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Private Equity in France

2020 Edition

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Private Equity in France

Dechert partnered with *Getting the Deal Through* and *Law Business Research* on their annual Market Intelligence Private Equity Guide. The 2020 Guide invites leading practitioners to reflect on evolving legal and regulatory landscapes and global trends. Private equity experts from Dechert's Corporate, Finance, Financial Services and Tax practices in Paris provided the France chapter content, which is in Q&A format and is reproduced below.

Please [click here](#) to access the full Market Intelligence Private Equity Guide

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1. What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Regarding buyouts, we have continued to see some highly competitive bids with aggressive buyers trying to pre-empt, and in some cases succeeding in pre-empting the process. By offering attractive management packages including significant leverage, investment funds are able to compete successfully with strategic buyers. In addition, the number of initial public offerings (IPOs) has declined significantly. Major IPOs have been postponed and large sales, which were initially structured as IPOs, such as SMCP, have been completed with private equity funds.

In large-scale transactions, bidders entered into consortium agreements because of the size of the transactions. For mid-scale and small-scale transactions, private equity funds are looking for new investment opportunities, such as spin-offs from strategic buyers.

Another trend is the increase in the number of players financing leveraged buyouts (LBOs) thus entailing more competition between lenders, including unitranche funds. In addition, we are also seeing new players in the equity and LBO space, such as highly specialized U.S. funds or family offices.

Stock-market volatility and stock-market valuations force public companies to be continuously reacting to markets turbulences and affect their ability to build mid- or long-term strategies, while the groups under LBO may implement their strategy over a four to five-year period. This may explain the growing attractiveness of private equity.

The COVID-19 crisis has opened a new era in this market, but for the time being players are waiting to receive revised budget and business plan to answer the impact of the crisis on the level of performance of the target companies.

2. Looking at types of investments and transactions, are private equity firms primarily pursuing straight buyouts, or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being explored?

We recently closed an LBO transaction for one of our clients. The week after the closing, we were already working on a build-up operation. External growth is still the privilege route to foster the growth of groups under LBO. As such, the ability of the investment fund to finance such growth is closely considered by management during the process.

In addition, owing to the competitive nature of the bidding process, some funds choose to take an alternative path and opt for a minority-stake participation, which has proved successful on several occasions. This option is being increasingly considered by private equity funds that are seeking investment opportunities in fast-growing companies.

New comers and excess of cash result in highly competitive deals and leave numbers of bidders by the wayside. Making room for an unfortunate bidder in the final structuring is more often considered by funds.

We also completed during H1 2020 an LBO transaction where the sponsors accepted a minority stake to convince the management of the sellers.

3. What were the recent keynote deals? And what made them stand out?

The market had been very seller-friendly until the beginning of the COVID-19 crisis. Bidders have had to be flexible to meet sellers' demands, in terms of price and certainty of completion. In several recent bid processes, the bidders were successful because they managed to secure a fully financed offer in a short amount of time, with equity commitment and debt commitment letters that the sellers considered satisfactory. In this competitive environment,

negotiating the management package, to include reinforced governance rights and incentive instruments, has been a key aspect of the approach early in the process.

4. Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? How are those challenges evolving?

M&A targets generally have multi-jurisdictional operations. This requires close coordination with the local counsel at the due diligence and negotiation stage, to understand and address local regulatory or tax issues. In competitive bid processes, it is crucial to have reliable local counsel to identify and understand the key concerns, and report and explain them to the client so they may be taken into account in the investment decision.

5. What are some of the current issues and trends in financing for private equity transactions? Have there been any notable developments in the availability or the terms of debt financing for buyers over the past year or so?

In our view, the main trends can be summarized as follows:

- leveraged loans and high-yield bonds are in decline;
- bank lenders remain under strong pressure from their regulatory environment;
- French and European debt funds have continued to develop strongly, benefiting from a favorable regulatory environment;
- there has been a convergence of terms between U.S. and European term loans and high-yield bonds (i.e., loosening of financial covenants and lender protection, and increase of flexibility for borrowers); in general, the U.S.-style provisions appear more and more frequently in European credit agreements;
- covenant-lite terms have become available in European deals; and
- strong development of unitranche solutions and number of players.

6. How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

Further to the presidential elections in 2017, the new government introduced a series of reforms in favour of investment that led to, inter alia, (i) a progressive reduction of the standard rate of corporate income tax from 33.33 per cent to 25 per cent by 2022, (ii) a significant change in the taxation of individuals with respect to capital gains, dividends and interest, which are now all taxed at a 30 per cent flat tax rate, (iii) a new reform of the tax and social security contributions regime of the free shares and (iv) the implementation of a regime of a 'trust' to enable monitoring security interests more efficiently in syndicated financings.

Besides, the French tax landscape is rapidly evolving under the combined impulsion of the OECD and the European Anti-Tax Avoidance Directives ("ATAD 1" and "ATAD 2") which both undertake to tackle tax avoidance practices and profit shifting. In past years, France has notably introduced into its domestic tax law (i) a major reform of the rules governing the deduction of financial charges (now capped to 30% of the borrower's Tax EBITDA) as well as (ii) a new set of measures neutralizing the tax effects of hybrid arrangements (the "anti-hybrid" rules). The implementation of these reforms has been a real game changer in the tax and legal structuring of domestic and transnational private equity deals and LBOs. The transposition of the DAC 6 Directive in France, introducing

mandatory disclosure requirements for certain cross-border tax arrangements, has also led the taxpayers and intermediaries involved in the structuring of private equity deals to review and adapt their tax policies and strategies.

In addition, PACTE Law, passed on 22 May 2019 and supplemented by several implementation decrees since, has broadened the eligible supports for life insurance to include professional private equity funds including *fonds professionnels de capital investissement* and *sociétés de libre partenariat*. This change aims to attracting French people's savings to private equity funds to enable better financing of the real economy.

Naturally, the COVID-19 pandemic has also been an important test for private equity funds which were able to count on the support of the public authorities. Indeed, the French government and the French financial regulator (the *Autorité des Marchés Financiers*) have introduced many transitional measures to deal with the COVID-19 pandemic since March 2020 and support asset managers.

As an example, the ordonnance 2020-740 dated 17 June 2020 has eased on a temporary basis the constraints on private equity funds for lending, through the current account advance mechanism, to portfolio companies which have difficulty dealing with the pandemic.

Finally, the public authorities have increased their scrutiny on ESG related subject in line with the developments initiated by the EU (e.g. Disclosure Regulation, Taxonomy Regulation). In particular, the French regulator (the *Autorité des Marchés Financiers*) published a new position-recommendation setting minimum standards for funds authorised for marketing in France and wishing to communicate on the consideration of non-financial criteria.

7. What are the current attitudes towards private equity among policymakers and the public? Does shareholder activism play a significant role in your jurisdiction?

We believe the perception of private equity funds has improved among policymakers and the public. Large French companies have been sold to private equity funds over the past few years and these funds have been instrumental in initiating a new development strategy, including providing new money and leading the renegotiation of debt in distressed M&A deals.

Shareholder activism plays a growing role in the public equity space, for underperforming public companies and squeeze out attempts. Under French securities law, in order to complete a squeeze out following a tender offer, minority shareholders must not hold more than 10 per cent of the share capital and voting rights following the offer. In several public-to-private deals, funds have acquired a minority shareholding participation following the announcement of the offer to impede the squeeze-out and to force the bidder to offer a higher price.

8. What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

There is a strong appetite for acquisitions through LBOs. Private equity funds have raised significant amounts of capital to be invested and, as a result, secondary and tertiary LBOs are very frequent. This is particularly the case for mid- and small-cap companies as private equity funds have the financial capacity to conduct the deal alone, and the company's management tends to have a strong preference for a new private investor, to enhance the development of the company and generate significant value over a four- to five-year period.

9. Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

Fundraising activity in France has been very dynamic over the past two years. In our experience, successful asset managers (i.e., managers with a good track record) do not have any difficulty when raising capital, and their funds are usually oversubscribed. The process for such managers is quick and certain funds are now able to finalize their

fundraising with a single closing instead of having a one- or two-year subscription period. In this respect, managers are currently favoured on the French market (it being understood that new managers, or managers with a poor track record, may have trouble successfully raising a new fund). However, limited partners have more leverage nowadays with respect to the fees charged by the managers. Most institutional investors have now formalized their investment process and call upon legal advisers to negotiate their investment.

10. Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

The timeline of fundraising in France depends on the manager. French private equity funds with total commitments in excess of €1 billion have recently been raised in less than four months over a single closing. However, some fundraisings can last for up to 12 or 18 months, even in the current favorable market conditions. In the past, private equity funds have been structured as fonds professionnels de capital investissement or as fonds professionnels spécialisés, which are two forms of French regulated funds. Now, more funds are structured as société de libre partenariat, a form of limited partnership established in 2015 with legal personality, with the objective, among others, to attract foreign investors and which can offer the same tax advantages as the fonds professionnel de capital investissement.

The key contractual points discussed in France are linked to the following: fault or no-fault divorce clause, key man clause, fees, costs and expenses, and transparency-related clauses (e.g., reporting and valuation).

The key legal issue specific to France is the banking monopoly, the prohibition for non-bank entities to carry out any of the credit operations, which is gradually eroding. Indeed, French fonds professionnels spécialisés and fonds professionnels de capital investissement, which are investment vehicles initially designed for private equity, were allowed to originate loans in 2014. Similarly, in 2017, the organisme de financement spécialisé, a vehicle designed for creating debt funds was also added to the range of investment fund structures. A specific point to highlight: this new structure is allowed to issue units (as the other funds) or notes.

11. How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

Private equity sponsors are rare in France, with the exception of banking or insurance companies that invest in management companies or historic shareholders in management companies. These entities are not supervised as sponsors of private equity funds, but are usually subject to their own sets of regulations. As a result, French regulations (e.g., the Law on the Separation and Regulation of Banking Activities), European regulations (e.g., Solvency II and CRD IV) and U.S. regulations (e.g., the Dodd-Frank Act or BHC Act) may have an impact on the day-to-day business of managers.

12. What effect has the AIFMD had on fundraising in your jurisdiction?

The AIFMD has not had a material effect on fundraising in France, as private equity funds are usually set up as regulated funds.

13. What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

The main tax issue within the framework of a private equity structuration relates to the tax deductibility of financial expenses, particularly regarding the tax deductibility of the interest under related-party loans, which is currently aggressively challenged by the French tax authorities. Furthermore, it should be noted that the tax structuring of the private equity deals must now be determined taking into account that most of the private equity funds finance

part or all of their investment at closing through an equity bridge financing. The introduction of anti-hybrids rules in France has also become a hot topic, given that the use of hybrid entities (such as certain funds) and instruments (such as CPECs) were quite common in the private equity landscape.

Regarding the carried interest, it is in principle taxed as employment income, but a favourable tax regime exists in France if certain conditions are met. In this case, carried interest is taxed as capital gains (i.e., at a 30 per cent flat tax rate). Further to recent changes in the law, the capital gain tax treatment became more accessible to managers of large-size funds (i.e., whose capital commitments exceed €1 billion).

14. Looking ahead, what can we expect? What might be the main themes in the next 12 months for private equity deal activity and fundraising?

The main event affecting the sector and the world is the COVID-19 pandemic, and it is expected to continue to disrupt private equity deal activity and fundraising in the next 12 months. Indeed, we anticipate an increase in the holding period of the companies in the funds' portfolios, which could lead investors to be more cautious. Similarly, first-time funds may have even more difficulty raising funds.

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Dechert's Private Equity Practice

Overview

For more than 35 years, Dechert has been at the forefront of advising private equity firms – long before it was called “private equity.” With approximately 350 private equity and private investment clients, we are involved in a broad cross-section of transactions and can see and spot deal issues from multiple sides of the table. We have a deep understanding of the latest market terms and trends and provide creative solutions to the most complex issues in evaluating, negotiating, structuring and consummating private equity transactions.

Dechert in Paris

Dechert's team in France consists of more than 90 highly regarded lawyers who collaborate with colleagues throughout Europe, the United States, Asia and the Middle East. We structure corporate and financial transactions, advise on a wide range of regulations, IP, antitrust and employment matters and resolve disputes through litigation or arbitration.

Dechert lawyers in France are widely recognized by market sources and leading legal directories. Our dynamic, results-focused team includes professionals with dual training in law and business. In addition to French law, many are qualified to practice U.S. or English law and are members of the bar in Paris, England and New York.

Private Equity in Paris

Our private equity team in France covers the whole spectrum of the investment life cycle, including buyouts, build-ups, exits, growth capital and venture capital, for both managers and private equity houses. We work for major financial investors, including private equity and venture capital firms advising on stock and asset sales and transfers, auction strategies, investments in portfolio companies, refinancing, restructurings and exit strategies.

We also have wide-ranging experience advising on M&A and capital markets matters relating to portfolio companies financed by private equity clients.

Recent Transactions

Examples of recent transactions on which Dechert advised include:

- **ArchiMed**, a European investment firm specialized in the Healthcare industries, in the partial sale of Polyplus-transfection® SA, a developer of innovative and cost-effective technology used in gene and cell therapy, to Warburg Pincus, a global private equity firm focused on growth investing.
- **One of the largest private equity firms in the world**, on the tax structuring in connection with the acquisition of the second biggest French operator of private hospitals and clinics.
- **Mérieux Equity Partners** in connection with its investment in the LBO on Ceva, the world's fifth largest veterinary pharmaceutical laboratory.
- **4Bio Capital** and **Ysios Capital**, as investors, in connection with SparingVision's €44.5 million Series A2 fundraising.
- **InnovaFeed**, a leader in the rearing of insects for animal feed, on the equity portion of its financing round, which represents half of the €140 million total fundraising value.
- **Robocath** in its €40 million series C round, as well as in its strategic agreement signed with MicroPort to set up a China-based joint-venture company.

About Dechert

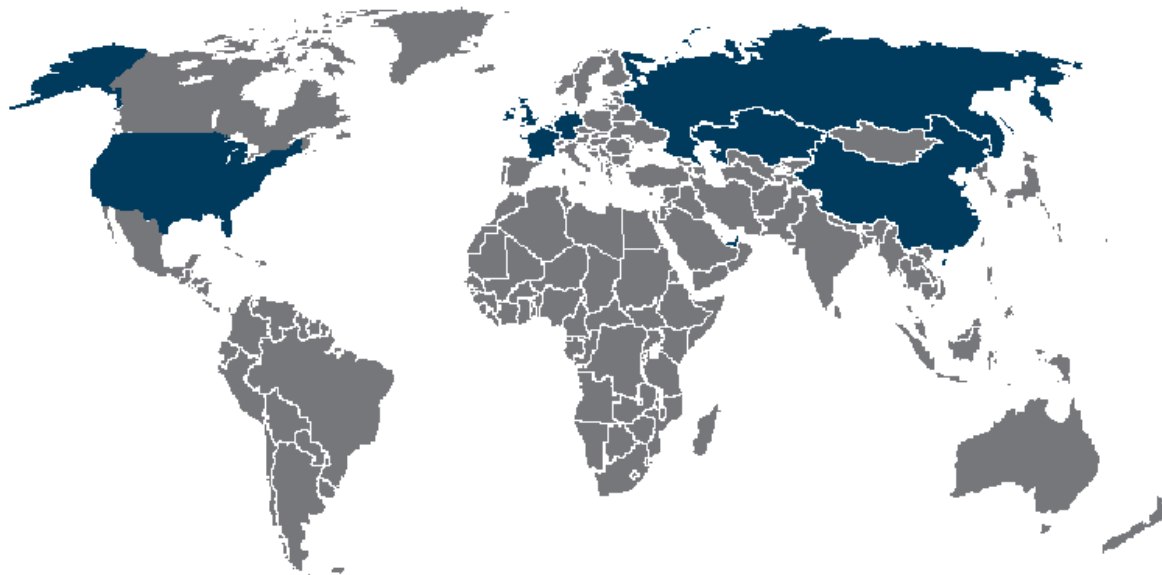
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