SITUATION OF INVESTORS AND CREDITORS IN CONNECTION WITH A COMPANY RESTRUCTURING

Does France offer a favorable environment for investment ? In connection with a restructuring, are creditors well protected ?

Until 2006, the World Bank's "Doing Business" reports answered in the negative. However, starting with the 2007 issue, the World Bank, aware that its methodology did not allow a proper evaluation of France's special features, invited a number of professionals, including this firm, to take part in the preparatory work and its analysis of criteria: unlike many countries, and in particular common-law countries, where asset-poor proceedings are not opened (Germany, UK, Poland, etc.), proceedings in France are opened for all distressed businesses in order, even if there are no assets, for all the aspects of the end of a business's life to be managed and in particular all the pending salary claims, through the National Salary-guarantee Fund. This explains the wide discrepancy and the fact that 90% of proceedings opened result in judicial liquidation.

The reform of the treatment of insolvency enacted is the outcome of very extensive consultations initiated in 1999, and resulting in a statute in July 2005. This reform has not, however, modified the background for French insolvency proceedings, which nevertheless remain a matter for the Courts.

As it has been reviewed at length in a commentary published in the Norton Journal of Bankruptcy Law & Practice under the title "The reform of insolvency proceedings in France: a professional's point of view", we shall mention only in passing the main lines of the reform, the environment and insolvency proceedings, before reviewing the position of investors and creditors in connection with a company's restructuring.

I - ENVIRONMENT FOR THE TREATMENT OF DISTRESSED COMPANIES

The judges making up the 184 French Commercial Courts are unpaid and frequently working at the time of their appointment. Most of them come from banking and industrial backgrounds.

The professionals of insolvency proceedings, administrators who assist in the restructuring and liquidators who handle the liquidation aspects, are auxiliary Court officers, and accordingly enjoy a monopoly, even though the law has sought to open to other persons eligibility for appointment in connection with preventive proceedings.

As the procedures are judicial, the Public Prosecutor's Office has a substantial supervisory role and right of appeal.

Nevertheless, in spirit, the new law has moved away from a highly administrative attitude, possible a hangover from the Code Napoleon, and has taken the market-based economy more into account.

It offers businessmen and their advisers various procedures, five in number, which will seek to deal with all the problems encountered according to the degree of foresight applied.

The reform's spirit is to develop upstream a preventive arsenal that will allow the business's main partners to sit down at a single table with the managers.

Upstream, the reform marks the success of counselling, a creation of the Courts in the early 1990s, and here again, institutionalizes the discussion between the business and its creditors in order to allow its restoration and durability.

REMINDER OF THE VARIOUS PROCEDURES

Counselling

This is a simple procedure, allowing the business manager alone to apply to the President of the Commercial Court for appointment of an officer nominated by the business manager, in order to assist him in its recovery.

The procedure is flexible and does not require the Court's involvement. Only those creditors accepting it take part in any forgiveness of debts. The agreement is strictly contractual.

The procedure is not publicized in any way.

When it is implemented, it allows two out of three businesses to be saved.

Mediation

In the event of foreseeable difficulties, business managers may make use of it (even if in cessation of payments provided that it occurred less than 45 days previously) and, as in the aforementioned procedure, apply for appointment of a mediator.

The use of mediation prevents the opening of proceedings for judicial reorganization.

The aim of this procedure is to facilitate an agreement between the debtor and its major creditors.

The mediation agreement can be validated in two different ways:
- a simple notice of the agreement taken by the President of the Court, without any publication, but in that case the mediation agreement is ineffective in relation to third parties and binds only the parties;
- approval of the mediation plan by the Court, which will provide additional security for past action. In addition, that approval will provide financial partners, through the attendant publication, with a guarantee that no action will be brought against them for undue support in respect of any assistance provided during the mediation period.

During this procedure, action for recovery brought by the creditors individually may nevertheless be stayed by the President of the Court, upon the debtor's motion and after obtaining the mediator's opinion.

The mediation procedure (replacing the former amicable settlement) has been a success. It grew by 300% in 2006, but in 90% of cases, according to the Paris Chamber of Commerce and Industry, approval is not applied for.

The rescue procedure

This procedure is the major innovation in the Act. The Minister of Justice set the tone for what the rescue procedure is designed to be by stating that "*it marks a change from the era of filing for bankruptcy to the era of application for judicial protection. The former sanctioned a failure, the latter carries a hope.*"

It offers a business manager unable to overcome difficulties that might lead to a cessation of payments an opportunity to apply for a freeze of the business's liabilities before it ceases payments.

This procedure will enable him to negotiate with the creditors a plan for restructuring of its debt, that will need to be validated by the Court.

The creditors on the Committees (one of financial institutions, the other of major suppliers) will be called upon to approve the plan submitted by the debtor.

This procedure is also included in Annex A to the European Insolvency Regulation.

Five hundred proceedings were opened in 2006, including 50% for businesses with fewer than 10 employees. They have allowed 11,000 jobs to be saved.

Judicial reorganization and judicial liquidation

The procedures of judicial reorganization and judicial liquidation have been maintained by the new law as formerly.

These proceedings are opened by the Court *sua sponte*, or upon a referral by a creditor.

Most of the provisions relating to the Company Rescue Act apply to judicial reorganization, in particular as regards Creditors' committees.

As regards judicial liquidation, a simplified procedure has been added to clear the Courts' backlog more quickly since in France, as mentioned above, all proceedings are opened, even if there are no assets. The simplified liquidation procedure (if there are no assets) will certainly be viewed

favorably by the Courts, which will see delays reduced. For creditors, as there will be no further economic incentive, they will receive the no-collection certificate enabling them to deal with tax aspects more promptly.

In these procedures, the main changes in the creditors' favor are the creation of creditors' committees in the proceedings for rescue and judicial reorganization, and the creation of a special priority for investors in the mediation procedure.

II. IMPROVEMENT OF CREDITORS' RIGHTS

The rights of a defaulting debtor's creditors were greatly reduced by the Act dated January 25, 1985. That statute had been viewed as rather unfavorable to creditors, since by some estimates, 60% of secured claims and 5% of unsecured claims had been paid since that statute's enactment, owing to the priority conferred on later creditors over creditors secured by special security interests.

The act of June 1994 sought to restore a balance between the secured creditors and the creditors of the business's reorganization by restoring the priority for certain special security interests in relation to later claims, known as "Article 40" claims. No additional special priority was granted for the funds contributed by investors during the reorganization.

The legislature sought to provide the creditors with even more room by reconsidering their position as genuine partners of the business. The creation of creditors' committees in the rescue procedure and the procedure for judicial reorganization is a step forward. In addition, the law has amended several rules, which are now more favorable to creditors.

1. Creditors' representation through the creation of committees

The practice of votes by the meeting of certified creditors existed in the 1967 act. What is new is the division of creditors into two classes: lending institutions, and major suppliers. Their mandatory establishment relates to criteria of size and turnover of the business, but it may also occur at the request of the debtor or administrator. The terms are left to the administrator's discretion.

The establishment of committees is designed to increase the creditors' involvement in development of the plan for the business's rescue or reorganization. The plan accordingly tends to become contractual in nature, through the role conferred on creditors' committees. The interests of minority creditors are protected, however, by the Court's review.

Establishment of these committees has been much debated. Whereas the law mentions persons, its application in the *Eurotunnel* case, in the name of economic pragmatism, relied on the nature of the claims. Appeals are pending before the Court.

2. Impact on the creditors' position of the forgiveness of public creditors' claims

Public creditors' claims account for a very substantial part of the liabilities of distressed businesses. By laying down a principle of forgiveness of public claims, the legislature intended a real change of culture.

The implementing decree relating to forgiveness of debts by public creditors, dated February 5, 2007, specifies that these waivers may not exceed three times the amount of private debt forgiven for the distressed business, and that the rate may not exceed a weighted average rate.

Nevertheless, having public creditors take part in waivers of claims is a real step forward for the business's private creditors since public creditors were previously always paid off on a priority basis. This change enables creditors to hope to see their turn come sooner in the discharge of liabilities.

3. Maintenance of claims: improvement of the fate of time-barred creditors

Claims not reported in the course of the proceedings opened will no longer be extinguished, as used to be the case. An unreported claim will now not be enforceable against the creditors collectively and the creditor may not take part in the share-outs, or claim his capacity as beneficiary of retention of an object belonging to the debtor, nor assert the off-set of related claims.

However, the claim shall remain effective in relation to the debtor and the creditor may claim against a personal surety the amounts due to him, unless he has deprived the surety of a preferential right or the latter enjoys the benefit of terms in a rescue plan.

In addition, as the creditor has not forfeited his right, he may now report his claims in proceedings opened subsequently, if the plan is converted into a judicial reorganization or liquidation.

Finally, since the claim is not extinguished, he may now resume individual proceedings once the requirements are satisfied.

4. Release from the duty to report claims

Creditors subjected to a plan for continued operation or rescue that has been rescinded and in respect of which new proceedings have been opened are no longer required to report their claims in the new proceedings opened. Their claims are admitted as of right, after deduction of amounts already recovered. This provision is naturally such as to improve the protection of creditors' rights.

The law has also accepted the principle of no report of maintenance claims created by precedent.

5. Extended powers of controllers

Creditors meeting the requirements of the law (no links to the debtor, no direct or indirect holding of the business's stock) may apply on a unilateral basis for appointment as controllers in the

proceedings opened. This option already existed and they were consulted and informed throughout the proceedings. What is new is the extension of their powers: they may act in the creditors' collective interest in the event of default of the liquidator after notice remaining ineffective for two months. They may also apply to the Court, during the monitoring period, for a partial discontinuation of operation. In order to secure their independence, the Public Prosecutor's Office has sole authority to apply to the Court for their dismissal.

6. Other amendments

a. Selection of the procedure

Creditors may apply for the opening of proceedings for judicial reorganization or judicial liquidation; the other preventive procedures are up to the debtor, however.

Their application is no longer required, as formerly on penalty of inadmissibility, to contain a statement of the enforcement measures sought.

b. Payment of installments

The law organizes in the same manner the terms of satisfaction of creditors enjoying liens or security interests *in rem* if the charged asset is sold, but specifies that henceforth the portion of the price relating to such secured claims shall be paid to the *Caisse des Dépôts et Consignations* (public depositary). Payment of installments may be made more promptly.

c. Disclosure to the creditors

The law has also extended to all parties to published contracts (and no longer merely to parties to hire-purchase contracts) the obligation to give them personal notice and caused the two-month period to run not from the time of publication of the judgment in the BODACC but from the notice given by the administrator. If none is given, the period does not run.

d. Remedies

Creditors who consider that they have been harmed by judgments determining plans for rescue or reorganization may henceforth use the remedy of third-party appeal, which they were denied by the former legislation. The extension of remedies is also part of the improvement of the creditors' position.

III. INVESTORS IN THE MEDIATION PROCEDURE

Owing to changing attitudes, globalization and naturally the Basel II rules which will make credit more difficult to obtain for businesses, new constructions and new operators (hedge funds) are getting involved, and a real market for restructuring is being observed at the international level.

This market is still in its infancy in France, but will certainly develop.

Certain provisions of the law have resulted in an improvement and greater effectiveness of the insolvency proceedings, and made the activity of lending to businesses, including distressed businesses, more attractive. These are first a priority granted to parties contributing, in connection with mediation proceedings, new money to a distressed business or supplying goods or services in order to secure its continued operation, and second, a principle of absence of liability granted to those investors.

I. The new payment priority

The new law grants a priority in connection with mediation proceedings (often referred to as a "new-money priority") to lending institutions and/or suppliers granting new receivables (credit, advances, overdrafts, etc.) to the distressed business when an approved agreement is made.

The legislature has sought to incite stakeholders in the business to provide their support to the distressed business while limiting their risks of not being paid (which previously accelerated the business's bankruptcy). The purpose of this provision is accordingly to increase the chances of the business's recovery.

This means that those investors would be satisfied on a priority basis with respect to all claims prior to the judgment opening subsequent proceedings for rescue, judicial reorganization or liquidation, if the mediation plan were to be rescinded, even if the other creditors' claims are secured. The creditors enjoying this priority are accordingly sure to retain it regardless of the changes that may be made.

It should be pointed out that shareholders are eligible for this priority if the contributions are made in current accounts, but are excluded in relation to a capital increase.

The information report on implementation of the Company Rescue Act noted that Article 36 of the Decree dated December 29, 2005, which provides that a notice of the approval judgment is to be sent for publication in the BODACC, ought to be amended. This causes excessive delay, whereas the new money is paid only once the approval judgment has been rendered in the case of rescue deals involving major international players, as was the case for the Bank of America (intervening for a hedge fund which had acquired the company's debt for EUR 48 million), which paid EUR 30 million in January 2006 for the IT company Infogrammes.

The solution contemplated to reduce delay to a minimum would be direct publication with the Registry of Commerce and Companies, which takes only a few days.

For small and medium-sized businesses, the traditional banks continue to pay funds without requiring publication of the agreement, and are satisfied with an agreement of which the Court has taken notice: these banks, which during the parliamentary proceedings demanded the grant of

security through approval, have found that the publicity of the approved agreement usually led to worse financial difficulties, and now prefer a mediation with notice. Will they claim extension of the priority to all mediations of which notice has been taken ? That would be a blow struck against approval, but also against confidentiality of the agreement.

2. Absence of undue support or liability of creditors

Action has been taken to secure the position of a creditor, usually a lending institution, running the risk of supporting a distressed business: banks were often charged with undue support, defined by the case-law as credit granted by an institution to a business, the position of which was irretrievably compromised. This conferred on the business an appearance of solvency that might damage third parties, and banks were very frequently held liable in tort on that basis.

To guard against this risk, lending institutions did not grant the loans that would have allowed those businesses to recover, and thereby accelerated their debtors' bankruptcy.

Article L.650-I has laid down a principle of absence of liability. Creditors will henceforth incur liability only in three situations:
- in cases of fraud;
- in the event of interference in the business's management; or
- if the security obtained is out of proportion with the funding granted;
in which case the security granted would be void.

While this article clearly aims mainly at the liability of banks, it is nonetheless a fact that in France, supplier credit is very important and that this article could well apply to their situation.

The information report found that this Article (L.650-I) made banks cautious: the law has not specified which forms of security would be avoided. According to the rapporteur, the drafting ought to be amended, as the legislature did not intend to avoid all the protection obtained, but only disproportionate security.

CONCLUSION

In general, the Act dated July 26, 2005, after much consideration, taking foreign experiences into account, has sought to restore a more important standing for creditors in the course of insolvency proceedings, and to provide investors with security through the mediation priority in order to secure the business's survival.

The review of creditors' rights in connection with the business's restructuring has also shown that the legislature's economic vision has developed and that it has granted priority to the preventive tools in order to meet the challenge of saving the business while satisfying the creditors.

It is still too soon to ascertain the impact of the legislation passed, but the early statistics are highly encouraging, and the Supreme Court and legal writers can be expected to provide solutions where there may be a few difficulties.

TABLE OF PROCEDURES - ACT DATED JULY 26, 2005

The procedures below are not relevant to non-tradesmen individuals, who are eligible for a specific procedure: personal recovery.

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
Purpose of the procedure	Favoring the execution of an amicable agreement between the debtor and its major creditors intended to put an end to the business's difficulties (L.611-7)	Facilitating reorganization of the business in order to allow continuation of the economic operation, maintenance of employment and the discharge of liabilities	Allowing continued operation of the business, maintenance of employment and the discharge of liabilities (L.631-I)	Putting an end to the business's operation or realizing the debtor's assets through a comprehensive or separate sale of his rights and assets
Initiative of opening	Debtor (L.611-6)	Debtor	- Debtor (within 45 days) - Court *sua sponte* - Referral by the Public Prosecutor's Office - Creditor	- Debtor (within 45 days) - Court *sua sponte* - Referral by the Public Prosecutor's Office - Creditor
Requirements for opening	- Cessation of payments less than 46 days previously - Undergoing actual or foreseeable legal, economic or financial difficulties (L.611-4)	- Absence of cessation of payments - Providing evidence of insuperable difficulties of a nature such as to cause cessation of payments - Not being currently subject to proceedings for rescue, judicial reorganization or judicial liquidation	- Cessation of payments - Not being currently subject to proceedings for rescue, judicial reorganization or judicial liquidation	- Cessation of payments and recovery manifestly impossible - Not being currently subject to proceedings for rescue, judicial reorganization or judicial liquidation

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
Stay of proceedings and accrual of interest (except loans for more than a year)	- Optional during the mediation phase, with a deferral or rescheduling of debt up to two years (Art. 1244-1 *et seq.* of the Civil Code) in relation to the creditor taking action - If approved agreement, stay of proceedings (Art. L.611-10)	Yes	Yes	Yes
Thresholds		If less than EUR 3 M and fewer than 20 employees at the date of opening of proceedings, option not to appoint an administrator	If less than EUR 3 M and fewer than 20 employees at the date of application or if referral *sua sponte* by the date of calling of the debtor, option not to appoint an administrator	If no more than EUR 750,000 at the close of the latest financial year and no more than 5 employees at the date of opening of proceedings, application of simplified treatment If more than EUR 3 M and/or more than 20 employees at the date of opening of proceedings, mandatory appointment of an administrator for continued operation If more than EUR 3 M and/or more than 20 employees at the date of opening of proceedings, mandatory representation of the Public Prosecutor's Office at the discussions for determination of the sale plan

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
		If EUR 3 M and 20 employees at least at the date of opening of proceedings, mandatory appointment of one or more experts by the Court If more than EUR 20 M or more than 150 employees at the date of opening of proceedings, mandatory creation of creditors' committees If more than EUR 3 M and/or more than 20 employees at the date of opening of proceedings, mandatory representation of the Public Prosecutor's Office at the discussions for determination of the sale plan		
Duration of proceedings	4 months + 1 month at the mediator's request	Monitoring period of 6 months subject to one extension + special extension at the request of the Public Prosecutor's Office, not to exceed 6 months	Monitoring period of two months + 4-month extension if financial capacities sufficient + 6 months + exceptional option for extension up to 6 months	No duration Simplified judicial liquidation: not to exceed 15 months
		Special feature: Creation of two creditors' committees in excess of specified thresholds (see thresholds)		
Possible outcomes	- Notice taken of an agreement, at the parties' joint request, by the President of the Court with the main creditors, or approval of the agreement at the debtor's	- For non-committee creditors: rescue plan for a maximum term of 10 years (only exception: for farmers, the 15-year duration for the plan has not been amended) - For committee-member	- Reorganization plan for a maximum term of 10 years (except for farmers, for whom the 15-year duration for the plan has not been amended) - Reorganization plan, and	- Discontinuation of operation and sale of the business's assets - Continued operation (3 months + 3 months at the request of the Public Prosecutor's Office) and sale of the business

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
	request - If no agreement possible, termination of the mediator's assignment	creditors, no maximum term - Discontinuation, addition or sale of one or more operations	if appropriate, discontinuation, addition or sale of one or more operations	
Effect if not performed	Rescission of the agreement by the Court Lapse of the agreement if proceedings for rescue, judicial reorganization or judicial liquidation are opened	Rescission of the plan and opening of proceedings for judicial liquidation	Rescission of the plan and opening of proceedings for judicial liquidation	
Dismissals	According to generally-applicable rules	According to generally-applicable rules or rules for sale of the business, if sale of operation	Pursuant to an order of the Supervising Judge or judgment determining the reorganization plan with or without sale of part, or judgment determining a complete sale of the business	By the liquidator, by the judgment determining sale of the business
Involvement of the AGS	No	Yes, but not automatic, only for severance pay arising out of dismissals for economic reasons ordered during this period or within one month after determination of the rescue plan, and to the extent	Yes, as before	Yes, as before

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
		of the maximum cover determined by Article D. 143-2 of the Labor Code		
Effect on sureties and co-obligors	Individual sureties, co-obligors and providers of independent security may rely on the approved agreement.	Individual sureties, co-obligors and providers of independent security may rely on the stay of proceedings during the monitoring, then the plan period.	Individual sureties, co-obligors and providers of independent security may rely on the stay of proceedings during the monitoring period. They may not rely on the plan.	Individual sureties, co-obligors and providers of independent security may not rely on the stay of proceedings.
Effect on claims	Mediation priority Art. L.611-1 for a new contribution of cash or the supply of new goods or services If the agreement is approved, the claim shall be paid after satisfaction of the employees' claims and Court costs in the proceedings opened subsequently for rescue, reorganization or judicial liquidation.	Art. L.622-17 These are claims arising duly for the purposes of the proceedings or during the monitoring period, or in consideration of a service provided to the debtor for its operation. They rank 4th after the mediation priority. Personal claims and tortious debts are excluded. A subsequent unpaid claim enjoying the priority shall be	Art. L.631-14 applying Art. L.622-17 As in rescue	Art. L.641-13 Unpaid claims validly arising after the judgment opening judicial liquidation rank 5th after the priority under Art. L.611-11 and claims secured by special real or personal charges.

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
		reported to the auxiliary officer, administrator or agent in charge of the plan or liquidator within one year after the end of the monitoring period.		
Advantages of the procedure	- Forgiveness of debts, including tax and welfare, other than indirect taxes and contributions on salaries - Confidentiality if agreement with notice - If approved agreement, -- the suspicious period for any subsequent proceedings for judicial reorganization may not start before the ruling approving the agreement, subject to proven fraud -- stay of proceedings and establishment of priority for sureties and co-obligors.	- Stay of proceedings - Optional forgiveness of principal by public creditors, including tax and welfare - Tax deductibility of forgiven claims - The absence of penalties for the manager is an incentive, as for sureties.	Establishment of committees	Expedited procedure if no assets
Drawbacks of	- No tax deductibility of	- Cumbersome	Sharing of tasks for the	

	Mediation	Rescue	Judicial reorganization	Judicial liquidation
the procedure	forgiven claims - Confidentiality destroyed by approval of the judgment If no approved agreement - no stay of proceedings - no release for sureties - no security of commitments	- Powers of controllers	sale between the administrator and liquidator	