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# **French Insolvency Law: Outline of Reform Proposals**

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## *The Pressure for Reform*

The French Government is taking action with view to undertaking reforms in the fields of company law, insolvency law and practice as well as the administration of justice in the commercial courts. With respect to insolvency, the legislative framework is contained in a law passed in 1984 and in two laws promulgated in 1985.<sup>1</sup> These deal respectively with pre-insolvency measures, insolvency proceedings and the rules relating to insolvency practice. Although there was strong support for the changes which were necessary in order to modernise insolvency law and introduce pre-insolvency measures, the use of the procedures has been particularly susceptible to criticism. In the case of the Insolvency Law, which altered the balance between creditors' and employees' interests, this resulted in opposition from financial institutions and creditors generally. The Prevention of Business Difficulties Law, in relation to the use of ad hoc mandates and mediation, is still little used in practice.<sup>2</sup>

Those criticisms which were expressed led to a reform law in 1994 that merely tinkered, some felt, with the procedural framework for both pre-insolvency and insolvency measures. It left, however, the law in relation to the professions largely untouched as its use had not till then met with any adverse commentary.<sup>3</sup> Following and despite the 1994 reforms, further criticisms have emerged in relation to both insolvency procedure as well as practice. Despite the advice of certain very eminent members of the insolvency profession, it has seemed as if reforms were not high on the Government's agenda, given other priorities of an economic nature.<sup>4</sup>

Matters were precipitated when, as a result of a scandal occurring during 1996-1997, it was alleged that two insolvency practitioners were involved in the disappearance of over FF 200 million from the coffers of companies they administered.<sup>5</sup> This has prompted close public scrutiny of the professions and intense press attention. During further investigations, a number of very serious allegations were made to the effect that it was common for many insolvency practitioners to use their positions to further their own business

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<sup>1</sup>Law no. 84-148 of 1 March 1984 (Prevention of Business Difficulties Law), Law no. 85-98 of 25 January 1985 (Insolvency Law) and Law no. 85-99 of 25 January 1985 (Insolvency Practitioners Law).

<sup>2</sup>For an introduction to French insolvency law, see Sorensen A & Omar P, *Corporate Rescue Procedures in France* (1996) Kluwer.

<sup>3</sup>Law no. 94-475 of 10 June 1994 (Insolvency Reform Law). See Vallens J-L, A propos de la reforme de la loi sur les entreprises en difficulte: Le rapport du groupe de travail du ministere de la justice, (in three parts) *Les Petites Affiches* Nos. 21-23 (18, 21, 23 February 1994).

<sup>4</sup>See Soenne B., *Le Bateau Ivre* (A propos de l'évolution récente du droit des procédures collectives), (in two parts) *Les Petites Affiches* Nos. 58-59 (14, 16 May 1997).

<sup>5</sup>This case, known as "l'affaire Sauvan-Gouilletquer" resulted in the arrest of both partners in February and April 1997 on charges of fraud, illegal acquisition of interests in companies and abetting criminal bankruptcy.

interests and that the practice of commercial judges in some districts came close to constituting potentially serious misconduct.<sup>6</sup>

### *The Government's Reaction*

The overall level of public concern and adverse comment led Elisabeth Guigou, the Minister for Justice, to use the occasion of the annual address to the General Conference of Commercial Courts in Paris on 24 October 1997, to announce a number of wide-ranging reforms. These would initially centre around four main issues: the reinforcement of penalties for supervising judges who misuse their influence for personal ends, the closer scrutiny of insolvency practitioners' accounts and a requirement that funds generated by companies in insolvency be deposited with the official deposit-taker as well as a greater role for public prosecutors in insolvency proceedings.

Proposals for legislative action which mirrored the announcement were presented to the Council of Ministers on 29 October 1997. Shortly after the announcement and following closely on these events, the National Assembly began a parliamentary enquiry into the proposed reforms. In addition, the French Government's Inspectorate-General of Finances and Inspectorate-General of Judicial Services were given a mandate to conduct an inspection into the areas of concern outlined by the Minister for Justice in her proposals. The scope of both enquiries, which seemed to range widely, included an examination of the entire legal framework for the administration of commercial justice in France and, in particular, its application to insolvency matters.

A recent press statement, issued by the Ministry of the Economy and Finances on 14 October 1998, reports on the outcome of the enquiries and fleshes out a number of the proposals in light of the conclusions reached by the enquiries. Nevertheless, not all the recommendations made by the enquiries were accepted by the Government. One in particular, suggested by Arnaud de Montebourg, the rapporteur for the Parliamentary Commission, to the effect that the profession of liquidator should be abolished, did not, in light of its controversial nature, get a warm reception.<sup>7</sup>

In all, there are three principal areas that are the focus of attention in the statement, the reform of the commercial justice system, the reform of professions linked to commercial justice and the reform of the framework for insolvency law. This article will deal with the last of the aforementioned areas.

### *The Reform Imperative*

The French Government is cognisant of the imperative to ensure that the law relating to pre-insolvency and insolvency proceedings is as effective as possible in meeting the aims set out as policy (and legal) objectives. These are to ensure the continuity of business, the safeguarding of associated

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<sup>6</sup>A journalistic enquiry by Fortin D et al., published in *Challenges* (January 1998 edition) highlights some of the causes of concern. The courts affected include Paris, Bobigny and Nanterre (two courts just outside Paris) as well as Nice and St. Lô.

<sup>7</sup>See Vidal F, *Options Finances* No. 507 (6 July 1997).

employment positions and the satisfaction of creditors.<sup>8</sup> Nevertheless, these objectives must be measured against the statistical reality which meant that in 1997, 58,000 insolvency proceedings were instituted affecting some 325,000 employees. Of these proceedings, 90% led to liquidation of the business concerned.<sup>9</sup> The French Government is conscious that these statistics are undoubtedly a factor in supporting criticisms of the present system, but that they should not be allowed to detract from the overriding objectives of the law, which are to find an equilibrium between creditors' and employees' interests. Nevertheless, important measures are suggested in order to meet those legitimate concerns which have been expressed.

### *I - Reform of the Procedural Framework*

A first step in reform of the procedural framework is stated as being to make the texts of the various laws more user-friendly by the introduction of new terminology, designed also to link the requirement for legal certainty to an overall need to orientate proceedings towards economic imperatives, especially efficiency. The need to speed up proceedings is evident from two specific proposals set out in the statement. These are to allow the transition from rescue procedures to liquidation to occur during the early stages of proceedings following detailed analyses of prospects for the business and its financial situation conducted within a few weeks of proceedings being opened.<sup>10</sup> Similarly, creditors will now be constrained by stricter time-limits for submitting their proofs of debt, with failure to prove being fatal for their claims.<sup>11</sup>

Greater attention will be paid to small-scale insolvencies, involving assets under FF 100,000,<sup>12</sup> as the costs of administering insolvency proceedings can be disproportionate in comparison with the assets that may be recovered and which are then available for distribution to creditors. A new streamlined procedure will be instituted within the framework of liquidation, designed to be easier to administer and faster to complete. Remuneration for these proceedings, which will also require less administrative tasks, will be based on a one-off fee. According to the French Government, more than half of total procedures could be dealt with in this way. Nevertheless, an important point is noted in the statement, to the effect that employee protection will still form an important consideration in any streamlined procedure.

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<sup>8</sup>Art. 3, Insolvency Law.

<sup>9</sup>These may be contrasted with the situation in 1993 when 70,000 businesses became insolvent, with liquidation in 93% of cases resulting in the loss of 300,000 jobs. In 1997, although fewer insolvency proceedings were instituted, these affected more jobs and the overall percentage of proceedings leading to liquidation changed only slightly.

<sup>10</sup>A direct route to liquidation is available at the first hearing of a petition for insolvency, if the court forms the opinion that the business is irredeemably compromised (Art. 1, Insolvency Law). During the observation period, the court may also convert proceedings into liquidation (Art. 36, Insolvency Law). Otherwise, the court awaits the production of the administrator's report, normally at the end of the observation period (Art. 61, Insolvency Law).

<sup>11</sup>These are, at present, 2 months for creditors in France and 4 months for those overseas (Art. 66, Decree No. 85-1388 of 27 December 1985).

<sup>12</sup>A simplified procedure is at present available to companies employing less than 50 employees (Art. 2, Insolvency Law) and whose turnover is less than FF. 20 million (Art. 1, Decree No. 85-1387 of 27 December 1985).

The use of pre-insolvency procedures, designed to allow debtors and creditors to negotiate their way out of a financial impasse under court supervision, will continue to be encouraged by the French Government.<sup>13</sup> However, the nature and features of pre-insolvency procedures should be kept apart and distinguished from insolvency proceedings. The institution of the ad hoc mandate, largely a creation of the courts, is to be regulated by the introduction of a new framework to govern practice conditions.<sup>14</sup> Public Prosecutors will also be given a right of access to the files involving ad hoc mandates in order to exercise some supervision. By far the most important suggestion contained in the statement is that courts will no longer be permitted to authorise a moratorium in the context of pre-insolvency measures.<sup>15</sup>

## *II - Transparency and Financial Control*

The French Government considers that the best answer to criticisms of insolvency procedures is to ensure they are conducted with the maximum of openness and transparency. The statement provides that, in future, parties to insolvency cases as well as employees of the business concerned will be able to require the courts to advertise the existence of proceedings and hold them in public.<sup>16</sup> The sale of the insolvent company's business, which can occur in liquidation,<sup>17</sup> will now be conducted according to the rules already used in rescue procedures, which are more open and allow for the use of a tender procedure. Similarly, equality of access by third parties who wish to purchase assets will be guaranteed by a more well-defined procedural framework with transparency, publicity and supervision of proceedings being built in.

Creditors will benefit from the package of measures designed to supervise the use of funds during insolvency proceedings. These will allow for a faster distribution of dividends.<sup>18</sup> Settlement of claims will be facilitated by the introduction of a number of measures, including closer supervision of insolvency practitioners, ensuring that proceedings are brought to an end within a clearly defined time-scale and ensuring that claims and securities are identified and their extent ascertained as quickly as possible during

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<sup>13</sup>There are two basic procedures: the ad hoc mandate, a judge-made (or pretorian) institution and mediation, which is related to the forms of conciliation that are more widely used in family and employment law matters.

<sup>14</sup>At present, the sole mention of the ad hoc mandate is in Art. 35, Prevention of Business Difficulties Law which reads: "Without prejudice to the power of the President of the [Commercial or High] Court to appoint a person under an ad hoc mandate, whose mission he shall determine, there is created a procedure entitled mediation..."

<sup>15</sup>This may well be a self-defeating move, as the experience in the United Kingdom suggests that the moratorium is indispensable to forcing creditors to negotiate in a CVA.

<sup>16</sup>At present, only some procedural aspects occur in public, for example the judgment opening proceedings (Art. 14, Decree No. 85-1388 of 27 December 1985).

<sup>17</sup>Sales of assets during liquidation quite often occur as a result of private agreement between liquidator and third party. This has the advantage of ensuring speedy transactions but the disadvantage of being closed to other interested parties if the liquidator does not/will not negotiate with them.

<sup>18</sup>The statement mentions that some FF. 56,000,000,000 is currently on deposit with the French Government's official deposit-takers.

proceedings. Creditors will also be given access to an annual report where proceedings extend over a period of time.<sup>19</sup> Nevertheless, advantages obtained by company creditors during the relation-back period will come under greater scrutiny, allowing the courts to order repayment of sums received where it is shown that the creditor has used privileged or confidential information in order to secure a financial advantage.<sup>20</sup>

### *Reform Timetable*

The statement expresses the scale of the reform when it notes that the reforms represent an important legislative task for Parliament. For this reason the timetable for a rolling programme of legislation extends over a period five years. Measures which affect insolvency practice occur in the first part of the programme, although related reforms to the administration of justice in the commercial courts will not be completed till 2002. The timetable is as follows:

Year	Legislation or Procedural Steps
1998	Legislation on supervision of insolvency practitioners
1999 (first semester)	Tabling of draft legislation containing: Reforms to the organisation of ad hoc mandates Reforms to the Insolvency Law and Prevention of Business Difficulties Law Reforms to insolvency practitioners' fee structures
1999 (second semester)	Legislation on insolvency practitioners' fees Legislation on insolvency procedures

### *Summary*

The period between reforms of insolvency law appears to be getting shorter. The law of 1967 lasted nearly two decades before economic pressures brought a reshaping of the corporate rescue framework in 1984 and 1985. Pressure for reform of the reforms started almost immediately, although not seeing fruit till 1994. Now, 5 years on, the French Government has found compelling reasons to embark upon an extensive reform agenda within an ambitious timetable. The reforms address some of the criticisms of present insolvency law and practice, especially the need for transparency and a more ethical dimension to the administration of procedures and the need for cost-effectiveness in smaller procedures, which form the majority of insolvencies annually.

Commentators will have the opportunity, once these reforms have been implemented, of determining the success of these proposals. To outside viewers, some of the proposals appear to be a retrograde step, particularly the proposal seeking to remove the moratorium in voluntary arrangements. Whether the proposals overall will bear the desired fruit remains to be seen and comment will not be long in coming once draft legislation is issued. What

<sup>19</sup>One possibly advantageous reform would be to limit rescue plans in time, the maximum for continuation plans currently being 10 years or 15 years in the case of agricultural businesses (Art. 65, Insolvency Law).

<sup>20</sup>At present, the relation-back period can extend for up to 18 months prior to the opening judgment and up to 24 months in instances of gratuitous disposals of property (Arts. 107-108, Insolvency Law).

can be agreed is that most believe that these reforms are necessary in order to introduce a modern framework for enterprise in France and to maintain competition with the favourable legislative framework existing in other jurisdictions.

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