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Venture capital investment in France: market and regulatory overview

by David-James Sebag and Rima Maitrehenry, Gide Loyrette Nouel

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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.

Market overview

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

Venture capital (VC) and private equity (PE)

PE and VC investments differ in several key areas:

- Type of investee company.
- Size of investment.
- Investment structure.

PE investments take the following form:

- Relatively large investments in mature, later-stage, profitable companies that have a good record of growth and expansion.
- Leveraged financing.
- Principally made to acquire a majority stake of the investee company.

VC investments take the following form:

- Focused on technology/data driven companies with high growth potential at an early stage of development.
- Limited or no recourse to debt instruments other than convertible notes.
- Generally limited to 20% to 30% of the investee company's share capital.

The risk profile of each category of investment is different, and decreases as the financing size increases (from seed financing to VC to growth equity to PE).There are typically different rounds of financing as follows:

- Seed funding is the first equity funding stage that helps a company to finance its initial steps and notably its product development. The most common investors at this stage are the founders, their friends and family, incubators and business angels. A company can raise up to EUR2 million through seed funding.
- Series A funding is used by a company to optimize its product offering and start its growth by developing its business in new markets. The most common investors at this stage are traditional VC funds. Sometimes existing shareholders also invest. A company can to raise up to EUR10 million through series A funding.
- Series B funding enables a company to increase the efficiency of its product and hire new talent to expand its commercial strategy. The investors at this stage are generally the same as those in the series A funding rounds. A company can to raise up to EUR30 million through series B funding.
- Series C funding enables a successful company to perfect its existing products, develop new products, conquer new markets or geographical areas and overall be a strong actor in its field of activity. The investors at this stage can be the same as in the series A and B funding rounds but in addition can include international VC investors, investment banks, private equity firms or sovereign funds. A company can raise several hundred million euros through series C funding.
- Series D funding and above are less common and confined to larger companies with profitable businesses or are carried out before an initial public offering (IPO).

Market trends

France is one of the most active VC investment markets in Europe, together with the UK and Germany.

In 2019, a record EUR5.03 billion was invested in start-ups through a total of 736 investments, an increase of

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39% in value and 14% in volume compared to 2018. EUR417 million was invested in seed rounds (270 investments), and the balance split between Series A, B and C rounds (462 investments) and growth equity funding (four investments).

The average investment in 2019 increased from EUR5.5 million to EUR6.8 million (an increase of 19% compared to 2018). The most active capital raising tiers were:

- Between EUR5 million and EUR10 million (an increase of 62% in value compared to 2018).
- Between EUR20 million and EUR50 million (an increase of 44% in value compared to 2018).
- More than EUR50 million (an increase of 73% in value compared to 2018). There were four investments exceeding EUR100 million, totalling EUR576 million.

Geographically the investment was concentrated in the:

- Île-de-France region which received 70% of the investment value.
- Auvergne-Rhône-Alpes region which received 8% of the investment value.
- Provence-Alpes-Côte d'Azur region which received 6% of the investment value.

Sources of funding

Bpifrance, the French public investment bank, 50% state-owned and 50% owned by the French financing public authority (*Caisse des dépôts et consignations*), plays a key role in the VC landscape and supports early-stage companies and VC funds. Bpifrance invested EUR191 million in start-ups between 2016 and 2018. In 2019, Bpifrance also launched the Deeptech Plan to support research and development (R&D) deeptech start-ups and invested EUR380 million through this plan in January 2020.

The French VC industry is very developed with numerous professional funds, sophisticated market practices and various professional organisations.

In addition, corporate VC (CVC) is developing rapidly. Many investment programmes were launched between 2016 and 2018, notably by:

- PSA Ventures (EUR100 million).
- Crédit Agricole (EUR100 million).
- LVMH Luxury Ventures (EUR50 million).
- MACIF Innovation (EUR30 million).
- RATP Capital Innovation (EUR15 million).

Family office and business angels are also VC investors in early-stage companies.

Types of company

VC funds invest in technology/data driven companies with high growth potential. In 2019, the most attractive sectors were:

- Software.
- Internet services.
- Life sciences.
- Data/big data.
- Fintech.
- Apps/marketplace.
- Telecoms/networks.
- Agriculture/food/cleantech.

Among these sectors, investment in:

- Software companies grew by 206% in 2019 with EUR1.5 billion raised, compared to EUR745 million in 2018.
- Internet services remained stable with EUR1.1 billion raised in 2019.
- The life sciences sector is also very active, growing by 41% in 2019 with EUR811 million raised, compared to EUR574 million in 2018.

Standardised investment terms

There are no standardised investment documents, but standard market terms are very developed, sophisticated and generally accepted in VC transactions. Several projects aim to standardise investment documentation, notably the Galion Project (https://thegalionproject.com/), a think-tank offering guidelines, templates and analysis to start-ups. Law firms and incubators have also developed standardised documents and much information is available online (notably on the Gide Venture platform, www.gide-venture.fr/).

Tax incentive schemes

2. What tax incentive or other schemes exist to encourage investment in portfolio companies? At whom are the schemes directed? What conditions must be met?

Investment in start-ups can offer various tax advantages. France has adopted various tax incentives, notably through the 2014 Madelin law and the 2007 TEPA law.

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18% income tax deduction on start-up investments

French tax resident individuals can deduct 18% of the amount subscribed to the share capital of start-ups from their income tax, provided they commit to hold the shares received for at least five years.

Investments must be made in companies that mainly:

- Have been established for less than five years.
- Are established in the European Union (EU) or the European Economic Area (EEA).
- Employ a maximum of 50 employees.
- Have a maximum turnover of EUR10 million.
- Are at an early stage of their commercial activity.

This tax incentive also benefits individuals investing in certain VC funds complying with quotas of investment in start-ups meeting the conditions described above. These funds are mostly the regional investment funds (*fonds d'Investissement de proximité*) (FIP) or professional private equity funds (*fonds commun de placement dans l'innovation*) (FPCI).

CVC measures

Companies subject to French corporate income tax can amortise their subscriptions to the share capital of innovative SMEs (or to certain investment funds meeting certain investment quotas in innovative SMEs) over a five year period (by deducting one-fifth of the investment from the company's annual income). This amortisation is subject to the following main conditions:

- The investment must be made in cash, not exceeding either:
  - EUR15 million; or
  - 1% of the investing company's total assets.
- The securities received in return for the investment must be kept for at least two years, and the investing company must not hold more than 20% of the innovative start-up.
- The investee company must be an innovative start-up.

Funding sources

3. How do venture capital funds typically obtain their funding?

There are two main types of investors in VC funds:

- Institutional investors:
  - banks;
  - insurance companies;
  - public actors;
  - corporate groups;
  - family offices;
  - sovereign wealth funds; and
  - pension funds.
- Individuals investors:
  - entrepreneurs;
  - industrials; and
  - wealthy individuals.

In 2019, VC funds raised 21% more than in 2018. In addition, foreign investors provided 49% of these funds compared to an average of 40% in the first quarters of 2009 to 2018. Among all investors, the most significant increases were an:

- 87% increase in public investments.
- 81% in sovereign wealth funds' investments.
- 17% increase industrials' investments.
- 16% increase in insurance companies' investments.

Fund structuring

4. What legal structure(s) are most commonly used as vehicles for venture capital funds?

The most common vehicles for retail investors are:

- Venture capital funds (fonds communs de placement à risque) (FCPR).
- Innovation common investment funds (fonds communs de placement dans l'innovation) (FCPI).
- Regional investment funds (fonds d'investissement de proximité) (FIP).

The most common vehicles for sophisticated and/or institutional investors are:

- Professional private equity funds (fonds professionnel de capital investissement) (FPCI).
- French limited partnerships (société de libre partenariat) (SLP) .

All these vehicles must be formed and/or managed by a licenced portfolio management company.

Other types of investment vehicles include:

- Limited liability companies used by professional investors.
- Club deals formed by business angels.

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

Syndication between French and/or international funds is fairly common. A lead investor invests the majority of the funds followed by one or more other funds. They will syndicate resources, notably legal and due diligence expenses.

Investment objectives

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

Most VC funds invest in unlisted companies. Their average life is about ten years. Certain funds are dedicated to a specific funding round, for example seed investments, series A and B, series C and above. Others are more industry driven and specialise in a particular sector, for example tech, agriculture or healthcare. VC funds can also be open-ended (evergreen funds) to pursue investment opportunities in series C and D over the long-term.

An attractive tax regime is available to French residents investing in VC funds dedicated to investments in small and medium sized companies and/or innovative companies located in the EU (*see* Question 2).

VC funds (irrespective of their investment strategy or the type of fund) typically target capital gains through exits from portfolio companies. They hold investments in portfolio companies for an average of three to five years.

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

Most VC funds provide equity/equity-like financing because:

- Tax incentives available to French residents are linked to the underlying equity/equity-like assets of these funds.
- Banking monopoly rules prohibit loan origination investments (other than shareholders' loans) except under certain limited conditions.

Equity financing is provided by all types of VC funds, irrespective of the fund structure and size of the investment.

Fund regulation and licensing

8. Do a private equity fund's promoter, principals and manager require authorisation or other licences?

VC funds must be managed by either:

- A management company licensed by the French regulator, the Financial Markets Authority (*Autorité des marchés financiers*) (AMF) as a PE portfolio management company. These PE management companies can be full scope alternative investment fund managers (AIFM) (as defined by the AIFM Directive (*2011/61/EU*)) or sub-threshold AIFMs. (In the latter case, most of the regulatory requirements of the AIFM Directive still apply by virtue of French local regulatory rules.)
- A European Union (EU) manager either:
  - authorised to operate in France through a management passport under the AIFM Directive (*2011/61/EU*); or
  - managing a VC fund that benefits from an EU label, for example, European Venture Capital Fund (EuVECA) (*EuVECA Regulation (345/2013)*), European Social Entrepreneurship Fund (EuSEF) (*EuSEF Regulation (346/2013)*) or European Long-term Investment Funds (ELTIF) (*ELTIF Regulation ((EU) 2015/60)*).
- Other entities registered with the AMF as other sub-threshold managers if:
  - these entities are not PE management companies licensed by the AMF as described above;
  - these entities are managing funds that are less than EUR500 million (or less than EUR100 million if leveraged); and
  - investors in the funds are professional investors (as defined under the MiFID II Directive (*2014/65/EU*)).

  If these conditions are not met, sub-threshold managers must be licensed by the AMF as a PE portfolio management company.

  EU sub-threshold managers cannot operate in France and benefit from the management passport under the AIFM Directive, unless they comply with the French local requirements applicable to sub-threshold managers described above (that is, being licensed as a PE management company or registering as another sub-threshold manager).

The management company/manager must appoint a custodian authorised by the French Prudential Supervisory and Resolution Authority (*Autorité de contrôle prudential*) (ACPR) to provide safe keeping and custody of assets for investment funds. Sub-threshold managers that are only required to register with the AMF are exempt from this requirement.

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

VC funds open to retail investors (FCPRs, FCPIs and FIPs) must be authorised by the AMF before both:

- Formal establishment of the entity
- Marketing its interests to prospective investors.

VC funds limited to non-retail/professional investors (FPCIs and SLPs) must be notified to the AMF within one month after their formation.

Since the implementation of the AIFM Directive (*2011/61/EU*), the marketing of interests in a VC fund must comply with French regulations relating to:

- Public offerings (VC funds that are offered to the public require the AMF's prior approval of the offering terms).
- Solicitation (VC funds must not solicit if they are not approved for marketing either through a marketing passport or under the French local marketing regime).
- Marketing regime (the AMF's prior approval is necessary for a VC fund to benefit from the marketing passport or to be authorised to market under the French local marketing regime).

The available, limited, private placement exemptions are either:

- Contact with an investor on a reverse solicitation basis.
- Contacts with managers of funds authorised to operate in France (either by the AMF or through an EU passport) if the VC fund is marketed as an eligible investment for the funds managed by those managers.
- Contact with managers of third-party accounts authorised to operate in France (either by the AMF or through an EU passport) if the VC fund is marketed as an eligible investment for the portfolio managed by those managers.

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

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

- By-laws.
- Subscription agreements.
- Side letters.
- Articles of association.
- Shareholders' agreements and, if applicable, the terms and conditions of the securities issued by the fund.

The governing documents of a retail fund (FCPR, FCPI or FIP) must comply with detailed French law requirements for the fund to be approved by the AMF. Therefore, investors in a retail fund generally do not have the flexibility to negotiate the terms or to request protections in addition to those already provided by the by-laws.

The governing documents of VC funds that are dedicated to professional/non-retail investors are more frequently negotiated by investors because French laws and regulations allow the flexibility for a wide variety of terms. Investors negotiate provisions that are commonly looked for by investors in global PE funds, for example:

- Key persons and change of control provisions.
- Fault and no-fault removal of the management company.
- Limitations relating to raising a successor fund.
- Management and other fees.
- Reporting and environmental, social and governance (ESG) obligations.
- Advisory committee membership.

Interests in portfolio companies and securities regulation

11. What form of interest do venture capital funds take in an investee company? Are there any restrictions on direct investment in a company's equity securities by foreign venture capital funds? What regulations govern the offer and sale of securities in venture capital transactions?

Forms of interest

VC funds mostly invest in equity and subscribe to preferred shares. Funding is generally provided at closing but can also be contingent on milestones and/or paid in tranches. VC funds can also invest through convertible bonds (between two financing rounds). Investments in convertible bonds are structured to allow investors to participate in the next financing round on preferential terms (generally at a discount to the share price or with a non-conversion premium with a mandatory or optional conversion structure). The opportunity to raise funds through convertible notes is attractive for start-ups that have limited or no access to traditional debt instruments and want to limit early dilution.

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Restrictions on direct investment

Foreign investments require the Ministry of Economy's prior approval, where the target company's activities either:

- Are considered sensitive. The list of sensitive activities is fairly extensive and recent additions include:
  - data centers;
  - energy;
  - communication; and
  - infrastructure.
- Involve:
  - defence activities;
  - public order;
  - safety;
  - security; and
  - any national interests.

(*Article L. 151-3, R. 153-1 and seq., French Monetary and Financial Code.*)

The clearance of the foreign investment control procedure impacts the timing of the deal. The Ministry of Economy's approval is a condition precedent. Transaction documentation must clearly define conditions precedent and closing deliverables, interim period management clauses and a negotiated material adverse effect clause to prevent substantial change in the interim period may be recommended.

Securities regulation

There are no specific regulations governing the offer and sale of securities of non-listed companies in VC transactions, nor any specific public filings required. General corporate law requirements apply, and certain corporate decisions must be filed with the clerk of the commercial court. Listed companies are subject to AMF regulations on the issuance and trading of listed shares (*Securities and Capital Market Law*).

Valuing and investigating investee companies

12. How do venture capital funds value an investee company?

Valuation can be based on both:

- The company's potential development and growth.
- Any other metrics relevant for the business concerned:
  - revenues;
  - users;
  - data;
  - intellectual property (IP); or
  - earnings before interest, taxes, depreciation and amortization (EBITDA).

Valuation is discussed between investors and founders/shareholders based on the:

- Business plan.
- Competitive landscape (offer and demand).
- Size of the round.
- Prior financing history.

The term sheet can provide for investment amounts in a foreign investor's currency, but corporate law requires the transaction documentation to be drafted in the company's local currency (EURs).

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

VC funds' investigations into early-stage companies are limited and often rely on documentation prepared for previous rounds of financings and Q&A sessions with the management and finance/legal support team. Investigations generally cover the following topics:

- Corporate (compliance with laws of by-laws, other corporate documentation of the company and corporate governance).
- Capitalisation.
- Labour law.
- Intellectual property rights, data and General Data Protection Regulation ((*EU) 679/2016*) (GDPR) implications.
- Contracts.

For larger financing rounds, due diligence covers the investee's business and additional specific areas of law, including:

- Commercial law.
- Financial law (mainly confirmation that the terms and conditions of the financing agreements are compliant with French laws and that no provisions of these agreements (for example, change of control provisions or early repayment clauses) could have an impact on the completion of the transaction.
- Regulatory aspects.
- Tax.

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The due diligence highlights certain deliverables or conditions precedent necessary before closing and regularizations to be made post-closing, for example three or six months after completion of the investment.

Legal documentation

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

The main legal documents used in VC transactions are:

- Shareholders' agreement: executed by all the major investors, detailing the rights and protections of the investors, relationships between shareholders and governance. Simplified shareholders' agreements are executed by minority shareholders (with a limited set of rights for those shareholders, consistent with the main shareholders' agreement).
- Investment agreement: describing the terms and conditions of the investment along with the representations and warranties to be given by the company and its management because of the investment.
- Shareholders' resolutions: corporate documentation approving the investment.
- Revised by-laws: reflecting the share capital increase and rights attached to the preferred shares.

Shareholders' resolutions and revised by-laws are filed with the clerk of the commercial court and are publicly accessible. Rights granted to the investor and provided under the shareholders' agreement are not public and some of these rights are duplicated in the simplified shareholders' agreements with option holders and minority shareholders.

Protection of the fund as investor

Contractual protections

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

The shareholders' agreement details the investor's contractual protections. These protections include, among others:

- One or more board seats.
- Veto rights over certain key decisions (under qualified majority rule).
- Co-sale rights, notably where there is a transfer of a certain percentage of share capital by the founders.
- Full tag along rights if there is a change of control. The tag along protects minority shareholders, and enables them to tag their shares along with the shares of majority shareholders who are willing to sell their shares.
- Drag along rights. These rights are generally contained in the company's shareholders' agreement for a majority of the shareholders (with thresholds depending on the structure of the capitalization table and agreement between shareholders). They are rights to accept an offer to buy their shares and to force the holders of the remaining shares to accept this offer.
- Founders' leavers' rights and rules including non-compete clauses, IP assignment, exclusivity.
- Information and audit rights.
- Liquidity provisions including a liquidation preference or waterfall in the event of a liquidity event.

Forms of equity interest

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

Investors generally subscribe to preferred shares. These preferred shares are either:

- Statutory.
- Contractual.

Statutory preferred shares

Certain investors' rights (notably the liquidation preference) are set out in the company's by-laws, in addition to the shareholders' agreement. A court-appointed auditor (or an auditor appointed unanimously by the shareholders) must deliver a report to the shareholders on the impact of the issue of statutory preferred shares. This process can generate delays in the financing and is usually recommended for larger financing transactions or if statutory preferred shares were issued in prior financing rounds.

Contractual preferred shares

The rights of the investors are only set out in the shareholders' agreement, not the by-laws. The issue of contractual preferred shares is usually recommended for smaller financing transactions with timing constraints and is now frequently used by French VC funds and entrepreneurs as the default rule governing preferred rights. The only disadvantage in issuing contractual preferred shares is that a breach of the by-laws containing the specific rights benefiting the preferred shares is considered mismanagement (*faute de gestion*)

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with civil and criminal liability whereas a breach of the shareholders' agreement is contractual and only incurs damages. The shareholders' agreement can provide for leaver protection if investors' rights as provided in the shareholders' agreement are breached by any of its signatories.

Preferred shares

17. What rights does a fund have in its capacity as a holder of preferred or preference shares?

The rights of preferred shares issued in the context of a VC transaction are:

- A liquidation preference that gives the investor priority over other shareholders to recover its invested amount in a liquidity event (generally 1x non-participating, up to the invested amount).
- Right of conversion into ordinary shares or the obligation to convert in the event of a qualified IPO.
- Right to appoint one or more board members and veto rights over certain key decisions (under the qualified majority rule).
- Anti-dilution protection in the form of a ratchet warrant attached to the preferred shares, giving the right to receive additional preferred shares in the event of a post-closing equity down-round.
- Right to audit and right to information, including reports.

Management control

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

The rights commonly granted to give a fund a level of management control over the activities of the investee company are both:

- To appoint one or more members of the board of the investee company.
- Veto rights over certain key decisions of the investee company and/or its subsidiaries, through the qualified majority rule requiring the approval of the fund representative on the board, notably on:
  - issue of equity or debt;
  - sale;
  - a liquidity event;
  - budget and key operational decisions; and
  - appointment, removal and compensation of key executives and management.

Share transfer restrictions

19. What restrictions on the transfer of shares by shareholders are commonly contained in the investment documentation or the company's organisational documents?

French investment documentation commonly contains various types of restrictions on the transfer of shares:

- Except for certain free transfers, all transfers of shares, including the investors', are subject to the other shareholders' right of first refusal (*droit de pre-emption*) (investors and/or founders can have priority on transfer).
- The investors' or preferred shareholders' right of co-sale in the event of the founders' or ordinary shareholders' transfer. Generally, all shareholders have full tag along rights when the majority of the capital is transferred, in a liquidity event and also on investment in a strategic (non-financial) company or competitor of the investee. The shareholders' agreement always provides for drag along provisions to force a sale or liquidity with the approval of a certain percentage of shareholders.
- The founders' lock-up and leaver provisions, with a clawback on all or a portion of their shares (with or without vesting or discount over the fair market value of their shares) depending on the timing and grounds for their departure.

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

Investors usually protect themselves through:

- Liquidation preference rights, enabling the fund to recover the invested amount in priority to the other shareholders of the company (1x non-participating preference, up to the invested amount).
- Right to trigger and/or manage a liquidity process (IPO, sale or merger of the company) during a defined liquidity period (generally four or five years after the date of investment) by appointing an investment bank.
- Drag along rights enabling a majority of shareholders to force a liquidity of the company. The majority rules of the drag along clause can be amended during the liquidity period to allow the investors to impose a sale on the other shareholders.
- Tag along rights enabling the investors to transfer all their shares in the event of an unsolicited offer resulting in a change of control of the company.

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Pre-emption rights

21. Do investors typically require pre-emption rights in relation to any further issues of shares by an investee company?

Investors can require a right of first offer or pre-emption rights when the investee company issues further shares, but this is not standard in VC transactions. However, investors always require a right to maintain their percentage holding in the company's share capital in the event of third-party issuance.

Consents

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

Corporate consents are required to approve the investment documentation:

- The issuance of shares to the investor requires the approval of the shareholders of the investee company (the majority rule varies depending on the by-laws, but generally it is two-thirds of the shareholders).
- The issuance of statutory preferred shares (*see* Question 16) requires the individual approval of each class of securities to give access to the share capital of the investee company. (Shares are grouped in "mass" for various operations under French laws as soon as the securities are issued.)
- The approval of the board of directors can be required, depending on the existing shareholders' agreement and/or by-laws of the investee company.

In addition, all the shareholders and holders of securities giving access to the share capital of the company must execute either a shareholders' agreement or a simplified shareholders' agreement (*see* Question 14).

Note that a shareholders' agreement cannot be amended by a majority of shareholders to which the signatories would have given power in connection with a new round of financing (as one cannot agree in advance to unknown future changes to an agreement to which one is party). Therefore, securing the contractual consent of all shareholders and holders of securities giving access to the share capital of the company for each new round of investment can be critical.

Costs

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

The costs of VC funds are covered by the investee company. The envelope of fees (including legal, due diligence, and financial) is generally provided for in the investment term-sheet and capped.

Portfolio company management

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

Incentives

Employee Stock Ownership Plans (ESOPs) are generally offered at the time of investment, to incentivise current or future employees and managers of the company. The ESOP's dilutive impact can be included in the pre-money valuation, if the company does not have any plan in place. The size of the plan is generally between 5% and 10% of the company's total share capital post-investment, depending of the size of the company and round of financing.

Four different types of securities can be issued:

- Founders' warrants (*bons de souscriptions de parts de créateurs d'entreprise*) (BSPCEs).
- Warrants (*bons de souscription d'actions*) (BSAs).
- Stock options.
- Free shares (*allocation gratuite d'actions*) (AGAs).

Stock options, BSPCEs and BSAs enable the beneficiary to subscribe to ordinary shares of the company at a strike price based on the fair market value of the share, at the time of the investment. Free shares are equivalent to restricted stock units (RSU) and underlying shares are issued at no cost to the beneficiaries after a defined period. Grant of equity is generally subject to a four-year vesting.

Tax considerations

The BSPCEs and BSAs have the most beneficial tax regime for French beneficiaries and their issuance does not trigger any taxation for the company. The company (or its parent company) must be less than 15 years old and subject to corporate income tax in France to be eligible to issue BSPCEs.

Issuance of stock-options or free shares generates social charges for the company (subject to certain exclusions) and is therefore not frequently used in VC transactions (except to incentivise foreign employees).

BSAs are rarely used, mainly because they are widely viewed as very risky from a tax standpoint. Gains from

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BSAs could in principle be treated as capital gains, subject to the rather attractive "flat tax" (that is, a fixed 30% rate, including social contributions). However, unlike the other three types of securities, BSAs do not benefit from a defined tax framework protecting the holders against a re-characterisation of their gains into salaries. In practice, the tax authorities widely challenge BSA-based incentive mechanisms, taking the view that the BSAs were awarded in consideration for the managers' work, and should therefore be treated as salaries (subject to significantly higher taxation, and the social contributions due by the company).

25. What protections do the investors typically seek to ensure the long-term commitment of the founders to the venture?

VC investors typically require leavers', lock-up and non-compete/non-solicit provisions to ensure the long-term commitment of the company's founders. Conditions for these contractual protections are negotiated and tailored to the transaction.

Non-compete clauses must meet the following criteria to be enforceable:

- The restricted activity must be clearly defined. It is not possible to restrict all professional activities.
- They must be limited in duration and geographical scope. It is not possible to restrict all global commercial activity.
- They must be proportionate to the legitimate interests they serve.
- The employee must be compensated during the non-compete period, generally between 30% and 50% of their average monthly compensation over the past 12 months. Compensation is not legally required for founders without employee status but generally provided.

Lock-ups are generally provided for a period of four or five years, consistent with the liquidity window suggested by the fund. Founders can be provided with a limited right to transfer a portion of their shares as an exception to this lock-up (generally 10% to 15%).

Bad leaver provisions generally include:

- Resignation before the end of a four-year period.
- Dismissal for gross or voluntary misconduct (*faute grave ou faute lourde*).
- Breach of key provisions of the shareholders' agreement (notably non-compete and governance).

A person departing on any other grounds is considered a good leaver.

Exit strategies

26. 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?

Redemption of shares is not typical in French investments as the company's repurchase of its own shares is subject to a strict legal regime with certain delays. In the event of investment in an unsuccessful company, the fund may decide to transfer its shareholding to a secondary fund or to existing shareholders at a discount.

If the investee company goes bankrupt, all creditors must be paid before the shareholders, generally resulting in the investor being unable to recover their investment (even with preferred shares).

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

VC funds typically exit a successful company through a trade sale. For tax reasons, trade sales are often structured as a share deal (and infrequently as an asset deal or merger). Sellers must review the contractual representations and warranties to ensure compliance with the specific requirements of the funds (notably indemnity caps).

An alternative is an IPO, but the outcome is uncertain and costs are more significant than those incurred in a trade sale. Unlike in leveraged transactions, secondary buyouts were not a traditional exit route for VC investments. However, given the development of growth transactions and late-stage financings secondary transactions (or leverage transactions) are increasingly becoming an exit option.

28. How can this exit strategy be built into the investment?

Exit strategy can be built into the investment by focusing on drag along and liquidity provisions in the shareholders' agreement. Certain clauses also provide additional details including:

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- How to run the liquidity process.
- Responsibilities of each group of shareholders.
- Potential indemnification and warranties' structure.
- Role of the management in providing information.
- Due diligence.

However, the outcome of an exit process is always unpredictable and will rely on efficient co-operation in good faith between the management and the investors.

Reform

29. What recent reforms or proposals for reform affect venture capital in your jurisdiction?

In May 2019, France enacted the Pacte Law (Loi Pacte) to foster entrepreneurship and innovation. For example, the Pacte Law:

- Provides for an innovative legal framework for initial coin offerings. This new regime provides investors with better information and protection and issuers with greater certainty. It is overseen by the AMF.
- Extends the grant of BSPCEs to members of the board of directors (and not only employees).
- Reduces the threshold for squeeze-out mergers from 95% to 90% to facilitate public to private transactions.
- Amends various provisions of the French corporate and civil code.

Contributor profiles

David-James Sebag, Partner, Mergers and acquisitions / corporate group

Gide Loyrette Nouel

T +1 212 403 6703 / +33 0 1 40 75 36 41

E dj.sebag@gide.com

W www.gide.com/en

Professional qualifications. Member of the New York and Paris Bars

Areas of practice. M&A; VC and PE, with a concentration on cross-border transactions; Co-head of the VC practice group; Head of the New York Office.

Recent transactions

- Partech for its investments in various French technology companies including Evaneos, Hostnfly and SendinBlue.
- Balderton for its investments in various French technology companies including Virtuo, Tempow, Playplay, Ouiteam.
- MWM, Dreem, Launchmetrics, and other numerous growth companies, for their equity financings in France and the US.
- Temasek for its growth investment in French companies ManoMano and Alan.
- Motion Equity Partners in the leveraged buyout of Laboratoire Equilibre Attitude and Groupe Minlay.
- Idinvest Partners (part of Eurazeo) on various investments in technology companies in Europe (including WeFox, Secret Escapes, Happn, Storefront and Organica).
- The joint venture between the CDC International (French sovereign fund) and Qatar Investment Authority in the EUR100 million financing of Devialet.
- The management of Hana Group for the leveraged buyout of TA Associates, and the subsequent build-up acquisition of Genji in the US.

Languages. French, English

Rima Maitrehenry, Counsel, Fund Formation

Gide Loyrette Nouel

T +33 01 40 75 28 14

E rima.maitrehenry@gide.com

W www.gide.com/en

Professional qualifications. Member of the Paris Bar

Areas of practice. Structuring of private equity funds for managers and sponsors, fund review for investors investing in private equity funds, secondary transactions, and regulatory matters surrounding fund's operations and transactions (licensing, marketing and so on)

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Recent transactions

- Structuring of 360 Fund V, a venture capital fund dedicated to innovation and breakthrough technologies (target size EUR150 million).
- Structuring of Partech Entrepreneur III, a venture capital fund dedicated to seed investments in health, e-commerce, finance, mobility and computing (target size EUR100 million).
- Structuring of Hi inov 2, a venture capital fund dedicated to deeptech B2B investments (target size EUR90 million).

Languages. French, English

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