Venture capital investment in France: market and regulatory overview

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MARKET OVERVIEW

1. What are the main characteristics of the venture capital market in your jurisdiction?

Venture capital and private equity
Venture capital distinguishes itself by the:
• Early stage of development of the companies which are funded.
• Absence of revenues or absence of profit.
• The absence of leverage and consequently of debt in the investment, which is generally made in equity.

The relevant figures and more can be found on www.chaussonfinance.com. Other interesting websites are www.cliperton.net and www.go4venture.com, both with sectoral newsletters in English.

Sources of funding
Although smaller than the UK and the US, the business angels’ community in France is developing and becoming more organised. Over the past five years, non-profit organisations such as France Angels (www.franceangels.org) have promoted investments into early stage companies. France Angels is also part of a European network. In addition, the trend of successful entrepreneurs setting up their own seed investment funds (for example, Jainq, Isai, Kim, Newfund, Aurinvest) is stronger than ever. There are also corporate funds either internally managed (Bouygues Telecom Initiative, SFR Développement or Seb Alliance) or with the management delegated to professional teams (Orange-Publicis/Iris Capital, Electranova (Edf)/idinvest Edenred-Casino/Partech). This is good for the French market, which has been significantly weakened by the recent changes in France’s tax laws (see Question 2).

In 2013, a total of 779 companies have been funded for a total of EUR911 million, compared to EUR750 million in 2012 and EUR822 million in 2011.

Types of company
In 2013, seed investments represented only EUR50 million (stable) of the amounts invested, with Series A representing EUR183 million (down) and further rounds EUR678 million (up).

Over the last six months:
• Healthcare has been the leading sector, with 24.5% (up).
• E-commerce/internet: 21% (down).
• Software: 12% (stable).
• Cleantech: 10% (stable).
• Telecoms: 6.5% (up).

Market trends
Out of a total of EUR911 million invested in 2013, EUR562.2 million was invested by the ten most active funds (up). FCPs (Fonds Communs de Placements dans l’Innovation) and FIPs (Fonds d’Investissements de Proximité) were predominant during the first half of 2013. In the second half of 2013 the new state-owned investment vehicle Banque Publique d’Investissement (BPI), took the lead with EUR88.8 million invested.

The average amount per investment remains low at less than EUR1 million for the first half of 2013 and EUR1.3 million for the second half of 2013. This is compared to a total of EUR1.18 million for 2012.

An increasing number of corporate venture funds or corporate investors are being active on the French market. The French funds invested 20% of the amounts invested during the first half and 16% during the second half of 2013 outside France.

2. Are there any recent or proposed regulatory changes affecting the venture capital industry?

The venture capital industry is affected by any new regulations applicable to portfolio management companies, especially to the extent that these regulations impose new organisational and compliance standards and/or legal requirements. In particular, Directive 2011/61/EU on alternative investment fund managers (AIFM Directive), which has been transposed into French law has affected the French venture capital industry in various ways:
• Certain investment vehicles, including unregulated funds dedicated to private equity, now fall within the definition of ‘alternative investment fund’ and their managers are required to register as fund managers under the AIFM Directive (for example, certain SCR’s) unless they benefit from an applicable exemption or they do not operate as an alternative investment fund.
• There are additional reporting requirements to regulators, investors and employees in relation to any controlling acquisition.
• No distributions of assets or dividends, and no reduction of capital or share redemptions, are permitted for the first 24 months after an investment by a private equity fund. This rule, intended to prevent asset stripping, may have an operational impact on the fund’s ability to structure the investment.
• The AIFM Directive is not applicable to small fund managers (that is, fund managers with less than EUR500 million of assets under management), or to small or medium-sized enterprises (SMEs) (within the meaning of EU legislation). However, under French law, these fund managers are required to declare their identity and investment strategy to the regulator.
• The legal texts that implemented the AIFM Directive in French law are not yet final. Therefore, on some matters (for example, marketing), there is no clear guidance on how the new rules will work in practice.
• There have been various amendments relating to tax benefits applicable to French investors in certain regulated and unregulated funds (see Question 2). These amendments include the:
  - renewal of the tax benefits arising from investments in FCPIs and FIPs for another two-year period;
  - limitation of the wealth tax reduction for investment in SMEs (see Question 3).

**TAX INCENTIVE SCHEMES**

3. **What tax incentive or other schemes exist to encourage investment in venture capital companies? At whom are the schemes directed? What conditions must be met?**

French tax law provides for several tax incentive schemes to encourage investments in venture capital companies with industrial or commercial activities. Most of these schemes are directed at investors (both individual investors and corporate), but some incentive schemes specifically benefit innovative companies.

**Individual income tax exemptions**

Individual investors benefit from an exemption from income tax on investment income and capital gains derived through FCPPRs (Fonds Communs de Placement à Risques), FCPIs (Fonds Communs de Placement dans l’Innovation), FIPs and SCRs (Sociétés de Capital Risqué), if these investors:

• Hold their units (or shares) for a five-year period.
• Reinvest all distributions from the fund (or the SCR) over the same five-year period.
• Hold no more than 25% of the financial rights in the portfolio companies of the fund (or the SCR).

Individuals are also entitled to a tax exemption on capital gains derived from the disposal of shares in recently created and innovative enterprises, or JEl (Jeune Entreprise Innovante) (see below), if they have held the shares for at least three years at the time of the disposal.

In both cases, individuals residing in France remain subject to social contributions at an overall rate equal to 15.5%.

**Individual income tax reduction**

Investments (capital contributions) in European venture capital companies may entitle an individual to an income tax reduction if the:

• Company is not listed on a regulated market.
• Company has its registered office in a member state of the EU, Norway, Iceland or Liechtenstein.
• Company is subject to corporate income tax.
• Company has two employees or more.

• Company carries on industrial, commercial activities.
• Company is an SME.
• Investor elects to hold its shareholding for a five-year period from the date of contribution.

For payments made since 1 January 2013, the income tax reduction is equal to 18% of the investment, subject to a EUR9,000 cap for a single person (EUR18,000 for a couple) if the enterprise is a medium-sized enterprise (that is, with fewer than 250 employees and with revenues of no more than EUR50 million or total assets of no more than EUR43 million).

This income tax reduction also applies to investments in FCPIs and FIPs. In these cases, the reduction is capped at EUR2,160 for a single person and EUR4,320 for a couple.

**Wealth tax incentives**

Investments qualifying for the income tax exemption (see above, *Individual income tax exemptions*), made after 13 October 2010, can alternatively (and therefore not cumulatively) give a wealth tax reduction equal to 50% of the investment, but capped at EUR45,000.

The same reduction applies to investments in FCPRs, FCPIs and FIPs, with a cap at EUR18,000.

In both cases, the shares or units issued in consideration for these investments are exempt from wealth tax.

**Corporate tax exemption**

A special regime applies to corporate investors investing in FCPRs and SCRs if they elect to hold their units or shares for a five-year period.

In this case, distributions paid out of capital gains realised by the fund or the company and occurring at least two years as from the subscription are likely to be taxed at a reduced rate:

• 0% for that part of distributions relating to long-term capital gains (that is, investments of at least 5% in the share capital of underlying companies held for two years at least);
• 15% for the remainder.

In addition, after the five-year holding period has been satisfied, capital gains realised upon the sale of units in FCPRs or shares in SCRs may benefit from the same reduced rates under the same proportion as above.

**Tax incentives for innovative companies**

Enterprises that incur eligible research expenses may benefit from a research and development tax credit (Crédit d’Impôt Recherche (CIR)) (R&D Tax Credit), which is equal to:

• 30% of the eligible expenses up to EUR100 million.
• 5% above this threshold.

Enterprises that qualify as a European small and medium-sized enterprise (SME) can also benefit from an innovation tax credit equal to 20% of the innovative expenses, capped at EUR400,000 (tax credit equals EUR80,000).

Any R&D Tax Credit which cannot be offset against the corporate income tax can be carried forward over a three-year period. Any unused amount can be refunded at the end of this three-year period. However, JElS can benefit from an immediate refund.

JElS are defined as SMEs that have:

• Been incorporated for less than eight years.
• Research expenses eligible to the R&D Tax Credit equal to at least 15% of their tax deductible expenses.

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• A share capital mainly held by individuals or venture capital funds.
• Not been created through a merger, reorganisation, or extension of pre-existing activities.

Apart from the immediate refund of R&D Tax Credit, JEs are entitled to temporary exemptions from corporate income tax and business tax.

FUNDING SOURCES

4. From what sources do venture capital funds typically receive funding?

Venture capital funds receive funding from various players in the private equity market, such as:
• Institutional investors (such as banks, insurance companies, corporate investors, funds of funds and pension plans).
• French governmental agencies.
• Public agencies of the EU.
• Individuals (high net-worth or retail).
• The attractiveness of venture capital funds for certain investors depends on various factors such as:
  • The investment strategy followed by such investors (especially for institutional investors).
  • The willingness to promote investments in venture capital (especially for French and/or EU governmental agencies).
  • Tax incentives (especially for individuals; see Question 3).

It is to be noted that FCP and FIP, although having raised more than in 2012 (EUR530 million compared to EUR471 million) have seen their overall share reduced from 9% to 7%.

FUND STRUCTURING

5. Can the structure of the venture capital fund affect how investments are made?

Investments made by venture capital funds are impacted by:
• The legal structure used to form the funds.
• Whether an investment in this fund involves a specific tax benefit for French investors.

Legal structure

FCPI, FCPI, FIP and SCRs (see Question 7) must invest at least 50% of their assets in equity, equity-related securities or securities giving access to capital issued by non-listed companies (eligible investments). However:
• FCPiS must, in addition, invest up to 70% of their assets in eligible investments issued by innovative companies organised in France, the EU or countries in the EEA provided that appropriate tax treaties are concluded between such countries and France.
• FIPs must, in addition, invest up to 70% of their assets in eligible investments issued by SMEs organised in specific geographical areas of France, the EU or countries in the EEA provided that appropriate tax treaties are concluded between such countries and France (and up to 20% of this quota is invested in newly formed companies).

• FCPiS and FIPs must invest up to a certain percentage of their assets within a period of twelve months following their last closing date and are allowed to invest on a limited basis in listed companies and/or holding companies.

Tax benefits

Certain venture capital funds can provide tax benefits to their French investors (see Question 3), provided that such funds comply with additional requirements, such as:
• Investing at least 50% of their assets in eligible investments issued by companies organised in France and/or the EU (limited exemptions are available for investments made in holding companies and/or investment funds organised in countries in the EEA, provided that appropriate tax treaties are concluded between such countries and France);
• Investing a certain percentage of their assets within a period of 12 months following their last closing date.
• Investing in portfolio companies that are SMEs, provided that the aggregate funding by FCPiS and FIPs in such SMEs does not exceed EUR1.5 million.

6. Do venture capital funds typically invest with other funds?

Venture capital funds typically invest with other funds, as most deals are done by a syndicate of two to three funds. However, except when business angels are involved, seed investments are frequently made by one investor. At the other end of the cycle (Series D), players (mostly foreign) tend to invest alone or take the largest portion of the investment.

7. What legal structure(s) are most commonly used as vehicles for venture capital funds in your jurisdiction?

The most common legal structures used as vehicles for venture capital funds in France tend to be the fund structures that have tax incentives. For retail investors, the structures generally used are an FCP and an FIP (retail funds) (see Question 7, Market trend). In the case of sophisticated and/or institutional investors, a funds professionnel de capital investissement (FCPI), formerly referred to as FCP alléges, is the most common vehicle (non-retail fund).

Other legal structures can be used, including the following corporate entities:
• A Holding ISF, for private individuals seeking a tax benefit relating to the French wealth tax (see Question 3, Wealth tax incentives).
• An SCR, for private and professional investors forming a club deal of investors in an evergreen fund.

INVESTMENT OBJECTIVES

8. What are the most common investment objectives of venture capital funds?

The term of a venture capital fund that is not an evergreen fund does not differ from the market standards. They generally have a term of eight to ten years, with the possibility for the management company to provide an extension, either:
• In its discretion.
• With the prior approval of the advisory committee or a vote by a qualified majority of the investors.

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However, any investor in a retail fund can request redemption of its fund interest on the expiration of a ten-year blocking period following its subscription, unless the fund is already in liquidation. If the redemption request is not satisfied, the investor can then request that a court proceed with the compulsory liquidation of the fund.

In relation to a retail fund, the AMF, which has expressed concern about any extension of the term beyond ten years, will request that the management company provide specific disclosures to retail investors as to redemption possibilities.

Retail funds generally seek to exit their investments within four to five years from the initial investment, which would allow them to satisfy possible investor redemption requests occurring after the ten-year blocking period. The other types of venture funds (especially the SCR) are generally organised for more than ten years and do not allow their shares to be redeemed on an investor’s request. Investors can exit such funds through a secondary transfer of their interests.

**FUND REGULATION AND LICENSING**

9. Do a venture capital fund’s promoter, manager and principals require licences?

Venture capital funds must be managed by a management company licensed by the financial services regulator, the Autorité des marchés financiers (AMF), as a portfolio management company. The management company must appoint a custodian authorised by the Autorité de contrôle prudentiel to provide safekeeping and custody of assets for investment funds.

Certain private equity vehicles that were not regulated before the implementation of the AIFMD Directive but are now required to have their managers licensed (see Question 2) could be exempted from the appointment of a custodian if, in particular, they have total commitments of less than EUR500 million and their investors are not retail investors.

10. Are venture capital funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

**Regulation**

A retail fund must be authorised by the AMF before its formation and any marketing of interests to prospective investors. The formation of a non-retail funds must be notified to the AMF within one month of its formation.

The marketing of interests in a venture capital fund must comply with French regulations relating to public offerings, solicitation and the marketing regime applicable after the implementation of the AIFMD Directive, subject to applicable private placement exemptions.

**Public offering**

Since retail and non-retail regulated funds (see Question 7) are subject to prior approval of, or filing requirements with, the AMF, interests in such funds may be offered to the public without any additional approval or registration, if such funds are exclusively marketed in France. Any marketing outside of France must comply with the requirements relating to the marketing passport enacted by the AIFM Directive.

For French private equity funds that are not formed as retail or non-retail funds (see Question 7) prior approval of the AMF on any offering documentation must be obtained before interests in such funds can be offered to the public.

**Marketing and solicitation**

Interests in FPCI, FIP, FCPI and SCRs can only be marketed by French investment service providers or credit institutions, or by entities or individuals registered in a public registrar of authorised salespersons (démarcheurs). In practice, the marketing of non-retail funds is restricted to certain categories of investors.

Marketing of venture capital funds, other than those listed above, is not permitted unless such marketing is directed to qualified investors or to legal entities which satisfy any of the following criteria:

- Total balance sheet, total sales or total assets in excess of EUR5 million.
- Total workforce in excess of 50 individuals.

Qualified investors include:

- Institutional investors (credit institutions, insurance companies, and so on).
- Large corporate entities.
- Governmental or international bodies or organisations (or their equivalent under foreign laws).
- Any high net worth individual who both:
  - has elected to be treated as a professional client and with respect to whom an investment service provider authorised to operate in France has agreed to accept that election;
  - satisfies at least two of the following criteria:
    - holds a portfolio of financial instruments having a value in excess of EUR500,000;
    - carried out an average of at least ten major trades (that is, a gross amount of at least EUR600 per transaction) in financial instruments per quarter over the previous four quarters;
    - has held a professional position in the financial sector for at least one year requiring knowledge of investments in financial instruments.

11. How is the relationship between investor and fund governed? What protections do investors in the fund typically seek?

The terms and conditions of an investor’s investment are governed by the fund’s governing documents, which are:

- The bye-laws.
- Subscription agreements.
- Side letters.
- The articles of association.
- Shareholders’ agreements and, if applicable;
- The terms and conditions of the securities issued by the fund.

The terms and conditions applicable to investors differ between retail and other types of venture capital funds. The governing documents of a retail fund must comply with detailed French law requirements for the fund to be approved by the AMF. Therefore, investors in a retail fund generally do not have flexibility to negotiate the terms or to request protections in addition to those already provided by law.

The governing documents of the venture capital funds that are not retail funds are more frequently negotiated by investors because French laws and regulations allow flexibility for a wide variety of
terms. Investors negotiate provisions that are commonly looked for by investors in global venture capital funds, such as:

- Key person and change of control provisions.
- Fault and no fault suspension of the investment period/removal of the management company.
- Limitations relating to raising a successor fund.
- Management and other fees.
- Reporting obligations.
- An advisory committee role and seat.

**INTERESTS IN INVEESTEE COMPANIES**

**12. What form of interest do venture capital funds take in an investee company?**

Venture capital funds invest in equity. Preferred shares, introduced into French law in 2004, were the preferred instrument of venture capital funds. However, for the past couple of years, seed and first round are often invested in ordinary shares with or without ratchet warrants attached. This is due to the cost of issuing preferred shares and the protections granted to existing security holders and shareholders. The liquidation preference right is dealt with in the shareholders’ agreement.

When the investment is made in tranches, a warrant is attached to the preferred share to allow the further purchase of the relevant shares. Only in relation to bridge loans or in very specific circumstances will the fund purchase bonds that are either convertible or redeemable in shares.

Venture debt has not yet developed in France.

**VALUING AND INVESTIGATING INVEESTEE COMPANIES**

**13. How do venture capital funds value an investee company?**

Unlike mature companies whose valuation generally derives from a multiple of earnings before interest taxes depreciation and amortisation (EBITDA) (or equivalent financial criteria), valuation of emerging growth companies is mainly based on:

- A tentative determination of the future growth (market size, go to market strategy, uniqueness of technology, management team and so on).
- Mutual determination by the founders and the investor(s) of the level of dilution resulting from the investment.

Naturally EBITDA will be considered whenever it is appropriate.

**14. What investigations do venture capital funds carry out on potential investee companies?**

Venture capital funds carry out technical, financial and legal due diligence, mainly to ensure that:

- The core technology is efficient.
- The intellectual property attached to the technology is properly owned by or available to the investee company.
- There are no major issues in the company’s accounts.
- There is no significant existing or potential litigation.
- The target company is labour law compliant.
- The equity in the company has been validly issued and does not carry undisclosed potential dilution.

Venture capital funds also generally make reference calls as regards the managers and check their freedom to operate.

The representations and warranties also relate to these issues (see Question 10).

**LEGAL DOCUMENTATION**

**15. What are the principal legal documents used in a venture capital transaction?**

The main documents are:

- The investment agreement, which contains:
  - a detailed description of the existing shares and securities issued by the target company as well as of the terms and conditions of the investment (amount, allocation among investors, tranches and milestones, if any);
  - the representations and warranties to be granted in most cases by the founders, in contrast to the investee company in other jurisdictions;
  - anti-laundering as well as ethical and transparency provisions (increasingly).
- The resolutions to be passed at the extraordinary general meeting of the shareholders of the investee company, to increase the share capital, and which contain most of the terms of the preferred shares to be incorporated in the bye-laws (see Question 18).
- The shareholders’ agreement, containing:
  - the usual rights requested by the investors (see Questions 18 to 22);
  - rules of governance;
  - key management and information rights provisions;
  - intellectual property provisions;
  - ethical and transparency provisions (increasingly).

In seed rounds, the representations and warranties, and the investment agreement, are often replaced by a simple declaration letter dealing with the topics listed in Question 14 together with simple indemnification rules.

**PROTECTION OF THE FUND AS INVESTOR Contractual protections**

**16. What form of contractual protection does an investor receive on its investment in a company?**

On completion of its investment, an investor is granted representations and warranties, which are intended to give sufficient comfort on the substance of the company, in particular relating to the:

- Share capital.
- Intellectual property.
- Absence of litigation.
- Compliance with existing laws and regulations, especially those relating to employment.
Usually, representations and warranties are made by the founders in which case damages upon a breach are two-tiered:

- Up to one to two years of salary in cash.
- Up to a capped amount, in cash or shares at the founders' option except upon a fraudulent breach. In this case, the contractual terms of indemnification would not apply and damages would be fully indemnified in cash.

Where the founders are no longer managing the company, the manager(s) would be liable for the first-tier damages and the company for the rest except upon a fraudulent breach.

On completion of the investment, a shareholders' agreement is executed, which provides for the usual rights (see Questions 18 to 22), in addition to its other provisions (see Question 19).

In relation to seed investments, given the cost and time involved in drafting detailed representations and warranties, there is a trend to rely on a simple bullet point declaratory letter referring to accounts, tax, intellectual property and share capital.

**Forms of equity interest**

**17. What form of equity interest does a fund commonly take (for example, preferred or ordinary shares)?**

In most investments, funds buy preferred shares. When the investment is made in tranches, a warrant is usually attached to the preferred share, to allow the further purchase of the relevant shares once the agreed milestones have been achieved. Only in relation to bridge loans or in very specific circumstances will the fund purchase bonds convertible or redeemable in shares.

However, the issuance process is relatively complex (appointment of a special auditor to issue a report, and numerous securities holders' meetings) and involves time and cost. As a result, some French seed funds buy ordinary shares, and rely on the shareholders' agreement for their liquidation preference and on ratchet warrants for their anti-dilution rights. Before the introduction of preferred shares into French law, such warrants were commonly used to implement the anti-dilution protection.

**Preferred shares**

**18. What rights does a fund have in its capacity as a holder of preferred shares?**

Preferred dividend is rarely used as it serves little purpose. Interest on capital is not permitted and redeemable shares are not used, given the cumbersome rules governing reduction of capital.

Anti-dilution rights are implemented through ratchet (full or weighted average, as pay to play is rarely used) embedded in the preferred shares.

Unlike in the US or the UK where the board of directors is active and involved in sales or mergers, the boards of French companies, except for listed companies, are not concerned by the sale or merger of the company, which is considered to be a shareholders' issue. In contrast, the winding-up or bankruptcy of the company is deemed a corporate issue. Consequently, the liquidation preference is found in the:

- Shareholders' agreement in relation to the sale or merger of the company.
- Preferred shares for winding-up and bankruptcy.

Sale of most or all of the assets is dealt with in the shareholders' agreement.

**Management control**

**19. What rights are commonly used to give a fund a level of management control over the activities of an investee company?**

Board seats go to the most significant investors to keep boards as small and efficient as possible. Some funds satisfy themselves with observer seats.

A number of management decisions are subject to the prior approval of the board at a simple or qualified majority, according to their importance. Often the prior approval of the preferred shareholders is not required. This is to avoid cumbersome and expensive shareholders' meetings when, due to a qualified majority requirement, it is obvious that the required majority will not be reached in shareholders' meetings. However, under the influence of foreign investors, prior approval of the preferred shareholders is becoming increasingly common.

**Share transfer restrictions**

**20. What restrictions on the transfer of shares by shareholders are commonly contained in the investment documentation?**

The shareholders' agreement usually provides for a right of first refusal (droit de préemption), different to the pre-emption right (see Question 22), forcing a shareholder willing to sell its shares to first offer them to the other shareholders. This right may be granted with various priorities by different categories of shareholders (founders, investors and others).

Founders are often subject to a lock-up period for the term of either their claw-back obligation or the liquidity period. This lock-up often includes an exception for up to 10% of a given founder's shares (clause de respiration).

Claw-back or good and bad leaver obligations are for terms of up to five years, and are commonly restricted to resignation and dismissal for gross negligence.

**21. What protections do the investors, as minority shareholders, have in relation to an exit by way of sale of the company?**

Tag-along rights are most commonly split into full and proportional tag-along rights.

The full tag concerns change of control situations or sale of shares to industrial companies, usually competitors. The proportional tag, frequently only benefiting investors, applies to any sale of shares. The full tag allows the transfer of all the shares held by the shareholders.

Drag-along rights are triggered by offers to purchase all the shares of the company accepted by a given majority of shareholders, irrespective of their category and, often, a preferred shares' majority. Drag-along majorities are designed so that the preferred shareholders (or one class of them) cannot be forced to sell.

Irrespective of the terms of the drag-along, mergers as such require by statute the affirmative vote of a two-third majority of all shares, and often also require the affirmative vote of a given majority of the preferred shares.
22. Do investors typically require pre-emption rights in relation to any further issues of shares by an investee company?

On top of the statutory pre-emption right (droit préférentiel de souscription), a contractual pre-emption right relating to further issues is generally found in shareholders’ agreements. Further issues are also usually subject to prior approval of the existing preferred shareholders.

Any change of the existing rights of a category of preferred shares is by statute subject to prior approval from the relevant category, requiring a two-third majority.

Consents

23. What consents are required to approve the investment documentation?

In certain circumstances, anti-trust or foreign investment governmental prior approval may be required.

Investment is approved according to the fund’s governance rules. The partner in charge approves the investment documentation. Only large private equity funds with in-house counsel require the general counsel’s prior approval.

More generally, any increase of capital requires a two-third majority of all shares and, on a case-by-case basis, the prior approval of the preferred shares, except when the rights of a category are being amended. In this case, a two-third majority of the relevant preferred shares is required.

COSTS

24. Who covers the costs of the venture capital funds?

As a matter of principle, the company covers the legal and due diligence costs of the investment. However, these costs are generally capped.

Break-up fees are rare.

FOUNDER AND EMPLOYEE INCENTIVISATION

25. In what ways are founders and employees incentivised? What are the resulting tax considerations?

Incentives

The most commonly used incentives are the following:

- Options to purchase or subscribe shares (stock options) may be granted to employees and managers of the issuing companies and to those of a related entity. Beneficiaries must not hold more than 10% of the share capital of the company at the time of the grant; in addition, the global amount of shares under option must not represent more than one-third of the share capital of the company. For the favourable tax regime to apply beneficiaries must not dispose of underlying shares before the fourth anniversary of the date of grant.

- Restricted stock units (free shares) may be granted free of charge to the same beneficiaries and under the same limitations as those of stock options except that beneficiary must not hold more than 10% of the share capital either at the time of the grant or as a result of the grant. To benefit from the favourable tax regime, free shares must be issued or attributed after a minimum of two years, and then held by the beneficiary at least for another two years.

- Founders warrants (bons de souscription de parts de créateurs d’entreprises) can only be granted to employees and managers of the issuing company and therefore not to those of related entities. The issuing company must have been incorporated for less than 15 years and must not have been created through a merger, reorganisation, or extension of pre-existing activities. In addition, if listed, its average market cap must not exceed EUR150 million for the 60 business days preceding the date of grant. Also at least 25% of its share capital must have been held by individuals since its inception.

Tax

The tax regime depends on whether or not stock options and restricted stock units have been granted before or after 28 September 2012.

Stock options and RSUs granted before 28 September 2012. If they comply with the above requirements (see above, Incentives), gains arising from incentives are taxed as follows:

- Stock-options:
  - on granting: a social contribution is due by the employer at the rate of 30% of the fair market value of the underlying shares;
  - on sale of underlying shares (at least four years after the grant):
    - acquisition gain (that is, the fair market value of shares on exercise minus exercise price) is subject to income tax at the rate of 30% for the part below EUR152,500 and 41% above (these rates are reduced to 18% and 30% if the employee elects to hold the shares for two additional years as from the end of the initial four-year period), social contributions at the global rate of 15.5%; and an employee’s contribution at the rate of 10%.
    - capital gain (that is any gain made on top of the acquisition gain) is subject to income tax at the progressive income tax rates and social contributions (15.5%). Such capital gain could benefit from a discount, the rate of which depends on the holding period of the shares (for example 50% if the holding period is at least equal to 2 years).

- Free shares:
  - on granting: employer’s contribution is due at the rate of 30% of the fair market value of the shares granted;
  - on sale of shares:
    - acquisition gain (that is, the fair market value of the shares on acquisition, that is on the second anniversary of grant) is subject to income tax (30%), social levies (15.5%) and employee’s contribution at the rate of 10%.
    - capital gain (that is any gain made on top of the acquisition gain) is subject to income tax at the progressive income tax rates and social contributions (15.5%). Such capital gain could benefit from a discount, the rate of which depends on the holding period of the shares (for example 50% if the holding period is at least equal to 2 years).

- Founders warrants. In relation to founders warrants, capital gains realised on the disposal of underlying shares are subject to social levies at the rate of 15.5% on top of income tax at the following rates:
  - 30% if the employee has been employed for less than three years at the time of disposal;
  - 19% in other cases.

Source: global.practicallaw.com/privateequity-mjg
Stock options and RSUs granted on or after 28 September 2012. The tax treatment is as follows:

- Stock-options:
  - on granting: a social contribution is due by the employer at the rate of 30% of the fair market value of the underlying shares;
  - on sale of underlying shares, the
    - acquisition gain is subject to income tax at the progressive income tax rates, social contributions (15.5%) and an employee’s contribution at the rate of 10%;
    - capital gain (that is any gain made on top of the acquisition gain) is subject to income tax at the progressive income tax rates and social contributions (15.5%). Such capital gain could benefit from a discount, the rate of which depends on the holding period of the shares (for example 50% if the holding period is at least equal to 2 years).

- Free shares:
  - on granting: employer’s contribution is due at the rate of 30% of the fair market value of the shares granted;
  - on sale of shares, the:
    - acquisition gain (that is, the fair market value of the shares on acquisition on the second anniversary of grant) is subject to income tax at the progressive income tax rates, social contributions (15.5%) and employee’s contribution at the rate of 10%;
    - capital gain (that is, any gain made on top of the acquisition gain) is subject to income tax at the progressive income tax rates and social contributions (15.5%). Such capital gain could benefit from a discount, the rate of which depends on the holding period of the shares (for example 50% if the holding period is at least equal to 2 years).

- Founders warrants. In relation to founders warrants, capital gains realised on the disposal of underlying shares are subject to social levies at the rate of 15.5% on top of capital gains tax at the following rates:
  - 30% if the employee has been employed for less than three years at the time of disposal;
  - 19% in other cases.

Founders see their existing shares submitted to claw-back provisions. Such provisions remain simple when the bad-leaver clause is limited to resignation and gross negligence. They are more complex when the bad-leaver clause is extended to breach of employment agreement or other event(s).

Only a few funds ask for good-leaver provisions.

EXIT STRATEGIES

27. What forms of exit are typically used to realise a venture capital fund’s investment in an unsuccessful company? What are the relative advantages and disadvantages of each?

The investors can decide to force the company to sell its assets and distribute the cash by way of dividends, or to wind up the company and distribute the liquidation proceeds.

The sale of assets triggers stamp duty on the purchase price and is likely to trigger tax consequences for the company, as would the winding-up of the company. In addition, the proceeds of the sale cannot be easily distributed to the shareholders in the context of liquidation.

As a consequence, the company will usually be sold and the price kept confidential.

28. What forms of exit are typically used to realise a venture capital fund’s investment in a successful company? What are the relative advantages and disadvantages of each?

There are three primary types of exits:

- Sale of the company.
- Initial Public Offering (IPO).
- Leveraged buyout.

The sale of the company consists of the sale by the shareholders to a third party of all the securities issued by the company in exchange for cash or shares. When for cash, it provides immediate and certain liquidity to the investors. It also allows flexibility to remunerate the management and possibly the investors through earn-out clauses.

An IPO allows the company to raise cash, through the sale of shares issued due to an increase of the share capital and liquidity to the investors. However, due to lock-up provisions, the sale of the entire shareholding held by the founders, usually together with the investors, is extended over a period of time. The extent of this depends on the market on which the shares are to be listed.

A leveraged buyout consists of the sale for cash of a majority of the shares to a newly formed holding company, combined with debt issuance by the holding company. It has the same advantages as the straight sale, but also cashes out the investors willing to exit while allowing the other shareholders to stay in. However, it is only available to profitable companies.

It is quite difficult for a company to complete an IPO or leveraged buyout without retaining investment bankers, while the sellers of the company may decide against that.

In a sale of the company, the managers give representations and the sellers (or the most significant sellers) grant warranties, which involve sellers and buyers in adversarial negotiations. In an IPO, the company is usually responsible for representations and warranties. In a leveraged buyout, the representations and warranties are given by the sellers and the company.
29. How can this exit strategy be built into the investment?

The drag-along and liquidity clauses of the shareholders’ agreement allow the investors to prevent an exit at unsuitable price conditions, and also to force exits that suit them. The liquidity clause sets the time after which, failing an IPO or a trade sale, the investors will be able to force an exit. Also the liquidation preference will impact the exit strategy.

ONLINE RESOURCES

legifrance.gouv.fr
W www.legifrance.gouv.fr

Description, Légifrance is the official website of the French government for the publication of legislation, regulations, and legal information. Translations are available in the most common languages on the website.

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Professional qualifications. Paris, Bar, 1992
Areas of practice. Private equity; M&A; securities law.
Recent transactions
- Representing ETF (Environmental Technology Fund) on its investment in the company ENABLON.
- Representing Group Climater and its managers in a secondary LBO with Weinberg Capital.
- Representing Ecomobilité Ventures on its three 2012 investments in Zilok Auto, Move About and EZ Wheel.
- Representing INSIDE SECURE on its acquisition of Embedded Security Solutions (ESS).
- Representing La Maison Bleue and its managers in a LBO with Activa Capital and EPF Partners.
- Representing Vermeer Capital Partner in the restructuring on the LBO on the Regie Linge Group.
- Representing EOS Imaging in its acquisition of OneFit Medical.
Professional associations/memberships.

Areas of practice. Emerging business; private equity; M&A.
Recent transactions
- Representing Teads Technology and existing founders and investors (including Partech International Partners and Ela Partners) in the merger with Ebuzzing.
- Representing Bpifrance in its EUR30 million investment in Talend.
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**Professional qualifications.** New York, Bar, 1981; Paris, Bar, 1985  
**Areas of practice.** Private investment funds.

**Recent transactions**
- Representing a large secondary manager in the acquisition of several portfolios of fund interests, including venture funds and their registered manager, from French financial institutions.
- Representing a French venture capital manager, for the fundraising of a new fund.
- Representing Fondinvest Capital for various primary and secondary investments.
- Representing institutional investors and family offices for their investments in various French venture and other funds, such as investments in AlpInvest Secondaries Fund V and Swan Cap Opportunities Fund.
- Representing a sovereign fund and a European institution for their investments in various French venture and other funds.

**Professional qualifications.** Paris, Bar, 1969  
**Areas of practice.** Emerging business; venture capital; M&A.

**Recent transactions**
- Representing the founders and the company in the sale of the investors’ interest in Aldebaran Robotics to Amuse Three Corporation and the reinvestment by the same in Aldebaran Robotics followed by the purchase of Gostai by Aldebaran Robotics.
- Representing Spartoo in the Series D financings of respectively EUR15 million purchased by the existing investors (A Plus finance, CM-CIC Capital Privé, Endeavour Partners and Highland) and EUR10 million by Sofina.
- Representing SoftBank in the Series D financing of EUR30 million in Criteo.
- Representing Codenvy in a Series A US$9 million financing from Auriga and a US Business Angel.

**Professional associations/memberships.**
- CroissancePlus - Co-chairman of the Legal and Tax Commission.
- PME Finance - VP and Secretary General.
Professional qualifications. Paris, Bar

Areas of practice. Christian has an extensive experience in M&A transactions and in the structuring of acquisition for private equity funds and large companies. Christian advises, on a day-to-day basis, companies on their tax affairs, and entrepreneurs as shareholders of companies. In addition, he manages tax audit with the French tax authorities.

Recent transactions
These include transactions completed before joining Gide Lovrette Nouel.
- Representing La Maison Bleue and its managers in a LBO with Activa Capital and EPF Partners.
- Representing SK Capital in the structuring of the acquisition of the group IB Pharma.
- Representing One Equity Partner in the structuring of the acquisition of a shareholding interest in Technicolor.
- Representing a large US investment fund in the structuring of the acquisition of a French listed company.
- Representing managers in the structuring of an investment vehicle for the acquisition of large companies in Africa.

Professional associations/memberships.
- Secrétaire Général of the Association CroissancePlus and Chair of the Tax Commission.
- Co-founder and Secrétaire Général of the Fondation Croissance Responsable and Secrétaire Général of Nous Citoyens.

Professional qualifications. Paris, Bar

Areas of practice. Private Investment Funds

Recent transactions
These include transactions completed before joining Gide Lovrette Nouel.
- Representing a large secondary manager in the acquisition of several portfolios of fund interests, including venture funds and their registered manager, from French financial institutions.
- Representing a French venture capital manager, for the fundraising of a new fund.
- Representing Forinvest Capital for various primary and secondary investments.
- Representing institutional investors and family offices for their investments in various French venture and other funds, such as investments in AlpInvest Secondaryles Fund V and Swan Cap Opportunities Fund.
- Representing a sovereign fund and a European institution for their investments in various French venture and other funds.