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Chapter 11 *à la française*: French Insolvency Reforms

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Introduction: new French reforms and background

The French Minister of Justice has recently introduced new draft proposals ('the Draft Law') the overall aim of which is to cure a company's financial problems even more quickly and efficiently than seems to be the case at the moment, largely through creditor input. This is also to be achieved by means of quick asset sales or by the use of a moratorium to stem any further losses created by the debtor company.

It is envisaged that there will be at least two committees of creditors representing largely trade and financial creditors respectively. The mechanics of operating the committees are still to be worked out but further mention will be made of this development below.

The perceived existing problem is that out-of-court procedures may be said to suffer from two fundamental defects, namely that the debtor will have not been granted complete or sufficient protection from continuing liabilities, whilst creditors equally will not have been afforded similar cover against increasing exposures. These problems, according to some, have meant that, far from saving companies from formal insolvency, the present system has in fact contributed to the far more rapid decline of companies in difficulties into some form of insolvency process.

French insolvency law underwent substantial reform in 1985. The overriding aim behind those reforms was to help in the recovery of companies which had been placed into insolvency proceedings. Unfortunately that otherwise laudable aim has not really been achieved. About 90% of insolvency proceedings started against insolvent companies in France have ended up with some form of liquidation process. Out of the remaining 10% only 5% have been saved by virtue of a sale of the assets or by the continuation of the activities of the company over a limited term to allow it to repay some, if not all, of its creditors.

Further reforms in 1994 failed to change the overall picture.

The new Draft Law

The present reform takes the form of a draft law dealing with the rescue of companies in a form to be called a '*projet de loi de sauvegarde des entreprises*'. It was presented by way of a first draft in October 2003. The Draft Law was subsequently revised and the second draft was published at the end of January 2004. The entire question is currently the subject of intense and fluid discussions involving both professionals and the government. There is certainly no guarantee that the reforms discussed in this article will see the light of day in anything like their present form. The reference to *sauvegarde* of itself indicates the intended similarity with a United States Chapter 11-style of rescue mechanism. Indeed in a discussion document published in October 2003 the French government indicated that the concept of Chapter 11 would be used as a template for the reforms, in particular the Chapter 11 concepts of an amicable settlement and the pro-active involvement of creditors in any ongoing settlement regime.

Impact on current procedures

Under the present regime, insolvency proceedings can take the form either of amicable proceedings represented by a *mandat ad hoc* or by a *règlement amiable* (both of which proceedings are in general referred to as '*prévention*') which can be opened only when the debtor company is not insolvent, or alternatively of formal insolvency proceedings which can take the form of more formal procedures such as administration ('*Redressement Judiciaire*') or liquidation ('*Liquidation Judiciaire*'), both of which must in general be opened at the request of the formal representative of the debtor company within a 15-day time span from the date on which the company becomes insolvent. For latter purposes the company will be regarded as insolvent when it is unable to pay its debts as they fall due out of its realisable assets.

The new Draft Law aims to introduce greater flexibility with regard to the above definition of insolvency and, as indicated in the introductory

passage to this article, to induce a dialogue between potential purchasers and creditors as soon as the company's difficulties began to appear whilst continuing to respect existing contractual obligations and commitments otherwise borne by the company in question.

There are four particular intended improvements: first, the tightening up of the two existing forms of *prévention* mentioned above, namely *mandat ad hoc* and *règlement amiable*, which to some extent have already proved their worth; secondly, the introduction of a Chapter 11-style proceeding to which further reference will be made below; thirdly, the acceleration of formal liquidation proceedings together with the creation of a simplified form of liquidation process suitable for small companies only; and fourthly, changes to certain aspects of attendant liabilities and remedies within the context of insolvency proceedings. Each of these matters will be commented upon in turn.

Mandat ad hoc and *règlement amiable*

Both of these proceedings have developed predominantly as a result of the practice of the Paris Commercial Court. Their growth rose principally in the context of the restructuring of certain real property cases in the 1990s. The legislation formally endorsed the practice in 1984 and certain modifications were enacted in 1994. *Règlement amiable* is now to be called '*Conciliation*'.

Briefly, the chairman of a company in difficulties requests the President of the appropriate local Commercial Court to appoint a *mandataire ad hoc* or a *conciliateur*. Both these appointees will in turn assist not only the chairman but also the company's management in both those parties' negotiations with creditors and with other affected entities such as banks, shareholders and bond holders in order to achieve arrangements which in English law terms represents something of a cross between a scheme of arrangement and a company voluntary arrangement designed to achieve the continuation of the company's business.

Whilst a *mandat ad hoc* will not be limited in time, a *conciliation* will be subject to a limited period of 4 months. For that reason, the latter procedure very often represents the step which is embarked on after the imposition of a *mandat ad hoc*. Furthermore, ratification of any agreement reached between the affected parties (called a *homologation*) can only take place within the framework of a *règlement amiable*.

By and large, both forms of *prévention* have operated reasonably well in practice in recent years. There have appeared, however, some inherent weaknesses, principally the following: first, the subject company must not be insolvent; secondly, ratification or *homologation* provides only a partial protection against any subsequent formal attacks upon banks or other institutions that may have advanced credit to the company in question on the basis that they did so excessively or improperly or against any other action which seeks to impeach any prior transactions should the company later go into formal insolvency; thirdly and finally, creditors who extend credit or forego or otherwise delay collection of their debts as reflected and embodied in any subsequent agreement are not afforded any form of priority.

The Draft Law attempts to deal with the above points in a number of ways. First *conciliation* will be permitted even though the company is already technically insolvent but only for a period not exceeding 1 month and provided certain specific legal and economic criteria are satisfied; secondly, ratification can now be the subject of a court order after appropriate representations have been made by certain specified parties who are directly affected as distinct from the more restricted existing formal pronouncement declared by the Court President alone: thirdly, in the event of there being a subsequent formal insolvency proceeding, the date on which insolvency is deemed to have formally occurred cannot be the subject of any formal declaration by the Court, at least not before the date of the judgment (just referred to) which ratifies the restructuring agreement, in the absence of fraud; and fourthly, any creditors who may have extended credit or otherwise foregone their claims for the purposes of the restructuring agreement now enjoy priority over all claims which arose after the opening of the conciliation proceeding; again in the absence of fraud such creditors cannot be held liable for any damages incurred as a result of the relevant extension of credit as reflected and incorporated in the restructuring agreement.

The procedure of *sauvegarde*

Perhaps the principal innovation of the Draft Law is the introduction of a new Chapter 11-style rescue procedure.

The formal representative of the company in distress can now request a stay on the company's ongoing obligations to fulfil its financial commitments prior to its formal insolvency. The procedure is open to all debtors who are in financial difficulties and where the difficulties are of such a degree as might otherwise cause the debtor to go into a formal insolvency procedure.

The aim of the new procedure is to achieve the execution of a plan of reorganization which will entail either the continuation of the company or its continuation coupled with a partial divesting by way of sales or other disposals of part of its undertaking.

During the period leading up to the execution of the plan, the company will continue to carry on business supervised or assisted by a court-appointed adminis-

trator whose function it will be to prepare the plan, together with the company.

To achieve its desired effect, the Draft Law puts forward two principal measures which are intended to facilitate any reorganisation plan: first, as the introduction to this article suggests, it creates two principal forms of creditors' committees which can approve the plan by virtue of a qualified majority in each case. Further detailed rules on the precise mechanics involved will be issued in the near future. What is totally new to French law, at least in this particular area, is the resort by the legislature to the concept of a creditors' committee. In due course and not unnaturally, the court must ensure that the interests of all creditors are sufficiently protected and must, if it thinks it appropriate, formally approve the plan. Indeed the Draft Law demonstrates that the legislature is in effect positively encouraging companies in distress to seek the protection of the court as soon as possible before there is any real risk of insolvency by means of this form of Chapter 11-style procedure.

The Draft Law provides that the *sauvegarde* procedure is not mandatory for small companies which for present purposes are companies employing less than 300 employees. It is perhaps ironic in the context of the not too distant political climate that the French Justice Minister following a field trip on the subject to the United States opined that Chapter 11 was 'too heavy and too complex' for small companies.

Redressement judiciaire

Under the Draft Law *redressement judiciaire* which is outlined above is in general terms the French equivalent of the administration order procedure in English law. It has been maintained with only a few improvements brought in by the new reforms. A company which is unable to pay its debts as they fall due must presently file for insolvency either by means of a *redressement judiciaire* or must do so via a formal liquidation within 15 days of the date of the insolvency. The draft law extends this delay period to 1 month.

At present the *redressement judiciaire* process will be formally closed either by the entering into by the company of a 'plan of continuation' which incorporates terms dealing with repayments to creditors over a stipulated time period or by a plan which involves a sale of its assets or by liquidation.

It now seems, at least provisionally, as if the legislature intends to do away with redressement judiciaire and replace it either by the *procédure de sauvegarde* or formal liquidation if there is no chance of a rescue.

Liquidation judiciare

The Draft Law aims to accelerate the liquidation process by creating a simplified form of liquidation suitable only for small companies. It seeks to achieve this by modifying current liquidation practice and procedures in three principal ways: firstly, by allowing the continuation of the activities of the company by virtue of being authorised only if there is a realistic prospect of a total or partial sale of the company's business or alternatively if the public interest or the interests of the creditors generally requires that aim; secondly, certain aspects relating to the present management regime of an insolvent company in liquidation are improved and clarified; thirdly, the delays inherent in the present system are addressed in order to accelerate generally the liquidation process; and finally the circumstances in which creditors can reactivate legal proceedings against a company in distress are modified.

The new simplified form of liquidation procedure is introduced principally to assist small companies, which it was thought are the most likely candidates for a rapid treatment of all relevant claims and for a quick administration of the insolvency generally in order to enable the management to be relaunched in the commercial arena as soon as possible. There is a one-year maximum time limit at the end of which period the liquidator must present a request to the court which must formally pronounce that the proceedings be closed, unless, and then only in the most exceptional circumstances, they are further extended for three months.

Liabilities and remedies

There are a number of important provisions in the new Draft Law which bear upon the extent of the liabilities which arise in an insolvency. Perhaps the most important change concerns the provision that it will be incompatible on the one hand to entertain the approval of a reorganisation plan and on the other to permit there to be an action for the recovery of assets which represents the short fall due in an insolvency against a director who is found guilty of mismanagement.

In addition it is provided that managers can now be sanctioned in respect of serious mismanagement which is proved against them. This will render them liable for the totality of any shortfall without the need formally to pursue them to bankruptcy.

Europe and Conclusions

The Draft Law takes into account the European Regulation and adapts French insolvency law to its provisions.

In summary, the effect of the Draft Law will be that before a company becomes insolvent it can choose between the differing measures of *mandat ad hoc* or *conciliation* on the one hand, or on the other it can consider the new procedure reflecting Chapter 11, namely the *procédure de sauvegarde*. It is critical to bear in mind that the former represent confidential procedures, at least up until ratification, whereas *sauvegarde* is by its very nature a public and publicized event. Circumstances will differ, but after the company does become insolvent the current *redressement judiciaire* will be maintained but its scope will be much reduced with a view to benefiting the overriding aim in order to seek rescue or alternatively a liquidation proceeding. In any event the liquidation process is in a large part accelerated and simplified.

The Draft Law has been presented to the Conseil d'État. It is intended that it be presented to the Ministers' Council during the first term of the year 2004 with discussions in Parliament being planned for the end of the same year. Further modifications are intended, and it is hoped and expected that in the light of those modifications a further article in this journal will cover the final form which the Draft Law eventually assumes.