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The Reform of Insolvency Law in France: The 1999 Orientation Document

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Introduction

The French Government is at present undertaking a raft of reforms with the aim of modernising the country's justice system and providing its users with a wide range of sophisticated legal tools apt to meet the challenges of globalisation. Part of these reforms concern the commercial environment and will involve radical changes to company law, insolvency law and the commercial justice system. Although the framework for insolvency law and practice is of comparatively recent vintage, dating to the reforms of 1984-85,¹ there have been moves over the years to refine its provisions, most recently in 1994 following criticisms from creditors and financial institutions whose interests were not being met by the social-oriented legislation.² Despite these changes, further criticisms emerged especially in relation to insolvency practice from eminent members of the insolvency profession.³ Media and public interest stepped up pressure for reforms in the commercial justice system following allegations of financial improprieties on the part of insolvency professionals and commercial court judges in hitherto well-regarded jurisdictions.⁴

The overall level of public concern led Elisabeth Guigou, the Minister for Justice, to announce in 1997 wide-ranging reforms involving the reinforcement of penalties for delinquent supervising judges, closer scrutiny of insolvency practitioners' accounts, a requirement that insolvency funds be deposited with an official body and a greater role for public prosecutors in insolvency proceedings. At the same time, the National Assembly and the Inspectorate-General of Finances and Inspectorate-General of Judicial Services opened enquiries into the commercial justice system, the outcome being reported in a 1998 press statement recommending widespread reforms to the commercial justice system, professions linked to commercial justice and the framework for insolvency law.⁵ In relation to insolvency practice, the Government acted swiftly to produce subsidiary legislation aimed at restoring

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

²Law no. 94-475 of 10 June 1994 (Insolvency Reform Law). See Vallens, A propos de la réforme de la loi sur les entreprises en difficulté: Le rapport du groupe de travail du ministère de la justice, *Les Petites Affiches*, 18, 21 and 23 February 1994, Nos. 21-23, at 11, 4, 15.

³See Soenne, *Le Bateau Ivre* (A propos de l'évolution récente du droit des procédures collectives), *Les Petites Affiches*, 14 and 16 May 1997, Nos. 58-59, at 2 and 4.

⁴See Fortin in *Challenges*, January 1998 edition at 48 citing the courts of Paris, Bobigny, Nanterre, Nice and St. Lô.

⁵These last reforms may also be prompted by continuing unfavourable statistics. In 1993, 70,000 business insolvencies occurred with 93% liquidated and 300,000 jobs lost. In 1997, 58,000 business insolvencies occurred with 90% being liquidated and 325,000 jobs lost.

public confidence through new measures regulating entry and practice conditions for insolvency professionals.⁶ These texts were holding measures, pending the introduction of legislation to reform both insolvency procedures and practice. Pursuant to this initiative, the Ministry of Justice issued a paper in early 1999 in the form of a “preparatory orientation document”.⁷ This text outlines proposals by the French Government with respect to the regulation of insolvency law and will, if legislation is enacted in accordance with these proposals, bring about substantial reform to the framework for insolvency proceedings.

The Scope of the Reforms

The reforms outlined in the document contain both substantive changes and a number of technical amendments seeking to streamline the rules of insolvency generally. The overall scope of the reforms is aimed at substantive changes in five discrete areas with view to improving the efficiency of insolvency law procedures, these being (in the order they appear in the law):

- diagnosis and prevention of financial difficulties at a stage before the formal onset of insolvency;
- informal treatment of business difficulties through compositions and agreements with creditors;
- formal definitions of insolvency;
- proper supervision of rescue plans;
- definition and simplification of liquidation procedures.

Diagnosis and Prevention of Financial Difficulties

The Government’s initiatives in this area look to reforms around three particular points, the role of the auditor, the means of diagnosing financial difficulties and the control of company reporting measures.

On the role of the auditor, whose diagnosis and subsequent notification of the appropriate authorities is deemed essential to bring into play prevention measures, the Government seeks to avoid two problems encountered at present, the first being the question of professional ethics and client confidentiality, the second the delays while steps within the procedure take place. Business professionals have mixed views on the client confidentiality aspect,⁸ noting that while lifting the restriction on professional information might lead to the auditor being able to inform the court at an early stage, the result may well be to discourage company officers from sharing all necessary information with the auditor. As to procedural delays, a way around the current legal constraints requiring completion of particular formalities might

⁶Decree no. 98-1232 of 29 December 1998, Circular no. 99-4 of 26 January 1999 and Arrêté of 16 August 1999.

⁷Document d’orientation préparatoire.

⁸For an exhaustive look at Government proposals from the point of view of business, see Courtière, Réforme du droit des entreprises en difficulté: réaction au document d’orientation de la Chancellerie, Chambre de Commerce de Paris (CCIP) Report (February 1999), available at the CCIP website: <www.ccip.fr>.

see the auditor given a new role in encouraging company managers to seek professional advice for any business difficulties faced.

On the methods for diagnosing and detecting financial problems, the document does not seem to take the views of business on access by the courts to documents held by tax authorities and the Banque de France, which at present can only take place within the context of formal proceedings as a result of a decision by the court to investigate the company's health. As a compromise, the Government will seek to reform the structure of the court registry so as to make more use of company information whose filing is required by law. The views of business with respect to this last proposition are positive, noting that the functioning of the commercial courts is under review and that it would be appropriate to deal with the status of the registry and fees charged for access to information. Nevertheless, the question of suitable access by the court to administrative documents is felt by business to be one meriting discussion, particularly around the questions of the possibility of early diagnoses and interventions as well as more generally on the question of keeping business matters confidential.

On the control of company reporting measures, the Government wishes to reinforce present arrangements by making the obligation incumbent on auditors to verify whether accounts have been filed and to remind management of their obligations. In cases of persistent default, the auditor is required to notify the public prosecutor's office. Company management will have new penalties applied, consisting of a daily fine for failure to file accounts and the possibility, should the business subsequently go insolvent, of further sanctions in the course of insolvency proceedings. The views of business are on the whole positive to this development and would also suggest that the court be entitled to summon the auditor for an explanation where a failure to file accounting documents has been detected.

Suggestions from the business world to make the diagnosis and prevention of financial difficulties more efficient include creating a level playing field at national level given existing disparities in treatment between the different commercial courts. Reforms would be enhanced by the creation of specialist groups within commercial courts dealing exclusively with diagnosis and prevention points. The Government has already responded to some of these points by reducing the number of courts to encourage better use and targeting of resources. Business leaders have also suggested that the present system of prevention groups⁹ could be replaced by less formal arrangements such as resort to consultancy and specialist advice. From the point of view of business, the advantage would be the ability to maintain the requirement of professional confidentiality and for business to enjoy the flexibility to call for specialist advice as and when necessary.

Informal Treatment of Business Difficulties

⁹This consists of Government sponsored associations inviting companies to become members with view to providing them with auditing and specialist information services.

As part of its reforms, the Government seeks to redefine the contractual nature of the voluntary arrangements procedure and to emphasise its distinctiveness compared to insolvency proceedings. Reforms would concentrate on the role of the court in approving voluntary arrangements, the use of the moratorium and the status and responsibility of the nominee and the public prosecutor within proceedings.

On the role of the court, the fact that voluntary arrangements are conceived as being contractual in nature is not seen as an obstacle to the exercise of supervision by a court. This has the benefit of allowing court-approved agreements to be enforced on the parties. The Government seeks to improve these arrangements by requiring all agreements to be filed in court, even if they are only arrangements with principal creditors, by giving the court discretion not to approve arrangements, even where these have been concluded between the debtor and all the creditors, by allowing the court to better define the purpose of any agreement, and by amending the current law which makes the existence of arrangements a bar to later proceedings avoiding payments during the relation back period.

The views of business are positive with regard to requiring all arrangements to be filed in court and giving the court discretion on the approval it gives, this latter especially because many creditors rely on courts to enforce agreements and court consideration of the contents of the agreement is viewed as vital to securing the interests of creditors. Reaction to allowing courts to assist in defining the purpose of the agreement is more negative, the fear being that the courts will in fact remove the contractual underpinning of arrangements by interfering in the writing of the agreement. On the interplay between voluntary arrangements and the relation-back period, the views expressed agree with the Government that the existence of voluntary arrangements cannot operate so as to cover transactions that should legitimately be impugned for the benefit of any subsequent insolvency proceedings.

On the moratorium, the Government intends to remove this institution completely on grounds that, despite its utility as a method of persuading recalcitrant creditors to negotiate, it is often misused by debtors to avoid more formal insolvency proceedings. This has the effect in many cases of unrealistically making the situation of the business appear more optimistic than it is, resulting in further involvement by creditors to their detriment. The views of business are genuinely ambivalent with some agreeing that a moratorium would seem incompatible with what are, after all, contractual arrangements and would lead to the creation of a virtual mini-insolvency procedure without many of the formal rules designed to offer creditors protection being available. Nevertheless, many insolvency practitioners, called to act as nominees in voluntary arrangements, underline the effectiveness of the moratorium as a tool dissuading creditors from striking out on their own and forcing them to negotiate for the collective benefit. One compromise the Government is putting forward would allow for recourse to early insolvency proceedings at the instance of the debtor as an alternative to the moratorium, the threat having a similar dissuasive effect on creditors.

On the status of the nominee, the Government intends to introduce rules affirming the independence of nominees and supervisors of ad hoc mandates by prohibiting the simultaneous exercise of functions within arrangements and that of a commercial court judge or paid employment connected with the company in question as well as a role for the public prosecutor's office in delivering an opinion on the suitability of the person nominated to act. Practice insurance would also become a formal requirement. The reaction of business to these points is very positive. Nevertheless, in relation to another proposal, that of creating a definition for the role of the nominee in the law, business appears unfavourable, the argument being that the mandate and voluntary arrangement already offers a framework flexible enough to cover a variety of purpose and a definition would not add greatly to this.

The Government also wishes to see an enhanced role for the public prosecutor by requiring notice of voluntary arrangements and ad hoc mandates to be served on the court and the public prosecutor's office. The views of business are favourable only so far as voluntary arrangements are concerned and are deeply hostile to any attempt to make the ad hoc mandate subject to scrutiny of this type, the practice already being that the president of the court appointing the supervisor of an ad hoc mandate is kept informed of progress.

Formal Definitions of Insolvency

The Government is looking to reform the formal definition of insolvency, currently stated as being the moment where the business concerned finds it impossible to meet a due debt with the assets available at its disposal.¹⁰ The reasons given include the overall technical bias of the definition and its failure to create the right conditions for the opening of insolvency proceedings, leading to anticipated filings in the case of otherwise solvent companies and failure to file by some insolvent companies, with consequent detriment to the debtor and creditors respectively. The government intends to avoid the purely accounting based definition of a comparison of assets and liabilities and to add to the definition a requirement that the business be in a "compromised situation likely to persist".¹¹ As an alternative to this, debtors will still be able to petition for insolvency proceedings despite not being technically insolvent provided that insolvency is a likely outcome and that voluntary arrangements would not greatly assist as a solution to business difficulties.

The views of business concur in that the definition at present is unworkable and has led to difficulties in application, resulting in unequal treatment for businesses verging on insolvency. Nevertheless, the business world as a whole is keen to ensure that these definitions maintain the dividing line between pre-insolvency procedures and insolvency proceedings and do not lead to any reduction in the availability of the right procedures for the needs of particular debtors. One comment about the extended definition of a "compromised situation" is that this might tend to reduce the number of

¹⁰Article 3, Insolvency Law.

¹¹Situation durablement compromise.

businesses qualifying automatically for rescue proceedings, leading to attempts at voluntary arrangements or other forms of compromises, not all of which might be suitable for the needs of the debtor concerned. Furthermore, the definition carries an element of subjectivity that might lead to difficulties of appreciation, given the close resemblance to the definition for liquidation of “a situation in which rescue is manifestly impossible”. This could lead to some businesses being consigned to liquidation prematurely. On the whole, a change in the definition is warranted and an alternative canvassed by business is perhaps for the law to widen the definition of those assets which a business may take account of when comparing its asset-base to outstanding liabilities.¹²

On the question of debtor-led procedures, the view of the Government is that debtors should be permitted to file for rescue as an alternative on the same pre-conditions as for voluntary arrangements, where these latter would not be suitable because of particular needs of the business, for example to conduct redundancies and dispose of major assets. The Government is, however, cautious in that it does not wish to see the rescue regime become a purely business technique for periodic reconsolidation and would require some proof that the business in question has a cogent need for rescue. Business response to the Government’s recommendation is positive on the principle that debtors should have early access to rescue procedures but, by way of adverse comment, looks at the question of the preconditions, especially the need for forecast accounts, at present an option for most small and medium enterprises, but which in practice are relied on to provide proof of the insolvent status of the business. These are not always to be found in the case of businesses most in need, for whom the benefit of insolvency proceedings might be lost if this were the only proof courts would accept for the opening of proceedings.

Proper Supervision of Rescue Plans

At the heart of the formal rescue regime, rescue plans feature on the Government’s list of reforms, notably looking at changes in the role of the public prosecutor in proceedings, the nature of supervision of rescue arrangements and, in relation to sales plans, better control of the asset disposal process.

On the role of the public prosecutor, the Government will seek to bring in amendments allowing the public prosecutor to scrutinise rescue plan proposals and to be present at hearings at which rescue plans are adopted or dissolved. In themselves, these are not revolutionary ideas, meeting as they do the wishes of business for involvement by the public prosecutor’s office in an attempt to ensure protection of the overall interests at stake. In fact, the business world would go further and ask for mandatory representation of the public prosecutor’s office at all of the most important stages of the process, especially, as is also the case with liquidation noted below, in connexion with the disposal of substantial assets and units of production. Nevertheless, there

¹²Examples would include stock-in-trade and debts owed to the business.

is a recognition that resources will have to be invested by government in providing training and staff to meet the demands of increased procedural representation and that reforms in this area should take place in the context of changes to the framework governing the administration of commercial justice that are at present under consideration.

On the aspect of supervision, the Government contemplates that appointment as supervisors of rescue plans should go to the administrator of rescue proceedings or, in default, to the creditors' representative.¹³ Furthermore, new powers are to be given to rescue plan supervisors as well as new obligations, for example to ensure that proceeds of rescue are deposited with the Government's official deposit-taker. The Government also wishes to close a lacuna in the law to allow, where a creditors' representative remains in place after the adoption of a rescue plan, this person only to become *functus officio* after a definitive list of debts has been established and not, as at present, when the debts have been ascertained. The views of business strongly coincide with those of Government on all of these points with the exception of the first, where the feeling is that the creditors' representative is best placed, having supervised the proof of debt stage, to divide resulting proceeds amongst creditors. In any event, the business world would like to see maintained current provisions giving the court discretion as to whom it wishes to appoint, which at present also extends to non-practitioners albeit with experience or special expertise.

On the disposals process in the case of sales plans, the Government wishes to see greater rigour in the examination of proposals, especially in determining whether the offeror has the necessary means to carry the proposal through and are not made on a speculative basis. Business representatives point to existing practice requiring offerors to deposit funds with the court and provide a forecast for any disposals of assets within two years of the takeover as being a sufficient guarantee that would-be asset strippers are dissuaded from making bids for insolvent companies. In contrast, however, the question of sanctions for offerors failing to meet their obligations is still open, according to commentators, who feel that the present sanction of dissolution of the rescue plan is more likely to adversely affect the future of the rescued business than the offeror. There is also the question of substitution of performance by means of which a third party takes over the contract by means of a substitution clause in the rescue plan, a practice that is reluctantly accepted by the courts but of which business leaders are not in favour, their views being that there should be clear indications of the identity of future shareholders in the rescued business and a guarantee by the named offeror of compliance with the terms of the rescue plan.

Definition and Simplification of Liquidation Procedures

The reforms the Government intends to introduce in this area concentrate on the purpose of liquidation proceedings, the simplification of its structure and the transparency of asset disposals in the course of liquidation.

¹³The creditors' representative is more often than not a liquidator by profession.

In connexion with the definition of liquidation, the Government wishes to underline the purpose of liquidation as being to gather in assets with view to satisfying the creditors as far as possible. The Government does not want to change the conditions in which liquidation was reformed in 1994 avoiding the need for prior intervention in the form of rescue proceedings. The pre-requisites for insolvency, however, the cessation of business activity and the irremediable state of the company are to be made joint requirements in the case of creditor-led proceedings and alternatives in the case of debtor filings. The views of business on the overall aim of the reforms is helpful, although doubts are raised about the wisdom of making the conditions concurrent as this might result in the opening of rescue proceedings inevitably destined to become liquidation proceedings where the business happens to fail at the point of filing to meet one of the criteria.

On the simplification of insolvency, the Government acknowledges a need in the case of insolvencies involving very small asset bases for there to be an appropriate procedure that does not absorb in costs or fees the amount realised by way of assets gathered in for the satisfaction of creditors. This entirely concurs with the expectations of the business community. The orientation document proposes the creation of a new and express simplified procedure which would remain under the supervision of the court but which would include a rapid enquiry into the state of the business. By way of contrast with existing procedures, creditors would not have their rights of enforcement suspended but may sue the debtor to recover within six months of proceedings being opened. Only after this period would the liquidator intervene to ensure that any remaining assets would be divided *pari passu* among all the creditors.

The views of business on whether retaining individual enforcement rights is desirable would depend on the type of enterprise under consideration. Where the business has no assets or employees to speak of, proceedings could be simplified to the extent of being a pure administrative formality, winding up the business and removing it from the register. Where the business has a weak asset base and/or employees, simplified proceedings could be opened but with a moratorium on enforcement for the benefit of all creditors, in which case a liquidator would only be appointed for a short period to gather in the assets and conduct the redundancy procedure. There would be a very short enquiry into the state of the business and no proving of debts, although the liquidator would retain the right to ask that proceedings be converted into normal liquidation on stated grounds.

On the transparency requirements, the Government is keen to avoid criticisms of liquidation which, at best, did not ensure equality among candidates seeking to acquire assets and, at worst, afforded opportunities for the acquisition of assets at substantial undervalue by unscrupulous parties. The orientation document provides the public prosecutor with an enhanced role in supervising liquidation proceedings by requiring his consent in cases of sales of substantial assets as well as whole units of production. This meets

wholeheartedly with the approval of business, which called for this measure to be introduced for assets worth more than FF250,000.

Furthermore, advertising requirements in cases of asset disposals will be introduced using the opportunities of new technology. This is aimed at giving would-be offerors a wider opportunity to bid for assets besides potentially increasing through more open competition the likely realisable value of assets. To a certain extent, these proposals would also avoid the occurrence of a problem experienced at present, that of liquidation being used as the favoured method for asset disposals because of procedural advantages, including easier terms for worker redundancies, lower asset prices and the overreaching of charges over assets being attached to proceeds.

Summary

The proposals for reform contain a large number of measures destined to affect all areas of insolvency law from the diagnosis of business difficulties to liquidation, passing through the definition of insolvency and aspects of rescue procedures, including the all-important disposals of the business or its assets through a rescue plan. It is an ambitious project, not the least because it attempts to provide answers for perennial economic problems. The reforms can not be said to be more debtor or creditor oriented, given that they contain both reforms directed to the purpose of insolvency proceedings as a method of satisfying creditors' needs and those allowing the debtor a measure of freedom in directing the course of insolvency, principally by opting between formal and informal procedures. In fact, the reforms may be said to be targeted more to the functioning of insolvency law, which has come under scrutiny in France for being slow, inefficient, expensive and potentially prone to abuses. Many of the reforms look to streamlining procedures and removing causes for concern by providing for appropriate supervision. Others look to transparency of the workings of the process and equality between participants.

Nevertheless, reform of insolvency law is not among the first set of finalised texts submitted to the Council of Ministers in July 2000 as part of the ongoing process of reforms to the commercial justice system and related areas, although a clause seeking to remove the moratorium does feature in one of these texts, which include laws on changes to the composition of Commercial Courts and to Courts of Appeal hearing matters on appeal from the jurisdiction of the Commercial Courts as well as a draft law substantially amending the framework dealing with insolvency practitioners. These texts are all intended to enter into force in early 2002 and join a law passed in 1999¹⁴ as well as further draft proposals seeking to amend the economic framework for company law due for legislative consideration in the course of 2000. All of these texts form what the Ministry of Justice describes as: "essential elements of the Government's plan to adapt [France] to meet the needs of increased economic efficiency".¹⁵ In connexion with the production of the text on

¹⁴Law no. 99-587 of 12 July 1999.

¹⁵From the general outline presentation of these reforms on the Ministry's website at <www.justice.gouv.fr>.

insolvency practitioners, commentators have questioned the wisdom of pushing ahead with reforms to practice conditions without waiting for developments in relation to insolvency law, despite the fact that the latter are considered the most urgent of all the reforms.

At the same time, there are questions as to the precise timetable for the reforms outlined in the preparatory orientation document, given that the Government is also proceeding to the recodification of the Commercial Code, with the intention of including insolvency law and practice within its text.¹⁶ Whatever consolidation or amended text may ultimately emerge, it is perhaps right, in light of the scandals affecting the world of politics and business generally and the loss of faith in the ability of the business community to deliver economic prosperity for more than a limited class of entrepreneurs, that the Government should attempt reforms on this scale so as to reflect widespread public concerns about the probity of the commercial justice system and to install measures restoring public trust in an area of law with at best an indifferent reputation. Insolvencies after all affect a considerable number of French businesses and associated employment prospects. In a country wedded to the ideas of social cohesion and the ideal of full employment, the management of insolvency lies at the heart of the political agenda and its integrity and efficiency are accordingly high priorities for Governments of whatever political colour in France.

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¹⁶Law no. 99-1071 of 16 December 1999 authorising the Government to adopt, because of pressures on Parliamentary time, ordinances recodifying major codes, subject to later ratification by Parliament.