

The reform of insolvency  
proceedings in France

A professional's point of view

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## INTRODUCTION

### A. BACKGROUND

In July 2005, France equipped itself with a new statute for the treatment of insolvency, namely the « Loi de Sauvegarde » or the *Company Rescue Act*. Act n° 2005-845 dated July 26, 2005 and its decree n° 2005-1677 dated December 28, 2005 came into force on January 1, 2006.

This legislation does not apply to so-called personal excessive indebtedness proceedings, which are subject to Article R.332-19 of the Consumer Code.

It is the successful culmination of long and time-consuming consultations with professional organizations and the lobbies concerned. The French Justice Department, the French National Assembly and the Senate led the push for reform together; foreign systems were also taken into consideration.

Observers will note that every twenty years, the French laws on insolvency evolve: 1967, 1985 and most recently 2005.

This latest series of legislation should provide us with necessary management tools and preventive measures (a major focus of the reform), that are both lasting and compatible with changing business trends and cycles.

The result of political will, the *Company Rescue Act* also attempts to throw off the all-too-frequent image of the French insolvency system as being inefficient, operating with a minimum of transparency and lacking in predictability.

Until now, the French situation has been openly criticized in the international business press and in professional publications. In the report “Doing Business” published by the World Bank, France ranks 44<sup>th</sup>, just behind Jamaica. While the methodological approach can be questioned, the criteria analyzed are nevertheless relevant and raise concerns over the adequacy of the French judicial system to operate in an international context. Further, the financial crises that our rich economies are faced with today are leading us to debate openly the appropriateness of existing measures in dealing with companies in difficulty. Today’s context provides a strong argument in favor of increased judicial cooperation and communication among insolvency professionals.

Legislative reform sends a loud message. This new law is a national step forward directed at the country's businessmen as much as to their representative bodies (official representatives / trade associations, respective unions, etc), and to professional personnel directly involved in the management of companies in distress. It is a call for commitment among financial and judicial authorities at an international level.

*"I am proposing reform which will reduce the risks that companies face. France is a good place to do business."* This statement was made by the Minister of Justice, Pascal Clement, when commenting on the new *Company Rescue Act* at a symposium on "The Company Rescue Act's contribution" organized on September 13, 2005 by the Paris Chamber of Commerce and Industry, the AFFIC, the Paris Bar, the National Bar Council and the Conference of Bar Leaders.

The generally-held conviction by most parties to the process is that previous texts had not succeeded in protecting the French economy or in saving jobs, although these were precisely the objectives that had been sought after in the 1985 statute.

Should we hope that this new law, with a new baseline message in marketing terms, that of "prevention", will be a paragon of all virtues and succeed where others have failed?

Recently, the Minister spoke again and reminded the players that *"the success of the reform will depend in large part on the companies in difficulty changing their attitude and on the creditors doing likewise. The trust that the lawmaker places in the company directors must be reciprocated with a similar commitment by business leaders to the legal reform and the institutions enforcing them"*.

The strong words "instilling fear", "the obsolescence of the system" and the "destructive law" are used to describe the past and the hopes for the future are reiterated again and again through the catch phrase: we must create a climate of "trust".

In this way, the government hopes to convey the message to the international community that France offers a stable and sound business environment where company managers need not fear being dispossessed; they will be provided with the necessary tools and support through the new laws to find appropriate solutions to their problems.

Because these problems can be multiple, the solutions can be as well and because in the past we have associated late requests for assistance with minimal chances of recovery, the government has decided to launch a communication campaign to encourage companies to sound the alarm as soon as the first signs of distress appear. In this way, the government hopes to convince business leaders to react before the fatal outcome of compulsory liquidation becomes the only option.

Having said all that, the reform, which was widely publicized and in spite of the American influence hoped for by the previous Minister of Justice following visits to the USA, has not succeeded in changing the very essence of French insolvency procedures. Judicial they were, judicial they remain. Should prevention be desirable, it continues to be organized by the court having local jurisdiction.

No “forum shopping”. In France, jurisdiction is tied to the company headquarters. The first article of the Decree stipulates that a change in address of the headquarters can only be recognized six months following the date of official publication of the notice of the transfer. It is therefore impossible to redirect a case on a last-minute basis should the company address correspond to the jurisdiction of a Court whose skills are questionable.

By putting the focus on reforming the law rather than on the badly-needed reorganization of the Commercial Courts, the government deliberately, and again for political reasons, brushed aside changes to the archaic French system which has existed since 1563. Perhaps the political and financial costs of this type of reform are too high. The original intention was to perform a complete overhaul of the Commercial Courts and a review of the professional status requirements of the judges to bring them into line with the business realities of the 21<sup>st</sup> century.

To answer mounting criticism, the previous Socialist government attempted in 1998 to introduce reform in the Commercial Courts by imposing a mix of judges, that is, to include both professional and elected judges in their ranks. As a result of tremendous opposition, this initiative never saw the light of day, and instead the number of Commercial Courts in France was reduced from 191 to 184. This 3% reduction is hardly a significant response to the issues involved.

The background in a few figures:

In 2004, France had (estimates):

- population of 61,000,000
- 2,568,000 businesses  
including 230,000 businesses created in 2004  
with 42,000 insolvency proceedings opened yearly. It should be pointed out that in France the legal and accounting discontinuation of any business, even devoid of assets, requires the opening of insolvency proceedings
- 181 Commercial Courts
- 3,100 Commercial Court judges
- 317 liquidators
- 115 administrators
- 49,500 lawyers.

## **B. THE LEGAL ORGANISATION AND ITS PLAYERS**

### **1) The Commercial Courts**

There are 184 Commercial Courts handling insolvency proceedings in France with a total of 3,100 judges. Of these Courts, 25 are composed of more than 25 judges, the largest Court being the Tribunal de Commerce de Paris (Paris Commercial Court) with 180 judges. These 25 Courts handle approximately 40% of insolvency proceedings, which represent 21,000 cases of the annual 50,000, of which 900 are voluntary arrangements and conciliations (2004 figures).

The 14 smallest French courts are composed of 5 to 7 judges but they only handle about 500 cases per year (that is, 1% of the total) of which around 50 are preventive procedures.

The judges are elected by their peers for a term of 14 years maximum. They are volunteers and hold a business occupation when designated. They are therefore financed by their company whose interests are protected by the elected judge's active lobbying of its causes before the Courts when required. For instance, banking circles and industry are most represented among the judges in the Commercial Court of Paris.

Certain judges are lawyers by training, others less so, or not at all. The issue of training of newly-appointed judges is a problem for which there appears to be no easy solution. Due to a lack of funds, judges often resort to internal resources for training, i.e., paid conferences and funding from the Chambers of

Commerce. And in fact, it is precisely this shortage of resources that explains why the current system of elected judges endures.

Basic training for newly-elected judges has been instituted. On an annual basis, it affects from 10 to 15 % of the 3,100 elected judges. The training is spread out over 2 years and consists of 9 days of courses. 7 of the days are devoted to the acquisition of the “legal system fundamentals” and 2 days are reserved for the handling of specific legal problems (most often the management of insolvency proceedings). The training is delivered at regional sites by both civil and elected judges having previously received the training themselves.

Continuing education is also provided. It consists of the Commercial Court judges participating in training sessions organized by the Ecole Nationale de la Magistrature (National Judges School). In 2004, 111 judges took this type of training. It could be worthwhile to invest in more of this kind of training but the cost of doing so as well as the limited time available to the judges (due to their ongoing professional activities) prevents this from happening.

The idea of volunteers financed by the businesses involved in designating a colleague to fulfill this public service role is naturally based on an expectation similar to the basic idea that business conflicts will be decided by the businessmen themselves, acting more or less disinterestedly. In this way, we better understand the strong presence of certain legal specialists, such as those representing the interests of the banks who are only too eager to give “*advice*” to their colleague judges who may come across disputes involving banking matters.

Accordingly, the decisions rendered in certain Courts can be better understood by viewing them through this filter of interests, which is of the essence of the institution. The legal system’s independence has a price, and the elective system allows it to be economized. Perhaps this system is the best under the circumstances?

The cohabitation of elected judges with professional magistrates proposed by the previous government never saw the light of day. It would, however, have allowed maintaining the competence of the elected judges (the know-how of these judges was widely recognized) and the need for impartiality which would have been assured by the presence of the professional judges. Even the best of women and men cannot guarantee the independence of their decisions if they are both judge and party to the matter. This would nevertheless have been the best way to make the institution evolve, by protecting it from what will always

risk tarnishing its image (conflicts of interest, unclear duties, ambiguous status, etc).

It is a fact that incidents were frequent enough in the past to generate the need for mixed panels; for professional judges to sit along with the elected judges, as guarantors of the principal tenets of justice: impartiality, due process and the right to a fair trial.

This project, in addition to its cost, bore a political price and was therefore abandoned as each elected judge is an important local figure whose vote can swing the political pendulum.

Moreover, each elected judge felt personally targeted by the methods employed to achieve the intended reform. In denouncing the problems, the rapporteurs to the French National Assembly castigated the elected judges as a group, which had the unfortunate effect of provoking their collective reaction against the arbitrary attacks. And yet, while the difficulties do exist, it remains nevertheless that the majority of the elected judges are committed citizens serving the needs of the public. Where efforts should have been made by the proponents of the mixed system to convince and attract those concerned, hard-boiled tactics were used instead and had the opposite effect.

The existence of such a system, that is the notion of volunteer judges, may be surprising, but there are many who find satisfaction in this type of commitment. For some it is the privilege of being part of an inner circle of notables, for others the exercise of power and authority, and for others still, it is an opportunity to remain active intellectually at retirement age and to remain among peers. For others, it is the stepping stone to a more lucrative situation where eventually they will arbitrate more important disputes and be paid accordingly. And then there remains a very small minority who unfortunately take advantage of these types of positions to benefit from more direct methods of financial compensation, as in any human organization. It is then up to the organization concerned to declare war on them officially, combat such unacceptable conduct actively and support those brave enough to stand up to abuses, rather than denounce them.

This is why, while since the beginning of the institution, sensitive situations arising have been dealt with informally by members of a same group with a thank you and a withdrawal for personal reasons, a few cases have ended up in Court, including criminal proceedings, and certain elected judges have been censured.

Even more reassuring is the willingness to make these elected judges responsible for their acts. It is obvious that these judges who are bound to a private employer cannot be treated in the same way as the professional judges. Threats to career advancement opportunities are ineffective in such cases.

The National Council of Commercial Courts was created by Decree n° 2005-1201 on September 23, 2005, following the presentation of the report of the working party chaired jointly by the Judicial Services Inspectorate and the Judicial Services Authority, and to which the General Conference of the Commercial Courts was associated.

An advisory body reporting to the French Minister of Justice, the National Council of Commercial Courts is competent in advising the Minister in three areas:

- The code of ethics and the training of elected judges
- The functioning and organization of the Commercial Courts
- The establishment and subject-matter jurisdiction of the Commercial Courts.

Furthermore, the National Council may visit Commercial Courts for information-gathering purposes, and must hand in an annual activity report to the Minister of Justice.

Presided over by the French Minister of Justice (also known as the Keeper of the Seals), the National Council of Commercial Courts includes the Director, Judicial Services Branch; the Director of Civil Affairs and of the Seal; the Director of Criminal Affairs and of Pardons; two Heads of Courts of Appeal, a member of the Council of State; a Registrar of the Commercial Courts; two qualified personalities; and ten Commercial Court judges. The vice-president of the Council will be elected by fellow members from among the ten Commercial Court judges.

The creation of this Council is part of the reform package aimed at reorganizing the Commercial Court system. It will allow discussions to go forward on a number of important questions affecting the future of the commercial courts system such as amendments to the judicial map, the specialization of courts, or the implementation of the *Company Rescue Act* voted on July 26, 2005. It will also have to deal with prevention of the ever-present risk of the Commercial Court system's image being tarnished by the problems of incompatibility between professional activity and the elected judges' status. The demand for an

independent status with fair pay for Commercial Court judges would be one line to be explored.

Naturally, there may be concern as to this National Council's ability to perform its duty to supervise the institution, bearing in mind that its co-chairman is a representative of the institution who was censured by the civil Courts on several occasions (decisions of the Court of Appeal in July and November 2001) for failing to comply with the requirement of impartiality imposed on each of the agencies of insolvency proceedings, in reliance "on the principle of impartiality laid down by European Convention on Human Rights", Article 6-1.

Once again, the impartiality expected of the Commercial Courts may be lacking where it would be necessary, in order to reassure businesses and their creditors, to have high-standard correspondents able to take on issues in an objective, neutral and benevolent manner.

Justice, in order to be well administered and accepted, must be fair and predictable.

Having regard to previous experience, there is every reason to believe that with its current membership, this National Council will merely add a little extra complexity to an environment that is already very sensitive and difficult to appraise.

## **2) The Public Prosecutor's Office**

Insolvency proceedings in France are under judicial authority and fall under the auspices of the Public Prosecutor's Office. The Public Prosecutor represents the side of public law and order, for both social and economic interests, when facing the Commercial Court judges.

The "Company Rescue Act" of July 26, 2005 confirmed the legislative will to see the Public Prosecutor become more involved in the day-to-day management of the prevention and handling of companies' difficulties. The reform enhances the general and traditional role of this office, that of ensuring the proper application of the law and overseeing that the interests of conflicting parties are given fair consideration. The new law also now equips it with the extra tools needed to accomplish this mission

The reference to the term prosecutor gives way to that of Public Prosecutor's Office, in an attempt at depersonalization of the institution, by replacing a title redolent of criminal matters with a more neutral term.

The Public Prosecutor's office defends the law and its objectives in cases involving economic and social interests. The law establishes a system of social and economic public policy, guarded by no other than the Public Prosecutor's Office.

At a recent conference, a member of the Public Prosecutor's office, in whose view we concur, stated that the new act has also extended the Public Prosecutor's office's right to disclosure. This right is limited in conciliation proceedings (Article L.611-6) but general (Articles L.621-8, L.631-9 and L.641-7) and extended in connection with rescue, reorganization and judicial liquidation proceedings.

The Public Prosecutor's Office is required to provide fully-supported and detailed opinions. Article 425 of the New Code of Civil Procedure, which requires the Public Prosecutor's Office to be kept officially informed of all proceedings relating to distressed businesses, also confers upon this office the right to comment when it so sees fit throughout the entire process. The new law also calls for his opinion being given in very specific cases such as:

- Approval of the conciliation agreement
- The partial discontinuation of the business
- The transition to receivership or to liquidation
- Whenever a substantial change to the sale plan is being debated, for the drawing-up of a management agreement,
- For a modification, in the case of a management agreement, to the original conditions of acquisition,
- When the close or resumption of court-ordered liquidation is requested.

The Public Prosecutor's Office must be present in the following cases:

- At the opening of rescue proceedings when this procedure was preceded by ad hoc proceedings or conciliation in the previous 18 months; During discussions over the company rescue plan when it concerns a company with more than \*\* employees or having annual sales excluding taxes in an amount exceeding EUR 3 M; or
- In the event of sale.

The Public Prosecutor's Office is invested with its own power, shared or exclusive. The new act provides that this is the only authority to be able to:

- request the appointment of several liquidators or administrators at the opening of the company rescue proceedings;  
object to the appointment of the ad hoc receiver or conciliator as Administrator;  
request the dismissal of a controller;  
request the replacement of one or more managers upon adoption of the Rescue Plan
- request, in the case of liquidation, the sale of the company to one of the persons listed in the 1<sup>st</sup> paragraph of article L642-3 (the debtor and the members of his/her family).

## **Remedies**

The Public Prosecutor's Office, "even if it has not acted as principal party", now enjoys the possibility of appealing to the Court of Appeal and the Supreme Court, an option also available to the debtor, to the claiming creditor, to the Administrator and Liquidator, to the staff delegate, to the Enforcement Plan Commissioner, to the purchaser or to the contracting partner, for a certain number of decisions listed on a comprehensive basis in articles L661-1 I and L661-6 of the Act.

The Public Prosecutor's Office also has sole authority to

- appeal to the Court of Appeal or Supreme Court against rulings made on remedies against certain orders of the insolvency judge,
- appeal against decisions regarding the appointment or replacement of the Administrator, liquidator, controllers (inspectors), or the expert or experts or acting on the length of the monitoring period, on the continuation or discontinuation of the business.

Two new provisions, contained in Articles L.611-1 II and L.611-11, deserve a mention. The former provides that a stay of immediate enforcement, which is granted as of right in all cases of appeal by the Public Prosecutor's office, may not be applied to rulings on the opening of proceedings for rescue or judicial reorganization.

The general view is that the presence and effectiveness of the Public Prosecutor's office's action are not consistent throughout France, so that unfortunately there is room for disappointingly "unpredictable" rulings.

However, as in any organization, we should not stigmatize the mistakes but observe optimistically the desire to act for the best within an ancient organization through the willingness and skill of its members, while understanding the fundamental difference of the French system, where the judges, in addition to their volunteer status, are also active professionals, at least during most of their careers on the Commercial Court, required to sacrifice their personal and family time to meet this commitment.

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### 3) The judicial auxiliary officers

The judicial auxiliary officers are now called, according to the new names given under the Act, Administrators and Liquidators. These professionals, previously recognized under one title ("*syndic judiciaire*") since 1838, were split into two professions in 1985:

- The Administrators, who oversee the restructuring of distressed companies
- The Liquidators, who realize the remaining assets and who represent the interests of the creditors in receiverships. They also handle payment to the employees through the AGS.

These two professions are another French exception as they have quasi-judicial powers. Appointed by the Courts, and legally competent over the entire French territory but operating locally by custom, they are organized into two parallel professions under the same governing body, the National Council. They also benefit from the same insurance underwritten by the Caisse de Garantie (Professional Mutual Insurance).

This small profession (432 members of whom 115 are Administrators) over the entire French territory is, moreover, subject to a rule of joint liability among its members, using their own personal property as security for otherwise uninsured misconduct. For that matter, this joint liability came into play recently, when two Administrators having "invested" their clients' funds into highly-speculative American ventures were unable to recover their risky investments.

In other respects, these two professions are incompatible with all others and are altogether completely different from each other. Only the professions of lawyer and Administrator are compatible, but examples of such combinations are rare.

This profession, which is extremely hard to get into (the turnover is less than the needs estimated by the profession), is also subject to regular triennial inspections by its peers and an auditor whose report is submitted to the Public Prosecutor's Office and the Ministry of Justice's administration. The latter can also deploy its own services to perform inspections among the insolvency professionals.

All of the information with regard to the funds managed and to the professional fees is brought to the attention of the professional body, the Public Prosecutor's Office and the Ministry of Justice's administration.

The size of a Liquidator's firm obviously differs in terms of numbers of staff and financial turnover depending on whether it is located in a geographically-dense industrial sector or not. In any event, a liquidator's office normally consists of a small independent structure organized around one to five insolvency professionals and employing fifty people at most.

Until a Decree dated June 10, 2004, the insolvency professionals were appointed by the Court having jurisdiction for all proceedings, whether assets remained or not. In this way, liquidators when closing down companies and settling disputes were led to manage from 30 to 60 per cent of "no-asset" cases on a volunteer basis, that is to say free of charge. The accounts were supposed to even out through an offset with the higher revenues generated by the more productive cases.

This unbalanced system was naturally denounced as it was hardly possible to determine the substance of cases in advance.

The question of not opening the no-asset proceedings as is done in other countries (such as Germany, Great Britain, Poland and many others) was debated but rejected so that the Liquidators could continue to manage the French employee salary questions raised during the insolvency by activating the FNGS insurance scheme. It was also to allow the liquidators to put an end to the many contracts and disputes left unsettled by the previous management in difficulty.

Nevertheless, to readjust the previous situation, Decree N° 2004-518 provided for creation of a fund, managed by the Caisse des Dépôts et Consignations and financed by a portion of the interest earned on funds coming from assets disposed of by the liquidators and deposited at the CDC, which enjoys a statutory monopoly on deposits. So that now, even if less obvious, the earlier criticism on distribution remains an issue because it is still the interest from asset-rich cases that ends up paying for the others. But it is an equally unassailable economic reality that the cost of handling the no-asset cases is charged either to the State (in Great Britain, for instance, the Official Receiver handles these cases when they are of interest) or to the creditors. In the current mutual sharing of costs system, the fees paid by the fund managed by the Caisse des Dépôts et Consignations are fixed and amount to 1,500 € which are paid to the liquidators only.

It is nevertheless comforting that this service is no longer left for the account of one profession in which an astonishing 30 to 60% of business was unpaid. The financial equilibrium of these two professions is, in any case, a subject for discussion, which occupies the ranks of the professional organizations and their governing bodies.

No method of remuneration has, to date, been judged fully adequate. Payments are set by statutory scales and are decided by the judge up to the amount of 68,500 € before taxes and by the President of the Court beyond this amount. A remedy may be sought before the President of the Tribunal de Grande Instance (Civil Court) or the Court of Appeal.

Moreover, it is quite upsetting that this system remains very bureaucratic and does not include in a clear manner the notion of results achieved, even though the Paris Court of Appeal and Senator MARINI, in a report on the subject (<http://www.senat.fr/rap/a04-355/a04-3556.html#fnref96>), had estimated that it was in the interest of the parties involved that standards on the quality of work be established and incorporated into the pay scales.

By seeking to impose heavy constraints on a profession, administrative and financial (controls, insurance – 10 times greater than those of lawyers- and joint liability), without valuing the work done and without accepting the idea of the free play of competition, it is to be feared that an erosion will take place and that the function of liquidator will become an exception whose life expectancy will be reduced over time. The continuity of the judicial mandate is obviously in question when, in Europe, the effects of the Bolkestein directive on the free movement of services argues in favor of an opening up and to the end of

cultural exceptions. For all that, the judicial auxiliary officers (court-appointed professionals) assigned to the Courts are at the present time an indispensable link for the proper functioning of insolvency proceedings.

Even if the monopoly which is at the foundation of the existence of these two twin professions has been mitigated by the new law, which allows the Court to appoint ad hoc receivers or conciliators from outside the lists, it remains nevertheless that this same statute reinforces the dominating role of the court-appointed insolvency professionals.

As for the relaxing of the rules on the appointments provided for by the law, because of habit and the relationship of trust established between the Court and its insolvency professionals, it is not expected that outside resources will be called upon frequently.

However, because reform is a sign, let this change not go unnoticed.

With the concern of avoiding criticism that obsolescent corporatism is being favored, France has opened up the voluntary arrangement / out-of-court system of handling companies in difficulty. However, provision of the same guarantees of independence will be required of prospective candidates. For the principle of incompatibility between the professions of Administrator and Liquidator, and for that matter with all other professions, ensures to those clients whose interests they are protecting, their complete independence in relation to the other parties concerned.

The founding principle behind the monopoly of the judicial mandate is precisely that of providing such a guarantee to the different parties (debtor, creditors ...). However, the question which must be asked is whether the monopoly is a trap for the profession itself. Because, as opposed to a profession subjected to competition, the Liquidator is in appearance protected from too aggressive an environment. The number of proceedings in relation to the number of professionals (432 professionals for some 45,000 proceedings yearly) remains stable and, while the quality fluctuates, the cycles (ebbs and flows) restore the balance.

Unfortunately, in this environment, as in any other, the right balance is hard to strike. The assignment of the cases by the Court, the sole client, is liable to be influenced for unjustified reasons and the taxation of the fees by the same judges renders the profession of liquidator dependent on the court and its customs. So that, indirectly, instead of being the guarantors of the Commercial

Court system's independence, the judicial auxiliary officers, the Administrators and Liquidators, find themselves caught between their personal interests and those of the companies and creditors they represent.

It is highly unusual for a liquidator to seek recourse against a decision of his Court. Further, if he proceeds, retaliatory measures are commonly taken against him.

The Commercial Justice system has everything to gain by granting its auxiliary officers a status protecting their financial and intellectual independence with regard to the Court which appoints them.

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The system can function, provided that all parties to the procedure reveal themselves to be as many guardians and guarantors of the independence of the proceedings: this includes Commercial Court judges as much as the Public Prosecutor's Office, auxiliary officers (Liquidators and Administrators), lawyers and the debtors and creditors themselves.

The Minister of Justice calls for the necessary trust. However, trust has to be far more extensive than what he is describing. Admittedly, the companies must have faith in the law but they must also place their trust in the institution, its judges and its auxiliary officers.

Likewise, this trust advocated by the government must exist in the relationships among the parties themselves: courts and auxiliary officers. It is also important that these two pillars of the commercial justice system share confidence in a better future thanks to a just law and more serene environment and be able to carry out, for the one group, their mandate and profession under rules of fair competition, and for the other, their duties in complete clarity. Finally, to enable vulnerable companies to get back on their feet, it is also essential that the creditors be able to have faith in the law and in courts reinforcing the trust that they themselves place in their defaulting customers and know that they will not end up being the victims.

Sadly and curiously enough, in an environment of civil and therefore written law, documents are not the end-all within the Commercial Court institutions. And influence networks are terribly active. Thus, , and to fight against this

disturbing custom, it is necessary to be careful and not to place one's trust too easily in others, at least not before ensuring that it is well-placed.

Provided that all participants in the process perform to professional standards, the law does provide for the tools required to deal with both prevention and insolvency and the resolution of financial issues and other concerns.

We shall accordingly review these tools.

Of course it is necessary to address more specifically the funding requirements of companies in distress. Also, the handling of the employee-employer relationship should be looked at in connection with preventive and insolvency proceedings.

Last, we shall examine the aspects of cross-border proceedings and the impact of the European Regulation dated May 29, 2000 on the subject.

## THE TOOLKIT

Describing the "Company Rescue Act" as a toolkit may seem irreverent, and yet... If one considers the matter, the act to handle distressed companies is a set of measures made available by the legislature to businesses in the various areas of the economy to deal with the difficulties they face.

It is a statute in the service of a market economy, intended to resolve the crisis faced by the business in the best and fastest manner possible, with the least collateral damage (to staff, creditors, customers, the local economic network), and at the best price for the business and its environment, but also for the judicial system.

The tool itself is nothing. It is merely a means to an end, and will be unable to do anything but acknowledge the eventual inevitable outcome (liquidation) if the business has broken all the bonds that make it an entity able to create value on a market. This naturally assumes customers...

The objections made to the previous statutes may not all have been founded. Perhaps the application of the tools that those acts provided to unsuitable objects should have been criticized: asking suppliers to sacrifice their claims in support of an unrealistic plan or one for which analysis in further depth of the competitive environment would have shown the market's disappearance or the loss of any trust is a mistake.

This has led to generalized distrust of the tools offered by the law, whereas it would have been necessary only to refuse their application in those cases and to contemplate judicial liquidation. Saving a business in order to liquidate it (possibly on less favorable terms) 18 months later is not a success of the Commercial Court system (and this is a real-life case). It carries a dual cost for the institution, and is accordingly wasteful for the community.

The new Act provides business managers and their advisers with five procedures designed to handle the difficulties encountered by businesses according to when their awareness arises.

The first three procedures – ad hoc proceedings, conciliation (preventive procedures), and rescue – can be applied before difficulties arise, whereas traditional solutions such as judicial reorganization and liquidation can be applied after difficulties have arisen.

It is interest to note that, side by side with the statutory tools, “soft law” and practice have developed so-called alternative solutions, fully suited to the environment of distressed businesses.

## **I. PREVENTIVE PROCEDURES**

As it is accepted that late awareness of the difficulties is one of the main reasons why restructurings fail, it was considered essential to provide the economic and judicial world with legal tools allowing intervention well upstream, as soon as the very first difficulties arise.

### **A. MEANS OF INFORMATION = PREVENTION IS BETTER THAN CURE**

#### **1) The alarm of the Auditor**

The auditor has an important role. He is obliged to sound the alarm in a company when it is revealed that there are “events likely to compromise the continuity of business”. The auditor sounds the alarm by informing the managers. No particular means of transmission are imposed in formulating this information.

The information will be transmitted neither to the shareholders, nor to the Works Council in order to avoid complicating the issues. This first phase remains confidential if the auditor deems the response by the managers (within 15 days) to be satisfactory.

In the event that the response is not considered as satisfactory, the auditor must provide a special report that is submitted to the manager of the company and, depending on the type of company, to the shareholders, the Board of Directors, the Supervisory Board and the Works Council.

If there are doubts about the company’s ability to continue operating, the auditor must inform the President of the Commercial Court and this information must be accompanied by all documents supporting the justification of the steps taken, together with the auditor’s reasoned opinion.

The result will be either the commencement of proceedings if the President believes the company is no longer able to pay its debts, or a meeting with the manager in order to address the problems of the company together, to try and make the manager aware that the situation could become serious if nothing is done, and to consider suitable measures to remedy the situation.

Despite the importance of the auditor’s role, there is always a time lag. The auditor intervenes after the development of the annual statements, in essence several months after the first difficulties.

As a result of this delayed intervention, it is up to the company's whole environment, and advisers, to help the manager to become aware of the seriousness of events and the consequences they could have on the company. The goal is to enable the manager to react to the situation.

However, if this is not enough, the law provides for a judicial authority, the President of the Commercial Court, to be empowered with the means to cause the manager to face the reality of the situation.

## **2) The preventive role of the Presidents of the Commercial Courts**

The larger commercial courts that are equipped with resources have assigned to the Registries the evaluation of distressed businesses, on the basis of multiple criteria and the Courts' contacts with public administrative bodies such as tax and welfare agencies. The latter are obliged to publish the debts they hold over the companies in a protest, or non-payment, register. The register lists the unpaid bills, which is also a signal of the economic difficulties facing a company. The absence of the filing of annual statements is regarded as an additional indication of economic difficulty.

The results of this review by the Registry will lead to a President's order for the representatives of the company in difficulty to appear before the President and appointed judges of the Commercial Court to consider those measures suitable to rectify the situation.

The President of the court, who has exorbitant powers under the Act, may also obtain from the auditor, employees, and tax, social and financial authorities any useful information that may help him procure accurate information on the debtor's economic and financial situation.

This demonstrates the paramount role given to the Presidents of Commercial Courts, despite the fact that not all Presidents are equally capable of assuming this preventive mission, the effectiveness of which depends to a large extent on the ability to filter the local economic environment.

In addition, since in every human venture it is necessary to fear abuse and the arbitrary, the implementing decree for the new Act wisely provided for attachment by the President of the Commercial Court of a memo explaining the facts motivating his summons. In the same manner as the public authorities, the people contacted by the president to provide information will be able to exonerate themselves if the forms required by the demand are not respected.

In this relationship with the President, the game is biased against the debtor, who may be ordered by the Commercial Court to pay a penalty without recourse to appeal if he or she does not comply and file account statements. The President decides the amount of the penalty.

It is widely known that certain large companies have in the past refused to file their accounts to avoid providing information to the competition. In future, how will these companies settle the conflict between confidentiality and legality?

Everything will depend on the amount of the penalties. The Commercial Court will decide in the last resort up to 4,000 euros. The company may appeal the decision when the penalty is above this amount. There is no doubt, however, that when competition issues are involved, the managers of companies with sensitive accounting data will continue to protect their information by refusing to publish it.

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The Paris Commercial Court wanted to make these discussions on preventive measures provided for by the Act an alternative to insolvency proceedings. It seems that the initiative to convince the managers and their advisers requires more than the opportunity created by the law. It remains difficult for the manager to overcome his fear of entering into discussions with a third-party interlocutor. This is because the latter, in the guise of an expert in preventing problems, also personifies the institution that will judge the executive's actions and responsibility if the prevention process fails.

In this situation, how is it possible to be perfectly at ease? How can transparency be demonstrated?

If debtors cannot be guaranteed that any information they disclose will remain confidential for the near future, and that it will be analyzed benevolently, there is a risk that no 'spontaneous' approach will exist. However, this environment could also help the manager to become aware of the company's situation and to seek the help of an ad hoc receiver.

The President of the Commercial Court must convene the managers in order to tackle the problems and to discuss the possibilities of remedying the situation. They are not obliged to appear before the President but if insolvency

proceedings are subsequently commenced, their unwillingness to cooperate could weigh against them if sanctions against them are sought.

It is important to note that successful dialogue between the President and the manager will depend above all on the 'charisma' and recognized humanity of the President of the Commercial Court. Any misuse of authority or of the information provided in connection with these measures will have undesirable effects on that measure's future. In the recent past, the judges assigned to preventive action within the Courts were already in a sensitive position: many were the company managers who sought to have the Court itself accept, in connection with insolvency proceedings and analysis of sanctions, that their late filing of a report of suspension of payments was justified since the Court itself (or even the President) had "granted permission", or at least, not demanded the report of suspension of payments.

The analysis in connection with sanctions led to the view that the weeks or months spent in a courteous relationship with a delegate of Presidents of the Commercial Court monitoring their cases did not in any way relieve the manager of responsibility. Well and good, but it must be conceded that such a manager would have had every reason to be unsettled by the lack of consistency among his correspondents within the same institution.

### **3) The role of advisers and other parties concerned**

- The shareholders of a company and the Works Council also have the right to sound the alarm when they discover that the company is experiencing difficulties. These parties have the right to question the manager and, if there is no response, they can either warn the auditor so that he can trigger the procedure or they can alert the President of the Commercial Court directly.
- Approved parties experienced in preventive measures have the right to sound the alarm.
- The usual advisers, lawyers and experts, for their part, have a duty to inform the manager to help him make a decision that each party recognizes is extremely difficult.

## **B. AD HOC PROCEEDINGS**

A creation of the Courts, ad hoc proceedings (*mandate ad hoc*) was used especially by the Paris Commercial Court during the real-estate crash of 1993-1996. The strength of ad hoc proceedings lies in its lack of legal rules and its confidentiality. Owing to its great flexibility, the system was very successful, with a rate of achievement of some 70%. This percentage is obviously related to the fact that applications for ad hoc proceedings concern companies, the credibility of which is intact since no hazardous attempt to proceed with operation has occurred yet and their credit has not been impaired.

### **1) Features of ad hoc proceedings**

The new act did not seek to regulate ad hoc proceedings, but has now endorsed it in Article L.611-3. This provides that the Presidents of Courts (Civil and Commercial) at the location of the principal office may, upon the application of the business's representative, appoint an ad hoc receiver, whose assignment they shall determine. This application must be made in writing and contain a statement of reasons (Article 11 of the Decree).

As in the past, it is reserved for businesses not having suspended payments, i.e., those whose available assets are sufficient to face the liabilities due.

It remains confidential (an obligation laid down by Article L.611-15 for any person informed of it), and is not bound by any period except as determined by the President's order. This period may in fact be extended without any statutory limitation.

It is not subject to any specific requirements, making it very flexible.

The only restriction on confidentiality is contained in the new Article L.621-1 which provides that, if rescue proceedings are opened within eighteen months after appointment of the ad hoc receiver, the Public Prosecutor's office shall be in attendance and may obtain disclosure of the documents and instruments relating to the ad hoc proceedings. This will raise the issue of the possibility, which remains available, of having the date of suspension of payments set during the period of ad hoc proceedings.

### **2) The ad hoc receiver's appointment and compensation (Articles 12 to 14 of the Decree dated December 28, 2005)**

The guarantee of the effectiveness of ad hoc proceedings accordingly lies in the selection of the ad hoc receiver, who may be nominated by the debtor.

The issue remains whether the President of the Commercial Court is bound by the nomination submitted by the debtor.

On the basis of the Courts' practice, it is to be feared that the debtor will not enjoy full discretion, even though it is known that there will be a favorable background for harmonious cooperation, in all parties' interest, only if the debtor trusts the ad hoc receiver appointed.

It is now clearly provided that only the business manager may take the initiative of applying for ad hoc proceedings and its purpose by a motion supported by any appropriate documents. The Court may accordingly no longer act *sua sponte*.

When the President receives the application for appointment of a ad hoc receiver, he must immediately cause the Clerk to call the applicant to a meeting. He is allowed one month after the meeting to issue the order appointing the ad hoc receiver. If not, the application is deemed to have been denied. The order must define the purpose of the assignment and set the terms of compensation.

The ad hoc receiver must be a specialist of the treatment of distressed businesses. This means, in general but not only, administrators entered in the nationwide list, owing to the security they provide (specific professional insurance, rules of professional ethics and supervision). The only requirement to be observed is the absence of conflicts of interest and in particular, not having received compensation from the business counseled or one of its creditors within the past twenty-four months.

They may also be former Commercial Court judges, but it is essential that they ceased to hold office five years previously at least. This ban is intended to put an end to contested practices and is connected with the intent of the cabinet and legislature to create a trust-building environment.

The ad hoc receiver's assignment may be very varied. It may be to resolve a dispute relating to funding or employment, between shareholders, or relations with suppliers or financial institutions.

The ad hoc receiver's compensation is negotiated freely between the different parties and must be set, at least in its terms, by the President of the Court before the assignment starts. It may be raised after an agreement of the parties and consent by the President of the Court during the assignment.

### **3) Advantages and drawbacks of ad hoc proceedings**

Over ten years' practice of ad hoc proceedings have demonstrated that this flexible contractual system is appreciated by the parties concerned.

They freely accept the solution developed during the ad hoc proceedings owing, naturally, to the constraints, risks and circumstances:

- image risks;
- concern for protecting business relationships;
- ability to use the ad hoc receiver as a mediator to restore the connection between divided parties.

For those who wonder about ad hoc proceedings, we shall say that it borrows the tools of mediation, and owes its effectiveness to the imminence of a crisis, provided that it is supported by the realistic nature of each party's expectations. It is preferable, for the sake of effectiveness, for an audit of the situation and requirements for assistance to have been performed by the business and its advisers prior to application to the President of the Court, since the assignment will be finally set by the appointment order.

Ad hoc proceedings remains confidential. As it has no specific duration or limits, this legal protean ectoplasm is accordingly a very useful negotiating tool, but it shall be noted that these assignments are frequently used in the same way as mediation, or sometimes as a preparatory phase for conciliation or rescue which, unlike it, will bind third parties through approval of the agreement or adoption of the plan.

The legal force of the document(s) achieved by the ad hoc receiver is an agreement binding the parties.

The advantage of ad hoc proceedings is also its drawback. Flexible and contractual, it has no effect on parties not privy to the agreement. So that in the event of a subsequent suspension of payments, the agreements made will not be protected against any claims for annulment.

In addition, no facility is granted in amicable negotiations with the public agencies such as URSSAF. The rules are those of traditional amicable negotiation:

- immediate payment of employee contributions (30% of total contributions)
- personal surety of the business manager regarding the entire amount due
- deferral not exceeding 24 months

- late interest of 10% at the due date plus 2% per quarter of delay, with an optional waiver of part.

## C. CONCILIATION

This is also a preventive procedure. More structured and more legalistic, it is bound by stricter deadlines (4 months + possible 1-month extension).

Having regard to the technical and practical difficulties involved in achieving a meeting, in support of the distressed company, of all the parties concerned and to complete negotiations, often complex, within what is in the final analysis a very brief period, the common practice is to have conciliation preceded by a phase of ad hoc proceedings preparing the case, determining the guiding principles and desirable solutions, and finally submitting agreements.

For the parties' safety, these agreements need to be binding on third parties; then, and only then, an application for conciliation, which will allow such a decision to be obtained, is made to the President of the Commercial Court (611-6) by motion supplemented by the documents, mainly of an accounting nature, required by Article 15 of the Decree.

### 1) The conciliator's appointment and assignment

Like for ad hoc proceedings, the debtor takes the initiative of an application by motion, but in this case, is granted the option to nominate a specific conciliator (assignment and compensation negotiated and specified in order to allow the President to deliver his order).

As in all preventive procedures, it seems desirable, in general, for the Court to accept the debtor's nomination and appoint the desired professional in order to improve the conciliation's chances of success, which require harmonious cooperation between the company and conciliator.

The conciliator is usually an administrator, for the same reasons of trust between the President of the Commercial Court and the auxiliary officers of that Court, security provided by the assistance of a specific professional, and the existence of rules of professional ethics and strict supervision of the profession.

Nevertheless, other professionals may be appointed, such as a certified accountant, lawyer, professional performing executive duties in the company, or former Commercial Court judge (5 years after ceasing to hold office).

Appointed on the basis of their skills or reputations, they then become auxiliary judicial officers on a temporary basis.

## **2) Features of conciliation**

- The debtor has the initiative of proceedings, by motion to the President of the Court with a statement of the economic, labor and financial position, the financing requirements and the means of dealing with it;
- it is confidential;
  - brief (4 months + 1 month)
  - it is not unduly detrimental to third parties.

The parties are not bound by any specific rules, provided that they observe the interests of parties not privy to the agreement, which may not be detrimental.

- The debtor

The debtor retains full control. No delegation of authority over the business is applied.

- The conciliator

The conciliator is responsible for fostering an agreement with the main creditors and contracting parties (Article L.611-7) and submitting proposals to rescue the business, continue operation and maintain employment.

The terms used are of importance. The conciliator is to foster these agreements and submit proposals. This implies that successful conciliation requires genuine cooperation between the business developing the proposals and the conciliator obtaining acceptance and making the agreements emerge.

The Act is intended to provide the conciliator with resources to obtain a full view of the company's real situation, even though he has no powers of investigation. He may obtain from the debtor any appropriate information, but also be provided by the President of the Court with the information obtained by the latter from public agencies, banks, lending institutions, etc.

Naturally, he is subject to the rules of incompatibility of offices arising out of conflicts of interest.

A challenge procedure has been provided for, exercised if such a situation is observed, or if an anomaly requires the President to issue a ruling.

He is also subject to a confidentiality duty, and reports to the President of the Commercial Court.

### **The expert appraiser**

In addition, a new actor has appeared: an appraiser, appointed by the President of the Commercial Court to draft a report on the basis of the information obtained regarding the company's position.

The Act thereby puts on a formal footing the practice resulting in appointing a certified accountant or auditor to perform a review of the data, to ascertain their value and accuracy, in order to reassure the Court and to enable the conciliator to develop in confidence proposals submitted to the third parties.

This same need for safety enables the conciliator to call for a termination of his duties if the debtor does not accede to the conciliator's recommendations (Article 29, Decree).

### **The President of the Commercial Court**

He makes appointments and sets the limits of assignments and compensation. He is the authority acknowledging agreement.

### **The Public Prosecutor's office**

It is present at the approval hearing.

### **3) The requirements for opening (L.611-4 and 5)**

The conciliation procedure is available to individuals or legal entities engaging in commercial, crafts, or professional activities, and undergoing or foreseeing legal, economic or financial difficulties.

This prospective element is particularly innovative in the Act of July 26, 2005. It allows the establishment of solutions to avoid the difficulty.

The Act has also accepted that suspension of payments was no longer an essential criterion. A debtor *in bonis* or having suspended payments less than 45 days previously is eligible for conciliation.

Insolvency professionals and company advisers are well aware that despite any efforts to convince or entice debtors, the looming of the fatal obstacle is what allows the completion of negotiations that are stretching out, or the last objectors' reluctance to be overcome.

This latent or actual suspension of payments is finally avoided by making the agreements.

#### **4) Outcomes of the conciliation procedure (Art. L611-7, 8, 9 and 10)**

The Act provides for several possible outcomes:

##### **a) No agreement: failure**

Upon the conciliator's report, the President of the Commercial Court puts an end to the conciliator's assignment and to the proceedings themselves. There is no remedy against this ruling. The debtor may himself apply for termination of the conciliation.

Article 631-4 provides that if the conciliation fails and the conciliator's report shows a suspension of payments, the Court shall act *sua sponte* upon the opening of judicial reorganization.

##### **b) Successful negotiation and the making of agreements**

These agreements may, however, at the parties' option, have very different effects according as:

- the President of the Commercial Court acknowledges the agreement or
- the Court approves the agreement.

##### **Acknowledgement of the agreement**

Upon a joint motion of the parties, the President's order acknowledging the agreement makes it enforceable. In that case, the Court is not required to review the scope of the agreement.

The debtor attests that he has not suspended payments, as the negotiations conducted are supposed to have put an end to an earlier suspension of payments.

The order is not published and there is no form of remedy. It puts an end to the conciliation procedure and the process has allowed maintenance of the confidentiality desired by the parties.

### **Approval**

Sometimes (or even usually), however, the parties prefer to make their agreements more official and will apply, through the debtor alone, for approval by the Court. In that case, the Court will call for evidence (like for acknowledgement) of the absence of suspension of payments, but also that the agreement:

- secures durable operation of the firm and
- is not unduly detrimental to the interests of third parties.

The latter criterion is interesting, in that it has drawn the lesson of a recent past when the end sometimes justified the means!

Many agreements made between 1995 and 1998 were criticized for taking into account the interests only of the parties to the agreement, to the detriment of unsecured creditors. This new requirement is a necessary precaution and plays a part in balancing the rights of the parties involved, and therefore in improving the practice and image of French proceedings.

Once the approval procedure has started:

- the Court calls and hears the parties to the agreement and the staff representatives, Public Prosecutor's office and conciliator (if applicable, for regulated professions, the professional governing body is invited to attend).

These called parties are informed of the agreement but on a confidential basis.

The Act has ingeniously provided for protection of this principle while securing the judgment's publication. The judgment does not mention the contents of the agreement but the existence of that agreement, and only the amount of the beneficiaries of priority relating to "new money" and the security provided. Any third party may object to the approval ruling within 10 days after publication.

The parties, for their part, may appeal against a judgment denying approval.

The agreement remains confidential and in the event of approval, a copy of the approved agreement is provided to the statutory auditor.

### **c) Termination of the agreement**

The opening of rescue, judicial reorganization or judicial liquidation proceedings terminates the agreement achieved and the creditors recover the full remaining amount of their debt.

In the event of failure to perform one of the commitments under the agreement, the Court is required to rescind the agreement, regardless of the default's importance.

## **5. Advantages and drawbacks of the conciliation procedure**

### **a) Waivers of debts and deferrals**

The Act provides for a stay of proceedings only if the conciliation agreement is approved, which corroborates the procedure's purpose, to wit, fostering one or more agreements out of Court putting an end to difficulties between the debtor and the main creditors and/or contracting parties.

This procedure provides an opportunity for a forgiveness of debts by the tax and welfare agencies. Again with a concern for fostering negotiations between the business and its creditors and allowing a restoration of the distressed business, the Act contains an extremely important provision which further restricts the State's priority. The tax and welfare (and unemployment-insurance) agencies may waive debts (Articles L.611-7 para. 3 and L.626-6) provided that their effort is concurrent with those of other creditors.

Concurrence is a matter of timing, but the Act refers mainly to a concept of similarity in efforts. The public agencies' efforts will be contingent on those of other creditors in order to avoid any recharacterization as government support by the EU, hence the sentence "the waivers shall comply with ordinary market conditions and shall be those which a private economic operation in the same situation would grant".

However, the scheduling and percentage of abatement that the public agencies may grant and the nature of security demanded are unknown to date. Unless

these actions are substantial, the existence of priority liabilities will require companies to opt for insolvency proceedings, or for rescue (if there is no suspension of payments).

Conciliation allows prior creditors to be satisfied.

On the other hand, while it does not allow a stay of proceedings, it allows applications for deferrals not to the Court having jurisdiction over the disputed contractual relationship, but to the judge to whom the conciliation is submitted. The defendant debtor may refer to the President of the Commercial Court, acting in summary proceedings, thereby freezing the proceedings brought by creditors. The President may allow up to 2 years' grace (Article L.1244-1 of the Civil Code). These periods are devoid of collective effect.

This referral to the President is naturally revealing of the company's position. The confidentiality of conciliation is therefore infringed.

#### **b) No possible application for judicial reorganization**

Likewise, Article L.631-5, which provides that during a conciliation procedure, action for judicial reorganization may not be brought against the debtor, creates a reassuring background for the course of negotiations, but also results in the disclosure of information regarding the conciliation's existence.

This highlights the ambivalence between the desire to keep the negotiations confidential and the need to make third parties allow adequate time to develop solutions.

It will be noted that an agreement that has been acknowledged by the President of the Commercial Court is not binding on third parties, so that the advantages of conciliation lie rather on the side of approval.

- Only approval interrupts the risk of backdating the suspension of payments (see Article L.631-8) since the date of suspension of payments may not be earlier than the date of the judgment approving the agreement out of Court. So that action taken prior to the approval will remain valid. In connection with that approval, the Court may also impose the rescheduling of debts over two years.

- Individuals standing surety, having granted independent security or acting as co-obligors may assert the terms of the agreement (Article L.611-10).
- Only approval provides creditors contributing further cash or further goods or services to secure maintenance of the company with the "new money" priority ranking immediately after salaries and Court costs (Article L.622-17 for rescue and judicial reorganization, L.641-13 for judicial liquidation) and ahead of earlier creditors secured by collateral. But in the event of failure and opening of insolvency proceedings, these debts are to be notified to the liquidators within one year after the end of the monitoring period. In default, such a creditor's "new money" powers would be forfeited.

What will be the practical scope of this "new money" priority that has caused so much comment? With the setting of ratios of equity in relation to the rating of risk provided for under the Basel II Agreements, one may wonder whether banks, cautious by nature, will grant further credit. In addition, shareholders will obtain its benefit only by making contributions in shareholders' accounts or securities, and not through a recapitalization. If that contribution is capitalized after the approval, they may be expected to lose their priority since it would be tantamount to disregarding two principles: the corporate capital is security for the creditors collectively and the shareholders are paid after the other creditors.

It shall be noted, however, that in France, supplier credit is one of the forms of funding (voluntary or forced) of SMEs and that the act provides that suppliers as well as banks will be eligible for this new priority.

- Sales of divisions of business are possible.
- Pecuniary or professional sanctions are not applicable.

But on the other hand, the following should be noted:

- ↳ The approval judgment is not enforceable as of right, hence uncertainty for the duration of possible third-party objection regarding the notion of suspension of payments.
- ↳ the risk of third-party objection has been heightened by the extension of disclosure to third parties. Any third party considering that the agreement is detrimental may enter an objection but the risk is restricted as the agreement is publicized on a limited basis;

↳ accordingly, the effects mentioned above involve the risk of a loss of confidentiality.

Notwithstanding the wish to maintain confidentiality, all the documents relating to agreements in connection with ad hoc proceedings or conciliation will have to be disclosed in the event of opening of rescue proceedings if the Public Prosecutor's office or Court so request.

The conciliation procedure appears as a simple and effective tool, even though it cannot work miracles. Combined with ad hoc proceedings to provide extra time to finalize the agreements, it ought to be usable extensively.

## II. RESCUE: A PREVENTIVE AND A REMEDIAL PROCEDURE

The rescue procedure, presented as the innovation's great reform, is indeed original in nature. Both preventive and innovative, traditional in structure and conditions, which are very close to those of judicial reorganization, it is triggered by the debtor alone (cf. the other preventive procedures: ad hoc proceedings and conciliation) although the company has not suspended payments.

The intended aim is to lead the debtor, without fearing loss of control over his operation, to take action in order to forestall difficulties that could jeopardize the economic activity.

The rescue procedure is the cornerstone of the new Act, which took on its name. This is an indication of the high hopes placed in it.

The innovations concern mainly the absence of suspension of payments as a criterion for opening proceedings, the forestalling of difficulties, the cooperation hoped for in creditors' committees between the business and its creditors/partners in restructuring, and the option for abatement of government receivables.

### A. FEATURES (ARTICLES L.620-1 ET SEQ.)

The procedure applies to any legal entity or individual, engaging in commerce, crafts, farming or the professions. The Civil Court has jurisdiction for the professions, farmers and unregistered craftsmen, the Commercial Court for all others.

The new Act uses the earlier case-law and provides an opportunity to extend the initial judgment if there is a fictional legal entity or a commingling of patrimonies.

It is initiated by the debtor alone. Upstream of the difficulties, the creditors do not take the lead.

The French legislature sought to keep the spirit of the US "debtor in possession" rules, but without taking the approach to its logical end. While the debtor may apply for the opening of proceedings, he is not free to appoint the agents.

It is up to the debtor to prove that he has not suspended payments and is encountering genuine difficulties (of an environmental, labor, legal or economic nature) which have or will have effects on the business that the latter is unable to overcome in the normal course of operation.

The Court must analyze the information. At the hearing, in addition to the business manager, it hears testimony from the staff representatives and, in the case of a professional with a protected title, the competent professional body. It may also hear any appropriate person (the statutory auditor in particular). The Court hears opinions but decides freely. It may be assisted by a judge to obtain any appropriate information, or an expert appraiser. The Courts already used since 1985 the option to obtain expert assistance to cause legal auxiliary officers to perform enquiries regarding the actual condition of businesses subjected to insolvency applications.

The Public Prosecutor's office shall be present at the opening hearing and any earlier conciliation or ad hoc proceedings must be reported. The Public Prosecutor's office, together with the Court, may obtain its disclosure. In that case, the conciliator is called to attend.

It is in fact astonishing that in such a case the Court might (Article L.621-12) reverse the finding made pursuant to the rescue and consider subsequently that at the date of opening of the rescue, there had been a suspension of payments, and therefore recharacterize the rescue, retroactively, as judicial reorganization!

If, on the other hand, the suspension of payments occurs subsequently, conversion of the reorganization is provided for. It can only become a judicial liquidation.

It shall be recalled that the statute's aim was to facilitate reorganization in order to allow the maintenance of the economic activity, the protection of employment (like the 1985 statute) and the discharge of liabilities.

Having regard to the obligation imposed on the Commercial Court to assess, on the basis of the evidence provided by the business, this absence of suspension of payments which, under the earlier case-law, means the impossibility of facing the due liabilities with the available assets, certain Courts including the Paris Court have already stated that they would interpret the act in an extremely restrictive manner.

Thus, of the 12,000 proceedings opened in France in 2006, i.e., over 4 months, none of the 99 rescue proceedings were opened in Paris, although it is by far the largest Court.

As always in France, there is a considerable inconsistency among the positions of Commercial Courts regarding the same legislation, since 80% of the proceedings were opened within a single region.

## **1. Duration**

In practice, the monitoring period, once initiated by the Court with an appraisal of the information provided by the manager, will last 6 months subject to one extension, with a possible 6-month exceptional extension upon the application of the Public Prosecutor's office (maximum of 18 months).

## **2. Players**

The judgment appoints one or more bankruptcy judges who shall "ensure that the proceedings take place expeditiously and protect the interests involved" and two (or more) judicial auxiliary officers: a Liquidator, who has sole authority to act in the name of the creditors and, oddly since the principle of maintenance in possession is recommended, an administrator. Admittedly, this choice is optional for companies with gross sales less than 3 million € or fewer than 20 employees.

Although the administrator does not replace the debtor, he does have extensive powers. He takes protective and provisional measures, decides upon maintenance or termination of contracts, may submit a discontinuation of part of the business, and above all, may apply for termination of the rescue proceedings and conversion into a judicial reorganization or judicial liquidation. Thus a tight guard is set on the debtor in possession. The debtor nonetheless remains in charge of management (subject to the powers conferred on the administrator).

We are a long way from Chapter 11, all the more so since, if the Court considers that this is justified by the business's rescue, and upon the Public Prosecutor's office's application, it may replace one or more corporate officers, restrict disposal of their shares, deprive them of votes, or even compel them to sell their shares at a price determined by an appraiser. These measures seem harsh to some, normal to others, according to habit.

However, the French Courts make very moderate use of spoliatory measures, as protection of the "boss" is still very dominant in the minds of Commercial Court judges.

The following are also players in rescue proceedings:

- Staff-representatives bodies: the staff representative appointed or elected by the employees.
- A professional in charge of taking a statement of assets and liabilities (bailiff or auctioneer)
- One or more expert appraisers (for such assignments as the Court or judge may determine).
- Controllers (Article L.621-10): any creditor may be appointed as a controller, and obtain assistance from counsel at his own expense. There may not be more than 5 controllers, who must include at least one secured creditor and one unsecured creditor. The professional governing body, if there is one, shall be among the five controllers. A controller may be represented by an agent or lawyer. This position is a volunteer one, subject to a confidentiality duty. Controllers may be dismissed by the Court upon the application of the Public Prosecutor's office (liability for gross misconduct). Incompatibility of offices on the basis of conflicts of family or financial interests is provided for.

Creditors appointed as controllers are accordingly given a far more important and far less passive role than previously. They retain their traditional role as assistants to the liquidator, but must also defend the creditors' collective interest in the event of that agent's failure to act (L.622-20). The controllers will be required to prove that deficiency.

The duties of controllers are the same whether in proceedings for rescue, judicial reorganization or judicial liquidation.

As before, the creditors are to be heard before any major decision is made, but they are now to be consulted regarding any proposed settlement of debts. They are to be provided with all the creditors' replies and receive the offers in connection with a sale.

Likewise, the economic and social report is to be provided to them for comments, forwarded to the bankruptcy judge if he decides on sale of the debtor's assets.

A controller may act alone insofar as the creditors' collective interest is defended (extension for commingling of assets, application for nullity based on a suspicious period, etc.).

Action for personal liability, assumption of liabilities, and sanctions may be brought by a majority of controllers in the event of failure to act.

A controller may no longer submit take-over offers or acquire assets of the insolvency during the 5 years after the sale.

The creditors' committees (Articles L.626-29 to L.626-34 of the Act and Articles 162 to 168 of the implementing Decree): creation of those committees is one of the main advances of the Rescue Act, since the creditors have genuine power over adoption of the rescue plan, in businesses with sales in excess of EUR 20 M and 150 employees.

## **B. THE ORIGINAL SPIRIT OF THE REFORM: THE RESTORATION OF TRUST BETWEEN THE BUSINESS AND ITS CREDITORS**

In addition to the assurance of remaining in possession provided to debtors (and the related limitations were considered above), the initial spirit of the reform was to restore to the creditors room for discussion.

The cabinet and legislature had been receptive to the demands of creditors, and banks in particular, which led the criticism, considering that Commercial Court decisions, by allowing distressed-price sale plans, broke the rules of fair competition and despoiled creditors, in particular secured creditors, for reasons which, though admirable (preservation of the business and of jobs), were of unproven effectiveness in the medium term, in terms of the economy and even of employment.

It was then decided to create a procedure (rescue) taking the collective interest into account and in which the creditors would be players, willing partners in a resumption of operation, and not victims of proceedings perceived as unfair.

It was then remembered that the voting by creditors of plans in proceedings for judicial reorganization had been abandoned because those creditors, called sometimes ten years after the proceedings were opened, had lost any interest in their outcome.

It was accordingly decided to involve them from the outset of the proceedings, within two months after establishment of their committees (which is to occur within 30 days after the judgment) and to submit the plan proposals to them. They are provided with an opportunity to discuss their contents and amend them if appropriate. Formal approval from such committees (two in number: a

committee of banking creditors, and a committee of supplier creditors, the receivable of each of the latter exceeding 5% of the total amount of supplier receivables) is then obtained. The plan, accepted by both committees (acting by a dual majority of the members and 2/3[??of the amount of claims??]), is determined by the Court (Article L.626-31), which also ascertains that the interests of all third-party creditors are sufficiently protected.

Concurrently with creation of the committees, the debtor shall have prepared a draft plan, to be submitted to them for approval by a ballot carried out in the manner provided for by law.

An affirmative vote of the proposals contained in the draft plan by both creditors' committees will not suffice, however, for its adoption: the Court will be required to ascertain that the creditors' interests are sufficiently protected. This means the creditors on the committees not having accepted the plan proposals, and who would be forced to accept them in the event of its adoption. But it also means the creditors not on the committee.

In the absence of proposals accepted by both committees, within the period set by the plan, the traditional procedure for adoption of the rescue plan will be observed.

In parallel with consultation of the committees, creditors not on the committees, including welfare and tax agencies, are consulted individually. The act makes government creditors into the business's partners. The financial government agencies may waive all direct taxes, but not indirect taxes collected in favor of the State and local authorities, or miscellaneous levies for the State's budget payable by the debtor.

There shall be two creditors' committees, one of all the lending institutions and the other of the main suppliers of goods and services.

Having regard to the rules specific of negotiation with government creditors, it is already customary to say that three committees will have to be established to allow the adoption of a plan.

At a first stage, only suppliers with receivables accounting for more than 5% of aggregate supplier receivables may be members of this committee. They are in fact entitled to be members. But other suppliers may become members when invited by the administrator and if they accept those duties in writing.

The creditors' committees shall be established within thirty days after the opening judgment.

### *Creditors not on the committees*

Creditors not on the committees are informed in the customary manner, by individual mail and, though this is largely immaterial, collectively, of the proposals for discharge of debts and applications for deferrals and waivers. If, within 30 days, the creditor has not responded, he is deemed to have accepted.

If the committees have not replied within 30 days or have refused, or if the Court considers that the plan does not provide sufficient security for third parties, the plan is submitted again, in writing, to all the creditors, who are allowed 30 days to reply.

### **Commentary**

Thus the French conception of collaboration among the debtor, administrator and creditors is not to allow the parties full discretion to determine the business's fate.

If the creditors' committees refuse the offers, the company is allowed another chance, arising out of a change of majority.

Likewise, the situation described above of creation of creditors' committees as being the reform's spirit has finally become a mere exception. This collaboration will be organized on a mandatory basis only in the largest cases (sales in excess of 20 million €, or more than 150 employees).

There remains the French vision of the need to preserve the business, even if it has lost its attraction and its trustworthiness for suppliers and banks.

It will be interesting to see as time goes by whether the opportunity afforded to smaller businesses to organize creditors' committees develops: it would be unfortunate to treat this creditors' organization as merely an appendage of large proceedings and not as a fundamental part of the rescue and reorganization procedures. How could one fail to consider the existence of strong bonds between the business and its bankers, suppliers and contracting partners as the only criterion allowing an appraisal of the desirability of preserving one business or another?

A business is the sum of the bonds that it has created throughout its existence. If, as a result of errors or malfunctions, it has broken those bonds, if it operates unsupported in a highly-competitive environment, the same ills may reasonably be expected to have the same effects. The establishment of committees in all proceedings involving the business's fate seems to me to be a necessity to obtain an objective appraisal of the network of the business's relations and its ability to use them to make a new start. If this is not achieved, the resulting solution will be sale of the operation and not preservation of the business.

It is interesting to note that whereas the initial bill had chosen to restrict sales to judicial liquidations, the Act and the Decree provide for this outcome in rescue proceedings.

One may wonder as to the ability of the business and/or its administrator to obtain the creditors' involvement in very short order without their being able to be players in the solution. A mechanism in which the business's fate would be determined according to the converging views of the majority had been imagined. There is a risk that, as in the past, through mere misplaced sentimentality, poor economic solutions damaging the act's main thrust will emerge.

### **C. MONITORING PERIOD (ARTICLE L.622-9)**

This first phase (6 months subject to a maximum of three extensions), during which the business operates almost normally, allows the Liquidator to receive the lodgment of claims and the administrator to review the contracts to be terminated or maintained, and on the basis of that information, to draw up an economic and labor, or even environmental, audit.

Article L.623-1 provides that the Administrator shall draw up an economic, social and environmental report on the basis of the information provided by third parties, and the bankruptcy judge in particular. It shall mention difficulties that could lead to a suspension of payments. That report shall also include a statement of the company's assets and liabilities, so that the rescue procedure implies an ascertainment of the company's debts. Here we have again the traditional features of the procedure for ascertainment and acceptance of claims.

The purpose of the rescue's monitoring phase is to develop a plan determining the prospects for recovery according to market conditions and available sources of funding. It deals with the methods for settlement of the liabilities and security provided by the business manager. It provides for the level of employment and if redundancies are to be planned, defines the action to be taken for placement, and

includes the necessary work in the environmental audit. If a sale, discontinuation or addition of business is provided for, the plan must so state (Article L.626-1). The sale is carried out in accordance with the rules of judicial liquidation.

## **1) Solutions**

### **a) End of the difficulties**

The Act provides (Article 222-12) that if the difficulties cease during this period, the proceedings are simply discontinued upon the debtor's application.

### **b) Discontinuation of operation: conversion into a judicial reorganization or judicial liquidation**

### **c) Close for discharge of the liabilities (Article L.631-16)**

If the debtor has sufficient funds to satisfy his creditors and bear the costs of proceedings, the Court may put an end to the proceedings.

### **d) End of the monitoring period with a conversion into judicial reorganization or judicial liquidation**

### **e) Presentation of a plan for rescue and/or sale of all or part of the business**

The plan is supposed to allow the business's rescue. It shall include a business plan and evaluate the state of the market and financing resources. It shall define the terms of discharge of liabilities and the security to be provided. It shall evaluate the necessary measures relating to employment and the placement and indemnification action. Finally, it shall include the work justified by the environmental report. If applicable, it shall specify any changes in capital and may, as mentioned above, suggest the replacement of one or more managers or the sale of their shares by *de jure* or *de facto* managers, at a price determined by an appraiser. It may also ban the disposal of securities. In such case, the applications are made by the Public Prosecutor's office.

The plan is determined by a judgment of the Court after hearings in the presence of the Public Prosecutor's office. The representatives of the Works Council or staff delegates, controllers and debtor shall be called to attend.

If the plan is not submitted in due time, the Court shall close the rescue proceedings.

The plan shall provide for the persons appointed to perform it and the commitments made with respect to the business's future, discharge of liabilities and employment prospects. The inalienability of certain assets may be decided upon for a term not exceeding the plan's duration.

The Court shall take notice of the deferrals and abatements granted by creditors. For the remainder, it shall set uniform time limits for discharge.

The plan may not exceed 10 years. The first due date shall be within one year after the plan and installments may not be less than 10% of the amount of liabilities. Payments of installments in the plan shall be carriable, and shall be allocated by the commissioner in charge of the plan's enforcement.

## **2) Advantages**

The business is entitled to cease paying its debts, even though it is not distressed (Article L.622-7). This is an astonishing innovation provided by the Company Rescue Act.

- The business may no longer pay debts subsequent to the judgment not arising for the purposes of the proceedings, those in compensation of the business for its operation after the opening judgment.

This measure ought to allow the business to improve its immediate cash position.

- The administrator may terminate contracts without requiring proof of their disadvantageous nature for the company. Failure to perform creates entitlement to damages, to be entered among the liabilities. Termination may be immediate after the opening or at any subsequent time (time limit for reporting: three months after the termination date).

- Any clause allowing termination of the contract on the grounds of the proceedings is null and void, which allows inclusion in the sale of all the contracts useful for its purposes.

- Article L.622-21 implies a stay of individual proceedings, whereas Article L.622-28 suspends the accrual of interest (except for loans for one year or more).

- Abolition of the extinction of unreported claims: it is difficult to tell whether Article L.612-25 will be an advantage or a drawback. It is intended to bring French

procedure into line with the international rules, and results in claims not reported in time no longer being deemed to be extinguished.

- Article L.626-6 allows a waiver of tax and welfare liabilities.
- The act is designed to be attractive, and grants guarantors and co-obligors the suspension of accrual of interest and the abatements granted by creditors in connection with the plan for the discharge of liabilities.
- No nullity relating to a suspicious period may be applied.

### **3) Drawbacks**

- Claims for restitution of personal property are allowed (Article L.624-9), which is odd since the business is in bonis.

- In accordance with Article L.625-9, the AGS will not provide unconditional assistance for the labor restructuring. Article 143-11 para. 1 of the Labor Code provides that any employer is required to insure its employees, including against the risk of failure to pay the amounts due in respect of their contracts of employment, in connection with rescue proceedings. Termination of the contract pursuant to the rescue proceedings is to be carried out within one month after the judgment adopting the plan. The act provides that if the company undergoing rescue (in bonis) does not have sufficient funds to meet the employment liabilities arising out of restructuring action, the Liquidator shall require them to be advanced and shall provide evidence of the deficiency in assets. This statement may be challenged by the bankruptcy judge, whose permission for the advance shall be required. The advance shall be repayable against the first revenues. In practice, the AGS is known to accept a moratorium on repayment of its claim for a brief period (less than 24 months).

- The overlap of duties between the administrators and liquidators, an inevitable source of friction.

Article L.626-4 has provided that the administrator shall take the action required for implementation of the plan.

All sales shall be carried out in accordance with the rules of judicial liquidation. The liquidator shall collect and pay out the proceeds.

Either may be appointed as commissioner in charge of the plan's enforcement. The latter may bring action in the creditors' interest.

If the principles of compensation for the two professionals competing in these areas of operation are not set on a very fair basis in the near future, there is no doubt that the rescue procedure will have an unwanted but inevitable side-effect since, by splitting the task in two (preparation of the plan then of the sale by the administrator, collection and allocation of the proceeds by the liquidator), one may wonder on which value the compensation will be based (will two charges be made against the sale price?).

### III. THE TRADITIONAL TOOLS: INSOLVENCY PROCEEDINGS

#### A. JUDICIAL REORGANIZATION (ARTICLE L631-1 ET SEQ.): SEQUENCE AND FEATURES OF THE PROCEDURE

On a preliminary basis, it shall be noted that the procedure for judicial reorganization is the procedure least amended by the reform of July 26, 2005. Some authors have even questioned the relevance of that procedure's maintenance since, logically, debtors ought unhesitatingly to prefer a rescue which, as mentioned above, allows them to maintain their operations with a stay of proceedings and to discharge their liabilities under the Court's protection, on the same terms as a reorganization, except that they remain in charge of their businesses (despite the strong judicial involvement).

It may be deduced that the drafters of the act sought to preserve the opportunity for the Public Prosecutor's office, creditors, or the Court itself to open proceedings that could result in the maintenance of the business in the event that the debtor had not himself sought the protection of rescue proceedings.

Accordingly, if debtors, as is hoped, use the rescue procedure, judicial reorganization would become a mere ancillary procedure and would concern only the few cases where the debtors have waited for suspension of payments before seeking assistance from the Court.

This reasoning is perhaps not yet perceptible to managers since the earliest figures show that only 99 rescue proceedings have been opened over four months, out of a total of 12,000 collective proceedings opened, and it should be added that only 5 related to companies making gross sales in excess of 15 million €.

Initial reactions to the "Rescue Act" were not as hoped. Preservation of the judicial reorganization procedure has been found to be indispensable.

Accordingly, the process and content of the judicial reorganization proceedings have been retained.

➡ The Court still opens such proceedings on the basis of a dual criterion: suspension of payments and possible recovery. In addition, the company may not be undergoing conciliation.

The law's objectives remain the same, to wit,

- allowing continued operating of the business,

- saving the related jobs
- and discharging the liabilities, unlike judicial liquidation, the sole purpose of which is discharge of the liabilities through sale of all the business's assets, either as a going concern or separately.

➤ Any individual or legal entity engaging in commerce, crafts, farming, or the professions, and legal entities under private law and professionals having ceased to operate, are eligible. The proceedings may concern a person deceased less than one year previously. The Court at the location of the operation has jurisdiction.

➤ The application is made either by the manager (within 45 days after the date of suspension of payments), or by a creditor. It may also be ordered by the Court *sua sponte*, or upon an application by the Public Prosecutor's office.

➤ The judgment sets the date of suspension of payments, within no more than 18 months of the judgment, and in any event, before the date of the judgment approving the agreement. This date may be amended subsequently, within one year after the opening judgment.

➤ The judgment shall provide that shares may not be sold.

➤ The Court opens a monitoring period, that may vary from six to eighteen months, and the purpose of which is to develop the plan to be adopted , and may lead to the creation of two creditors' committees (cf. rescue).

## 1) The players

The judgment appoints one (or more) bankruptcy judges, and the agencies of the proceedings.

### a) Administrator

The rule is that an administrator is appointed to perform one of the following duties:

- assistance to the debtor for some or all acts of management;
- administration of all or part of the business being reorganized.

There is no longer any supervisory assignment, which concerns rescue alone.

The administrator is to draft a report to the Court within two months after the opening judgment, enabling it to appraise the desirability of permitting

continuation of the monitoring period. This report is usually also sent to the creditors' representative, controller, staff representative and committees for comment.

The most common practice is the appointment of an administrator with a role of assistance and in that case, the administrator jointly signs the instruments relating to the debtor's management.

However, it may sometimes be useful for the debtor to be kept away from his own business. In that case, the administrator is endowed with a representative assignment. In that situation, accordingly, the debtor is deprived of all acts of management of the business, which is managed in his stead by the administrator. But in practice, the judicial auxiliary officer is required to inform the debtor and hear the latter's observations. This is an essential condition for the debtor to feel that the proceedings against him have been fair. Unfortunately, too often burdened by the number of cases handled, judicial auxiliary officers do not have sufficient time to receive, inform and support debtors. Poor communication is the most common cause of disputes.

The Court may amend the administrator's assignment at any time *sua sponte* or if requested by the Liquidator or Public Prosecutor's office.

If justified by the size of the business, the Court shall also appoint one or more expert appraisers to assist the Administrator. Their compensation is borne by the insolvency.

#### **b) The Liquidator**

The liquidator acts as the creditors' representative. He shall advise them and receive their claims.

#### **c) The controller**

The controller, like in rescue proceedings, is present in judicial reorganizations, with the same prerogatives and powers.

#### **d) The creditors' committees (if applicable)**

Creditors' committees are present in judicial reorganizations as in rescue proceedings. Their roles are similar .

The committees of banking and major supplier creditors may also be established in judicial reorganization proceedings. Their establishment is mandatory if the business has gross sales in excess of EUR 3 million ex VAT and more than 150 employees. They may also be established at the request of the

debtor or administrator in the case of smaller companies if the bankruptcy judge allows that representation.

If the committees agree with the offer made by the debtor, the Court's only task will be to ascertain that the interests of creditors not on the committees are protected before the plan is determined. They are not bound by any time limit, and the rebates granted may be treated differently.

In the event of the committees' refusal or failure to reply, the proceedings need to be resumed from the start to prepare a new plan proposal.

There should be no creditors' committees if there is no administrator.

#### **e) The staff representative**

His role and appointment are the same as in rescue proceedings.

#### **f) The debtor**

The act has provided that on an exceptional basis, the debtor may remain in possession, i.e., continue to exercise alone over his property all the rights and actions relating to the direction and management of his business. The act provides that the business must have fewer than twenty employees and sales not exceeding 3 million € ex VAT. This situation is extremely rare in practice. In fact, this is applied only in certain provincial Courts, but never in Paris: it is well known that the smaller the company, the more guidance and assistance the manager requires, as he cannot all at once be operational, generate the turnover required for recovery and handle the complexity of the insolvency proceedings.

#### **g) The expert appraisers**

The Court appoints one or more expert appraisers to assist him in the management assignment. This demonstrates the difficulty of a judicial auxiliary officer's assignment. He may replace the debtor, but becomes, by law, an agent of the Court. Instead of being, like any professional adviser, judged on his action and performance, he is in a system of dependency fettering his initiative. It is the Court which appoints the experts to assist the liquidator. The appointed professional has no say in the appointment of those with whom he will have to collaborate, at the risk of losing effectiveness. The concern is to avoid possible problems of collusion between players in excessively close relationships. This idea might be of interest if it did not run up against reality.

In order to work quickly and safely in usually sensitive cases, it is necessary to be able to rely on the ability of the experts appointed. Working on distressed businesses involves the application of diverse skills, which are naturally

impossible to combine on a permanent basis within small entities. Nevertheless, the system of recourse to recognized and reliable third-party correspondents meets this need. There is no doubt that the law burdens professionals with the President's lottery, making this teamwork far more complex or even impossible.

## **2) The monitoring period**

No more than 2 months after the opening judgment, the Court shall order continuation of the monitoring period, upon the administrator's report, if the business is financially able for the purpose.

That period is intended to allow the drafting of the economic, employment and environmental report, determine its potential and liabilities, and settle the liabilities arising out of contracts of employment.

If there are cash-flow problems, the Court may terminate the monitoring period. Dismissals may be carried out if they are urgent, unavoidable and essential. They require permission from the bankruptcy judge after notice to the appropriate government agencies.

## **3) Solutions**

There are different possible outcomes of judicial reorganization:

- sale (Articles L.631-13 and L.631-22), which continues the traditional solution, whereby any company under judicial reorganization is up for sale. It is true that for the tool to be used, it will be necessary to turn to judicial liquidation, but this is a mere formal difficulty. The substance remains the same. The business or part of it, as a self-contained productive unit, may be sold as soon as the collective reorganization proceedings are opened if the Court has received offers. The administrator may also seek solutions for sale if it appears that the company will be unable to submit a maintenance plan;
- discontinuation of part of the business upon an application by the debtor, administrator, liquidator, controller or Public Prosecutor's office;
- judicial liquidation upon an application by the debtor, administrator, liquidator, controller or Public Prosecutor's office (putting an end to the monitoring period and the administrator's duties);
- close for discharge of liabilities (Article L.631-16), upon the debtor's application, if there are sufficient funds to satisfy the creditors and pay the costs;
- submission of a plan (Article L.631-19), designed like a rescue plan. The dismissals are to be carried out within one month after the judgment.

## **a) Plan**

In connection with judicial reorganization, the plan is governed by the same rules as in rescue proceedings.

A plan (including proposals for discharge of the liabilities, moratoria, any restructuring measures and any redundancies after consultation of the Works Council and appropriate government agencies) will be developed if there are reasonable chances of success. It shall be submitted to the creditors' committees if any. The restructuring carried out is intended to allow the business to restore its cash balance and sufficient working capital to face the future. AGS coverage will apply only to dismissals carried out within one month after the judgment adopting the plan. The procedure will be the same whether the plan provides for continued operation or for sale. This is an important exception from Article L.122-12 of the Labor Code.

The plan may accordingly provide for continued operation or for sale.

## **b) Sale**

The bill for the new act intended the business's sale to occur only pursuant to a liquidation.

The Act, in response to vocal opposition, then extended this measure, so that the monitoring period may tend to preparation of a sale plan in the event that the business is unable to submit a plan for continued operation. In that case, it will be up to the administrator to negotiate the terms of sale, and for the liquidator to collect the price and share out the proceeds.

For this purpose, the National Assembly amended in this respect the draft initially submitted by the cabinet. Under Article 102 of this bill, it entered a new Article L.631-18 of the Commercial Code, providing that "*on the basis of the administrator's report, the Court may order a sale of all or part of the business if the debtor is unable to secure its recovery himself*". The provisions relating to judicial liquidation then become applicable and "*the Liquidator shall perform the duties relating to liquidation.*"

This measure is puzzling: since the professions' split in 1985, the professionals with a more proactive, businesslike, attitude have tended towards duties as administrators, and have developed teams of specialized collaborators able to handle the presentation of distressed companies, receive offers and analyze proposals, while complying with the obligations to the staff representatives and

observing highly-demanding statutory time limits,, their fees being in return, naturally, based on these sales.

The idea of transferring these tasks, 20 years later, to a sister profession not trained for this purpose will necessarily cause a loss of abilities. As the initial proposal raised a genuine storm of protest, the final draft assigned to the one group the task of selling and to the other the task of allocating the proceeds. No-one knows yet how the compensation will be shared. Here is a solution, the usefulness of which will need to be demonstrated in future. It is safe to assume that it will cause problems rather than improve matters.

For professionals subject to a regulated status, the sale plan may concern only the tangible assets (Article L.642-1 para. 4).

#### c) Conversion into judicial liquidation

Finally, and at any time, reorganization may be found to be manifestly impossible during the monitoring period, which will automatically imply a conversion of the judicial reorganization proceedings into judicial liquidation proceedings.

## **B. JUDICIAL LIQUIDATION**

Comment: as this procedure has remained substantially unchanged, we shall mention it more briefly.

### **1) Objectives of the Act**

The main objective of judicial liquidation now appears consistent in law even though it is based on a breach of the earlier balance between the two professions and abdicates genuine know-how possessed by the Administrators:

Liquidation (Article L.640-1) puts an end to the business's operation when the debtor, having suspended payments, "is manifestly unable to ensure, through development of a reorganization plan, the continued operation of his business".

#### **a) Disclosure**

The Act has sought to improve procedures and mitigate the problems mentioned above by stressing the concepts of "transparency" and "disclosure". In an attempt to improve the public's perception of commercial proceedings, the Act intended to stress these two concepts, and for this purpose, to extend the related formalities, in particular with respect to sales which are to be publicized

### **b) Expedited process**

For this purpose, within one month after the opening judgment and in accordance with Article L.641-2, the liquidator shall draw up a report on the company. Within two months, he shall draw up a statement of assets and liabilities. The Court will then appraise the desirability of checking the liabilities.

A deadline for close shall be set as soon as the proceedings are opened.

A simplified procedure (Article L.641-1) has been established for companies devoid of real assets, for which the closing time limit shall be one year (subject to 3 months' extension).

### **c) Solutions: realization of the assets**

The Court, if it receives one or more offers, shall analyze them on the basis of the information provided by the liquidator (price offered and terms for the discharge of liabilities, residual assets, debts, continued operation, etc.) and shall select, after obtaining opinions from all parties, the offer that will durably secure employment and the payment of liabilities, and will provide the best security for performance.

The plan shall provide for dismissals and may not be determined without the liquidator having consulted the Works Council or delegates and informed the appropriate government agencies.

If provided for under the plan, the dismissals shall be carried out by ordinary notice from the liquidator within one month after judgment on the plan.

Liquidation also allows the sale of real assets, goodwill and all other assets, either by public auction or privately, after obtaining the debtor's opinion.

## **2) Features and players of traditional liquidation**

The opening may occur as a result of failure of: conciliation (if a suspension of payments has occurred and reorganization is impossible), rescue (the only outcome), or judicial reorganization. It may also occur;

- upon the manager's application (within 45 days after a suspension of payments is observed);
- upon a creditor's motion;
- upon the Public Prosecutor's office's application;
- sua sponte.

The evidence of impossibility of reorganization shall be provided. The judgment shall set the date of suspension of payments, which may not exceed 18 months.

Judicial liquidation causes all receivables to mature.

The transfer of authority to the liquidator is unrestricted but the corporate officers of a legal entity shall remain in office, unless the by-laws or a resolution of the meeting of shareholders provide otherwise, in order to represent the legal entity in connection with the various action to be taken.

The principal office is deemed to be located at the domicile of the business's legal representative or of the appointed agent.

The opening judgment shall appoint:

- a bankruptcy judge;
- one (or more) liquidators
- one staff representative
- one (or more, up to 5) controllers
- one professional to take a statement of assets and liabilities.

### **3) Sequence of the procedure and outcomes**

#### **a) Option to continue operating**

Judicial liquidation may allow, by Court permission, continued operation limited to 6 months which will allow, in traditional fashion, the realization of assets (by auction or private sale), ascertainment of the liabilities (if there are sufficient funds), and dismissal of the staff to implement the FNGS security within 15 days after the judgment of judicial liquidation.

#### **b) Option : "Simplified" liquidation or "traditional" liquidation**

The liquidator must draw up a report on the debtor's position enabling the Court to choose the standard or simplified procedure. If it appears, from the liquidator's report, that "the debtor's assets include no real property, that the number of employees over the past six months and gross sales ex VAT do not exceed the

thresholds set by Decree after consultation of the Council of State", the Court will choose simplified liquidation (the exception).

It is subject to the same rules as "standard" liquidation; however, it should be pointed out that it concerns only small businesses without real assets, and those having only small or non-existent personal assets.

Proceedings may be opened as a simplified liquidation but if the agent discovers new assets, the legislature has provided for an option to switch to a "standard" liquidation.

The advantage of the simplified procedure is the simplified ascertainment of receivables: the Liquidator is bound to check only employees' receivables and those that may be ranked for the proceeds of sales of assets.

In practice, the liquidator will nonetheless need to identify the claims that are liable to be satisfied and therefore ascertain them with a view to a perfect allocation. The latter will be simplified, however, since only claims likely to be satisfied will have been checked.

At a first stage, the proposed allocation is filed with the Registry and any interested party may object. Rulings on objections will also be publicized and notice given to creditors, who are provided with a further remedy.

These various forms of remedy, which involve a risk that the liquidation will not be closed within a year, as proposed by the legislature, have drawn considerable criticism. In addition, though simplified, the procedure will be time-consuming and hardly consistent with the one-year period desired by the act.

When there are a few assets, the liquidator is required to sell them and for such purpose to apply to the Court for permission to offer a private sale, to be carried out within three months. If the liquidator fails to sell within that period, the assets must be auctioned.

On an exceptional basis, a simplified liquidation may be extended by three months. In order to expedite the close, it has been provided that the existence of employment litigation does not prevent the close of a simplified liquidation.

### **c) Close**

Close shall be ordered either because the liabilities have been discharged, or because there are insufficient assets, and in the event of sale, close shall occur only after ascertaining that the seller has complied with his obligations. If assets are recovered subsequently, the proceedings may be reopened.

The Public Prosecutor, the debtor or any creditor may apply for close of the proceedings, within one year after the judgment ordering judicial liquidation.

## IV - ALTERNATIVE TOOLS

The toolkit designed to handle insolvency proceedings is even better equipped than might be imagined: since the law of preventive and insolvency proceedings has been enrolled in protecting the economic environment, it behooves it to support the distressed company with all the effective methods and techniques proven in other areas.

### A) ADR (ALTERNATIVE DISPUTE RESOLUTION): ARBITRATION AND MEDIATION

This is the case in particular of arbitration and mediation. Alternative dispute resolution methods are developing and have shown over the past ten years their ability to resolve the most difficult situations painlessly.

The area of companies' difficulties, too long considered as a ghetto, has kept those sick and vulnerable companies and their managers away from the tools used in more favorable circumstances. This must cease.

The fact that a business is defaulting is no reason for considering that it is of no interest to the economic and social community, and the fact that a manager stumbles is no reason not to help him, quite the opposite.

The area of company distress is particularly well suited to mediation or settlement out of Court as all the parties are certain to suffer large losses, and because settlement opens the way to a possible improvement, however small, in their own situations.

This view, which I personally have been advocating for over 15 years, is no longer a mere statement of principle. It now has its defenders internationally, and has shown its merit domestically.

Thus, through alternative dispute resolution methods applied in systematic fashion to handle all the problems arising out of the discontinued operation of a real-estate group, liabilities of over EUR 1.4 billion were handled over a period of 18 months: 450 agreements were made, all the criminal and commercial proceedings were discontinued. It took another ten years to finalize performance of all the commitments made in the agreements.

But at the end of those 12 years, it is a delight for a professional to see that her constant work enabled the banking creditors, who ran a serious risk of incurring liability, to find an alternative solution to stressing their liability, more favorable

for third parties, and for those third parties to achieve a reasonable pay-out, so that all interests converged in a virtuous circle.

The energy needed for these cases is positive energy that benefited all the parties:

- the legal system, which was spared the management of complex and time-consuming litigation;
- the creditors, who obtained satisfactory indemnification in kind or in cash;
  - the debtors, who were able to contribute to the resolution of problems having arisen in third parties and recover their dignity, or even start afresh in some cases;
  - the financial partners, whose image was greatly at risk and whose current international development is reassuring for their health.

Out of 20 years' professional activity, 10 years' commitment to a business group is enormous but the stakes for the parties concerned justified it. The decision to apply alternative dispute resolution methods was found to be the only pragmatic and effective solution.

French law allows it both in rescue proceedings and in those for reorganization or judicial liquidation, providing in its Articles L.622-7 and L.642-24 that the Court-appointed agent may compromise and settle (except in the area of sanctions) regarding any disputes of collective interest to the creditors, subject to consent by the bankruptcy judge and Court approval of the agreement made.

All the parties concerned agree that this unique resolution through multiple negotiation (450 agreements) met all its targets.

The close for discharge of these EUR 1.4 billion liabilities was achieved at the end of the process.

What does this show? That the ambition of international organizations such as GRIP 21, Insol Europe, the IBA or the ICC to recommend the use of ADR in connection with insolvency proceedings is justified and that all parties should monitor with interest this positive development which, by restoring dialog among frustrated players, allows value to be created.

Arbitration, for its part, is now recommended for the resolution of jurisdiction disputes: it seems appropriate to find in cross-border cases means of resolving expeditiously, with increased legal certainty, the issue of Courts' jurisdiction and the COMI.

Analysis by one or more neutral arbitrators of the evidence allowing a determination of the COMI seems an attractive solution, more satisfactory than a costly and excessively time-consuming recourse to domestic or EU Courts. It is good to see that, in 2006, all the major international organizations have acknowledged the interest of crossing insolvency law with arbitration law.

## **B) BEST PRACTICES - JUDICIAL AND PROFESSIONAL COOPERATION**

There are also many domestic and international initiatives to demonstrate the need to develop professional best practices, including especially judicial and profession cooperation (see The American Law Institute in association with the International Insolvency Institute "Guidelines for Court-to-Court Communications in Cross-Border Cases).

The US Judges and in particular Judges Tina Brozman, Leif Clark and Burton Lifland, were among the first, at their respective levels, to understand the desirability of using ADR. Thus in connection with diversity or cross-border proceedings, agreements are carefully developed at length by them to allow those complex proceedings to proceed harmoniously in future.

Like the influence of international legislation on the handling of proceedings or the effect on security interests, pragmatic resolution of the legal situations arising out of international proceedings will eventually have an effect on French professionals and Commercial Court judges.

Finally, there is a recent initiative within Insol Europe, energetically driven by the Dutch Professor Bob Wessels ([b\\_wessels@iiiglobal.org](mailto:b_wessels@iiiglobal.org)), who recommends effective cooperation among professionals of different nationalities to overcome the growing complexity of proceedings and the deadlocks arising out of misunderstanding. It is safe to assume that the principles selected in this code of conduct known as the "co-project" will include recommendations for what every individual owes his neighbor: respect and understanding.

In order to be able to communicate in these international cases, it will be necessary to be open-minded and accept different ways of thinking, in order to develop together the best possible compromises.

## V. A FEW SPECIFIC ASPECTS

Certain aspects of insolvency proceedings in France, such as the availability of a reorganization involving redundancies, have always been regarded with concern by foreign counsel and investors. In order to allow a reasonable approach of the matter, we have sought to analyze them independently and in summary fashion in order to consider the reality.

### A. LABOR RESTRUCTURING AND EFFECTS ON EMPLOYEES

France has always been considered as a "difficult" country. The welfare protection justifying impingements on the creditors' rights is usually the matter. Is it really impossible to have a redundancy plan in France when the business's interest imposes a solution in which it would be preferable to dismiss a reasonable number of employees while securing all their rights and protections, or is it preferable to imperil the entire ship and crew ? The situation is naturally very varied, and there is no open-and-shut answer.

The "Pages Jaunes" precedents (Judgment of the Supreme Court delivered on January 11, 2006 regarding the possibility of economic dismissal to protect the business's competitiveness even though it is not distressed), which caused extensive commentary, opened the way for a far more economic interpretation by the Courts, but it would be rash to deduce that the rule has changed irrevocably.

Any labor restructuring must be preceded by attempted placement within the business, or the group in some cases.

#### **1) The business's labor restructuring in connection with ad hoc proceedings or conciliation**

In connection with those two procedures, the new law has no impact and the generally-applicable rules accordingly prevail.

#### **2) The business's labor restructuring in connection with a rescue**

In a rescue, the dismissal procedure is governed by generally-applicable rules. This choice has been much discussed. Many were of the view that it would be necessary to have an expedited dismissal procedure in order to make the restructuring as effective as possible. It was finally decided not to create an exception in order not to affect the French principles of labor law and competition rules.

AGS coverage was obtained, however. The guarantee covers only the receivables arising out of termination of the contracts of employment occurring during the monitoring period and within one month after the judgment determining the rescue plan (L.143-11-1 2° of the Labor Code). On the other hand, amounts payable to employees on the date of opening of the rescue proceedings are not covered, since the business has not suspended payments. But it may make a refundable advance against the first revenues if the Liquidator certifies that there is a cash-flow problem (the AGS may, however, challenge this opinion).

In the event of conversion of the rescue proceedings into judicial reorganization, the AGS will secure claims remaining due at the date of opening of the rescue proceedings if they have not been paid by the date of conversion into reorganization. Salaries will not be secured during the monitoring period.

In the event of conversion into liquidation proceedings, the AGS will secure claims remaining due at the date of opening of the rescue proceedings if they have not been paid by the date of conversion into liquidation. It will also secure salaries accrued during the rescue's monitoring period and during 15 days after the judgment ordering judicial liquidation. Severance pay resulting from dismissals carried out, during the monitoring period, within 15 days of the judicial liquidation are secured on the customary terms of AGS involvement.

In the event of rescission of the rescue plan, judicial liquidation proceedings are opened and any amounts due prior to the opening of those proceedings will be secured by the AGS. The FNGS cap for 2006 is EUR 60,000.

The inclusion of persons engaging in professional activity on a self-employed basis in the scope of insolvency proceedings has implied an extension of AGS coverage to the entire public sector. Though self-employed professionals have not contributed for this risk's coverage to date, the small number of staff they employ seems unlikely to upset the FNGS's budget.

### **3) The business's labor restructuring in connection with judicial reorganization**

The dismissals are subject to special rules.

☞ In principle, during the monitoring period of the judicial reorganization, there is no effect on the performance of contracts of employment, and the Act dated July 26, 2005 permits only on an exceptional basis the use of dismissal on economic grounds during this period. The dismissals, which must then be urgent, inevitable and essential, require permission by order of the bankruptcy judge. It may be imagined, however, that the Supreme Court's "Pages Jaunes" precedents will also

provide the bankruptcy judge's position with some flexibility, and lead to acceptance of dismissals to secure competitiveness during the monitoring period.

The business's labor restructuring may be contemplated in connection with a plan for sale of the reorganized business. The plan may in fact be determined by the Court only after consulting the Works Council, staff delegates or staff representatives in accordance with Article L.321-9 of the Labor Code. The government agencies must also have been informed.

➡ The dismissals carried out in connection with a reorganization plan must be performed within a very brief period (one month). If this time limit is not observed, the dismissals will nonetheless be valid but the AGS (the entity managing the scheme securing employee receivables) will not secure the indemnities payable to the employees. The administrator or liquidator may be held liable for failing to comply with these time limits.

The issue of time limits is thorny, and compliance with the limits under the various procedures for economic dismissal according to the number of employees in the business is cumbersome. If the administrator acts promptly, there is a risk of having the dismissal proceedings invalidated or annulled for irregularities. If he does not comply with the limits for the dismissal proceedings, the AGS may refuse to provide security. In any event, the option usually selected tends to favor protection of the employees' interests.

When several dismissals are contemplated, the administrator is required to define and comply with criteria setting the sequence of dismissals, which may naturally cause difficulties when the purchaser lists the employees whom he wishes to take over.

The administrator is also required to ascertain that no placement is possible and in order to avoid the dismissal being devoid of genuine and substantial cause (Supreme Court ruling dated June 8, 1999), the letter of dismissal must mention all the unsuccessful placement attempts.

An employee having received notice of dismissal may challenge it before the Labor Court. He may also assert a failure to comply with the sequence of dismissals.

Likewise, the AGS's support for companies undergoing rescue demonstrates open-mindedness and pragmatism. Upon the administrator's report, the AGS may advance a company not having the resources to finance a plan for

restructuring the funds required for redundancies. Though supposed to be refunded immediately, it is well known that this agency supports companies and does not convert its advances into claims for immediate repayment. This provides a breathing space.

#### **4) The business's labor restructuring in connection with judicial liquidation**

The business's labor restructuring may be contemplated in connection with a sale of the liquidated operation's production unit as a going concern. Sale may in fact be decided upon by the Court only after consulting the Works Council, staff delegates or staff representatives in accordance with Article L.321-9 of the Labor Code. The government agencies must also have been informed.

The dismissals are to be carried out within 15 days after the opening judgment. Within that period, the dismissals are carried out by ordinary notice given by the liquidator or administrator, subject to the periods of notice provided for by statute, collective bargaining agreements or labor contracts.

Transfer of contracts of employment pursuant to a sale plan resulting from judicial reorganization or judicial liquidation is mandatory (Article L.122-12) and releases the new employer from liability for breaches of obligations prior to transfer of the contracts.

The new employer will not be liable for failure to join a pension scheme for the period prior to transfer of the employee's contract of employment in connection with the sale plan.

He shall remain liable, however, for the period after transfer of the contract of employment to his business.

Let us assume that a labor restructuring, provided that it complies with generally-applicable obligations (placement, compliance with criteria, etc.), is possible. The facts that rescue and reorganization plans may provide for a labor restructuring, and that the sale plan through liquidation does not imply, any more than before, the assumption of all the contracts of employment are serious improvements and demonstrate the realism of the statute's drafters, even though some considered that they had remained over-cautious. These are employees' rights and the "Rescue Act" will not affect them.

Since the generally-applicable rules apply, their recent developments deserve a mention at this point.

The Social Cohesion Act drafted at the initiative of Minister Jean-Louis Borloo established the personalized redeployment agreement (CRP) in 2005. The purpose of that agreement is to provide employees dismissed on economic grounds (with 2 years' service or more) with action enabling them to find further employment more quickly.

The personalized redeployment agreement must be offered. If not, the employer will be required to pay a special contribution of two months' salary of the employee concerned.

### **The employee**

- He or she is provided with the personalized redeployment agreement for no more than 8 months;
- the employee has the status of a vocational trainee;
- within the first 8 days of the agreement, the employee will undergo a pre-evaluation individual meeting;
- on the basis of that pre-evaluation, the employee may be provided with various forms of assistance, including in particular customized monitoring by a personal tutor, social and psychological assistance, orientation, support, training, validation of professional experience, and if necessary, a skills appraisal;
- in return, the employee is provided with a specific benefit, increased for three months (80% of the reference salary during the first three months, then 70% the next five months);
- if the employee has not found further employment by the end of the eight months, he or she will be provided with the allowance for assistance to return to employment (ARE) for the standard duration, minus the duration of indemnification for the specific redeployment benefit.

### **The employer**

The employer is required to pay to the ASSEDIC, for employees having 2 years' service in the business, 2 months' notice indemnity including all welfare charges. He is required to pay for all employees the training allowance accrued yearly to employees in connection with the personal entitlement to training (DIF), on the basis of 20 hours per year. For employees, he is required to pay all the severance

indemnities, except for 2 months' notice for employees having 2 years' length of service.

These are the obligations, therefore, that will also apply to preventive proceedings.

## **B. FUNDING OF THE BUSINESS DURING THE “PRE-INSOLVENCY” PERIOD**

### **1) The priority of “new money”**

The French cabinet's desire to incite creditors to support the debtor during conciliation led it to create a so-called "new money priority".

In procedural terms, this priority may come into existence only if the conciliation agreement has been approved and proceedings for judicial reorganization or judicial liquidation are opened subsequently.

The purpose of this priority is to improve the treatment of parties having granted to the debtor additional cash support under the approved agreement, or providing new goods or services in order to maintain the business's operation and its durability. This new effort must be provided for in, and be subsequent to, the agreement.

The legislature has great expectations of this new priority as an incentive for banks, traditionally fairly inactive in this area of fragile SME-SMIs, the difficulties of which in obtaining funding are well known.

There is room for very substantial doubt regarding this advance of the law, which is likely to be beneficial, in France, more to the principal suppliers wishing to accompany a distressed contracting partner, since the latter also generates sales needed by the supplier.

The banks' timidity will further increase with the new European Basel II prudential and accounting rules. However, it is also clear that new players (foreign financial institutions) will seize this opportunity disregarded by the French traditional banks.

These creditors will be paid off before any other receivables having arisen prior to the opening of conciliation, ranked as provided for under Articles L.622-17 (rescue and judicial reorganization) and L.641-13 (judicial liquidation), except for court costs and the AGS's priority.

The act rules out this “new money” priority for contributions by shareholders of the debtor pursuant to increased assets.

Will a current-account contribution be eligible for the new priority? It seems possible to answer in the affirmative.

## **2) The liability of credit providers**

The concept of "undue support" by creditors, and more specifically lending institutions, to a debtor, was a creation of case-law with the *Laroche* case in 1976, based on an extension of the general principle of tortious and quasi-tortious liability under Article 1382 of the Civil Code. It is also connected with the provisions of Article L.313-12 of the Monetary and Financial Code, relating to the possibility of early termination of credit, which provide that "the lending institution may bear pecuniary liability for failure to comply with these provisions".

The issue of financial support to a distressed business remains difficult.

According to the case-law, funding a distressed business is not objectionable *per se*, provided that its financial position has not been irreparably compromised, and may contribute to the debtor's recovery and avoid new losses, or to accompanying a restructuring approved by public authorities. A bank may not, on the other hand, grant assistance worsening the business's position, constituting undue support detrimental to other creditors, and intended, for instance, to "mitigate" the uncertainty of earlier receivables through the grant of costly short-term credit.

This case-law has evolved, however, towards the definition of a number of criteria demonstrating a strict appraisal of liability for undue support.

Undue support concerns funding granted once the business is no longer viable or able to recover, which may confer on it an appearance of prosperity by keeping it alive artificially, and the effect of which is to increase its liabilities or even reduce its assets, the sole security for creditors.

A banker's advisory duty implies that he must refuse the grant of credit that would jeopardize the business's viability.

It remains that a bank bears no liability for undue grant of credit if it is proved that it was unaware of the debtor's irreparably compromised position, as pointed out by the Supreme Court in a judgment dated January 7, 2004.

Undue support provided by a bank misleads third parties as to the business's real solvency, and is therefore detrimental to other creditors: the bank, which is presumed to have sufficient knowledge of its customer's position, contributes to

creating a reassuring image of its debtor for third parties, so that the latter will be injured if this image is eventually found to be misleading.

The lending institution's duty to advise and inform also applies to sureties, and breaches in this area may result in disproportionate security. The *Macron* precedent of the Supreme Court (Commercial Section, June 17, 1997) was a milestone case in that it censured serious misconduct by a lending institution, on the grounds that the latter had obtained disproportionate security from an individual, whose ability to repay led him to creating a dependency placing him, in the event of the debtor's bankruptcy, in the bank's dependency for life. The scope of this proportionality principle was subsequently restricted, however, by the *Nahum* judgment (Supreme Court, Commercial Section, October 8, 2002) which held the sureties to be liable on the grounds that they had failed to prove or demonstrate that "the bank had, in relation to their income, patrimonies and reasonably foreseeable repayment abilities, in the situation of expected success of the realty project undertaken by the company, information of which they were themselves unaware".

#### **Why wish to reform this case-law?**

It is customary to say, as the banking lobby did not fail to do, that the threat of liability for undue support deters lending institutions from providing credit.

The government's wish to support the development of funding for distressed businesses, and more particularly SMEs (small and medium-sized enterprises), provided this banking community with the government's ear. One article now lays down a principle of exemption of all creditors from liability for damage suffered as a result of the assistance they provide. It remains to be seen whether the consideration offered by the banks, of funding SMEs, will be reality or a soon-forgotten promise.

There are three exceptions from the exemption, fraud, blatant interference in the debtor's management and the obtaining of disproportionate security in consideration of the assistance. At what time is the disproportion appraised ? Should it be appraised at the time when the security is obtained, or at any time during the term of the agreement? We shall have to wait for an answer from the case-law.

The second paragraph provides, as a sanction, the nullity of security obtained. Some professionals have in fact wondered whether, by specifying nullity as a

sanction in the statute, this does not mean that other forms of claim are no longer valid. Could a claim in damages still be entered for reparation for the damage?

The government's approach of appeasement of the banks was very well received by the banking community, but it soon discovered worrying interpretations of the legislation that dampened its enthusiasm... or will serve as justification for the next instance of its obvious lack of interest for the SME market. Whether justified or not, it remains nonetheless that these legal refinements will delight lawyers and Courts for years to come.

While this is not a principle of exemption from liability but only a limitation of lending institutions' liability, there is no doubt that it is a very substantial improvement of their position.

The Act has not modified the duties of care, information and advice required of the lending institutions.

#### **C – THE EFFECT ON SURETIES AND CO-OBLIGORS**

In insolvency proceedings, the fact that the defaulting SME hides a manager having struggled for months, or even years, for his business's life or survival, is disregarded all too often. The French banking system is such that, beyond the company's assets, the security for debts, credit to SME-SMIs is in fact credit to shareholder managers who assume obligations with their companies. Their personal solvency determines their companies' future. This slippage of credit coverage is usually what makes the occurrence of insolvency proceedings so painful and devastating. The effects of implementation of the security provided are feared more than the effects of the liquidation.

Thus, in order to attract the interest of managers for the new rescue procedures, the legislature was justified in using a particularly effective form of incentive: connecting the effect on sureties with the measures negotiated in rescue plans or conciliation agreements.

As an incentive for use of the rescue procedure rather than judicial reorganization, the act applies a stay of proceedings against individuals standing surety, acting as co-obligors or providing independent security, whether during the monitoring period or during performance of the rescue plan. These individuals are eligible for the negotiated abatements and deferrals. It should be pointed out, however, that this measure will apply only after the agreement is approved.

On a corollary basis, as regards judicial reorganization, the Act expressly provides that the same persons may no longer claim a stay of proceedings.

Finally, as regards judicial liquidation, neither individuals nor legal entities will be eligible for a stay of proceedings.

#### **D – THE EFFECT ON CONTRACTS**

It appeared important to us to highlight this specific issue since it has become apparent, in connection with exchanges among professionals of different nationalities, that what seems to French professionals to be one of the very bases of a sale of a self-contained unit is not a universal truth.

In Germany, for instance, a business may not be sold with all contracts without obtaining prior consent from the other contracting parties. France has chosen the opposite course.

##### **1) Maintenance of current contracts (regardless of nature, subject only to contracts of employment)**

Whether in connection with rescue, reorganization or judicial liquidation, during the monitoring period, a debtor remaining in possession or an administrator, if one has been appointed, may call for the maintenance of current contracts.

If the debtor or administrator exercises the option, the contracting party will be bound to continue to perform the obligations under the contract with the debtor despite the latter's failure to perform obligations prior to the opening judgment.

An application for maintenance may be made during the proceedings for all contracts current on the date of the judgment opening proceedings for rescue, judicial reorganization or judicial liquidation. Contracts of insurance are now subject to the same treatment as all other contracts since the new Act, whereas they were subject to a special system under the 1985 Act.

Maintenance of the agreement requires payment at maturity (when the business's funds allow). If not, a reasonable deferral may be granted. In the event of insolvency during the term of the contract and insofar as the contract is maintained with a view to the entity's continued operation, the contracting party, on the contrary, will be provided with priority payment in relation to contracting parties prior to the opening judgment.

The debtor's failure to perform obligations prior to the opening judgment will allow the creditors only to lodge a claim, and likewise as regards damages arising out of termination of the contract.

The administrator may demand performance of current contracts by providing the service to the debtor's contracting party. The agreement is terminated as of right upon formal notice given to the administrator and remaining unanswered for more than one month.

It is important to note that for creditors entitled to claim restitution, the time limit for such a claim for property subject to a contract current on the date of opening of the proceedings is three months after the contract's termination or expiry.

## **2) Transfer of contracts pursuant to a sale plan**

When a sale plan is adopted during proceedings for conciliation, judicial reorganization or rescue, the Court will determine the agreements for finance-leasing, leasing or supply of goods or services necessary to maintain the operation having regard to the debtor's contracting partners' observations notified to the liquidator or administrator if one has been appointed (Article L.642-7).

Therefore, no clause in the agreement banning an assignment is binding against the insolvency proceedings in the event of a plan for sale of the business to a third party taking it over. The Rescue Act provides for a system of compulsory assignment of contracts when they are required to maintain the operation.

## **E – SANCTIONS**

Historically, Roman law granted a creditor a power of life and death over the debtor, then a right to take possession of his property. The consequence of these forms of execution was "*infamia*", which rendered the debtor morally and legally inferior. It determined the mental attitude of most of Europe for centuries.

During the 17th century, in France, even though a debtor could obtain of the King a letter of respite (approximately 6 months) when the bankruptcy was not caused by misconduct, the aim of the law remained nevertheless punishment, and a debtor failing to pay his debts was jailed, pilloried, or sentenced to the galleys.

From enactment of the Commercial Code in 1807 to the first real emergence of law governing distressed businesses with the 1967 Act, some alleviations were attempted. Nevertheless, the law's function as censure remained dominant.

With the 1967 Act, there was a change in culture: the fate of the business and that of the managers were now to be considered separately. It was necessary to "eliminate economically-doomed businesses without, however, disgracing managers who did not deserve it."

The Act of January 25, 1985 acknowledged that the failure of a business was not necessarily evidence of misconduct and decided that personal bankruptcy was no longer to be automatic, and that the action for assumption of liabilities was to be more difficult to bring, since it would now be necessary to prove the manager's misconduct.

Under the Act of January 25, 1985, personal bankruptcy resulted in depriving the manager of civil rights, and prohibiting him from managing any business, resulting in a resumption of creditors' individual actions. And the law continued to allow judicial liquidation as a sanction of managers and individuals having committed misconduct.

As for managers jointly liable without limitation for certain entities (EIG and private company), the proceedings brought against the company they managed were extended to them automatically, even if they had not themselves suspended payments.

Under such auspices, company managers were not keen to apply for assistance to the Courts where a right to make mistakes was not - or rarely - recognized and sanctions were handed out at a rate leaving little leeway for adversarial discussion. Managers accordingly waited for the very last moment before going to the Court and applying for the opening of insolvency proceedings, which naturally resulted in a very large number of judicial liquidations.

As an incentive for debtors to go to the Courts as soon as possible without fear, and so as not to deter entrepreneurs having had one unfortunate experience, the legislature sought, with the Rescue Act dated July 2005, to mitigate the effects of the law of collective proceedings for unlucky entrepreneurs, and to develop the recognition of a risk to make mistakes. Only crooks and repeat offenders should now be censured.

Debtors appearing before the suspension of payments has occurred will have a privilege of being spared any sanction, provided, however, that the rescue proceedings are not converted into proceedings for judicial reorganization or liquidation.

This Rescue Act has accordingly taken a large step forward, by removing the automatic extension of proceedings for judicial reorganization or liquidation to persons bearing joint liability for the debts of a legal entity (SNC and EIG), and abolishing judicial liquidation as a sanction.

This opening as a sanction has been replaced, however, by liability for corporate debts limited to proceedings for judicial liquidation. It should be noted that the bankruptcy judge in charge of the case may neither sit on the judgment Court nor take part in deliberation. Some Commercial Court judges have wondered whether this was not evidence of some distrust against them, but the aim is obviously the avoidance of problems of inconsistency with Article 6 of the European Convention on Human Rights.

The Public Prosecutor's office has been granted a right to appeal against any ruling with respect to sanctions, thereby endorsing the idea that the regime of personal sanctions, designed to remove dishonest or merely incompetent managers from business relations, is by nature a matter of public policy.

In addition, it should be noted that the main line for development of the Public Prosecutor's office's role with respect to personal and pecuniary penalties is likely to be the abolition of action *sua sponte*: in most Courts, the rate of action *sua sponte* with respect to sanctions remains extremely high, at least as regards personal sanctions. In particular, the main causes for opening of personal bankruptcy are now the same as those of fraudulent bankruptcy. Will the Public Prosecutor's office, which is known hardly ever to initiate action before the Commercial Court owing mainly to action *sua sponte*, adapt to the procedure specific of the Commercial Court (summons, placement, monitoring of proceedings) or will it apply to its traditional judge, the Criminal Court, thereby allowing to escape a whole section of duties traditionally assumed by the Commercial Courts alone?

The sanctions are collected in Section V of the Commercial Code, and the civil and professional sanctions concern the first three chapters, with the final chapter dealing with criminal penalties.

## **1) Civil and commercial sanctions**

The two following actions lie mainly in the area of judicial liquidation.

### **a) Liability for insufficient assets**

The misconduct on which the action is based must be mismanagement having contributed to the deficiency in assets.

The act provides that this action may not be brought when a rescue plan or judicial reorganization has been opened. If the plan has been observed, the creditors are deemed to have been satisfied and any reference to a deficiency in assets becomes immaterial.

This action remains available, however, if the rescue plan or reorganization plan is rescinded.

### **b) Action for liability for corporate debts**

In an action for liability for corporate debt, the misconduct on which the action is based is one of the five forms listed in Article 652-1 (disposal of assets of the legal entity, engaging in acts of trade for personal purposes, use of assets or credit inconsistent with the legal entity's interests, improper maintenance of a loss-making operation, misappropriation of assets or fraudulent increase of liabilities), insofar as it contributed to the suspension of payments.

In these circumstances, the manager, whether *de facto* or *de jure*, will be required to assume "all or part of the debts of the legal entity". If several managers are liable, the Court will have regard to the degree of misconduct of each to determine the portion of liabilities to be assumed by them.

The legislature has laid down a rule barring a concurrence of such two actions, the priority action being that for liability for corporate debts. Accordingly, the action for liability for insufficient assets may be applied only if no action is brought for liability for corporate debts.

### **2) Professional sanctions: personal bankruptcy**

During a judicial reorganization or judicial liquidation, the Court may, in relation to individual *de jure* or *de facto* managers of legal entities, but exclusive of those engaging in self-employed activities subject to disciplinary rules, order a prohibition on management or personal bankruptcy of a person having committed one of the seven forms of misconduct listed under Article 653-1, 4 conventional plus 3 new provisions:

- having impeded the proper course of the proceedings, by intentionally abstaining from cooperating with their agencies;

- having procured the disappearance of accounting documents, or having kept no accounts or fictional accounts;
- and for a manager of a legal entity: not having discharged the debts for which he was held to be liable.

The effect of personal bankruptcy is a prohibition on management, direction, administration or control of any business, and forfeiture of certain rights. The reason for keeping this name is to send a signal and continue to shame an incompetent or dishonest debtor, and in that case, the Court may order ineligibility for public office (L.653-10) for up to five years, the same period as the personal bankruptcy ordered.

The sanctions of personal bankruptcy or management prohibition are limited to 15 years, and are no longer subject to minimum periods. This maximum applies to sanctions ordered before January 1, 2006.

For all these sanctions, the Court having jurisdiction is the one having initiated the insolvency proceedings against the legal entity, to wit, the Commercial Court or Civil Court. Only the administrator, liquidator, Public Prosecutor's office or, a novelty, a majority of controller creditors in the event of the Liquidator's failure to act, may apply to the Court to exercise the sanction. The limitation period applicable to all these actions lasts three years, running from either rescission of the plan (for continued operation or rescue) or the legal entity's judicial liquidation, or, as regards personal bankruptcy, delivery of the judgment opening insolvency proceedings.

In general, the hearings are held in chambers. If the debtor, agent, administrator, liquidator, staff representative or Public Prosecutor's office so request, the hearings shall be public, unless the President of the Court decides that they will be held in chambers if there occur "disturbances such as to interfere with the proper administration of justice".

For performance of these actions, the President of the Court grants the bankruptcy judge extensive investigating powers and the option of taking provisional and protective measures. All these actions are subject to the generally-applicable remedies, and the Public Prosecutor's office may appeal, even if it did not act as a principal party. In that case, the appeal holds the proceedings in abeyance.

### **3) Criminal sanctions**

The legislature has not modified the criminal penalties substantially, and the relevant area remains that of judicial reorganization or judicial liquidation.

The grounds for "fraudulent bankruptcy", incurring 5 years' imprisonment and a EUR 75,000 fine (misappropriation of assets, fraudulent increase in liabilities, keeping fictional, incomplete or improper accounts, or no accounts), have been extended, however, to persons engaging in the professions. What is new is that the criminal Court having found a person guilty of fraudulent bankruptcy may order either that person's personal bankruptcy or a management prohibition, unless a civil or commercial Court has already taken that action. No aggregation of penalties is possible, therefore.

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In spirit, a significant step has been taken. A debtor eligible for a rescue plan and able to comply with it will be assured of incurring no sanction of any kind whatsoever.

In personal terms, the abolition of the opening of proceedings as a sanction is a step forward, as is abolition of the sanctions connected with late report of suspension of payments (45 days maximum).

It remains to be seen how the Courts will be able to sort managers into the classes of unlucky, incompetent and dishonest.

## VI. TRANSNATIONAL ASPECTS

### A - INTERNATIONAL PROCEEDINGS

The development of an international economy necessarily leads to situations of company failures involving several States, and therefore international bankruptcies.

A bankruptcy is treated as being international provided that it involves extraneous factors, i.e., when the debtor owns assets in several States or has creditors established abroad.

The development of international bankruptcy law meets a need for legal certainty. The existence of strict and well identified legal rules for bankruptcy is an essential condition for the development of international economic relations, and of international trade credit in particular.

It should be stressed that it is not surprising that the handling of international bankruptcies is inconsistent and that harmonized legislation is unlikely, at least in the short or medium term, in this area where the applicable principles are the outcome of a long historical process of evolution and where national interests remain highly relevant.

In order to enhance coordination between countries and facilitate the provision of assistance in the administration of insolvency proceedings opened abroad, insolvency laws need to contain rules on cross-border insolvency, including in particular the recognition of foreign proceedings.

There are three legislative instruments at the international level to resolve these issues: the multilateral Council of Europe convention adopted in Istanbul on June 5, 1990; the convention on insolvency proceedings prepared by the Council of the European Union in November 1995 (but not yet in force in the absence of the UK's signature); and the model law of the United Nations Commission on International Trade Law adopted on May 30, 1997.

On the whole, these instruments provide for:

- *recognition of liquidation rulings* issued in the country where the principal establishment is located by other countries where assets of the debtor are also located and where a concurrent activity may have been operated;
- the *action to be taken* in the latter countries, in particular through the appointment of a person in charge of protecting the assets located there, and also the option of opening a "secondary" bankruptcy, with the aim of liquidating the assets located in that country.

The purpose of the UNCITRAL model law on cross-border insolvency, for its part, is to offer effective ways of handling international insolvencies, in order to promote the following objectives: securing cooperation between the Courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency; greater legal certainty for trade and investment; fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor; protection and maximization of the value of the debtor's assets, and facilitation of the rescue of financially-troubled businesses, thereby protecting investment and preserving employment.

This law does not govern the proceedings in the place of domestic legislation; it merely allows a statement of the broad principles to be observed in order to harmonize the handling of insolvency to the greatest possible extent.

In a highly international environment, the law of insolvency proceedings is seeking to defend against excessive foreign influence in the name of domestic public policy. This disregards the weight and influence of the legislation developed by the international community.

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Even though it has not adopted the UNCITRAL model law, France is present in international fora, represented by Professor Jean-Luc Vallens, a renowned judge whose statements always attract respect. The "empty chair" policy in international matters is always unsound.

Few or no French professional bodies, other than GRIP 21 (<http://www.grip.21.com>), are present where the common-law professionals are assiduous in their presence and drafting activity. Accordingly, in the near future, we will have to acknowledge the impact of international legislation developing without us even though the UNCITRAL's working group V, through its Secretary General, Mr. Sekolec, has always made it clear how important he considered the diversity of representation and intervention of the civil-law countries to be.

If they fail to make the essential effort in funding and time, France and its legal professionals will see irreparable consequences in the evolution of international legal rules and their impact. Their excessively domestic, or even parochial, interest even now hinders recognition of the civil-law point of view. The French exception, nowhere represented, is unlikely to make converts, even though our foreign counterparts may have been attracted to specific aspects of our procedures, such as ad hoc proceedings which provides the flexibility they like.

The disease of French business law is made up of its exceptions, which it has too long considered as protecting it.

## **B - EU PROCEEDINGS**

With a view to organizing insolvency proceedings among the various Member States of the European Union, EU Regulation 1346/2000 was adopted on May 29, 2000.

In France, this EU Regulation is referred to only under Article 1 of the 2005 Decree relating to determination of the French Court having territorial jurisdiction in relation to debtors not having their headquarters on French territory, and Article 66 of that Decree relating to the lodgment of claims by foreigners.

Its objective is not to harmonize the law governing insolvency proceedings at the EU level, but to coordinate the various domestic laws among themselves.

This coordination consists, through two kinds of proceedings, of determining the applicable law and the Court having jurisdiction.

The jurisdiction applicable to the main insolvency proceedings is that of the Member State in which the proceedings are commenced;

- the other Member States must recognise the administrator/liquidator appointed in the main insolvency proceedings;
- the administrator/liquidator appointed in the main insolvency proceedings can dispose of assets and subsidiaries situated in the other Member States without having to apply for *exequatur*
- the secondary proceedings are carried out under the management of the main proceedings.

The EU regulation has been established mainly in order to avoid forum shopping by managers.

It endorses the criterion of the Centre of Main Interests (COMI) in order to enable a Court in one Member State to hold that it has jurisdiction to try reorganization or winding-up proceedings relating to a business group, the head office of which is located in another Member State. Those proceedings where the COMI is located are known as "main" and may lead to one or more "secondary" proceedings.

For legal entities, the centre of main interests is presumed to be the location of the registered office.

Once main proceedings have been opened in one Member State, the Courts of other Member States have no further jurisdiction to open such proceedings against the debtor. The jurisdiction is accordingly exclusive.

The Regulation provides for one exception, however: if the debtor has an establishment (i.e., devoid of legal personality) in one such Member State, so-called secondary proceedings may be opened by the Courts of the Member State concerned, but these may only be winding-up proceedings.

The main effect of this allocation of jurisdiction is to make the debtor subject to the law of the State of opening. This is relevant only for the main proceedings insofar as the establishment subjected to secondary proceedings will be subject to the law of the Member State where it is located.

The centre of main interests is briefly defined in recital 13 of the regulation which provides that "*the centre of main interests should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties*".

This criterion's flexibility highlights both the Regulation's usefulness and its weakness: by denying the debtor the option to connect to the legislation which he considers to be most favorable, the regulation achieves its stated aim of avoiding any forum shopping. On the other hand, as several Courts may hold that they have jurisdiction, disputes can arise, despite the principle of mutual recognition.

## THE LEADING CASES

The four cases mentioned below are the most recent and correspond to different treatments of EU proceedings on French territory involving a Europe-wide dimension.

### *Isa Daisytek case*

The **Isa Daisytek** case is the first significant precedent relating to implementation of the EU regulation.

It concerned a group consisting of a parent in the USA and a subsidiary in England, which itself had a number of subsidiaries in Europe including one in France, within the circuit of the Pontoise Commercial Court.

Under the regulation and having regard to the difficulties faced by the group (in particular, the US parent was in Chapter 11), the High Court of Justice in Leeds, by administration order dated May 16, 2003, opened single main insolvency proceedings against the 14 companies (including one French subsidiary).

Shortly afterwards, the manager of the French subsidiary filed a report of suspension of payments with the Registry of the Pontoise Commercial Court and judicial reorganization proceedings were opened by a judgment dated May 26, 2003.

The English administrators entered a third-party objection against the judgment opening the proceedings. The Pontoise Commercial Court dismissed it on July 1, 2003.

A further third-party objection was entered against that judgment before the Versailles Court of Appeal which, by judgment dated September 4, 2003, recognized the primacy of the English main proceedings and reversed the two judgments of the Pontoise Commercial Court relating to opening of the proceedings and the first third-party objection.

An appeal to the French Supreme Court was then lodged on the grounds that, unlike the English procedure, the presence of the staff representative and his testimony are mandatory in France.

The Supreme Court is now to rule on this issue.

### **Commentary**

This judicial process, while it has made the background complex, has not prevented the proceedings, both English and French, from being directed at the best interests of the parties involved through a highly pragmatic solution. This case shows the use of one of the preferred tools of mediation. An agreement was developed between the French and English professionals and approved by the Courts in both countries. Under that agreement, the French professional sold the business and implemented the redundancy plan. He then handed the funds over to his English counterpart pending the final ruling on jurisdiction. It should be borne in mind that the mutual interest is the same: "selling businesses in the best possible manner at the best possible price".

On the other hand, judicial rivalries become relevant when it is necessary to allocate the proceeds of sale. The court-appointed agents in each country will be required to ensure that domestic creditors are treated fairly in structures of different nationalities, whichever proceedings are treated as the main proceedings. Difficulties will necessarily arise according as one country or another has waived its State's privileges or not.

### *Rover France case*

The High Court in Birmingham opened insolvency proceedings against SAS Rover France's parent, in which it considered, under Article 3 of the EU Regulation on insolvency proceedings, that the SAS Rover France's centre of main interests was in England, and opened insolvency proceedings against it.

The debtor filed a declaration of suspension of payments with the Nanterre Commercial Court.

By judgment dated May 19, 2005, the French Court, within the circuit of which the SAS Rover France had its registered office, was accordingly called upon to rule on the High Court's jurisdiction.

The English administrators appointed pursuant to the insolvency proceedings opened by the High Court in Birmingham asserted the following contrary arguments.

1. The centre of main interests of the SAS Rover France, the criterion for territorial jurisdiction pursuant to the aforementioned Regulation, was determined by the High Court of Justice in Birmingham on the basis of evidence reviewed by the English judge: "the subsidiary has indeed no independence in day-to-day management, in particular with respect to the management of human resources, no financial or accounting independence, no independence in terms of commercial and marketing decisions, and third parties are well aware that the centre of main interests of the SAS Rover France is located not at its registered office but at Longbridge in England";
2. "No particularly serious circumstance that could be analyzed as a manifest breach of French public policy has been demonstrated."

Applying Article 3 of the aforementioned Regulation, whereby "the place of the registered office shall be presumed to be the centre of [its] main interests in the absence of proof to the contrary", the Court held that the English Court had jurisdiction, on the grounds that "the English judge, in order to rebut the presumption [...] listed for Rover France the significant action taken in England; whereas he thereby obtained a conviction that the centre of Rover France's interests was located in Longbridge and accordingly conferred on him jurisdiction to open insolvency proceedings relating to that company".

Pointing out that "recourse to public policy is conceivable only where the recognition or enforcement of the judgment delivered in another Contracting State would be an unacceptable infringement of the legal system in the requested State", the Nanterre Commercial Court considered that it was in no way proven that there had been an essential breach of the law or of a fundamental right, which alone could support the public-policy exception.

The Court, having reviewed the position of employees which was the basis for the Public Prosecutor's recourse to public policy, held that they were sufficiently protected, since the effects of the English insolvency proceedings would not deprive them of any of the rights that would have arisen from French proceedings if the latter had been opened.

### *EMTEC case*

This case shows how the solutions work reciprocally: since EC Regulation 1346/2000 of May 29, 2000 had come into effect, no French Court had been required to rule on the reverse situation and to open insolvency proceedings relating to a parent company and its subsidiaries established in other Member States. This has now happened with the judgment of the Nanterre Commercial Court in the EMTEC case (February 15, 2006). This judgment opened judicial reorganization proceedings in relation to the French companies considered as being parent companies and as actually managing the entire group. It then opened separate judicial reorganization proceedings against the subsidiaries located in other Member States (Spain, Austria, Poland, the Benelux countries and Italy), and in Singapore.

It is interesting to note that the Court did not extend the proceedings to the foreign subsidiaries, but opened separate proceedings ("Might this not be a sign of caution on the part of the judges, caused by the *Metaleurop* case which reminded lower-Court judges that the extension of proceedings required the finding of a real commingling of the companies' assets, a particularly difficult requirement for companies under different laws ?" Question raised by Mr. Vallens, judge and associate professor at the Université Robert-Schumann).

Thus, it may be concluded that the French case-law is now established. The COMI determined by the Court having jurisdiction will not be disputed by the French Court, which either acknowledges its finding or opens secondary proceedings if it so sees fit.

The Court used several criteria to locate the COMI:

- the location of meetings of the Board of Directors
- the location where the main contracts are made
- the geographical location of the major customers
- the geographical location of the group's main financial institutions
- the location where commercial policy is determined
- the need for a subsidiary to obtain its parent's consent for financial decisions
- the location of the head office (location of accounting or human resources departments, etc.).

What will happen if the COMI is not the registered office? It will be necessary to ascertain the location of the real COMI in order to open the main proceedings at the right location.

The Court pointed out that it must always be possible to open secondary proceedings in order to protect the interests of employees and creditors; the former will enjoy the benefit of domestic legislation relating to welfare rights (redundancy plan, placement, unemployment insurance, security of salaries, etc.), and the latter will maintain their occasional privileges or ranking in the pay-out.

The Nanterre Court, after ascertaining that the COMI was indeed located in France, ordered the opening of main proceedings in France involving the group's various subsidiaries. These main proceedings in France will accordingly be governed by French law.

Concerning the German subsidiary (MPOTEC), the Court noted that:

- the shareholders had no influence over the management of the companies in France;
- management decisions were indeed made by the French managers;
- in matters of financing, commercial activity and accountancy, decisions lay with the directors of a parent company situated in France;
- the same decision-makers situated in France provided the supply of all goods. A monthly meeting took place on the subject in France. The goods were bought and paid for by one of the French parent companies;
- the group's commercial policy was determined and put into practice in France;
- the development of the products sold was carried out in France, including design;
- the invoicing contract had been signed in France;

- MPOTEC had notional capital of 25 000€, while the debt to the French parent companies reached almost 8 million E;
- all liquidities were to be found in France;
- the commercial agreement with the main client was signed in France; and
- the employees confirmed that the head-office functions and the management of the subsidiary was carried out in France.

The arguments were the same for the other subsidiaries.

Some concern has been displayed among French Commercial Court judges and professionals regarding the possible effects of excessively opportunistic forum shopping on both French companies and their creditors: to date, secondary proceedings may only be winding-up proceedings, and no-one has yet seen how the proposed allocation of proceeds of sale of global companies will be determined in future.

It is well known that certain sales have been carried out "globally", integrating parents and subsidiaries. How will the subsidiaries be valued, and how will these proceeds, if identified, be allocated among domestic creditors, including in particular priority creditors such as the unemployment-insurance funds or the Public Treasury?

One hardly dares to ask the question for unsecured creditors.

Against heated discussion and situations that will crystallize national resentment and feed litigation, there is a reasonable course. Prior negotiation and the tools of mediation or even arbitration could be used to develop reasonable pragmatic solutions.

Other European courts take the same position, in that they consider that combining the proceedings against the subsidiaries into the main proceedings is appropriate.

#### *ENERGOTECH case*

More recently, the Lure Court in France, by an order dated March 29, 2006, commenced main proceedings against ENERGOTECH, a Polish legal entity, a builder of metal structures, with its registered office in Myslowice/Poland, which is a subsidiary of a French parent company, EUROCOOLER, the object of insolvency proceedings.

French administration was extended to ENERGOTECH as it filed a bankruptcy petition in Lure.

The Court mentions in its decision that in establishing where the COMI of the subsidiary was situated it relied on a number of elements, the same as those listed by the Nanterre Court, that is:

- the president and vice-president of ENERGOTECH are the same as for the parent company;
- the manager of the Polish subsidiary acts only with the French directors' consent;
- the parent company provides technical assistance;
- the parent company deals with all issues in connection with the products and their delivery, the sales, the budget, the commercial relationship with customers; the parent company deals with all market negotiations instead and for the subsidiary;
- the parent company deals with all technical documentation and manufacturing standards;
- the parent company's orders account for 93% of the subsidiary's turnover;;
- the parent company sets the prices for the subsidiary's products.

Under these conditions the Court considers that we are dealing here with more than a mere program of technical assistance: the parent company imposes on the subsidiary its own choices in all technical and commercial problems.

The Polish subsidiary is proved to have no independence in terms of industrial, commercial or financial policies.

The Lure Court, like the Nanterre one, has thus chosen to order the commencement of main insolvency proceedings concerning the subsidiary, instead of extending to the Polish subsidiary the assignment over the parent company. Also like the Nanterre Court, the Lure Court helps in this way to bridge the gap in the Regulation concerning the treatment of corporate group insolvencies.

## **C – FOREIGN CREDITORS IN INSOLVENCY PROCEEDINGS OPENED IN FRANCE**

All creditors are required to lodge their claims at the time of opening of insolvency proceedings. Unchanging case-law accepts that all creditors, regardless of nationality, may lodge claims (report receivables) in proceedings opened in France, and lays down a principle of non-discrimination and equal treatment among French and foreign creditors.

Foreign creditors are granted, however, an additional two months to lodge their claims, i.e., 4 months after publication of the judgment in the BODACC (Bulletin Officiel des Annonces Civiles et Commerciales/ Official Gazette).

If the foreign creditor has not lodged a claim in time, he has available, like French creditors, an action for relief from the expiry of time limits, which must be exercised within one year after the decision opening the proceedings. A judgment of the Paris Court of Appeal dated December 17, 1999 held, however, that creditors domiciled abroad are allowed a two-month extension to apply for relief from the expiry of time limits (the creditor is required to prove that he is not responsible for the failure to lodge a claim, or that there was a willful omission by the company).

In addition, a foreign secured creditor having had the security interest publicized in France will be given notice of the opening of proceedings personally or, if applicable, at the domicile elect of the proceedings. Personal notice to the creditor shall not apply, however, if the security interest or leasing agreement has been publicized abroad.

A foreign creditor will be required to comply with the forms of lodgment imposed by the Commercial Code, which must:

- contain the amount of the receivable due on the date of the judgment opening the proceedings, stating the amounts due in future and their maturities;
- specify the nature of any liens or security interests attaching to the receivable;
- contain evidence in support of the receivable's amount and existence if it is not documented, or its evaluation if it is not determined;
- contain the terms of computation of interest if no rate is specified; and
- specify the Court seized if the receivable is the object of litigation.

The claims are to be lodged in the French language, or in a foreign language and accompanied by a French translation. This was held by the Lyons Court of Appeal in two judgments dated March 15 and September 7, 2001.

A foreign creditor will be allowed, however, to remedy the defect either by translating directly into French or by attaching a translation, until the bankruptcy judge acts upon acceptance or denial of the claim.

As regards the denomination of the claim in a foreign currency, the law has provided for two cases:

At the date of opening for judicial reorganization and at the date of conversion for judicial liquidation, the conversion into euros will be performed at the exchange rate on the date of such judgment.

French law will be applicable only if the claim has been found to be valid under the law governing the contract, or the foreign law in the case of a tort-based claim.

Stays of individual proceedings are binding on foreign creditors, together with the principles of the ban on registration of security interests and suspension of the accrual of interest. A foreign creditor may nevertheless act abroad, where the debtor owns property, insofar as the French ruling is not recognized by foreign authorities.

If a foreign creditor has a current contract with the French debtor, he may, under the Act, be required by the Administrator to maintain that agreement. In practice, especially if the agreement is to be performed abroad, a ruling by a foreign Court will be required to compel the contracting party's compliance with the maintenance decision.

The EU Regulation of 29 May 2000 dedicates many provisions to the situation of creditors in the Member States. In addition to those mentioned above, they are provided with more sophisticated notice. Article 40 of the Regulation provides that information is to be provided to creditors through the sending of individual notices including the time limits to be observed, the penalties laid down in regard to those time limits, the body or authority empowered to accept the lodgment of claims and other measures laid down. A form bearing, in all the official languages of the European Union's institutions, the heading "Invitation to lodge a claim - Time limits to be observed" shall be used for that purpose.

In addition, EU creditors of the debtor in rem enjoy the benefit of Article 5 of the Regulation, which provides that opening of the insolvency proceedings shall not affect their rights. This information shall be provided by the liquidator, who shall inform the known creditors.

Any creditor may lodge a claim in connection with both the main proceedings and any secondary proceedings opened, which protects the creditors if the debtor has substantial assets in another Member State. In order to secure the equal treatment of creditors, a system of return and imputation is provided for, so that the creditor is not afforded more favorable treatment than others.

However, creditors enjoying the benefit of Articles 5 and 7 (which protect rights in rem or based on a reservation of title) are not affected by the return mechanism provided for under Article 20 of the Regulation. Rights in rem accordingly remain subject to their own law and avoid the law applicable to the insolvency proceedings. It follows that creditors need not submit to the rule of stay of individual proceedings and may avoid the rules for ranking of priorities provided for under the law of the proceedings.

However, in the event of sale of an asset belonging to the debtor, the excess proceeds of sale of the asset subject to the right in rem are to be paid to the liquidator of the main proceedings. In addition, if the creditor in rem does not realize the asset, the liquidator may sell it in compliance with the forms required by the law of the Member State where he proposes to act, provided that he satisfies that creditor.

Foreign creditors, like any others, may apply for appointment as controllers of the proceedings (Article L.621-11).

The administrator may invite banking institutions or suppliers accounting for more than 5% of supplier liabilities to join the creditors' committees called upon to analyze and vote on the proposals in the rescue or reorganization plan.

## CONCLUSION

When in late 2005 I acceded to the kind request from my eminent colleague and friend Bruce Leonard, to present the reform of the system of French insolvency proceedings, I didn't realize how arduous the task would be.

It was, since the new Act sought to simplify the procedures in order to reassure its future users, and accordingly hastened to create five processes, the extensive imbrication and overlaps of which will generate epic discussions in the Courts. This perceived complexity is unlikely to favor achievement of the stated goals of prevention, predictability and trust.

Arduous also since, wishing to explain if not justify French practices, I felt it incumbent upon me to stand back from the Act to seek to explain this exceptional country where the best and worst stand side by side.

My decision to be objective and acknowledge the difficulties is unusual among auxiliary officers dependent on the Commercial Court system.

It seems to me, however, that this is the only way to raise awareness among honest and committed Commercial Court judges, concerned for the public interest. Their evolution requires an acknowledgement of international competition, boosted by the concern caused by forum shopping.

It is in fact highly comforting to see the need and desire displayed by certain Courts, among the more important, to measure up and to accept, once again, using their own resources, to build bridges with their prestigious US counterparts in order to understand and analyze the management and resolution of cross-border cases by agreement.

Let us wager that this first initiative launched by the Courts of Evry and San Antonio (Texas) will be the first of many, until these programs for exchanges and judicial cooperation are institutionalized. These approaches will lead to awareness of the need for the Courts in charge of economic difficulties to evolve into credible correspondents for the professional judges in common-law countries, in particular. The resulting emulation will be beneficial to debtors and to creditors.

As a result, Commercial Court judges will act as promoters of new professional practices to which the auxiliary officers will be required to adapt. This cultural upheaval will generate the handling of difficulties required by our society and economy.

Beyond the tools and professionals using them, it should be recalled that the individual stands at the heart of everything.

The fact that insolvency injures or even destroys individuals and their environment is inescapable. It is up to professionals and to the judicial institution to be able to listen, assist and allow individuals either to give up irreparably compromised situations, or to start up again.

The professional's role as "ferryman" should not be overshadowed by administrative or judicial duties. A noble mission is incumbent on professionals having chosen this fascinating area of the handling of distressed businesses.

To those who have taken the trouble to read this, I shall point out that the French exception that I am proud of having had the opportunity, over more than 15 years, to evolve with and thanks to that international community of colleague

lawyers, accountants, auditors and judges, passionately devoted to their professions and open to exchanges.

Let this document stand as a first approach for an unprejudiced analysis of the French commercial environment.

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