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## *Terminal Decline of a Business: The Institution of Liquidation Judiciaire in France*

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# **Terminal Decline of a Business: The Institution of *Liquidation Judiciaire* in France**

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## **Introduction**

The history of the modern institutions of insolvency begins in 1889,<sup>1</sup> with the law that first introduces the institution of French insolvency known as *liquidation judiciaire*. This was designed to improve the fate of luckless debtors, who had previously been dealt with under the provisions of penal statutes, in situations where insolvency was not due to an absence of good faith on the part of the debtor.

The first substantial reform of the law relating to insolvency appeared in 1955,<sup>2</sup> which introduced a new system of *règlement judiciaire*, or recovery proceedings, in substitution for *liquidation judiciaire*, that provided for two possible outcomes, either the re-establishment of the debtor in business and the partial or total payment of the creditors or the realisation of all the debtor's assets and the extinction of the business.

Where the insolvency was due to the fault of the manager of the business, an alternative procedure was employed to sequester the debtor's assets and force liquidation so as to drive the blameworthy tradesman out of business. The result of these twin procedures was not always equitable, with many businesses going needlessly to the wall and others, less apt at survival, lingering on with detrimental consequences before their collapse.

The modern institutions as they exist were formed by the provisions of the law of 1967.<sup>3</sup> This retained *règlement judiciaire* and reintroduced *liquidation judiciaire*, renamed *liquidation des biens*. A court was called upon to choose which of these two procedures to follow in the event of an insolvency.

*Règlement judiciaire* was chosen if the court was satisfied that a likely outcome of the negotiations was a concordat, resulting in the debtor remaining in business. If there was little possibility of the business surviving, *liquidation des biens* was ordered so as to realise the assets of the debtor. The fate of the business was decided in line with the court's view of its viability. If a court, having ordered *règlement judiciaire* subsequently changed its views, liquidation was normally ordered. Unfortunately, the converse was not at all possible, the initial view prevailing resulting in the destruction of a possibly viable business.

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<sup>1</sup>Law of 4 March 1889.

<sup>2</sup>Decree-Law no. 55-583 of 20 May 1955.

<sup>3</sup>Law no. 67-563 of 13 July 1967 on recovery proceedings, liquidation of assets and personal bankruptcy, implemented by Decree no. 67-1120 of 22 December 1967.

*Règlement judiciaire* was designed to restore the debtor to a position of being able to manage his assets, following an arrangement with his creditors, subject to approval by the court. Once the extent of debts was known, the debtor was required to submit to court his proposals for re-establishing the business as well as proposals for the settlement of book debts.

*Liquidation des biens* involved grouping together all the creditors with view to gathering the debtor's assets for the purposes of realising these and dividing the proceeds. The assets could be disposed of by auction, by agreement between the parties or by forfeit. Once the procedure had been carried out, the group was dissolved and the officials ceased having any function. If there were no assets to distribute, the court might suspend the procedure pending the discovery of any new asset.

The Law of 1967 was designed to meet the needs of a relatively prosperous world. The procedures instituted under the insolvency regime failed to meet their target, saving very few businesses from collapse, resulting in detriment to the creditors following the inevitable liquidation of the business. The duration of the procedures often lasted for two to three years and did not include any reference to the workforce, who were excluded from participating.

The changing economic climate meant that traditional methods for dealing with insolvencies no longer were able to work. The emphasis in social policy moved from the liquidation of businesses to the maintenance of businesses, often because of the harmful effects unemployment caused by business failure had on local and rural economies. Many attempts at reform were made between 1967 and the eventual adoption of a new pre-insolvency regime in 1984,<sup>4</sup> called *règlement amiable*. This largely informal procedure permitted businesses to reach agreement with their creditors for moratoriums or delays in settlement of debts.

At the apex of the ambitious project of reform is the current and principal text dealing with the law and institutions of insolvency in France.<sup>5</sup> This retains the twin institutions of recovery proceedings, renamed *redressement judiciaire*, and liquidation. Following criticism of the Law of 1985, notably by creditors who had felt their rights declining in favour of the debtor, and also due to the greatly increasing number of insolvencies being declared,<sup>6</sup> this text was the subject of amendment by legislation in 1994,<sup>7</sup> which restored certain rights to creditors.

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<sup>4</sup>Law no. 84-148 of 1 March 1984 on the prevention and amicable resolution of business difficulties, implemented by Decrees nos. 85-295 of 1 March 1985 et 85-665 of 3 July 1985.

<sup>5</sup>Law no. 85-98 of 25 January 1985 on the institution of recovery proceedings or liquidation of businesses, supplemented by Decrees nos. 85-1388 et 85-1389 of 27 December 1985. References below to articles of a law (L) or decree (D) will be to this Law and the first-mentioned decree.

<sup>6</sup>In 1993, 70,000 businesses became insolvent, with liquidation following in 93% of cases resulting in the imperilment of nearly 300,000 jobs and only 5% of debts ever recovered (statistics quoted in Lamy Droit Commercial, para. 2312).

<sup>7</sup>Law no. 94-475 of 10 June 1994 on the prevention and treatment of business difficulties, implemented by Decree no. 94-910 of 21 October 1994.

### **The Institution of *Liquidation Judiciaire***

Any business which, in the view of the court, has ceased being able to pay its creditors, is eligible for liquidation provided that the business has completely ceased all activity and where the re-establishment of the business is patently impossible.<sup>8</sup> This is one of the more important reforms achieved as a result of the Law of 1994, before which liquidation was a procedure which could only follow in the wake of recovery proceedings.

In order for liquidation to be initiated, the debtor must petition the court within fifteen days of being unable to meet his debts.<sup>9</sup> A creditor may also petition the court for proceedings to be commenced, though there is a risk of damages being awarded to the debtor if the suit is held to be unwarranted.<sup>10</sup> Owing also to the difficulty of obtaining proof that the debtor has ceased all activity and that the future of the business is parlous, a creditor will often only request that the debtor business be placed in recovery proceedings and rely on proof being provided as part of discovery during proceedings.<sup>11</sup> Once the petition has been filed, the competent court will hear preliminary points and establish the date when cessation of payments occurred.<sup>12</sup>

In its order commencing insolvency proceedings, the court will appoint a judge to oversee the procedure and a liquidator. The liquidator may be replaced by the court following a petition by the debtor or one of the creditors.<sup>13</sup> A workers' representative is elected or nominated from among the employees of the business.<sup>14</sup> The task of this representative will be to represent the views of the workforce, particularly in respect of any redundancies being proposed.<sup>15</sup> A number of monitors may also be nominated from among the ranks of the creditors, their functions being to monitor the progress of the proceedings.<sup>16</sup>

The order pronouncing the business to be in liquidation has the same effects as an order instituting recovery proceedings in several instances.<sup>17</sup> It suspends payment of any debt incurred before the date of order, excepting in situations of set-off or contra accounts and it enables any payment to be declared void at the instance of any interested party.<sup>18</sup> The order also suspends the institution of new suits against the debtor and the suspension of actions in progress.<sup>19</sup>

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<sup>8</sup>L. Art. 148 (inserted and renumbered by the Law of 1994).

<sup>9</sup>L. Art. 148 al. 2, applying the provisions of L. Arts. 3 al. 2, 4-7, 16, 17.

<sup>10</sup>Article 1382 of the Code Civil.

<sup>11</sup>D. Art. 7.

<sup>12</sup>L. Art. 148, applying the provisions of Art. 9.

<sup>13</sup>L. Art. 148-1, inserted by the Law of 1994.

<sup>14</sup>L. Art. 10 or L. Art. 139 al. 1 respectively.

<sup>15</sup>L. Art. 44.

<sup>16</sup>L. Art. 148-1 al. 3, applying the provisions of L. Art. 15.

<sup>17</sup>L. Art. 148-2 (inserted by the Law of 1994).

<sup>18</sup>L. Art 33 al. 1, al. 4.

<sup>19</sup>L. Arts. 47, 48.

The order requires creditors to declare and prove the debts owed them.<sup>20</sup> Interest on the sum owed ceases to be charged, except in relation to agreements where repayments are scheduled over a period lasting longer than 12 months.<sup>21</sup> Legal charges may not be granted over property of the business.<sup>22</sup> Any interest in property as well as retention of title over property in the possession of the debtor must be claimed.<sup>23</sup>

The liquidator is required to proceed with the winding up of the business at the same time as he ascertains the debts. He may institute any suit on behalf of the business normally the prerogative of the creditors' representative.<sup>24</sup> In particular, the liquidator establishes an inventory of the assets of the business,<sup>25</sup> defends on behalf of the business any suits permitted by law to continue against the business,<sup>26</sup> and represents the business in hearings on issues raised by employees of the business.<sup>27</sup> The liquidator also carries out the procedures associated with redundancies of employees of the business.

### **Liquidation during the Observation Period**

During the observation period, initiated as part of recovery proceedings and in which the progress of the ailing business is monitored closely, a court may decide to place the business in liquidation and will appoint the creditors' representative as the liquidator in this instance. The court may also appoint any professional as the liquidator.<sup>28</sup> In this context, the liquidator will also exercise those powers given to the creditors' representative, in particular representing the interests of the creditors, defending or instituting actions on behalf of the business and aiding in the establishment of the list of business debts.<sup>29</sup>

The court may replace the liquidator at any time. The liquidator will be required to proceed with the winding up of the business at the same time as he ascertains its debts. He may, in addition, institute any suit on behalf of the business normally the prerogative of the creditors' representative.<sup>30</sup> The liquidator is also responsible for redundancies of employees of the business.

### **Rules of Liquidation**

A liquidator may not be related to any of the members or directors of the business concerned, so as to avoid any potential for conflicts of interest.<sup>31</sup> During the period of the liquidator's appointment, he is required to keep the

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<sup>20</sup>L. Arts. 50-54.

<sup>21</sup>L. Art. 55.

<sup>22</sup>L. Art. 57.

<sup>23</sup>L. Arts. 115, 115-1, 121.

<sup>24</sup>L. Art. 148-3 (inserted by the Law of 1994).

<sup>25</sup>L. Art. 27.

<sup>26</sup>L. Arts. 47, 48.

<sup>27</sup>L. Arts. 124, 125.

<sup>28</sup>L. Art. 148-4.

<sup>29</sup>L. Arts. 46, 49-51, 53.

<sup>30</sup>L. Art. 148-3 (inserted by the Law of 1994).

<sup>31</sup>L. Art. 149.

judge and public prosecutor informed with respect to the running of the procedure at intervals of every three months.<sup>32</sup>

In addition to these reports, the liquidator is required to file a report annually, or more frequently if the court so orders, which mentions in detail the sums realised from the sale of assets, their destination and deposit as well as any amounts given out to creditors.<sup>33</sup>

The liquidator is given general powers to receive mail addressed to the business.<sup>34</sup> Furthermore, he may directly operate the bank accounts belonging to the business for a period of six months beginning with the date of the order. After this initial period, the use of these bank accounts requires the supervision of the judge.<sup>35</sup>

### **The Effects of Liquidation on the Business**

The order placing the business in liquidation has immediate effect on the debtor. He is divested of the management of his business and may not dispose of any of his assets, however he may have come by them, while the procedure is in operation. The management of the debtor's personal property is equally taken over by the liquidator.<sup>36</sup> The debtor may not exercise any civil rights, including the institution of any suit except where he has been the victim of a crime.<sup>37</sup>

### **Maintaining the Business**

By way of an exception to the general rule, where the public interest or the interest of the creditors' warrants, a court may order that the business be permitted to continue its activity.<sup>38</sup> This period normally of up to two months may be extended once for a similar period.<sup>39</sup>

The running of the business is in the hands of the administrator, usually the person appointed during recovery proceedings, or the liquidator if none exists. If the business does not have a sufficient cashflow to continue operations, the liquidator may be required to advance moneys.<sup>40</sup> Where the business is being continued, the administrator or liquidator must inform the court of the results of operations carried out during that period.<sup>41</sup>

### **General Principles of Liquidation**

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<sup>32</sup>L. Art. 150.

<sup>33</sup>D. Art. 119.

<sup>34</sup>D. Art. 119-3 (inserted by the Law of 1994).

<sup>35</sup>D. Art. 121.

<sup>36</sup>L. Art. 152 al. 1.

<sup>37</sup>In criminal causes, a victim may join the case as the "partie civile" and may enjoy legal representation, usually with view to an award of damages.

<sup>38</sup>L. Art. 153.

<sup>39</sup>D. Art 119-2 (inserted by the Law of 1994).

<sup>40</sup>L. Art. 153 al. 1, al. 2.

<sup>41</sup>D. Art. 120.

The judge exercises an authority similar to the role he plays in recovery proceedings.<sup>42</sup> In particular he oversees the smooth functioning of the procedure. He is also responsible for the nomination of monitors and for receiving information from all necessary persons relating to the running of the business. The judge also supervises the inventory of business assets and orders the transmission of business mail to the liquidator and fixes his remuneration. Furthermore, the judge gives the administrator his authority to act in the continuation of business contracts and may permit the administrator to sell any business asset.<sup>43</sup>

The liquidator, for his part, receives from the judge all necessary communications and information to enable him to fulfil his function.<sup>44</sup> The liquidator is responsible, in particular, for carrying on any functions associated with running the business, replying to business mail and reclaiming any assets on behalf of the business.<sup>45</sup> He, or the administrator if one is appointed, may require that contracts with third parties be continued.<sup>46</sup>

The fact that a business is placed in liquidation does not result in the automatic surrender of leases over property being used by the business.<sup>47</sup> The liquidator may choose to carry on with the lease or transfer it to a third party together with all benefits and burdens.<sup>48</sup> In general, those provisions of law dealing with the rights and obligations of business guarantors and co-sureties apply during liquidation. Similarly, those provisions dealing with the verification of debts, the void nature of certain acts by the debtor, the rights of a debtor's spouse, the rights of third parties over property and workers' rights all apply during liquidation.<sup>49</sup>

### **The Sale of Real Property**

The sale of real property is carried out according to general legal principles governing the seizure and disposal of real property. Nevertheless, the judge is required to listen to the opinions of all parties interested in the insolvency and will fix the level of price to be achieved by a sale and the conditions of that sale.<sup>50</sup>

The reforms of 1994 gave the liquidator the possibility of being subrogated to the rights of any creditor who, prior to the order instituting recovery proceedings or liquidation, began proceedings relating to the seizure of any real property belonging to the business. The liquidator steps in at that point of the procedure suspended by the effect of the insolvency order, all acts prior to that moment being deemed to have been performed by him.<sup>51</sup>

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<sup>42</sup>L. Art. 153-1 (inserted by the Law of 1994).

<sup>43</sup>L. Arts. 14, 15, 19, 27, 29, 30, 37 al. 1, 39 al. 4 respectively.

<sup>44</sup>L. Art. 153-2 (inserted by the Law of 1994).

<sup>45</sup>L. Arts. 26, 29, 112 respectively.

<sup>46</sup>L. Art. 37.

<sup>47</sup>L. Art. 153-3 al. 1.

<sup>48</sup>L. Art 153-3 al. 2.

<sup>49</sup>L. Art. 153-4 applying L. Arts. 58-60, 100-127.

<sup>50</sup>L. Art. 154 al. 1.

<sup>51</sup>L. Art. 154 al. 2 (inserted by the Law of 1994).

If conditions permit, the judge may order that the property be disposed of in an informal sale to any of the parties who have presented an offer. The price may be fixed by the judge or agreed subject to further negotiations and conditions established by the judge.<sup>52</sup> The proceeds of sale are then divided by the liquidator among the creditors according to their ranking.<sup>53</sup>

### **The Sale of Units of Production**

Units of production consisting of real property and other business assets may be subject to sale in part or as a whole.<sup>54</sup> The liquidator is required to submit to court a list of units of production which, in his opinion, could be sold in that condition and indicate a time limit within which he will consider all reasonable offers.<sup>55</sup> All offers must be submitted in writing and contain sufficient indications as to the proposed terms for taking over the asset and means of payment.

The manager, *de facto* or *de jure*, of the debtor business and any relation of his may not submit bids to purchase assets of the business.<sup>56</sup> All other offers will be considered by the judge, who will select the offer which best appears to assure the continuity of workers' employment and settle the debts of the business. In this task, he is aided by the views of the debtor, creditors, monitors and employees.<sup>57</sup>

### **The Sale of Other Assets**

The judge sets the procedure for the sale of the remaining business assets, having listened to the observations of the debtor and monitors. The disposal of these assets may be by auction or more informally, in which case any agreement may be submitted for approval by the judge.<sup>58</sup> The records of the business and its files may be destroyed by the liquidator unless they contain material of some public interest, in which event the National Archives must be informed and may exercise a right of purchase.<sup>59</sup>

The liquidator may compromise or come to terms in any dispute concerning the collective interests of creditors, including those relating to interests in real property. Where the property is of a certain value, any agreement or compromise reached must be submitted for approval by the judge.<sup>60</sup> In cases where the debtor's property is bailed, the liquidator may proceed with the disposal of the property with the approval of the judge. The bailee of the

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<sup>52</sup>L. Art. 154 al. 3.

<sup>53</sup>L. Art. 154 al. 4.

<sup>54</sup>L. Art. 155 al. 1.

<sup>55</sup>L. Art. 155 al. 2 and D. Art. 138-1.

<sup>56</sup>L. Art. 155 al. 3.

<sup>57</sup>L. Art. 155 al. 5 (reworded by the Law of 1994).

<sup>58</sup>L. Art. 156.

<sup>59</sup>L. Art. 157.

<sup>60</sup>L. Art. 158.

property may request the court to ascertain any debt owed him, which will be paid out of the proceeds of sale.<sup>61</sup>

### **The Settlement of Debts**

The order that institutes liquidation has the effect of converting a debt, payment of which is not yet due, into one immediately due. These debts in foreign currency are converted into French Francs at the rate operating on the date of order ordering liquidation.<sup>62</sup>

Where the liquidator has failed to proceed with the sale of property to which a legal charge applies within the three months permitted by law, creditors who have declared the debts owing to them may institute actions to recover the amounts owing although a court may not have pronounced on the admission of their debts to the official list.<sup>63</sup> Similarly, where an action has been suspended due to the order instituting insolvency proceedings and the liquidator fails to take any further steps, the creditor may resume the suit, all procedural steps taken prior to the latter order being deemed to have been correctly taken.<sup>64</sup>

The judge may authorise the payment in part of a debt admitted to the official list on the request of the administrator or liquidator. This provisional payment may be made subject to a letter of guarantee of repayment being obtained from a listed credit institution.<sup>65</sup> Distributions of the proceeds of liquidation from other business assets may be made before the sale of property, on which some creditors are secured, to all creditors in the proportion of the overall amount of debt. Secured creditors must, however, credit the amounts received against any receipts from the sale of property on which their legal charge operates. Any excess may be made available to unsecured creditors.<sup>66</sup>

Secured creditors whose claims are not met in full from the proceeds of the sale of the charged property will have to compete on equal terms with the unsecured creditors.<sup>67</sup> If any excess remains after the sale of real property, unsecured creditors are paid a pro rata dividend. A portion is kept for the settlement of any debts, which may in future be admitted to the official list.<sup>68</sup>

### **The End of Liquidation**

The court may at any time order that liquidation proceedings be terminated. It will normally do this having examined the affairs of the debtor and having heard the report of the judge subject to two conditions being met.

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<sup>61</sup>L. Art. 159.

<sup>62</sup>L. Art. 160.

<sup>63</sup>L. Art. 161 al. 1.

<sup>64</sup>L. Art. 161 al. 2.

<sup>65</sup>L. Art. 161-1 (inserted by the Law of 1994).

<sup>66</sup>L. Art. 162.

<sup>67</sup>L. Art. 164.

<sup>68</sup>L. Art. 166.

Firstly, either where there are no longer any assets which may be realised or where the liquidator retains in his possession an amount that would not interest any creditor whose debts has not yet been met in full. Secondly, where the proceedings in liquidation are rendered nugatory because there are no assets to be realised.<sup>69</sup>

The order ending liquidation is made public and must be advertised in the legal gazette.<sup>70</sup> Following the order, the liquidator is required to submit to court his accounts within three months. These accounts will mention in detail the procedure taken for the realisation of any assets and the distribution of any proceeds and are available for inspection by any creditor.<sup>71</sup> The liquidator is required to safeguard any documents entrusted to him during liquidation for a maximum of five years.<sup>72</sup>

The fact that order ending liquidation has been pronounced does not entitle individual creditors to take action against the debtor in court, except where these actions do not concern the business activities of the debtor or are rights in personam attached to the creditor. Any guarantor or co-surety of the debtor may, however, pursue an action for an indemnity.<sup>73</sup>

Creditors may also recover some right of pursuit if the placing of the business in recovery proceedings or liquidation is attributable to the fraud, negligence or other gross fault of the debtor.<sup>74</sup> Proceedings of liquidation may be reopened, following a petition by a creditor, if it appears assets may exist which may be recovered or that an issue may need to be litigated to establish some interest of the business.<sup>75</sup>

**10th December 1995**

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<sup>69</sup>L. Art. 167.

<sup>70</sup>D. Art. 152.

<sup>71</sup>D. Art. 153.

<sup>72</sup>L. Art. 168.

<sup>73</sup>L. Art. 169 al. 1, al. 2.

<sup>74</sup>L. Art. 169 al. 3.

<sup>75</sup>L. Art. 170 (reworded by the Law of 1994).