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Paul J. Omar

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International Insolvency Institute

PMB 112

10332 Main Street

Fairfax, Virginia 22030-2410

USA

Email: info@iiiglobal.org

The Moratorium in France: An Institution Not Worth Keeping?

by
Paul J. Omar
of Gray's Inn, Barrister

Introduction

As part of reforms of the commercial justice system, insolvency and company law, the French Government, in the person of the Minister of Justice, Mme Elisabeth Guigou, submitted three draft laws to the Council of Ministers for approval on 18 July 2000. The texts include a Law on the Organisation of Commercial Courts, introducing the principle of mixed benches of lay and professional judges in cases involving economic matters (including company law, insolvency law and the law relating to financial instruments), an Organic Law on the Composition of Benches in Courts of Appeal, providing for lay judges to hear commercial matters on appeal as well as a Law on Reform of the Status of Insolvency Practitioners, providing for new rules and competition within the twin professions of administrators and liquidators.

The first-mentioned law,¹ intended to bring sweeping changes to the organisation of the commercial court system, also contains in its text a clause that will remove the right to petition for a moratorium as part of the informal settlement (*règlement amiable*) procedure. Draft Article 20 states simply that: "the third to seventh paragraphs of Article 36 of Law no. 84-148 of 1 March 1984² on the prevention and informal settlement of business difficulties are hereby repealed." This effectively removes the moratorium from the range of measures available to French judges in pre-insolvency matters. All of the laws are expected to be formally submitted for consideration by Parliament in the autumn term and to come into force at the beginning of 2002.

Informal Settlement

Informal settlement, comparable to the British institution of the Corporate Voluntary Arrangement, is a largely informal procedure in comparison to insolvency proceedings. It is a revival of procedures already known to French law, such as the court-approved composition (*concordat homologué*) and the provisional stay of action (*suspension provisoire des poursuites*), which had been largely sidelined in the rush to reform the law relating to insolvency in 1967.³ The Law of 1984 brought informal settlement back into use together with a range of new diagnostics tools and prevention measures. This was seen as the first step in the comprehensive reform of the institutions relating to the insolvency of individuals and companies and was followed by two laws in 1985 updating insolvency law and practice.⁴ As part of further reforms of all

¹Assemblée Nationale Document no. 2545 of 18 July 2000.

²Law no. 84-148 of 1 March 1984 ('Law of 1984'), implemented by Decree no. 85-295 of 1 March 1985 ('Decree of 1985').

³Ordinance of 23 September 1967.

⁴Laws no. 85-98 and 85-99 of 25 January 1985.

of the texts in the Law of 1994,⁵ substantial amendments were brought in giving fresh impetus to the informal settlement procedure. The practice reveals, however, a gap in the application of the law, in terms of the numbers of informal settlements actually attempted, the wide variations in practice from court to court and the low success rate for these procedures.⁶

Although intended to allow more access to rescue for businesses, informal settlement remains an optional procedure and does not exclude the possibility that debtors may come to other, more informal, agreements and voluntary compacts with their creditors. Informal settlement is expressed as having four main aims. The first is to fill the legislative gap for informal resolution of business difficulties. The second is to find a solution for temporary business difficulties without subjecting businesses to the stresses of formal insolvency procedures and, through a flexible approach, to enable the debtor to reorganise. This has the added benefit of creditor protection by enabling conditions for the full settlement of business debts. The third is to allow for assistance by administrative bodies set up with the aim of counselling and supporting businesses in difficulty.⁷ The fourth is to avoid prolonged deficit financing often resulting in insolvency and to involve creditors in safeguarding the interests of their debtor, a worthwhile aim given the factor of knock-on insolvencies.

The Introduction of the Moratorium

The Law of 1994 introduced the option for a moratorium into the framework for informal settlements. Under the Law of 1984, this had merely been one of a range of possible measures whose application was at the discretion of the Court. The moratorium, a measure within the exclusive competence of the President of the Commercial Court, had also been available, before the Law of 1994, in cases of informal settlement affecting agricultural enterprises and in rescue proceedings governing indebted individuals. The moratorium is designed to encourage debtors to seek court protection before their financial difficulties deteriorate and is an essential prerequisite before reaching a composition agreement with the creditors. The idea behind the introduction of the moratorium was to substantially increase the chances for the negotiation of a settlement, experience having shown that many potential agreements failed because of the intransigence of a single creditor.

The procedure, nevertheless, presents two particular disadvantages. First, as will be seen below, the requirements for giving notice and the attendant publicity may detract from sensitive negotiations that would otherwise benefit from confidentiality. Second, the procedure, although optional, is also exceptional and the debtor must not be in too perilous a situation, which otherwise would require the opening of formal insolvency proceedings.

⁵Law no. 94-475 of 10 June 1994 ('Law of 1994').

⁶In 1987, there were 145 *règlements amiables* ordered by 35 Commercial Courts, of which 48 achieved some success. In 1991, the Commercial Court of Paris alone reported granting 7 applications, of which only 2 succeeded (Statistics quoted in Couret, *Les Nouveaux Règlements Amiables*, *Gaz. Pal.* 16-17 November 1994 p.2.).

⁷CODEFI, CORRI, CIRI.

Gauging the right moment when informal settlement might be useful for the business is an extremely delicate task. A further possible objection to the use of the moratorium is that it removes the contractual nature of informal settlement, effectively making the process amenable to the discretion of the court, a discretion that is also exercised by the requirement for court approval of the finished agreement.

The Workings of the Moratorium

The request must come from the mediator, appointed to conduct negotiations, who must be satisfied that it would greatly ease moves towards concluding a settlement agreement with the creditors.⁸ The request must be accompanied by precise information as to the extent of business debts, including a list of known creditors, the sum of all debts due to these creditors and any response given by creditors to advice solicited by the mediator as to debt-settlement proposals. Before making the order, the President of the Commercial Court will normally consult the Public Prosecutor.⁹ Principal creditors will also be consulted but the order is not conditional on their assent. The moratorium period may not exceed the duration of the mediator's mandate, which is at most four months.¹⁰ The order must mention the fact that opinions have been solicited as well as the contents of any advice given by principal creditors.¹¹ The law does not require reasons for the order though, to avoid any uncertainty, it will normally mention its purpose as being to facilitate the conclusion of an agreement. Similar powers are given to the President of the High Court in judicial districts where no Commercial Court has been established.¹²

The order is the subject of a certain amount of publicity, which, as noted above, may be inconvenient if the negotiations for the conclusion of an arrangement are delicate by nature. In the first instance, the Commercial Court Registry sends notice of the order to the debtor. The Public Prosecutor is also informed, as are all the creditors by any means the President may order. Notification is normally by post, but other means are permitted, including the publication of a legal notice in a newspaper.¹³ An annotation is made on the Companies Register, noting the existence of the order. Similarly, if the debtor is not a company, a note is mentioned on the register of orders at the High Court. Although the annotations are expunged at the expiry of the moratorium period, their existence may come to public knowledge owing to the public nature of the registers.¹⁴ Costs incurred by the Registry for any attendant publicity will need to be paid for by the debtor.¹⁵

⁸Article 36 al. 3, Law of 1984.

⁹Article 37-1 al. 1, Decree of 1985.

¹⁰Article 36 al. 3, Law of 1984.

¹¹Article 37-1 al. 2, Decree of 1985.

¹²Article 37, Law of 1984.

¹³Article 37-1 al. 2, Decree of 1985.

¹⁴Article 37-1 al. 3, Decree of 1985.

¹⁵Article 37-1 al. 4, Decree of 1985.

The order for a moratorium has effect immediately and binds all creditors whose debts antedate the making of the order.¹⁶ Any person affected by the order may take out interlocutory proceedings to annul the order and a further appeal is possible within a ten-day period from pronouncement, although this appeal does not suspend the application of the order.¹⁷ It is not unknown for notification of the order to creditors to occur after the period of appeal has expired, given administrative and postal delays. In this event, the position of an interested party may be irrevocably compromised.

The order has the effect of prohibiting the institution of proceedings or the continuance of actions arising from a claim for a sum of money or for the resolution of a contract due to default by the debtor.¹⁸ The order also prohibits the execution of any judgment obtained prior to the moratorium against the debtor's property, whether real or personal.¹⁹ Any limitation period for actions or periods within which execution was required are deemed to have been suspended and do not run during the currency of the moratorium.²⁰ The debtor is bound by the order to refrain from paying any creditor and to refrain from doing any act that would prefer any creditor above another, including granting a mortgage or legal charge. This stay does not apply, however, to payments to employees arising from the contract of employment.²¹ In certain circumstances, this restriction may be lifted by an order of the President of the Court, upon advice being received from the mediator, though it must be notified to all interested parties by any means as authorised in the order.²²

The Views of the French Government

The Government's view on the moratorium is that it should be abolished. In the explanatory memorandum accompanying the draft law,²³ the Ministry of Justice underline the fact that, despite the utility of the moratorium as a dissuasive element forcing recalcitrant creditors to assist in negotiations for an informal settlement, the availability of the moratorium may in effect result in the diversion of businesses away from insolvency proceedings, where the needs of the business may be subsidiary to the desire of the management to avoid the risks attendant on formal proceedings. This would result, say the Government, in an ill-defined and ill-controlled procedure that would affect the philosophy behind the separation of pre-insolvency and insolvency measures. This being the case, there is no option but to remove the right to a moratorium. The prevention element behind the use of the moratorium can, according to the Government, be better achieved by the introduction of new measures governing early access by debtors to rescue proceedings.

¹⁶Article 36 al. 4, Law of 1984.

¹⁷Article 39-1, Decree of 1985.

¹⁸Article 36 al. 4, Law of 1984.

¹⁹Article 36 al. 5, Law of 1984.

²⁰Article 36 al. 6, Law of 1984.

²¹Article 36 al. 7, Law of 1984.

²²Article 37-2, Decree of 1985.

²³Copies of the Draft Law, Explanatory Memorandum and Outline Presentation may be seen at the Ministry of Justice website at <www.justice.gouv.fr>.

Two other objections to the moratorium emerge from the document. First, the Government intends to introduce mixed benches for economic cases, defined so as to include insolvency matters. The role of the mixed benches, to include both lay and professional magistrates may be compromised if residual powers to order a moratorium remained with the President of the Commercial Court, eligibility for the appointment being likely to remain with the lay magistracy for the foreseeable future. In effect, a one-stop shop for insolvency measures, under the direction of a professional magistrate, is the Government's preferred solution. Second, the view that informal settlement should remain an essentially contractual procedure seems to have been taken on board as far as the moratorium is concerned. The Government accepts that court involvement would undermine the contractual basis of creditors agreeing to assist in the rescue of their debtor.

Responses to the Proposals

Views canvassed by the government include those from the Chambre de Commerce et d'Industrie de Paris ('CCIP').²⁴ Their view is that it cannot be denied that the principle of a moratorium is contrary to the intended contractual nature of the informal settlement regime. Although removing it would satisfy part of the desire to see more autonomy for debtor-creditor negotiations, it is instructive to note that as part of reform initiatives in the insolvency law field, outlined in a 1999 Orientation Document, the discretion of the court has been widened with regard to the approval it gives to the concluded agreement. It seems difficult, in this case, for the Government to logically sustain the argument of restoring the contractual element when it intends to enhance the role of the court in other areas of the informal settlement procedure.

With regard to the use of the moratorium as what has been qualified as 'mini-rescue proceedings', the CCIP agree that unchecked use of informal settlement with a moratorium could lead to creditors' interests not being protected, particularly as informal settlement lacks many of the protection rules and guarantees of formal rescue procedures. On the contrary, however, practitioners report that the use of the moratorium or, in many cases, the threat to apply for a moratorium, is very much part of the arsenal of weapons regularly used by mediators. In many instances, a settlement agreement could not be made without the threat implicit in the availability of the moratorium. The CCIP underline here the fact that the utility of the institution may well outweigh the perceived lack of rigour with respect to legal principles. In fact, the CCIP report shows that there is a strong feeling among many practitioners that the moratorium should be kept.²⁵

The misuse of the moratorium might be moot if proposals by the Government to introduce early recourse by the debtor to rescue proceedings are enacted.

²⁴A copy of the Courtière Report on Insolvency Law Reforms, released on 4 February 1999, may be seen at the CCIP website at <www.ccip.fr>. The comments that follow are to be found at pp.17-18.

²⁵See comments by Monsieur Sulitzer, Délégué général à la prévention au Tribunal de Commerce de Paris, in the above report in fn.13 at p.18.

The availability of early rescue proceedings would bring into play the use of the automatic moratorium, which is a feature of all rescue regimes, and allow for the protection of creditors in this manner. It would also allow the mediator or debtor in the course of informal settlement measures, as under the previous system, to use, this time, the opening of early proceedings as a bargaining counter, to force recalcitrant or unwilling creditors to consider proposals for settlement. Nevertheless, the view of the CCIP is that removing the moratorium in informal settlement can only occur if early recourse to rescue proceedings is also brought in as part of the reforms in insolvency law.

The CCIP question the reasons advanced by the Government for associating this reform with the changes to the structure of the Commercial Courts. They argue, in effect, that ability of the mixed benches to exercise jurisdiction is unlikely to be considerably affected by recourse to the powers of the President of the Court with regard to imposing a moratorium. As noted above, one of the disadvantages of the informal settlement procedure was that gauging when the debtor was more likely to benefit was a sensitive point requiring experience of economic and commercial conditions. In this, the CCIP argue that the moratorium fits in with the informal character of settlement proceedings and that the role of the President is one that is particularly suited to appreciate and form a judgment on what is, after all, an economic definition. In any event, the question of retaining the moratorium as part of pre-insolvency procedures would be dealt with more appropriately in the context of the reforms of insolvency law that have already been the subject of consultation.²⁶

Summary

The informal settlement procedure has excellent antecedents in the history of legislative provisions dealing with the insolvency of businesses. It remains the case that, despite the attempts of the legislator to favour corporate rescue procedures, these have not had the required impact in practice. In light of this perhaps, the Government has sought to popularise measures by removing what is seen as an impediment to the successful conclusion of agreements, the moratorium.²⁷ Unfortunately, there is no apparent consensus on the desirability of removing the moratorium entirely. The commentary thus far qualifies acceptance of the proposals only if reforms of insolvency law to introduce early recourse to rescue and to make the distinction between formal and informal measures clearer are enacted.

The question commentators ask is, even given the manifest disadvantages associated with the moratorium, whether a return to the pre-1994 system is desirable. The 1994 reforms were felt by commentators to be half-measures with limited effectiveness which gave the institution of informal settlement an ambivalent status in insolvency law.²⁸ Nevertheless, the proper place for such

²⁶Comment in the Courtière Report on Reforms to the Commercial Courts, released on 15 June 2000, at p.29. (This report is also available at the CCIP website).

²⁷It is interesting to contrast here proposals in the United Kingdom to introduce a moratorium into CVAs contained in s1, insolvency Bill 2000.

²⁸Guyon, Procédures Collectives at para. 1089.

a step is still felt to lie within the insolvency law reforms scheduled to take place and the incidental treatment of such an important measure within the confines of a law dealing for the most part with reforms to the commercial court structure is felt highly inappropriate.

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