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A Q&A guide to venture capital law in France. The Q&A gives a high level overview of the venture capital market; tax incentives; fund structures; fund formation and regulation; investor protection; founder and employee incentivisation and exits.

For a full list of recommended venture capital law firms and lawyers in France, please visit [PLC Which lawyer?](#)

This Q&A is part of the PLC multi-jurisdictional guide to venture capital. For a full list of jurisdictional Q&As visit www.practicallaw.com/vchandbook.

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Market

1. Please describe briefly the venture capital market in your jurisdiction, in particular:

- How it is distinguished from private equity.
- The sources from which early stage companies obtain funding.
- The types of companies that attract venture capital investment.
- Market trends (for example, levels of investment, the type of companies invested in and where those companies are located).

Venture capital and private equity

Venture capital distinguishes itself by the:

- Early stage of development of the companies which are funded.
- The absence of leverage and consequently of debt in the investment, which is generally made in equity.

The following figures and more can be found on www.chaussonfinance.com. Other interesting websites are www.clipperton.net with sectoral news letters in English, and www.aeliosfinance.com.

Early stage companies sources of funding

Unlike the UK and the US, the business angels community is scarce. Yet over the past five years, non-profit organisations such as CroissancePlus or France Angels have promoted investments in favour of early stage companies, and successful entrepreneurs have set up their own seed investment funds (for example, ISAI and Kima Ventures).

Over the past 12 months, a total of 668 companies have been funded by about 55 venture capital funds, for a total of EUR922 million (as at 1 November 2010, US\$1 was about EURO.7) (compared to EUR910 million in 2009). Out of these 55 funds, only 15 to 20 funds are active in seed.

Types of company

In 2009, seed investments represented only 6% of the amounts invested, with Series A representing 22% and further rounds 72%.

Over the past 12 months, healthcare has been the leading sector, closely followed by e-commerce/internet. Cleantech takes a solid third place and telecoms a weak fourth.

Market trends

Out of a total of EUR910 million invested in 2009, EUR455 million was invested by the ten most active funds. FCPIs (*Fonds Communs de Placements dans l'Innovation*) and FIPs (*Fonds d'Investissements de Proximité*) (see [Question 6](#)) are predominant. They represented:

- 21 of the 51 funds investing in 2009 for 54% of the amounts invested.
- Over the past six months, 24 of the 52 funds, investing a very high figure of 72% of the aggregate amounts invested.

The average amount per investment remains low at EUR1.4 million for the first semester of 2010, compared to EUR1.3 million for 2009 during which the ten most active funds represented a steady total of 50% of the amounts invested.

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Tax incentives

2. What tax incentive 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 to investors (both individual investors and corporate), but some incentive schemes specifically benefit innovative companies.

These schemes are likely to be altered by the Finance Law for 2011 and the Corrective Finance Law for 2010, which are both under discussion.

Individual income tax exemptions

Individual investors benefit from an exemption from income tax on investment income and capital gains derived through FCPRs (*Fonds Communs de Placement à Risques*), FCPIs, FIPs and SCRs (*Sociétés de Capital Risque*), if such 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 JEI (*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 taxes at an overall rate of 12.1%.

Individual income tax reduction

Investments (capital contributions) in European venture capital companies may give right 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 or Iceland.
- Company is subject to corporate income tax.
- Company carries on industrial, commercial activities.
- Company is a small or mid-cap enterprise (SME) within the meaning of EU legislation.
- Investor elects to hold its shareholding for a five-year period from the date of contribution.

The income tax reduction is equal to 25% of the investment, subject to the following caps:

- EUR5,000 for a single person (EUR10,000 for a couple) if the enterprise is a mid-size 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).
- EUR12,500 for a single person (EUR25,000 for a couple) if the enterprise is a small enterprise (that is, of fewer than 50 employees and with revenues or total assets of no more than EUR10 million).

This income tax reduction also applies to investments in FCPIs and FIPs. In such cases, the reduction is capped at EUR3,000 for a single person and EUR6,000 for a couple.

Wealth tax incentives

Investments qualifying for the income tax exemption (*see above*) can alternatively (and therefore not cumulatively) give a wealth tax reduction equal to 75% of the investment, but capped at EUR50,000.

The same reduction applies to investments in FCPRs, FCPIs and FIPs, with a cap at EUR20,000.

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 such a case, distributions paid out of capital gains realised by the fund or the company and capital gains derived from the disposal of units in the funds or shares in the company are likely to be taxed at a reduced rate:

- 0% if those distributions or gains relate to long term capital gains realised by the fund or the company.
- 15% in other cases.

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.

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, JEIs can benefit from an immediate refund.

JEIs are 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.
- 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, JEIs are entitled to temporary exemptions from corporate income tax and business tax.

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Fund structure

3. 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 2](#)).

4. Can the structure of the venture capital fund impact on how investments are made?

Investments made by venture capital funds are impacted by:

- The legal structure used to form such funds.
- Whether an investment in this fund involves a specific tax benefit for French investors.

Legal structure

Regulated funds (see [Question 6](#)) 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:

- The FCPR *contractuel* is not required to comply with this quota but must invest principally in unlisted securities.
- FCPIs are required, in addition, to invest up to 60% of their assets in Eligible Investments issued by French innovative companies (and up to 6% of this quota in small sized companies).
- FIPs are required, in addition, to invest up to 60% of their assets in Eligible Investments issued by French SMEs organised in a specific geographical area (and up to 10% of this quota in newly formed companies).
- Certain limited investments are permitted in listed companies, holding companies and/or companies organised in the European Economic Area (EEA), provided that appropriate tax treaties are concluded between such countries and France.

Tax benefits

Certain venture capital funds (excluding FCPRs *contractuels*) can provide tax benefits to their French investors, 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 in a period of 16 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 EUR2.5 million (although this cap will be reduced to EUR1.5 million to put the French tax code requirements in line with the *de minimis* EU regulations, see [Question 11](#)).

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

Venture capital funds do 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, foreign players have recently invested alone or taken the largest chunk of the investment.

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Fund formation and regulation

6. 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 regulated fund structures (Regulated Funds), which provide their investors with greater transparency. For retail investors, the structures generally used are an FCPI and an FIP (Retail Funds). In the case of sophisticated and/or institutional investors, a FCPR *allégé* or a FCPR *contractuel* (Non-Retail Funds) are the most common vehicles.

In unregulated funds (Unregulated Funds), the legal structures commonly used are the following corporate entities:

- A Holding ISF, for private individuals seeking a tax benefit relating to the French wealth tax (see [Question 2](#)).
- An SCR, for private and professional investors forming a club deal of investors in an evergreen fund.

7. Do a venture capital fund's promoter, manager and principals require licences?

Regulated Funds must be formed by a:

- Management company that is licensed by the *Autorité des marchés financiers* (AMF) as a private equity portfolio management company.
- Custodian that is authorised by the *Autorité de contrôle prudentiel* to provide safe keeping and custody of assets for investment funds.

There is no licensing requirement for forming or managing an Unregulated Fund.

Individual investment managers employed by a licensed portfolio management company require a professional certification.

8. Are venture capital funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions? Include, in the answer, any restrictions on how a venture capital fund can be marketed or advertised (for example, under private placement or prospectus rules).

A Retail Fund must be authorised by the AMF before its formation and any marketing of interests to prospective investors. In relation to a Non-Retail Fund, only a notification to the AMF is required within one month following its formation.

Unregulated Funds do not require a specific licence.

The marketing of interests in venture capital vehicles must comply with French regulations relating to public offerings and solicitation, subject to applicable private placement exemptions.

Public offering

If interests in an Unregulated Fund are offered to the public, the AMF must give its prior approval to any offering documentation. Prior approval of the AMF is not required for an offering to the public of interests in Regulated Funds, provided that the offering complies with applicable rules governing marketing and solicitation.

Private placement exemptions for public offering

An offering of interests in an Unregulated Fund to qualified investors or to a restricted circle of fewer than 100 investors is exempt from complying with the public offering rules, provided that the offering complies with French rules governing marketing and solicitation or otherwise benefits from an applicable exemption.

Marketing and solicitation

Interests in Retail and Non-Retail Funds 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*). However, interests in Non-Retail Funds must only be marketed to sophisticated investors, such as:

- French or foreign institutional investors.
- High net worth individuals.
- Any entity or individual subscribing more than EUR500,000.

Unlisted Unregulated Funds can only be marketed in compliance with specific exemptions.

Exemptions from marketing and solicitation restrictions

The marketing and solicitation of prospective investors for an investment in an unlisted Unregulated Fund is exempt from French regulations relating to marketing and solicitation if either (provided the offering complies with the French rules governing public offerings or otherwise benefits from applicable exemptions):

- The offer is addressed to qualified investors or large entities.
- The offer relates to an investment in shares issued by an SCR.

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

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

- For Regulated Funds: the bye-laws, subscription agreements and, if applicable, side letters.
- For Unregulated Funds: the articles of association, shareholders' agreements and, if applicable, the terms and conditions of the securities issued by such funds.

Terms and conditions applicable to investors in Unregulated Funds are not generally relevant to determine venture capital market trends.

Terms and conditions applicable to investors in Regulated Funds differ between Retail and Non-Retail Funds. The governing documents of a Retail Fund must comply with detailed French law requirements to obtain the required prior approval of the AMF. Accordingly, 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 a Non-Retail Fund 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 discussed by investors in global venture capital funds, such as:

- Key person and change of control provisions.
- Limitations relating to raising a successor fund.
- Management and other fees.
- Reporting obligations.
- Advisory committee role and seat.

10. What are the most common investment objectives of venture capital funds (for example, what is the average life of a fund, what return will a fund be looking for on its investments and what is the time frame within which a fund would seek to exit its investment)?

The term of a Regulated Fund does not differ from the market standard for venture capital funds. 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.

However, any investor in a Regulated 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.

Regulated 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.

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

The venture capital industry, as with the private equity industry generally, is affected by any new regulations applicable to portfolio management companies, especially if such regulations impose new organisational and compliance standards and/or legal requirements. As a result, it has become more difficult and costly for new entrants to form a regulated portfolio management company in France.

Recent regulatory changes include the entry into force of:

- The rules implementing Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.
- Professional certification requirements for investment managers working for portfolio management companies.
- Various amendments relating to tax benefits applicable to French investors in certain Regulated and Unregulated Funds. These amendments include:

- the renewal of the tax benefits arising from investments in FCPIs and FIPs for another two-year period, although such vehicles are still required to invest up to a certain percentage of their assets in a period of 16 months following their last closing date;
- the cap on investments by Regulated Funds in portfolio SMEs, which allows a French individual investor to benefit from a favourable tax regime on income and wealth tax, will be reduced to EUR1.5 million (after a temporary increase to EUR2.5 million).

FCPI and FIP funds are therefore required to invest capital contributions within a short period of time and in a higher number of enterprises. This could be a major hurdle facing venture investment managers in the near future.

The EU Directive on alternative investment fund managers was approved by the European Parliament on 11 November 2010. After formal approval by the EU Council, it will be transposed into French law by 2013. The Directive will impact the French venture capital industry in various respects. For example, there will be additional reporting requirements for any controlling acquisition to regulators, investors and employees. Further, no distributions of assets or dividends will be permitted for the first 24 months after the investment by the venture capital fund. This rule, intended to prevent asset stripping, is likely to have an operational impact on the fund's ability to structure the investment.

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Investor protection

12. What form of investment do venture capital funds take? (For example, equity, debt or a combination.)

Venture capital funds invest in equity, mostly preferred shares introduced into French law in 2004. 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.

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.

14. What investigations will 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 representations and warranties also relate to these issues (see [Question 16](#)).

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 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.
- 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).

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 on the:

- Share capital.
- Intellectual property.
- Absence of litigation.
- Compliance with existing laws and regulations, especially those relating to employment.

Representations and warranties are usually made by the founders. Damages in case of breach are:

- Up to one to two years of salary in cash.
- Up to a capped amount, in cash or shares at the founders' option.

It is only where the founders are no longer managing the company that the second part of the damages may be taken on by the company.

On completion, a shareholders' agreement is executed and will provide for the usual rights (see [Questions 18 to 22](#)), in addition to its other provisions (see [Question 15](#)).

Claw-back provisions for good and bad leavers are also found in the shareholders' agreement, and are commonly restricted to resignation and dismissal for gross negligence.

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

In most investments investors purchase 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 (appointing a special auditor to issue a report, and numerous securities holders meetings) and involves time and cost. As a result, some French seed funds purchase 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.

18. What rights does a fund have in its capacity as a holder of preferred shares (for example, what rights to capital and/or to interest)?

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.

19. What rights are commonly used to give a fund a level of management control over the activities of an investee company (for example, board representation, certain acts of the company subject to investor consent)?

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 frequent.

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 preemption*), 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 (for example, drag-along and tag-along rights)?

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, regardless of their category and a preferred shares' majority. Those 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-thirds 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-thirds majority.

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-thirds 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-thirds majority of the relevant preferred shares is required.

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.

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Founder and employee incentivisation

25. In what ways are founders and employees incentivised (for example, through the grant of shares, options or otherwise)? What are the resulting tax considerations?

It is common to grant stock options to founders and key employees. This includes options to purchase shares and specific warrants (*bons de souscription de parts de créateurs d'entreprise*). Restricted stock is also often granted, consisting of existing or future shares to be obtained free of charge (*actions attribuées à titre gratuit*).

Free shares and stock options can be granted to employees of the company and its subsidiaries. Specific warrants can only be granted to employees of the issuing company, and provided that the company meets the required tax conditions.

However, the beneficiary must not hold more than 10% of the share capital either:

- When the options are granted.
- As a result of the grant of free shares.

Shares under option or potential free shares must not represent more than one-third of the share capital. There are no such limits for specific warrants.

To benefit from the preferred tax regime:

- Shares under options must be sold after the fourth anniversary of the date of grant.
- Free shares must be issued or attributed after a minimum of two years, and then kept for another minimum of two years.

Tax rates (including all social charges of any kind) for shares purchased on the exercise of stock options are as follows:

- The capital gain on purchase (*plus value d'acquisition*) is taxed at 52.1% (42.1% for that portion of the gain below EUR152,500), and at a reduced rate of 42.1% (30.1% for that portion of the gain below EUR152,500) if the beneficiary holds the shares for a two-year period after the first four-year period (in the absence of an option for income tax at progressive tax rates: the marginal tax rate is 40% in the category of wage and salaries, plus social levies at 12.1%). In addition, social security contributions apply at a global rate of 11.5%.
- The capital gain realised above the purchase capital gain, on the sale of the shares (*plus value de cession*), is taxed at the rate of capital gains on securities (30.1%).

Tax rates (including all social charges of any kind) for free shares are as follows:

- The capital gain equal to the value of the share on its acquisition (that is, at the end of the two-year period) is taxed at 42.1% (in the absence of an option for income tax at progressive rates: the marginal tax rate is 40% in the category of wage and salaries, plus social levies at 12.1%). In addition, social security contributions apply at a global rate of 22%.
- The capital gain equal to the difference between the above value and the sale price is taxed at 30.1%.

Tax rates (including all social charges of any kind) for shares purchased on the exercise of specific warrants are:

- 42.1% if the employee has a seniority of fewer than three years.
- 30.1% for any seniority above three years.

26. What protections do the investors typically seek to ensure the long-term commitment of the founders to the venture (for example, good leaver/bad leaver provisions and restrictive covenants)?

All stock options, free shares and specific warrants are subject to standard market practice vesting conditions. Most commonly vesting is structured as a one-year cliff, followed by quarterly periods. Shares are fully vested after four years.

Other milestones relating to creation of value are increasingly requested for the senior management team.

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

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Exits

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. Further, 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 (for example, trade sale, initial public offering and secondary buyout)? 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 buy-out without retaining investment bankers, while the sellers of the company can decide to not have that support.

In a sale of the company, the managers give representations and the sellers (or almost all the main 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 buy-out, 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 price conditions which do not suit them, and also to force exits that suit them. The liquidity clause will set the time after which, failing an IPO or a trade sale, the investors will be able to force an exit.

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Areas of practice. Private equity; M&A; securities law.

Recent transactions

- Representing Inside Contactless in its acquisition of the Secure Microcontroller Solutions (SMS) business of Atmel Corporation.
- Representing Accel Ventures in its investment in Showroomprivé.
- Representing Sofinnova, Abingworth Bioventures, Crédit Lyonnais Innovation and GIMV in the sale of the entire shareholding in Fovea to Sanofi Aventis.

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Recent transactions

- Representing Cerenis Therapeutics and existing investors (including Sofinnova Partners, TVM Capital, HealthCap, Alta Partners, EDF Ventures, Daiwa Corporate Investments, and OrbiMed) in its series C financing.
- Representing Sofinnova Partners, Abingworth Bioventures, Atlas Ventures, NeoMed, GS, Daiwa Corporate Investments, and Edmond de Rothschild Investment Partners in the sale of the entire shareholding in Novoxel to AstraZeneca.
- Representing Dailymotion and existing investors (including Atlas Ventures, Partech International Partners, Advent Ventures and Idinvest) in its series C financing.

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- Representing LBO France Gestion for the formation of its large and small cap LBO funds.
- Representing institutional investors and family offices for their investments in various French venture and other funds, including Sofinnova Capital, MBO Capital and Committed Advisors.

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Recent transactions

- Representing Sofinnova Partners and others in the sale of the entire shareholding in Sensitive Objects to Tyco Electronics.
- Representing Accel Ventures in its investment in Showroomprivé.
- Representing the existing investors (including CAPE, NBGI, Auriga, EdRip, Wellington Partners, Bioam) in their series C financing of Supersonic Imagine SA.