Reform of the French Insolvency Regulation

Following an important law in 2005 based on a preventive approach, a regulation in 2008 on guarantees, and the law of 2010 on financial safeguard proceedings, there is a new wave of reforms in France aimed at adapting the law on companies in financial distress to the current financial crisis.

The reform's main objective is to reinforce and extend the measures for detecting companies in financial distress to enable them to restructure and avoid formal insolvency and to simplify the insolvency procedures in order to adapt them to the economic climate.

The regulation is applicable to those procedures commenced after 1st July 2014[1], and affects mostly the French Commercial Code. The key points are set out below:-

More Reorganisation Procedures Introduced

French insolvency law includes two preventive procedures that were introduced in 2005: (1) the *mandate ad hoc* (appointment of a commissioner to guide the managers and to allow them to get through a difficult period; this procedure is completely confidential as regards third parties) and (2) the *conciliation* (appointment of a conciliator to allow them to come to an agreement, for example with their creditors and their suppliers, the contents of which will remain confidential where it is simply a case of rubber stamping by the judge in charge; in the case where approval by the court is required (*homologation*), third parties will have knowledge of the existence of an agreement but not the terms).

1) Automatic termination provisions: contractual clauses that can often be found in bank loan agreements, and which terminate the agreement if preventive proceedings are commenced, are treated as null and void. This rule, already applicable to administration proceedings (*redressement judiciaire*) and safeguard proceedings (*sauvegarde*), is thus extended.

2) Fee provisions: the regulation also makes null and void any contractual provisions that impose all fees on debtors, for the advice which the creditor (usually the bank) is likely to take to defend its interests, when the debtor appoints a special commissioner (*mandat ad hoc*) or commences a conciliation procedure[2].The limit is now 75 %[3].

3) Establishment of a "*grace*" period for the debtor and its guarantors: a debtor who, during the conciliation procedure, is given formal notice or pursued by one of its creditors (who refuses to suspend its action) can request the judge who opened the conciliation procedure to grant him a payment extension, in accordance with the conditions under civil law (article 1244-1 of the French Civil Code); which

[1] The implementation decree n°2014-736 was published the same day
[2] The debtor will not have to pay more than 2/3 of the fees of the bank's global lawyer
3 *Arrêté* published the 25 July 2014

corresponds to a maximum 24 month extension. The guarantors of the debtor will also benefit from the payment extensions granted.

4) Strengthen the position of creditors: the "new money privilege" (being the priority rank that is given to those creditors who provide the insolvent company with a new cash flow, a new security or service after the conciliation agreement) is now extended to the creditors providing such provisions during the conciliation procedure.

5) Extension of the role of the conciliator: the conciliator, whose principal role is to promote the conclusion of an agreement between the debtor and its principal creditors, can from now on prepare the sale of the business where the debtor has taken the initiative to do so, and where the creditors have given their approval on the matter. The process of sale will then take place by way of administration or liquidation proceedings.

6) Information to the employees: when the company asks the commercial court for its approval of the deal (*homologation*), the works council or, failing that, the staff representatives (for companies with less than 50 employees), are from then informed by the debtor of the content of the conciliation agreement. The content will remain confidential from the works council if the company only asks for the "*constatation*" (rubber-stamping) of the deal.

Changes to the Insolvency Procedure

1) General

Simplification for proof of debts: whatever the insolvency procedure (safeguard, administration, liquidation), the rules for the proof of debts (*déclaration de créance*) and for their verification have been simplified (notably the role of the insolvency judge and the relief from foreclosure).

Instead of the creditor having to send in his proof of debt, the debtor will now inform the administrator or the liquidator of the existence of all the debt it owes by providing a list within two months after the publication of the decision to open the proceedings in a specific register called the BODACC. The debtor will from now on be presumed to have acted "on behalf of" the creditor.

If the creditor is happy with the information detailed in the listing (some clarification is still required regarding access to the listing) or, as in the majority of the cases, forgets to declare his debt, he could rely on this declaration from the debtor as his proof of debt.

This is an important change to the existing rules, which currently require everyone (except certain privileged creditors, taxes and social security) to make their own declaration within the specified time limit (two month, or four months for foreign creditors).

As such, it seems necessary for creditors to remain vigilant as to the amounts declared by the debtor, and the mention or omission of guarantees. In reality, it would be best to continue to self-declare in any case, at least for a couple of years.

It is also important to point out that the maximum time for applying for relief of foreclosure (*relevé de forclusion*) is now limited to 6 months (formerly 1 year in some specific circumstances) and that any extension remains very limited.

2) Safeguard

a) Draft plan to be made on the initiative of a creditor: the members of the creditors' committee may propose an alternative safeguard plan concurrent with the one envisaged by the creditor, which is an important addition to the rules.

b) Creation of an accelerated safeguard: a new form of safeguard has been created, between the classic safeguard and "accelerated financial safeguard proceedings" (SFA - only 5 of which have been commenced since its creation in 2010), aimed at reinforcing the effectiveness of this procedure:

- The debtor should create a draft plan with its principal creditors, as from the start of the conciliation procedure.
- The accelerated safeguard can only be commenced if the debtor has previously benefitted from a conciliation procedure.
- The debtor can be in default of payments at the time of commencing the accelerated safeguard procedure if this situation does not precede the date of the request for commencing the conciliation procedure by more than 45 days.
- This accelerated safeguard is limited to a duration of 3 months during which time a safeguard plan must be approved.
- There is a threshold for companies of up to 20 employees, or up to 3 million euros of turnover, or 1.5 million euros on the balance sheet that is applicable to the SFA, which makes the procedure accessible to a larger group.

c) Removal of the down payment: in the safeguard procedure, the obligation to pay the counter-party to the contract upfront or prior to delivery during the observation period is removed. This obligation remains applicable only in procedures of administration or liquidation. This should help companies to conserve their cash flow.

3) Administration

a) Draft continuation plan undertaken by the creditor: the members of the creditors' committee can propose an alternative plan to that envisaged by the directors, which is also an important addition to the rules.

b) Reconstitution of funds of the distressed company: if, following commencement of the receivership, the capital is not reconstituted as required by law, the administrator has the ability to order the appointment of a *mandataire,* who will be charged with summoning the competent assembly and approving the reconstitution of capital to the minimum level required, in place of those partners or shareholders opposing it.

4) Liquidation and "professional recovery" proceedings

The regulation also provides for the following modifications:

- Reduction from one year to 6 months of the duration of the simplified liquidation proceedings (*liquidation judiciaire simplifiée*), which represent more than 60% of open procedures.
- Simplification of the liquidation proceedings (to speed up the process).
- Establishment of "professional recovery proceedings" without liquidation (*procedure de rétablissement professionnel*), open to any individual debtor who is not already a party to an insolvency procedure, who has not employed anybody for the last six months and of which the reported assets have a value of less than 5,000 euros (micro proceedings).The closure of the professional recovery proceedings will erase the majority of the creditors' debt whose credit was created before the order for the commencement of the procedure (similar effect to the civil procedure of *surendettement – droit de la consommation*).This procedure could affect 10-15,000 procedures per year out of the 60,000 that currently exist.

This Regulation, which will impact the everyday treatment of businesses in financial difficulty, has been completed on the 24 September 2014.

In order to fine tune the new safeguard proceedings, there will most likely be a reform of the role of shareholders of the company during the period of insolvency procedures (having been considered, then postponed, and consisting of the forced termination of their rights / obligation to sell, to avoid abusive delays and to facilitate the taking of control and therefore the action plan for distressed funds).

For any questions on this topic, please do not hesitate to contact Alexandre Le Ninivin – alexandre.leninivin@squirepb.com