Proskauer

Opinion Leaders

July 2009

EDITORIAL: Review of June's ups and downs

Will June 2009 stand out in the history of legislation regarding Private Equity managers? Time will tell, but it is clear that it has brought its own share of uncertainties.

It all started on June 15 with the publication of **two AMF instructions relating to licensed and simplified Fund prospectuses.** Although these instructions will not take effect until August 15, and will then replace the COB instructions of June 6 2000, professionals have already started to adapt to them, and some of them urgently so. It is traditionally in July that FCPI and FIP managers submit their AMF approval applications so as to start marketing them after the summer break. But the new instructions have a wider scope, affecting all Funds that will soon be created, as well Funds in existence on June 15 which will continue to be marketed after June 15, 2010. In the future, prospectuses (i.e. regulations for simplified Funds and regulations and instruction leaflet for licensed Funds) will have to describe the Fund's investment strategy for each share type, whether it is eligible for investment quotas or not. Prospectuses will also have to be clearer about the risks linked to investing in a Fund, such as the capital loss risk, the risk of non-liquidity of valuation etc. To this end, a "Risk profile" is created. Managers must also be more transparent about all fees and commissions by specifying their basis and amount (or maximum percentage). Lastly, there is a contradiction which should be pointed out: whereas the instruction relating to licensed FCPRs restricts the share of products and net capital gains which return to the management company and its team to 20%, at the same time, the government has circulated a white paper concerning the carried interest regime which authorizes a higher percentage...

The next day, i.e. June 16, 2009, **the "Adnot" amendment** came into force**,** forbidding ISF holdings from having more than 50 shareholders and which, in practice, put an end to the marketing of holding companies by means of "public offer".

On June 29, **the "Arthuis" bill** was passed by the Senate. It provides that Funds ("ISF Funds" and "IR Funds") will have (i) six months, effective from the end of their subscription period[1], which may not be longer than eight months after the date of the Fund's constitution, to achieve 50% of their investment ratios and (ii) 12 months to achieve 100% of these ratios. Furthermore, their fees and commissions will be capped[2]. If today, this involves draft legislation which should be debated by the National Assembly in October, professionals are already anticipating its adoption.

Lastly, June 30 marks the coming into force of the new tax regime[3] applicable to **carried interest** but without the terms of the legislation and its special investment rates, nor tax instructions explaining the new regime having been published. Professionals therefore find themselves obliged to invest 1% of the total amount of the share subscriptions or carried interest if they want to benefit from the transfer of investment securities regime. Failing this, distributions and net profits pertaining to these interests or shares will be subject to taxation in accordance with the rules relating to employment income. And, as Gilles Carrez, the budget's rapporteur-general, said in his report of July 2 on the application of tax measures contained in the finance laws and in the TEPA law, "*it is up to the head of Social Security to confirm or refute the non subjection to social contributions of amounts taxed according to rules relating to employment income*".

Let's hope that the next return to work will be calmer...

Legal and Tax Watch

Legal News

Draft legislation encouraging credit access for small and medium-sized businesses and to improve the functioning of financial markets

Draft legislation encouraging credit access for small and medium-sized businesses and to improve the functioning of financial markets has been passed by the National Assembly. This obliges the banks to provide advance written notice of a reduction or interruption in facilities that have been agreed and to communicate their rating to small and medium-sized businesses seeking credit and to publish the amounts of financing given to small and medium-sized businesses created in the same year and to businesses less than three years old. It also provides for, under the auspices of Oséo, the creation of a special loan, guaranteed by the State, for young companies between two and five years old, of a maximum amount of €50,000.

It will also allow companies listed on Euronext to transfer onto unregulated markets (organized markets and SMN). Lastly, the draft legislation ratifies the orders relating to SICAFs, to closed-end foreign funds and certain financial instruments, to third party asset management, to share buybacks, to notifications in the event of breaching statutory thresholds and of intent.

Remuneration of corporate officers and market operators

An information report presented on July 7 2009 by the Deputé, Mr. Philippe Houillon, recommended the implementation of 16 measures aiming to control the remuneration of corporate officers. Thus:

- the amount of remuneration and all benefits paid annually to corporate officers that are tax liable will be capped at €1m,
- management and supervisory boards must consult ordinary general shareholder meetings about all remuneration components and any sort of undertakings corresponding to compensation or benefits owed or likely to be owed as a result of taking on, relinquishing or changing a corporate office,
- the number of corporate officer positions held by the same person in a public company registered in France is limited to three, when at least one of these companies presents its turnover excluding tax, a balance sheet total or average number of employees exceeding the thresholds set by article R. 233-16 of the Commercial Code,
- accumulation between corporate office and employment contracts is forbidden in order to prevent any accumulation of severance compensation,
- no attendance allowances can be paid to Chairmen of management or supervisory boards or to Managing Directors or Directors when they are administrators of the

company that they manage.

The Obama administration wants to better regulate the activity of traders, brokers and financial advisers

During the first half of July, the Obama administration put forward two pieces of draft legislation aiming to exert greater control over the activity of financial intermediaries. The first one aims to require that when brokers, traders or financial advisers provide investment advice, they act exclusively in the interests of their clients. Notably, the draft legislation gives more power to the SEC. It can ban certain forms of remuneration for financial intermediaries which might encourage them to offer inappropriate financial products to their clientele. This proposal could lead to a fundamental change in systems of remuneration for financial intermediaries in charge of marketing Funds. The SEC could also ban a person having committed a financial offense as part of their professional activities, from practicing in finance again, whether this field relates to the offense or not. The second piece of draft legislation will introduce compulsory registration of all managers based in the United States or people, wherever they work, advising US Funds (Hedge and Private Equity funds).

For its part, France its putting pressure on the European Commission so that it goes further in its proposed directive relating to equity capital requirements for the banks. France wants the part dealing with remuneration of banking professions, and especially traders, to be supplemented to allow authorities to sanction the non respect of the principles laid down by the financial Stability Forum (balance between salaries and bonus, partly differed payment of bonus etc).

Reform of financial instrument valuation

The IASB (*International Accounting Standards Board*) is proposing to review the principle of financial instrument accounting based on "*fair value*". According to the proposal that is undergoing consultation until September 14, the methods for valuing financial instruments will be reduced from around twenty to two: either the instruments will be valued at their redeemable cost (when they have the characteristics of a loan and a return has been contractually agreed upon), or they will remain valued at *fair value*, i.e. their market value.

Publication of the list of regulated European markets

This list was published in the Official Journal of the European Union on July 11. In France, this concerns the Euronext in Paris, the MONEP and the MATIF.

Towards a good practice code for underwriting agents?

The EVCA (*European private equity and Venture Capital Association*) has drafted a code for underwriting agents, in addition to a good practice code, which should be definitively adopted and published by the end of the year.

Tax news

Business tax: implementation of progressive taxation on added value?

In exchange for the removal of business tax on equipment and movable property, the State will now tax businesses for their added value as soon as their turnover reaches €500,000 as opposed to the current figure of €7.6m. The rate will be progressive; starting at 0.50% for turnover of €3m and climbing to 1.5% for turnover of €50m.
If this reform turns out to be favorable in overall terms for some sectors such as industry, it is clear that many businesses (especially in the financial sector) will be losers.
Thus, if today, it is only some venture capital companies, achieving gains of less than €7.6m, who can reclaim the payment of the minimum business tax contribution, it is clear that tomorrow, if this bill is passed, all companies (and not just some SCRs) will be taxed once they achieve a minimum of €500,000 in gains.

Reduction in wealth tax for investments in small and medium-sized firms

A draft tax regulation giving details on the "Adnot" amendment relating to wealth tax holding companies and the increase in State aid is at the consultation stage.

Decree of June 30 2009 relating to procedures for applying articles 223 E and 223 L of the CGI (French General Tax Code)

This specifies the tax consequences of a company leaving a consolidated group of companies within 18 months of starting insolvency protection or receivership procedures, or following the start of liquidation proceedings.

Recent taxation instructions:

- **5 G-5-09** no. 70 of July 16 2009: Income tax. Non commercial profits. Industrial property profits. Transfer of industrial property elements to a company. Change in the regime for deferral of added value contribution provided for in I ter of article 93 quater of the CGI. Article 14 of the Finance Law for 2008.
- 4 A-11-09 no. 68 of July 13 2009: Tax credit in favor of incentivization
- 7 G-6-09 no. 66 of July 2 2009: Free transfers. Exonerations and special regimes. Exonerations justified by the status of the beneficiary. Exoneration of gifts and bequests given to endowment funds. Comments of II on article 141 of law no. 2008-776 of August 4 2008 on the modernization of the economy

Latest rulings:

- RES No. 2009/38 (FE) Application of the anti under-capitalization measure provided for by article 212 of the CGI: "*What are the procedures for applying the tolerance provided for in no. 56 of the 4 H-8-07 administrative order allowing share capital to be substituted by shareholder equity for the calculation of the ratio provided for by 1 and II of article 212 of the CGI?*"
- RES No. 2009/40 (FP) Reduction in income tax for cash subscription to unlisted companies. Procedures for assessing the status of small and medium-sized

businesses as defined by EEC legislation, when the company receiving subscriptions is a newly created company and whose accounts have yet to be closed. "*For the application of the reduction in income tax for cash share subscription in small and medium-sized businesses, provided for in I to V of article 199 terdecies-0 A of the CGI, at which date must one assess the condition relating to the status of being a small or medium-sized business, as defined by EEC legislation, of the company receiving subscriptions when it is newly created and its accounts have not yet been closed?*"

AMF news

OPCI

The AMF has published a new instruction relating to the complete prospectus of approved OPCIs.

Professional accreditation of market players

The measure to verify the professional knowledge of investment service providers (PSI) will come into force on July 1 2010. But requests for examination accreditation will be processed by the accrediting financial market High Commission in order to be approved by the AMF from October onwards.
Generally speaking, all people under the authority of the PSI or acting on its behalf must have the appropriate qualifications and skills as well as a sufficient level of experience. But henceforth, the implementation of this principle must be verified. The PSI must ensure that people carrying out certain key functions (manager of a portfolio management company, financial analyst, RCCI etc) have the necessary skills. In order to do this, the PSI can either carry out an internal assessment according to a formalized procedure which be checked *a posteriori* by the AMF, or make these people take a certified external examination. Nonetheless, in accordance with the grandfather clause, key people who are practising as of July 1, 2010 are not subject to this procedure, unless they change company after this date.

AMF report on remuneration of Directors of listed companies

The AMF report on the implementation of the AFEP-MEDEF recommendations is available on our website.

Recent Legal Advice and Key Deals:

Upcoming conferences

Recent Legal Advice and Key Deals:

- ???drawing up a legal opinion as part of guarantees given by a French parent company to cover the obligations incurred by one of its American subsidiaries for a commercial lease.
- ???dealing with and amiably resolving a dispute concerning the occupation of premises by a lessee after the expiry date of a commercial lease.
- ???drafting FCPI and FIP regulations and instruction leaflets in accordance with the new instruction.
- ???analysis of eligibility of innovative companies for FCPI ratios.
- ???consultation on the different mechanics that could be put in place for a start-up to motivating and retaining its management (profit-sharing, participation, BSPCE, carried interest, free share allocation etc.)
- ???consultation on procedures for marketing foreign investment entities (private placements, solicitation, investment advice, etc.)

Upcoming conferences:

September 2009

Private Equity/Finance

September 15-17 2009 – **Capital Creation** – 9th annual European Private Equity conference – in Monaco. Proskauer Rose is a sponsor of this event. With participation from and involvement of several of the firm’s lawyers from London, Paris and Boston.

Competition / Commercial Disputes

September 22 2009 – **Breakfast Seminar on "Contractual termination of commercial relations: main trends in jurisprudence"** – from 8.30am to 10.00am – in the Paris offices of Proskauer Rose. Led by Valérie Lafarge-Sarkozy, Mireille Dany and Nicolas Faguer, lawyers from Proskauer Rose in Paris.

Employment Law

September 24 2009 – **First session of professional training "Certificate in Psychosocial risk management"** – in the Paris offices of Proskauer Rose. training in partnership with the ESC Dijon. With the involvement of several experts, including Béatrice Pola, a Proskauer Rose lawyer.

Publications:

- ***"Les Fonds de Capital Investissement, Principes Juridiques et Fiscaux",*** *2nd edition,* Daniel Schmidt and Florence Moulin (Cabinet Proskauer Rose), Preface by Mr Hervé Novelli, Publisher Gualino. Currently on sale from the AFIC.
- ***Guide de l'investissement ISF dans les PME",*** published by Les Echos-Capital Finances, with contributions from Daniel Schmidt and Florence Moulin (Cabinet Proskauer Rose).

Fore more details; www.lesechos.fr

- ***Le Guide des négociations commerciales 2009-2010,*** Mireille Dany (Proskauer Rose), Régis Fabre and Léna Sersiron (Baker & McKenzie), Éditions Dalloz

[1] Or for funds that already exist, six months effective from the date of the law's promulgation.

[2] At an amount that will be set by the Minister for the Economy!

[3] The new regulations "apply to FCPRs created after the date of publication of the law mentioned in b of 3° and in b of 5° of I and no later than June 30 2009 and, for venture capital companies and entities, to shares and rights issued effective from the same date".