

Reform of French Insolvency Proceedings - Key Points

Ordinance No. 2008-1345 of 18 December 2008, published in the Official Journal on 19 December 2008 (the “**Ordinance**”), will reform the Business Safeguard Act (*loi de sauvegarde des entreprises*) of 26 July 2005, which has been in effect since 1 January 2006.

The principal provisions of this Ordinance will come into force on **15 February 2009**, and will apply to insolvency and quasi-insolvency procedures opened from such date.

The principal objective of the Ordinance is to make the safeguard procedure (*procédure de sauvegarde*) more accessible and more attractive. In order to achieve this, the Ordinance relaxes the conditions which must be satisfied in order to initiate safeguard proceedings, encourages debtors to use the procedure by reinforcing the powers of directors, and substantially alters the rules governing the membership and functioning of creditors’ committees. Various measures to facilitate the continuation of the debtor’s business during the observation period have also been introduced. Finally, the Ordinance clarifies both the responsibilities of creditors and directors, and the sanctions applicable to them.

1 Initiation of safeguard proceedings

From now on, safeguard proceedings may be opened at the request of a debtor which “without being cash flow insolvent (*en cessation des paiements*), is experiencing difficulties that it is unable to overcome”.

Safeguard is still only available to debtors which are not cash flow insolvent. However, a debtor experiencing difficulties is no longer required to demonstrate that such difficulties are of a nature that would lead to it becoming cash flow insolvent, a fact which, in practice, was difficult to prove.

The definition of “cash flow insolvency” (*cessation des paiements*), which marks the boundary between safeguard (*sauvegarde*) and administration (*redressement judiciaire*), has also been modified by the Ordinance to take into account undrawn credit and extensions to payment deadlines granted by creditors: “a debtor which establishes

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that its undrawn credit lines or the moratoria granted to it by its creditors enable it to meet its current liabilities with its available assets is not cash flow insolvent (*en cessation des paiements*)”.

2 Creditors’ committee / Bondholders’ meetings

The Ordinance amends the rules governing the composition and functioning of the various creditors’ committees and bondholders’ meetings, in particular by taking into account the experience gained during the Eurotunnel safeguard procedure.

Composition of creditors’ committees

The principle of having two separate creditors’ committees, one composed of credit establishments and the other of suppliers, is maintained under the Ordinance. However, membership of the credit establishments’ committee has been extended to include:

- certain lenders ‘assimilated’ to credit establishments, the list of which is to be determined by decree, and
- holders of debt acquired from credit establishments, or lenders ‘assimilated’ to credit establishments, provided that the debt acquired was incurred prior to the opening judgment of the relevant collective proceedings.

In addition, the Ordinance confirms that the right to join the creditors’ committee constitutes “an accessory to debt incurred prior to the opening of proceedings” and “shall be transferred to all successive holders of such debt, notwithstanding any provision to the contrary”.

These measures confirm that transferees of debt which are not credit institutions are entitled to participate in the creditors’ committee, dealing with the uncertainty which surrounded the issue before the reform.

In addition, it is expressly provided that any creditor whose debt is extinguished ceases to be a member of the creditors’ committee. This change deals in particular with the issue of factor creditors, whose debt is extinguished by payment of receivables after the opening of the safeguard.

The goal of extending membership of the committees is achieved, as regards the suppliers’ committee, by reducing the threshold for membership from 5% to 3% of the total debt (excluding tax) owed to suppliers on the date safeguard proceedings are commenced.

Other creditors

There are some limits to the extended membership of the creditors’ committees however, and notably the Ordinance provides for special

treatment of two classes of creditor: bondholders and creditors secured under a fiduciary arrangement (*fiducie-sûreté*).

- **Bondholders**

Although bondholders are still not members of the creditors' committees, they are from now on united in a single decision making assembly, whose purpose will be to consider and approve (by a majority of two-thirds (calculated as a proportion of the debt held)) the draft safeguard plan adopted by the two creditors' committees, regardless of the number of bond issues made or whether the issues are French domestic issues or issues made outside of France. This removes a doubt as to how holders of different issues of bonds are to be treated.

- **Creditors benefiting from *fiducie-sûreté***

The Ordinance provides that creditors benefiting from fiduciary security will be consulted in the same way as creditors not forming part of the creditors' committees, in respect of whom the court can impose only payment deferrals of up to ten years (therefore excluding any waiver or conversion of debt without the consent of each such creditor). The objective of the Ordinance is to ensure that creditors benefiting from fiduciary security are not bound by the decision of the majority, which might otherwise oblige them to take steps that would undermine the superior status of their fiduciary security relative to other forms of security. It should be noted however that implementation of fiduciary security under French law provisions introduced in 2007 has so far been hindered by significant practical hurdles (notably as regards creation and transfer). Reform of these provisions is awaited.

Relaxation of the rules governing the functioning of the creditors' committees

- **Procedural rules**

Various measures have been introduced with a view to improving the rules governing the functioning of the committees. For example, the timetable for carrying out consultations has been relaxed and now simply provides for a period of six months within which the relevant consultations must be completed (subject to a minimum 'reflection period' between the submission of proposals and the subsequent vote on such proposals). The previous regime provided for a number of intermediate deadlines which were often too restrictive in practice.

It is important to note that creditors have also been granted the right to submit proposals to the debtor and administrator while the safeguard plan (*plan de sauvegarde*) is being prepared, which brings more balance in the debtor and creditors' respective powers.

The rules governing voting have also been relaxed by the abolition of the requirement for a double majority (now only a majority of two-thirds calculated as a proportion of the debt held, and not also as a proportion of the number of creditors in the committee, will be required). Furthermore, the requisite two-thirds majority will henceforth be calculated as a proportion of the debt held by the creditors who voted, rather than as a proportion of the debt held by all the members of the committee.

Finally, in order to ensure that appeals do not cause excessive delays to the adoption of a safeguard plan, the Ordinance provides that creditors may only challenge the decisions made by the committee or assembly of which they are a member.

• **Substantive changes**

These relaxations in respect of the rules governing the functioning of the committees are accompanied by a more fundamental change. The draft plan submitted to the creditors' committees may from now on provide for the conversion of debt into securities giving, or capable of giving, the holder access to the share capital of the company (although this option will only be available to limited liability companies). This is a significant change as it expressly allows for the creditors' committee (by majority vote) to impose a debt for equity swap. Such a conversion still requires the approval of the shareholders. More generally, if it can be justified by the circumstances, the plan may also provide for differential treatment of creditors. In spite of these amendments, certain elements of the safeguard procedure (proving for debts, consultation of suppliers, etc) do not make it easy (other than perhaps where the debtor is a pure holding company) to use the safeguard procedure for the sole purpose of endorsing restructuring agreements made between the debtor and the majority of its lenders prior to the opening of the procedure, and which would require, outside a safeguard procedure, unanimous consent ('pre-pack' procedures).

3 Reinforcement of directors' powers in relation to the administration and reorganisation of the company

Changes to directors' powers

The Ordinance extends the prerogative of the directors/debtor during the safeguard procedure, and thereby makes this procedure more attractive to them.

- **Choice of administrator**

From now on, in the context of a safeguard procedure (and as is the case for *mandat ad-hoc* and conciliation), a debtor will be able to propose the name of its preferred administrator to the court.

- **Freezing of certain guarantee claims**

The Ordinance also extends the categories of person who can benefit from the suspension of the accrual of interest and the freeze on legal proceedings during the safeguard procedure to include “natural persons who are co-obligors or who have granted *in personam* security interests or have assigned assets by way of security”. This will therefore apply to guarantees (*cautionnements*), stand-alone guarantees (*garanties autonome*) and letters of intention (*lettres d'intention*), together with *in rem* and similar security (*in rem* guarantee (*cautionnement réel*), retention rights (*droits de retention*) and property held as security (*propriété-garantie*), provided that such security has been granted by a natural person, for example by a director or a director’s relative.

- **Preparation of plan and changes in business operations**

The option of going to court to request a partial cessation of business, to ask the judge to authorise disposals outside the ordinary course of business, or to propose guarantee or security substitutions to creditors, will from now on be reserved to the debtor, without the need to involve the administrator.

The role of the directors is also strengthened as regards the preparation of the company’s safeguard plan: it is for the directors, in collaboration with the administrator, to prepare the safeguard plan and to propose it to the creditors.

- **Removal of directors**

The Ordinance removes the risk of the directors of the debtor being ousted during a safeguard procedure by deleting the provisions whereby, at the request of the public prosecutor, the adoption of a safeguard plan can be made subject to the removal of one or several of the directors, or the non-transferability or forced transfer of their shareholders’ rights. These provisions are however maintained in the context of administration proceedings (*redressement judiciaire*).

Conversion of safeguard into administration proceedings

The outcome of the observation period remains substantially unchanged: either a safeguard plan will be adopted (accompanied, as the case may be, by the sale of one or several businesses) or the company will go into administration (*redressement judiciaire*) or involuntary liquidation (*liquidation judiciaire*) if the relevant conditions are satisfied. The Ordinance also provides that a debtor may request

that a safeguard procedure (*sauvegarde*) be converted into an administration procedure (*redressement judiciaire*), where “the adoption of a safeguard plan is manifestly impossible and the termination of the procedure would lead, certainly and within a short period of time, to insolvency”, without the debtor having to wait until it actually becomes cash flow insolvent.

It is important to note that contrary to what was at one point envisaged in the draft reform, the Ordinance has not introduced the possibility of a total sale of the business in safeguard, as exists in the context of an administration. However, the extension of the circumstances in which a safeguard procedure can be converted into an administration procedure should make it possible to obtain a very similar outcome.

Finally, in the event that a debtor becomes cash flow insolvent (*en cessation des paiements*) during a safeguard procedure, the Ordinance removes the obligation for the court to order an involuntary liquidation. From now on, if recovery is still possible, administration proceedings may be commenced instead.

4 Improvements to the conditions relating to the reorganisation of the company

The Ordinance introduces various technical provisions aimed at facilitating the continuation of the debtor’s business during the observation period and the preparation of the safeguard plan, notably by altering the effects of certain types of security and facilitating the payment of certain debts.

• Fiduciary security

For example, where a debtor has granted fiduciary security (*fiducie-sûreté*) over its rights or assets, and that debtor is entitled, pursuant to a usage agreement (*convention de mise à disposition*), to the use or enjoyment of those rights or assets, the Ordinance provides that no assignment or transfer of such rights or assets for the benefit of a creditor can be triggered solely by the initiation of safeguard proceedings, non-payment of a debt incurred prior to the opening judgment of such proceedings, or the adoption of a safeguard plan.

Similarly, the Ordinance also neutralises any provisions of a fiduciary contract (*contrat de fiducie*) preventing the termination of ongoing contracts solely due to the opening of safeguard proceedings or a default arising prior to such date, with the notable exception of the agreement pursuant to which the debtor is entitled to the use or enjoyment of the assets transferred as fiduciary property (*patrimoine fiduciaire*).

- **Pledges without dispossession**

In the same vein, creditors benefiting from a pledge without dispossession (*gage sans dépossession*), which have a retention right (*droit de rétention*) since the law of 4 August 2008 implementing article 2286 (4°) of the French Civil Code (*Code civil*), cannot enforce their retention right during the observation period and the implementation of the safeguard plan, unless the pledged asset is included in a business sale. This provision will enable a debtor, for example, to use stock which is the subject of a pledge without dispossession (*gage sans dépossession*), subject to the provisions of articles L. 527-1 *et seq.* of the French Commercial Code (*Code de commerce*). This unenforceability will also apply in the context of an administration (*redressement judiciaire*). It will not however affect retention rights created by other specific texts (e.g. pledges of shares in limited liability companies (*nantissement de comptes-titres*)).

- **Payments permitted to certain creditors**

Also with a view to facilitating the continuation of the debtor's business, the reform extends the circumstances in which debts incurred prior to the opening judgment of the safeguard procedure may be repaid. In addition to payments made in order to obtain the return of assets pledged to, or legitimately retained by, a third party, the exceptions to the suspension of payments rule will henceforth also include payments made to obtain the return of rights and assets transferred as fiduciary property (*patrimoine fiduciaire*) by way of security, and payments made to exercise the purchase option in a leasing contract, where the exercise of such option is justified by the pursuit of the business and the payment to be made is of an amount less than the market value of the asset to be purchased.

5 Changes to liabilities and sanctions

The Ordinance makes two clarifications in respect of the liability of creditors for the provision of credit:

- action against a provider of credit for responsibility under art. L. 650-1 of the French Commercial Code (*Code de commerce*) (limited to fraud, substantial interference in the management of the debtor or disproportionate guarantees and security) can only be taken once collective proceedings have been started (safeguard, administration or liquidation). However, it is still not clear from the text when the acts which potentially give rise to liability must have been carried out.

- relaxation of sanctions: the cancellation by the court of guarantees and security found to be excessive is now optional rather than mandatory. From now on, judges will also have the alternative of simply reducing the extent and scope of such guarantees and security.

In relation to directors' liabilities, the Ordinance also clears up a previous ambiguity by limiting the maximum liability for mismanagement (*faute de gestion*) to the amount by which the company's assets are found to be insufficient. Furthermore, it will from now on be impossible for a director of a company convicted of having insufficient assets, who is also a creditor of that company, to participate in the distribution of that company's assets and thus to recover sums in respect of which he has been found liable.

Finally, liability for corporate debts (*obligation aux dettes sociales*), which sought to make directors through whose fault a company had become insolvent (*en cessation des paiements*) liable for its debts, has been abolished, as practice has shown since 2006 that it overlapped with liability for insufficient assets.

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