



# Private Equity

in 33 jurisdictions worldwide

Contributing editor: Casey Cogut

# 2011



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# France

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## 1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction?

### Venture capital and seed capital

These transactions involve entities at an early stage of development or companies starting the expansion of their business; venture capital differs from seed capital, as the latter is supposed to finance entities that have not reached start-up phases yet; seed financing is designed to finance research, assessment and development of an idea or an initial concept, whereas start-up financing is used for funding the development of production and the initial marketing.

Financing the development of such entities takes the form of equity (preferred shares, most of the time, with at least a liquidation preference).

### Development transactions

The companies involved in these transactions have reached their break-even point and wish to increase their activity. Development financing usually uses a combination of equity and debt.

### Buyout transactions

These transactions concern closely held entities such as family companies or non-core business units of a group of companies that are sold as part of a carve-out. The financing of such deals uses a combination of equity, debt and quasi-equity (eg, mezzanine finance). The cash flow of the target company enables the set up of a leverage transaction (LBO transactions).

### Turnaround transactions

Turnaround financing is designed to help entities facing financial difficulties; the biggest part of financing turnaround transaction takes the form of equity.

According to a survey prepared by the French Private Equity Association (AFIC) and Grant Thornton dated 30 March 2010, the number of investments closed in 2009 decreased significantly compared to 2008 (a fall of 59 per cent of the amounts invested, down to €4.1 billion, and a fall of 8 per cent of the number of entities receiving private equity funds, down to 1,469 companies).

Another survey prepared by the AFIC and Grant Thornton dated 13 October 2010 shows a new tendency: the number of investments closed in the first semester of 2010 increased by 66 per cent in comparison with the first semester of 2009. The amounts invested increased from €1.78 billion to €2.97 billion.

It also shows an increase in buyout transactions (the number of transactions has been multiplied by 2.8 during the first semester of 2010 compared to the same period in 2009; buyout transactions represent 60 per cent of private equity transactions, whereas venture capital transactions represent 9 per cent and capital development transactions 27 per cent).

The French market for private equity transactions is dual: on the one hand, there is a large number of transactions involving small and medium cap companies (companies with a turnover of €50 million or less), and on the other hand, there is a small number of large cap deals, which represent an important part of the total volume of the amounts invested.

Secondary LBOs showed signs of recovery during the first semester of 2010, whereas jumbo deals are still affected by the credit crunch.

## 2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or become public companies?

French corporate law traditionally includes strong corporate governance principles. Some of these principles are contained in basic company law rules and are applicable without distinction to all companies (whether listed or not). Public companies listed on a regulated market (as defined by the Markets in Financial Instruments Directive of 21 April 2004) are also subject to specific corporate law rules and to the regulations issued by the French financial markets authority (AMF), so that they are generally subject to more restrictive rules on disclosure and transparency than unlisted companies. For instance, the earnings and advantages allocated to corporate executives shall be disclosed each year in the annual report submitted at the general shareholder meeting. The report shall also contain information about 'golden handshakes' and retirement allowances. Moreover, these retirement allowances have to comply with some performance criteria approved by the supervisory board of the company. The AMF has published some recommendations in a report dated 9 July 2009 regarding the managers' earnings. According to these recommendations, an executive who is also employed by the company he or she manages shall terminate his or her employment contract.

Going private in leveraged buyout or similar transactions allows freedom from restricting rules and reporting obligations applicable to public companies listed on a regulated market. NYSE Alternext is an exchange-regulated market with a lighter regulatory regime. Modalities of transfer on the Alternext market were facilitated at the end of 2009. As a consequence, the number of transfers on this market should continue to increase.

There are no specific issues regarding companies that, following a private equity transaction, remain public or become public. Any rule applicable to public companies shall apply to these companies.

### 3 Issues facing public company boards

What are the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What is the role of a special committee in such a transaction where members of the board are participating or have an interest in the transaction?

It has always been a general principle in France that directors shall act in the best interests of the company, its business and its shareholders taken as a whole, and set aside their own interests.

Within the past 10 years, the legal precedents of the highest French court (the Cour de Cassation) also developed a fiduciary duty of loyalty and a duty of transparency and information of directors towards shareholders. The duty of loyalty mainly prohibits directors from creating a situation likely to generate a conflict of interest between their personal situation and the interests of the company, its business and its shareholders.

Within the framework of going-private transactions, as for any takeover bids, the board of directors (or the supervisory board) has to disclose its reasoned opinion regarding the benefits of the offer or the consequences of the offer for the target company, its shareholders and its employees. The voting procedures by which this opinion was obtained are disclosed, with the possibility for dissenting members to request that their identity and position be mentioned.

If the transaction is likely to cause conflicts of interests that could impair the objectivity of the reasoned opinion of the competent board or threaten the fair treatment of the shareholders, the AMF's regulation requires the appointment of an independent appraiser. The AMF considers that the following situations are likely to cause such conflicts of interests or characterise an impairment of objectivity: if the target company is already controlled by the offeror before the bid is launched; or if the senior managers of the target company, or the persons that control it, have entered into an agreement with the offeror that could compromise their independence, etc. The target company shall also appoint an independent appraiser before implementing a squeeze-out. This independent appraiser will prepare a report on the financial terms of the offer or transaction. The report's conclusion takes the form of a fairness opinion.

It is possible to consider that in France, the appointment of this independent appraiser is a substitute for the appointment of a special committee comprising disinterested directors. It is also important to note that in France, committees in charge of specific issues (eg, remuneration committee, audit committee) may be formed by the board of directors, but they have no decisional power.

### 4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

There are no heightened disclosure issues in connection with going-private transactions or other private equity transactions as such. The AMF regulations apply to going-private transactions and contain detailed provisions regarding the content of the offer documentation and the dealings in the target company's shares to be disclosed to the market. Indeed, once a draft offer has been filed, any restrictive clause agreed by the parties concerned or their shareholders that could have an impact on the assessment of the offer or its outcome must be disclosed to the AMF and the public.

### 5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The timescale for a public offer is regulated precisely by the AMF's regulation depending on whether the procedure is simplified or standard.

If the offeror acting alone or in concert holds less than half of the shares or voting rights of the target company, only the standard procedure shall apply. If the offeror holds more than half of the shares or voting rights of the target company, the simplified offer procedure may be used.

For a standard public offer, the term of the offer is at least 25 trading days and may be extended to not more than 35 trading days. At any time after the opening of the offer, but no later than five trading days before it closes, a competing offer on the securities of the target company may be filed with the AMF. Where the AMF determines the timetable for the competing offer, it aligns the closing dates of all competing bids on the furthest date. During the offer period, and no later than five trading days before its closing, an offeror may improve upon the terms of its original offer or the most recent competing offer. Where the AMF declares an improved offer to be compliant, it determines whether to postpone the closing date of the offers and to void orders tendering securities to the earlier offers.

In principle, the outcome of the offer is published no later than nine trading days after the closing date.

If the AMF determines that the offer has succeeded, the offer is reopened within 10 trading days, for a minimum of 10 trading days.

The offer period for a simplified offer may be limited to 10 trading days in the case of a cash offer and to 15 trading days in other cases. Besides, a simplified offer cannot be reopened even if it has succeeded.

Concerning private equity transactions on a private company, the timetable will be essentially set up on the basis of negotiations between the parties.

### 6 Purchase agreements

What purchase agreement provisions are specific to private equity transactions?

The form and terms of purchase agreements in private equity transactions do not substantially differ from other M&A transactions.

Financing conditions are usually similar, even if during recent years the proportion of bullet debt in the financing was very significant and the covenants were very light. This situation has, however, changed recently and the proportion of the amortisation debt has increased as financing conditions have been restricted.

The scope of the representations and warranties in private equity transactions has become much more similar to those negotiated in M&A transactions; in particular, whereas it was common practice that no warranty was granted (except basic ones regarding shares), such a practice has become more isolated. The indemnification mechanisms are usually the same. They may vary, however, especially in venture capital transactions when there is no cash out; in these circumstances, the indemnification is seldom paid in cash but usually paid in kind (shares are allocated to the investors).

Break-up fees and reverse break-up fees are commonly agreed during negotiations.

Typically, the judicial remedy for breach of contract is monetary damages or, in some limited cases, specific performance. A penalty clause (providing an amount payable as penalty and indemnification for failure) may be included in the purchase agreement. However, the judge is not bound by this provision and may reduce or increase the amount payable in accordance with it. The agreement may also contain a specific performance clause, even if the validity of such provision is questionable.

### 7 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues?

As for any private equity transaction, participation of the management is essential in the scope of a going-private transaction in the

view of strengthening involvement and commitment. There are no legal restrictions on the means by which management of the target company can participate in a going-private transaction. The common practice consists of the participation of the management in the bidding vehicle through subscription of shares, which implies investment of private funds by the managers. The management's investment must be effective, for example, without a counter-guarantee protecting its investment. The financial instruments to be issued must be assessed at their fair value. If the management already holds shares in the target capital, it will typically contribute its shares to the bidding company and receive shares of this company in consideration for its contribution.

The management of the target company can also participate in the transaction using a *rétrocession* agreement on the selling price, call options between financial shareholders and management or stock options, free shares, preferred shares, warrants, etc.

The involvement of the company's management is so important for investors that specific provisions regarding restrictions in the transfer of all or part of their shares are usually provided in shareholders' agreements.

French law promotes the involvement of employees in private equity transactions. A mutual investment fund for employees (FCPE) is an instrument that can be composed of shares of the company up to 95 per cent and is entitled to enter into a shareholders' agreement. In consideration for the tax advantages applicable to this instrument, employees must keep their shares for a minimum period of five years. Nevertheless, the involvement of employees can raise some confidentiality issues related to the contemplated transaction.

## 8 Tax issues

What are the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

In France, private equity transactions are usually designed by a holding company acquiring the shares of the target. Offsetting financial and acquisition costs against the target income is usually reached via the tax consolidation regime where the holding and the target company are considered a unique entity for tax purposes. It may also be reached by the 'look-through' tax regime of the target. The most critical tax issues are linked to the offsetting calendar, the 'pre-consolidation losses' and the possible restrictions of the tax consolidation regime where formerly related or partly related companies are concerned. More recently, the thin capitalisation rules new restrictions have also become a major issue in highly leveraged acquisition schemes.

Share deals are usually preferred to asset deals, due to the differences of legal and tax treatment of these types of transaction.

Asset deals give rise to the payment by the acquirer of transfer duties amounting to 5 per cent of the purchase price (or fair market value if higher; no tax is payable on the portion of the price below €23,000, and a reduced 3 per cent rate applies to the portion of the price between €23,000 and €200,000), while acquisitions of shares in a corporation usually raise a transfer duty amounting to 3 per cent of the purchase price, capped at €5,000 (there is no cap, however, in case of a partnership or a SARL (ie, equivalent to private company limited by shares) shares acquisition, but a maximum €23,000 abatement).

The seller is generally taxable on the capital gain arising from an asset deal, while a qualifying parent company can benefit from a 95 per cent capital gain exemption in the case of disposal of shares in a subsidiary held for at least a two-year period. In addition, individual sellers benefit from a rollover on the capital gain where receiving new holding company (holdco) shares (only if the latter is submitted to corporation tax) in exchange for shares primarily held in the

target (the capital gain taxation is then postponed until disposal of the shares received in exchange).

The acquisition price is not tax-deductible, nor is it amortisable for the purchasing company. On the other hand, the other acquisition costs (such as transfer duties, auditor fees, bank fees, lawyers' fees) are amortised over a five-year period.

As a general rule, financial expenses borne by the SPV for the target acquisition financing are tax-deductible, provided that the financing conditions remain at arm's length. A set of rules limits the tax deductibility of interest expenses on loans granted by related companies where the interest rate exceeds the ordinary rate that could have been obtained on the market (3.82 per cent for fiscal year ending 31 December 2010).

Besides, thin capitalisation rules were dramatically changed in France in 2008, based on the following mechanism – the deduction of interest paid to related companies in excess of the following three points are not deductible (although part of the deduction can be postponed):

- 1.5 per cent of the company's net equity notional remuneration;
- 25 per cent of the company's EBITDA (enterprise value/earnings before interest, taxes, depreciation and amortisation) (subject to specific adjustments); or
- interests received from related companies.

Beginning in 2011, also affected by this deduction limit are the interests paid as part of a loan from a financial institution but guaranteed by a related company.

When the borrowing entity is a member of a tax-consolidated group, the above-mentioned criteria apply to consolidated financial data of the tax group (intra-group loans being neutralised, however).

These thin capitalisation rules may not be applicable in certain circumstances (eg, when the loan is granted by a financial institution but not guaranteed by a related company or when the amount of non-deductible financial expenses is less than €150,000).

In addition, the 'charasse provision', a specific anti-high leveraged schemes mechanism applicable to tax-consolidated groups, denies the tax deduction of the financial expenses where an acquisition is made to a related entity or company ('self-acquisition'). Under these provisions, a portion of the financial expenses borne by the group is deemed to result from the said 'self acquisition' and therefore rejected during a nine-year period. As of 2010, the purchase of its shares by the company itself is no longer within the scope of the charasse provision.

The holdco is generally entitled to the participation exemption regime (exemption of 95 per cent of the dividend received from a qualifying participation) and thus is in principle in a tax loss-making position. The offset of the losses suffered at the SPV's level with the profit deriving from the target can be achieved by setting up a fiscal unity or tax consolidation group.

Among the various conditions to be fulfilled in order to set up a tax group, the holdco has to hold at least 95 per cent of the target company's share capital (excluding, under certain conditions, the shares held by employees of the target company). Companies located in France but held via another company located in another EU country can elect for tax consolidation membership, if the 95 per cent holding condition is met.

In order to avoid significant stuck pre-consolidated losses (losses that remain in the target accounts and which can only be offset against the acquisition vehicle's profits and not as part of the group relief), it can be useful to change the closing date of the financial year of the group members.

When no consolidated group can be set up (eg, when the SPV holds less than 95 per cent of the target's share capital), an alternative way to achieve such a tax consolidation is to merge the target into the acquisition vehicle subsequent to the target acquisition. The French tax administration used to consider that this 'quick merger' could be

challenged pursuant to the abuse of law or the abnormal management decision incrimination. However, several court decisions have weakened this position.

In most cases, no interest or dividend withholding tax is levied in France on payments made by a company to a non-resident lender (provided treaties and EC conditions are fulfilled).

**9 Existing indebtedness**

What issues are raised by existing indebtedness at a potential target of a private equity transaction? How can these issues be resolved?

First, the buyer will have to analyse contractual provisions contained in the contracts related to the existing indebtedness – generally within the frame of a due diligence – in order to raise any issue, with special attention on restrictions on dividends and distributions provisions, refinancing costs provisions and change of control provisions. Change of control provisions have an important impact on the contemplated transaction because there is a risk of early debts repayment and payment of penalties.

Most of the time, existing indebtedness needs to be refinanced, which generally implies the approval of the bank that provides the financing for the acquisition of the target company and additional costs. If the buyer decides to use a repayment mechanism, it will be necessary to take into consideration the costs of the penalties.

If the existing indebtedness is important, it is also possible to include in the share purchase agreement a condition precedent by which the target company will have to pay all or part of these debts before a given date, or to take into account these debts for the assessment of the purchase price, which will be diminished accordingly.

**10 Debt financing structures**

What types of debt are used to finance going-private or private equity transactions? Do margin loan restrictions affect the debt financing structure of these transactions? Are there any other restrictions in your jurisdiction on the use of debt financing for private equity transactions?

Three types of debt are usually used for the financing of going-private and private equity transactions (LBO transactions); these types are classified according to their priority of reimbursement, thus according to the risk and remuneration attached to these types of debt:

- ‘senior debt’ – the reimbursement of this debt is prior to junior debt; it is divided into tranches (it is not unusual to have senior debt divided into three to four tranches; but it is usually less in the present economic circumstances); its maturity is from five to seven years, sometimes up to 10 years;
- ‘second lien’ – this is a long-term debt (nine to 10-year maturity), which is warranted on the same assets as the senior debt but its reimbursement is subordinated to the prior reimbursement of the senior debt. This debt is usually subscribed by institutional investors, hedge funds or specialised funds; and
- ‘junior debt’ (or mezzanine) – this debt is usually brought by mezzanine funds; it is subordinated to senior debt (more than 10-year maturity) and has a better remuneration than the latter. It is usually issued through bonds (often with warrants attached).

Before disruption in the credit markets occurred, one noticed an ever-higher burden of debt borne by the companies involved in buyout transactions; indeed, the debts subscribed as part of the transaction were usually bullet debts (most of the time reimbursed on the secondary, tertiary, LBO), the free cash flow of the target company being mainly used to finance acquisitions and to reimburse the debt subscribed for the financing of investments. Today, because of the decrease of the number of ‘LBO of LBOs’, it is likely that financing will have to be restructured as divestments are usually delayed and the targets are not able to shoulder the reimbursement burden. According to a survey prepared by the AFIC, dated 11 May 2010,

29.6 per cent of companies involved in LBOs have not been able to comply with their covenants and the schedule of payment on 30 December 2009.

Because of the scarcity of credit and the increase of the price of the credit, the proportion of equity and bonds in the financing has increased since 2007, the rest of the transaction being financed through amortising senior debt and mezzanine loans. Private investors became the first subscribers in private equity transactions since 2008. Moreover, due to the cost of senior debt and the fact that the number of leveraged buyouts remains low, financial analysts anticipated the development of mezzanine financing. Such a development has, however, not been observed. The predominant proportion of senior debt leaves little room for mezzanine financing, which has become rare in private equity financing.

**11 Debt and equity financing provisions**

What provisions relating to debt and equity financing are typically found in a going-private transaction? What other documents set out the expected financing?

Financing a going-private transaction is fairly similar to financing any private equity transaction involving a private company. It generally includes debt financing and equity financing. Specificity is, according to the applicable law, that the acquisition of a listed company requires a public, definite and irrevocable offer to acquire securities of the target company. Another French specificity is that the offeror has no guarantee of obtaining 95 per cent of the voting rights and shares that will enable the offeror to launch a squeeze-out. Consequently, the offeror has no guarantee of obtaining the delisting of the target company.

Consequently, the offeror must have available funds to satisfy the entire cash consideration payable under the offer – this being guaranteed by at least one of the sponsoring institutions. The final amount of financing must be adjustable with regards to the number of securities that might be acquired and to a potential competing offer or an improved offer that could entail overpricing. The offeror shall also take into account the risk of not being able to obtain 100 per cent of the voting rights and shares, which will reduce the leverage of the transaction.

**12 Fraudulent conveyance and other bankruptcy issues**

Do private equity transactions involving leverage raise ‘fraudulent conveyance’ or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Fraudulent conveyance issues mostly arise in cases of bankruptcy, guarantees granted within a going-private transaction and financial assistance.

French insolvency law aims to avoid preferential treatment of some creditors where a company’s insolvency is imminent. The law declares void some contracts entered into as from the company’s insolvency (eg, any contract by which the debtor has more obligations than the other party or any contract by which the debtor makes a payment before the debt is mature). Liquidators and administrators have the power to challenge transactions entered into by the company within a period prior to the initiation of the insolvency procedure, including powers to set aside a transaction at an undervalue. The nullity of such contracts allows the debtor to rebuild its assets.

We have also observed that bankruptcy rules are sometimes used in order to try to urge the financial investors (especially the banks) to renegotiate the terms and conditions of their financing.

In a going-private transaction, ‘fraudulent conveyance’ issues are also handled by representations and warranties, usually made by the shareholders and by the directors of the target company. French law limits the use of securities and loans. The French Commercial Code (article L225-216) provides that a company shall not advance funds, grant loans or provide guarantees to enable a third party to subscribe

### Update and trends

Two major developments at European level should be noted.

First, the European Commission has proposed a Directive on Alternative Investment Fund Managers (AIFM). The Directive will introduce a harmonised comprehensive and effective regulatory and supervisory framework for AIFM in the EU (requirements on the operations of AIFM, such as capital requirements or remuneration policies, extensive disclosure requirements on AIFM). Such obligations will impose costs for the private equity industry, which should be compensated by the benefits in terms of improved public image.

This Directive will enter into force following its publication in the Official Journal of the European Union (in early 2011) and must be implemented into national law within two years from that date (expected to be in early 2013).

The second development concerns the Solvency II Directive, which includes ambitious and far-reaching proposals for a new, principles-based and risk-sensitive solvency regime. It will modify the equity capital that institutional investors have to constitute in order to cover the risks related to their investments. Institutional investors, and in particular insurers, may be forced to reduce their investments in private equity transactions because of the load supported regarding their equity capital. The draft Directive sets a deadline of 31 October 2012 for implementation. Practitioners have tried to warn European institutions of the negative effects of this Directive.

or purchase its own shares. This provision derives from the European Second Company Law Directive. In cases of violation of this provision, loans or warranties can be cancelled and directors incur a criminal liability. A report dated as of January 2008 submitted to the Ministry of Justice suggests abolishing the criminal liability provided in this case but the provision has not yet been amended. Moreover, some authors consider that article L225-216 of the French Commercial Code should be amended in order to harmonise French law with some other European regulations, such as English law, which is much more permissive.

### 13 Shareholders' agreements

What are the key provisions in shareholders' agreements covering minority investments or investments made by two or more private equity firms?

Key provisions in shareholder agreements concern the following:

#### Corporate governance

This issue is important for investors holding a minority stake in the target company. Investors usually negotiate a number of seats at the board (board of directors or supervisory board, as the case may be). It is often negotiated that investors' representatives have specific veto and information rights regarding material and strategic decisions, as well as decisions out of the ordinary course of business. The list of these decisions is looked at very carefully by investors, whose responsibility may be at stake in cases of bankruptcy if they are treated like other directors (even if they are members of a supervisory board). These veto and information rights may alternatively be mentioned in the company's bylaws as part of the rights attached to preferred shares held by the investment funds; this insertion increases their enforceability towards the company.

#### Shares

Provisions of shareholder agreements usually comprise pre-emption rights, drag-along and tag-along clauses, as well as buy or sell provisions; when there are several investors, those provisions may be triggered upon the initiative of a majority of the investment funds, and sometimes with the consent of one (or more) member of the founders.

Specific provisions regarding the subscription or the acquisition of shares by an industrial entity (contrary to a financial entity) are also often negotiated because of the impact of such operation on the liquidity or value of the stake held by the investment funds; the latter usually have a veto right combined with an exit right.

Regarding key managers, there are usually provisions regarding restrictions on the transfer of all or part of their shares, bad-leaver and good-leaver provisions (in favour of the investment funds), non-compete clauses and management packages (retrocession agreement, etc).

### 14 Limitations on transaction size

Do private equity firms have limitations on the size of transactions they may engage in?

A private equity transaction may be engaged through different vehicles such as specific private equity entities (venture capital firms (SCR), venture capital funds (FCPR), innovation funds (FCPI), etc). A common limit to any vehicle consists in the respect of the Competition Law; this is, for instance, the case regarding investment funds whose subscribers benefit from a specific tax regime (created by French laws adopted in August 2007 and 2008, No. 2007/1223 and No. 2008/776) that fall within the scope of the European Commission Regulation regarding de minimis aid (No. 1998/2006 of 15 December 2006). Private equity entities also have specific rules limiting their investments in order to benefit from tax incentives. For instance, some vehicles cannot invest more than a certain proportion of their assets in the same target company or, as far as FCPI are concerned, 60 per cent of their assets shall be invested in innovative companies (recognised as such in particular by Oséo Innovation or, as a matter of fact, with a minimum level of investments made by the company in R&D), or may not have a shareholding giving more than a certain portion of the voting rights of the target company. Geographical limits may also be imposed on certain private equity entities preventing them from investing outside the European Union or the European Economic Area or outside a limited local area (eg, local investment fund – FIP).

Finally, each vehicle has its own investment constraints and policies that impose restrictions such as minimum and maximum thresholds for the value of specific investments, and permitted businesses and geographical areas where investments may be made.

### 15 Exit strategies and investment horizons

How do the exit strategies and investment horizons of private equity firms affect the structuring and negotiation of leveraged buyout transactions?

Exit strategies and investment horizons are taken into account in different manners. Investment horizons depend on the type of private equity transaction (development capital, risk capital, etc), but a private equity transaction does not generally last more than five to seven years.

It is important to note that the tax-efficient exit, in order to optimise the share value for the private equity firm, is a key issue of exit strategies.

There are four main potential exits for private equity investors: IPO, trade sale, secondary buyouts and sale of the company to the management team. In France, Alternext, which is a regulated but not controlled market dedicated to SMEs in need of financing, constitutes a favourable factor for the IPO exit strategy; the number of IPOs has considerably increased in 2010 compared to 2009, following a considerable decrease between 2008 and 2009 induced by the financial turmoil.

Generally, documentation (loan agreement, shareholders' agreement) precisely defines the transfer of shares, mainly to provide to the private equity investors as many liquidity rights as possible. In this view, typical provisions such as tag-along rights, drag-along rights or

a call and put option are subject to negotiations. It is also possible to provide that the shares held by key managers will not be transferable for a limited period (eg, the period before the exit date). Exit strategies and investment horizons also imply an incentive system for management (see question 7).

**16 Principal accounting considerations**

What are some of the principal accounting considerations for private equity transactions?

From 2005, the International Financial Reporting Standards (IFRS) have been applicable to French publicly traded companies. Unlisted companies can choose either to adopt the IFRS for their consolidated financial statements or to use the accounting principles issued by the Comité de la Réglementation Comptable (CRC). The rules issued by the CRC are, however, mainly influenced by the IFRS. From a practical standpoint, French companies are encouraged to convert their financial statements into statements complying with the IFRS, especially in relation to realising transactions or financing operations with foreign or international entities.

An important difference between both sets of rules is that the scope of financial consolidation appears to be broader with IFRS than with the principles of the CRC. Thus, it may be more difficult to implement an unconsolidated structure in the case of private equity transactions.

**17 Target companies and industries**

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Very few going-private transactions occur in France, mainly due to the level of shareholding above which a squeeze-out and a tax consolidation can be implemented: currently 95 per cent of shares and voting rights. Private equity professionals are currently seeking to obtain legislative changes.

Some companies are subject to specific regulations because of their purpose, which corresponds to a regulated activity under French Law (eg, pharmaceutical activities, medical analysis laboratories). Consequently, within the framework of a private equity transaction, some corporate aspects must be specifically taken into account, mainly the shareholding (qualified persons in relation with the purpose of the company must hold a minimum percentage of the share capital) and the management (eg, corporate bodies of such company

must be composed of qualified persons in relation with the purpose of the company).

**18 Cross-border transactions**

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Private equity operations that are realised in France frequently involve foreign investors. One of the main aspects in the structuring of cross-border private equity transactions is the tax treatment applied to the proceeds deriving from the French target. First, the choice of the form of the SPV may impact the application of foreign tax pass-through regimes, such as the US ‘check the box regulations’. Moreover, investors have to examine whether some tax arbitrage structures can be implemented in order, for example, to achieve a ‘double-dip’ operation (eg, using the difference of tax treatment existing in two different jurisdictions). One typical example would be the tax deduction at the French SPV’s level of interest expenses that would qualify as an exempt dividend in the hand of the foreign recipient.

It is also necessary to structure the investment in order to reduce the withholding tax that may be levied on dividend payments made by the French SPV to the foreign investors as much as possible. As mentioned in question 8, as a general rule no withholding tax is levied on interest payments made by French companies to lenders established abroad.

It is also important to note that foreign investments in France are unrestricted: there is only a legal obligation to declare foreign investment in France. This declaration concerns direct investment (constitution of a company or acquisition of a branch of business) and indirect investment (changing the shareholding of a foreign company holding an interest in a French company). Nevertheless, some transactions do not need to be declared (eg, direct investment between companies belonging to the same group).

Some specific transactions must be duly authorised by the Ministry of Economy when the contemplated transaction participates in the exercise of public authority or pertains to activities likely to jeopardise public order, public safety or national defence interests and research in, and production or marketing of, arms, munitions or explosive powders or substances. When granted, the administrative approval may include specific conditions in order to ensure that the planned investment does not jeopardise French national interests.

Foreign investments significantly decreased since 2008, but a recovery of such investments has been observed during the first semester of 2010.



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**19 Club and group deals**

What are the special considerations when more than one private equity firm (or one or more private equity firms and a strategic partner) is participating in a club or group deal?

'Club' deals or 'group' deals were not often used in France before the disruption in the credit markets occurred, when the syndication of the debt did not raise specific concern. Since the financial turmoil, a leveraged loan is now arranged at an earlier stage of the transaction, in a club or group deal where up to five or six banks (and sometimes more) gather. There is no specific legal provision with regard to a club or group deal in France.

Members of a club deal usually fix the terms of their relationship with regards to the voting rules, the corporate governance and the exit strategies by concluding a shareholders' agreement. From a competition perspective, French and European authorities have not yet indicated whether club deals may raise anti-competition issues.

**20 Issues related to certainty of closing**

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Many private equity transactions include break-up fees and reverse break-up fees. Break-up fees or termination fees have to be paid by the seller to the buyer if the transaction is not consummated for reasons previously specified between the parties. Reverse break-up fees are the counterparts to break-up fees and are due by the private equity buyer if it doesn't close the deal in certain circumstances. The principal aim of these fees is to compensate the parties for their expenses and lost opportunity.

Confidentially agreements or non-disclosure agreements are also often concluded between the parties in order to protect sensitive information exchanged by the parties during the negotiations from being disclosed.

Closing conditions are common as well. For instance, acquisition agreements frequently include as a closing condition the receipt of a financing by the buyer.

MAC clauses may also be provided. According to such a clause, the buyer may not be obligated to close the transaction, in the event the seller experiences a 'material adverse change' or a 'material adverse effect'.

# GETTING THE DEAL THROUGH

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