

SWEEPING REFORM FOR FRENCH BANKRUPTCY LAW

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Law n° 2005-845 regarding the Safeguarding of Enterprises (the "New Bankruptcy Law")¹ was enacted on July 26, 2005². Most of its provisions came into force on January 1st, 2006³. The New Bankruptcy Law substantially reforms French bankruptcy provisions.

The reform of the bankruptcy system had been under discussion for several years prior to this promulgation. As early as 1998, the Ministry of Justice published an orientation document suggesting changes to the legal provisions governing bankruptcy proceedings. Subsequently, judges, bankruptcy practitioners, and business representative organizations reviewed the document and issued numerous proposals to reform bankruptcy law⁴.

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¹ Official Journal, July 27, 2006, p. 12187. Most of the articles of the New Bankruptcy Law have been included in Book VI of the Commercial Code. On the New Bankruptcy Law, see e.g. Colloque, La sauvegarde des entreprises, *Revue des procédures collectives*, Décembre 2005, page 342 ("Colloque"); Legros, La loi du 26 juillet 2005 de sauvegarde des entreprises, *Droit des sociétés*, JurisClasseur, October 2005, p.8, November 2005, p. 7, December 2005, p. 14, January 2006, p.10 ("Legros"). The implementing decree of the New Bankruptcy Law, Decree n° 2005-1677 of December 28, 2005 (the "Decree") was published on December 29, 2005. Official Journal, December 29, 2005, p. 20324. The Decree abrogates the implementing decree of the previous bankruptcy law of January 25, 1985. On the Decree, see Roussel Galle & Girardin, Présentation du décret d'application de la loi de sauvegarde des entreprises, *JCP E*, 2006, Actualités p. 111 ("Roussel Galle").

² The petition lodged against the bill before the Constitutional Council was rejected on July 22, 2006. On the decision of the Constitutional Council, see *Les Petites Affiches* ("LPA"), n° 154, August 4, 2005, p. 14. The petitioners had argued *inter alia* that the bill infringed the general principle whereby creditors must be treated alike.

³ Certain provisions came into force as of the publication date of the New Bankruptcy Law. These provisions relate *inter alia* to the milder sanctions applicable to the debtor's managers and the closing of judicial liquidation proceedings. In principle, the New Bankruptcy Law only applies to the proceedings commenced after January 1st, 2006, except for certain provisions relating *inter alia* to the new simplified judicial liquidation procedure, the non performance by the debtor of the reorganization plan and the pecuniary and professional sanctions applicable to managers.

⁴ As to the history of the New Bankruptcy Law, see e.g. Vallens, *Réforme des procédures collectives: premier commentaire de l'avant projet de loi*, *Bull. d' Actualité Lamy, Droit commercial*, 2003, n° 160, p. 1 ("Valens"); Soinne, *la réforme des procédures collectives, la confusion des objectifs et des procédures*, *Revue des procédures collectives*, June 2004, p. 81.

Former bankruptcy provisions failed in numerous cases to prevent enterprises' defaults at an earlier stage and avoid that their financial difficulties lead to bankruptcy proceedings. Between 50 000 and 60 000 enterprises are subject to bankruptcy proceedings each year affecting over 300 000 jobs annually, and nine out of ten bankruptcy proceedings lead to the debtor's liquidation. In addition, 70 per cent of the judicial liquidations are immediately commenced upon the rendering of the bankruptcy judgment. Also, in most cases, the debtor's assets are at a minimal⁵ when the liquidation judgment is rendered.

Moreover, the EU Regulation on insolvency proceedings of May 29, 2000, in effect as of May 31, 2002, led to the review of the then current bankruptcy mechanisms and their compatibility with the bankruptcy systems of the other EU countries⁶.

French bankruptcy proceedings rules also gave rise over the years to an increasing number of judicial decisions. This case law often purported to adjust otherwise inadequate provisions rendering bankruptcy matters particularly complex⁷.

In addition, the bankruptcy regime in France had been described as overly "*debtor friendly*" rather than "*creditor friendly*", that is socially oriented towards restructuring the debtor and maintaining employment rather than satisfying creditors⁸. Reportedly, this legal environment discouraged many creditors from participating in court-driven rescues of the concerned companies as the expected recovery level of the creditors' claims was unpredictable⁹.

The New Bankruptcy Law seeks to respond to these criticisms and to remedy these drawbacks.

The crux of the New Bankruptcy Law is the putting into place of broad early-warning procedures to prevent ailing enterprises from becoming insolvent¹⁰.

⁵ Revue de Jurisprudence Commerciale, Entreprises en difficulté: nouvel essai, Hors Série, Colloque de Deauville les 3 et 4 avril 2004 ("Revue de Jurisprudence Commerciale"), p. 4; Monsérié – Bon, La diversification des liquidations judiciaires in Colloque, p. 367 ("Monsérié – Bon").

⁶ Council Regulation (EC) n° 1346/2000 of May 29, 2000, Official Journal of the European Communities, June 30, 2000, L. 160/1 (the "Council Regulation").

⁷ Valens, p. 2.

⁸ See e.g. Moody's Investors Service, Global Credit Research, Bankruptcy & Ratings: A Leveraged Finance Approach for Europe Part II: France, June 2000, p. 6.

⁹ Reportedly, the applicable bankruptcy provisions hindered, for example, the rescue of the company Alstom, whereby foreign banks were not inclined to participate in the rescue plan of this company due to legal provisions that granted very limited protection to creditors. See e.g. Le Monde, August 7, 2003, p. 8.

¹⁰ Draft Bill on The Safeguarding of Enterprises n° 1596, presented before the National Assembly on May 12, 2004, Statement of Grounds p. 2; Revue de Jurisprudence Commerciale, p. 81. In this respect, the rationale of the new provisions is the same as that of the previous bankruptcy law: safeguarding the enterprise.

Also, the New Bankruptcy Law vests creditors with more active roles in the proceedings and better protect certain creditors.

In addition, the new provisions intend to simplify and accelerate the liquidation process and render more equitable the possible sanctions applicable to the debtor.

Before analysing these main features of the New Bankruptcy Law **(II)**, it appears necessary to summarily describe the previously applicable provisions **(I)**.

I. The former bankruptcy law - summary¹¹

The former bankruptcy law provided for preventive measures that sought to avoid future bankruptcy proceedings **(A)** as well as bankruptcy proceedings per se triggered by the debtor's "*cessation of payments*"¹² **(B)**.

A. Preventive measures

1. Settlement

The law of March 1, 1984¹³ sought to encourage so-called amicable settlement procedures pursuant to which under the supervision of a conciliator appointed by the Court, the creditors could agree with the debtor to waive and/or postpone the payment of their claims,. Upon request of the conciliator, the President of the Court could impose a stay of action against the debtor.

2. Mandataire ad hoc

Private parties were increasingly inclined to resort to the appointment of a *mandataire ad hoc*. This procedure initially developed by the Paris Commercial Court was informal, flexible and voluntary. Pursuant to this procedure, the President of a commercial Court could appoint a so-called *mandataire ad hoc* (*ad hoc* agent) to assist an undertaking facing financial difficulties. The *mandataire ad hoc*'s mission was determined by the President.

The Court-appointed *mandataire ad hoc* would draw up a report detailing the financial situation of the concerned undertaking, and would attempt to find an agreement with the undertaking's creditors regarding payment of debts, or reorganization of the undertaking.

¹¹ As to the former bankruptcy law, see e.g. Laurent Gaillot, Practitioner's Guide to Cross-Border Insolvencies - France, Dobbs Ferry, NY, Oceana Publications 2000, at 37 ("Practitioner's Guide").

¹² A "*cessation of payments*" was defined as "*the impossibility of meeting liabilities which are due with available assets*". This definition remains unchanged under the New Bankruptcy Law. As to this notion, see also Footnote n°20.

¹³ Codified under the former Articles L. 611-1 and followings of the Commercial Code.

The parties could successively resort to the *mandataire ad hoc* and the amicable settlement procedures, the *mandataire* procedures being priorly used to identify and assess the debtor's difficulties.

Difficulties arose when the *mandataire ad hoc* and/or the amicable settlement procedures failed and the Court subsequently determined that the debtor had ceased its payments after these procedures had been commenced. Case law firmly held that the ordering of such measures did not create any *res judicata* effects on this issue and that the Courts could date back the debtor's cessation of payments. The amicable procedures therefore did not protect the debtor who could still be subject to sanctions for not having filed for bankruptcy in due time even though he had requested the opening of an amicable settlement procedure¹⁴.

2. Bankruptcy proceedings

Under the law of January 25, 1985¹⁵, bankruptcy proceedings could only be commenced if the debtor had ceased its payments.

The Courts could either decide to open a liquidation procedure, in the event the debtor had "*ceased any activity*" or when the rescue of this enterprise appeared "*manifestly impossible*", or commence a reorganization procedure (the so-called "*redressement judiciaire*"), which was intended to save the enterprise, to maintain the enterprise's activities and employment and to satisfy the creditors' claims.

II. The main features of the New Bankruptcy Law

A. The preventive measures and the safeguarding of the enterprise

The goal of the New Bankruptcy Law is clearly expressed in the parliamentary reports: "*improving the procedures in privileging the anticipating*" of financial difficulties¹⁶.

¹⁴ See e.g. Cour de Cassation, Commercial Chamber, July 8, 2003, Bull. civ. IV, n° 129. Martineau-Bourgninaud, *Le spectre de la cessation des paiements dans le projet de loi sauvegarde des entreprises*, Dalloz 2005, chron., p. 1356 ("Martineau-Bourgninaud"), at 1358.

¹⁵ Codified under the former Articles L. 620-1 and followings of the Commercial Code.

¹⁶ Report of the Representative Xavier de Roux, p. 37. According to the Ministry of Justice, the New Bankruptcy Law should allow more enterprises to be saved which will allow the preservation of employment. The New Bankruptcy Law also improves the existing means to detect financial difficulties. See generally, Legros, October, 2005, p. 9. It strengthens the obligation to publicize the debtor's delay in paying its debts vis-à-vis tax, customs and social security authorities. Also, the President of the commercial Court may issue an injunction to deliver the debtor's financial statements under penalties. Failing compliance with this injunction, the President may now collect information on the debtor's economic and financial situation without having first heard the debtor's managers. In addition, the New Bankruptcy Law reforms and simplifies the so-called alert procedure. *Inter alia*, pursuant to the new provisions, the President of the commercial Court and the general assembly of shareholders should be advised of the debtor's financial difficulties at an earlier stage. *Id.*, p. 10.

To this effect, the New Bankruptcy Law renovates the amicable procedures in treating the *mandataire ad hoc* process as an autonomous procedure, renovating the former amicable settlement procedure now entitled the "*conciliation procedure*" and creating a new so-called safeguard procedure (1). It also modifies the judicial reorganization process (2).

1. The amicable measures

a. The *mandataire ad hoc* procedure

The New Bankruptcy Law recognizes the *mandataire ad hoc* process as a separate and independent procedure¹⁷.

This procedure remains voluntary. Only the debtor may request the appointment of a *mandataire ad hoc*. Furthermore, the Court will terminate the *mandataire ad hoc*'s mission upon the debtor's request. The Court only determines the *mandataire*'s mission and the terms of the *mandataire*'s compensation¹⁸.

The appointment is not subject to any conditions. This procedure is treated as a procedure which provides assistance to the debtor and therefore should remain flexible¹⁹.

b. The conciliation procedure

The conciliation procedure replaces the former amicable settlement proceedings. It is a four-month voluntary settlement process renewable for one-month, under which a court-appointed conciliator negotiates agreements with the debtor's main creditors and draws up a plan for reorganizing the enterprise.

The conciliation procedure is designed to allow the debtor and its main creditors to agree, on a confidential and contractual basis, upon a mutually acceptable solution among them and to resolve the debtor's financial difficulties. The conciliator may, under the supervision of the President of the competent commercial Court, make any proposal with regard to maintaining the debtor's enterprise, economic activity and employment²⁰.

¹⁷ Article L. 611-3 of the Commercial Code. The New Bankruptcy Law provides for the *mandataire ad hoc* procedure in a separate article whereas the former bankruptcy law only incidentally referred to this procedure. Roussel Galle, p. 40.

¹⁸ Various provisions ensure that the *mandataire ad hoc* is a person independent from the debtor or the creditors (Articles L. 611-3 and L. 611-13 of the Commercial Code).

¹⁹ Report of the Senator Hyest, p. 100. See Legros, October 2005, p. 13.

²⁰ Article L. 611-7 of the Commercial Code.

b.1. Commencement of a conciliation procedure

The debtor may seek the benefit of the conciliation procedure before the competent commercial Court when it faces "*legal, economic or financial difficulties*" established or foreseeable, or even when it has ceased its payments, provided that the cessation of payments²¹ does not date back to more than 45 days from the time the debtor's petition for the conciliation procedure is filed²².

Clearly, in practice, the notion of "*foreseeable difficulties*" may give rise to debate. The judge has sovereign powers to examine whether or not the debtor faces such difficulties. To this effect and in order to appreciate the "*economic, social and financial situation of the debtor*", the judge may appoint an expert²³. The existence or not of foreseeable difficulties will be determined on a case-by-case basis depending upon the underlying circumstances of the case²⁴.

b.2. Effects of the conciliation procedure

Under the conciliation procedure, the management of the concerned undertaking remains in place, and the conciliator is not empowered to make any management decision.

A conciliation procedure does not automatically stay claims against the debtor²⁵.

b.3. Homologation of the conciliation agreement

The Court may either acknowledge ("constater") or, upon the debtor's request, homologate the agreement between the debtor and its creditors. The agreement may be homologated provided that:

²¹ In a 1998 decision, the Supreme Court had held that the existence (or not) of the cessation of payments condition should be determined on the basis of the debts whose payment is demanded (*exigé*) by the creditors and not of the debts which are only due by the debtor. Cour de Cassation, Commercial Chamber, April 1998, JCP E, p. 1926. See generally, Martineau-Bourgninaud, at 1356 and 1357. The New Bankruptcy Law does not follow this case law and the definition of "*cessation of payment*" remains unchanged under the new provisions.

²² Thus, the cessation of payments is no longer the paramount consideration in distinguishing amicable and judicial measures since the conciliation procedure may be commenced not only when the debtor has not ceased its payments but also when it has ceased its payments for less than 45 days. See Legros, October 2005, p. 12.

²³ Article L. 611-6 of the Commercial Code.

²⁴ Conceivably, social strikes, an increase in the price of raw materials, an adverse evolution of exchange rates or purchase orders could constitute "*unforeseeable difficulties*". See Barbieri in Colloque, Le choix des techniques de traitement des difficultés des entreprises, Réflexions liminaires, p. 346.

²⁵ The Court, however, may grant so-called grace delays under the standard applicable provisions of the Civil Code (Articles 1244 -1 and followings of the Civil Code).

- the debtor has not ceased its payments or the agreement puts an end to the cessation of payment situation;
- the terms of the agreement ensure the perennial character of the enterprise's activities; and
- the interests of the creditors who are not party to this agreement are safeguarded²⁶.

Clearly, in practice, determining whether or not these requirements are satisfied raise numerous difficulties²⁷.

The Court may homologate the concerned agreement after having heard the debtor, the creditors parties to the agreement, the representatives of the debtor's work council (if there exists one) or the employee delegates, the conciliator, the public prosecutor, and any other party it deems necessary.

The judgment homologating the agreement (and not the agreement itself) is subject to publicity. Any third party may have access to this decision.

Further to the homologation, the debtor is released as a matter of right from the prohibition to issue checks.

The homologated agreement stays all existing legal actions against the debtor exercised by creditors²⁸. Correlatively, the time periods within which creditors parties to the agreement must enforce their claims are suspended.

In addition, the rights of creditors extending cash flow facilities to the debtor's business are privileged²⁹. In case the conciliation process fails and safeguard, judicial reorganization or judicial liquidation proceedings are subsequently commenced, these creditors' claims will be paid prior to the creditors' claims which accrued prior to the opening of the conciliation procedure.

²⁶ Article L. 611-8 II of the Commercial Code.

²⁷ See e.g. for example, as to the determination of the cessation of payments, Soinne, *Brèves réflexions sur la nouvelle loi et son application au 1^{er} janvier 2006*, *Revue des procédures collectives*, September 2005, p. 176; Martineau-Bourgninaud, p. 1358. This latter commentator characterizes as "unrealistic" the conditions required. She concludes that given the difficulties in assessing whether or not the homologation requirements are satisfied under the circumstances of the particular case, the judges may be reluctant to grant this homologation. *Id.*, p. 1359.

²⁸ Article L. 611-10 of the Commercial Code. Accordingly, the debtor's guarantors may not act against the debtor. Legros, October 2005, p.13.

²⁹ (the so-called "new money" or "fresh money" privilege). Article L. 611-11 of the Commercial Code. This privilege is enjoyed by the persons who under the conciliation agreement have extended cash flow facilities (apport en trésorerie) or supplied new goods or services in view of ensuring the continuation of the enterprise's activities and its perennial character. This privilege only applies to cash flow facilities (including those extended by the debtor's shareholders). It does not apply to issuances of guarantees or capitalisation of the creditors' or shareholders' claims.

Homologating or not the conciliation agreement may place the debtor before strategic alternative options. From the debtor's point of view, not alerting trade suppliers, clients and competitors and preserving confidentiality about the encountered difficulties may be a key reason for refusing the homologation. Indeed, the conciliation procedure entails this confidentiality provided that the agreement is not homologated. To maintain such confidentiality, the debtor may prefer to have the conciliation agreement only acknowledged by the Court³⁰.

Conversely, homologating the conciliation agreement may be in the debtor's interest. Indeed, the staying of the creditors' actions only applies if the agreement is homologated. Also, the homologation may induce certain creditors to extend cash flow credit facilities.

In any event, the creditors will presumably require this homologation from the debtor. Their claims in regard to the extension of cash flow credits would not otherwise be privileged. Also, in case of non homologation and if the non conciliation procedure ultimately fails, reorganization proceedings would be commenced. The judge might then date back the cessation of payment date to 18 months prior to the bankruptcy judgment. In the absence of homologation, the execution date of the conciliation agreement might fall during the so-called suspect period and as a result certain provisions of the agreement might be avoided or subject to possible avoidance.³¹

In case of homologation, however, the cessation of payments may not be dated back to prior to the date of the final homologation decision³².

c. The new safeguard procedure

The safeguard procedure is a new procedure available to a debtor that has not yet ceased its payments, but that is undergoing financial difficulties which may lead to this situation in the near future. The safeguard procedure constitutes the most significant innovation of the New Bankruptcy Law. It has been inspired by the US

³⁰ or, at an initial stage, to resort to the *mandataire ad hoc* procedure. The decision acknowledging the conciliation agreement is not subject to publication. Article L. 611-8 of the Commercial Code. The New Bankruptcy Law does not contain detailed provisions as to the effects of a conciliation agreement which has only been acknowledged by the Court. Article L. 611-8 of the Commercial Code states that the Court grants executory force to the acknowledged agreement.

³¹ Certain transactions executed or measures taken during the suspect period are void or subject to avoidance. See Practitioner's Guide, p. 33. The New Bankruptcy Law also reforms the former provisions on this issue. In particular, certain transactions relating to stock options and related measures and various enforcement measures are now respectively void and avoidable if occurring during the suspect period (Articles L. 632-1 and L. 632-2 of the Commercial code). See Vinckel, le nouveau régime de la période suspecte dans la loi n°2005-845 du 26 juillet 2005 et le décret n° 2005-1677 du 28 décembre 2005: une réforme en trompe l'œil ("Vinckel").

³² Article L. 631-8 of the Commercial Code. This provision reserves the case of fraud.

Chapter Eleven which allows a debtor to seek judicial protection prior to a cessation of payments³³.

The safeguard procedure is intended to reorganize the debtor's enterprise, under the supervision of a court-appointed administrator, at an early stage of financial difficulties, with a view towards maintaining the debtor's activity, employment, and ensuring the payment of the debtor's creditors³⁴. It may be characterized as an early judicial reorganization procedure which is initiated prior to the debtor's cessation of payments.³⁵

c.1. Commencement of a safeguard procedure

Only the debtor may request the commencement of the safeguard procedure. The safeguard procedure is considered as a measure favourable to the debtor and therefore to be triggered only at its own initiative.³⁶

The debtor's request may be filed when the debtor is not in a position to "surmount" difficulties³⁷ which may lead to a cessation of payments. The safeguard procedure will be transformed into judicial reorganization proceedings should it subsequently appear that the debtor had already ceased its payments upon the commencement of the safeguard procedure³⁸.

The competent commercial Court initiates a safeguard procedure after having heard the debtor, the representatives of the debtor's work council (if there exists one) or its employee delegates, and any other party it deems necessary³⁹.

³³ As to a comparison between Chapter 11 and the safeguard plan, see e.g. Lucheux, *Le US chapter eleven: une inspiration possible?*, in *Revue de Jurisprudence Commerciale*, p. 160.

³⁴ Article L. 620-1 of the Commercial Code.

³⁵ French based European multinational groups could resort to this procedure pursuant to Article 3 of the Council Regulation. This Article provides that the courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open bankruptcy proceedings. Such a solution requires that Annex A of the Council Regulation be amended and include the safeguard procedure.

³⁶ The Court may extend the safeguard procedure to a third party or parties in case of an intermingling of assets among them or a fictitiousness of the concerned debtor's corporation. Article L. 621-2 of the Commercial Code.

³⁷ The text refers to the word "difficulties" in plural form. The existence of only one difficulty, therefore, does not seem to be sufficient to commence a safeguard procedure.

³⁸ Article L. 621-12 of the Commercial Code.

³⁹ Before rendering its decision, the Court may also appoint a judge whose mission is to obtain all information on the financial, economic and social situation of the concerned enterprise (Article L. 621-1 of the Commercial Code). Similarly to the formerly applicable judicial reorganization procedure, the judgment commencing the safeguard procedure appoints various officials such as the "*juge commissaire*" who oversees the procedure, an administrator, a judicial agent ("*mandataire judiciaire*", formerly named the creditors' representative) and calls for the designation of an employees' representative. The Court-appointed administrator may request that certain ongoing agreements continue to be performed.

An observation period⁴⁰ is then commenced. During this period, the administrator assisted by the debtor will establish a thorough economic and social inventory of the debtor's enterprise and draw up a proposed safeguard plan to allow the enterprise to continue its activity⁴¹.

c.2. Effects of the safeguard procedure

In principle, the debtor remains in possession. It may continue to exercise its activity and maintains management control over the concerned enterprise. The judicial administrator may only supervise or assist the debtor's management. It may not represent the debtor.

The opening of the safeguard procedure suspends the claims against the debtor⁴² and its individual sureties, guarantors or joint obligors⁴³. In principle, it prevents the debtor from paying any claims having arisen prior to the judgment which opened the safeguard procedure⁴⁴.

During the procedure, the administrator and the debtor will negotiate reorganization measures with the creditors⁴⁵. Negotiations are conducted with a view towards drawing up a reorganization plan. These negotiations involve two creditors' committees: a bank creditors' committee and a trade creditors' committee⁴⁶. Those who may participate to this latter committee are only the main trade creditors, i.e. the creditors who represent each more than 5 per cent of the trade creditors' claims as well as the trade creditors "solicited" by the administrator⁴⁷. These committees

⁴⁰ The maximum duration of the observation period is six months. It may be renewed once upon request of the administrator, the debtor or the public prosecutor. Exceptionally, it may be extended upon request of the public prosecutor for a maximum period of six months (Article L. 621-3 of the Commercial Code and Article 64 of the Decree).

⁴¹ Articles L. 623-1 through L. 623-3 of the Commercial Code.

⁴² Article L. 622-21 of the Commercial Code.

⁴³ Article L. 622-28 of the Commercial Code. Joint obligors, sureties and guarantors which are legal entities do not enjoy the benefit of this provision. This stay of action applies until the Court approves the plan or pronounces the liquidation. The creditors may seek provisional remedies to secure the payment of their claims against the joint obligors, sureties and guarantors. Id.

⁴⁴ Article L. 622-7 of the Commercial Code. This provision reserves the case of payments through set off between interrelated debts (dettes connexes).

⁴⁵ The creditors must file their claims with the judicial agent within two months of the publication of the judgment commencing the procedure. This two month period is extended to four months when the creditor does not reside in continental France. (Article L. 622-24 of the Commercial Code and Article 99 of the Decree).

⁴⁶ Creation of the creditors' committees is mandatory when (i) the debtor's financial statements are certified by a statutory auditor or prepared by an accountant expert (expert comptable) and (ii) the number of employees and the annual turnover respectively exceed 150 employees and 20 million euros (Article L. 626-29 of the Commercial code and Article 162 of the Decree).

⁴⁷ Article L. 626-30, first paragraph of the Commercial Code.

consider and respond to the debtor's reorganization proposals⁴⁸. They must vote thereon within 30 days.

The private creditors who are not members of the creditors' committees as well as the public creditors⁴⁹ are consulted by the administrator on an individual basis.⁵⁰

A safeguard plan is then drawn up and approved by the Court if there exists a "*serious possibility that the enterprise may be safeguarded*"⁵¹. Before approving such a plan, the Court must hear the debtor, the administrator, the judicial agent, the controllers, the representatives of the debtor's work council (if there exists one) or its employee delegates, and request the opinion of the public prosecutor. A safeguard plan may provide for example for the sale of all or parts of the branches of activities of the debtor's enterprise, and/or a change in its capital structure, and/or the replacement of the debtor's management⁵².

If the debtor subsequently does not perform the safeguard plan, the Court may terminate the plan depending upon the underlying circumstances and in particular, the seriousness of the debtor's breach⁵³.

From the debtor's point of view, the safeguard procedure presents several advantages as compared to the conciliation procedure and the judicial reorganization procedure.

In principle, the safeguard procedure entails a stay of the creditors' actions while in the case of a conciliation procedure the debtor may only request so-called grace delays pursuant to the standard provisions of the Civil Code.

⁴⁸ Various provisions of the New Bankruptcy law regulate the repayment of the creditors' claims under the plan. Articles L. 626-12 and L. 626-18 of the Commercial Code. For example, the first dividend must be paid within one year. After the second year, the amount of each annual payment may not be inferior to 5 per cent of the debtor's liabilities. The debtor's proposals to the creditors, members of the committees, are not subject to these requirements. Article L. 626-30 of the Commercial Code. The goal is that the debtor and the committees' members freely negotiate the proposed plan. Legros, November 2005, p. 9.

⁴⁹ Public creditors such as the tax, customs or social security authorities may take part in the negotiations and agree to cancel their claims provided that the private creditors also grant such cancellations. The magnitude of this cancellation must be equivalent to the one of a cancellation which would be granted by a private party under standard market conditions and who would be facing the same situation (Article L. 626-6 of the Commercial Code). The rationale of these provisions is to avoid a possible distortion of competition favourable to the debtor.

⁵⁰ Specific provisions apply to the consultation of bondholders. Article L. 626-32 of the Commercial Code.

⁵¹ Article L. 626-1 of the Commercial Code.

⁵² Articles L. 626-1 and L. 626-4 of the Commercial Code.

⁵³ Article L. 626-27 of the Commercial Code. Legros, November 2005, p. 13.

Also, as opposed to a reorganization procedure, the safeguard procedure does not imply that the debtor's business may be put up for sale. In addition, in case of a safeguard procedure, the debtors' managers are not subject to civil sanctions. Such sanctions may however apply in case of reorganization proceedings⁵⁴.

B. The judicial reorganization process

The New Bankruptcy Law has maintained the judicial reorganization procedure which was contained in the former bankruptcy provisions.

The judicial reorganization procedure's objective, namely to maintain the debtor's activity and employment, and to ensure the payment of the debtor's creditors, is identical to the one set out under the safeguard procedure⁵⁵. Maintaining the judicial reorganization procedure was, however, necessary as the commencement of the safeguard procedure only rests on the debtor's initiative. Also, in any event, the debtor may cease his payments during the safeguard proceedings.

1. Commencement of a judicial reorganization process

The judicial reorganization procedure may be initiated upon the debtor's request within forty five days⁵⁶ following its "*cessation of payments*"⁵⁷. It may be also commenced upon the creditors' or the public prosecutor's request and as a matter of right by the Court.

In the event a conciliation procedure has failed, the court commences as a matter of right the judicial reorganization proceedings if the conciliator's report shows that the debtor has ceased its payments.

The provisions as to the commencement of an observation period in view of establishing a thorough economic and social inventory of the debtor's enterprise, as well as the drawing up of proposals to allow the enterprise to continue its activity

⁵⁴ The safeguard process, however, does not allow the debtor to resort to the simplified dismissal procedure applicable in case of judicial reorganization proceedings. In this latter case, the bankruptcy judge may authorize the administrator to proceed during the observation period with dismissals which are urgent, unavoidable and indispensable (Article L. 631-17 of the Commercial Code). See *infra*.

⁵⁵ The safeguard procedure and the judicial reorganization procedure, however, differ in several fundamental respects. *Inter alia*, the judicial reorganization procedure may be commenced upon the request of parties other than the debtor. During this procedure, the debtor may be divested of its management of the business. In the case of the judicial reorganization procedure, the debtor's managers may be subject to civil sanctions. Also, specific rules as to economic dismissals apply in case of judicial reorganization proceedings. Finally, the notion of suspect period only applies to the judicial reorganization procedure.

⁵⁶ Rather than 15 days under the former bankruptcy law.

⁵⁷ if it has not, within this period of time, requested that a conciliation procedure be commenced.

applicable under a safeguard procedure, are also applicable during a judicial reorganization process.

As opposed to the safeguard procedure, however, the judge may authorize the administrator to proceed during the observation period with economic dismissals if such dismissals are "*urgent, unavoidable and indispensable*"⁵⁸.

2. Effects of a judicial reorganization procedure

Under a judicial reorganization procedure, the Court may decide to either confide the management of the debtor's enterprise to an administrator appointed by the Court, or require that the current management of the debtor's management be assisted by this administrator.

The provisions as to the establishment of a reorganization plan discussed above under the safeguard procedure are also applicable under the judicial reorganization process.

Although a debtor's enterprise is not be put up for sale during a judicial reorganization procedure, interested buyers may submit purchase offers⁵⁹.

B. A more active role for the creditors and a better protection for certain creditors

1. A more active role for the creditors

Further to the new provisions, the creditors may be more actively involved in the drawing up and adoption of safeguard or reorganization plans and controlling of the bankruptcy proceedings.

a. The creditors' committees

The constitution of the creditors' committees is mandatory when the debtor's activities exceed certain thresholds⁶⁰.

⁵⁸ Article L. 631-7 of the Commercial Code.

⁵⁹ Article L. 631-13 of the Commercial Code. The goal of this provision is to maintain the debtor's activities. The Court may order these transfers when the debtor is unable to rescue the enterprise. Article L. 631-22 of the Commercial Code. The terms and conditions applicable to these transfers are those applicable to the transfers occurring in connection with judicial proceedings.

⁶⁰ See Footnote 46.

The administrator organizes the two creditors' committees (the bank creditors' committee and the trade creditor's committee) within 30 days of the commencement of the bankruptcy proceedings. As mentioned, these two committees vote upon the debtor's proposals within 30 days of their presentation by the debtor⁶¹.

The proposed plan, if approved by the two committees, may not be modified by the Court⁶². The Court may then either adopt the plan or refuse it on the grounds that certain creditors' interests have been infringed⁶³.

b. The controllers

The bankruptcy judge may designate up to five so-called controllers⁶⁴ selected among the creditors. The controllers assist the judicial agent, i.e. the bankruptcy official in charge of representing the creditors' interests and the bankruptcy judge⁶⁵.

Controllers have played an increasing role in bankruptcy proceedings. The New Bankruptcy Law grants additional powers to the controllers. Significantly, the creditors' controllers may now act on behalf of the creditors and in their best collective interests should the bankruptcy officials fail to perform their duties. The question will arise as to whether under such circumstances, the creditors' controllers may initiate actions to avoid or to seek the avoidance of certain transactions during the suspect period⁶⁶.

2. A better protection for certain creditors

Satisfaction of the creditors' claims is one of the major goals of the New Bankruptcy Law⁶⁷. The new provisions introduce various measures which aim at better

⁶¹ The Committees' decisions are subject to a double majority rule, i.e. a majority of the members representing at least two thirds of the claims as well as a majority of the creditors which are members of the relevant committee (Article L. 626-30 of the Commercial Code).

⁶² The Court may demand that the plan be established and adopted in accordance with the system applicable to the judicial reorganization proceedings should one or the other creditors' committee does not take any decision in due time or refuse the debtor's proposals or the interest of the minority members of the creditors' committees be not sufficiently protected (Article L. 626-34 of the Commercial Code). The Court may then impose a uniform deferment of payment up to 10 years (except when the parties had initially provided for a longer period) (Article L. 626-18 of the Commercial Code). It may not however require from the creditors the cancellation of their claims. See also *supra* Footnote 45.

⁶³ Article L. 626-31 of the Commercial Code. If approved, the plan applies to all committees' members. *Id.*

⁶⁴ See generally Roussel – Galle, *Les contrôleurs gardiens de l'intérêt collectif*, *Gaz. Pal.* 9 -10 September 2005, p. 3.

⁶⁵ Article L. 621-11 of the Commercial Code.

⁶⁶ Jazottes in *Colloque, Les innovations des procédures de sauvegarde et de redressement judiciaire*, p. 361 ("Jazottes"). *Contra*, Vinckel, p. 132.

⁶⁷ See Saint-Alary-Houin in *Colloque, Propos introductifs sur la loi applicable aux entreprises*, p. 345.

protecting certain creditors' interests. These measures mostly relate to the creditors whose claims accrued prior to the cessation of payments.⁶⁸

The claims which accrued prior to the bankruptcy judgment and for which creditors have omitted to file a petition in due time will no longer be extinguished⁶⁹. Admittedly, such creditors may not participate in the distribution of dividends⁷⁰. They may however enforce their claims against the debtor's joint obligors, sureties or guarantors in case of a reorganization procedure⁷¹.

Also, in case of failure of the safeguard plan or a judicial reorganization plan, creditors will not be required to file their claims with the liquidator when such claims have already been recorded with the plan. Such claims will be admitted as a matter of right⁷².

More significantly, creditors may no longer be held liable for abusive support. Under Article L. 650-1 of the Commercial Code, creditors shall not be liable for the losses caused as a result of the credits they extended. Given the very broad language of Article L. 650-1, this provision should logically apply to any type of credit, and to any creditor (i.e., not only to banking establishments but also, for example, to trade suppliers, another company of the debtor's group or state or state-related entities). It should also apply regardless of the moment when the concerned credit was extended and of the type and magnitude of the wrongful action committed by the creditor having extended the credit. In addition, it should be enforceable vis-à-vis any third party⁷³.

This non liability principle, however, is subject to certain exceptions. It does not apply in case of fraud, or when the creditor has interfered in a significant matter (caractérisé) with the management of the debtor's business or if the collateral which secures the payment of the creditor's claim is disproportionate as compared to the credit extended. Commentators note that the text of these exceptions is fraught with ambiguities and that its application will probably create difficulties⁷⁴.

⁶⁸ Conversely, certain creditors enjoy a less favourable treatment under the new provisions. These creditors are mostly certain creditors whose claims accrue after the bankruptcy judgment. The conditions under which such claims are privileged have been restricted. See Article L. 622-17 of the Commercial Code.

⁶⁹ This reform is introduced in compliance with Article 5 of the Council Regulation.

⁷⁰ Article L. 622-6 of the Commercial Code.

⁷¹ Légevaques, *La loi de sauvegarde et les cautions: au bonheur des cautions?*, *Revue des procédures collectives*, December 2005, p. 296, at 298. As to the defense to be possibly raised by sureties, see *id.*

⁷² Article L. 626-7 of the Commercial Code.

⁷³ See generally Robine, *L'article L. 650-1 du Code de Commerce : un cadeau empoisonné*, *Daloz* 2006, *chron.*, p.69 ("Robine").

⁷⁴ As to these difficulties, see Robine, *id.*, pp. 74 and followings. The New Bankruptcy law does not define the scope of these exceptions. For example, the question arises as to when the alleged disproportion between the collateral and the extended credit should exist, i.e. upon the extension of the credit or alternatively, upon foreclosure of the security. In the former case, the question

In case the creditor is held liable, the security granted to this creditor is avoided⁷⁵.

C. The renovated judicial liquidation procedure

A judicial liquidation is initiated when the debtor has ceased its payments and the rescue of its business is "*manifestly impossible*". As defined by the New Bankruptcy Law, this procedure is designed to terminate the enterprise's activity and to sell the debtor's assets in all or in part⁷⁶.

1. Commencement of a judicial liquidation procedure

A debtor must file for liquidation within forty five days from its cessation of payments⁷⁷ if it has not begun a conciliation procedure. If there is no ongoing conciliation procedure, the public prosecutor or a creditor may also request that a judicial liquidation procedure be commenced. In addition, this procedure may be commenced as a matter of right by the Court⁷⁸.

The Court then opens a judicial liquidation procedure after having heard the debtor, the representatives of the debtor's Work Council (if there exists one) or its employee delegates, and any other party it deems necessary⁷⁹.

In its judgment, the Court designates in particular a liquidator who must establish, within one month of its appointment, a report on the situation of the debtor⁸⁰. This report is designed to assist the Court in determining whether a simplified liquidation procedure should be commenced. This new simplified liquidation process is intended to accelerate the liquidation of small companies that do not own real estate

further arises as to whether the judge should only appreciate this disproportion on the basis of the credit initially extended or should also take into account the possible future borrowings under the credit facility. The reach of Article L. 350-1 is also ambiguous. Certain commentators debate whether this Article may prevent the creditor having extended credit from being held liable on other grounds than Article L. 650-1 (for example, on the ground that the creditor knew or should have known that the debtor's situation was irreparably jeopardized). Id.

⁷⁵ Article L. 650-1, second paragraph. This paragraph also raises difficulties. In particular, the question arises as to whether this sanction applies regardless of the exception on the basis of which the creditor is held liable under Article L. 650-1. Id, p. 77.

⁷⁶ Article L. 640-1, second paragraph.

⁷⁷ The debtor's work council (if there exists one) or employee delegates may communicate to the Commercial Court or the Public Prosecutor any element revealing the debtor's cessation of payments (Article L. 640-6 of the Commercial Code).

⁷⁸ Article L. 640-5 of the Commercial Code. A liquidation procedure may also be commenced if the conciliation procedure has failed (Articles L. 640-4 of the Commercial code). Likewise; it may be opened during the observation period of safeguard or judicial reorganization proceedings or during the related plan when the debtor has ceased its payments (L. 622-10 and L. 626-27 of the Commercial Code).

⁷⁹ Prior to the rendering of its decision, the Court may appoint a judge whose mission is to obtain all information on the financial, economic and social situation of the concerned enterprise (Article L. 641-1 I of the commercial Code).

⁸⁰ unless the Court opens a liquidation procedure during an observation period.

property, and whose annual turnover and number of employees do not exceed certain thresholds⁸¹.

2. Outcome of the judicial liquidation procedure

The liquidation procedure may lead to the transfer of the debtor's business.

The New Bankruptcy Law substantially modifies the provisions regulating the disposal of this business. Previously, in connection with judicial reorganization proceedings, the Court could approve a reorganization plan whereby the debtor's business would be transferred to a third party (the so-called transfer reorganization plan⁸²). This transfer plan now becomes part of the judicial liquidation⁸³. The sale of the debtor's enterprise under a judicial liquidation procedure is intended to maintain those activities that may be autonomously sustainable and the employment attached thereto, and pay the outstanding debts⁸⁴. A party interested in purchasing all or part of the debtor's enterprise must submit to the Court a detailed offer, which the Court may accept or deny.

In selecting an offer, the Court must hear the debtor, the liquidator, the administrator if there exists one, the representatives of the debtor's Work Council or the employee delegates, and must obtain the public prosecutor's opinion.

The Court chooses the offer which best insures on a durable basis that the employment attached to the transferred elements will be preserved, that the creditors will be paid, and that offers the strongest guarantees of performance⁸⁵.

The new provisions seek to ensure a better transparency of the transfer transactions under liquidation proceedings⁸⁶. Thus, any interested person may now have access to the purchase offers⁸⁷. Also, the applicants are required to provide more detailed information about the subject matter of the offer and the offered purchase price⁸⁸. In addition, the restrictions as to the persons who may not be transferees have been

⁸¹ Article L. 641-2 of the Commercial code. The simplified liquidation procedure applies when the number of employees and the annual turnover are respectively inferior or equal to 5 employees and 750 000 euros (exclusive of taxes) during the 6 month period prior to the commencement of the proceedings (Article 223 of the Decree).

⁸² See Practitioner's Guide, p. 30.

⁸³ The previously applicable provisions relating to the disposal of the debtors' assets during the liquidation proceedings were less constraining for the transferee. They induced potential purchasers to await the liquidation of the debtor's business and not to offer or submit a purchase offer during reorganization proceedings. These provisions are now abrogated. See Monsérié – Bon in Colloque, La diversification des liquidations judiciaires, p. 369 ("Monsérié – Bon").

⁸⁴ Article L. 642-5 of the Commercial Code.

⁸⁵ Article L. 642-1 of the Commercial Code.

⁸⁶ The conditions under which such transactions occurred under the former bankruptcy law had indeed been questioned and criticized due to a lack of transparency vis-à-vis third parties.

⁸⁷ Article L. 642-2. IV of the Commercial Code.

⁸⁸ Article L. 642-2 II of the Commercial Code.

significantly strengthened⁸⁹. For example, the creditors' controllers may not acquire the debtor's assets. These restrictions apply during a five year period following the transfer. Any transfer which has been made in violation of these restrictions must be avoided by the Court, upon the request of any interested party⁹⁰.

In addition, the new provisions seek to remedy the difficulties which previously often arose during the period between the adoption of the transfer plan and the execution of the transfer documentation⁹¹. Upon the transferee's request, the Court may authorize the transferee who has deposited the purchase price or a similar guarantee to take over the business during that interim period⁹². Also, in practice, a newly created company formed after the presentation of the offer is often substituted to the offeree. A substitution of purchaser is now subject to the Court's authorization⁹³. In such a case, the offeror will remain jointly liable with the actual transferee for the performance of the undertakings contained in the purchase offer.

Finally, the New Bankruptcy Law addresses the consequences of the non performance by the transferee of its obligations under the transfer plan. The Court may order the cancellation or the termination of the transfer plan. In such a case, the purchase price may not be necessarily reimbursed to the transferee. Furthermore, the transferee may be held liable for the non performance of the transfer plan⁹⁴.

D. Alleviation of certain sanctions applicable to managers

The New Bankruptcy Law also marks a shift with the former bankruptcy law regarding certain sanctions applicable to managers.

The new provisions alleviate these sanctions. The goal is to induce the debtors' managers to seek rescue measures before the cessation of payments. The rationale of the sanctions is no longer to penalize the managers but rather to identify the persons responsible for the enterprise's failures and to repair the consequences of their defective management⁹⁵.

⁸⁹ Article L. 642-3 of the Commercial Code.

⁹⁰ Id.

⁹¹ See Monsérié – Bon, pp. 369 and 370.

⁹² Article L. 642-8 of the Commercial Code.

⁹³ Article L. 642-9, third paragraph of the Commercial Code.

⁹⁴ Article L. 642-11 of the Commercial Code.

⁹⁵ Mascala in Colloque, L'amélioration de la situation du chef d'entreprise ("Mascala"), p. 370; Legros, January 2006, p. 10.

1. Pecuniary sanctions

a. Liability action in case of the debtor's insufficiency of assets

Under the previous bankruptcy law, individuals that *de facto* or *de jure* managed the debtor's enterprise could be held liable to pay all or part of the debtor's debts, if their defective management contributed to the debtor's situation⁹⁶. This sanction is maintained under the New Bankruptcy Law⁹⁷. It now also applies to the safeguard procedure. The New Bankruptcy Law has however substantially modified (in a manner favourable to the managers) the conditions under which this sanction may be imposed.

The liability action against the managers may now only be initiated if, in case of safeguard or judicial reorganization procedures, the concerned plan is not performed or if, in case of a judicial liquidation procedure, the debtor's assets are insufficient to satisfy the creditors' claims⁹⁸. Thus, the manager may not be sued for his defective management if the safeguard or reorganization plans succeed. The rationale of the new provisions is to induce the debtor's manager to contribute to the success of the plan⁹⁹.

The statute of limitation for such action is three years from the time the judgment terminating the safeguard or reorganization plan or opening a judicial reorganization procedure is rendered (and no longer three years from the time when the judgment commencing the bankruptcy proceedings was rendered).

In addition, the managers who have been liable for the debtors' debt and who do not pay those debts are no longer exposed to the risk of being subject to bankruptcy proceedings on a personal basis¹⁰⁰.

b. New obligation to pay the debtor's debts

The New Bankruptcy Law creates a new statutory obligation whereby the debtor's managers may be required to pay the debtor's debts¹⁰¹.

This obligation replaces the former sanction which permitted the Court to extend the ongoing bankruptcy procedures to the manager who had committed specific wrongdoings. The Court may now order the *de jure* or *de facto* managers to pay the debtor's debts when these managers committed certain serious wrongdoings set out

⁹⁶ Practitioner's Guide, p. 38.

⁹⁷ Articles L. 651-1 and followings of the Commercial Code.

⁹⁸ Article L. 651-2 of the Commercial Code.

⁹⁹ Mascala, p. 371.

¹⁰⁰ Mascala, id.

¹⁰¹ Article L. 652-1 of the Commercial Code.

in the New Bankruptcy Law¹⁰². This obligation, however, is limited in several respects. The Court may impose this obligation only in case of judicial liquidation and when the wrongdoings have contributed to the cessation of payments situation.

The persons who may initiate the new liability action are the public prosecutor, the liquidator or, when these persons fail to act, the creditors' controllers.

The applicable statute of limitation is three years from the time the liquidation judgment is rendered.

The sums recovered are allocated to the satisfaction of the creditors' claims on the basis of their respective ranking rights¹⁰³.

2. Professional sanctions

The so-called personal bankruptcy sanction (faillite personnelle) may be imposed upon a manager who has committed serious wrongdoings, and prohibits the concerned manager from managing directly or indirectly a commercial enterprise or an enterprise of the private sector¹⁰⁴. Additionally, depending upon the circumstances of the particular case, the Court may prevent the manager from holding a public office¹⁰⁵.

This sanction only applies in case of judicial reorganization or judicial liquidation proceedings.

Previously, this action was not subject to any statute of limitation. It may now be initiated only within three years from the date of the bankruptcy judgment.

In addition, the Court must specify the maximum period during which the sanction applies. This period may not exceed 15 years¹⁰⁶.

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¹⁰² Id.

¹⁰³ Article L. 652-3 of the Commercial Code.

¹⁰⁴ Article L. 653-1 of the Commercial Code.

¹⁰⁵ Article L. 653-10 of the Commercial Code. See generally Schultz in Colloque, La faillite personnelle après la loi du 26 juillet 2005 sur la sauvegarde de l'entreprise, p. 299. Under the former provisions, this additional sanction was automatically applied in case of personal bankruptcy.

¹⁰⁶ Under the previous provisions, this sanction applied during a minimum period of five years. The former bankruptcy law did not provide for any maximum period.