ (i) Commission Directive 2007/14/EC of March 8, 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market; (ii) Directive 2007/44/EC of September 5, 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector; (iii) European Parliament and Council Directive 2007/64/EC of November 13, 2007 on payment services in the internal market, amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.

- Turning Paris into a leading international capital market for French and other issuers who do not opt for public offerings; this implies, inter alia, a reform of the requirements applicable to public offerings and equity issues;
- Modernizing the rules applicable to asset management; this would entail a reform of the rules governing closed-end collective investment schemes (OPCVM, OPCI, SICAF) and other investment funds in order to ensure that they can be marketed outside France, to improve their liquidity and to allow for their listing;
- Reforming securities laws, including regulations applicable to preferred stock and stock buybacks.

...Including in the Area of Private Equity

The bill covers all private equity funds. "Local investment funds" (*fonds d'investissement de proximité – FIP*) would be authorized to invest in four adjacent regions as opposed to only three at the present time. "Innovation investment funds" (*fonds communs de placement dans l'innovation – FCPI*) would still be required to invest 60 percent of their assets in "innovative" companies, but these would be redefined.

Venture capital funds (*fonds communs de placement à risques – FCPR*) would be permitted to engage in lending on a regular basis. As for venture capital funds subject to a simplified procedure (FCPR *allegés*), in which only qualified persons may invest, their assets could include:

- For up to 15%, shareholder advances to companies in which they hold an interest, for the duration of that investment, irrespective of the size of the investment (the funds must currently hold 5% of the companies' equity),
- Ownership interests representing a financial investment in an entity primarily formed to invest in unlisted companies but not necessarily required to make direct investments in such companies or to be incorporated in an OECD member country (this has notably been making limited partnerships incorporated in the Channel Islands ineligible).

...the emergence of a new "contractual venture capital fund"...

Investment in contractual venture capital funds (FCPR *contractuels*) is restricted to qualified investors. The main features of such funds are specified in a contract between the investors and their managers.

Rules governing FCPR funds apply to the new funds, with the following exceptions:

- Contractual funds do not have any quota requirements but must be formed to invest in unlisted securities; in particular, they may hold ownership interests representing financial investments in any entity, regardless of where it is located;
- They may borrow as permitted by their by-laws;

- The lockup period applicable to their shares is set by contract and may exceed ten years.

These funds are particularly well-suited for the financing of infrastructure.

...Pass-through "Simplified" Corporations...

At this stage, only family groups may form pass-through SAS corporations. The authorities are expected to consider the possibility of allowing a more extensive use of this form of business organization.

...Endowment Funds to Finance Projects

By proposing the creation of endowment funds (fonds de dotation), the bill draws on US practice. Endowment funds are primarily used to finance non-profit institutions such as universities, hospitals, museums, etc. for a significant portion of their budgets. They receive an initial capital that is irrevocably contributed by their sponsor, and only the income generated by this capital is made available for the operating budget of the endowed institution.

The bill was submitted following the Council of Ministers meeting of April 30 and is expected to be debated before the National Assembly as of May 27, before being examined by the Senate on June 23. It is expected to be finally adopted in July.

Legal News

Management

The AMF has updated its directive no. 2005-02 dated January 25, 2005 on the full prospectus for collective investment schemes. The directive pertains to general funds and does not apply to FCIMT, FCPR, FCPI, FIP, FCPE and SICAVAS funds, for which specific directives have been issued.

Distribution of UCITS – Amendments to Book IV of the AMF General Regulations

Book IV of the AMF General Regulations concerning collective investment products has been amended, primarily to have uniform provisions apply to the distribution of UCITS. The objective is to ensure that identical rules of conduct govern the distribution of all UCITS, regardless of whether the distributor is a management company or another investment service provider.

Article 411-53 of the Regulations now states that "portfolio management companies distributing UCITS shares which they manage shall comply with the rules of conduct applicable to persons executing orders on behalf of third parties and those distributing UCITS shares managed by third parties shall comply with the rules of conduct applicable to persons receiving and transmitting orders on behalf of third parties."

Distribution of Limited Partnership Shares in France

In a communication dated April 7, 2008, the AMF confirmed that Limited Partnership shares are now categorized as financial instruments, following the transposition of the Markets in Financial Instruments Directive (the "MiFID").

Those shares may accordingly be sold in France:

- Either in accordance with the procedure applicable to the distribution of foreign funds in France, in the case of open-end entities,
- Or in accordance with public or private offering procedures in the case of closed-end entities.

What exactly is meant by open-end and closed-end entities remains to be defined...

Alternative Management/Hedge funds

The AMF General Regulations (articles 313-54 and 411-34) AMF Directive no. 2005-02 were amended following the report of the working group chaired by Philippe Adhémar on the French regulatory framework for alternative multi-management.

Henceforth, French management companies:

- Wishing to invest in a foreign alternative management fund will have to ensure that the fund complies with four general principles, rather than the current thirteen eligibility criteria;
- Will be obliged to implement the necessary procedures and resources to carry out the measures (selection, monitoring and control of financial instruments) required of them in connection with investments in financial instruments on behalf of the UCITS which they manage;
- Will be required to include a specific disclaimer in the prospectus of their alternative funds in the event that the diversification of investment strategies is narrowed.

Lastly, future statutes are expected to authorize the creation of alternative multi-management structures at three levels, i.e. funds of funds of hedge funds and the setting of redemption thresholds restricting liquidity for such funds under extraordinary circumstances.

Sovereign Funds: Public Authorities are Taking a Closer Look

Questioned by the French Senate² regarding the strategy that the government intends to follow with respect to sovereign funds, Finance Minister Christine Lagarde noted that she had asked Alain Demarolle to report to her quickly on the question of sovereign funds, in

² Written question no. 01962 by Mr. Bruno Retailleau (Vendée - NI) published in the Official Record of Senate Proceedings (JO Sénat) on September 27, 2007 - page 1693

order for a review the current debate to be carried out at both the international and the European levels, and to assess the appropriateness of the French legal framework, in particular in light of the approaches used by France's major partners³.

In addition to the Finance Ministry, the Senate Finance Commission has also been taking a closer look at sovereign funds. On May 15, it held a roundtable discussion on the role of those funds, at which it was reported that sovereign funds manage an aggregate of between 2,000 and 3,000 billion US dollars in assets at the end of 2007. They were expected to grow further and to manage combined assets of 8,000 billion dollars by 2011 and 12,000 billion by 2015. The four largest funds are the Abu Dhabi Investment Authority (500 to 875 billion US dollars), the Government of Singapore Investment Corporation (300 to 330 billion US dollars), the Norway Government Pension Fund - Global (322 billion US dollars) and the China Investment Corporation (200 billion US dollars). The Commission may also issue a report on this issue.

Real estate investment funds: the European Commission is looking into the adoption of a common framework in connection with the improvement of the framework governing the single market in investment funds

The Commission recently published a report on the sector, analyzing the obstacles in accessing the markets of other Member States by real estate investment funds.

Banking services: the European Commission holds hearings on changes to the banking Directives

The Commission has been holding public hearings, which will last until June 16, on possible changes to its capital requirements directives (Directives 2006/48/EC and 2006/49/EC intended to ensure the financial soundness of banks and investment companies).

Solvency II: the proposed Directive adopted by the European Commission last July is currently being examined by the Council and the Parliament

In April, the Commission also started a fourth quantitative impact study, which is scheduled to be completed next June. The objective is for the Directive to be adopted in November 2008 and to be transposed by the Member States in 2012. The current draft would require insurance companies to apply new solvency ratios when calculating their invested capital. The ratios limit investments in listed companies to 32% and investments in unlisted companies to 45%.

³ Reply by the Finance Ministry published in the Official Record of Senate Proceedings (JO Sénat) on May 8, 2008 - page 920

Corporate law: the bill proposing a series of measures to bring French corporate law into line with European law was adopted by the National Assembly on May 6 and will be examined by the Senate later this month

A decree implementing articles L. 225-42-I et L. 225-90-I of the Commercial Code, provided for in the "TEPA" Act dated August 21, 2007, which requires improved disclosure of deferred compensation, was published in the Official Gazette (Journal Officiel) on May 11, 2008

Tax News

ISF wealth tax: a decree and directives have been published implementing the reduction in the ISF wealth tax provided for in the Act dated August 21, 2007 on labor, employment and purchasing power (the "TEPA" Act)⁴, as amended by the 2008 Finance Act and the 2007 Amending Finance Act (Loi de Finances Rectificative)⁵

The Decree was issued on April 14, 2008⁶. All parties are required to file certain forms with the tax authorities, including the company in which the investment is made, if any, the investment entity (holding entity or investment fund, in practice the manager or the custodian) and the individual investors.

In this regard, it should be specified that an administrative decision by the tax authorities has extended the deadline for making the necessary arrangements the first year. This means that taxpayers settling their ISF obligations for 2008 will be allowed to submit supporting documents until September 15, 2008.

Lastly, tax directive 7 S-3-08 of April 11, 2008⁷ – which cancels and supersedes tax directive 7 S-2-08 of February 21 – comments on all measures reducing the ISF wealth tax for investors in small and medium-size businesses. It places a ceiling on such investments (€1.5 million in any twelve-month period), and specifies that it applies only to the company receiving the investment and under no circumstances to the holding entity or the investment fund. It also provides that failure by the target company to comply with the requirements for the tax treatment would not have an impact on the investment vehicle or the investor/taxpayer.

Latest Tax Directives Issued:

4 B-3-08 no. 49 of May 7, 2008: Abatement of long-term capital gains tax on real property used in connection with the operation of business, based on the period over which such property is held. Article 36 of the 2005 Amending Finance Act.

⁴ Act no. 2007-1223 of August 21, 2007 on work, employment and purchasing power (article 16)

⁵ 2008 Finance Act no. 2007-1822 of December 24, 2007 (article 22) and 2007 Amending Finance Act no. 2007-1824 of December 25, 2007 (articles 38 et seq.)

⁶ Decree no. 2008-336 of April 14, 2008 on the reduction of the ISF wealth tax provided for in article 885-0 V bis of the General Tax Code (Code général des impôts – CGI)

⁷ Tax directive 7 S-3-08 of April 11, 2008 on the reduction of the ISF wealth tax for investors in small and medium-size businesses.

5 C-1-08 no. 43 of April 15, 2008: Capital gains on sales of securities by private individuals. Exemption for capital gains generated by sales of securities in new, innovating companies (JEI).

4 C-3-08 no 41 of April 11, 2008: Fees and expenses (business income, corporate income tax, common provisions). Interest on funds belonging to third parties. Conditions and limits applicable to the deduction of interest on shareholder advances above and beyond their equity investment. Maximum interest rate qualifying for tax deductions.

4 N-1-08 no. 39 of April 9, 2008: Business taxation, incentive plans, employee profit sharing. Tax treatment of bonus shares distributed to employees and other information concerning employee stock ownership.

4 B-1-08 no. 36 of April 4, 2008: Capital gains and losses (business income, corporate income tax, common provisions). Tax treatment of long-term capital gains and losses. Amendment of rules applicable to companies subject to corporate income tax as provided for by article 39 of the 2004 Amending Finance Act.

Long-term capital gains from sales of shares of "tax" venture capital funds or venture capital companies as well as the distribution of assets or other distributions by such entities that are subject to the same tax treatment, will be dealt with in a special directive that is expected to be issued shortly.

4 H-2-08 no. 35 of April 2, 2008: Corporate income tax. Miscellaneous provisions. Tax treatment of consolidated groups ("Charasse" amendment).

Important Dates

- **May 15, 2008:** Deadline for sending the 2007 annual report by the Compliance and Internal Control Officer (RCCI) to the AMF
- **June 14, 2008:** last day for payments qualifying for ISF wealth tax reductions
- **June 15, 2008:** ISF wealth tax payment date
- **September 15, 2008:** Deadline for taxpayers to file individual returns and any additional documents, as provided for in articles 299(7) and 299(8) of the General Tax Code (ISF wealth tax abatement for investments in small and medium-size businesses).
- **September 30, 2008 :** Deadline for sending the AMF the 2008 specific report on investment consulting by investment service providers offering investment consulting services.

Recent Legal Advice and Key Deals – Upcoming Conferences

Recent legal advice and key deals

- Incorporation of holding entities, "innovation" (FCPI) funds and "local" (FIP) funds eligible for ISF wealth tax reductions and marketing methods and conditions
- Devising methods for calculating the legal and tax ratios of funds, for use by management companies
- Extension of the SGP (asset managers') program of activities
- Investment fund distribution agreements
- Assistance to a US-based broker-dealer trading for its own account using automated trading technology, in relation to the setting up of operations in Europe
- Review of the French regulatory framework and constraints applicable to post-trade activities (clearing, settlement-delivery and custody),
- Tax problems related to the conditions of eligibility for the New Innovating Firms (JEI) treatment
- Taxation issues of French employees entitled to foreign stock options
- Terms and conditions for the return of capital contributions made to "variable-capital" corporations

Upcoming conferences

"Mergers and acquisitions and private equity: a review of the new legal and tax practices", a May 26, 2008 symposium under the auspices of AFIC, with the participation of Guillaume Kellner, Partner, and Maité Lavrilleux, Avocat à la Cour, Proskauer Rose LLP.

Corporate and Private Equity

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