

DRAFT BILL ON REORGANISATION

PROJET DE LOI DE SAUVEGARDE DES ENTREPRISES

Over the past 20 years the French Economy has changed – the French system is no longer characterized by state intervention and nationalizations.

Bankruptcy law, born in this context in the 1980s, had the essential objective of protecting employment at the risk of sacrificing creditors' rights and triggering cascading bankruptcies. This resulted in a reduction in creditors' rights in favour of focusing efforts at all costs on preserving businesses in difficulty, and in insufficient means being devoted to the objectives and process of judicial liquidation ("liquidation judiciaire").

This law then proved to be unsuited to the economic evolution of the country and required reform.

1. At present, the existing bankruptcy law can be summarized as follows:

- As soon as a business is in a state of suspension of payments (where the liabilities that are due exceed the available assets), the court initiates a proceeding. This commences an **observation period** of a maximum of 20 months during which the court takes the time to assess the situation of the business and its prospects for recovery.
- If the court decides that a recovery is not possible, then it orders the **judicial liquidation** ("liquidation judiciaire") of the business. If, on the other hand, it finds the business to be viable, it orders and determines a recovery plan ("plan de redressement") consisting of a **continuation plan** "plan de continuation" (where the same corporation continues to operate the business through a rescheduling of the liabilities and possible waiver of claim) or an **assignment plan** "plan de cession" (where only the assets are transferred to an assignee).

Prevention

Since the real estate crisis in the 1990s, preventive measures for settling difficulties have been largely used to provide for more effective restructuring of businesses and to find solutions as soon as the business experiences legal, economic or financial difficulties, although it is not yet in a state of suspension of payments. This is known as the **ad hoc mandate and amicable settlement** practice ("mandat ad hoc et règlement amiable"), which consists of an agreement concluded with the creditors with the assistance of a court-appointed ad hoc agent and/or **mediator** ("mandataire ad hoc et/ou conciliateur"), dealing essentially with the rescheduling of the liabilities. The success of this process stems from the fact that it gives the parties the freedom to contract as they see fit and in complete confidentiality. In almost all cases, there is not any stay of proceedings.

2. The new draft bill confirms this trend of **dealing at an early stage** with business difficulties as soon as they become foreseeable and even before they affect the cash situation. It also better reconciles the objectives of preserving employment and repaying creditors.

The text reorganizes the law concerning businesses in difficulty both at the **stage of prevention** with the new mediation procedure ("procédure de conciliation") (I), and at the **stage of dealing with the difficulties** by creating a reorganisation procedure ("procédure de sauvegarde"), by redefining the judicial recovery procedure ("procédure de redressement judiciaire"), and by revising the judicial liquidation procedure ("procédure de liquidation judiciaire") (II).

I. STRENGTHENING PREVENTION

At the present time most amicable settlements concluded with businesses in difficulty enable them to be rescued and the creditors to be paid. However, this contractual process is not yet being sufficiently used because the legal protection which it affords to creditors and investors is considered insufficient. The bill makes changes to encourage the parties to conclude such an agreement.¹

In the new bill, the mediation procedure, substituted for the amicable settlement: gives the creditors the opportunity to conclude a legally secured agreement.

A. Improvements in prevention

Preliminary comments: encouragement to the detection of difficulties.

Not **filing the annual accounts** within the legal term often reveals the difficulties of the company. So the President of the court can address an **injunction of doing it** in a brief delay. If this injunction is not followed, the President of the court can summon the managers in order to consider the possibilities to correct the situation of the company³.

The **alert proceeding** done by the auditors is modified in order to be more effective. As soon as the auditor sends the **chairman** a letter asking him to organise a vote of the board, a copy of this letter is given to the President of the court⁴.

1. Broadening of conditions for instituting a mediation ('conciliation')

Until now, amicable settlement ("règlement amiable") was only available to businesses meeting the following two conditions: that they not be in a situation of suspension of payments, and that they be experiencing legal, economic or financial difficulties.

Henceforth, mediation is open to businesses experiencing an acknowledged or **foreseeable difficulty but also to those who have been in a situation of suspension of payments for less than one month**.⁵ Businesses thereby benefit from an extension of contractual freedom by one month.

2. Extended and secured mediation procedure ("procédure de conciliation")

The mediator's mandate (now defined more clearly⁶) is henceforth extended by one month, to a maximum of 5 months.⁷

The **approval** of the agreement entered into between the debtor and the creditors is at present conditional upon the fulfillment of various expressly stipulated requirements⁸. Essentially, thanks to the agreement, the debtor is no longer in a state of suspension of payments.

¹ The bill also imposes more obligations on the officers. For example, section 4 of the bill amending article L. 611-2 of the Commercial Code provides that the presiding judge may issue a prescriptive injunction against the **officers of corporations** where they do not file their annual accounts within the specified time limits, and a summons of the said officers if they do not follow up on this injunction.

Section 2 of the bill

³ Art L. 611-2 – art 4 of the bill

⁴ Art L. 234-1 – art 140 of the bill

⁵ Article L. 611-3 of the Commercial Code - section 5 of the bill

⁶ Article L. 611-3-1 mending L.611-4 – section 6 of the bill. By virtue of the **new** wording, the objective of concluding **an** agreement with the creditors **seems** to be emphasized in relation to that of **preserving employment** and the business activity.

⁷ Article L. 611-3 of the Commercial Code -section 5 of the bill

According to the draft bill, it is now the court and no longer the President of the Court which approves the agreement in order to confer a collegial nature on the decision and give it greater authority?

Henceforth, by virtue of the approval, if a proceeding for reorganisation, recovery or judicial liquidation ("procédure de sauvegarde, de redressement, ou de liquidation judiciaire") is subsequently instituted, it will not be possible to cancel any security taken or payments made during the mediation on the basis that these actions were carried out during a suspect period.

3. Better protection for creditors participating at this **stage** of the procedure

In order to assist the financing of the agreement approved as a result of the mediation ("conciliation") the new creditors participating at this stage of the procedure will henceforth have a preferential claim in comparison with the creditors asserting a claim that originates before the institution of the mediation.¹⁰ In addition, by reference to the new article L. 621-32 of the Commercial Code,¹¹ the loans, credits, and delays of payment created during the mediation also take precedence over the claims under article L. 621-32 of the Commercial Code (subsequent to the judgment instituting the bankruptcy).

Previously, lending institutions risked incurring liability due to the fault arising from the misleading appearance of solvency which they conferred on a business by granting it financing. However, the parties involved during the negotiation of the agreement are able to assess the situation of the business. For this reason, henceforth, civil liability actions brought against lending institutions based on the abusive extension of credit ("soutien **abusif**") will be dismissed (subject to fraud or clearly abusive conduct by a creditor).¹²

B. Remarks **concerning** the new bill

The decision appointing an ad hoc agent or instituting the mediation procedure ("procédure de conciliation") is henceforth communicated to the Prosecutor ("Procureur de la République")¹³.

In addition, the mediator must report to the President of the Court on the progress of his mandate.¹⁴

Finally, the approved agreement is submitted to the auditors of the business which is subject to legal oversight of its accounts. The judgment granting approval is filed at the court office where any interested person may take cognizance thereof and is subject to **publication**.¹⁵

⁸ Article L. 611-4 of the Commercial Code - section 7 of the bill. The debtor is not in a situation of suspension of payments or the agreement entered into puts an end thereto; the terms of the agreement enable the business to continue its activities, and, especially, the agreement does not detrimentally affect the interest of the creditors who are not party to it.

⁹ Article L. 611-4 of the Commercial Code - section 7 of the bill

¹⁰ Art L. 611-4 of the Commercial Code - section 7 of the bill.

¹¹ Art L. 621-32 – amended by section 36 of the bill

"Article L. 611-4 – sec. 7 of the bill: "Such persons [the persons granting credit in advance or an extension of payment to the debtor in this agreement with a view to ensuring the continuation of the businesses activities and its longevity] cannot, subject to fraud or clearly abusive conduct by them, be held liable for prejudice suffered due to the assistance granted under the approved agreement."

"Article L. 611-3 of the Commercial Code - section 5 of the bill

"Article L. 611-4 of the Commercial Code - section 7 of the new bill

¹⁵ Article L. 611-4 of the Commercial Code - section 7 of the new bill

The publication, the access by the public and the submission to the auditors are new provisions of the draft bill that may hamper, to some extent, the effectiveness of the mediation due to the fact that, in France, when knowledge of a business's difficulties becomes public, this generally causes credit to be cut off, in contrast to the United States where creditors continue to contract with the business for so long as they believe in its recovery.

II. THE NEW PROCEDURES FOR ADDRESSING DIFFICULTIES

Henceforth, the **reorganisation ("sauvegarde") and recovery ("redressement") of the business** are the only procedures available when the debtor is able to **continue operating his business on his own**. The purpose of these two procedures "is to reorganize the business so as to enable it to maintain its operations and employment and settle its liabilities."¹⁶

On the other hand, **judicial liquidation ("liquidation judiciaire")** is intended "to terminate the business operations or to **realize** the debtor's assets through a **global or separate assignment of its rights or assets**."¹⁷

A. The new reorganisation procedure ("procédure de sauvegarde")

90% of bankruptcies end up in a judicial liquidation ("liquidation judiciaire") and do not enable a true solution to be found for ensuring the survival of the business. In addition, nearly all judicial liquidations ("liquidations judiciaires") are closed due to the insufficiency of the assets.¹⁸ The reason for this failure is essentially due to the fact that it is currently impossible to institute a procedure where the business is encountering serious difficulties without yet being in a situation of suspension of payments.

The new reorganisation procedure strengthens the effectiveness of our law. It enables a procedure to be instituted even before the business is in a situation of suspension of payments. It provides for a plan to be drawn up to allow for the restructuring of the business and the settlement of its liabilities.

1. Conditions for commencing the reorganisation procedure ("procédure de sauvegarde")

The rationale for this procedure resides in the fact that it can be instituted at an early stage before the business is in a suspension of payments situation. Thus, the text indicates that "the reorganisation procedure ("procédure de sauvegarde") is open to any debtor (...) who demonstrates that he is experiencing difficulties that are likely to lead to a suspension of payments."¹⁹ The idea is to anticipate the difficulties in the same manner as chapter 11 of US bankruptcy law in order to ensure more effective repayment.

It is up to the debtor to apply for the institution of the reorganisation procedure.

2. Conduct of the new procedure

The institution of a reorganisation proceeding triggers a **stay of proceedings**.

Under this procedure, **corporate managers retain their authority to act**. They can however be **assisted** by one or more judicial administrators.²⁰ The designation of administrators by the court is subject to threshold requirements.

¹⁶ Art L. 620-1 of the Commercial Code - section 12 of the bill

¹⁷ id note 18.

¹⁸ www.senat.fr/rap/r01-120/r01-1200html

¹⁹ Art L. 621-1 of the Commercial Code - section 15 of the bill

²⁰ Art L. 621-22 of the Commercial Code - section 28 of the bill

The debtor submits his proposals with a view to drawing up a draft plan and negotiates them with the creditors assembled in **2 committees**.²¹ These two committees, based on "chapter 11", are only partially inspired by the organization of the US procedure. The first committee is comprised of all the lending organizations, and the second, the main suppliers of the business.²²

Once the committees adopt²³ a draft plan, the court approves the plan after ensuring that the interests of all the creditors are sufficiently protected.²⁴ The court's decision renders the proposals accepted by each committee applicable to all their members.

In other cases concerning:

- creditors who are not members of these two committees;
- and the creditors on the committees where the said committees:
 - do not make a decision on a draft plan within the time limit;
 - turn down the proposals made to them by the debtor;
 - or the court does not approve the plan;

the procedure is followed under the provisions of article L. 621-60 of the Commercial code (approval by the creditors individually or collectively obtained by the creditors' representative).

The plan is then adopted in accordance with the provisions of articles L. 621-72 and L. 621-73 of the Commercial code.²⁵ These provisions (which are those of the currently existing continuation plan) mean that the creditors who refuse waivers of claims cannot have such waivers of claims imposed on them and can claim the repayment of their total claims within a maximum time period of 10 years.

The term of the **plan**²⁶ is still fixed by the court. The maximum duration is maintained at 10 years. However, if, prior to the institution of the procedure, the parties stipulated lengthier time periods, they may exceed the term of the plan.²⁷

If certain creditors have agreed to make concessions for the benefit of the business, the state creditors (Tax Authority, Social security), can henceforth make partial or total waivers of claims.

No one doubts in practice that the position state creditors take will strongly affect that of the other creditors.

3. Effects of the reorganisation plan ("plan de sauvegarde")

This plan either provides for the continuing operation of the business or its continuing operation accompanied by a partial **assignment**.²⁸

²¹ Art L. 621-85 of the Commercial Code – art L. 621-85

²² Article L. 621-84 of the Commercial Code - section 75 of the bill

²³ According to majority rules determined on the basis of the claim amounts. Under article L.621-91 of the Commercial Code (section 75 of the bill), an order-in-council of the State establishes the conditions for the application of, the composition of, and the formation of the committees, the majority rules, and the applicable time limits.

²⁴ Art. L. 621-86 – art 75 of the bill

²⁵ formerly articles L.621-76 and L.621-77 of the Commercial Code

²⁶ Article L. 621-66 – section 61 of the bill

²⁷ Art. L. 62-76 replaced by L. 621-72 – section 70 of the bill

²⁸ Art. L. 621-62 of the Commercial Code – s. 57 of the bill.

Thus, the provisions of the draft bill encourage the negotiation of lasting restructurings, and allow for the separate assignment of independent divisions of the operations.

Henceforth, individuals who have acted as guarantor for the debtor's commitments may benefit from the provisions of the plan (time limits and waivers of claims).²⁹ The draft bill thus improves the situation of individuals acting as guarantors, thereby encouraging the managers of businesses in difficulty to undertake the reorganisation procedure ("procédure de sauvegarde").

The **Prosecutor ("Procureur de la République")** is henceforth present and informed of the reorganisation procedure.

In the event that the debtor finds himself in a **suspension of payments** situation during the implementation of the plan, the court will order the cancellation of the plan, terminate the operations and declare the **judicial liquidation** ("liquidation judiciaire") of the business.³⁰

²⁹ Art. L 621-65 of the Commercial Code – s. 60 of the bill

³⁰ Art L. 621-82 of the Commercial Code – s. 72 of the bill

B. The new judicial recovery procedure (“procédure de redressement judiciaire”)

1. Context and conditions for instituting the recovery procedure (“procédure de redressement judiciaire”)

The judicial recovery procedure (“procédure de redressement judiciaire”) is available to debtors who are **in a situation of suspension of payments**. The debtor may also apply to institute a recovery procedure (“procédure de redressement”) within eight days **of the failure of the mediation procedure**.³¹ Lastly, the judicial recovery procedure (“redressement judiciaire”) may be instituted by means of a writ of summons by a creditor, regardless of the nature of his claim.³²

In concrete terms, the judicial recovery regime (“redressement judiciaire”) is necessary in all cases where business leaders **do not implement the anticipatory measures**³³ before the cessation of payments, or such measures have not **dealt with all the business’s difficulties**.

In this context, because of the recovery procedure (“procédure de redressement”), the liquidation of these businesses can be avoided.

2. Purpose of the recovery procedure (“procédure de redressement”)

Unlike the reorganisation plan (“plan de sauvegarde”), **the administrator either manages the business on his own or assists the debtor in doing so**.³⁴

The judicial recovery procedure (“procédure de redressement judiciaire”) enables **preparations to be made for continuing** the operations of the business. It can, however, be oriented toward the **preparation of a plan for the assignment** of the business. While the assignment plan (“plan de cession”) is still prepared during the recovery procedure, the novelty of this bill lies in the fact that the assignment takes place during the liquidation procedure and not during the judicial recovery.

“Effective upon the institution of the procedure, third parties can submit offers to the administrator intended to maintain the business’s activities through a total or partial assignment thereof”.³⁵

At the end of the observation period, the court considers the opportunities for the continuation of the business, and any offers for the acquisition thereof.

3. The recovery plan “le plan de redressement”

The recovery plan (“plan de redressement”) is inspired by the continuation plan of the current judicial recovery (“redressement judiciaire”). Seeing the opacity of this provision, the greatest care must be taken in its interpretation³⁶.

³¹ Art L. 621-93 of the Commercial Code – section 76 of the bill

³² Art L. 621-93 of the Commercial Code – section 76 of the bill

³³ The mediation procedure and protection procedure

³⁴ Art L. 621-100 of the Commercial Code – section 76 of the bill

³⁵ Art L. 621-101 of the Commercial Code – section 76 of the bill

³⁶ Art 76 of the bill – new article L.621-102 III of the Commercial code: [translation] “the provisions of the sub-section 4 of the section 1 of the first chapter of the title 2 apply to the recovery plan”. The sub section 4 is newly created by the bill and deals with the reorganisation plan. The current section 2 is cancelled.

At this stage of the bill, we think that the rules of the current continuation plan ("plan de continuation") are taken:

- it is impossible to impose waivers of claims to creditors who refused them³⁷.
- the maximum duration of the recovery plan is 10 years, except if parties stipulated longer time periods.
- guarantors and other persons jointly and severally liable with the debtor will not be able to benefit from the recovery plan's provisions (unlike the reorganization plan)³⁸.

4. Provisions common to the reorganisation procedure ("procédure de sauvegarde") and the judicial recovery procedure ("procédure de redressement judiciaire")

The creditors' representative is now replaced by the judicial agent.³⁹

As already indicated, the claims classified under article L. 621-32 of the Commercial Code are less advantageous because claims arising from the mediation ("conciliation") are better ranked.

The bill⁴⁰ provides ~~that~~ the claims under this article lose their priority [translation] "where they have not been brought to the **attention of the judicial agent and the administrator (...)** or, where these persons cease to perform their functions as the commissioner for the implementation of the plan or the liquidator within a period of one year from the end of the observation period".

Out of a concern for harmonizing our law with European law, the bill repeals the provision according to which undeclared claims arising before the judgment instituting the procedure for which a statement of foreclosure was not issued are **extinguished**.⁴¹

³⁷ Art L. 621-76 of the Commercial Code

³⁸ Art 76 of the bill – new art L. 621-102 V of the **Commercial code**

³⁹ section 142 of the bill

Article L. 621-32 of the **Commercial Code** – section 36 of the bill

⁴¹ Articles L. 621-46 – s. 43 of the bill

c) Realization of assets

Debtors who are clearly unable to continue the operation of their businesses will assign the business itself or separate divisions of the business operations, or, on the other hand, where the operations have ceased, isolated assets.

According to the bill, the assignment of the business or of separate divisions of the operations takes place in accordance with the terms and conditions of the assignment plan currently provided for in cases of recovery. Its purpose is "to ensure that activities are maintained that are capable of being operated independently and that all or a portion of the associated jobs are maintained, and to secure the discharge of the liabilities. It may be total or partial".⁴⁸

Assignment offers are again prepared at the time of the commencement of the judicial recovery ("redressement judiciaire"), which enables the managers to be involved in preparing the plan. The implementation of these offers is, however, carried out at the time of the liquidation by the liquidator or, beyond a certain limit, by the administrator,⁴⁹ who informs the debtor, the employees' representative and the controllers of the content of the offers received. He files them with the court office where any interested person may take cognizance thereof.⁵⁰

The court will then choose the offer that is best able to provide sustainable employment and the payment of creditors' and which determines the contracts necessary to maintain the business activity.⁵²

Lastly, the liquidator or administrator executes all instruments necessary to implement the assignment plan decided by the court.⁵³

The effectiveness of this measure is now reinforced by the fact that, where the assignee does not fulfill his undertakings, he is subject to the cancellation of the plan, but remains bound by his undertakings and cannot claim restitution of the price paid. The court can declare the cancellation or termination of the instruments executed in carrying out this plan.⁵⁴

3. The simplified liquidation

The goal of this procedure is, among other things, to allow the heads of small businesses to bounce back faster to have a fresh start, and to ensure that the proceeds from the realization of their assets are not absorbed by the expenses of the procedure.

This procedure is reserved for businesses with few assets (in particular, it seems, without immovable asset) and is applicable in accordance with threshold criteria (sales figure and number of employees).

⁴⁸ Article 622-15-2 of the Commercial Code - section 99 of the bill

⁴⁹ Article L. 622-15-3 of the Commercial Code - section 99 of the bill

⁵⁰ Article L. 622-15-3 of the Commercial Code - section 99 of the bill

⁵¹ Article L. 622-15-5 of the Commercial Code - section 99 of the bill

⁵² Article L. 622-15-7 of the Commercial Code - section 99 of the bill

⁵³ Article L. 622-15-8 of the Commercial Code - section 99 of the bill

⁵⁴ Article L. 622-15-11 of the Commercial Code - section 99 of the bill

It maintains the main features of the current liquidation regime but operates on a fast-track basis.

The court decides on the institution of this simplified procedure based on a report by the liquidator submitted to the court within one month of the institution of the judicial liquidation procedure ("liquidation judiciaire"). The liquidator can then proceed with the sale of the assets by private agreement or by public auction without the necessary authorization from the supervisory judge.⁵⁵

At the end of a simplified procedure verifying only a **few claims**⁵⁶ and realizing on the property, the liquidator prepares a proposed distribution which he files with the court office and which is published.⁵⁷

The time periods are shorter than for the normal procedure: no later than one year after the commencement of the procedure, the liquidator submits his report to the court which declares the procedure closed or decides on an exceptional extension of the procedure not exceeding three **months**.⁵⁸

Final comments

The legal regime relating to the liability **of the** managers has been revised. The bill repeals the commercial and professional sanctions leading to the institution of a recovery or a liquidation for persons not experiencing difficulties. However, with a view to making life more difficult for dishonest debtors, the existence of a penal sanction gives rise to the resumption of individual proceedings by the victim as the creditor of the damages after the close of the liquidation procedure ("procédure de liquidation").

In addition, the bill broadens the remedies. For instance, the debtor can appeal judgments that adopt or dismiss the assignment plan ("plan de cession") as part of the liquidation of the business.

⁵⁵Article L. 622 - 36 of the Commercial Code – section 111 of the bill

⁵⁶ These are claims that are likely to be well ranked in the distribution and, systematically, wage claims. In the case of a normal judicial winding-up procedure, note that unsecured liabilities are not verified where the payment of these claims is impossible.

⁵⁷ Any one can take cognizance thereof.

⁵⁸Article L.622-39 of the Commercial Code – section 111 of the bill

C. New features of the judicial liquidation procedure ("liquidation judiciaire")

1. Goals and conditions of the judicial liquidation procedure ("liquidation judiciaire")

According to the new bill, the judicial liquidation procedure ("procédure de liquidation judiciaire") is **intended to end the business's operations or realize the debtor's assets** through a global or separate assignment of its rights and assets.

Judicial liquidation ("liquidation judiciaire") is available to any debtor **in a state of suspension of payments** who is clearly **unable** to ensure the **continuation of his business** through the development of a recovery plan.⁴² ("plan de redressement"). It must be **applied for within one month of the suspension of payments⁴³ or within eight days of the failure of the mediation.**

2. Conduct of the procedure

a) Option of maintaining operations and fast-tracking proceedings

Judicial liquidation ("liquidation judiciaire") may be implemented either while **maintaining or ceasing business operations**. Maintaining the operations is authorized where the total or partial assignment of the business is possible, or where required in the public interest or the interests of the creditors.

The **liquidator⁴⁴** administers and manages the business, except in the case of a large-sized businesses where numerous jobs are at stake, which must benefit from the experience acquired by **judicial administrators**, or where the court deems it necessary to appoint one.

In addition, "where the debtor is a corporate entity, the corporate managers holding office when the judicial liquidation order is issued, remain in office"⁴⁵.

As soon as the procedure is instituted, the court then assigns **a date** (which can be extended by a reasoned decision) at which time the matter will be examined with a view to ending the procedure. In addition, **within a period of two years** from the date of the liquidation order, the prosecutor, the debtor or any creditor may apply to the court to close the procedure.⁴⁶

b) Creditors' rights

After the close of the liquidation procedure ("procédure de liquidation judiciaire"), creditors⁴⁷ are entitled to **resume individual proceedings**. Cases of the resumption of individual proceedings with regard to the debtor are modified. And **all claims resulting from a penal conviction** can now be **recovered by an individual action** of the holders thereof.

⁴² Article L. 622-1 of the Commercial Code – section 88 of the bill

⁴³ Article L. 622-1-1 of the Commercial Code – section 89 of the bill

⁴⁴ Article L. 622-10 of the Commercial Code – section 95 of the bill

⁴⁵ Article L. 622-9 of the Commercial Code – section 94 of the bill

⁴⁶ Article L. 622-30 of the Commercial Code – section 108 of the bill

⁴⁷ Article L. 622-32 of the Commercial Code – section 109 of the bill