ICLG

The International Comparative Legal Guide to:

Private Equity 2019

5th Edition

A practical cross-border insight into private equity

Published by Global Legal Group, with contributions from:

Aabø-Evensen & Co
Advokatfirman Törngren Magnell
Ali Budiardjo, Nugroho, Reksodiputro
Allen & Gledhill LLP
Ashurst Hong Kong
Avance Attorneys Ltd
Bär & Karrer Ltd.
British Private Equity & Venture Capital Association (BVCA)
Bub Memminger & Partner
Consortium Legal
Davis Polk & Wardwell LLP
Debarliev, Dameski & Kelesoska Attorneys at Law
Dechert LLP
Dentons
DS Avocats
Eversheds Sutherland (Luxembourg) LLP
Faveret Lampert Advogados
Garrigues
HBK Partners Attorneys at Law
Houthoff
Johnson Winter & Slattery
Maples Group
Matheson
McMillan LLP
Morais Leitão, Galvão Teles, Soares da Silva & Associados
Pirola Pennuto Zei & Associati
Proskauer Rose LLP
Samvād: Partners
Schindler Attorneys
Solórzano, Carvajal, González, Pérez-Correa, S.C. (SOLCARGO)
Udo Udoma & Belo-Osagie
Van Olmen & Wynant
Webber Wentzel
Zhong Lun Law Firm

BVCA British Private Equity & Venture Capital Association

glg global legal group

glg
global legal group

Contributing Editors
Christopher Field &
Dr. Markus P. Bolsinger,
Dechert LLP

Publisher
Rory Smith

Sales Director
Florjan Osmani

Account Director
Oliver Smith

Senior Editors
Caroline Collingwood
Rachel Williams

Sub Editor
Jenna Feasey

Group Consulting Editor
Alan Falach

Published by
Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
iStockphoto

Printed by
Ashford Colour Press Ltd
July 2019

ISBN 978-1-912509-82-9
ISSN 2058-1823

Strategic Partners

General Chapters:

Country Question and Answer Chapters:

Continued Overleaf

glg
global legal group

Country Question and Answer Chapters:

PREFACE

We are privileged to have been invited to preface the 2019 edition of *The International Comparative Legal Guide to: Private Equity*, one of the most comprehensive comparative guides to the practice of private equity available today. The Guide is in its fifth edition, which is itself a testament to its value to practitioners and clients alike. Dechert LLP is delighted to serve as the Guide's Editor.

With developments in private equity law, it is critical to maintain an accurate and up-to-date guide regarding relevant practices and legislation in a variety of jurisdictions. The 2019 edition of this Guide accomplishes that objective by providing global businesses leaders, in-house counsel, and international legal practitioners with ready access to important information regarding the legislative frameworks for private equity in 31 different jurisdictions. This edition also includes five general chapters, which discuss pertinent issues affecting private equity transactions and legislation.

The fifth edition of the Guide serves as a valuable, authoritative source of reference material for lawyers in industry and private practice seeking information regarding the procedural laws and practice of private equity, provided by experienced practitioners from around the world.

Christopher Field & Dr. Markus P. Bolsinger

Dechert LLP

Chapter 14

France

Arnaud Langlais

Gacia Kazandjian

DS Avocats

1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions? Have you seen any changes in the types of private equity transactions being implemented in the last two to three years?

The French private equity sector is well-developed and growing.

In the past couple of years, this sector has been subject to several favourable factors: (i) availability of financing sources; (ii) association with tax and labour law reforms; and (iii) a positive global outlook. Together, these have contributed to the improvement of this sector in France.

Funds provided by the transaction to the investee company can be used for a variety of entrepreneurial purposes. Private equity is used to: finance growth for start-ups but also established companies as replacement capital when the ownership structure changes; to realise succession plans; or as distressed investment for turnaround financing.

A great variety of businesses in different industry sectors benefit from private equity, including those in high technology, industrial, healthcare, consumer, services, financial and other sectors, and in different development stages from start-ups to large established companies.

In the last three years, we have seen a rising cooperation of investors with other strategic investors in private equity transactions. These new alliances are considered as the most common change in the private equity firms' business models, ahead of using leverage or financial engineering or focusing on active portfolio management.

1.2 What are the most significant factors encouraging or inhibiting private equity transactions in your jurisdiction?

The growing attractiveness of the French market may partially be explained by the recent reforms intended to enhance the investment environment and to stimulate economic growth.

For instance, the wealth tax in France, called *l'Impôt de solidarité sur la fortune* ("ISF") which used to assess the total wealth owned by a tax payer has been replaced by the *Impôt sur la Fortune Immobilière* ("IFI") which only assesses property assets (please refer to question 9.4). Furthermore, there were significant changes with respect to capital gains, dividends, and interest, which are now taxed at a 30% flat tax rate.

Moreover, Bpifrance, the public investment bank, and the European Investment Fund ("EIF") provide support and facilitate access to funding (loans, guarantees equity) for enterprises, small- or mid-size, in any sector of activity from their early stages to a public listing.

A new alternative investment fund, the *Société de libre partenariat* ("SLP") was created. It possesses legal personality and is comparable to the English limited partnership. Designed to address key demands of investors, it allows greater flexibility and provides for legal certainty.

In order to further promote investment in French companies, the Pacte (*PACTE – Action Plan for Business Growth and Transformation)* legislation simplified the use of certain instruments that are typically used in private equity operations (i.e. the conditions of allocation of preferential right shares ("*actions avec des droits de préférence*"), BSPCE, advantages in relation to the French PEA, etc.).

1.3 What trends do you anticipate seeing in (i) the next 12 months and (ii) the longer term for private equity transactions in your jurisdiction?

In 2018, there were over 5,100 private equity backed buy-out deals, the larger number of deals registered in the last 10 years. With the continuing low interest rates, we expect private equity to remain active during 2019, though perhaps not at the record levels of 2018.

Two major trends may have an impact on private equity transactions. Firstly, reforms, under the liberal government, will continue to incentivise private equity investment. In addition to the measures mentioned previously, corporate tax in France is expected to be reduced from 33% to 25% by 2020.

Furthermore, geopolitical factors may also shift some European private equity initiatives to the French market. Recently, in the context of Brexit, British investments have been made in France in order to gain a foothold in Europe and certain projects that would have naturally been developed in the UK previously are being relocated to France.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction?

When a target is identified, a special purpose vehicle ("SPV") is created in most cases under the form of a *société par actions simplifiée* ("SAS") to gather all the investors under one corporate entity.

In addition to the vehicles mentioned above, we should also note a special purpose vehicle referred to as "NewCo", established to raise funds in order to acquire the target company. Subject to certain conditions, this vehicle allows to facilitate the consolidation for tax purposes and to offset the interests on debt against the target's profit (please refer to question 9.1 for further information).

When the private equity fund wishes to offer management packages to a large number of managers, they usually prefer to create a separate and unique structure under which all managers are part of ("ManagementCo").

2.2 What are the main drivers for these acquisition structures?

Private equity is mainly encouraged by financial considerations. It offers investors the opportunity to have an experienced fund manager invest their money according to the guidelines of the fund and distribute the profits amongst its members. This activity is often categorised as an "alternative investment" which entails a variety of investment techniques, strategies and asset classes which are complimentary to the stock and bond portfolios traditionally used by investors and which provide attractive returns, higher than public equities, stocks or bonds.

Tax rationales are the second driver to promote private equity investments. Last year, the French government increased tax incentives to attract private investors. The investors benefit from a lenient, even favourable, tax system including an income tax cut, exemption on capital gains or deferred contributions. For instance, when French tax residents make investments through private equity investment funds ("FPCR"), they may use a tax exemption on capital on gain.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

As explained above, private equity funds invest the funds in the target company.

Private equity fund managers are generally rewarded with fees income and a share in the profits of the fund, generally known as carried interest.

Furthermore, in a buy-out, private equity investments are often channelled through a new company ("NewCo") which raised the funds to acquire the target company. In this case, private equity funds invest a small amount of equity and use leverage, i.e. debt or other non-equity sources of financing, to fund the remainder of the paid consideration.

2.4 If a private equity investor is taking a minority position, are there different structuring considerations?

Yes, the investor's positions depend on its contributions on the capital. However, although the dispositions of the law offer a certain protection, the by-laws or a shareholders' agreement may offer higher protection to the minority shareholders. For instance, a minority shareholder may get a veto right on any strategic decision which may have a direct impact on the value of its investment such as a build-up, a security over the assets of the company, etc. In addition, minority investors may request other specific rights such as the appointment of a director, a reinforced right to information through reporting clauses, preferential shares with multiple voting rights, and, in some cases, the right to conduct an audit of the company.

These rules, which mainly relate to corporate governance matters and security transfers, are generally set out in a shareholders' agreement and reiterated to a certain extent in the by-laws of the acquisition vehicle, especially if incorporated in France under the form of an SAS, which offers great flexibility to tailor the by-laws to the shareholders' needs.

2.5 In relation to management equity, what is the typical range of equity allocated to the management, and what are the typical vesting and compulsory acquisition provisions?

In private equity transactions, investors will generally seek to acquire a stake in a target under preferential conditions. Thus, private equity investments are usually associated with a management package – offered to the managers of the target company.

It is also common market practice to have managers invest in preferred equity instruments, the return of which are higher than on ordinary shares but contingent on a certain level of global return, measured through the return on investment ratio established by private equity investors (*"le TRI, taux de rendement interne"*).

Moreover, the terms of the exit itself can be a matter of consensus with other shareholders. The shareholders' agreement can anticipate this issue by requiring cooperation from the target company. For instance, a "drag-along" clause gives the private equity firm, as a majority shareholder, the right to compel the other shareholders to sell.

2.6 For what reasons is a management equity holder usually treated as a good leaver or a bad leaver in your jurisdiction?

In order to reinforce management's involvement, the concepts of good and bad leavers are often introduced to determine the price for the shares in case the shareholding manager departs. The usual position is that a good leaver will receive market value for its shares and a bad leaver will receive the lesser of the market value or nominal value (although other means may also be negotiated).

A management equity holder can usually be treated as a good leaver if they leave after a negotiated contractual period, for the following reasons: death; a mental or physical incapacity preventing them from continuing their involvement; or their dismissal or removal without misconduct.

In other cases, a management equity holder may be penalised through a bad leaver clause, in circumstances where they take the initiative to leave shortly after the private equity transaction or for any type of misconduct, subject to negotiations between the parties.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

Most private equity portfolio companies are registered as an SAS. The main idea behind the SAS is to offer a vehicle whose main operational rules can be set by the parties with very light statutory prescriptions. Such flexibility allows the setting up of governance structure to be adapted to a wide range of investors' profiles. In this type of vehicle, by-laws may be tailored to the investors' expectations: in most cases, some wish not to partake in any management role, preferring a supervisory role.

Such rules are generally set out in a shareholders' agreement and reiterated to a certain extent in the by-laws of the acquisition vehicle. In France, such arrangements are confidential whilst by-laws are public. Thus, any confidential information should be further set out in the shareholders' agreement.

Following recent trends, minority investors have preferred the role of an observer "*censeur*". As such, the investor is entitled to attend all meetings of the board of directors and present its observations but has no voting rights. The rationale underlies a supervisory role to ensure profit but not to participate fully in the management.

3.2 Do private equity investors and/or their director nominees typically enjoy veto rights over major corporate actions (such as acquisitions and disposals, business plans, related party transactions, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

Yes. Private equity investors generally enjoy veto rights, not conferred by law but set out in a shareholders' agreement. These veto rights allow such investors to oppose any decision which goes against the very essence of their investment. The list of veto rights may include any commercial or financial matters related to the main assets of the company, which may have an impact on the investment.

Minority private equity investors also have veto rights which confer protective provisions in order to protect their minority position against the majority shareholders. These veto rights mainly relate to corporate governance matters and security transfers, or dilution issues.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

As stated above, the veto arrangements are not provided by law but by contractual provisions set forth in a shareholders' agreement. Veto rights are effective between parties but not opposable to third parties.

The representatives' veto rights need to be balanced with the corporate purpose of the company. With regard to third parties and in principle, managers have broad powers to act on behalf of the company they represent, within the limits of the corporate purpose of the company.

The company may also be engaged even when the acts do not fall under the corporate purpose of the company, unless it is proven that the third party was aware that such an act exceeded the said purpose. Thus, the company bears the burden of proving the bad faith of the third party, by demonstrating that the latter knew that such acts exceeded the corporate purpose of the company.

In other words, despite a veto right of the board or general meeting, the legal representation of the company may ignore such decisions and have the company legally bound with third parties. In such cases, they may be found liable towards the company and its shareholders provided that damage is proven which may also consequently result in dismissal.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

Majority investors shall not take any actions that unfairly prejudice the minority shareholders (oppression of a minority shareholder) and *vice versa* a minority shareholder cannot use its minority right to act against the interest of the company.

Certain duties may also be owed if the company is incorporated under a limited company form. Apart from the common rights granted by each share to their respective shareholders (for example, right to participate in the general meetings, voting rights, right to receive dividends, right to participate in any increase of the share capital, etc.), specific rights are also granted by law to minority shareholders, including the right to (i) request information and to question about the course of the company matters and its financial situation, and (ii) request the performance of a legal audit of the company before the courts.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

There are no such limitations or restrictions that would apply with respect to a French company with regards to enforceability. However, as mentioned below, under French law (as well as other laws), the shareholders' agreement only binds the involved parties.

Although not very common, the parties may submit the contract to laws and jurisdictions other than France, provided that there is no fraudulent intent. It is important to note that even when the contract is governed by a foreign jurisdiction, the contract shall still respect French public order dispositions.

As for the enforceability of a non-compete or non-solicit provision, its scope of application shall only be limited to the protection of the legitimate business interest of the company as well as limited to its geographical location and duration.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies?

Private equity investors must ensure that nominee directors are not disqualified or prohibited from acting as directors.

In the case of proven damage, a director who has committed mismanagement and not acted in the interest of the company may incur liability. Liability may be incurred in the case of harm caused by a breach of the law or of its contractual obligations, as well as by a management fault. The private equity fund may revoke its mandate to act as a director.

Moreover, directors may also incur liability in the cases of criminal offences such as (i) breach of trust, (ii) fraudulent circumstances, and (iii) where they have not designated an auditor requested by law. As a principle, the liability of the private equity investor will not be incurred based on the fact that it has appointed the director who has acted unlawfully and against the interest of the company.

However, in certain circumstances, private equity investors may be considered as a *de facto* director. For instance, if the investor actively participates in the management of the company on a daily basis, then the investor will be treated as a director and the duties of a director shall also apply.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Among their key general duties, directors must avoid potential conflicts of interests. In order to ensure compliance with this principle, French law imposes efficient control measures to directors in the form of a prior approval of any agreement arising between the company and its directors. In addition, it is forbidden for a director to obtain a loan or a credit from the company.

The French association for private equity investors in France Invest has also established a code of conduct which includes a range of good practices directed at portfolio management companies involved in the investment. In particular, these rules aim to ensure a higher degree of loyalty and transparency.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including antitrust and other regulatory approval requirements, disclosure obligations and financing issues?

Bearing in mind to better oversee foreign investments in France, the French law provides that any investment in sensitive sectors deemed crucial to France's national interests in terms of public order, public security and national defence, be subject to the prior compulsory approval of the Minister of Economy and Finance. The relevant sectors include the supply of energy and water, transportation and communication services, facilities and infrastructures that are deemed critical within the meaning of the French Defence Code, the production or trade of weapons and ammunitions, and the healthcare sector. Based on the latest news, the scope of the mentioned sectors may increase in the coming months.

In addition, any transaction which may have an impact on competition and anti-trust issues (subject to the fulfilment of conditions pertaining to the turnovers) is also subject to the prior approval of the Ministry of Economy and Finance or the European Union-based Commission.

Another important aspect underlies the requirement of the prior opinion of the Work Council of the company with regards to the decision of acquiring or investing in the company. However, such employee representations body does not have a veto right.

Finally, it is also important to mention the application of the *Loi Hamon* where, if the contemplated share transfer represents 50% or more of the share capital, all employees (in small- and medium-sized companies only) must be informed individually before the contemplated transaction, in such a way that it entitles them to make an offer to acquire the said shares.

4.2 Have there been any discernible trends in transaction terms over recent years?

French private equity has been recovering over the past two years and has recently benefitted from several favourable factors such as those mentioned throughout this chapter: tax reforms; positive global outlook; availability of financings from banks which altogether foster a level of trust to increase investments in start-ups; SMEs; and mid-caps.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

A public-to-private transaction generally involves several challenges. The acquisition process involving a tender offer is defined as a cumbersome transaction. There is a higher level of confidentiality towards the financial market which adds to the difficulty of collecting information for due diligence purposes as well as to gather information from the management team and shareholders of the target company. Excluding minority shareholders is also a challenge. The squeeze-out can only be effected if the offering party has a shareholding of at least 95%.

5.2 What deal protections are available to private equity investors in your jurisdiction in relation to public acquisitions?

The Financial Markets Authority ("*Autorité des marches financiers*") ("AMF") publishes a set of rules and regulations concerning public takeovers, in order to ensure the protection of private investors in public acquisitions. They aim to (i) establish equal treatment and access to information by securities holders concerning the offer, (ii) promote market transparency and integrity, (iii) level the playing field for alternative bids, and (iv) ensure fairness in transactions and in competition among bidders.

Break-up fees are allowed in public-to-private transactions, not by virtue of law but through contractual provisions.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

On the seller's side, private equity investors prefer not to offer warranties and consequently only provide such warranties on the title of ownership of their shares or capacity warranties. On the buyer's side, however, private equity investors need to be reassured and thus request a series of guarantees.

Moreover, the "locked-box" structure is fairly common as it offers in particular a firm price independent from the normal activity and greater control over financial information. In return for the price protection, the seller undertakes not to extract value (in the form of cash, assets or other benefits, together defined as "leakage") from the target group in the period from the locked-box date to completion.

6.2 What is the typical package of warranties/indemnities offered by a private equity seller and its management team to a buyer?

As mentioned above, the private equity seller usually avoids providing warranties and indemnities. However, in order to mitigate such a situation, the seller accepts to offer warranties, but on a smaller scale and for the shortest duration period possible.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

As mentioned above, in the locked-box structure, it is essential that no "leakage" of value occur from the target company during the period between the balance sheet date and completion of the transaction. Therefore, a private equity seller will usually provide pre-closing undertakings ensuring that no value has been extracted from the company. The business shall also continue to be conducted in its ordinary course (no distributions on dividends, payments or returns, no transaction other than on arm's-length terms or no waiver towards third parties).

Moreover, the private equity seller may undertake some other restrictive covenants or a period of time after the sale such as not to compete and/or solicit the employees.

6.4 To what extent is representation & warranty insurance used in your jurisdiction? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such insurance policies, and what is the typical cost of such insurance?

Representation and warranties insurance, "*assurance de garantie de passif*" is more and more used to "bridge the gap". This flexible tool covers the consequences for breaches by transferring the risks from the private equity seller to the insurer. It allows the private equity seller to reduce the level of the guarantee that it must grant, and the consequent commitments. At the same time, it enables the private equity buyer to benefit from strengthened insurance.

Given the cost inherent to this insurance, investors in lower middle scale and smaller acquisitions prefer to negotiate contractual representations and warranty. The premium costs on average between 1% and 1.6% in Western Europe. The policy limits are typically between 10% to 20% of the transaction value of the deal, but vary according to the scope of coverage of the policy.

Insurers typically choose to exclude from their coverage the following risks deemed uninsurable: (i) the non-availability of net operating losses; (ii) breaches known by the insured; (iii) purchase price adjustments; (iv) fines and criminal penalties; (v) anti-corruption legislation; and (vi) in some cases, market specific exclusions (medical malpractice, product liability, etc.).

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

The private equity seller's liability will be limited to a relatively short period of time and with a certain scope confined to title and capacity. As mentioned above, private equity sellers usually seek to obtain a guarantee cap as low as can be associated with individual and global deductibles.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

Escrow accounts are used in some transactions. However, as indicated above, private equity sellers attempt to resist such covenants, preferring to avoid any warranty.

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain in the absence of compliance by the buying entity (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

Private equity funds usually provide an equity commitment letter to the seller. This letter agreement sets forth the terms and conditions by which the private equity fund is bound to provide equity financing to fund an acquisition.

Where commitments are breached, a specific performance or enforcement may be difficult to obtain since such commitments are themselves subject to conditions precedents. In most cases, a seller may obtain compensation for their damages instead of specific performance.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Break-up fees are not commonly used to limit private equity buyer's exposure in France.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

This is an exit strategy used by private equity providers for larger deals, due to the fact that when the proper market conditions are available, this method is likely to enable the investor to realise the highest return on its investment. There are a number of key issues which need to be considered by private equity sellers who are considering an IPO exit including: (i) the timing for performing such exit, which underlies the analysis of the prevailing economic conditions, the perception of valuations in the markets, the vibrancy of the IPO markets (to mitigate the market risk); and (ii) to enter into lock-up agreements (they prohibit company insiders such as private equity investors, major shareholders, from selling their shares for a set period of time). As such, lock-up agreements ensure that a significant number of shares are not sold shortly after completion of the IPO exit. The terms of lock-up agreements may vary. Please refer to question 7.2 for further information related to the holding period.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

The investor seeking to perform an exit will be exposed to fluctuations and other market risks for a certain amount of time after the IPO is carried out. As mentioned above, the terms of lock-up agreements may vary.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Although a dual-track strategy is possible in the French market, transactions are most commonly conducted through sale rather than IPOs.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

It is essentially debt financing provided by a banking pool, combined with mezzanine financing (i.e. a hybrid between debt and equity financing, such as convertible bonds or exchangeable bonds) that gives the lender higher returns than senior debt but lower returns than equity. It may also give, as the case may be, the right to convert to an equity interest in the company, provided some conditions are met such as events of default.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

Financial assistance under French law is not permitted. It refers to assistance given by a company for the purchase of its own shares or the shares of its holding companies.

For instance, a target company cannot grant security over its assets as a guarantee towards the obligations of the holding company.

8.3 What recent trends have there been in the debt financing market in your jurisdiction?

In previous years, the financing of transactions was through mezzanine financing, composed of senior debt divided into tranches (senior, second lien) and junior debt.

However, in mid-cap acquisitions, we have seen a growing trend of financing through "unitranche" loans. Unitranche loans are defined as debt financing through one debt instrument, subject to the same terms, instead of both senior and mezzanine debt. This alternative provides the benefit of simplifying the documentation required and limiting the number of participations in the unitranche loan.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

Investing in a French target is influenced by several tax incentives. First of all, private equity investors can benefit from an attractive tax consolidation regime. French corporations and their 95%-owned subsidiaries may elect to form a consolidated group in order to combine their profits and losses and, consequently, to pay corporate income tax on the aggregate result. The group will pay a single tax based on the taxable earnings of the group members, and consequently, allow the offset of losses of a group corporation against the profits of a company from the same group. In private equity investments, this regime allows for the charge of interest on the acquisition-related debt on the target's profit.

Moreover, a French mechanism "*the Carrez Amendment*", recently modified by the *Loi Finance pour 2018* (Finance Act for 2018), limits under certain conditions the deductibility of interest expenses on debt subscribed for the acquisition of qualifying participations by a French company not able to demonstrate that the decisions related to the acquired shares are made and that effective control or influence is exercised over the acquired entities either by the French acquiring company itself or by a company established in France, established in the EU, or in a country of the European Economic Area ("EEA"). Moreover, the interests paid to the foreign vehicle are only deductible if the entity is subject to income tax in its country of tax residence. As such, the use of off-shore structures is significantly limited.

9.2 What are the key tax-efficient arrangements that are typically considered by management teams in private equity acquisitions (such as growth shares, incentive shares, deferred / vesting arrangements)?

In France, taxation on capital gains and wages are different. Incomes from capital (interests, dividends, capital gains on shares) are taxed a 30% flat tax ("PFU") whereas salaries are currently taxed at the progressive rates of personal income tax (with a maximum rate of 49%) plus social charges. It is thus preferable to use the flat tax regimes on capital gains. However, the tax administration reserves the right to re-qualify the gain realised by the manager as salary and not capital. The French fiscal administration is very strict on the use of such mechanisms. In order to avoid such requalification, the manager should subscribe to significant investments to prove the risk taken.

Recently, France's highest administrative court, the *Conseil d'Etat*, has underlined that the capital gains in a management package granted to the manager, must be in relation with the risk allocated in the beneficiary's quality of investor, and not as a result of his performances in order to avoid being re-qualified as salary.

9.3 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

The "Charasse Amendment" provides for a partial recapture of financial expenses borne by a French tax group. The recapture arises when: (1) a tax-consolidated company acquires shares of another company from an entity that is not part of the French tax group but that controls the acquiring company or is under common control with the acquiring company; and (2) the acquired company joins the tax group.

However, if the sellers become minority shareholders following the transaction, it does not influence the decision to opt for the tax consolidation regime. On the contrary, in the case of the majority, the "Charasse Amendment" may lead to the tax consolidation regime being renounced.

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

Since the beginning of this year, French tax residents have seen the suppression of the wealth tax in France, the ISF. Its replacement, the IFI, is a property tax, payable only on property assets – there is none on financial assets.

Moreover, the Finance Act for 2018 provided a decrease of the corporate tax rate. Currently set at 33.33%, it will gradually decrease to 25% in 2022.

10 Legal and Regulatory Matters

10.1 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

Private equity is regulated by a series of regulations such as the French Monetary and Financial Code, ethical rules, and is subject to the regulation and control of the French Financial Market Authority ("AMF") in addition to the European regulations ("OPCVM IV" and "AIFMD").

10.2 Are private equity investors or particular transactions subject to enhanced regulatory scrutiny in your jurisdiction (e.g. on national security grounds)?

Certain transactions by non-EU foreign investors in relation to the acquisition of a French company that have strategic and/or sensitive business activities are subject to the prior approval of the Minister of Economy and Finance, on the grounds that they are in relation to the protection of military and national security interests and public order. These activities include, for example, those pertaining to energy and water supply, transport, communication, artificial intelligence, cyber security and public health. This list has recently been widened by a decree of December 1st, 2018, in relation to foreign investments, applicable since January 1st, 2019.

In this context, the foreign investor may be asked to take active commitments involving the corporate governance of the company, the management of the sensitive activity, and the protection of the sensitive information and data collected through his activity. In some cases, in significative transactions, the French government can also condition their authorisation to the investor taking active industrial measures in favour of employment, development of the sites, R&D efforts, continued investment in the company, participation in the development of the French ecosystem, etc.

In addition, the right to control certain business activities is exclusively reserved for French and European investors: insurance companies; financial institutions; press companies; entities involved in the manufacturing of war materials; publications dedicated to young people; the audiovisual sector; the air transport sector; and investment concerning ship ownership.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope etc.)?

Private equity is a technical and fairly long process that is generally conducted by an outside counsel in order to perform due diligence. Although red-flag reports are common, the timeframe of the transaction and scope remain similar to any other transaction.

Private equity investors tend to focus more on standalone risks to ascertain the target's autonomous status and possible resale without having to receive third-party approvals.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

Over the last few years, France has built an extensive set of regulations to fight against bribery and corruption. These new measures inevitably impact private equity, in particular due to a stricter regulatory framework and increased penalties.

Following on the footsteps of the FCPA or the UKBA, France has also adopted an anti-corruption legislation known as the Sapin II Law (Law No. 2016-1691).

Recently, in order to transpose EU Directive 20158/849 dated May 20th, 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, France implemented legislation providing for a new duty to declare the ultimate beneficial owners of all non-listed corporate entities registered in France.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

Generally, the portfolio companies are Limited Liability Companies. On the contrary, if an unlimited company is preferred, the shareholders' liability will be strengthened.

In addition, as explained in question 3.6, a private equity investor may be held liable if the damage is the result of its own mismanagement. However, portfolio companies may not theoretically be held liable for the liabilities of another portfolio company.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

Legislative measures recently taken in France and the healthier economic trend and occurrence of certain events (Brexit), will certainly favour France in becoming an important player in the private equity market.

Acknowledgments

The authors would like to thank Christophe Billet, Partner in the Tax Department of DS Avocats, and Ava Sereshki, for their invaluable assistance in the preparation of this chapter.

Arnaud Langlais

DS Avocats
6 rue Duret
75116 Paris
France

Tel: +33 1 53 67 50 00
Email: langlais@dsavocats.com
URL: www.dsavocats.com

Prior to joining DS Avocats in January 2007, Arnaud Langlais began his career in 1998 at Jeantet & Associés in Paris, then joined the London office of Berwin Leighton and later, the Paris office of Clifford Chance.

A partner since 2014, he has completed many transactions both for public or private entities or professional investors including: acquisitions; joint ventures investment; and private equity in various sectors such as IT, energy, media, entertainment, food, wine and spirits, logistics, etc.

He has developed a particular knowledge of private equity acquisitions and investments and is called upon for legal advice by private equity investors and funds investing in France.

Arnaud received his law degree at the University of Paris Panthéon Sorbonne and obtained a Master's in business law in 1994 and a DEA of business law in 1995. He was "Lauréat" of the Paris Bar School in 1998. He works both in English and French.

Gacia Kazandjian

DS Avocats
6 rue Duret
75116 Paris
France

Tel: +33 1 53 67 50 00
Email: kazandjian@dsavocats.com
URL: www.dsavocats.com

Gacia Kazandjian is a member of the Barreau du Québec (2005), the Law Society of Ontario (2007) and the Paris Bar (2012).

Head of the Europe-Canada Desk at DS Avocats, she regularly assists French or European companies doing business in Canada and inversely Canadian companies who wish to carry on business in France or Europe.

She intervenes in cross-border M&A, international contracts, corporate, IT and business law in general. Her bijural skills, languages and knowledge of both the civil and common law systems are of added value for our clients.

Gacia has published many articles and is a regular speaker in Europe and Canada.

DS Avocats

Founded in 1972 in Paris, DS Avocats has 25 offices on four continents. Today, the firm consists of 400 legal professionals who provide legal advice and litigation services in all areas of business law.

Current titles in the ICLG series include:

- Alternative Investment Funds
- Anti-Money Laundering
- Aviation Law
- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Construction & Engineering Law
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Investigations
- Corporate Recovery & Insolvency
- Corporate Tax
- Cybersecurity
- Data Protection
- Employment & Labour Law
- Enforcement of Foreign Judgments
- Environment & Climate Change Law
- Family Law
- Financial Services Disputes
- Fintech
- Franchise
- Gambling
- Insurance & Reinsurance
- International Arbitration
- Investor-State Arbitration
- Lending & Secured Finance
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Outsourcing
- Patents
- Pharmaceutical Advertising
- Private Client
- Private Equity
- Product Liability
- Project Finance
- Public Investment Funds
- Public Procurement
- Real Estate
- Securitisation
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks
- Vertical Agreements and Dominant Firms

glg global legal group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: info@glgroup.co.uk

www.iclg.com