

Opinion Leaders

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Editorial

As expected, this issue of Opinion Leaders is mostly related to the draft Act for the Modernization of the Economy (designated as the LME).

From the point of view of financial services law and regulation, this draft bill includes numerous technical provisions, which, in addition to the fact that they will be amended and supplemented during the parliamentary debates, will be further developed within the framework of the Ordinances which must be adopted by the Government on the basis of the authorization afforded to it by the LME to implement a series of important reforms - concerning in particular various forms of investment vehicles, notably in the property and alternative investments areas (OPCI, SICAF, ARIA funds...), liquidity restrictions (gates and lock ups), prospectus, public offering, listing of closed-end funds etc.

We will of course monitor and report on these regulatory developments in the coming weeks and months.

Beyond these technical aspects (which are extremely important *per se* !), we should note, and fully support, the determination of the French public authorities to engage, in consultation with appropriate professional associations, an intense effort of *modernization* of the regulatory framework within which operates the French management industry. Let us hope that such engagement will keep its momentum.

Because "better regulation" is perhaps also a continuing process of re-assessment of and adjustment to a changing environment...

Legal and Tax Watch

The “LME” bill on the modernization of the economy

Several amendments have been added to this “grab-bag” bill as it is winding its way through a series of parliamentary committees (committee on the economy, finance committee and committee on laws).

The bill currently before the National Assembly proposes the following:

* **In the area of corporate law**, and more specifically:

- concerning corporations (*sociétés anonymes – SA*), to loosen rules requiring that directors and supervisory board members of privately-held companies hold a certain number of shares, and to preserve the double voting rights attached to certain shares held by entities when these are merged, spun off or when their assets are transferred;
- concerning “simplified corporations” (*sociétés par actions simplifiées – SAS*) to ease registration formalities for those with a sole shareholder and to allow 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, to raise a minimum amount of capital or to file annual statements of voting rights;
- concerning limited liability companies (*société à responsabilité limitée – SARL*), to provide model articles of incorporation and bylaws, to simplify their public notice requirements and to allow their shareholders to hold meetings by teleconference.

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

Lastly, the Finance Committee proposed improvements in 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.

* **In the commercial sphere**, in addition to reforms concerning the relationship between producers and retailers and rules on the location of supermarkets, the bill calls for:

- reducing the time for settling suppliers’ invoices to 45 days from the end of the invoice month or 60 calendar days, with an increase in penalties for non-payment;
- facilitating access by innovative small businesses to public procurement markets in the case of requests for proposals (“Small Business Act”);
- revising the penalties barring persons from engaging in commercial and industrial activities;

- creating a Competition Authority, which would be an independent administrative agency formed as a result of the transformation of the current Competition Council; it would be in charge of regulating industry concentration and anti-competitive practices and would issue opinions on competition issues.

* **In the area of bankruptcy law**, the LME bill would make it possible for the government to make changes in protective measures in view of:

- facilitating voluntary pre-bankruptcy proceedings (*mandat ad hoc*) and conciliation by 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;

- rendering 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 a more effective coordination between court-ordered liquidations and simplified liquidation procedures.

* **In the financial sphere**, the bill would:

- broaden the scope of market-making agreements with financial intermediaries, to allow for companies whose stock is traded on a regulated market to avail themselves of such agreements, as well as companies with shares listed on organized multilateral trading systems such as Alternext;

- require lending institutions to publish annual reports on their small business loans;

- create a special AMF license for rating agencies.

In the specific area of investment funds, the LME would:

- change the definition of “innovative companies” eligible for inclusion in the investment ratio of “innovation investment funds” (*fonds communs de placement dans l'innovation – FCPI*); it would continue to recognize the classification by Oséo Innovation but would apply a new standard for the research and development expenditure. 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);

- permit “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; by expanding the geographical scope of these investments, the bill seeks to provide financing for less-favored regions in terms of per capita GDP and to increase the size of those funds;

- reduce restrictions placed on “simplified” venture capital funds (*fonds communs de placement à risques – FCPR*), whose assets could include up to 15% of shareholder advances to companies in which the funds hold an equity interest, for the duration of that investment; the FCPR 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 companies whose stock is not publicly traded.

- create “contractual venture capital fund” (*FCPR contractuel*) that would give more leeway to the parties concerned (in all instances qualified investors) regarding investment and commitment rules as well as redemption terms and conditions, all of which would be set forth in a contract between the parties, in most instances the fund’s rules.

- create endowment funds, for financing non-profit institutions such as hospitals, universities and museums; they would receive donations from corporations or individuals wishing to contribute to public-interest projects; as in the case of their English and American counterparts, contributors and the fund would be entitled to certain tax benefits (similar to those for philanthropic contributions). Individuals would therefore be entitled to an income-tax exemption on 66% percent of any sum donated, provided it does not exceed 20% of taxable income, while donating 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 would also authorize the government to issue orders aimed at making Paris more attractive as a financial center. In this connection, the government can be expected to reform the laws governing mutual funds and investment companies, including real estate investment funds (OPCI) and closed-end investment companies (SICAF), as well as closed-end funds. Regulations governing ARIA funds (*OPCVM Agréés à Règles d’Investissement Allégées*) would be updated to allow their managers to place a ceiling on redemptions on each withdrawal date; rights to carried interest would be extended to include additional managers; funds would 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 would 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 bill provides:

- that corporations (*sociétés anonymes*) 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; the system, which draws on the rules governing “Subchapter S” corporations in the United States, would 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 simplifiée*) or limited liability companies (*sociétés à responsabilité limitée*);

- that the so-called "Madelin" benefit, which provides income-tax relief of up to € 20,000 (or € 40,000 for married couples) to individuals investing in small businesses, would be increased to € 100,000 or € 200,000 whenever the investment is in a start-up or used by a company to expand its operations;
- the repeal of the sole-owner venture capital company (*société unipersonnelle d'investissement à risques - SUIR*);
- the creation of "business angels investment companies" (*sociétés d'investissement de business angels – SIBA*), which would be venture-capital companies eligible for wealth-tax deductions on investments in small businesses (as provided for by the TEPA Act on labor, employment and purchasing power) provided that they invest at least 60% of their assets in small businesses in existence for less than seven years and that they hold on to the corresponding shares for at least five years.
- a new procedure making it possible for companies to submit research projects directly to the ministry of research or an agency in charge of innovation such as OSEO, to determine whether they meet scientific or technological criteria making them eligible for research tax credits.

The bill on the modernization of the economy is currently being debated by the National Assembly and is scheduled to come before the Senate at the end of June. It is expected to be formally adopted in July.

Legal News

New AMF rules on third-party portfolio management and investment advisory services

An update of the rules concerning the terms and conditions applicable to the registration of portfolio management companies, to bring them in line with the provisions of the 2004 Markets in Financial Instruments Directive ("MiFID") had been anticipated since November 1, 2007.

This has now been accomplished, with the publication of new AMF rules on May 28. "Instruction" 2008-03 issued February 8, 2008 concerns not only service providers managing assets on behalf of third parties but also those advising investors. As from November 1, 2007, investment advisory services have been considered full-fledged financial services and not just subsidiary services. Accordingly, firms offering such services must now be licensed.

Guidelines for the drafting of documents issued in connection with the distribution of financial products

The AMF has issued a set of guidelines for drafting distribution documents, covering:

- information for investors,
- information on past performance,
- balanced information.

On each topic, the AMF reviews applicable regulations and gives examples of practices it considers improper, based on its monitoring and examination of such documents.

Closed-end investment funds and foreign funds – Are your articles and bylaws in compliance with the law?

A government decision dated May 19, 2008 (published in the *Journal Officiel* on May 28, 2008) has adapted the rules applicable to mutual funds and closed-end investment companies (SICAF).

SICAF companies¹ and foreign investment funds are now required to have articles or bylaws that:

- allow their shareholders or unit holders to exercise effective control over their investment policies;
- provide that material decisions pertaining to their operation must be submitted to their shareholders or unit holders for approval.

Is government assistance in the form of guarantees permitted or prohibited?

On May 20, the European Commission issued a communication concerning government assistance in the form of financial guarantees. According to competition commissioner Neelie Kroes, the aim is to have more transparency regarding the use of guarantees, including for the purpose of facilitating the financing of small businesses.

The communication sets forth the methods used to determine whether a government guarantee amounts to prohibited assistance within the meaning of the Treaty. It also contains simplified rules for guarantees extended to small businesses, including rules that exempt categories of businesses.

Tax News

Wealth-tax and income-tax exemptions on investments in FCPI or FIP funds: The tax administration spells out how subscription fees and commissions must be taken into account when calculating income-tax exemptions.

A private letter ruling (no. 2008/12 issued on May 27, 2008) explains that subscription fees and commissions, including front-end charges:

- may not be taken into account when calculating the ISF wealth-tax exemption;
- may be taken into account when calculating the income-tax exemption, but only to the extent that they apply to the portion of the investment used to calculate that exemption.

Accordingly, subscription fees and commissions applying to the portion of the investment eligible for the wealth-tax exemption may not be factored in when calculating the income-tax exemption.

¹ SICAFs are corporations formed to manage securities portfolios. They were created and are governed by Order 45-2710 of November 2, 1945. Unlike mutual funds and SICAV investment companies, a SICAF is a closed-end investment fund, meaning that it is not required to issue or redeem shares at the request of holders.

The tax directive gives the following situation as an example:

Mr. and Mrs. X are married and file joint ISF wealth-tax and income-tax returns. On April 15, 2008 they invest € 21,000 in an FCPI (including a front-end fee of € 1,000 or 5% of the value of units purchased) that is eligible for a wealth-tax reduction; 60% of the fund's assets are invested in shares issued by small and medium-size companies that also qualify for a tax exemption. The subscription price is immediately paid in full.

For 2008, the couple is entitled to the following tax exemptions:

- a wealth-tax exemption of € 6,000, representing one-half of $60\% \times € 20,000$;
- an income-tax exemption of € 2,100, representing 25% of $[(€ 20,000 \times 40\%) + (€ 1,000 \times 40\%)]$.

Wealth-tax exemptions for investments in FCPR, FCPI and FIP funds: proposed new regulations... for later

A government decree and a tax directive implementing the wealth-tax exemption (provided for in article 885 I ter of the General Tax Code) for direct or indirect (through a holding entity or a fund) investments in small businesses are currently in the draft stage. They are not expected to be issued for several weeks.

Latest tax directives:

5 F-13-08 no. 58 of May 30, 2008: Income tax. Wages and salaries. Exemption of overtime. Interpretation of article 81(4) of the General Tax Code, implementing article 1 of the Act on labor, employment and purchasing power (the "TEPA" Act) (no. 2007-1223 of August 21, 2007).

5 C-2-08 no. 50 of May 14, 2008: Capital gains by individuals on the sale of securities and ownership interests. Increase in the tax rate and annual ceiling. Interpretation of articles 74 and 75 of the 2008 Finance Act (Act no. 2007-1822 of December 24, 2007).

Important dates:

- **June 14, 2008:** Deadline for finalizing investments qualifying for ISF wealth-tax exemptions
- **June 15, 2008:** Deadline for payment of ISF wealth tax
- **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:

- Incorporation of holding entities eligible for wealth-tax exemptions and management contracts
- Review of features and restrictions contained in regulations applicable to employee investment funds (FCPE) and employee savings funds (PEE)
- Compliance by portfolio management companies with their obligations under the MiFID Directive
- Divestments of portfolio investments in US, French and Belgian companies held by a private equity fund
- Loans to employees for purchasing Company shares, in accordance with article L.225-216 of the Commercial Code on legal and tax treatment
- Acquisition of an interest in a project to design and start up a wind farm
- Assistance with a project to acquire a minority interest in a joint solar-power production venture
- Review of terms and conditions applicable to cross-product close-out netting.

Upcoming conferences:

- **"Ethique et business sont-ils compatibles?"** ("Are ethics and business compatible?") symposium organized by the European American Chamber of Commerce, jointly with Cercle Montesquieu and Proskauer Rose, June 18, from 9:00 a.m. to 1:00 p.m. at the Automobile Club de France.

We will be honored to receive **Hervé Gattegno**, assistant managing editor of the periodical *Le Point* who will lead the discussions. **Mr. Robert Leblanc**, President of the MEDEF's Ethics Commission; **Mr. Emmanuel Lulin**, l'Oreal's Ethic's Director, as well as **Mr. Etienne Pfimlin**, President of the Crédit Mutuel will attend as well and give their insight through their professional experience.

Valérie Lafarge-Sarkozy and **Guillaume Kellner**, Partners, Proskauer Rose LLP will also give their insight on a legal perspective.

Admission is free – If you wish to attend, please send us an email at leaders.dopinion@proskauer.com

- **"Impact of European Regulation on Private Equity Firms and Funds"** June 19, 2008 as part of the Madrid EVCA Symposium of June 18-20, with a presentation by Daniel Schmidt, Partner, Proskauer Rose LLP.
- **"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.
- **"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

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