The Venture Capital Law Review

Editor
Hajime Tanahashi

The Law Reviews

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PREFACE

I am very pleased to present this first edition of *The Venture Capital Law Review*, for which it has been my honour to serve as editor.

A country's economic outlook can often be gauged by the environment for start-up companies within its borders. Start-ups are key drivers of the new technologies and industries that enable economies and society to flourish. The entire start-up ecosystem is important but the financing environment is key, which is where venture capital plays a pivotal role.

Despite all the hardships of the ongoing covid-19 pandemic, the venture capital sector has remained relatively resilient. While many countries saw some slowdown in venture capital investments in 2020, many also saw generally healthy growth in new fund formation and fundraising. Many governments are also fostering the start-up ecosystem in their countries through ongoing regulatory reforms, in addition to special measures enacted to ease the economic impact of the pandemic.

This publication provides a legal and regulatory overview of VC funds, including both fund formation and management. We look at the various types of legal entities and regulatory frameworks that are available in forming a fund, as well as the key terms of the agreements that are entered into between funds and their investors. We also highlight the regulatory environment for fund managers.

Of course, we also take a look at the raising of capital from the start-up perspective. Start-ups still primarily rely on VC funds to finance the various stages of their growth. However, we are seeing a variety of new fundraising options for start-ups – including crowdfunding – although these often encounter a different set of regulatory issues and restrictions.

Ultimately, the exit from a VC investment is important both to the VC fund and also to the start-up. We take a look at various exit options, which typically entail either an initial public offering or a negotiated acquisition of the start-up. The use of a SPAC (special purpose acquisition company) has been attracting interest as a potential exit mechanism, although the degree of availability of this structure varies widely across jurisdictions.

I hope that you will find this first edition of *The Venture Capital Law Review* to be an interesting and informative overview of the venture capital and start-up environment in many important jurisdictions around the world. I would like to thank the many leading practitioners who have generously contributed their time and expertise to make this publication possible.

Hajime Tanahashi
Mori Hamada & Matsumoto
Tokyo
August 2021

Chapter 5

FRANCE

Charles-Emmanuel Prieur, Laura Malach, Dalida Yusupova and Rebecca El-Hakim[1]

I OVERVIEW

In France, the private equity market has been structured for more than 25 years. The private equity market is still developing and regularly breaks records for fundraising and investments. It is made up of more than 400 management companies (366 of which are registered with France Invest, the association that brings together all the funds in the market). All of these actors raise nearly €30 billion per year from their financiers and invest about the same amount each year.

The private equity market is now the key growth driver for innovative small and medium-sized companies in France. Nearly 8,200 companies are currently supported by investment funds (of which 2,027 were financed in 2020).

The investment fund ecosystem is divided between a limited number of large funds specialising in LBOs and a large number of funds operating in the venture capital and growth equity markets. The most important funds in the LBO market are: Ardian, Advent International, Astorg, Cinven, Eurazeo, Montagu Private Equity and Apax Partners. This is a market that has always been buoyant and is still significantly so. For example, in 2021 Ardian raised its new LBO fund, which amounted to €7.5 billion, an all-time record in France and 60 per cent higher than its previous fund raised in 2016.

The current period is also very favourable for venture capital funds (Bpifrance, Kima ventures, Idinvest partners (which became Eurazeo Capital), Elaia Serena Capital, Partech, Alven Capital, Daphni). Digitalisation and technological innovations are bringing about a particularly exceptional period for this market, symbolised by the establishment of the French tech, an ecosystem financed and supported by public funds. A Secretariat of State has been set up to deal with the digital transition, the current minister being Mr Cédric O.

A number of new funds are also being set up to invest in infrastructure projects. Thirty-three funds invested more than €5.3 billion in 121 infrastructure projects (mainly renewable energy sites) in 2020.

II YEAR IN REVIEW

€18.5 billion was raised by French investment funds during 2020 compared to €20.9 billion in 2019 – a 12 per cent decrease. All figures are for investment funds registered with the association France Invest. This performance shows a certain resilience of the fundraising

1 Charles-Emmanuel Prieur is a managing partner, Laura Malach is a senior associate, and Dalida Yusupova and Rebecca El-Hakim are associates at UGGC Avocats.

market compared to previous years despite a difficult economic context. €5 billion was raised in infrastructure projects.[2] Capital invested by French investors represented 69 per cent of all capital raised in private equity over the past year, compared with 49 per cent in 2019. This decline in foreign investment is explained in particular by a decrease in large-scale capital raising and a corresponding increase in small and medium-scale capital raising.

The year 2020 was marked by an increase in funds between €100 million and €1 billion. Indeed, while these funds accounted for 38 per cent of fundraising in 2019, they accounted for 60 per cent of fundraising in 2020. These funds aspire to acquire new resources to support small and medium-sized enterprises and mid-market institutions in the coming years (these funds raised will be invested over the next five years).[3] Less than €3.5 billion was invested in large funds of more than €1 billion when it was more than €10 billion in 2019. But these large investments are made in a limited number of funds that do not raise a new vehicle every year. As a result, investments in LBO funds showed a 39 per cent reduction in 2020 compared to 2019 when, on the contrary, capital venture funds revealed a 35 per cent increase in investments in 2020 compared to 2019. Success of the French tech environment in favour of start-ups certainly explains the performance of venture capital activity.

The main investors in French investment funds are insurance companies (26 per cent), investment funds investing in funds (17 per cent), public institutions (15 per cent), and individual and family offices (13 per cent). These limited partners have invested in 239 vehicles created by fund managers.

Regarding investments, the total amount of investments in French companies decreased in 2020 compared to 2019. In fact, €19,300 million was invested in 2019, compared to €17,800 million in 2020. This represents a 9 per cent decrease in the total number of investments in 2020 compared to 2019.[4] In 2020, 60 per cent of investments are reinvestments. These figures show an increase in the number of reinvestments compared to the average annual weight of investments over the period 2010–2019. They accounted for 48 per cent of the total number of investments over this period. The funds supported their portfolio companies during this difficult pandemic period.

During 2020, we saw a sharp increase in the amount invested in the medical/biotech sector by 48 per cent compared to 2019, due to the attractiveness of this sector in the context of the health crisis. This increase in investment in this sector is due in particular to the increase in the supply of telemedicine, online prescriptions and urgent care at home. Of the €17,761 million invested in 2020, €4,287 million was invested in the medical/pharma and biotech sector. In addition, we also saw some progress in the IT sector, where €3,509 million was invested in 2020 compared to €2,865 million invested in 2019. Indeed, due to the crisis related to covid-19, which forced a large part of the global and French population to lock themselves in and resort to teleworking, the number of investments in this sector has not stopped growing. However, by the end of 2020, the trend is beginning to turn downwards due to the decline in activity of some companies.[5]

2 France Invest – Unlisted activity in France: private equity and infrastructure 2020.

3 France Invest – Unlisted activity in France: private equity and infrastructure 2020.

4 France Invest – Unlisted activity in France: private equity and infrastructure 2020.

5 EY Study 2020 – What is the impact of Covid-19 on companies' IT investment?

In 2020, 77 per cent of the companies supported are based in France, for 71 per cent of the amounts invested. These figures are up on 2019, in which 81 per cent of the companies supported were based in France, for 62 per cent of the amounts invested.[6]

III LEGAL FRAMEWORK FOR FUND FORMATION

i Legal structures for investment funds in France

There are several structures for capital funds in France. The choice between these different structures is made based on legal and tax criteria. But it is also guided by the type of investors to whom the fund will be marketed: non-professional investors or professional investors.

Concerning funds open to non-professional investors, venture capital funds mainly take the form of venture capital mutual funds (FCPRs) and their variations, which are innovation mutual funds (FCPIs) (investments in innovative companies) and local investment funds (FIP) (investments in companies located in a specific geographical area).

Funds reserved for professional investors often take the form of specialised professional funds (FPSs) or professional private equity funds (FPCIs). The *société de libre partenariat* (SLP) created in 2015 also constitutes a specialised professional fund that can be used for investment capital.

All of these funds – whether or not reserved for professionals – are alternative investment funds (AIFs) covered by the Monetary and Financial Code and subject to regulation and supervision by the French Financial Markets Authority (AMF). These AIFs 'by nature' are covered by the European AIFM Directive of 8 June 2011 – introduced in France by the Order of 25 July 2013 – and are defined as those that (1) raise capital from several investors with a view to investing it, in the interest of these investors, in accordance with an investment policy that these AIFs or their management companies define; and (2) are not undertakings for collective investment in transferable securities (UCITS).

In France, this category of 'AIF by nature' is opposed to the category of 'Other AIFs', which are investment vehicles that, although AIFs, are not expressly covered by the French Monetary and Financial Code.

Venture capital funds may also be set up in the form of French ordinary companies such as a *société anonyme* (SA) or a *société par actions simplifiée* (SAS) whose purpose is to manage investments in unlisted companies. In addition to these ordinary companies, France has a specific structure dedicated to private equity called the 'venture capital company' (SCR). The SCR is a joint-stock company whose purpose is to acquire stakes in unlisted companies and which benefits, as do its partners, from a preferential tax regime. The SCR is part of the 'Other AIF' category and benefits under certain conditions (1) from an exemption from corporate income tax and (2) from a privileged regime for its distributions and capital gains on disposal.

Specific structures dedicated to venture capital in France (notably FCPRs, FPSs, FPCIs and SCRs) are more often chosen than ordinary companies because of the special tax features they offer and which ensure investors a principle of tax neutrality. Indeed, the absence of effective taxation at the level of the legal structure is an essential criterion for being chosen to carry investments. The vehicle must not generate any tax friction and the investors – members of this vehicle – must therefore be taxed as if they had invested directly in the target portfolio.

6 France Invest – Unlisted activity in France: private equity and infrastructure 2020.

For non-professional investors, certain structures also offer additional tax advantages at the time of entry. This is the case with FCPI and FIP funds, which offer tax reductions simply by subscribing to shares. In addition to tax criteria and the distinction between professional and non-professional investors, the choice of fund will also depend on the asset class the fund wishes to hold. Some funds are in fact subject to investment quotas and asset structuring ratios stipulated by law.

Thus, for funds intended for non-professional investors:

a the assets of FCPIs must be made up of financial instruments defined by law and issued by companies qualified as innovative; the innovative character results in particular from a minimum percentage of research expenditure; and

b the assets of FIPs must consist of financial instruments defined by law and issued by companies operating mainly in establishments located in the regions chosen by the fund.

As regards funds reserved for professional investors, FPCIs must meet strict requirements regarding the composition of their assets, unlike FPSs. FPCIs are subject to investment quotas and asset structuring ratios set by law. FPSs, on the other hand, are not subject to any investment or holdings ratios. The rules of the FPSs may, however, define them but they will be contractual and not legal.

An FPS will therefore be preferred over an FPCI concerning the desired asset class. This FPS may take the form of a mutual fund (SICAV) or a limited partnership (SLP). The SLP was created in France in 2015 to offer private equity players a vehicle with great flexibility in the organisation of its operation. Indeed, the SLP is not restricted by law in the typology of assets in which it can invest, which makes it a malleable vehicle. Thus, it can be used in several types of investment strategies and can hold any type of asset (financial instruments, receivables, real estate, etc.).

ii Fund formation

The procedure for setting up most of the funds mentioned above does not follow the same legal regime depending on whether professional or non-professional investors are involved. The creation of funds open to non-professional investors (FCPR, FCPI and FIP) is subject to prior approval by the AMF. These funds are subject to strict rules on investment ratios, risk spreading and control. Funds open to professional investors (FPS, FPCI, SLP), on the other hand, are simply declared funds and are not subject to prior approval by the AMF. The formalities for declaring the formation of these funds are carried out after the fact.

FCPRs (and their variations, FCPIs and FIPs) – for non-professionals – and FPSs and FPCIs – for professionals – have the common characteristic of being entities without legal personality. A fund of this nature constitutes a co-ownership of financial instruments without legal personality. The investors in the fund are therefore not shareholders of the fund, as it is not a company. They hold units in the fund that give them co-ownership rights in the fund's assets. Since they do not have a legal personality, these funds necessarily have outsourced management. The law provides that these funds are managed and represented by a management company that must be approved by the AMF. To obtain approval, the management company must describe a programme of operations for each of the services it intends to provide. It must describe the funds it plans to create and the management guidelines for these funds. It is the management company that prepares the fund's constitutive documents. The law also gives it the power to take legal action to defend or assert the interests of unit holders. Management companies are remunerated by management fees, which are governed by the internal regulation of the fund. The management company does not have physical possession of the fund's assets. To strengthen the security of investors, the fund is required to appoint a custodian, which can only be chosen from among the institutions designated by law (banking institutions, etc.). The custodian's mission will be to hold the assets held by the fund and ensure that the fund's decisions are in line with the applicable legal and regulatory provisions.

The SCR or the funds incorporated as companies, in particular the SLP, are, on the other hand, entities with legal personality. They therefore have their own management bodies and can in principle manage themselves. Their management bodies are responsible for both the day-to-day management of the company within the meaning of company law and the management of their portfolio. However, they may choose to delegate the management of their portfolio to a management company. This will be the most common case in practice because the law provides that when an FIA does not delegate the management of the capital raised globally, it must itself meet the conditions applicable to portfolio management companies and comply with the provisions applicable to such companies, and therefore seek approval. This is why, in practice, these companies call upon ad hoc management companies.

Some 'Other AIFs', such as SCRs, may not be required to have an AMF-authorised management company if their assets under management are below the thresholds for application of the AIFM Directive and they have no non-professional investors. If these criteria are met, they may be managed by a legal entity that is not a portfolio management company and is therefore not authorised as such. The advantage of an SCR over an FIA 'by nature' is that it can avoid the obligation to be managed by an AMF-approved management company. Professional investors, however, prefer collective investment vehicles managed by management companies that must meet stringent requirements to receive AMF approval and are subject to AMF supervision.

iii Marketing of funds

The act of marketing AIF units consists of presenting them on French territory by various means (advertising, canvassing, advice, etc.) to induce a client to subscribe to or purchase them. The marketing regime is territorial – that is, each act of marketing to an investor located in France at the time it is carried out will be subject to the regime defined by the AMF.

However, the AMF has specified that there is no marketing when the subscription is made in response to a request from an investor, not as a result of a solicitation, concerning an AIF specifically designated by him. This is passive marketing or 'reverse solicitation'. The AMF has also introduced the pre-marketing regime, specifying that the practice of management companies or third parties acting on their behalf approaching a maximum of 50 investors to asses their appetite prior to the launch of an AIF does not constitute marketing when (1) it is carried out with professional investors or non-professional investors whose initial subscription would be equal or greater than €100,000 and (2) it is not accompanied by the delivery of a subscription form or documentation presenting definitive information on the characteristics of the fund that would enable these investors to subscribe or commit to subscribing to the units of the AIF to which this appetite test relates.

Management companies are authorised to market the units of the funds they manage and may therefore engage in canvassing. The management company may also provide the investor with investment advice (i.e., personalised recommendations).

IV FUND AGREEMENTS

FCPRs (and their variations, FCPIs and FIPs) – for non-professionals – and FPSs and FPCIs – for professionals – are governed by an internal regulation set of rules. The operating rules of funds set up as companies will be described in their articles of incorporation. The fund rules are the reference document that governs relations between investors and the management company and describes the fund's operating rules.

The rules of a fund reserved for professional investors will be negotiated with the investors. The following provisions will typically be found:

a a 'key person' clause that provides that the members of the management team undertake to devote part of their professional activity to the fund. In the event of the departure of one of these members, it is usually provided that the fund's unit holders have the power to demand either the definitive end of the investment period or the transfer of the management of the fund to another management company;

b a 'penalty' clause under which, in the event of misconduct by a member of the management team, the unit holders may vote, by a certain majority, for the departure of the said member and the loss of carried interest rights; and

c a 'change of control' clause, which provides that a change of control of the management company is subject to the prior approval of the fund's investors.

The rules of a fund reserved for non-professional investors will not include this type of clause and will most often constitute a contract of adhesion. The fund rules will be drawn up at the sole initiative of the management company and the investor will adhere to them without being able to negotiate them in advance. For these non-professional investors, the regulations will be supplemented by an investor information document (DICI), which will present the essential information necessary for the investor to make a decision and which will aim to help the investor understand the risks associated with venture capital investments.

The regulations or articles of association of a fund (whether professional or not) must contain the information required by the AMF, in particular (1) the minimum amount of assets; (2) the management orientation (i.e., the investment objective and strategy); (3) the principles implemented to protect the interests of unit holders; and (4) the economic sectors targeted, the types of financial instruments used and the geographical areas targeted. The regulations will also specify the life of the fund, the terms and periods for subscribing to units, the fund's governance structure, and all the costs borne by the unit holder.

The constitutive documents of the investment entity (fund rules or company articles of association) also provide for the terms and conditions relating to the carried interest mechanism. Carried interest allows the fund's management team to capture a fraction of the capital gain realised by the entity. Carried interest represents a preferential right granted to the management team over the performance of the investment entity and is generally set at 20 per cent.

Investors accept this dilution of their financial rights in favour of the management team provided that a certain level of profitability is achieved. In principle, no carried interest is paid until investors have been reimbursed for their contributions and received a hurdle return. This hurdle often corresponds to an annual return of between 6 and 8 per cent of the amount of the contributions paid by the investors.

In France, carried interest rights are generally structured as a specific class of shares issued by the investment entity. France also has a preferential tax regime applied to the carried interest mechanism, which allows the management team to benefit from the capital gains tax regime on the sale of company rights and securities and to avoid taxation of the carried interest as salary and wages. This preferential regime is only intended to apply to certain funds covered by the law and subject to certain conditions.

V FUND MANAGEMENT

Management companies that manage and represent venture capital funds are subject to several obligations throughout their existence. The AMF's General Regulation requires them to have dedicated material and technical resources that are sufficient and appropriate for the instruments used and the proposed management, as well as control and security systems. Thus, they must be able to justify at all times a level of equity at least equal to the thresholds provided for in the AMF General Regulation.

They must have procedures in place to detect any risk of non-compliance with their professional obligations. They are required to have a compliance and internal control officer (RCCI). Management companies may be sanctioned by the AMF Enforcement Committee for non-compliance with applicable regulations. The AMF reitarates that management companies must comply with rules of good conduct and act honestly, fairly and professionally in the best interests of investors.

They should therefore implement a risk management policy that identifies the risks of the collective investments they manage. A management company should monitor liquidity risk by the fund to ensure an appropriate level of liquidity for each fund, taking into account investment strategies and redemption policies. In order to monitor liquidity risk, the management company must regularly perform stress tests, under normal and exceptional liquidity conditions, which allow it to assess the liquidity risk of the funds.

Management companies must also comply with transparency requirements vis-à-vis investors and the AMF. They must provide information (1) to AIF unit holders by publishing an annual report for each financial year for each AIF they manage and (2) to the AMF by providing various information, including on the composition of the AIF's assets and on the monitoring of the AIF's liquidity risk described above.

On an ancillary basis, asset management companies may be authorised to provide certain investment services as defined by MiFID II. These services are investment advice and the reception and transmission of orders on behalf of third parties. These services may only be provided if the management company is expressly authorised by the AMF to provide them.

VI RAISING CAPITAL BY START-UPS

i Overview

France has more than 10,000 start-ups, a number that increases by at least 20 per cent each year. As an illustration, in 2019, French start-ups raised over €4.5 billion, an increase of 25 per cent compared to 2018.[7] The world of French start-ups, commonly known as 'La French Tech', is divided into several ecosystems. These ecosystems are all actively supported by the French government and more precisely the Public Investment Bank (BPI). Among these different ecosystems, many start-ups have realised different rounds of investments:

a advertising and marketing companies (adtech and martech) such as Contentsquare;

7 KPMG Pulse: Start-up: the key figures of the ecosystem to know in 2020.

b fintech and assurtech (finance and insurance companies) (Lydia, Alan, Lemonway, October and Qonto);
c foodtech (Frichti, Ynsect and Microphyt);
d biotech and medtech (Doctolib, Qare and Withings);
e entertainment and mediatech (Voodoo, Deezer and Brut);
f mobility companies (BlablaCar and Cityscoot); and
g the retail and e-commerce sector with many start-ups such as Veepee, Back Market and ManoMano.[8]

For venture capital, investments in start-up amounted to €5 billion in 2020, which remained stable compared to 2019 (€4.9 billion) despite the covid-19 pandemic: 646 rounds were financed in 2020 compared to 677 rounds in 2019. We are witnessing an unprecedented situation with an increase in investment intentions in innovation capital and with a significant increase in realised investments. Indeed, the forecast for venture capital intentions is up by 35 per cent in 2020 compared to 2019. And in the first half of 2021, the French Tech raised €4.73 billion. In 2020, at the same period, French Tech raised €2.72 billion. This represents an increase of more than 74 per cent and almost all the amounts raised in 2020. In the first half of 2021, French Tech completed nine mega-investment rounds (i.e., rounds of over €100 million) and 10 operations between €50 and €100 million (i.e., 19 very large tickets compared to 14 last year).[9]

In recent years, France has seen the emergence of 'trust-based' seed rounds. This new version of seed funding is based on the personality of an entrepreneur who has already created and successfully sold start-ups. In the first quarter of 2021, French Tech recorded the highest seed rounds of this kind in its history, namely: €15 million for mobile game publisher Homa Games, invested by Idinvest, e.ventures and OneRagtime and including debt and grants from BPIFrance; €7 million for Kili Technology, a specialist in data annotation for artificial intelligence, financed by e.ventures, Serena, Kima Ventures, Financière Saint James and business angels; and €6 million for Cajoo, in the food delivery market, backed by First and Xange.[10]

France currently has 15 'unicorns'. Unicorns are start-ups with a valuation of more than US$1 billion. Unicorns are also companies whose growth is so rapid that they can raise several million dollars or euros in a single round of financing to continue to develop.[11] Thus, the business model of unicorns is initially based on rapid growth, financed by external funds that have to make bolder bets to avoid missing out on great opportunities, before focusing on its profitability and revenues.

On the podium are Contentsquare (more than US$2.5 billion), ManoMano (US$2.4 billion) and Blablacar, valued at nearly US$2 billion. Also near the podium are Alan (insurance) and Vestiaire Collective (retail), valued at US$1.7 billion and US$1.0 billion respectively. In 2020, Voodoo, which specialises in games for smartphones, has raised almost US$400 million, an unofficial figure as the fundraising amount has not been made public. Mirakl (platform for marketing activities) raised US$300 million in Series D funding, valuing

8 https://ecosystem.lafrenchtech.com.
9 La Tribune – Exceptional half-year for French Tech: 4.7 billion euros raised, almost as much as the whole of 2020 – 2 July 2021.
10 Private equity magazine – April 2021 – Survey: seed capital: ready for take-off.
11 Les Echos – 'What is a tech unicorn, anyway?' – Vicki Owen – 17 December 2020.

it at over US$1 billion. The year 2021 started slowly but has seen an exceptionnal rebound since April 2021, which started with Alan (US$185 million Series D). A new record was set in May 2021 by Contentsquare, a French start-up specialised in online user journey analysis, which announced that it had raised US$500 million, now valued at US$2.8 billion. Immediately followed by Back Market (marketplace for consumer electronics) US$335 million Series D also in May 2021, by ManoMano (gardening and DIY community) US$ 355 million Series F in June 2021 and by Ledger (electronic security) US$380 million Series C also in June 2021.

ii Raising capital

The start-up development process in France includes fundamental key stages and for each stage has its own financing methods:

a concept development: the start-up is financed by its founders' own funds;

b creation of the company (initiation): the start-up is financed by its founders' own funds or by its friends and family (also known as 'love money'), by business angels and with loans (Bpifrance Investissement creation guarantee and participating loans, loans of Scientipöle, Réseau Entreprendre, Initiative France, etc.), tax advantages (tax credits, reduced employer's contributions, etc.);

c seed or pre-seed: at this stage the start-up is financed by raising seed capital (usually between €500,000 and €1 million), by business angels or by public funding;

d scaling: the start-up is financed by a Series A fundraising (between €1 and €5 million) or by public funding; and

e expansion: the start-up is financed by a Series B or C fundraising (more than €5 million) or by public funding.

The exceptional period of fundraising that France has experienced in recent months has resulted in an increase in the amounts of each type of fundraising and it is not uncommon to see seed capital rounds of more than €1 million (e.g., MayDay US$2.5 million seed round in June 2021) and Series A at €15 million and more (e.g., YouSign US$36 million Serie A in June 2021) and Series B at over €30 million (e.g., FairMoney US$42 million Series B in July 2021).

All stages of financing with the exception of IPO are governed by French common law (i.e., the Civil Code, the Financial and Monetary Code and the Commercial Code). The founders and investors establish a contractual relationship between them by entering into the investment agreement, shareholders' agreement and, as the case may be, a representations and warranties agreement.

Early stage

Crowdfunding, introduced in France in 2014,[12] is only used in the early stages of development whether in the form of equity, donations (with or without consideration), loans or royalties (if the start-up is able to generate turnover quickly). The first two are the most commonly used by French start-ups: equity to increase equity capital and encourage love money, and donations, particularly with consideration, which correspond to pre-sales to test the market, carry out a communication campaign, and finance the industrialisation of the first series. Crowdfunding is rarely, if at all, developed for Series A, B and C financings, as originally it

12 Order No. 2014-559 30 May 2014.

does not organise liquidity and does not set a framework for enhanced reporting to investors. Thus, equity crowdfunding ultimately creates the situation that French company law has always sought to avoid: a shareholder base weakened by its fragmentation and without an effective exit route.

Initial coin offering (ICO), a hybrid between the crowdfunding and fundraising, represented €80 million in 2017, with three transactions realised in France (Beyond the Void, iEx.ec, Domraider).[13] This cryptocurrency fundraiser allows blockchain start-ups to access funding very quickly. While cryptocurrency-related markets have fallen sharply in 2018, the French government has adopted the 'Pacte' Acte,[14] which gave a legal framework to ICOs and the possibility for the French Financial Markets Authority (AMF) to issue a label to serious projects and with certain guarantees such as a mechanism for securing the funds raised. The AMF's General Regulation gives details of the optional visa to which project holders may subscribe. The issuer of tokens must be a legal entity established or registered in France. ICOs must be subscribed to by the general public by more than 150 people. In other words, no fundraising from a few large qualified investors. Despite the potential token earning and an investment opportunity open to all internationally, ICO does not only have advantages: there is still a very unstable legal and regulatory corpus (KYC, etc.), the lack of information and knowledge of individuals, facilitating scams and frauds, and the volatility of tokens whose value depends entirely on the project financed. This explains why, at present, projects awaiting approval of the AMF can be counted on the fingers of one hand.

Series A and alternative instruments

While French start-ups benefit from strong support from the French government and use all the opportunities given by the digital world at early stages, traditional equity fundraising is still the most common way to raise capital. There are more than 150 funds in France, which intervene at different stages in the life of the company (seed, venture capital, development funds), and are often sector-based. The seed financing is widely used by the funds by way of subscription to preferred shares giving to investors the liquidation preferences, information rights and precipitated dividends. However, the preferred shares issue requires the company's auditors' monitoring. Therefore, the French regulations allow some flexibility to the simplified joint-stock companies (*sociétés par actions simplifiée*), the company form mostly used by start-ups. Such companies may issue contractually labelled shares containing the same rights without an intervention of a special benefits auditor. In such case, this type of shares is included in the company's articles of association, which commonly contain a clause pursuant to which such shares may be converted to preferred shares upon the investor's request. In both cases, the parties basically enter into (1) an investment agreement setting out the condition precedent, if any, representations and warranties and other conditions to their entry into the share capital of the company, and (2) a shareholders' agreement in order to set up the provisions regulating share transfers, detailing liquidation preferences, framing the liquidity process (future IPO conditions) or other exit possibilities such as drag along, the good and bad leaver options of current managers of the company, and non-compete provisions, which are particular key terms used in the vast majority of transactions at this stage of financing.

13 PWC 'From the ideation phase to the early stage: financing a start-up'.

14 Law No. 2019-486, 22 May 2019 on business growth and transformation.

Even in simplified joint-stock companies, raising funds by way of share issue is a long and selective process, which is sometimes necessary (in certain sectors such as biotechs, which are very capital-intensive with a very long time to market), and often recommended if one wishes to accelerate and develop rapidly internationally, but which is not the only possible development model for young innovative companies. More modest growth based on turnover on a small enterprise model is a real economic alternative, particularly for managers who wish to remain at the head of their project for the long term. The practice is increasingly oriented towards alternative financing methods, with a common philosophy: immediate payment of funds and conversion into shares at a later date, according to a future valuation ('AIR' warrants (*BSA Air accord d'investissement rapide*), convertible bonds, bonds redeemable in shares, among others). These securities skilfully postpone the thorny issue of valuation of the company. The common philosophy of these new fundraising methods is simple: initially, an immediate payment of funds by the investors to the company; then, in the long term, a conversion into shares of the amounts made available to the company, according to a valuation decided at the time of this conversion. In most cases, the conversion takes place at the time of the next significant fundraising and on the basis of the price per share retained at the time of this fundraising, applying a discount of the order of 15 to 25 per cent, to reward the risk taken by the investor.

While convertible bonds and bonds redeemable in shares are frequently used and well known to investors who easily balance between the remuneration of the bonds (by interest, often paid at maturity and which may or may not be added to the conversion basis) and the level of discount provided for at the time of conversion, they have added the AIR warrants, previously used by friends and family at earlier stages due to their simplicity, to the list of assets in which they invest. These warrants are inspired by Ycombinator's 'Simple Agreement for Future Equity', which enables rapid financing to be obtained by postponing some of the phases required for a traditional capital investment, in particular the question of the company's valuation and discussions relating to the shareholders' agreement. This instrument has the advantage of being turnkey, now well known on the market and available in open source.

The AIR warrant will give its holder the right to subscribe, at par value, to a number of shares that will be determined in accordance with a formula, depending on the intervention of a subsequent event (e.g., a new financing round, an operation leading to a change of control of the company, a merger or an IPO). This subsequent event allows the company's valuation to be established within the framework of a floor and a cap valuation established in the AIR warrant issue contract. The practice has therefore shifted massively towards AIR warrants, which, with virtually standardised legal documentation and a very limited shareholders' agreement, make it possible to combine efficiency, speed of execution and cost control, particularly because of the absence of legal formalities. However, as of the 'Pacte' Act, the companies have to solicit a statutory auditor, who will have to give an opinion on the issue price of an AIR warrant, even though the purpose of the latter is – in particular – to be valued by reference to an unknown future valuation. In summary, this reform introduced by the 'Pacte' Act will lead to an increase in the process and costs especially for 'early stage' start-ups, which need to carry out their operations urgently and at a lower cost.

Later stage

Despite the strong development of start-ups in France, they had difficulties in raising funds at later stages (i.e., for fundraising above €50 million), and at the IPO stage – due to the lack of investors specialising in these segments in France.[15] But 'La French Tech', the French ecosystem supported by French public institutions is starting to change this perspective. The number of funds specialising in growth equity is higher than ever and consists of typical venture funds raising more money than in the past in new vehicles to finance Series B and C rounds and also consists of leveraged buyout funds that are moving into debt-free equity investment. Institutional investors are increasingly encouraged by the French government to devote a larger part of their allocations by financing French innovation capital funds with a vocation to manage more than €1 billion in favour of unlisted companies on a later stage and, for the listed companies, by developing global tech funds, which will enable the structuring in France of a leading expertise in the financing of technology companies, in particular.

VII EXIT

i Typical and preferred exit used by venture capital funds in France

In 2020, 1,322 companies were sold in an exit process, a decrease of 86 compared to 2019. This decrease is explained by the willingness of the private equity players to postpone divestments because of the pandemic. However, the number of companies sold in 2020 remains above the historical average (an annual average of 1,117 companies sold).

In France, while the myth of the initial public offering (IPO) remains important, it has been shown in recent years that this type of exit concerns a marginal percentage of divestments. Indeed, in 2020 divestment via an IPO was not at all successful, with no divestments achieved via an IPO (compared to three exits by way of IPOs in 2019).[16] The failure of IPO deals can be linked to the exponential development of international accounting standards, but also to governance codes and stock exchange regulations that make the IPO process more difficult.

Thus, the sale of non-listed companies is more favourable for buyers who focused on the long-term development of the company. Furthermore, for private equity operators wishing to exit a company's share capital, the IPO involves a significant cost representing between 5 and 10 per cent of the funds raised, but also administrative and accounting obligations.

Contrary to the above, in France, the most popular divestments are those made to industrialists or private equity companies (+13 per cent in 2020 versus 2019, in terms of amounts divested at historical cost). In 2020, the percentage of amounts divested in favour of industrials represents 25 per cent (€1.18 billion), an increase of 8 per cent compared to 2019. An exit process to an industrial purchaser is based on a totally different logic than an IPO. The industrial purchaser is not only guided by financial criteria but also by economic and industrial criteria.

The objective of the buyer is to develop the company by generating goodwill from industrial or commercial synergies. Very often, the exit through an industrialist allows the latter to enter a new market in its own field of activity. This being said, the exit process through an industrialist can therefore raise obvious competition law issues and make the sale process more complicated by having to obtain authorisation from the French antitrust

15 Report to the Minister of Economy and Finance by Mr Philippe Tibi, July 2019.

16 France Invest – Unlisted activity in France: private equity and infrastructure 2020.

authority or the European Commission. Furthermore, in the context of an exit through industrialists, the sellers are often faced with the matter of the representations and warranties granted to the industrialist. In practice, it is obvious that when industrialists dispose of their businesses they grant representation and warranties to the purchaser. Conversely, in the case of acquisitions of a start-up by industrialists the sellers are confronted with this issue and are often forced to grant representations and warranties which may involve the payment of significant indemnities.

In 2020, the percentage of amounts disinvested to private equity companies represented 39 per cent (€2.76 billion), an increase of 3 per cent compared to 2019. The sale of shares by the investor to another investment fund via a secondary leveraged buyout is the most common exit method in France. The main challenge of this type of exit is the difference in interest between the existing investor, who wishes to increase the value of his investment at exit, and the remaining shareholders, who wish to find a new financial investor who has the same vision of the company's development and performance.

The exit by way of sale to the management is also a common exit strategy in France. In 2020, exit by transfer to the management represented 9 per cent of the amounts sold (i.e., €636 million). In practice, the managers wishing to acquire the shares held by the outgoing investor seek both a bank loan and an investment fund to participate in the acquisition alongside them, while remaining in the minority.

ii Special purpose acquisition companies

The IPO through a special purpose acquisition company (SPAC) has recently been successful in France. This type of operation has been experimented with very little by the French market operators. The first SPAC listed on Euronext Paris was Mediawan, founded by Pierre-Antoine Capton, Xavier Niel and Matthieu Pigasse. This SPAC was endowed with €250 million and was launched in April 2016.The second French SPAC was 2MX Organic, founded at the end of 2020 by Xavier Niel and Matthieu Pigasse, and headed by Moez-Alexandre Zouari. This SPAC aims to invest in retail companies.

Since the beginning of 2021, the AMF has reported a significant increase in the number of proposed SPAC listings projects on the Paris stock exchange. French legislation is favourable to the development of SPACs. Indeed, the French legal instruments in favour of SPACs cover the following points:

a the issuance of preferred shares, which allows the issuance of shares with specific rights and allows a distinction between shares subscribed for by the founders and sponsors and those subscribed for by investors within the SPAC;

b the issuance of redeemable preference shares for the benefit of investors. This legal instrument allows investors to sell the shares they hold through the SPAC if they do not wish to remain shareholders in the company after the initial business combination;

c the issuance of share warrants, which allows investors to acquire in the future shares of the SPAC at a predetermined price and thus benefit from the eventual success of the company after the initial business combination; and

d the possibility to escrow the funds raised during the IPO and pending the initial business combination. In France there are several types of escrow that can be used and they are characterised by their flexibility.

Over the past months, SPAC launchings have been increasing in France, in various sectors, including (1) production and distribution of consumer durables (2MX Organic); (2) energy transition (Transition); (3) the tech industry (DEE Tech); and (4) foodservice, flex office, wellness, entertainment, events and hotel-related technologies (Accor Acquisition Company). This new kind of investment vehicles allows companies seeking to access the capital markets a lower cost alternative to traditional IPOs. Although the number of SPACs seems to be increasing, the performance of these investment vehicles is still uncertain.

VIII OUTLOOK

Previously considered with reserve, the ESG (environmental, social and governance) criteria are now the subject of increasing attention by venture capital funds. Beyond the differentiation strategy adopted by some investors, criteria related to corporate responsibility or seeking to integrate the notion of sustainability are now an important part of the investment models of many funds in the French marketplace. Until recently, the focus was primarily on the organisation of corporate governance. However, a significant part of the venture capital industry is now developing a growing sensitivity to social and sustainability issues.

This integration of ESG principles is reflected in the conduct of due diligence but also in the highlighting of companies with a positive impact on the economy. Furthermore, the performance of an investment and the value creation process are no longer measured solely on purely financial criteria. This trend is expected to continue.

There are also growing changes in the nature of investors.

While the world of venture capital was usually reserved to institutional players and large family offices, some major investment funds are looking to raise money with individual investors. In fact, the French have largely saved money during the period of confinement due to covid-19 (public institutions mention the figure of €125 billion) and the world of private equity is trying to position itself to collect part of these savings to invest. To do this, many funds are thinking of opening up the subscription of new vehicles for individuals.

For example, on 1 October 2020, Bpifrance opened the subscription of 'BPIfrance Entreprises 1', an investment fund aimed at investing in 1,500 French non-listed companies and every individual had the possibility to access it in exchange for a minimum investment of €5,000. Beyond the 'patriotic' objective of this investment fund, this new vehicle increases the democratisation of the venture capital industry. Indeed, the fund was limited to €100 million but was fully subscribed three months in advance and Nicolas Dufourcq, Bpifrance's General Manager announced that a new vehicle of that type was already being considered.

Appendix 1

ABOUT THE AUTHORS

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Charles-Emmanuel Prieur has spent his entire professional career at UGGC Avocats and became a partner in 2006. He was appointed managing partner of the firm in 2011. He enjoys working on M&A and private equity cases because it allows him to work with entrepreneurs. In an external growth operation of a large group or in a fundraising of a start-up, there is always the discovery of a new business and an original business project. His job is then to show that company law offers all the necessary tools to enable the entrepreneur to carry out his particular project.

Charles-Emmanuel advises industrial and commercial operators in their external growth operations and asset acquisitions. He acts on behalf of investment funds or managers in the context of venture capital, private equity or LBO transactions. Charles-Emmanuel also advises his clients on internal corporate law structuring (regulatory, governance, management packages) and defends them in litigation or arbitration related to equity and financing transactions.

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