

**INSOL
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2 years after the entry into force of the new French law described as the “Law regarding the rescue of enterprises”, it is possible to focus more clearly on a few interesting points in order to take stock as to the effectiveness of the new regulations.

I should perhaps first remind you of the main characteristics of the new law before making some personal remarks and giving you the latest statistics about the new proceedings.

For having a direct access to the French insolvency law, see on the following website: www.legifrance.fr, the commercial code is available in English version. Insolvency proceedings are regulated by the 6th Book (“Livre VI”) of the code.

1. Principles and characteristics of the new proceedings

Actually we are now far from the Commercial code enacted 200 years ago under Napoleon, for which the debtor was deemed fraudulent.

The new law is aimed at facilitating corporate rescue by means of a voluntary process which is extended to those who operate and manage the corporate enterprise. As to the various techniques provided by the new law, they have been called a “boite à outils” (a tool kit).

1.1 The mandat ad hoc

It is now possible for the debtor to apply and seek to open pre-insolvency proceedings for assistance in order to enter into a pre-insolvency process based on dealing with any form of problem by means of all appropriate negotiations, including the preparation of a restructuring plan. The enterprise will invariably be cash insolvent and the mandataire ad hoc (designated as being appointed “for this purpose”) as appointed by the court upon application filed by the debtor (c. com. art L 611-3). No specific duties will be imposed upon the mandataire, who simply acts as a crisis manager, appointed by a judge. This practitioner is appointed in order to negotiate any kind of agreement with creditors without any legal advertisement nor any need for him to assess or approve or admit claims: moreover, he will not be subject to any time constraints in which to deal with the situation of the troubled company. The debtor, of course, keeps all its powers with regard to the operation of its business affairs. The mandataire ad hoc fulfils the functions of an auditor: he does not act as a liquidator or as an administrator vested with any powers in running the business. Such proceedings are extremely useful and often successful. Sometimes, however, the “mandat” issue is merely a first step toward the second kind of proceedings which I shall now turn to.

1.2 Conciliation

When facing a financial crisis (and prior to any formal insolvency), a company may use a form of pre-insolvency proceeding called “conciliation” or alternatively chose to file for specific insolvency proceedings called “sauvegarde”.

Both of these forms of proceedings are opened only upon application made by those in control of the company, i.e. its managers, without any possibility for creditors to file involuntary proceedings against the company as long as the demand filed by the debtor is not rejected.

Conciliation offers several advantages.

First, the court has not to advertise the fact of conciliation by legal publication. A practitioner will be appointed who is called a “conciliator” and whose aim is to reach an agreement with the principal relevant creditors. No judicial assessment of the claims need be addressed by the conciliator (c. com. art. L 611-7).

Creditors who do not want to sign up to any agreement are not bound by it. However, the president of the court may impose a postponement of the debts due to these creditors, if need be.

The tax and social security authorities may grant the debtor a suitable deferment of their debts as well a remission of their debts within an approved agreement on the same basis as in the case of non-public creditors (c. com. art. L 611-17). That is a great step forward, as to public claims before a deep financial illiquidity.

On the other hand, some advantages have been created by the new law, in order to give creditors an incentive in favour of supporting such an arrangement:

Any “new money” provided to the debtor in relation to such an agreement will be granted in the form of a priority in the event of subsequent formal insolvency proceedings (c; com. art. L 611-11).

Not all such agreements create such a priority right: The agreement has to be approved by the court (c. com. art. L 611-8). This is the reason why creditors often prefer not to file for any judicial approval, choosing instead to opt for a non public procedure without the need for any hearing and with no advertisement of the decision. As we say in French “Pour vivre heureux vivons cachés”, i.e. if you want a good life, you better keep quiet about it.

That is the reason why the law allows the parties to ask the court to record their agreement by order without the need for a formal ratification: This is called “constatation de l'accord amiable” (c. com. art. L 611-8), following a formal declaration stating that the debtor is not insolvent or no longer insolvent.

Most of these provisions give troubled companies a real breathing space and enable them to facilitate their recovery in an informal manner. In fact, 60% of conciliation proceedings are successful.

1.3 Rescue proceedings

The “procédure de sauvegarde” has been generally called “redressement judiciaire anticipé” (anticipated judicial reorganisation). It is applicable to companies facing financial difficulties prior to insolvency (c. com. art. L 620-1) and attracts most of the characteristics of judicial reorganisation proceedings, such as a general stay on individual proceedings, a stay on financial claims and the appointment of an administrator and the preparation and approval of a plan of reorganisation. Such a general stay is quite important since it prevents secured creditors from acquiring any

advantages during the relevant period. Only two kinds of security remain valid: retention of title in respect of goods and a lien with a right of retention.

After 2 years of this procedure being in operation, one can say that it seems to have been in part at least, successful.

About 500 companies in one year have filed for rescue proceedings under this court regime (see below statistics). This seems very few if we take into consideration the number of proceedings opened by commercial courts: they amount to about 50,000 per year!

However, this last figure is not relevant:

- (1) because most of the proceedings are liquidation proceedings which generally apply to small corporate entities with no real chance of rescue (comprising more than 80% of the total figure); and
- (2) because many “sauvegarde” proceedings apply to big and medium sized companies and enterprises.

Rescue proceedings contain many characteristics of which the following are the most relevant:

First, only the debtor may file for the opening of the proceedings. Next, a reorganisation plan may be invoked by virtue of the guarantees afforded to creditors. Third, the debtor remains in possession. Fourth, the company cannot be sold and the proceedings are aimed at a continuation plan to preserve the enterprise as a going concern; and finally, the question of redundancy will be subject to the Code du Travail, i.e. the general law and not to the Code de Commerce, i.e. insolvency law provisions as a whole.

Other characteristics remain common to both “sauvegarde” proceedings and to “redressement judiciaire” proceedings (judicial reorganisation proceedings), without any major changes having been introduced. Such proceedings have been used for small and medium sized companies, and also for far larger enterprises: for example, the Eurotunnel Group has filed for rescue in respect of its various companies and subsidiaries across Europe.

1.4 Judicial reorganisation proceedings

This form of proceeding presents some traditional features: There is a general stay, there is a system of proofs of debt, there is a plan prepared by the administrator with specific rights granted to suppliers and secured creditors, e.g. those with leasing entitlements or retention of title claims. Moreover, it offers some new features similar to those found in rescue and reorganisation proceedings.

So for example, pending contracts can be continued by the administrator; in large companies, (i.e. where there are more than 150 employees and a turnover of more than €20 million per year) creditors’ committees have to be set up by the administrator, one committee representing institutional lenders such as banks and the other in respect of principal suppliers. These committees convened by the administrator have to vote on the proposals made by the debtor (c. com. art. L 626-29 s.).

If they do express their approval, the court approves the plan. If not, all the creditors then in effect agree to postpone their claims. If the plan seems serious and workable, the

court will approve it. If the debtor does not get a sufficient positive vote by creditors in favour of the proposed plan, or if the plan does not seem feasible, the court may order liquidation.

Liquidation can also be ordered at any time, if the company does not pay its current debts within a reasonable timeframe during the proceedings or if the plan is not fully adhered to by the debtor.

The law provides time limits in order to avoid being too protracted: an observation period should not last for more than 6 months (or at most an additional 6 months after that): such delays generally should be sufficient to allow the court to decide upon the future of the company.

The proceedings usually are terminated by the adoption of a plan or by a liquidation order, within these relevant time limits.

In both these two proceedings (i.e. "sauvegarde" and judicial reorganisation), creditors are not grouped as one single general assembly for voting purposes except in the case of creditors' committees. The law provides for a solicitation of their opinion on the progress of the proceeding and the court takes their views into consideration without any binding effect.

1.5 Judicial liquidation

In this area, no major specific modifications have been provided for by the new law. Some characteristics however should be mentioned. A plan involving the transfer of the business of the company as a whole may be ordered by the court, even in liquidation proceedings, when such a solution appears to be economic and efficient (c. com. art. L 642-1). Otherwise it is possible to order a transfer of part of the enterprise as a going concern. After the end of all the company's operations and the realisation of its assets, and the payment of creditors (depending on the value of the assets), closure is ordered by a formal court judgment. As to companies, it entails cancellation of the legal entity from the Register of commerce and companies. As to individual debtors, it entails a discharge in respect of debtors who have been properly and honestly run: exceptions are provided by the Code de Commerce in specific cases similar to the equivalent provisions in the US Bankruptcy Code (c. com. art. L 643-11).

For small enterprises (i.e. where there is no immovable property, fewer than 6 employees and a smaller turnover than €750,000 per year) specific rules have been established by the legislation in order to authorise expedited proceedings, i.e. where less than 1 year is involved (c com art L 641-2 and L 644-1 s.). Such rules, however, can be chosen only in respect of simple proceedings and where there are no pending law suits or any legal proceedings against the directors or third parties or any other procedural difficulties.

Most insolvency proceedings are liquidation proceedings (90%) and where very small enterprises are involved: The most common examples involve individual traders or companies with less than 10 employees.

2. Some remarks on the new French insolvency law

It is perhaps appropriate now to focus on a few pertinent points in relation to French insolvency law generally.

2.1 More debtors

First, one should stress the influence of the US Bankruptcy Code in general upon the reforms in French law. This influence was already apparent 20 years ago with the enactment of the “plan” as a tool to assist in the reorganisation of troubled companies as well as with regard to the discharge from insolvency afforded to individual debtors in good faith. The influence appears today in relation to two other major innovations. First, with regard to the possibility of applying for insolvency proceedings prior to insolvency (by this I mean rescue proceedings) and secondly, in relation to the creation of two creditors’ committees, vested with rights to vote on the proposals made by the debtor for biggest companies.

In addition, the scope of insolvency proceedings has been expanded in two directions. First, all those persons whom one can regard as professionals, i.e. lawyers, architects, doctors, etc are now authorised to file for bankruptcy. Certain useful specific provisions can be referred to: for example, their mail cannot be redirected in favour of their Official organisations (“Ordres”) are legally appointed as “controllers”, in order to supervise operations and actions lead by the administrator or liquidator in respect with specific requirements as professional secrecy.

A second development needs to be underlined: namely the application of proceedings to groups of companies, by “extension” (“i.e. substantive consolidation) of whatever proceedings are pending as between a company and another company in the same group. The law envisages two kinds of cases which have received the blessing of French Cour de cassation: proceedings can be applied to another company, even solvent, whenever there is a co-mingling of their assets and liabilities, i.e. if one can prove there existed between them an abnormal financial situation or if the insolvent company appears to be a sham entity (c. com. art. L 621-2).

Moreover, I should mention in relation to that point another provision which existed prior to the new law, namely the possibility of holding the parent company liable for the payment of the debts of its subsidiary to the extent of its involvement in the latter’s business. One calls it: “gestion de fait” (a form of *de facto* direction).

2.2 More flexibility for the distressed company

The new legal provisions offer to debtors and their partners a real choice, among the various proceedings, depending on the level of indebtedness. As far as possible, the debtor itself at least may chose between two or more proceedings, namely conciliation and judicial reorganisation, and in the case of a more recent insolvency, conciliation or “sauvegarde” prior to actual insolvency. Moreover, if liquidation is opened by the court, the company still may be sold as a going concern by its selling assets as a whole to another company or by the selling of its shares to new shareholders.

In different proceedings, securities are still available, with very few restrictions upon the rights of secured creditors.

2.3 More rights for creditors

A third aspect which deserves a mention is the significant role entrusted to creditors and the recognition of their rights and interests, when dealing with companies facing financial difficulties. As to this aspect, I obviously mean the committees of creditors prescribed for large companies, as I have already mentioned.

It is also necessary to focus on several provisions granting creditors a better treatment, for example in relation to the lodging of their claims, and the constitution of new securities in the form of a trust (“fiducie”).

I would finally like to underline the fact that the bankruptcy judge can nominate, upon application, certain creditors as “controllers”. This possibility has been provided for by the law for a long time, but it has been modified and widened by the new law. The Commercial Code provides these controllers with the right to engage in and prosecute proceedings, in respect with the collective interest of creditors, whenever the liquidator does not wish to act (c. com. art. L 622-20).

The Commercial Code was finally amended in order to create a kind of solidarity between the Tax & Social Security Authorities and private creditors. With this purpose in mind, new provisions allow these authorities to agree to the postponement of their debts, as well as to the remission of their debts. Such relief can be granted in much the same way as the debtor achieves a similar result with its banking creditors and suppliers. The goal of this rule is a double one: to make the rescue of troubled companies easier and to avoid any reproach as to the rule of fair and free competition (c. com. art. L 611 -7 for conciliation proceedings, art. L 626-6 for “sauvegarde” proceedings and art. L 631-18 for reorganisation proceedings).

The French legislation did not dare go any further and relax the legal privileges granted to tax claims in the same way as the English Enterprise Act did a few years ago.

Lastly, I have to mention a specific provision in the new law which grants the creditors a particularly high level of protection. Creditors who have financially supported the debtor are now protected against any collective action filed by the liquidator in respect of their individual liability. Such a rule has been criticised, but in fact it has been enacted as an incentive to creditors who are to be, and can be expected to grant financial support to distressed companies. Liability can only be engaged under specific conditions, i.e. in the case of fraud on the part of a creditor, or if a creditor has acted as a *de facto* manager, or if a creditor has acquired too many securities in respect of the same debt (c. com. art. L 650-1).

Outside the field of insolvency law, I should perhaps mention that after the new law regarding the rescue of companies, another bill has been passed in February 2007 in order to introduce the concept of trust into French law. It therefore grants a new form of security to credit institutions: the trustee and the beneficiary are well protected against the insolvency of the settlor, since its assets remain out of any insolvency proceedings.

2.3 More contract and less court

The involvement of creditors is very visible from the time of the very commencement of the proceedings up to the end, particularly if a plan is approved by them.

One of the signs which indicates a certain withdrawal from the process on the part of judges can be viewed in the case of a plan being presented by the debtor: the courts here have very restrictive powers in the face of a plan approved by the creditors’ committees: they can only check if the interests of other creditors are respected, whatever the duration of the plan and its content.

3. Some statistics.

Thanks to Deloitte Finance and Altares, we are able to evaluate the effectiveness of the new proceedings.

A better legal framework has first entailed a diminution of 4,5% of proceedings in 2006, the first year of the new law.

A major visible trend shows links between the size of companies and their insolvency. Most of reorganisation proceedings and transfer plan of companies as a going concern involve biggest companies.

For the last 18 months (January 2006 up to June 2007), 740 rescue proceedings have been opened, i. e. about 1% of all insolvencies (50 000 per a year). They apply mainly to SME, and generally young entities (50% are less than 10 years old).

New pre insolvency proceedings are widely successful: one observe an increase of 30% for “mandat ad hoc” proceedings and an increase of 200% for “conciliation” proceedings (compared to the former amicable settlement).

Moreover, a quite important number of new proceedings concerns independent individual debtors, who were not allowed before 2006 to file for bankruptcy.

Final remarks.

First, there are still some legal aspects which remain and can be viewed as elements of weakness in the overall scheme.

No legal effect arises out of the mere filing of a case in front of the court: it is necessary to await the making of a judicial order, i.e. on the opening of proceedings upon application which may result in a delay of one or two weeks before a general stay can be obtained.

No votes expressed by creditors are planned by the law except in insolvency proceedings which involve the largest companies which benefited from the presence of creditors' committees.

However, as a final remark, I should stress the rapprochement of the French law with laws of similar countries in Europe and throughout the world. By improving the legal process and the procedures regarding the rescue of companies and the rights of creditors generally, the French legislator has come closer to its neighbours in a very appreciable manner.

With this new law, the French legislator has also in practise recognised, and has taken into account, the guidelines and recommendations provided by the UNCITRAL Legislative guide on insolvency. Three examples of this influence can perhaps be stressed: first, the right granted to controllers who can act if the liquidator does not seek to act either of his own accord or in respect of the collective interest of creditors: second, there is a greater incentive in favour of negotiations generally, and third, there is now a more flexible approach towards insolvency with particular regard to the way in which insolvency proceedings are opened.

This overall trend may contribute not only to limiting the risk of forum shopping (that often means shopping for laws), but it also improves the attractiveness of French law to companies and investors generally.

This therefore enables me to end this talk on a note of optimism.