Why the valuation of intangible assets matters: the unstoppable rise of intangibles’ reporting in the 21st century’s corporate environment

It is high time France and the UK up their game in terms of accounting for, reporting and leveraging the intangible assets owned by their national businesses and companies, while Asia and the US currently lead the race, here. European lenders need to do their bit, too, to empower creative and innovative SMEs, and provide them with adequate financing to sustain their growth and ambitions, by way of intangible assets backed-lending.

Back in May 2004, I published an in-depth study on the financing of luxury brands, and how the business model developed by large luxury conglomerates was coming out on top. 16 years down the line, I can testify that everything I said in that 2004 study was in the money: the LVMH, Kering, Richemont and L'Oreal of this word dominate the luxury and fashion sectors today, with their multibrands' business model which allows them to both make vast economies of scale and diversify their economic as well as financial risks.

However, in the midst of the COVID 19 pandemic which constrains us all to work from home through virtual tools such as videoconferencing, emails, chats and sms, I came to realise that I omitted a very important topic from that 2004 study, which is however acutely relevant in the context of developing, and growing, creative businesses in the 21st century. It is that intangible assets are becoming the most important and valuable assets of creative companies (including, of course, luxury and fashion houses).

Indeed, traditionally, tangible and fixed assets, such as land, plants, stock, inventory and receivables were used to assess the intrinsic value of a company, and, in particular, were used as security in loan transactions. Today, most successful businesses out there, in particular in the technology sector (Airbnb, Uber, Facebook) but not only, derive the largest portion of their worth from their intangible assets, such as intellectual property rights (trademarks, patents, designs, copyright), brands, knowhow, reputation, customer loyalty, a trained workforce, contracts, licensing rights, franchises.

Our economy has changed in fundamental ways, as business is now mainly “knowledge based”, rather than industrial, and “intangibles” are the new drivers of economic activity, the Financial Reporting Council (“**FRC**”) set out in its paper “Business reporting of intangibles: realistic proposals”, back in February 2019.

However, while such intangibles are becoming the driving force of our businesses and economies worldwide, they are consistently ignored by chartered accountants, bankers and financiers alike. As a result, most companies – in particular, Small and Medium Enterprises (“**SMEs**”)- cannot secure any financing with money men because their intangibles are still deemed to … well, in a nutshell … lack physical substance! This limits the scope of growth of many creative businesses; to their detriment of course, but also to the detriment of the UK and French economies in which SMEs account for an astounding 99 percent of private sector business, 59 percent of private sector employment and 48 percent of private sector turnover.

How could this oversight happen and materialise, in the last 20 years? Where did it all go wrong? Why do we need to very swiftly address this lack of visionary thinking, in terms of pragmatically adapting double-entry book keeping and accounting rules to the realities of companies operating in the 21st century?

How could such adjustments in, and updates to, our old ways of thinking about the worth of our businesses, be best implemented, in order to balance the need for realistic valuations of companies operating in the “knowledge economy” and the concern expressed by some stakeholders that intangible assets might peter out at the first reputation blow dealt to any business?

1. What is the valuation and reporting of intangible assets?

1.1. Recognition and measurement of intangible assets within accounting and reporting

In the European Union ("**EU**"), there are two levels of accounting regulation:

- the international level, which corresponds to the International Accounting Standards ("**IAS**"), and International Financial Reporting Standards ("**IFRS**") issued by the International Accounting Standards Board ("**IASB**"), which apply compulsorily to the consolidated financial statements of listed companies and voluntarily to other accounts and entities according to the choices of each country legislator, and
- a national level, where the local regulations are driven by the EU accounting directives, which have been issued from 1978 onwards, and which apply to the remaining accounts and companies in each EU member-state.

The first international standard on recognition and measurement of intangible assets was International Accounting Standard 38 ("**IAS 38**"), which was first issued in 1998. Even though it has been amended several times since, there has not been any significant change in its conservative approach to recognition and measurement of intangible assets.

An asset is a resource that is controlled by a company as a result of past events (for example a purchase or self-creation) and from which future economic benefits (such as inflows of cash or other assets) are expected to flow to this company. An intangible asset is defined by IAS 38 as an identifiable non-monetary asset without physical substance.

There is a specific reference to intellectual property rights

(“**IPRs**”), in the definition of “intangible assets” set out in paragraph 9 of IAS 38, as follows: *“entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights”*.

However, it is later clarified in IAS 38, that in order to recognise an intangible asset on the face of balance sheet, it must be identifiable and controlled, as well as generate future economic benefits flowing to the company that owns it.

The recognition criterion of “identifiability” is described in paragraph 12 of IAS 38 as follows.

“An asset is identifiable if it either:

a. is separable, i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

b. arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations”.

“Control” is an essential feature in accounting and is described in paragraph 13 of IAS 38.

“An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the

underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way".

In order to have an intangible asset recognised as an asset on company balance sheet, such intangible has to satisfy also some specific accounting recognition criteria, which are set out in paragraph 21 of IAS 38.

"*An intangible asset shall be recognised if, and only if:*

a. it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

b. the cost of the asset can be measured reliably".

The recognition criteria illustrated above are deemed to be always satisfied when an intangible asset is acquired by a company from an external party at a price. Therefore, there are no particular problems to record an acquired intangible asset on the balance sheet of the acquiring company, at the consideration paid (i.e. historical cost).

1.2. Goodwill v. other intangible assets

Here, before we develop any further, we must draw a distinction between goodwill and other intangible assets, for clarification purposes.

Goodwill is an intangible asset that is associated with the purchase of one company by another. Specifically, goodwill is the portion of the purchase price that is higher than the sum of the net fair value of all of the assets purchased in the acquisition and the liabilities assumed in the process (= purchase price of the acquired company – (net fair market value of identifiable assets – net fair value of identifiable liabilities)).

The value of a company’s brand name, solid customer base, good customer relations, good employee relations, as well as proprietary technology, represent some examples of goodwill, in this context.

The value of goodwill arises in an acquisition, i.e. when an acquirer purchases a target company. Goodwill is then recorded as an intangible asset on the acquiring company’s balance sheet under the long-term assets’ account.

Under Generally Accepted Accounting Principles (“**GAAP**”) and IFRS, these companies which acquired targets in the past and therefore recorded those targets’ goodwill on their balance sheet, are then required to evaluate the value of goodwill on their financial statements at least once a year, and record any impairments.

Impairment of an asset occurs when its market value drops below historical cost, due to adverse events such as declining cash flows, a reputation backlash, increased competitive environment, etc. Companies assess whether an impairment is needed by performing an impairment test on the intangible asset. If the company’s acquired net assets fall below the book value, or if the company overstated the amount of goodwill, then it must impair or do a write-down on the value of the asset on the balance sheet, after it has assessed that the goodwill is impaired. The impairment expense is calculated as the difference between the current market value and the purchase price of the intangible asset. The impairment results in a decrease in the goodwill account on the balance sheet.

This expense is also recognised as a loss on the income statement, which directly reduces net income for the year. In turn, earnings per share ("**EPS**") and the company's stock price are also negatively affected.

The Financial Accounting Standards Board ("**FASB**"), which sets standards for GAAP rules, and the IASB, which sets standards for IFRS rules, are considering a change to how goodwill impairment is calculated. Because of the subjectivity of goodwill impairment, and the cost of testing impairment, FASB and IASB are considering reverting to an older method called "goodwill amortisation" in which the value of goodwill is slowly reduced annually over a number of years.

As set out above, goodwill is not the same as other intangible assets because it is a premium paid over fair value during a transaction, and cannot be bought or sold independently. Meanwhile, other intangible assets can be bought and sold independently.

Also, goodwill has an indefinite life, while other intangibles have a definite useful life (i.e. an accounting estimate of the number of years an asset is likely to remain in service for the purpose of cost-effective revenue generation).

1.3. Amortisation, impairment and subsequent measure of intangible assets other than goodwill

That distinction between goodwill and other intangible assets being clearly drawn, let's get back to the issues revolving around recording intangible assets (other than goodwill) on the balance sheet of a company.

As set out above, if some intangible assets are acquired as a consequence of a business purchase or combination, the acquiring company recognises all these intangible assets, provided that they meet the definition of an intangible asset. This results in the recognition of intangibles – including brand names, IPRs, customer relationships – that would not have been recognised by the acquired company that developed them in the first place. Indeed, paragraph 34 of IAS 38 provides that "*in accordance with this Standard and IFRS 3 (as revised in 2008), an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree, if the project meets the definition of an intangible asset. An acquiree's in-process research and development project meets the definition of an intangible asset when it:*

a. meets the definition of an asset, and

b. is identifiable, i.e. separable or arises from contractual or other legal rights."

Therefore, in a business acquisition or combination, the intangible assets that are "identifiable" (either separable or arising from legal rights) can be recognised and capitalised in the balance sheet of the acquiring company.

After initial recognition, the accounting value in the balance sheet of intangible assets with definite useful lives (e.g. IPRs, licenses) has to be amortised over the intangible asset's expected useful life, and is subject to impairment tests when needed. As explained above, intangible assets with indefinite useful lives (such as goodwill or brands) will not be amortised, but only subject at least annually to an impairment test to verify whether the impairment indicators ("triggers") are met.

Alternatively, after initial recognition (at cost or at fair value in the case of business acquisitions or mergers), intangible assets with definite useful lives may be revalued at fair value less amortisation, provided there is an active market for the asset to be referred to, as can be inferred from paragraph 75 of IAS 38:

"*After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be measured by reference to an active market. Revaluations shall be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value*."

However, this standard indicates that the revaluation model can only be used in rare situations, where there is an active market for these intangible assets.

1.4. The elephant in the room: a lack of recognition and measurement of internally generated intangible assets

All the above about the treatment of intangible assets other than goodwill cannot be said for internally generated intangible assets. Indeed, IAS 38 sets out important differences in the treatment of those internally generated intangibles, which is currently – and rightfully – the subject of much debate among regulators and other stakeholders.

Internally generated intangible assets are prevented from being recognised, from an accounting standpoint, as they are being developed (while a business would normally account for internally generated tangible assets). Therefore, a significant proportion of internally generated intangible assets is not recognised in the balance sheet of a company. As a consequence, stakeholders such as investors, regulators, shareholders, financiers, are not receiving some very relevant information about this enterprise, and its accurate worth.

Why such a standoffish attitude towards internally generated intangible assets? In practice, when the expenditure to develop intangible asset is incurred, it is often very unclear whether that expenditure is going to generate future economic benefits. It is this uncertainty that prevents many intangible assets from being recognised as they are being developed. This perceived lack of reliability of the linkage between expenditures and future benefits pushes towards the treatment of such expenditures as "period cost". It is not until much later, when the uncertainty is resolved (e.g. granting of a patent), that an intangible asset may be capable of recognition. As current accounting requirements primarily focus on transactions, an event such as the resolution of uncertainty surrounding an internally developed IPR is generally not captured in company financial statements.

Let's take the example of research and development costs ("**R&D**"), which is one process of internally creating certain types of intangible assets, to illustrate the accounting treatment of intangible assets created in this way.

Among accounting standard setters, such as IASB with its IAS 38, the most frequent practice is to require the immediate expensing of all R&D. However, France, Italy and Australia are examples of countries where national accounting rule makers allow the capitalisation of R&D, subject to conditions being satisfied.

Therefore, in some circumstances, internally generated intangible assets can be recognised when the relevant set of recognition criteria is met, in particular the existence of a clear linkage of the expenditure to future benefits accruing to the company. This is called condition-based capitalisation. In these cases, the cost that a company has incurred *in that financial year*, can be capitalised as an asset; the previous costs having already been expensed in earlier income statements. For example, when a patent is finally granted by the relevant intellectual property office, only the expenses incurred *during that financial year* can be capitalised and disclosed on the face of balance sheet among intangible fixed assets.

To conclude, under the current IFRS and GAAP regimes, internally generated intangible assets, such as IPRs, can only be recognised on balance sheet in very rare instances.

2.Why value and report intangible assets?

As developed in depth by the European Commission (“**EC**”) in its 2013 final report from the expert group on intellectual property valuation, the UK intellectual property office (“**UKIPO**”) in its 2013 “Banking on IP?” report and the FRC in its 2019 discussion paper “Business reporting of intangibles: realistic proposals”, the time for radical change to the accounting of intangible assets has come upon us.

2.1. Improving the accurateness and reliability of financial communication

Existing accounting standards should be advanced, updated and modernised to take greater account of intangible assets and consequently improve the relevance, objectivity and reliability of financial statements.

Not only that, but informing stakeholders (i.e. management, employees, shareholders, regulators, financiers, investors) appropriately and reliably is paramount today, in a corporate world where companies are expected to accurately, regularly and expertly manage and broadcast their financial communication to medias and regulators.

As highlighted by Janice Denoncourt in her blog post “intellectual property, finance and corporate governance”, no stakeholder wants an iteration of the Theranos’ fiasco, during which inventor and managing director Elizabeth Holmes was indicted for fraud in excess of USD700 million, by the United States Securities and Exchange Commission (“**SEC**”), for having repeatedly, yet inaccurately, said that Theranos' patented blood testing technology was both revolutionary and at the last stages of its development. Elizabeth Holmes made those assertions on the basis of the more than 270 patents that her and her team filed with the United States patent and trademark office (**"USPTO"**), while making some material omissions and misleading disclosures to the SEC, via Theranos' financial statements, on the lame justification that *"Theranos needed to protect its intellectual property"* (sic).

Indeed, the stakes of financial communication are so high, in particular for the branding and reputation of any "knowledge economy" company, that, back in 2002, LVMH did not hesitate to sue Morgan Stanley, the investment bank advising its nemesis, Kering (at the time, named **"PPR"**), in order to obtain Euros100 million of damages resulting from Morgan Stanley's alleged breach of conflicts of interests between its investment banking arm (which advised PPR's top-selling brand, Gucci) and Morgan Stanley's financial research division. According to LVMH, Clare Kent, Morgan Stanley's luxury sector-focused analyst, systematically drafted and then published negative and biased research against LVMH share and financial results, in order to favor Gucci, the top-selling brand of the PPR luxury conglomerate and Morgan Stanley's top client. While this lawsuit – the first of its kind in relation to alleged biased conduct in a bank's financial analysis – looked far-fetched when it was lodged in 2002, LVMH actually won, both in first instance and on appeal.

Having more streamlined and accurate accounting, reporting and valuation of intangible assets – which are, today, the main and most valuable assets of any 21st century corporation – is therefore paramount for efficient and reliable financial communication.

2.2. Improving and diversifying access to finance

Not only that, but recognising the worth and inherent value of intangible assets, on balance sheet, would greatly improve the chances of any company – in particular, SMEs – to successfully apply for financing.

Debt finance is notoriously famous for shying away from using intangible assets as main collateral against lending because it is too risky.

For example, taking appropriate security controls over a company’s registered IPRs in a lending scenario would involve taking a fixed charge, and recording it properly on the Companies Registry at Companies House (in the UK) and on the appropriate IPRs’ registers. However, this hardly ever happens. Typically, at best, lenders are reliant on a floating charge over IPRs, which will crystallise in case of an event of default being triggered – by which time, important IPRs may have disappeared into thin air, or been disposed of; hence limiting the lender’s recovery prospects.

Alternatively, it is now possible for a lender to take an assignment of an IPR by way of security (generally with a licence back to the assignor to permit his or her continued use of the IPR) by an assignment in writing signed by the assignor[1]. However, this is rarely done in practice. The reason is to avoid “maintenance”, i.e. to prevent the multiplicity of actions. Indeed, because intangibles are incapable of being possessed, and rights over them are therefore ultimately enforced by action, it has been considered that the ability to assign such rights would increase the number of actions[2].

Whilst there are improvements needed to the practicalities and easiness of registering a security interest over intangible assets, the basic step that is missing is a clear inventory of IPRs and other intangible assets, on balance sheet and/or on yearly financial statements, without which lenders can never be certain that these assets are in fact to hand.

Cases of intangible asset- backed lending (“**IABL**”) have occurred, whereby a bank provided a loan to a pension fund against tangible assets, and the pension fund then provided a sale and leaseback arrangement against intangible assets. Therefore, IABL from pension funds (on a sale and leaseback arrangement), rather than banks, provides a route for SMEs to obtain loans.

There have also been instances where specialist lenders have entered into sale and licence-back agreements, or sale and leaseback agreements, secured against intangible assets, including trademarks and software copyright.

Some other types of funders than lenders, however, are already making the “intangible assets” link, such as equity investors (business angels, venture capital companies and private equity funds). They know that IPRs and other intangibles represent part of the “skin in the game” for SMEs owners and managers, who have often expended significant time and money in their creation, development and protection. Therefore, when equity investors assess the quality and attractiveness of investment opportunities, they invariably include consideration of the underlying intangible assets, and IPRs in particular. They want to understand the extent to which intangible assets owned by one of the companies they are potentially interested investing in, represent a barrier to entry, create freedom to operate and meet a real market need.

Accordingly, many private equity funds, in particular, have delved into investing in luxury companies, attracted by their high gross margins and net profit rates, as I explained in my 2013 article “Financing luxury companies: the quest of the Holy Grail (not!)”. Today, some of the most active venture capital firms investing in the European creative industries are Accel, Advent Venture Partners, Index Ventures, Experienced Capital, to name a few.

2.3. Adopting a systematic, consistent and streamlined approach to the valuation of intangible assets, which levels the playing field

If intangible assets are to be recognised in financial statements, in order to adopt a systematic and streamlined approach to their valuation, then fair value is the most obvious alternative to cost, as explained in paragraph 1.3. above.

How could we use fair value more widely, in order to capitalise intangible assets in financial statements?

IFRS 13 “Fair Value Measurements” identifies three widely-used valuation techniques: the market approach, the cost approach and the income approach.

The **market approach** “*uses prices and other relevant information generated by market transactions involving identical or comparable*” assets. However, this approach is difficult in practice, since when transactions in intangibles occur, the prices are rarely made public. Publicly traded data usually represents a market capitalisation of the enterprise, not singular intangible assets. Market data from market participants is often used in income based models such as determining reasonable royalty rates and discount rates. Direct market evidence is usually available in the valuation of internet domain names, carbon emission rights and national licences (for radio stations, for example). Other relevant market data include sale/licence transactional data, price multiples and royalty rates.

The **cost approach** “*reflects the amount that would be required currently to replace the service capacity of an asset*”. Deriving fair value under this approach therefore requires estimating the costs of developing an equivalent intangible asset. In practice, it is often difficult to estimate in advance the costs of developing an intangible. In most cases, replacement cost new is the most direct and meaningful cost based means of estimating the value of an intangible asset. Once replacement cost new is estimated, various forms of obsolescence must be considered, such as functional, technological and economic. Cost based models are best used for valuing an assembled workforce, engineering drawings or designs and internally developed software where no direct cash flow is generated.

The **income approach** essentially converts future cash flows (or income and expenses) to a single, discounted present value, usually as a result of increased turnover of cost savings. Income based models are best used when the intangible asset is income producing or when it allows an asset to generate cash flow. The calculation may be similar to that of value in use. However, to arrive at fair value, the future income must be estimated from the perspective of market participants rather than that of the entity. Therefore, applying the income approach requires an insight into how market participants would assess the benefits (cash flows) that will be obtained uniquely from an intangible asset (where such cash flows are different from the cash flows related to the whole company). Income based methods are usually employed to value customer related intangibles, trade names, patents, technology, copyrights, and covenants not to compete.

An example of IPRs' valuation by way of fair value, using the cost and income approaches in particular, is given in the excellent presentation by Austin Jacobs, made during ialci's latest law of luxury goods and fashion seminar on intellectual property rights in the fashion and luxury sectors.

In order to make these three above-mentioned valuation techniques more effective, with regards to intangible assets, and because many intangibles will not be recognised in financial statements as they fail to meet the definition of an asset or the recognition criteria, a reconsideration to the "Conceptual Framework to Financial Reporting" needs being implemented by the IASB.

These amendments to the Conceptual Framework would permit more intangibles to be recognised within financial statements, in a systematic, consistent, uniform and streamlined manner, therefore levelling the playing field among companies from the knowledge economy.

Let’s not forget that one of the reasons WeWork co founder, Adam Neumann, was violently criticised, during WeWork’s failed IPO attempt, and then finally ousted, in 2019, was the fact that he was paid nearly USD6 million for granting the right to use his registered word trademark “We”, to his own company WeWork. In its IPO filing prospectus, which provided the first in-depth look at WeWork’s financial results, WeWork characterised the nearly USD6 million payment as “fair market value”. Many analysts, among which Scott Galloway, begged to differ, outraged by the lack of rigour and realism in the valuation of the WeWork brand, and the clearly opportunistic attitude adopted by Adam Neumann to get even richer, faster.

2.4. Creating a liquid, established and free secondary market of intangible assets

IAS 38 currently permits intangible assets to be recognised at fair value, as discussed above in paragraphs 1.3. and 2.3., measured by reference to an active market.

While acknowledging that such markets may exist for assets such as “*freely transferable taxi licences, fishing licences or production quotas*”, IAS 38 states that “*it is uncommon for an active market to exist for an intangible asset*”. It is even set out, in paragraph 78 of IAS 38 that “*an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique*”.

Markets for resale of intangible assets and IPRs do exist, but are presently less formalised and offer less certainty on realisable values. There is no firmly established secondary transaction market for intangible assets (even though some assets are being sold out of insolvency) where value can be realised. In addition, in the case of forced liquidation, intangible assets’ value can be eroded, as highlighted in paragraph 2.2. above.

Therefore, markets for intangible assets are currently imperfect, in particular because there is an absence of mature marketplaces in which intangible assets may be sold in the event of default, insolvency or liquidation. There is not yet the same tradition of disposal, or the same volume of transaction data, as that which has historically existed with tangible fixed assets.

Be that as it may, the rise of liquid secondary markets of intangible assets is unstoppable. In the last 15 years, the USA have been at the forefront of IPRs auctions, mainly with patent auctions managed by specialist auctioneers such as ICAP Ocean Tomo and Racebrook. For example, in 2006, ICAP Ocean Tomo sold 78 patent lots at auction for USD8.5 million, while 6,000 patents were sold at auction by Canadian company Nortel Networks for USD4.5 billion in 2011.

However, auctions are not limited to patents, as demonstrated by the New York auction, successfully organised by ICAP Ocean Tomo in 2006, on lots composed of patents, trademarks, copyrights, musical rights and domain names, where the sellers were IBM, Motorola, Siemens AG, Kimberly Clark, etc. In 2010, Racebrook auctioned 150 American famous brands from the retail and consumer goods’ sectors.

In Europe, in 2012, Vogica successfully sold its trademarks and domain names at auction to competitor Parisot Group, upon its liquidation.

In addition, global licensing activity leaves not doubt that intangible assets, in particular IPRs, are, in fact, very valuable, highly tradable and a very portable asset class.

It is high time to remove all market’s imperfections, make trading more transparent and offer options to the demand side, to get properly tested.

3. Next steps to improve the valuation and reporting of intangible assets

3.1. Adjust IAS 38 and the Conceptual Framework to Financial Reporting to the realities of intangible assets’ reporting

Mainstream lenders, as well as other stakeholders, need cost-effective, standardised approaches in order to capture and process information on intangibles and IPRs (which is not currently being presented by SMEs).

This can be achieved by reforming IAS 38 and the “Conceptual Framework to Financial Reporting”, at the earliest convenience, in order to make most intangible assets capitalised on financial statements at realistic and consistent valuations.

In particular, the reintroduction of amortisation of goodwill may be a pragmatic way to reduce the impact of different accounting treatment for acquired and internally generated intangibles.

In addition, narrative reporting (i.e. reports with titles such as “Management Commentary” or “Strategic Report”, which generally form part of the annual report, and other financial communication documents such as “Preliminary Earnings Announcements” that a company provides primarily for the information of investors) must set out detailed information on unrecognised intangibles, as well as amplify what is reported within the financial statements.

3.2. Use standardised and consistent metrics within financial statements and other financial communication documents

The usefulness and credibility of narrative information would be greatly enhanced by the inclusion of metrics (i.e. numerical measures that are relevant to an assessment of the company's intangibles) standardised by industry. The following are examples of objective and verifiable metrics that may be disclosed through narrative reporting:

- a company that identifies customer loyalty as critical to the success of its business model might disclose measures of customer satisfaction, such as the percentage of customers that make repeat purchases;
- if the ability to innovate is a key competitive advantage, the proportion of sales from new products may be a relevant metric;
- where the skill of employees is a key driver of value, employee turnover may be disclosed, together with information about their training.

3.3. Make companies' boards accountable for intangibles' reporting

Within a company, at least one appropriately qualified person should be appointed and publicly reported as having oversight and responsibility for intangibles' auditing, valuation, due diligence and reporting (for example a director, specialist advisory board or an external professional adviser).

This would enhance the importance of corporate governance and board oversight, in addition to reporting, with respect to intangible assets.

In particular, some impairment tests could be introduced, to ensure that businesses are well informed and motivated to adopt appropriate intangibles’ management practices, which should be overseen by the above-mentioned appointed board member.

3.4. Create a body that trains about, and regulates, the field of intangible assets’ valuation and reporting

The creation of a professional organisation for the intangible assets’ valuation profession would increase transparency of intangibles’ valuations and trust towards valuation professionals (i.e. lawyers, IP attorneys, accountants, economists, etc).

This valuation professional organisation would set some key objectives that will protect the public interest in all matters that pertain to the profession, establish professional standards (especially standards of professional conduct) and represent professional valuers.

This organisation would, in addition, offer training and education on intangibles’ valuations. Therefore, the creation of informative material and the development of intangible assets’ training programmes would be a priority, and would guarantee the high quality valuation of IPRs and other intangibles as a way of boosting confidence for the field.

Company board members who are going to be appointed as having accountability and responsibility for intangibles’ valuation within the business, as mentioned above in paragraph 3.3., could greatly benefit from regular training sessions offered by this future valuation professional organisation, in particular for continuing professional development purposes.

3.5. Create a powerful register of expert intangible assets’ valuers

In order to build trust, the creation of a register of expert intangibles’ valuers, whose ability must first be certified by passing relevant knowledge tests, is key.

Inclusion on this list would involve having to pass certain aptitudes tests and, to remain on it, valuers would have to maintain a standard of quality in the valuations carried out, whereby the body that manages this registry would be authorised to expel members whose reports are not up to standard. This is essential in order to maintain confidence in the quality and skill of the valuers included on the register.

The entity that manages this body of valuers would have the power to review the valuations conducted by the valuers certified by this institution as a “second instance”. The body would need to have the power to re-examine the assessments made by these valuers (inspection programme), and even eliminate them if it is considered that the assessment is overtly incorrect (fair disciplinary mechanism).

3.6. Establish an intangible assets’ marketplace and data-source

The development most likely to transform IPRs and intangibles as an asset class is the emergence of more transparent and accessible marketplaces where they can be traded.

In particular, as IPRs and intangible assets become clearly identified and are more freely licensed, bought and sold (together with or separate to the business), the systems available to register and track financial interests will need to be improved. This will require the cooperation of official registries and the establishment of administrative protocols.

Indeed, the credibility of intangibles’ valuations would be greatly enhanced by improving valuation information, especially by collecting information and data on actual and real intangibles’ transactions in a suitable form, so that it can be used, for example, to support IPRs asset-based lending decisions. If this information is made available, lenders and expert valuers will be able to base their estimates on more widely accepted and verified assumptions, and consequently, their valuation results – and valuation reports – would gain greater acceptance and reliability from the market at large.

The wide accessibility of complete, quality information which is based on real negotiations and transactions, via this open data-source, would help to boost confidence in the validity and accuracy of valuations, which will have a very positive effect on transactions involving IPRs and other intangibles.

3.7. Introduce a risk sharing loan guarantee scheme for banks to facilitate intangibles' secured lending

A dedicated loan guarantee scheme needs being introduced, to facilitate intangible assets' secured lending to innovative and creative SMEs.

Asia is currently setting the pace in intangibles-backed lending. In 2014, the intellectual property office of Singapore ("**IPOS**") launched a USD100 million "IP financing scheme" designed to support local SMEs to use their granted IPRs as collateral for bank loans. A panel of IPOS-appointed valuers assess the applicant's IPR portfolio using standard guidelines to provide lenders with a basis on which to determine the amount of funds to be advanced. The development of a national valuation model is a noteworthy aspect of the scheme and could lead to an accepted valuation methodology in the future.

The Chinese intellectual property office ("**CIPO**") has developed some patent-backed debt finance initiatives. Only 6 years after the "IP pledge financing" programme was launched by CIPO in 2008, CIPO reported that Chinese companies had secured over GBP6 billion in IPRs-backed loans since the programme launched. The Chinese government having way more direct control and input into commercial bank lending policy and capital adequacy requirements, it can vigorously and potently implement its strategic goal of increasing IPRs-backed lending.

It is high time Europe follows suit, at least by putting in place some loan guarantees that would increase lender's confidence in making investments by sharing the risks related to the investment. A guarantor assumes a debt obligation if the borrower defaults. Most loan guarantee schemes are established to correct perceived market failures by which small borrowers, regardless of creditworthiness, lack access to the credit resources available to large borrowers. Loan guarantee schemes level the playing field.

The proposed risk sharing loan guarantee scheme set up by the European Commission or by a national government fund (in particular in the UK, who is brexiting) would be specifically targeted at commercial banks in order to stimulate intangibles-secured lending to innovative SMEs. The guarantor would fully guarantee the intangibles-secured loan and share the risk of lending to SMEs (which have suitable IPRs and intangibles) with the commercial bank.

The professional valuer serves an important purpose, in this future loan guarantee scheme, since he or she will fill the knowledge gap relating to the IPRs and intangibles, as well as their value, in the bank's loan procedure. If required, the expert intangibles' valuer provides intangibles' valuation expertise and technology transfer to the bank, until such bank has built the relevant capacity to perform intangible assets' valuations. Such valuations would be performed, either by valuers and/or banks, according to agreed, consistent, homogenised and accepted methods/standards and a standardised intangible asset's valuation methodology.

To conclude, in this era of ultra-competitiveness and hyper-globalisation, France and the UK, and Europe in general, must immediately jump on the saddle of progress, by reforming outdated and obsolete accounting and reporting standards, as well as by implementing all the above-mentioned new measures and strategies, to realistically and consistently value, report and leverage intangible assets in the 21st century economy.

[1] “Lingard’s bank security documents”, Timothy N. Parsons, 4th edition, LexisNexis, page 450 and seq.

[2] “Taking security – law and practice”, Richard Calnan, Jordans, page 74 and seq.

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How to lawfully broadcast your soundtracks in bars, restaurants, hotels & other public spaces, from France?

When a France-based sound system provider reproduces some phonograms on soundtracks, in order to propose such soundtracks for broadcasting in public spaces such as restaurants, bars, hotels, or shops, he/she needs to have a proper strategy in place, to lawfully implement his/her business plan. Especially when it comes to fostering useful and productive relationships with French, as well

as foreign, collecting rights societies. How can this legal compliance effort be done in the most time and cost efficient manner, to assist the developing business of any France-based budding sound system provider?

1. Registering as a user-reproducer with both SPPF and SCPP

There are four neighbouring rights collecting societies, in France, as far as music neighbouring rights are concerned, as follows:

- SCPP, which is a neighbouring rights collecting society for phonogram producers (i.e. record labels) that qualify either as major or independent;
- SPPF, which is a neighbouring rights collecting society for phonogram producers that are independent labels only;
- ADAMI, which is a neighbouring rights collecting society

for artists and performers and

- SPEDIDAM, which is a neighbouring rights collecting society for session musicians and vocalists.

Any new sound system provider based in France needs to be aware of such neighbouring rights collecting societies, since some may come knock at his/her door, in order to collect royalties.

Indeed, which neighbouring rights collecting societies may have a legal, and financial, claim against a France-based sound system provider?

A distinction needs to be drawn, between:

- neighbouring rights’ royalties collected on the basis of broadcasting phonograms, and
- neighbouring rights’ royalties collected on the basis of reproducing phonograms.

As far as neighbouring rights’ royalties collected on the basis of broadcasting phonograms are concerned, the French intellectual property code (“**IPC**”) provides that 50 percent of the royalties paid by users (i.e. sites which broadcast phonograms, such as public spaces, TV channels, radio channels, etc.) are directed to the right owner of the phonogram, while the remaining 50 percent goes to artists-performers, session musicians and vocalists. Article L. 214-1 of the IPC provides for the payment of neighbouring rights’ royalties relating to the right to broadcast, on the basis of scales which are, themselves, provided for in article L. 214-4 of the IPC. These royalties paid in relation to the right to broadcast are entitled “fair remuneration” (“*rémunération équitable*”) and are distributed to phonogram producers via SCPP and SPPF, to artists-performers via ADAMI, as well as to session musicians and vocalists via SPEDIDAM.

However, as far as neighbouring rights' royalties collected on the basis of reproducing phonograms are concerned, these are paid by users (i.e. sound system providers who provide sound via physical media, automated broadcasting systems, or satellite/ADSL) to phonogram producers only. Article L. 213-1 of the IPC provides for the payment of such neighbouring rights' royalties relating to the reproduction right. These royalties are distributed to phonogram producers solely, via SCPP and SPPF.

Therefore, a France-based sound system provider, who reproduces phonograms on soundtracks which will then be broadcasted in the sites of his/her clients (i.e. bars, hotels, restaurants, retail stores, lifts, etc., collectively referred to as "**Clients' Sites**"), located either in France and/or, for example, in the United Kingdom, will have a statutory obligation to negotiate, finalise and sign a common interest general agreement ("*contrat général d'intérêt commun*") between a user sound system provider, and each one of the neighbouring rights' collecting societies for phonogram producers solely, i.e. SCPP and SPPF. Following the execution of such agreements, the sound system provider will pay SCPP and SPPF some royalties due under the right of reproduction of phonograms.

Clients' Sites, i.e. public places in which the soundtracks will be broadcasted via physical media, automated broadcasting systems, or satellite/ADSL, will pay neighbouring rights' royalties pursuant to the right to broadcast phonograms, to SCPP, SPPF, ADAMI and SPEDIDAM.

2. On the agreements to be entered into, between users-sound system providers, and SCPP and SPPF respectively

The templates of common interest general agreements, between users-sound system providers, and each neighbouring rights' collecting societies for phonogram producers, i.e. SCPP and SPPF respectively, are freely available on their websites (together, the **“Agreements”**).

Key points to note, in relation to the Agreements, are that:

- there is some leeway while negotiating with SCPP and SPFF the terms of the Agreements, before they are finalised;
- SCPP owns 77 percent of the social repertoire of phonograms in France, while SPPF owns 23 percent of the social repertoire of phonograms registered in France, and these prorata numeris are set out in the calculation formula used to determine the amount of the royalty owed under the right of reproduction, as explained below;
- both SCPP and SPPF have entered into reciprocal agreements with the UK neighbouring rights’ collecting society PPL, which implies that, a priori, it is not needed that a France-based sound system provider enters into a similar contract than the Agreements, with PPL, even if his/her soundtracks are broadcasted on Clients’ Sites located in the United Kingdom;
- both SCPP and SPPF warrant and represent that the phonogram producers, members of their respective social repertoires, have obtained prior authorisation from artists-performers, session musicians and vocalists, to the reproduction of each of the phonograms registered in their social repertoires, in compliance with article L. 212-3 of the IPC;
- the annual turnover, exclusive of tax, generated by the sound system provider, will be the sole amount taken into account by SCPP and SPPF, when computing the royalty due under the right of reproduction;
- the formula to calculate the royalty is equal to ((annual turnover excl. tax * 15 percent) * 23 percent)

for SPPF, where 23 percent represents the prorata numeris applicable to SPPF, as explained above;

- the formula to calculate the royalty is equal to ((annual turnover excl. tax * 15 percent) * 77 percent) for SCPP, where 77 percent represents the prorata numeris applicable to SCPP, as explained above;
- both SCPP and SPPF have put in place some guaranteed minimums, for royalties, depending on the number of phonograms reproduced on a Client’s Site per year; which amounts must be set out in the Agreements;
- SCPP requests the sound system provider to pay a royalties’ deposit, while SPPF does not request any deposit;
- sound system providers have strenuous reporting obligations, as they need to send to SCPP and SPPF, on a regular basis, a filled-out excel spreadsheet, which sets out all the data to be reported, in relation to each one of the phonograms reproduced on their soundtracks, which belong to the respective social repertoires of SCPP and SPPF;
- soundtracks, as well as automated broadcasting systems, must allow for phonogram protection tools, such as digital rights management tools, which protect phonograms from unauthorised copy and
- data about phonograms can be traced and found in the databases of SCPP and SPPF, in particular their IRSC numbers.

SCPP and SPPF legal teams are useful to better understand the Agreements, as well as to negotiate, possibly customise, and then finalise such Agreements.

To conclude on this note, neighbouring rights’ royalties that any France-based sound system provider must pay represent 15 percent of his/her annual turnover, exclusive of tax.

What about any eventual royalties on copyright?

3. Relationships between users – sound system providers and SACEM-SDRM

Sound system providers do not have any statutory obligation to register with SACEM, i.e. the French music copyright collecting society, or to the "*Société pour l'administration du droit de reproduction mécanique des auteurs*" ("**SDRM**").

Indeed, Clients' Sites will pay royalties to SACEM and SDRM, relating to public performance rights and mechanical reproduction rights, provided for in article L. 122-4 of the IPC, through a representation agreement entered into by the authors, their beneficial owners as well as SACEM and SDRM, pursuant to article L. 132-18 of the IPC.

For example, a restaurant located in Paris will pay an annual fixed price exclusive of tax of 1,783.69 euros, pursuant to the royalties due under the public performance rights and the mechanical reproduction rights of the musical compositions of authors-composers registered with SACEM and SDRM.

Therefore, there is no obligation for a sound system provider to register with SACEM, in order to pay any royalties due under the right to reproduction, since his/her Clients' Sites located in France will pay such royalties, which are included in the annual fixed price exclusive of tax, that they will directly pay to SACEM and SDRM.

However, SACEM and SDRM recommend that professional sound system providers share their digital declarative forms (i.e. the reporting data on each phonogram which needs to be set out on an excel spreadsheet provided by SCPP and SPPF) with them. This way, SACEM and SDRM can make a realistic and exact sharing of the rights due under the mechanical reproduction, because they have the accurate information relating to each phonogram and musical composition reproduced on a soundtrack, which is then broadcasted in each Client’s Site located in France. So SACEM is currently putting together a charter, for the attention of professional sound system providers, in order to educate them on the need to report about the musical compositions which have been reproduced, to SACEM.

As far as Clients’ Sites located in the United Kingdom are concerned, SACEM has entered into a reciprocity agreement with the UK music copyright collecting society, PRS, in order to ensure that royalties collected by PRS in the name and on behalf of SACEM, be then sent to SACEM as soon as possible, for distribution to the appropriate authors and their beneficial owners, all members of SACEM.

To conclude, setting up a profitable sound system provider business in France comes with a few hoops and hurdles, from a regulatory standpoint. However, if these intricacies are rightly tackled, through appropriate software solutions (especially to deal with the strenuous reporting obligations on each phonogram reproduced on each soundtrack) as well as tactical and effective legal advice, nothing should come in the way of any savvy and business-minded sound system provider because he/she will have set up constructive and mutually beneficial relationships with French collecting rights societies.

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How to restructure your creative business in France

Almost any medium-sized and large creative business has overseas operations, in order to maximise distribution opportunities and take

advantage of economies of scale. This is especially true for fashion & luxury businesses, which need strategically-located brick & mortar retail outlets to thrive. However, such overseas boutiques may need to be restructured, from time to time, in view of their annual turnover results, compared to their fixed costs. What to do, then, when you want to either reduce, or even close down, your operations set up in France? How to proceed, in the most time and cost efficient manner, to restructure your creative business in France?

One thing that needs to be clear from the outset is that you must follow French rules, when you proceed onto scaling back or even winding up your operations set up in France.

Indeed, in case you have incorporated a French limited liability company for your business operations in France, which is a wholly-owned subsidiary of your foreign parent-company, there is a risk that the financial liability of the French subsidiary be passed onto the foreign parent-company. This is because the corporate veil is very thin in France. Unlike in the UK or the US for example, it is very common, for French judges who are assessing each matter on its merits, to decide that a director and/or shareholder of a French limited liability company should become jointly liable for the loss suffered by a third party. The judge only has to declare that all the following conditions are cumulatively met, in order to pierce the corporate veil and hold its directors and/or shareholders liable for the wrongful acts they have committed:

- the loss has been caused by the wrongful act of a director or a shareholder;
- the wrongful act is intentional;
- the wrongful act is gross misconduct, and
- the wrongful act is not intrinsically linked to the performance of the duties of a director or is incompatible with the normal exercise of the prerogatives attached to the status of the shareholder.

The specific action of liability for shortfall of assets is generally the route that is chosen, to pierce the corporate veil and trigger the director and/or shareholder liability of a French limited liability company. However, there is numerous French case law, showing that French courts do not hesitate to hold French **and** foreign parent companies liable for the debts of French subsidiaries, especially in case of abuse of corporate veil, by way of intermingling of estates, either by intermingling of accounts or abnormal financial relations. This usually leads to the extension of insolvency proceedings, in case of intermingling of estates, but could also trigger the director and/or shareholder liability in tort for gross misconduct.

Indeed, if a shareholder has committed a fault or gross negligence that contributed to the insolvency of, and subsequent redundancies in, the French subsidiary, that shareholder may be liable to the employees directly. Pursuant to recent French case law, the shareholder could be held liable in the event its decisions:

- hurt the subsidiary;
- aggravate the already difficult financial situation of the subsidiary;
- have no usefulness for the subsidiary, or
- benefit exclusively to the shareholder.

Of course, any French court decisions are relatively easily enforceable in any other European Union (“**EU**”) member-state, such as the UK, thanks to the EU regulation 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. This regulation allows the enforcement of any court decision published in a EU member-state without any prior exequatur process. Therefore, the foreign parent-company will not be protected by the mere fact that it is located in the UK, for example, as opposed to France: it will be liable anyway, and the French courts’ judgments will be enforceable in the UK against it. Moreover, a new international convention, the Hague convention on the recognition and enforcement of foreign judgments in civil or commercial matters was concluded, on 2 July 2019, which will become a “game changer” once it becomes ratified by many countries around the world, included the EU. It will therefore become even easier to enforce French court decisions in third-party states, even those located outside the EU.

So what is the best route to restructure or wind up the French operations of your creative business, if so much is at stake?

1. How to lawfully terminate your French lease

Most French commercial operations are conducted from commercial premises, be it a retail outlet or some offices. Therefore, leases of such commercial spaces were entered into with French landlords, at the inception of the French operations.

How do you lawfully terminate such French leases?

Well, it is not easy, since the practice of "locking commercial tenants in" has become increasingly common in France, through the use of pre-formulated standard lease agreements which impose some onerous obligations on commercial tenants, that were not subject to any negotiation or discussion between the parties.

This evolution is rather surprising since France has a default regime for commercial leases, set out in articles L. 145-1 and seq. of the French commercial code, which is rather protective of commercial tenants (the "**Default regime**"). It defines the framework, as well as boundaries between, the landlord and its commercial tenant, as well as their contractual relationship.

For example, article L. 145-4 of the French commercial code sets out that, in the Default regime, the term of the lease cannot be lower than nine years. Meanwhile, articles L. 145-8 and seq. of the French commercial code describe with minutia the Default regime to renew the lease after its termination, declaring null and void any clause, set out in the lease agreement, which withdraws the renewal right of the tenant, to the lease agreement.

But what does the Default regime say about the right of a tenant to terminate the lease? Nothing, really, except from articles L. 145-41 and seq. of the French commercial code, which provide that any clause set out in the lease agreement in relation to the termination of the lease will only apply after one month from the date on which a party to the lease agreement informed the other party that the latter had to comply with all its obligations under the lease agreement and, should such request to comply with its contractual obligations be ignored, the former party will exercise its right to terminate the lease agreement within a month. However, in practice, it is very difficult for French commercial tenants to invoke such articles from the French commercial code, and subsequently prove that their landlords have not complied with their contractual obligations under the lease. This is because such French lease agreements often set out clauses that exonerate the landlords from any liability in case the premises are defective, obsolete, suffer from force majeure cases, etc.

To summarise, the Default regime does not provide for any automatic right for a commercial tenant to terminate the lease agreement, for any reason. It is therefore advisable, when you negotiate the clauses set out in such lease agreement, to ensure that your French entity (be it a branch or a French limited liability company) has an easy way out of the 9 years' lease. However, since the balance of power is heavily skewed in favour of commercial landlords – especially for sought-after retail locations such as Paris, Cannes, Nice, and other touristic destinations – there is a very high probability that the landlord will dismiss any attempts made by the prospective commercial tenant to insert a clause allowing such tenant to terminate the lease on notice, for any reason (i.e. even in instances when the commercial landlord has complied with all its obligations under the lease).

Still included in the Default regime, on the topic of termination of leases, is article L. 145-45 of the French commercial code, which sets out that the institutionalised receivership or liquidation (i.e. "*redressement ou liquidation judiciaires*") do not trigger, in their own right, the termination of the lease relating to the buildings/premises affected to the business of the debtor (i.e. the tenant). Any clause, set out in the lease agreement, which is contradictory to this principle, is null and void, under the Default regime. While this article sounds protective for commercial tenants, it also infers that there is no point in placing the tenant's business in receivership or liquidation, to automatically trigger the termination of the lease. Such a situation of court-led receivership or liquidation of the French entity will not automatically terminate the lease of its premises.

Consequently, the most conservative way out may be to wait the end of the nine years' term, for a commercial tenant.

In order to have more flexibility, many foreign clients that set up French commercial operations prefer to opt out of the Default regime, which imposes a nine years' term, and instead enter into a dispensatory lease ("*bail dérogatoire*") which is not covered by the Default regime.

Indeed, article L. 145-5 of the French commercial code sets out that "t*he parties can (…) override*" the Default regime, provided that the overall duration of the commercial lease is not longer than three years. Dispensatory leases, which have an overall duration no longer than 3 years, are therefore excluded from, and not governed by, the Default regime set out in articles L. 145-1 and seq. of the French commercial code, and are instead classified in the category of "*contrats de louage de droit commun*" i.e. civil law ordinary law contracts of lease, which are governed by the provisions set out in the French civil code, relating, in particular, to non-commercial leases (article 1709 and seq. of the French civil code).

Therefore, if a foreign parent negotiates a dispensatory lease for its French operations, it will be in a position to call it a day after three years, instead of nine years. However, it will not be able to benefit from the tenants' protections set out in the Default regime and will therefore need to negotiate very astutely the terms of the commercial lease with the French landlord. It is therefore essential to seek appropriate legal advice, prior to signing any lease agreement with any French landlord, in order to ensure that such lease agreement offers options, in particular, for the tenant to terminate it, in case of contractual breaches made by the landlord, and, in any case, upon the end of the three years' term.

The tenant should keep a paper trail and evidence of any contractual breaches made by the landlord during the execution of the lease, as potential "ammunition" in case it decides to later trigger the termination clause under the lease agreement, for unremedied breach of contract.

2. How to lawfully terminate your French staff

Once the termination of the lease agreement is agreed, it is time for the management of the French operations to focus their attention on termination the employment agreements of French staff members (the **"Staff"**), which can be a lengthy process.

An audit of all the employment agreements in place with the Staff should be conducted, confidentially, before making a move, in order to assess whether such agreements are "*contrats à durée indéterminée*", or **"CDI"** (i.e. indeterminate duration employment agreements) or "*contrats à durée déterminée*", or **"CDD"** (i.e. fixed term employment agreements).

As part of this audit, the legal and management team should clarify the amount of the sums due to each member of the Staff, relating to:

- any paid leave period owed to her;

- in case of CDDs, if no express agreement is signed by the member of Staff and the employer upon termination, all outstanding remunerations due during the minimum duration of the CDD;
- in case of CDDs, an end of contract indemnity at a rate of 10 percent of the total gross remuneration;
- in case of CDIs, any notice period salary owed to her;
- in case of CDIs, any severance pay owed to her, and
- any outstanding social contributions on salary.

This audit will therefore enable the French business, and its foreign parent-company, to assess how much this Staff termination process may cost.

In France, you cannot terminate Staff at will: you must have a "lawful" reason to do so.

Justifying the termination of a CDD ahead of its term may be pretty complex and risky, in France, especially if the relevant members of Staff have behaved in a normal manner during the execution of such CDD, so far. It may therefore be worth for the employer to pay all outstanding remunerations due during the minimum duration of the CDD, in order to avoid any risk of being dragged to any employment tribunal, by such members of Staff.

As far as CDIs are concerned, there are three types of termination of CDIs, as follows:

- "*licenciement pour motif économique*" (i.e. layoff for economic reasons);
- "*rupture conventionnelle du CDI*" (i.e. mutually agreed termination of the employment agreement);
- "*rupture conventionnelle collective*" (i.e. collective mutually agreed termination of the employment

agreement).

A "*licenciement pour motif économique*" must occur due to a real and serious economic cause, such as job cuts, economic difficulties of the employer or the end of the activity of the employer.

This option would therefore be a good fit for any French entity that wants to stop operating in France. It does come with strings attached, though, as follows:

- the employer must inform and consult the "*représentant du personnel"*, or the "*Comité d'entreprise*";
- the employer asks the relevant Staff to attend a preliminary meeting and notifies them of the termination of their CDIs as well as the reasons for such termination;
- the employer sends a termination letter to the relevant Staff, at least 7 business days from the date of the preliminary meeting, or at least 15 business days from the date of the preliminary meeting if such member of Staff is a "*cadre*" (i.e. executive), which sets out the economic reason which caused the suppression of the job occupied by the employee, the efforts made by the employer to reclassify the employee internally, the option for the employee to benefit from reclassification leave and
- the employer informs the French administration, i.e. the relevant "*Direction régionale des entreprises, de la concurrence, de la consommation, du travail et de l'emploi*" ("**DIRECCTE"**) of the redundancies.

Another route to lawfully terminate the Staff is via a "r*upture conventionnelle du CDI"*, i.e. mutually agreed termination of the employment agreement. This is only open to French operations where the Staff is ready to cooperate and mutually agree to the termination of its employment agreements. This situation is hard to come by, in reality, to be honest, by why not?

If the French entity manages to pull this off, with its Staff, then the “*convention de rupture conventionnelle*” must be signed, then homologated by the DIRECCTE, before any employment agreement is officially terminated.

If the DIRECCTE refuses to homologate the convention, the relevant Staff must keep on working under normal conditions, until the employer makes a new request for homologation of the convention and … obtains it!

Finally, in case an “*accord collectif”*, also called “a*ccord d’entreprise*”, was concluded in the French company, then a “*rupture conventionnelle collective*” can be organised. If so, only the Staff who has agreed in writing to the “*accord collectif*” can participate to this collective mutually agreed termination of its employment agreements.

It’s worth noting that French employees are rather belligerent and often file claims with employment tribunals, upon termination of their employment agreements. However, the Macron ordinances, which entered into force in September 2017, have set up a scale that limits the maximum allowances which could be potentially be paid to employees with minimal seniority, in such employment court cases. Thus, employees having less than one year’s seniority are allowed to collect a maximum of one month of salary as compensation. Afterwards, this threshold is grossed up by more or less one month per year of seniority up to eight years. However, such scale does not apply to unlawful dismissals (those related to discrimination or harassment) or to dismissals which occurred in violation of fundamental freedoms. While many French lower courts have published judgments rejecting such Macron scale, the “*Cour de cassation*” (i.e. the French supreme court) validated such Macron scale in July 2019, forcing French employment tribunals to comply with such scale.

While this should come as a relief to foreign parent companies, it is worth noting that the more orderly and negotiated the departure of the Staff, the better. Having to fight employment lawsuits in France is no fun, and can be cost and time intensive. They therefore must be avoided at all cost.

3. How to restructure your creative business in France: terminate other contracts with third parties and clean the slate with French authorities

Of course, other contracts with third parties, such as suppliers, local service providers, must be lawfully terminated before the French operations are shut down. The takeaway is that the French entity and its foreign parent company cannot leave a chaotic and unresolved situation behind them, in France.

They must terminate and lawfully sever all their contractual ties with French companies and professionals, before closing shop, in compliance with the terms of any contracts entered into with such French third parties.

Additionally, French companies must pay off any outstanding balances due to French authorities, such as the French social security organisations, the URSSAF, and the French tax administration, before permanently closing down.

4. How to restructure your creative business in France: you must properly wind up your business

Once all the ongoing obligations of the French operations are met, by lawfully terminating all existing agreements such as the commercial lease, the employment agreements, the suppliers' agreements and the service providers' agreements, as discussed above, it is time to wind up your business in France.

French limited liability companies have two options to terminate their business as an ongoing concern due to economic grounds, i.e. proceed to a "*cessation d'activité*".

The first branch of the alternative is to execute a voluntary and early termination of the French business as an ongoing concern. It can be exercised by the French company, its shareholders and its board of directors, when it can still exercise its activity and pay back its debts. If the articles of association of such French company provide for the various cases in which the company may be wound up, such as the end of the term of the French company, or upon the common decision made by its shareholders, then it is possible for the French limited liability company and its directors to execute a voluntary and early termination of the business as an ongoing concern.

The second branch to the alternative, opened to French limited liability companies, occurs when a company cannot pay its debts anymore, and is in a situation of "*cessation de paiements*" i.e. it cannot pay its debts with its assets, in cessation of payments. In this instance, the French company must file a notification of cessation of payments with the competent commercial courts within 45 days from the date on which it stopped to make payments. Also, within that time frame of 45 days, the board of directors of the French company must open a "*procédure de redressement ou de liquidation judiciaire"* (i.e. receivership or liquidation institutionalised process, monitored by French courts) with the competent commercial court. This court will decide, further to examining the various documents filed with the "*déclaration de cessation des paiements*", which institutionalised process (receivership? liquidation?) is the most appropriate, in view of all the interests that need being taken into account (debts, safeguarding employments, etc.).

If you want to exit the French territory in a graceful manner, you do not want to find yourself in a situation of cessation of payments, and then receivership or liquidation monitored by French courts. Not only this guarantees a protracted and painful judiciary process to terminate your French operations, but this may lead to situations where the money claims made against the French company would be escalated to its shareholders, directors and/or parent company, as explained in our introduction above.

Not only the parent company, and any other shareholder, could be dragged in the mud and found liable, but its directors, and in particular its managing director, too. French commercial courts have no patience for sloppy and irresponsible management, and many managing directors ("*associés gérants*") have seen their civil liability triggered because their actions had caused some prejudices to the French company or a third party. Even criminal liability of an "*associé gérant*" can be triggered, in case the French court discovers fraud. In particular, it is frequent that in collective insolvency proceedings, if the judicial liquidation of a French limited liability company shows an asset shortfall ("*insuffisance d'actif*"), the courts order its managing director to pay, personally, for the company's social liability, if she has committed a management error.

To conclude, the French company acts as a shield for its managing director, except if such director commits a personal mistake detachable from her mandate, in case the company is still solvent. However, if the company is in receivership, both the shareholders', and the directors' liability may be triggered in many ways, by French courts, the French social security contributions entity URSSAF and the French tax administration.

It is therefore essential to leave France with a clean slate, because any unfinished business left to fester may hit your foreign company and the management like a boomerang, by way of enforceable and very onerous French court decisions.

Don’t worry, though, we are here, at Crefovi, to service you to achieve this, and you can tap into our expertise to leave French territories unscathed and victorious.

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Brexit: How to protect your creative business when the UK will crash out of the EU on 30 March 2019

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On 30 March 2019, the UK will crash out of the EU without a withdrawal deal in place, and without a request for an extension of the 2 years’ notification period of its decision to withdraw. No second referendum will be organised by the current UK government. Therefore, what’s in the cards, for the creative industries, in order to do fruitful business with, and from, the UK in the near future? [hr]

My previous article on the road less travelled & Brexit legal implications, published just after the Brexit vote, on Saturday 25 June 2016, delivered the main message that it was worth monitoring the negotiation process that would ensue the notification made by the United Kingdom (UK) to the European Union (EU) of its intention to withdraw from the EU within 2 years.

We have therefore been monitoring those negotiations for you, in the last couple of years, and came to the following predictions, which will empower your creative business to brace itself for, and make the most of the imminent changes triggered by, the crashing of the UK out of the EU, on 30 March 2019.

1. End of freedom of movement of UK and EU citizens coming in and out of the UK

On 30 March 2019, UK citizens will lose their EU citizenship, i.e. the citizenship, subsidiary to UK citizenship, that provide rights such as the right to vote in European elections, the right to free movement, settlement and employment across the EU, and the right to consular protection by other EU states' embassies when a person's country of citizenship does not maintain an embassy or consulate in the country in which they require protection.

Since no withdrawal agreement will be signed by 29 March 2019, between the EU and the UK, UK nationals living in one of the 27 EU member-states will be on their own, as no reciprocal arrangements will have been put in place, in particular in relation to reciprocal healthcare and social security coordination, work permits, right to stand and vote in local elections.

UK nationals living in one of the states which are members of the European Free Trade Association (EFTA), i.e. Iceland, Liechtenstein, Norway and Switzerland, will also have no safety net, as the UK will also crash out of the EU bilateral agreements with EFTA members, such as the EEA Agreement which ties Iceland, Liechtenstein, Norway and the EU together, on 29 March 2019. Meanwhile, "*the UK is seeking citizens' rights agreement with the EFTA states to protect the rights of citizens*", as set out on the policy paper published by the UK Department for exiting the EU.

It therefore makes sense for UK nationals living in a EU member-state, or in one of the EFTA states, to reach out to the equivalent of the UK Home Office in such country, and inquire how they can secure either a visa or national citizenship in this country. Since negotiating some new bilateral agreements with EU member-states and EFTA states will take years, for the UK to finalise such negotiations, UK nationals cannot rely on these protracted talks to get any leverage and obtain permanent right to remain in a EU member-state or an EFTA state.

For example, France is ready to pass a decree after 30 March 2019, to organise the requirement to present a visa to enter French territory, and to obtain a residency permit ("carte de séjour") to justify staying here, for UK citizens already living, or planning to live for more than three months, in France. Therefore, soon after 30 March 2019, British nationals and their families who do not have residency permits may have an "irregular status" in France.

While applying for a "carte de séjour" is free in France, and applying for French citizenship triggers only a 55 euros stamp duty to pay, EU nationals living in the UK, or planning to live in the UK, won’t be so lucky.

Indeed, it will set EU nationals back GBP1,330 per person, from 6 April 2018, to obtain UK citizenship, including the citizenship ceremony fee. However, there may be no fee to enrol into the EU Settlement Scheme, which will open fully by 30 March 2019, in particular if a EU citizen already has a valid “*UK permanent residence document or indefinite leave to remain in or enter the UK”*. The deadline for applying in the EU Settlement Scheme will be 31 December 2020, when the UK leaves the EU without a withdrawal deal on 30 March 2019.

Business owners and creative companies working in and from the UK will be impacted too, if they have some employees and staff. It will be their responsibility to ensure and be able to prove that their staff who are EU citizens, have all obtained a settled status: in a display of largesse, the UK government has therefore published an employer toolkit, to “*support EU citizens and their families to apply to the EU Settlement Scheme*“.

For short term stays of less than three months per entry, the UK government currently promises that “*arrangements for tourists and business visitors will not look any different*“. “*EU citizens coming for short visits will be able to enter the UK as they can now, and stay for up to three months from each entry*“.

To conclude, leaving the EU without a withdrawal agreement is going to create a lot of red tape, and be a massive time and energy hassle for EU citizens living in the UK, their UK employers who need to ensure that their staff are all enrolled into the EU Settlement Scheme, and for UK citizens living in one of the remaining 27 EU member-states. There will be no certainty of obtaining settled status from the UK Home Office, until EU citizens have actually obtained it further to enrolling into the EU Settlement Scheme. This is going to be a very anxiety-inducing process for EU citizens living in the

UK, and for their UK employers who rely on these members of their staff to get the job done.

Contingency plans should therefore be put in place by UK employers who have EU citizens on their payroll, in particular by setting up offices and subsidiaries in one of the remaining 27 EU member-states, so that EU citizens whose settled status was refused by the UK Home Office may keep on working for their UK employers by relocating to this EU member-state where they will have freedom of movement thanks to their EU citizenships. Besides the Home Office and immigration lawyers' fees, UK employers need to take into account the legal, accounting, IT and real estate costs of setting up additional offices and subsidiaries in a EU member-state, after 30 March 2019.

2. Removal of free movement of goods, services and capital

The EU internal market, or single market, is a single market that seeks to guarantee the free movement of goods, capital, services and people – the "four freedoms" – between the EU 28 member-states.

After 30 March 2019, the single market will no longer count the UK, as it will cease to be a EU member-state.

While it was an option for the internal market to remain in place, between the UK and the EU, as such market has been extended to EFTA states Iceland, Liechtenstein and Norway through the agreement on the European Economic Area (EEA), and to EFTA state Switzerland through bilateral treaties, this alternative was not pursued by the UK government. Indeed, the EEA Agreement and EU-Swiss bilateral agreements are both viewed by most as very asymmetric (Norway, Iceland and Liechtenstein are essentially obliged to accept the internal single market rules without having much if any say in what they are, while Switzerland does not have full or automatic access but still has free movement of workers). The UK, as well as EFTA members who were less than keen to have the UK join their EFTA club, ruled out such option, not seeing the point of still contributing to the EU budget while not having a seat at the table to take any decisions in relation to how the single market is governed and managed.

2.1. Removal of free movement of goods and new custom duties and tariffs

As far as the removal of the free movement of goods is concerned, it will be a – hopefully temporary – hassle, since the UK does not have any bilateral customs and trade agreements in place with the EU (because no withdrawal agreement will be entered into between the EU and the UK by 30 March 2019) and with non-EU countries (because the 53 trade agreements with non-EU countries were secured by the EU directly, on behalf of its then 28 member-states, including with Canada, Singapore, South Korea).

On 30 March 2019, the UK will regain its right to conclude binding trade agreements with non-EU countries, and with the EU of course.

While the UK government laboriously launches itself into the negotiation of at least 54 trade agreements, including with the EU, customs duties will be reinstated between the UK and all other European countries, including the UK. This is going to lead to a very disadvantageous situation for UK businesses, as the cost of trading goods and products with foreign countries will substantially increase, both for imports and exports.

Creative companies headquartered in the UK, which export and import goods and products, such as fashion, design and tech companies, are going to be especially at risk, here, with the cost of imported raw material increasing, and the rise or appearance of custom duties on exports of their products to the EU and non-EU countries. Fashion and luxury businesses, in particular, are at risk, since they export more than seventy percent of their production overseas.

Since the UK has most of its trade (57% of exports and 66% of imports in 2016) done with countries bound by EU trade agreements, both UK companies and UK consumers must brace themselves for a shock, when they will start trading after 30 March 2019. The cost of life is going to become more expensive in the UK (since most products and goods are imported, in particular from EU member-states), and operating costs are also going to increase for UK businesses.

While some Brexiters claim that the UK will be fine, by reverting to trading with the "rest of the world" under the rules of the World Trade Organisation (WTO), it is important to note that right now, only 24 countries are trading with the UK on WTO rules (like any one of the 28 member-states of the EU because no EU trade deal was concluded with these non-EU countries). After 30 March 2019, the UK will trade with the rest of the world under WTO rules, as long as the other state is also a member of the WTO (for example, Algeria, Serbia and North Korea are not WTO members). Moreover, some tariffs will apply to all UK exports, under those WTO rules.

It definitely does not look like a panacea to trade under WTO rules, so the UK government and its Bank of England will weaken the pound sterling as much as possible, to set off the financial burden represented by these custom duties and taxes.

Creative companies headquartered in the UK, which export goods and products, such as fashion and design companies, should now relocate their manufacturing operations to the EU or low wages and low tax territories, such as South East Asia, as soon as possible, to avoid the new customs duties and taxation of goods and products which will inevitably arise, after 30 March 2019.

While a cynical example, since James Dyson was a fervent Brexiter who called on the UK government to walk away from the EU without a withdrawal deal, UK creative businesses manufacturing goods and products must emulate vacuum cleaner and hair dryer technology company Dyson, that will be moving its headquarters from Wiltshire to Singapore this year.

Moreover, the UK will face non-tariff barriers, in the same way that China and the US trade with the EU. Non-tariff barriers are any measure, other than a customs tariff, that acts as a barrier to international trade, such as regulations, rules of origin or quotas. In particular, regulatory divergence from the EU will make it harder to trade goods, introducing non-tariff barriers: when the UK will leave the EU customs union, on 30 March 2019, any goods crossing the border will have to meet rules of origin requirements, to prove that they did indeed come from the UK – introducing paperwork and non-tariff barriers.

2.2. Removal of free movement of services and VAT changes

On 30 March 2019, UK services – accounting for eighty percent of the UK economy – will lose their preferential access to the EU single market, which will constitute another non-tariff barrier.

The free movement of services and of establishment allows self-employed persons to move between member-states in order to provide services on a temporary or permanent basis. While services account for between sixty and seventy percent of GDP, on average, in all 28 EU member-states, most legislation in this area is not as developed as in other areas.

There are no customs duties and taxation on services, therefore UK creative industries which mainly provide services (such as the tech and internet sector, marketing, PR and communication services, etc) are less at risk of being detrimentally impacted by the exit of the UK from the EU without a withdrawal agreement.

However, since the UK will become a non-EU country from 30 March 2019 onwards, EU businesses and UK business alike will no longer be able to apply the EU rules relating to VAT, and in particular to intra-community VAT, when they trade with UK and EU businesses respectively. This therefore means that, from 30 March 2019 onwards, a EU business will no longer charge VAT to a UK company, but will keep on charging VAT to its UK client who is a natural person. Also, a UK business will no longer charge VAT to a EU company, but will keep on charging VAT to its EU client who is a natural person.

Positive changes on VAT are also in the works, because the UK will no longer have to comply with EU VAT law (on rates of VAT, scope of exemptions, zero-rating, etc.): the UK will have more flexibility in those areas.

However, there will no doubt be disputes between taxpayers and HMRC over the VAT treatment of transactions that predate 30 March 2019, where EU law may still be in point. Because the jurisdiction of the Court of Justice of the European Union (CJEU) will cease completely in relation to UK matters on 30 March 2019, any such questions of EU law will be dealt with entirely by the UK courts. Indeed, UK courts have stopped referring new cases to the CJEU in any event, since last year.

2.3. Removal of free movement of capital and loss of passporting rights for the UK financial services industry

Since the UK will leave the EU without a withdrawal agreement, free movement of capital, which is intended to permit movement of investments such as property purchases and buying of shares between EU member-states, will cease to apply between the EU and the UK on 30 March 2019.

Capital within the EU may be transferred in any amount from one country to another (except that Greece currently has capital controls restricting outflows) and all intra-EU transfers in euro are considered as domestic payments and bear the corresponding domestic transfer costs. This EU central payments infrastructure is based around TARGET2 and the Single Euro Payments Area (SEPA). This includes all member-states of the EU, even those outside the eurozone, provided the transactions are carried out in euros. Credit/debit card charging and ATM withdrawals within the Eurozone are also charged as domestic.

Since the UK has always kept the pound sterling during its 43 years' stint in the EU, absolutely refusing to ditch it for the euro, transfer costs on capital movements – from euros to pound sterling and vice versa – have always been fairly high in the UK anyway.

However, as the UK will crash out of the EU without a deal on 30 March 2019, such transfer costs, as well as new controls on capital movements, will be put in place and impact creative businesses and professionals when they want to transfer money from the UK to EU member-states and vice-versa. While the UK government is looking to align payments legislation to maximise the likelihood of remaining a member of SEPA as a third country, the fact that it has decided not to sign the withdrawal agreement with the EU will not help such alignment process.

The cost of card payments between the UK and EU will increase, and these cross-border payments will no longer be covered by the surcharging ban (which prevents businesses from being able to charge consumers for using a specific payment method).

It is therefore advisable for UK creative companies to open business bank accounts, in euros, either in EU countries which are strategic to them, or online through financial services providers such as Transferwise's borderless account. UK businesses and professionals will hence avoid being narrowly limited to their UK pound sterling denominated bank accounts and being tributary to the whims of politicians and bureaucrats attempting to negotiate new trade agreements on freedom of capital movements between the UK and the EU, and other non-EU countries.

Also, forging ties with banking, insurance and other financial services providers in one of the remaining 27 member-states of the EU may be really useful to UK creative industries, after 30 March 2019, because the UK will no longer be able to carry out any banking, insurance and other financial services activities through the EU passporting process. Indeed, financial services is a highly regulated sector, and the EU internal market for financial services is highly integrated, underpinned by common rules and standards, and extensive supervisory cooperation between regulatory authorities at an EU and member-state level. Firms, financial market infrastructures, and funds authorised in any EU member-state can carry out many activities in any other EU member-state, through a process known as “passporting”, as a direct result of their EU authorisation. This means that if these entities are authorised in one member-state, they can provide services to customers in all other EU member-states, without requiring authorisation or supervision from the local regulator.

The European Union (Withdrawal) Act 2018 will transfer EU law, including that relating to financial services, into UK statutes on 30 March 2019. It will also give the UK government powers to amend UK law, to ensure that there is a fully functioning financial services regulatory framework on 30 March 2019.

However, on 30 March 2019, UK financial services firms' position in relation to the EU will be determined by any applicable EU rules that apply to non-EU countries at that time. Therefore, UK financial services firms and funds will lose their passporting rights into the EU: this means that their UK customers will no longer be able to use the EU services of UK firms that used to passport into the EU, but also that their EU customers will no longer be able to use the UK services of such UK firms.

For example, the UK is a major centre for investment banking in Europe, with UK investment banks providing investment services and funding through capital markets to business clients across the EU. On 30 March 2019, EU clients may no longer be able to use the services of UK-based investment banks, and UK-based investment banks may be unable to service existing cross-border contracts.

3. Legal implications of Brexit in the UK

On 30 March 2019, the European Union (Withdrawal) Act 2018 (the "**Act**") will take effect, repeal the European Communities Act 1972 (the "**ECA**") and retain in effect almost all UK laws which have been derived from the EU membership of the UK since 1 January 1973. The Act will therefore continue enforce all EU-derived domestic legislation, which is principally delegated legislation passed under the ECA to implement directives, and convert all direct EU legislation, i.e. EU regulations and decisions, into UK domestic law.

Consequently, the content of EU law as it stands on 30 March 2019 is going to be a critical piece of legal history for the purpose of UK law for decades to come.

Some of the legal practices which are going to be strongly impacted by the UK crashing out of the EU are intellectual property law, dispute resolution, financial services law, franchising, employment law, product compliance and liability, as well as tax.

In particular, there is no clarity from the UK government, at this stage, on how EU trademarks, registered with the European Union Intellectual Property Office (EUIPO) are going to apply in the UK, if at all, after 30 March 2019. The same goes for Registered Community Designs (RCD), which are also issued by the EUIPO.

At least, some clarity exists in relation to European patents: the UK exit from the EU should not affect the current European patent system, which is governed by the (non-EU) European Patent Convention. Therefore, UK businesses will be able to apply to the European Patent Office (EPO) for patent protection which will include the UK. Existing European patents covering the UK will also be unaffected. European patent attorneys based in the UK will continue to be able to represent applicants before the EPO.

Similarly, and since the UK is a member of a number of international treaties and agreements protecting copyright, the majority of UK copyright works (such as music, films, books and photographs) are protected around the world. This will continue to be the case, following the UK exit from the EU. However, certain cross-border copyright mechanisms, especially those relating to collecting societies and rights management societies, and those relating to the EU digital single market, are going to cease applying in the UK.

Enforcement of IP rights, as well as commercial and civil rights, is also going to be uncertain for some time: the UK will cease to be part of the EU Observatory, and of bodies such as Europol and the EU customs' databases to register intellectual property rights against counterfeiting, on 30 March 2019.

The EU regulation n. 1215/2012 of 12 December 2012, on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, will cease to apply in the UK once it is no longer an EU member-state. Therefore, after 30 March 2019, no enforcement system will be in place, to enforce an English judgment in a EU member-state, and vice-versa. Creative businesses will have to rely on domestic recognition regimes in the UK and each EU member-state, if in existence. This will likely introduce additional procedural steps before a foreign judgment is recognised, which will make enforcement more time-consuming and expensive.

To conclude, the UK government seems comfortable with the fact that mayhem is going to happen, from 30 March 2019 onwards, in the UK, in a very large number of industrial sectors, legal practices, and cross-border administrative systems such as immigration and customs, for the mere reason than no agreed and negotiated planning was put in place, on a wide scale, by the UK and the EU upon exit of the UK from the EU. This approach makes no economic, social and financial sense but this is besides the point. Right now, what creative businesses and professionals need to focus on is to prepare contingency plans, as explained above, and to keep on monitoring new harmonisation processes that will undoubtedly be put in place, in a few years, by the UK and its trading partners outside and inside the EU, once they manage to find common ground and enter into bilateral agreements organising this new business era for the UK.

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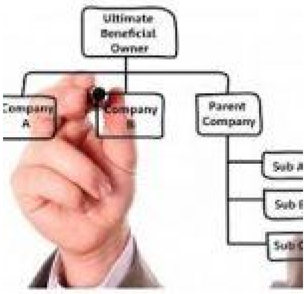
What are business owners obligations, in terms of registering beneficial ownership of their companies? How do these obligations differ, in France and the United Kingdom, even though such obligations stem from the same European legislation, i.e. the European Directive

2015/849 dated 20 May 2015 on money laundering? [hr]



1. What is this all about?

On 20 May 2015, the Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council, was published (the "**Directive**").

As set out in the recitals of the Directive, and in order to better fight against money laundering, terrorism financing and organised crime, "*there is a need to identify any natural person who exercises ownership or control over a legal entity (…). Identification and verification of beneficial owners should, where relevant, extend to legal entities that own other legal entities, and obliged entities should look for the natural person(s) who ultimately exercises control through ownership or through other means of the legal entity that is the customer*".

In addition, "*the need for accurate and up-to-date information on the beneficial owner is a key factor in tracing criminals who might otherwise hide their identity behind the corporate structure*".

Chapter III (Beneficial ownership information) of the Directive relates to such topic.

In particular, article 30 of the Directive provides that "*member states shall ensure that the information (on beneficial ownership) is held in a central register in each member state, for example a commercial register, companies register or a public register (…). Member states shall ensure that the information on the beneficial ownership is adequate, accurate and current*" and accessible "*to competent authorities, without any restriction; (…) and to any person or organisation that can demonstrate a legitimate interest*".

These persons or organisations shall access at least the name, the month and year of birth, the nationality and the country of residence of the beneficial owner as well as the nature and extent of the beneficial interest held.

2. Registration of beneficial ownership in French companies

With typical Gallic nonchalance, and while the deadline to transpose the Directive in each member-state was 26 June 2017, France transposed the Directive almost one year later, through its Ordinance n. 2016-1635 of 1 December 2016 reinforcing the French mechanism against money laundering and the financing of terrorism and of the Decree n. 2017-1094 of 12 June 2017 relating to the registry of effective beneficiaries as defined in article L. 561-2-2 of the French monetary and financial code (the "**Ordinance**" and the "**Decree**" respectively), with a compliance deadline of 1 April 2018.

The Ordinance and Decree, which have now been incorporated in the French monetary and financial code, compel all companies operating in France to register their beneficial owners with the Registry of Commerce and Companies of the competent Commercial court (the "**Registry**").

2.1. Beneficial ownership and filing with the Registry

The notion of beneficial ownership is not defined in the Decree, although is it defined in the Directive as including each natural person who either ultimately owns, directly or indirectly, more than 25% of the share capital or voting rights of the company, or exercises, by any other means, a supervisory power on the managing, administrative or executive bodies of the company or on the shareholders general assembly.

The information that must be filed is essentially identical to that required by financial institutions and other entities such as law firms, in order for them to carry out their mandatory Know-Your-Client (KYC) procedures.

2.2. The initial filings

The declaration of beneficial ownership must be filed at the Registry when a company is first registered with the Registry or, at the latest, within 15 days as of the date of issuance of the receipt of registration (article R. 561-55 of the French monetary and financial code) i.e. when it is created or opens a branch in France.

2.3. Corrective filings

For companies already registered, the deadline for the declaration is 1 April 2018. If subsequent updates are required, new filing must be made within 30 days as of the fact or the act giving rise to a required update (article R. 561-55 of the French monetary and financial code).

2.4. On the beneficial owner

The declaration must set out the owner’s name and particulars, as well as the means of control exercised by the beneficial owner and the date on which s/he became a beneficial owner (article R. 561-56, 2. of the French monetary and financial code).

2.5. Persons having access to the register of beneficial owners

Access to the register of beneficial owners is limited to magistrates of the civil courts and the Ministry of Justice; investigators working for the Autorité des Marchés Financiers (French financial markets regulator); agents of the Direction Générale des Finances Publiques (Directorate-General for Public Finances); qualifying credit institutions, insurance and mutual insurance companies and investment services providers; and any person authorised by a court decision to this effect.

2.6. Penalties for non-compliance

The new provisions of the French monetary and financial code provide remedial penalties with the possibility for any person having a legitimate interest to bring an action in order to force the defaulting company to fulfil its obligation to declare its beneficial owners (article R. 561-48 of the French monetary and financial code).

Punitive provisions have also been introduced: failure to declare the beneficial owners to the Registry or filing a declaration involving incomplete or inaccurate information is punishable by 6 months of imprisonment and a fine of Euros 7,500 (article 561-49 of the French monetary and financial code).

3. Registration of beneficial ownership in British companies

Well within the deadline to transpose the Directive in each member-state of 26 June 2017, the United Kingdom transposed the Directive on time, through its new paragraph 24(3) of Schedule 1A of the Companies Act 2006, as amended by Schedule 3 to the Small Business, Enterprise and Employment Act 2015 (the "**Companies Act**" and "**Enterprise Act**" respectively), with a compliance deadline of 30 June 2016.

The Companies Act and Enterprise Act, compel all companies operating in the United Kingdom to keep a register of Persons with Significant Control ("**PSC register**") and to file this PSC information via their confirmation statements, upon the due filing date of their respective confirmation statements with Companies House, i.e. the British equivalent to the French Registry of Commerce and Companies of the competent Commercial court ("**Companies House**").

3.1. Beneficial ownership and filing with Companies House

The notion of beneficial ownership, or significant influence or control, as set out in the Companies Act, is defined in the Companies Act as including each natural person who either ultimately owns, directly or indirectly, more than 25% of the share capital or voting rights of the company, or exercises, by any other means, a supervisory power on the managing, administrative or executive bodies of the company or on the shareholders general assembly.

UK companies, *Societates Europae* (SEs), Limited liability partnerships (LLPs) and eligible Scottish partnerships (ESPs), will be required to identify and record the people with significant control.

3.2. The initial filings

The PSC information must be filed with the central public register at Companies House when a company is first registered with Companies House, i.e. when it is created or opens a branch in the UK.

In addition, new companies, SEs, LLPs need to draft and keep a PSC register in relation to them, in addition to existing registers such as the register of directors and the register of members (shareholders).

3.3. Corrective filings

For companies already registered, on 6 April 2016, the Companies Act required all companies to keep a PSC register and, from 30 June 2016, companies started to file this PSC information via their confirmation statements.

As each company has a different filing date, based on the anniversary of their respective incorporation, it took up to 12 months (i.e. 30 June 2017) to develop a full picture of all UK companies' PSCs.

3.4. On the beneficial owner

Before a PSC can be entered on the PSC register, you must confirm all the details with them.

The details you require are:

- name;
- date of birth;
- nationality;
- country, state or part of the UK where the PSC usually lives;
- service address;
- usual residential address (this must not be disclosed when making your register available for inspection of providing copies of the PSC register);
- the date s/he became a PSC in relation to the company (for existing companies, the 6 April 2016 was used);
- which conditions for being a PSC are met;
    - this must include the level of shares and/or voting rights, within the following categories:

        - over 25% up to (and including) 50%;
        - more than 50% and less than 75%;
        - 75% or more;
    - the company is only required to identify whether a PSC meets the condition relating to the control and significant influence, if they do not exercise control through the shareholding and voting rights conditions;
- whether an application has been made for the individual's information to be protected from public disclosure.

3.5. Persons having access to the register of beneficial owners

A company's PSC register should contain the information listed in paragraph 3.4 above, for each PSC of the company. However, that may not always be possible. Where, for some reason, the PSC information cannot be provided, other statements will need to be made instead, explaining why the PSC information is not available. The PSC register can never be blank and such information must be provided to Companies House.

Unlike in France PSC information is freely available, for each company, on Companies House's website.

As the PSC register is one of the company's statutory registers, each UK company must keep it at its registered office (or alternative inspection location). Anyone with a proper purpose may have access to the PSC register without charge or have a copy of it for which companies may charge GBP12.

If compared with the French situation, it is therefore much easier to obtain the PSC register for a UK company, than for a French company.

3.6. Penalties for non-compliance

Company officers who fail to take all reasonable steps to disclose their PSCs are liable to be fined or imprisoned (by way of a prison sentence of up to two years) or both. If an investigated person fails to respond to the company's request for information, the company is allowed to "freeze" the relevant shares by stopping proposed transfers and dividends in relation to those shares.

Annabelle Gauberti is the founding partner of Crefovi, our London and Paris law firm specialised in advising the creative industries in general, in particular on their corporate and business law requirements. She is a solicitor of England & Wales, as well as an "avocat" with the Paris bar.

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