

# Insolvency Law in France

## Introduction

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This work describes insolvency procedures under French law. The introduction includes a definitions section of common terms encountered, summarises the historical development of the law in insolvency and critiques the effectiveness of the recent 2005 law. The work then examines in more detail the substantive legal provisions in two chapters:

- Chapter 1: Analysis of the key concept of “payment failure situation” (*«cessation des paiements»*), together with consideration of cross border aspects; and
- Chapter 2: Description of French collective insolvency proceedings.

The work incorporates and makes frequent reference to the changes that have been made to this area of the law by an order dated 18 December 2008,<sup>1</sup> in force as from 15 February 2009. The thrust of the 2008 amendments was to encourage use of proceedings to prevent insolvency by building and improving on the framework of the 2005 legislation.

### **Definitions**

**“Payment failure situation”** (*«cessation de paiements»*): a debtor company is in a payment failure situation if it finds itself unable to meet its current liabilities out of its disposable assets. This definition, the detail of which will be closely examined in this work, is currently to be found in article L.631-1 of the French Commercial Code.

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<sup>1</sup> Order n° 2008-1345, dated 18 December 2008, completed by decree n° 2009-160, dated 12 February 2009. The February 2009 decree also makes amendments to decree n° 2006-936, dated 27 July 2006 on proceedings relating to the seizure of real estate and subsequent distribution of the sale proceeds. The refinements introduced by the February 2009 decree also modify the simplified liquidation procedure, which is considered at the end of this work.

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**“Conciliation”** (*«conciliation»*): alternative dispute procedure, conducted under the supervision of a conciliator, appointed by the court. It can lead to a contractual agreement between the creditors and the debtor to defer payments or agree reductions to the amounts due. Only the debtor company can request this procedure.

**“Bankruptcy”** (*«faillite»*): generic name given to insolvency proceedings in popular parlance. The correct terminology is “collective insolvency proceedings” (*«procédure collective»*), a term used to describe French insolvency proceedings. The technical meaning of “bankruptcy” (*«faillite»*), for French lawyers, describes the range of penalties that may fall on the entrepreneur who finds himself subject to collective insolvency proceedings. Such penalties only apply if the manager concerned has breached a relevant provision of the French Commercial Code. The person is then described as a “bankrupt” (*«failli»*).

**“Ad hoc representative”** (*«mandat ad hoc»*): the President of the court can, but only if the debtor so requests, appoint an ad hoc representative. The court will define the extent of his mission. The debtor can propose the name of his preferred ad hoc representative. The competent court is the Commercial Court if the debtor carries on commercial or trade activities, and the High Court in all other cases.<sup>2</sup> This flexible and preventive procedure presupposes that the debtor company is not in a payment failure situation. The ad hoc representative can in fact play the role of a conciliator, but without being bound by the procedural rules that attach to a conciliation procedure.

**“Collective insolvency proceedings”** (*«procédure collective»*): generic expression to describe any insolvency proceedings where the debtor is in a payment failure situation. Safeguard proceedings (*«procédure de sauvegarde»*) are also categorized under collective insolvency proceedings even though the debtor is not in a payment failure situation. In contrast, conciliation is not categorized under collective insolvency proceedings and is not classed as an insolvency proceeding within the European Union. It is a preventive measure.

**Judicial reorganisation** (*«redressement judiciaire»*): classic proceedings aimed at allowing a debtor company to recover from financial difficulty. A moratorium on creditors’ claims is imposed during an observation period and the creditors must accept any reorganisation plan that is settled upon (i.e., validated) by the court. There are certain specific matters that apply to large companies. Companies whose accounts have been audited by an approved auditor and that employ more than 150 employees, or whose turnover exceeds €20m before tax, must submit their proposed reorganisation plan to creditors’

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<sup>2</sup> Article L.611-3 of the Commercial Code, as amended by the December 2008 order.

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committees. The creditors vote, but a negative vote does not necessarily signal final rejection of the reorganisation plan (article L.626-34 Commercial Code). In small companies, proceedings do not require an administrator but a judicial administrator must be appointed in the case of companies with at least 20 employees or turnover of €3m before tax (articles L.621-4 and R.621-11 Commercial Code).

**“Compromise arrangement”** (*«règlement amiable»*): name given to the conciliation procedure applicable only to agricultural businesses. The procedure has specific characteristics. For example, a creditor can request that the debtor submit to a compromise arrangement procedure.

**“Safeguard proceedings”** (*«procédure de sauvegarde»*): inspired by Chapter 11 proceedings in the United States, it is a variation on judicial reorganisation of which the principal distinguishing feature is that it can be invoked, at the debtor’s request, without the debtor being in a payment failure situation. The objective for the debtor, who seeks to take advantage of safeguard proceedings, is to obtain a moratorium on claims during the observation period. The required qualifying criteria to commence safeguard proceedings is set out at article L.620-1 of the Commercial Code:

A procedure for safeguard is hereby established, available on demand to a debtor mentioned at article L.620-2 who, without being in a payment failure situation, can show that he is encountering difficulties which he is not in a position to overcome.

This formulation of words, which is derived from Order no 2008-1345, dated 18 December 2008, significantly widens the potential scope of application for safeguard proceedings.

### **Development of the Law Applicable to Collective Insolvency Proceedings in France**

Since the accession to power of President Sarkozy in 2007, there has been a frenetic pursuit of reform, but in reality the law applicable to collective insolvency proceedings has always undergone continuous change. That is to say, in France, numerous laws have been passed one after the other to address the problems thrown up by companies in financial difficulty. These various laws have been considered as having fallen short of success because the number of company failures has continued to grow. However, the success of the laws on “bankruptcy” cannot be simply measured by the number of collective insolvency proceedings that are commenced. Instead, one must look at what results they produce. Collective insolvency proceedings are of many types, but there are fewer types of collective proceedings than there are ways of creating busi-

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nesses. The French create a lot of businesses: in 2007, 321,000 businesses were created—13% more than in 2006.<sup>3</sup> The Minister for the Economy views this as evidence of a return of confidence in the economic sector and of entrepreneurial spirit. With respect to entrepreneurial spirit, she is undoubtedly correct. So far as confidence is concerned, it is less certain, as the increase in business creation is perhaps simply revealing of concern about employment in the public sector and as an employee in the private sector. What is certain is that there are more businesses being created, which inevitably leads to more collective insolvency proceedings. 50% of new businesses disappear within 5 years of being created but only 38% cease their activity because of financial difficulties in connection with the market.<sup>4</sup> Almost half of those who create new businesses will try again within 3 to 5 years time.<sup>5</sup>

It is instructive to consider and summarise the sequence of relevant laws enacted since 1984:

- **1984:** The first law on prevention of financial difficulties for companies. The law introduced alert procedures, which are designed to oblige managers of a company showing signs of weakness to explain themselves as to how they are going to resolve growing difficulties. A court-supervised compromise arrangement procedure was also introduced.
- **1985:** The purpose of this law was to favour company reorganisation over winding-up proceedings. Reorganisation became the guiding principle, but reorganisation proceedings could be converted into liquidation proceedings after a period of observation.
- **1988:** This law addressed the agricultural sector. It introduced collective insolvency proceedings for farming professions. Since 1967, companies operating in the agricultural sector had been subject to collective insolvency proceedings (but not individual farmers). With the advent of the 1988 law, all farmers were subject to collective insolvency proceedings if they found themselves in a payment failure situation. However, the procedure was specific to farmers: jurisdiction of the High Court (and not the Commercial Court), except for companies registered at the RCS<sup>6</sup> as commercial businesses.<sup>7</sup> Moreover, the compromise arrangement procedure applicable to farmers remains specific to them, even after the 2005 law. For example, in practice, agricultural

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<sup>3</sup> CF: *Les Echos* (a French economics journal), 23 January 2008, p7

<sup>4</sup> According to a study carried out for the *Salon des Entrepreneurs* in January 2008.

<sup>5</sup> *Les Echos*, cited above

<sup>6</sup> *Registre du Commerce et des Sociétés*. Company registration information is held at the local Commercial Court. It may be accessed via internet at [www.infogreffe.fr/](http://www.infogreffe.fr/)

<sup>7</sup> For example, agro-alimentary businesses

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experts are nominated as conciliators and not judicial administrators. The conciliation procedure introduced by the 2005 law does not apply to farmers.

- **1994:** This law introduced a clear distinction between two types of collective insolvency proceedings: judicial reorganisation and judicial liquidation. In particular, the court was given the ability to order liquidation of a company immediately without necessarily having to go through the court supervised reorganisation phase.
- **2000:** The new Commercial Code was promulgated. The law applicable to collective insolvency proceedings features in Part 6: thus all the articles relating to collective proceedings now have the no. 6 as the first figure; but they begin either with the letter “L” for law or with the letter “R” denoting a regulation (articles which are derived from secondary legislation applicable to the laws in force). For example: Article L.631-1 of the Commercial Code derives from a law (or an order validated by Parliament) and it is the first article of Part 6, Title 3, Chapter 1 of the Commercial Code.
- **2002:** In 2000, a European Community (“EC”) regulation was brought into force. It is directed at insolvency proceedings. The regulation seeks to co-ordinate collective insolvency proceedings where the debtor’s assets are situated in the territories of several European Union (“EU”) states. In concrete terms, there are two categories of proceeding: the principal proceeding, which is commenced in the territory of one state; and another or several secondary proceedings, which are commenced in other EU states. The intended purpose is to encompass the total assets of the debtor by taking account of all his assets in the EU.
- **2005:** This law heralded a new approach in France’s insolvency laws and describes four types of proceedings: conciliation, safeguard, judicial reorganisation, and liquidation proceedings. Conciliation is a light-handed proceeding, whereas the three other proceedings are more involved in that they will last longer and require the court to nominate numerous participants to carry out the work of reorganisation or liquidation. The principal novelty of this law was the introduction of safeguard proceedings (a type of US Chapter 11 proceeding) with certain French particularities. This law also allowed for the nomination of an ad hoc representative, provided that the debtor is not in a payment failure situation, and it maintained the compromise arrangement procedure insofar as farmers are concerned.
- **2008:** This order, which gives effect to new reforms of the law applicable to companies in financial difficulties, came into force on 15 February 2009. This order amends numerous articles in Part 6 of the

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Commercial Code. It seeks to improve the effectiveness of the law of 26 July 2005, in force since 1 January 2006.

As a result of the sequence of laws described above, the system is now complex due to the increased choice of proceedings for businesses to react in the face of financial difficulties. Together with the alert procedures, introduced in 1984, it is now possible to discern seven types of procedure. From the most involved to the least invasive, they are court-supervised liquidation proceedings, reorganisation proceedings, safeguard proceedings, conciliation, compromise arrangement procedure specific to farming businesses, the ad hoc representative, and alert procedures.

### Assessment of the 2005 Law

The law of 26 July 2005 “constituted a first step in the right direction, but we must go further, much further, with much more boldness in the area of company re-structuring.” These are words taken from a short televised speech on 6 September 2007 given by the President of the French Republic to the Commercial Court in Paris.<sup>8</sup> The 2005 law offers a procedure that can be used in anticipation of difficulties—safeguard proceedings, offering court-supervised assistance before financial problems become insoluble.<sup>9</sup>

Although effective, the new procedure has remained underutilised; 507 safeguard proceedings were brought in 2006, and 540 were brought in 2007.<sup>10</sup> Over the same years, the number of judicial reorganisation proceedings, in the case of the Commercial Courts, was respectively 11,042 and 12,684.<sup>11</sup> In large measure, this lack of success is explained by insufficient knowledge of safeguard and conciliation proceedings amongst leaders of companies who encounter difficulties. In the opinion of the President of the Republic, it is necessary to “Americanise” French law even further with respect to anticipating company difficulties. In the same speech, he stated:

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<sup>8</sup> Speech given on the occasion of the bi-centennial of the Commercial Code.

<sup>9</sup> The level of success of safeguard proceedings is noticeably greater than that of reorganisation proceedings in the sense that businesses who submit to judicial reorganisation often sink into liquidation. This is much less the case, in percentage terms, for businesses that have been subject to safeguard proceedings.

<sup>10</sup> According to figures from the UNEDIC delegation from AGS (AGS is a guarantee fund which benefits employees in collective insolvency proceedings. See *infra* under heading “legal position of employees”).

<sup>11</sup> These statistics are taken from the database maintained by Infogreffe. Infogreffe collates statistics covering activity of the Commercial Courts.

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At the time of voting in the 2005 law, it seems to me that we were in error when we celebrated having adapted into French law only a part of America's Chapter 11 proceedings. Indeed, it had been decided that business leaders would need to comply with a number of conditions to qualify for access to safeguard proceedings. The result was predictable: as it turned out, this half innovation is not even half used.

The December 2008 order follows the line thus described by President Sarkozy and, *inter alia*, seeks to make safeguard proceedings more accessible and attractive for directors of companies in difficulty.

## Payment Failure Situation

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### Definition and Proof of a Payment Failure Situation

The definition of “payment failure situation” is found in the section of the Commercial Code dealing with judicial reorganisation at article L.631-1.<sup>12</sup> The debtor is in a payment failure situation if he finds himself “unable to meet his current liabilities out of his disposable assets.” Total liabilities are, of course, the sum total of a person’s debts, whether an individual or a company. Debts, or a part of them, are current where they have reached their due date for payment. It is therefore only when debts are due and owing that there can be a payment failure situation. As well, the debt must be considered both certain (that is to say not contested) and liquid (that is to say in an amount determinable in Euros). The December 2008 order adds as follows:

A debtor is not in a payment failure situation if he can establish that his credit reserves, or any moratorium which he has the benefit of vis-à-vis his creditors, permits him to meet his current liabilities out of his disposable assets.

The definition thus completed needs to be analysed from two perspectives: current liabilities, on the one part, and disposable assets, on the other.

The concept of current liabilities throws back to a simple and practical question: in whose interest is it to prove a payment failure situation and in whose interest is it to demonstrate that there is no payment failure situation?

When a creditor or the public prosecutor pursues a business into court-supervised reorganisation or liquidation, it is the management of the company that are most immediately concerned. They will fear the constraints that go hand-in-hand with reorganisation proceedings and, even more, the fatal ending embodied in liquidation proceedings. For this reason, they will often endeavour to counter proof of payment failure presented by the creditor or public prosecutor. The December 2008 order assists the debtor, and its management, in this

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<sup>12</sup> In the case of liquidation, article L.640-1 of the Commercial Code refers to the concept of payment failure without repeating the definition. Liquidation, like reorganisation, can only be commenced if the debtor is in a payment failure situation.



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regard. To demonstrate a debtor's payment failure,<sup>13</sup> it is classically incumbent on the creditor or prosecutor petitioning for relief to adduce proof of the serious difficulties being encountered by the respondent debtor. Once the petitioner has shown proof of serious difficulties with respect to the respondent, it is then for the latter, that is to say the debtor, to prove the contrary, if he is to resist the petition. Given the amendments introduced by the December 2008 order, the respondent now has the option of establishing that he has reserves of credit or a moratorium with his creditors, which allow him to meet his current liabilities.<sup>14</sup> This new provision is logical. If, for example, creditors are not claiming what is due to them, then in practical terms there is no reason to consider that the debtor is in a payment failure situation. It is therefore a liability for which there is current demand for payment (although the text talks in terms of current liabilities) that may well determine whether or not there is a payment failure situation. The new law appears to invite the court to adopt a more lenient approach towards a debtor, at least at the point where a creditor or the public prosecutor seeks to initiate collective insolvency proceedings.<sup>15</sup> However, once collective insolvency proceedings are commenced, the court is perhaps likely to be more rigorous when later asked to rule on and fix the date of payment failure.<sup>16</sup> For this purpose, the court uses the same definition of a payment failure situation to determine the payment failure date. In this context the payment failure date is important, as it is possible for the court to set aside

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<sup>13</sup> Cass. Com. 22 June 1999, *Revue des procédures collectives* 2000, p45 obs. *Deleneuveville*

<sup>14</sup> In this respect, the 2008 order follows the opinion of the Paris Chamber of Commerce (CCIP) who recommended clarifying the notion of payment failure. It proposed complementing article L.631-1 of the Commercial Code in order to take account of a decision from the Supreme Court in which it was held that, where agreement was reached to defer payment, the debt is not due and owing until expiry of the new agreed term. Cf CCIP, *Rapport Commission des droits de l'entreprise, Pistes pour l'évolution des textes relatifs à la prévention et au traitement des difficultés des entreprises, Études Actualités no 13, déc. 2007*. This report makes reference to a decision of the Supreme Court in which it was held that debts subject to a moratorium do not form part of the debtor's current liabilities; Cass. Com. 27 February 2007, no. 06-10.170, no. 382

<sup>15</sup> Thus where due date for payment has passed and the creditor concerned has not made demand for payment, the court will arguably be prepared to accept a submission from debtor's counsel that the creditor, by his inaction, has impliedly granted an extension of time for payment so that it cannot be said that there is a payment failure situation

<sup>16</sup> By the time such an action is brought, the court should be in a better position to judge the true position with respect to any claim by the debtor that a creditor had impliedly granted an extension of time for payment or moratorium. If the creditor's inaction lasted only days, rather than weeks, a finding of implied moratorium will be difficult to show

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transactions entered into by the debtor in the period between the payment failure date so determined and commencement of the judicial reorganisation or liquidation proceedings. This period is often referred to as the “suspect period.”<sup>17</sup>

It remains the case, despite this legislative change, that a company can very easily find itself in a payment failure situation. It need only have failed to pay one instalment of one of its debts for the public prosecutor, or the court of its own volition, or one of the creditors. Petition for reorganisation proceedings, with the result that the company may find itself the subject of heavy-handed collective insolvency proceedings. A single unpaid creditor is sufficient proof of a payment failure situation. Moreover, it is not rare for collective insolvency proceedings to be commenced on the initiative of a single creditor such as the tax authorities or URSSAF.<sup>18</sup>

The debtor therefore has every interest in being able to show that he is not in a payment failure situation in order to fend off those who wish to subject it to heavy-handed collective insolvency proceedings. But, there is also interest in being able to show there is no payment failure situation if the debtor wishes to take advantage of safeguard proceedings. Indeed, French law has resisted the temptation to allow safeguard proceedings where there has been a recent payment failure situation.<sup>19</sup>

It is also necessary to consider the other aspect of a payment failure situation—the concept of disposable assets. Assets are the sum of all rights that belong to a company or individual. Such rights include real rights (property rights, usufruct and bare ownership), personal rights<sup>20</sup> and intellectual property rights (industrial property, trademarks, patents, registered drawings and designs, plant varieties, literary and artistic rights). However, in order for there not to be a payment failure situation, the assets of the debtor must be available, that is to say immediately deployable to pay what he owes. For example, the debtor’s assets are considered to be unavailable when he is a creditor in his own right,

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<sup>17</sup> In French, the term is *«la période suspecte»*. This is addressed in more detail *infra*.

<sup>18</sup> *Union pour le Recouvrement des Cotisations de la Sécurité Sociale et des Allocations Familiales* (Union for the Collection of Social Security Contributions and Family Allowances). This organization is often referred to using the expression “*la Sécu*”, an abbreviation for social security in popular French parlance. URSSAF is responsible for collecting social security contributions.

<sup>19</sup> A proposal was put forward that the management of a company in difficulty should be allowed to take advantage of safeguard proceedings at any time in the 45 days following payment failure. However, the French legislator did not adopt this provision

<sup>20</sup> The debtor can be a creditor of someone else and thus has rights as a creditor with respect to that person. For example, where he has carried out a service that has not yet been paid for.

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but has not been able to collect the sums that are due to him. In this very classic situation, a popular French expression consists in saying that the debtor company “*has money on the outside*.”<sup>21</sup> The Supreme Court has held that unsold real property does not constitute part of a debtor’s available assets.<sup>22</sup>

This explains why, in French law, a payment failure situation is not the same as insolvency: the two concepts are distinct. A person is insolvent when his total liabilities are greater than his total assets. In such a case, the person has no chance of being able to honour all of his debts. On the other hand, a person is not going to avoid a payment failure situation by showing that his accumulated assets are theoretically sufficient to pay the sum total of his debts, where in practical terms he is unable to pay his creditors because he has “*money on the outside*”. Even after the reform of December 2008, it is therefore easier to be in a payment failure situation, than to be insolvent. Put another way, an insolvent person is necessarily in a payment failure situation but a person in a payment failure situation is not necessarily insolvent.

Very often, it is the debtor himself who will declare a payment failure situation. His declaration will serve in evidential terms as a confession of payment failure, thereby cutting through any discussion on matters of proof. When a company is in a payment failure situation, it is obliged to declare it within 45 days.<sup>23</sup>

### **Payment Failure Situation as the Criterion for the Various Types of Insolvency Proceedings**

In considering which proceedings would be best suited to deal with the difficulties faced by any particular company, one is immediately conscious of the fact that the concept of payment failure limits the choice. The principal criterion for the debtor is how likely it is that the type of proceeding envisaged will save the company. However, this criterion is in part subjective. Nobody can be sure that a company will recover even where a proceeding that favours recovery is applied to it. Under French law, payment failure remains the key concept where a company is experiencing financial difficulties. If a payment failure situation exists and is noted, judicial reorganisation or liquidation pro-

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<sup>21</sup> In French, «*a l’argent dehors*».

<sup>22</sup> Cass. Com. 27 February 2007

<sup>23</sup> Before 1 January 2006, the time allowed was 15 days. The declaration of payment failure is made on a form available from the Registrar of the court. In common parlance, it is said that the company “files for bankruptcy” («*dépose son bilan*»).

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ceedings should be initiated.<sup>24</sup> If a payment failure situation is threatening, the business owner can request an ad hoc representative or commence conciliation or safeguard proceedings.

In French law, a payment failure situation might be compared to the melting point of a metal: the company appears solid up until the payment failure point is reached, even if it is overheating, and then it runs the risk of meltdown unless a moratorium is introduced through use of one of the formal proceedings. As it is better not to wait for this liquefying process to occur, preventive proceedings are made available to the company management before it is too late to avoid meltdown.

For this reason, article L.620-1 of the Commercial Code, in the section dealing with safeguard proceedings, allows the collective insolvency proceedings to be initiated at the request of a debtor “who, without being in a payment failure situation, can show that he is encountering difficulties which he is not in a position to overcome”. Before the reform of December 2008, the law stipulated that the difficulties, which the debtor was not able to overcome, had to be “of a nature that would lead to a payment failure situation”. The removal of this requirement seeks to widen the scope of application for safeguard proceedings. The management of a company looking to take advantage of this type of proceeding no longer has to show that there is a risk of future payment failure. In short, management have greater control over when they can choose to shelter themselves against creditors by invoking safeguard proceedings.

The role played by the company managers is therefore reinforced. They are more liberally empowered to submit the company to a process that is likely to compromise creditors’ rights. This fact leads one to observe how the concept of pre-insolvency preventive measures has evolved. While it appears too ambitious to seek to prevent financial difficulties, the law has put in place measures to give warning of impending difficulties. It is no longer a case of focussing on anticipating financial difficulties before they appear, but to address the financial difficulties as soon as possible after they appear. While perfectly complementary of measures for the early detection of future difficulties, this somewhat more modest but realistic objective also serves to focus attention on the debtor’s decision, and thus on the debtor company’s management. It is up to management to decide whether or not to initiate preventive proceedings for the benefit of the company in difficulty. It is therefore possible for an initial phase, aimed at preventing a payment failure situation arising, to be followed by an episode or series of episodes where difficulties exacerbated by payment failure are ad-

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<sup>24</sup> However, the 2005 law has opened up the possibility of being able to demand conciliation proceedings in the 45 days following payment failure.

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dressed. This places emphasis on the importance of strategic management, as companies are now able to use safeguard proceedings as a management tool in order to temporarily freeze their liabilities. The security of transactions is thereby compromised, an opportunity that the cleverer and less scrupulous amongst managers will no doubt take advantage of. French law has become more Americanised. At a time when confidence should be particularly encouraged, this novelty of French law risks inciting mutual anxiety amongst participants in the economy.

This is even more the case in that the procedures are capable, at least in theory, of following one another sequentially. In the first instance, an ad hoc representative may assist the debtor company. The debtor can then take advantage of conciliation proceedings. Next it can try to experiment with safeguard proceedings, after which it may enter into judicial reorganisation and finally, in the case of a failure of all that has gone before, it can fall into liquidation. Certainly, there is very little evidence of debtors pursuing such an accumulation of proceedings. However, it begs the question as to what combinations of different proceedings are possible.

In theory, a company in difficulty can go through each type of proceeding. Some procedures are designed to prevent a looming payment failure arising. That is the case for alert procedures, the ad hoc representative, conciliation commenced before payment failure and safeguard proceedings. On the other hand, some proceedings, notably in the case of a failure of preventive proceedings, have automatic consequences that flow from the payment failure situation. In this category are reorganisation and judicial liquidation proceedings. Finally, in a category of its own so far as seeking to remedy the situation as early as possible through self-help measures is concerned, the law provides for the possibility of conciliation after a payment failure situation has arisen.<sup>25</sup> Sometimes there will be a transfer from one proceeding to another. But so far, no one company has successively used all of the solutions that are available in Part 6 of the Commercial Code. How will it be in the future? Specialists in strategic management will no doubt take pleasure in the self-help processes that may be used by company management faced with financial difficulties of varying degrees of severity.

Going from the most preventive towards the most desperate of these proceedings, can a company, as has been suggested, ask for nomination of an ad hoc representative, followed by a conciliator, then commence safeguard proceedings, followed by judicial reorganisation, and finally, at the end of it all,

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<sup>25</sup> In such exceptional circumstances, the conciliation proceedings must be commenced within 45 days of payment failure.

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abandon itself to judicial liquidation? In reality, this scenario is unlikely. A company in difficulty will only take advantage of a fraction of what is available. This either arises due to the debtor's own volition, or due to court proceedings that are started, or because demands are made by the public prosecutor or because the court takes matters into its own hands. It is in this way that when the court is seized of the matter through the existence of one or other preventive measures, it must react to any payment failure situation which arises or comes to light during the process, and of which judicial note is taken. Without waiting for any demand from the debtor,<sup>26</sup> the court will put in motion reorganisation or liquidation proceedings.

In the situation where a company is in emerging difficulty, and if it has not been in a payment failure situation for more than 45 days, it can invoke conciliation proceedings, a modern variant of the compromise arrangement procedure. The aim of conciliation is to avoid the business falling into a payment failure situation or remaining there. A conciliator, appointed by the court at the request of the head of the company, seeks to negotiate an agreement with the principal creditors. Once agreed, the agreement has the force of a normal contract but, if the debtor wishes to have it approved by the court, the agreement is made public. All the economic partners are thus informed of the difficulties. Publication is a significant disadvantage, but this approval process also presents advantages. For example, it is an absolutely essential precondition for a person who brings new capital into the distressed business, without which he cannot enjoy the priority status granted to providers of "new money".<sup>27</sup> A successful conciliation can allow a company to pick itself up again for a limited time, without prejudging the more distant future.

It can be seen that there is a wide diversity of procedures under French law allowing companies to react in the face of difficulties. They provide an array of strategic instruments that can be used depending on the difficulties that must be addressed. The preventive procedures, in theory, allow one to avoid a payment failure situation, or to emerge from one.<sup>28</sup> The curative procedures take into account, with a certain degree of realism, the weakened position of the company. Whereas reorganisation proceedings give the company a chance to recover, liquidation proceedings will lead to sale of the company or its simple

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<sup>26</sup> Except in the case where the payment failure situation date is less than 45 days old, in which hypothesis the debtor can ask to take advantage of conciliation proceedings.

<sup>27</sup> In French, «*privilege de l'argent frais*». The concept of special priority for "new money" was introduced by article L.611-11 of the Commercial Code.

<sup>28</sup> The case of conciliation requested in the 45 days following a payment failure situation. If conciliation leads to agreement on deferring payments or reducing debt, this will cure the payment failure situation.

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disappearance. In any case, the fear or the existence of payment failure guides the choice of the collective insolvency procedure that will be deployed. In practice, the choice is often limited:

Unfortunately the most frequent cases encountered do not allow for any choice between a preventive procedure, safeguard proceedings or judicial reorganisation. When they find themselves in front of Commercial Courts, the cash flow problems and the turnover figures of the companies are often such that the only solution that can be envisaged is the immediate termination of all activity within the context of judicial liquidation proceedings<sup>29</sup>

### **Payment Failure Situation as the Criterion for Defining the Suspect Period**

At the risk of stating the obvious, if a company is effectively in a payment failure situation, it is no longer able to pay what it owes. The head of the company is normally the first person to be aware of the situation. In such a case, some managers react in a legal manner: within the prescribed time of 45 days, they declare the existence of a payment failure situation. Others react in an illegal manner: they do not “file for bankruptcy” and try to find ways to avoid the disadvantages of judicial reorganisation and, even more so, judicial liquidation. If creditors are not diligent at a procedural level, considerable time can pass between the date of payment failure and the court decision initiating a proceeding. The head of the company may be tempted to illegally and artificially protect a part of the company assets and/or to favour certain creditors who are particularly diligent in claiming what is due to them. If he favours certain creditors by paying their claim in full while the company is in a payment failure situation, he will thereby compromise other creditors. The civil law sanction for such behaviour consists in setting aside transactions completed during what is termed the “suspect period”. Or, at least, transactions that seek indirectly or directly to conceal their real objective and transactions in favour of an economic partner to the prejudice of others. One speaks in terms of “void transactions during the suspect period”.<sup>30</sup>

First of all it is necessary to determine when the suspect period begins, knowing that it ends on the day judicial reorganisation or liquidation proceedings are commenced. After that, it is necessary to know which transactions entered into during the course of this period are voidable.

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<sup>29</sup> *Loi de sauvegarde : quelle procédure pour quelles difficultés des entreprises?*, Daniel Valdman, Gazette du Palais, 23 and 24 January 2008, p18.

<sup>30</sup> In French, «des actes nuls en période suspecte».

***Determining the Payment Failure Date***

The court is only able to determine the payment failure date after the collective insolvency proceedings have commenced. At that point, it is legitimate to ask whether the managers of the debtor company may have “cheated” during the period preceding the judgment that gave rise to the collective insolvency proceedings. The first judgment, which marks the commencement of reorganisation or liquidation proceedings, is called the commencement order.<sup>31</sup> It often happens that in the commencement order, the judges do not specify the payment failure date. This indicates that on the day of the commencement order, they do not have sufficient proof to be able to pinpoint the payment failure date with any certainty. However, they are always able, in a later judgment, to fix this date if they receive new evidence. The definition of a payment failure situation, outlined in the section above, must then be applied to the facts. The court will take into account a range of factors, such as letters seeking payment or injunction proceedings that pre-existed the collective insolvency proceedings. The payment failure date is a question of fact, which may be proved by any legitimate means.

If no judgment fixes the date of the payment failure situation, then it is assumed that there has been no suspect period: the payment failure date is deemed to be the date of the commencement order. In such a situation, no claim to set aside any transaction can be founded on the concept of the suspect period. Articles L.632-1 and L.632-2 of the Commercial Code, which list a number of transactions during the suspect period capable of being set aside, will not apply.

The rules used to determine the payment failure date are listed at article L.631-8 of the Commercial Code. These rules provide that the payment failure date may not predate the commencement order by more than 18 months. Accordingly, the suspect period cannot be longer than 18 months. Moreover, the suspect period cannot extend back earlier than the date of any final court ruling approving an arrangement reached with creditors through conciliation proceedings, absent fraud of the debtor.

When the court discovers after the event that there was a payment failure situation before the commencement of the collective insolvency proceedings, it can of course specify this date, but only in the context of a separate proceeding.<sup>32</sup> A court action such as this, brought before the court that is supervising the collective insolvency proceedings, may be commenced at the request of the

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<sup>31</sup> In French, «*le jugement d'ouverture*».

<sup>32</sup> In French termed «*l'action en report*».



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public prosecutor, the judicial administrator, or the creditors' representative. Any such action must be brought within a year of the commencement order.

It can, of course, happen that the court commences safeguard proceedings although the debtor, unknown to the court, was already in a payment failure situation. The court therefore has power to convert the safeguard proceedings into reorganisation proceedings. In such a case, the judgment taken into account to mark the end of the suspect period is the earlier judgment ordering commencement of the safeguard proceedings. However, the one year time limit within which any amendment to the payment failure date can be requested runs from the date of the later judgment that converted the safeguard proceedings into reorganisation or liquidation proceedings.<sup>33</sup>

### *Detecting Voidable Transactions*

Article L.632-1 of the Commercial Code lists the types of transactions that may be set aside, if they “took place”<sup>34</sup> between the payment failure date and the commencement order. The relevant provisions are found in the title relating to judicial reorganisation, but they also apply in the case of judicial liquidation.<sup>35</sup> They establish a distinction between transactions that are potentially voidable and transactions that are null and void as of right.<sup>36</sup> This latter French expression is a false friend. It does not mean that the transaction is automatically void: a claim must be brought to obtain an order from the court that the transaction be set aside. However, once application is brought, the court has no discretion in the matter and must set aside any transaction that the law qualifies as null and void as of right.

On the other hand the judge has discretion where the transaction is potentially voidable. He must first verify that the co-contractor knew about the payment failure situation of the debtor. If there is sufficient evidence of this, the court then takes into account the effect of declaring the transaction void, and in particular any advantage inuring to the co-contractor as a result of the transaction.

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<sup>33</sup> Article L.631-8 of the Commercial Code in its form as at December 2008

<sup>34</sup> In French, «*sont intervenus*».

<sup>35</sup> Article L.641-14 of the Commercial Code

<sup>36</sup> While the words do not appear in the Commercial Code, in this context French legal writers use the term «*nullités de droit*» to describe transactions that are void as of right and the term «*nullités facultatives*» to describe transactions that are potentially void.

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### *Suspect Period Transactions that are Null and Void as of Right*

#### Gratuitous Transactions

Falling into this category are gifts, unless it is shown that they were remunerated in some way, which would result in them losing their quality as a gratuitous transaction. Also in this category are remissions of debts that the debtor has granted to his own debtors.

#### Unprofitable Contracts

This is a reference to commutative contracts («*contrats commutatifs*») in which the respective obligations are disproportionate. A commutative contract is the opposite of an aleatory contract («*contrat aléatoire*»)<sup>37</sup> In a commutative contract, from the outset of the agreement, the parties know exactly what their responsibilities are. If the obligations of the debtor company significantly exceed the obligations of the other party, the contract is null and void as of right. The court will sanction manifest disparity, but the legislator has not given any firm guidelines in this area: the extent of the disparity therefore remains a matter for the judge to assess. In practice, judges enjoy a considerable degree of latitude in this area even though the issue concerns a transaction that is null and void as of right.

#### Payments for Debts not Due at the Date of Payment

What is suspect in such cases is paying a debt that is not yet due for payment, at a time when the company is in a payment failure situation.

#### Abnormal Payments

For example:

- payments in kind: if the debtor transfers a piece of real estate to the creditor in satisfaction of what he owes the creditor, this transformation of payment obligations, even if recorded in a notarial act, is null and void if completed during the suspect period;
- all forms of barter;
- an assignment of credit, other than those officially noted on assignment

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<sup>37</sup> An example of an aleatory contract would be an insurance contract, where the extent of each party's obligations is not known at the outset.

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slips<sup>38</sup> commonly known under the nomenclature Dailly.<sup>39</sup> «*Bordereaux Dailly*» are considered as “commonly accepted in business matters”<sup>40</sup> and are not void as of right, even if completed during the suspect period.

### Certain Deposits and Payments into Court

This concerns deposits and court-ordered payments into court made during the suspect period, principally by way of pledge. Since the reform of the law on security interests,<sup>41</sup> it is clear that the setting aside of a transaction is intended to prevent a creditor obtaining the status of pledgee when his debtor is in a payment failure situation. A creditor pledgee in effect benefits from a pledge, a form of security which confers a preferential right over the goods pledged—in this case the amount deposited or paid into court. What is suspect is the guile of the creditor who obtains this advantage through a court decision. However, if the court decision is final and not capable of appeal before the start of the suspect period, the “transaction” cannot be declared null and void as of right.

### Security Interests Granted for Prior Contracted Debts

A lender must negotiate and obtain contractual security at the time of credit negotiations. If the lender, subsequently creditor, requests security from the debtor after the loan agreement has been concluded, this is considered suspect. The debtor was not obliged to grant the guarantee because he had already obtained the loan. It is the time differential between the loan agreement and the agreement upon which the security is based that justifies setting aside the transaction as of right. In practice, this provision targets mortgages and pledges granted during the suspect period.

### Interim Measures

In practice, this essentially deals with the case of injunctive relief, which constitutes the precursor to final relief. If obtained during the suspect period, such injunctive proceedings are likely to advantage one creditor to the detriment of others. But other illustrations can be given. For example, a seizure order for

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<sup>38</sup> In French, «*Bordereaux Dailly*».

<sup>39</sup> Taken from the name of a Senator who was influential with respect to a 2 January 1981 law, facilitating credit to companies.

<sup>40</sup> They allow a party to transfer a book debt due from one of its debtors to a third party (typically a bank) in return for a discounted payment from the transferee.

<sup>41</sup> Order 2006-346 of 23 March 2006 that, *inter alia*, codified the right to pledge tangible goods, see articles 2333 *et seq* of the Civil Code.

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an aircraft, which is an interim measure,<sup>42</sup> falls within the scope of application contemplated by the provisions in this area. That is why the enforcement judge (*«juge de l'exécution»*)<sup>43</sup> does not have jurisdiction to rule on an action seeking to set aside a seizure order.<sup>44</sup>

### The Exercise and Sale of Options as Practised in Companies Denominated by Shares

Since the 2005 law, article L.632-1 of the Commercial Code makes reference to articles L.225-177 *et seq* of the same Code. Any grant or exercise of an option is null and void as of right if it occurs during the suspect period. In practical terms, it is stock options that run the gauntlet of the legislator. It is common knowledge that in a company, at an extraordinary general meeting, the management or board of directors can be authorised to grant employees options that allow them to subscribe to shares. This constitutes a form of deferred remuneration and is used most notably to the benefit of salaried managers. The exercise of an option, if it occurs during the suspect period, is null and void.<sup>45</sup> What is suspect is that the owners of stock options wish to be rid of them at a time when their company is not yet subject to a collective insolvency proceeding. It is considered that there can be no doubt that such employees have inside information on the near future of this company. The legislator shows little sympathy for “rats that abandon the ship”.

### Any Transfer of Goods or Rights into a Trust Fund in Application of Articles 2011 *et seq* of the Civil Code

A law of 19 February 2007 introduced the notion of a trust into French law. That is to say the equivalent of the trust, as it is known in Anglo Saxon countries. The objective behind the new law was to avoid delocalisation of businesses towards states that already benefit from this type of mechanism. The French trust, in so much as it is a voluntary and contractual regime, can allow for a diverse category of people to be relieved from the management of goods while at the same time attributing management of assets to a person (the trustee)

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<sup>42</sup> Cf: J Prévault, Rép. pr. Civ. Dalloz v° *saisie-revendication*, n° 1.

<sup>43</sup> The *«juge de l'exécution»* is a special judge who has jurisdiction with respect to enforcement of judgments and related issues that may arise.

<sup>44</sup> Cf: *Infra*—Setting aside proceedings.

<sup>45</sup> Article L.632-1 §1, 8° Commercial Code. In its form prior to the 2008 reforms, “any grant, exercise or transfer of options as defined at article L.225-177 of the present code” was null and void. The December 2008 order has softened the text so that now only “any grant or exercise of options as defined at article L.225-177 of the present code” is considered null and void

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in whom one may have confidence and who must manage the assets with loyalty and diligence for the benefit of the settlor. The 19 February 2007 law defined the French law concept of a trust at articles 2011 *et seq* of the Civil Code as being:

. . . an operation by which one or several settlors transfer goods, rights or guarantees, or a collection of goods, rights or guarantees, present or future to one or other trustees who, keeping them separate from their own property, act with the objective of benefiting one or several of the beneficiaries.<sup>46</sup>

In the law applicable to collective insolvency proceedings, use of this system is of course suspect if the settlor is in a payment failure situation, and therefore such transactions are void as of right. The December 2008 order added a technical detail: is equally null and void as of right “any addendum to a trust deed, affecting rights or goods already transferred into the trust property in guarantee of debts contracted before the addendum”.

### *Suspect Period Transactions that are Potentially Null and Void*

This covers transactions that have not been listed above, on condition that the co-contractor knew about the payment failure situation of the debtor company at the moment when the transaction was entered into.<sup>47</sup> Proving such knowledge is sometimes difficult as knowledge of something is not always discernible from the best evidence that can be adduced. Nevertheless, knowledge can sometimes effectively be proved. For example, if the co-contractor were a bank that kept the accounts of the debtor company, it would have had every opportunity to know about the payment failure situation. The same goes for a parent company of which the subsidiary is in difficulty.

The 2005 law made clear that enforcement procedures and notices to third party holders<sup>48</sup> are potentially voidable if they take place during the suspect period. This is in order to favour equality of creditors. Indeed, certain creditors, such as the tax authorities, are able to issue notices to third party holders without prior judicial approval. If that is done during the suspect period, while at the

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<sup>46</sup> «*La fiducie*», a French style trust, can be established by operation of law or by contract. It must be express. The trust contract is null and void if it is motivated by an intention to give for the benefit of the beneficiary.

<sup>47</sup> Article L.632-2 Commercial Code

<sup>48</sup> In French, «*avis à tiers détenteur*». A means by which a creditor can oblige a debtor of his principal debtor to pay the debt due to the principal debtor direct to the creditor who gives notice, in part or whole satisfaction of the debt between the creditor and principal debtor.

same time the tax officer knows about the payment failure situation,<sup>49</sup> the third party notice is theoretically voidable. But it is necessary that the practice of the courts should not present any obstacle to setting aside notices in such circumstances. The courts are not of one voice in this area. Although at least one court<sup>50</sup> has considered that in such circumstances the tax officer must be presumed to have had the required knowledge, the Paris Court of Appeal has given a restrictive interpretation to paragraph 2 of article L.632-2, which favours the tax authorities and by the same token penalises companies in difficulty and their economic partners. In the case,<sup>51</sup> the Court of Appeal ruled that knowledge of the payment failure situation had not been proved to the required standard. On the facts, the tax authorities had put in issue the moratorium that the company had obtained but which it was not adhering to. As it was not adhering to the payment dates, the debtor company was obviously in a payment failure situation. Yet the Court of Appeal was not persuaded to draw the necessary presumption of knowledge. Evidential presumption is not to be confused with legal presumption. In this case, the presumption of a payment failure situation, as held by the first instance court, was an evidential presumption. In the authors' view, the judges at first instance properly analysed the proof before them and drew the correct conclusion<sup>52</sup> that application of the legal provisions contained at article L.632-2 of the Commercial Code was justified. It was not a case of reversing the onus of proof for all matters of this type, but to consider that, in this particular case, the probability of knowledge within the tax authorities was such that it was for them to adduce evidence to negate the presumption, which they did not do. Nevertheless, accepted commentary<sup>53</sup> has approved the solution of the Paris Court of Appeal. Underpinning this approach no doubt is the fear that systematic presumption of knowledge would be the result whenever the tax authorities were to issue notices to third party holders during a suspect period, given their enhanced ability to know about the debtor's financial situation. However, it would have been more logical and transparent to state, in the manner of the December 2008 order, that where the tax authorities deliver a notice to a third party holder during the suspect period, the notice is not capable

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<sup>49</sup> As the tax authorities are demanding unpaid credit, through the use of notices to third party holders, how can they not know about the payment failure situation of the debtor?

<sup>50</sup> Bobigny, 25 October 2006, D2007, AJ p.220, obs Lienhard; Gaz. Pal. 2007 Somm. 1336 obs. Roussel Galle.

<sup>51</sup> Paris Court of Appeal, 13 December 2007.

<sup>52</sup> On the distinction between legal and evidential presumptions, refer, *inter alia*, Marty et Raynaud, *Droit civil Tome I, Introduction générale à l'étude du droit*, 2nd Edition, 1972, n° 244; JL Aubert, *Introduction au droit*, Armand-Colin 1995 p64.

<sup>53</sup> A Lienhard, obs au D.2008 AJ Droit des Affaires, p221; PM Le Corre, *Droit et pratique des procédures collectives*, Dalloz Action Ed 2008, § 654-24.

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of being set aside. The current system is not very satisfactory and is likely to surprise commercial practitioners. In any case, the result of this case law is that it will be necessary to prove carefully that the person who issued the notice to a third party holder knew about the debtor's payment failure situation, if the notice is to be set aside. If proof that the debtor failed to pay debts that are due, certain and liquid is not enough, it is difficult to see how one is expected to prove the matter at all. Case law<sup>54</sup> has instituted a quasi immunity for the tax authorities against the letter of the law.

Court approved garnishee proceedings and caveats that are ordered or lodged during the suspect period may be set aside, with the same qualifications as above where the party benefiting is a public body. Inevitably, such procedures disturb the notion of equal treatment of creditors if they take place during the suspect period. Whereas the law on enforcement procedures derived from the 1991 law was intended to exempt creditors with final judgments from the effect of any subsequent collective insolvency proceeding,<sup>55</sup> the legislator in 2005 made a different choice that has not been put in issue by the December 2008 order.

Finally, it should be noted that transactions for no consideration completed in the 6 months preceding the suspect period are also capable of being set aside.<sup>56</sup>



<sup>54</sup> At least the case law of the Appeal Courts because, in addition to the decision of the Paris Court of Appeal, one can cite a decision of the Dijon Court of Appeal, 15-2-207, Act Proc Coll 2007, n° 75. It will of course be necessary to await a decision of the Supreme Court for a determinative ruling in this area.

<sup>55</sup> Refer PM Le Corre, PM Le Corre, *Droit et pratique des procédures collectives*, Dalloz Action Ed 2008, § 654-24.

<sup>56</sup> In light of article L.632-1 § 2 Commercial Code.

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### *Setting Aside Proceedings*

Proceedings to set aside a transaction must be commenced in the court that is supervising the collective insolvency proceedings. In this respect, the law applicable to collective insolvency proceedings is by way of exception to the general position on jurisdiction for enforcement matters. Article R.662-3 of the Commercial Code provides that the court responsible for supervising the collective insolvency proceedings has jurisdiction for the setting aside proceedings. Conversely as a result, the enforcement judge does not have jurisdiction. There has been recent reminder of this fact by the Paris Court of Appeal in a case involving the seizure of an aircraft.<sup>57</sup>

Who has standing to request that a transaction be set aside?<sup>58</sup> The administrator, if one has been appointed, the creditors' representative in his role as representative of the creditors, and the commissioner charged with carrying out the reorganisation plan (after the period of observation). They must be in office at the time of the request to set aside the targeted transaction. The public prosecutor is also entitled to bring a claim to set aside a transaction for as long as the collective insolvency proceedings remain on foot. The December 2008 order has removed the liquidator's standing to take this action.<sup>59</sup>

Only such persons, who are in reality official participants (and part of the proceedings), can request that a transaction be set aside. There is no time limit within which setting aside proceedings must be brought. However, that is not to say that claims cannot be time barred: in order for the claim to be brought, it must be done by one of the official participants in the proceedings. Therefore, as soon as the collective insolvency proceedings have been terminated, it is no longer possible to bring a claim.

### **Declaration of Payment Failure Situation**

When a business finds itself in a payment failure situation, it has a 45 day period within which to declare the payment failure.<sup>60</sup> Before the 2005 law, it had a 15 day period. The 45 day period runs from the first payment incident. The businessman in difficulty is therefore well advised to make the declaration without delay. There are penalties for those who allow the period to lapse

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<sup>57</sup> Paris, 20 December 2007, D2008 AJ *Droit des Affaires*, p.222. It should be noted as well that relief in the Commercial Court was sought by the liquidator, which is no longer possible with the entry into force of the December 2008 order.

<sup>58</sup> Article L.632-4 Commercial Code.

<sup>59</sup> Article 90, 18 December 2008 order.

<sup>60</sup> Article L.631-4 Commercial Code.



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without making a declaration.<sup>61</sup> During this period, instead of declaring payment failure, company management can petition the president of the competent court to order conciliation proceedings. That presupposes it will be easy to recover from the payment failure situation by obtaining further extended payment terms after negotiation with the company's principal creditors. If there is no realistic prospect of obtaining such payment terms, the debtor must declare payment failure and at the same time ask that either reorganisation proceedings (article L.631-4 Commercial Code) or liquidation proceedings (article L.640-4 Commercial Code) be commenced. The debtor cannot request safeguard proceedings, as a condition for invoking safeguard proceedings is that the debtor not be in a payment failure situation.

It is still not part of French culture to speak in terms of "payment failure declaration". People talk in terms of "filing for bankruptcy" to describe this important formality. The debtor<sup>62</sup> must seek out the registrar of the competent court, that is to say the secretariat of the Commercial Court or the High Court, and fill out a form. He will be given a CERFA declaration, which he must complete. This form is not difficult to fill out but requires the debtor to provide numerous documents that, since 2007, are listed at article R.631-1 of the Commercial Code.<sup>63</sup> This bundle of documents is not easy to gather together. In practice, small businesses ask their accountants to prepare the bankruptcy filing.

### International Aspects

Where the debtor has goods or creditors located outside France or where the debtor is part of a group of companies spread over a number of jurisdictions, a number of problems can arise:

- Can the French courts exercise jurisdiction?

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<sup>61</sup> Article L.653-8: a debtor who is late in filing a declaration of payment failure runs the risk of being banned from directing, managing, administering or controlling, directly or indirectly any business, or such businesses as are listed in the judgment making the banning order. The December 2008 order stipulates that this prohibition "can equally be ordered as against any person listed in article L.653-1 who failed to request commencement of reorganisation or liquidation proceedings within the 45 day period as from the date of the payment failure situation, without having, moreover, requested commencement of conciliation proceedings."

<sup>62</sup> The debtor in person or the representative of a company

<sup>63</sup> The declaration must be filed with the registrar of the competent court. The legal representative of the company or the debtor in person must file the declaration. Given that a significant number of documents must be included with the declaration, preparation for this important step should not be left until the last minute.

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- Do collective insolvency proceedings in France have any effect on (a) the debtor's goods situated outside France or (b) overseas creditors?
- When do French courts recognize collective insolvency proceedings overseas and do they give effect to them?
- Does French law provide for coordination of different collective insolvency proceedings in several states, including France?

France does not have a specific legal framework within which international insolvencies are globally managed. However, there are some areas where French law has made specific provision.

France adopts a universal, rather than territorial, approach to insolvency processes. Under French law, French collective insolvency proceedings affect goods situated abroad as well as at home. Overseas creditors may participate in the French proceedings. Indeed, from the outset specific provision exists to accommodate overseas creditors by extending the usual two month time limit for lodging claims. Overseas creditors have the benefit of four months to complete this step. Everything takes place as if the proceedings commenced in France and intended to have universal effect. Indeed, by way of illustration of this, it has been held that the French courts cannot authorize a liquidator to ignore assets situated overseas.<sup>64</sup>

The reality is of course more complex. International insolvencies present formidable difficulties, both practical and legal. Apart from the conflicts of laws that arise, there can be very real difficulty in enforcing French judgments overseas. Cooperation of overseas courts will be required to obtain an enforceable judgment in another jurisdiction. The French legislation, as is the case for any national legislation, cannot on its own resolve the practical difficulties that arise when faced with multiple sovereign states each with its own legislation that may be more or less comparable to the French system. Attempts have been made to coordinate collective insolvency proceedings through use of international convention. However, these have generally been patchwork in nature and bilateral or applicable to limited numbers of states. Global cooperation is lacking in this area.<sup>65</sup> Unavoidably, while the economy is increasingly globalised, in the present state of affairs companies in financial difficulties must face nationally imposed solutions. The door is open to debtors moving assets and seeking

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<sup>64</sup> Cass Ire civ, 19 Nov 2002, n° 00-22.334, D.2002, AJ p.3341, obs A. Lienhard.

<sup>65</sup> Lacking the status of an international convention, the UNCITRAL Model Law nevertheless invites global cooperation in this area and has attracted the support of a number of countries, including significant ones such as the US and the UK, who have enacted the Model Law into their domestic legislation. However, France has not yet adopted the Model Law.

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out a jurisdiction with the most favourable prospects for the company in difficulty. Such behaviour is only likely to increase in the face of global economic crisis.

French law will apply its own conflicts of laws, which is part of its domestic law, to international issues, or more technically to situations in which there is any foreign element. It will generally remain true to the principles of unity and universality of insolvency proceedings. These will be the guiding principles in collective insolvency proceedings where the debtor carries on business in a state with which France has no specific international convention.

France has entered into a number of bilateral conventions in this area but they are of very limited practical interest.<sup>66</sup> However, a community regulation has established a common framework for insolvency proceedings throughout the European Union.<sup>67</sup> It marks the first step towards harmonisation of laws governing collective insolvency proceedings in Europe. It applies to all collective insolvency proceedings commenced after 31 May 2002, the date it entered into force. It clearly seeks to dissuade parties from seeking to move their assets or switch proceedings from one state to another with a view to improving their legal position.

The EU regulation represents a form of hybrid universal and territorial approach. It retains universality as the guiding concept but permits secondary proceedings to be commenced in other jurisdictions, but limited to that particular jurisdiction. The jurisdiction that is competent to entertain the principal proceedings is the member state in which the debtor's centre of main interests is located—the place where the debtor conducts the administration of his interests on a regular basis, and which is therefore ascertainable by third parties. In the case of legal entities, this would usually be the registered office, subject to contrary proof. Chronologically the principal proceedings would normally be commenced first.<sup>68</sup> Then secondary proceedings are commenced in other EU

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<sup>66</sup> For example, between France and Switzerland, between France and Monaco and between France, Belgium, Italy and Austria. Since 2002, the 2000 EU regulation now governs matters (with the exception of Monaco).

<sup>67</sup> Council Regulation No 1346/2000 of 29 May 2000 on insolvency proceedings. The regulation does not apply to Denmark, which elected to opt out.

<sup>68</sup> In certain situations, territorial proceedings can be independently commenced before the principal proceedings if local creditors so request. This is also possible where the law of the member state where the debtor's centre of main interests is located, does not allow collective insolvency proceedings to be commenced. For example, in Italy, small businesses cannot in principle be made subject to collective insolvency proceedings. Territorial proceedings are converted into secondary proceedings after the principal proceedings have been commenced.

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member states where the debtor has a presence. The principal proceedings produce effects throughout all EU member states whereas secondary proceedings have territorial effect that is limited to a single state.

The regulation applies to “collective insolvency proceedings that entail the partial or total divestment of a debtor<sup>69</sup> and the appointment of a liquidator.”<sup>70</sup> As French collective insolvency proceedings are based on the concept of payment failure and not insolvency, it was necessary to clarify matters in Annex A of the regulation. More particularly, safeguard and reorganisation as well as liquidation proceedings are all considered to be insolvency proceedings for the purposes of the regulation. Conversely, conciliation does not appear in the list nor, *a fortiori*, do other preventive procedures such as the ad hoc representative.

The «*syndic*» in the principal proceedings is entitled to request commencement of secondary proceeding. He is therefore added to the list of those in each member state who have standing to commence collective insolvency proceedings in that state. The secondary proceedings are liquidation proceedings<sup>71</sup> that are commenced without the secondary jurisdiction having to determine whether or not the debtor is insolvent. In France, based on the regulation, it is therefore possible to commence collective insolvency proceedings without the entity concerned being in a payment failure situation. It is enough simply to refer to the existence of the principal proceedings. Indeed, the purpose of the regulation is to coordinate realization of the debtor’s assets and protect creditors’ interests. It does not seek to coordinate reorganisation proceedings, which demonstrates how little the law on international insolvencies has advanced to date. However, using this hierarchical structure, it is possible to organize the break up of a company in difficulty in a rational way.

The system does not exclude the deployment of legal strategies. By being diligent in commencing principal proceedings, a legal adviser can condition the rules that will apply to the interests that he seeks to defend. In particular, it should be noted that it is the law of the principal proceedings that will determine the order of priority of claims, as well as the manner of distribution of funds

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<sup>69</sup> Except where the debtor is an insurance company, a credit institution, an investment undertaking holding funds or securities for third parties, or a collective investment scheme.

<sup>70</sup> Article 1 of the regulation. The term for liquidator used in the French version of the regulation is *syndic*. The *syndic* is the person who administers or liquidates the assets when the debtor is divested of them or who oversees management of its affairs. Annex C of the regulation lists which persons or organizations are authorized to carry out this function in each member state.

<sup>71</sup> Article 3 §3 of the regulation.

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realized from the sale of the debtor's assets. It will also govern when the proceedings come to a close, and in particular whether unpaid creditors thereafter recover their right to pursue the debtor who subsequently comes into money. Forum shopping is therefore not excluded but the opportunities are nevertheless limited by the need to commence the principal proceedings in the state where the debtor has his centre of main interests. Room for manoeuvre is therefore conditioned by a court's assessment in point of fact of the debtor's centre of main interests.<sup>72</sup>

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<sup>72</sup> Different countries have approached this critical question in different ways. The European Court of Justice has had occasion to rule on the matter in a battle for jurisdiction between the Irish and Italian courts in the Parmalat affair: *Eurofood IFSC Ltd*, *European Court of Justice Case*, C-341/04, Judgment of the Court (Grand Chamber), 2 May 2006.

## Description of French Collective Insolvency Proceedings

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This chapter is made up of three sections. The first is directed at rules common to the various proceedings, the second to the observation period that is specific to safeguard and reorganisation proceedings and the third to the legal position of each stakeholder in the various proceedings.

### Rules Common to the Different Types of Collective Insolvency Proceedings

This section first considers who may be made subject to collective insolvency proceedings. The section then describes the procedural rules that apply in such proceedings.

#### *Persons Subject to Collective Insolvency Proceedings*

It is first necessary to identify who may be submitted to collective insolvency proceedings. With the passage of time, more and more entities have been made subject to the law in this area. The scope of application has continuously been widened.<sup>73</sup> Whereas, before 1967 only commercial entities could be made subject to a collective insolvency proceeding, today all types of independent professionals and all types of legal entities are affected.<sup>74</sup>

#### *Sole Traders Subject to Collective Insolvency Proceedings*

All sole traders carrying on an independent activity may be made subject to collective insolvency proceedings. The most recent development concerns regulated liberal professions or professions whose status is otherwise protected. This category includes notaries public, architects, lawyers, doctors, and physiotherapists who are all now vulnerable to collective insolvency proceedings in the event that they find themselves in a payment failure situation.

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<sup>73</sup> Currently articles L.620-1 and L.621-2 of the Commercial Code (as amended by the December 2008 order) specify the categories of professionals who may be made subject to collective insolvency proceedings.

<sup>74</sup> It is no longer necessary to determine whether the person can be categorized as commercial.

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Liberal professions that are not regulated may also be made subject to a collective insolvency proceeding. Examples in this category include private detectives, as well as fortune-tellers and prostitutes.

When the professional concerned is part of a regulated profession, the professional governing body has a specific role to play in any collective insolvency proceeding involving the professional concerned. For example, if a doctor is made subject to liquidation proceedings, ethical questions arise. How is medical confidentiality owed to each client to be protected? What is to become of the patient's files? An adjustment to collective insolvency procedures is necessary in such cases so that the creditors' representative may not take possession of sensitive archives and so that non-medical personnel are barred access to the data. It is the professional governing body that is charged with policing medical confidentiality and more generally ensuring that professional confidences specific to the profession under consideration are respected. It is this body that is responsible for collecting all confidential information and then transferring it to other like professionals as required. Moreover, the representative of the governing body should, in theory, be well placed to know about the economic difficulties that members of the profession concerned are likely to encounter. He therefore has a right to be heard so that he may provide an opinion to the court. This feature of the process is dissuasive for liberal professionals in financial difficulty who are contemplating collective insolvency proceedings. They even fear requesting conciliation proceedings even though this type of proceeding can be accomplished discreetly and without the need to make the proceedings public.<sup>75</sup> But, where a liberal professional is in financial difficulty, if a governing body exists, then it must be notified.

In more traditional fashion, businessmen (and by this is meant sole traders registered with the local commercial registry<sup>76</sup>) can be made subject to collective insolvency proceedings. Since a law enacted on 4 August 2008, small businesses can legally carry on an independent profession, including in commerce or by way of craft, without being registered in the local commercial register or in the local trade directory.<sup>77</sup> However, they are not thereby disqualified from being made subject to collective insolvency proceedings.

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<sup>75</sup> This is the case when the party seeking to take advantage of conciliation proceedings does not wish to have the agreement reached with his creditors approved by the court. In such a case, the court makes an official note of the agreement, without any attendant publicity

<sup>76</sup> *Registre des Commerces et des Sociétés (RCS)*—records are kept in the local courts

<sup>77</sup> *Répertoire des Métiers*—a register for craftsmen. Provided for in law n° 96-603 dated 5 July 1996. Registration confers a number of tax and other benefits and, subject to certain conditions, allows a craftsman to obtain the title of Master Craftsman

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Farmers, as sole traders, have been subject to collective insolvency proceedings since 1968.

When a person dies while in a payment failure situation, his creditors can bring a claim against his estate but must do so within 1 year from the date of death.

### *Legal Entities Subject to Collective Insolvency Proceedings*

Since 1967, all types of private sector legal entities have been subject to collective insolvency proceedings. Since this law, even “*associations*”<sup>78</sup> in financial difficulty are subject to collective insolvency proceedings. It goes without saying that commercial companies, as well as “*sociétés civiles*”,<sup>79</sup> may be made subject to collective insolvency proceedings. Because of this, since 1967, liberal professionals and farmers were subject to collective insolvency proceedings if they had elected to form a company to trade together.

Public sector legal entities such as, for example, town councils, departmental councils or regional authorities, cannot be made subject to collective insolvency proceedings. If they fail to pay, they are put under the supervision of the French government.

### **Procedural Rules Applicable to Collective Insolvency Proceedings**

There are a number of procedural rules that are particular to collective insolvency proceedings. There are jurisdictional thresholds to meet, issues of standing and it is also important to understand the roles played by the various participants.

### *Jurisdictional Requirements*

The Commercial Court (*Tribunal de Commerce*)<sup>80</sup> has jurisdiction over commercial entities (sole traders and commercial companies). It also has jurisdiction over craftsmen.

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<sup>78</sup> An *association* in French terms denotes a legal entity that exists not for the personal profit of its members—a not-for-profit organisation.

<sup>79</sup> A *société civile* exists for the profit of its members but not for commercial purposes. A *société civile* is often contrasted in this respect with a *société commerciale*. Examples of *sociétés civiles* include agricultural companies, liberal professions, and more generally, all types of sub-denominations of *sociétés civiles* such as property management companies (*société civiles immobilières*).

<sup>80</sup> So far as the Commercial Courts are concerned, commercial court judges are judges



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The High Court (*Tribunal de Grande Instance*) has jurisdiction over agricultural businesses and over all non-commercial individuals, most notably liberal professionals.

At the request of the administrator, the creditors' representative, the prosecutor or of its own motion, the court can extend the proceedings to include one or more other persons if their assets have become mixed up with those of the debtor. Equally, this can be done where the legal entity is held to be a veil. In such cases, the court that pronounced the commencement order retains jurisdiction to extend matters in this way and to address the financial difficulties faced by the persons included in the extended proceedings.<sup>81</sup>

Where collective insolvency proceedings involve a debtor who has assets situated throughout several EU states, an EU regulation applies, as outlined at the end of the first chapter.

### *Standing to Invoke Court Proceedings*

Who may invoke the court's jurisdiction to commence collective insolvency proceedings?

#### The Debtor

The debtor has every interest in seeking to commence collective insolvency proceedings where the difficulties he faces are not irreversible. Indeed, he has every chance of obtaining extensions to payment terms and even in certain cases remission of debt. For these reasons, and for all types of collective insolvency proceedings, the debtor is always entitled to invoke the court's jurisdiction. He is the only stakeholder entitled to request conciliation or safeguard proceedings. When he is in a payment failure situation, he has an obligation to "file bankruptcy proceedings" within 45 days. Within this window of time, he must request that reorganisation or liquidation proceedings be commenced. However, he can also request conciliation proceedings within this time, if he believes that such a proceeding may quickly bring the payment failure situation to an end.

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elected by their peers. They are elected for an initial term of two years and can then be re-elected for a further 4 year term by virtue of articles L.412-1 to L.412-7 of the Civil Procedure Code. When they give rulings, they sit with an odd number of judges (collegiality) except when the president or an appointed judge is sitting in chambers. In collective insolvency proceedings, it sometimes happens that rulings are handed down by a single judge—these are decisions that fall to the supervisory judge.

<sup>81</sup> Article L.621-2 Commercial Code, paragraph 2 as amended by the December 2008 order.

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### Creditors

Every creditor has standing. That is to say, he may request that reorganisation or liquidation proceedings be commenced vis à vis his debtor. The basis of the creditor's claim is irrelevant in this regard. Thus even if the claim is not of a professional nature, the creditor's request is nevertheless valid.

A creditor does not have standing to request either conciliation or safeguard proceedings. If he serves the debtor with claim documents, it must be to commence reorganisation or liquidation proceedings. In practice, such requests often come from the tax authorities or the organisations charged with collecting social security contributions. However, any creditor may take such steps.

### The Public Prosecutor

The Commercial Code empowers the public prosecutor's office (*«le Parquet»*) to file proceedings with the court to commence reorganisation or liquidation proceedings.<sup>82</sup> In a free trade economy, this may be seen as surprising given that the public prosecutor's office represents the executive. It is a form of economic interventionism by the public authorities. It is very revealing of the way in which relations between the state and private enterprise is viewed. In France, the thinking is very much that the economy cannot be left to itself without any (and sometimes surprising) supervisory intervention by the state. An economic role is therefore granted to the public prosecutor, the importance of which has been gradually increased with each successive piece of legislation.

### The Competent Court May Invoke Matters of its own Motion

At an economic level, this means that the Commercial Court and the High Court are endowed with an economic role, or at least a role as guide with respect to businesses in financial difficulties and to their economic partners. This role is growing in importance and, today, evidence of it is most notably found in the powers attributed to the president of the court in relation to prevention of financial difficulties.

### *The Entities and Key Players Involved in Collective Insolvency Proceedings*

All collective insolvency proceedings are structured around a distribution of duties between certain key players. Collective insolvency proceedings often generate large files, which is the justification for this dividing up of tasks. The

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<sup>82</sup> Article L.631-5 Commercial Code.

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jurisdictional entities, that is to say the judges and courts responsible for these files, are quite distinct from the non-jurisdictional players, such as insolvency law practitioners and the stakeholders who are to play a role in the proceedings.

Ad hoc representative proceedings, conciliation and the compromise arrangement procedure are light handed proceedings, in which the only participants are the court president and a professional acting in a representative capacity or as conciliator. On the other hand, many participants fulfil distinct roles in more involved proceedings, that is to say in very elaborate or sophisticated proceedings.

### The Entities Involved in Safeguard and Reorganisation Proceedings

There are numerous roles that must be filled by appropriate persons in the course of collective insolvency proceedings. A description of the principal persons involved follows.

#### (a) Within the Competent Court

A **preliminary judge** (*«juge commis»*)<sup>83</sup> may optionally be appointed to undertake a form of preliminary audit of the debtor's situation. He is charged with gathering together "all information on the financial, economic and employment situation of the company in difficulty". Where required, he is assisted by any expert of his choice. He delivers a report that will serve as the basis for the first rulings made by the court.

A **supervisory judge** (*«juge-commissaire»*) is systematically appointed in the commencement order. In complex cases, the court can appoint several supervisory judges.<sup>84</sup>

In all cases, the duties of the supervisory judge are essential. He is the judge, within the court, who assumes principal responsibility for the company in question. In the Commercial Court, the supervisory judges are selected from the corps of judges with a minimum of 2 years judicial experience. Judges who meet the criteria are thus supervisory judges for certain files and ordinary judges for others. In other words, the judges divide up the work: one will be supervisory judge for one company and another for another company. The idea is that the

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<sup>83</sup> Article L.621-1 paragraph 3 Commercial Code.

<sup>84</sup> Article L.621-4 paragraph 1 Commercial Code. The December 2008 order adds, by way of amendment of article L.621-9: "The President of the court has jurisdiction to replace the supervisory judge where he is prevented from fulfilling duties or has retired."

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court in its collegiate form cannot be constantly marshalled to oversee almost daily events in each collective insolvency proceeding. The supervisory judge therefore has to make decisions on his own and on his own will hand down judicial orders. Accordingly, reference is often made to “orders of the supervisory judge”.

As can be seen, the position of supervisory judge bestows many powers on the judge who holds this position: he becomes his own jurisdiction. He appoints other entities in the proceedings,<sup>85</sup> he approves or rejects creditors’ claims,<sup>86</sup> and he issues various authorisations. Because he can issue orders, there are rights of appeal. An appeal is possible if brought within 10 days of the order handed down by the supervisory judge (abridged time limit) and the Court of Appeal is the competent court.

### (b) Legal Professionals Involved in Collective Insolvency Proceedings

For a long time,<sup>87</sup> in collective insolvency proceedings a single legal professional was appointed to represent, at the same time, both the debtor and the creditors: he was known as the “*syndic*”. Today, article L.621-4 of the Commercial Code provides that in principle the court must appoint two persons, known as the **creditors’ representative** («*mandataire judiciaire*») and the **administrator** («*administrateur judiciaire*»). These two categories of professionals are part of a broader category of court nominees. But within this broader category are to be found the administrator on the one hand, whose duty is to administer or supervise the company in difficulty, and on the other hand the creditors’ representative.<sup>88</sup>

#### (I) The Administrator

##### (i) The Role of the Administrator

The administrator is required to support the director of the company in difficulty but his precise role will be defined in each case in the commencement

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<sup>85</sup> In particular the controllers (article L.621-10 Commercial Code) and, if he considers it necessary, experts (article L.621-9 paragraph 2 Commercial Code).

<sup>86</sup> Article L.624-2 Commercial Code.

<sup>87</sup> Until 1 January 1986. The 1985 law split up the profession of *syndic*. This subdivision of the profession was done with the objective of allowing the court nominees to specialize and thereby increasing their efficiency.

<sup>88</sup> As the English translation of the term «*mandataire judiciaire*» suggests, the primary duty of the creditors’ representative is to act in the interests of the creditors. However, he is also required to ensure respect for the interests of all the stakeholders in the collective insolvency proceedings.

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order or in a subsequent judgment. The administrator may simply be given the task of overseeing management of the company in difficulty in the hands of the incumbent managers. The court can also order that the administrator carry out a supportive role. Ultimately, the court can order that the administrator purely and simply assume responsibility for managing the company in difficulty. This will be ordered where managers are to be replaced because they have been guilty of certain wrongs. Since the 2008 reform, this last option is only possible in the context of reorganisation proceedings. It is no longer possible within the context of safeguard proceedings.

In summary, in the case of safeguard proceedings, where he has been given the task of simply overseeing the company, the administrator's assignment consists first and foremost in checking that the management's actions are not compromising creditors or the future recovery of the company. If he has been given the responsibility of supporting management, his primary role is to countersign management decisions made by the directors of the company in difficulty. Finally and most importantly, the administrator's special skill consists in arriving at a safeguard plan for the company. His advice to the management of debtor companies can be determinative with respect to the plan to be submitted to the court. That of course comes at a financial cost and therefore increases costs for the company in difficulty.

In the case of reorganisation proceedings, the administrator's role is potentially even more conspicuous as it can extend to representation pure and simple of the directors, who are removed and discharged from management of their business.

### (ii) Criteria Applicable to Whether an Administrator is Appointed

An administrator is not systematically appointed. The presence of an administrator is only obligatory when the company meets one of two thresholds: 20 employees or 3 million Euros in turnover before tax.<sup>89</sup> If just one of these threshold figures is met, an administrator must be appointed. If the company does not meet either of the two thresholds, the court has discretion whether to appoint an administrator or not. Small businesses would typically struggle to cover the costs associated with such a professional.

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<sup>89</sup> Turnover is calculated from the last accounting year (article R.621-11 Commercial Code). The relevant figure is the net amount, defined by article R.123-200 as "the total sales of products and services in connection with current activity, reduced by any discounts on sales, sales tax ("TVA") and other similar taxes". In practice, this means the relevant criterion is the before tax turnover figure

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In principle, the court appoints an administrator registered on a list compiled by a national commission.<sup>90</sup> However, exceptionally, it can appoint an individual who can show that he/she has particular experience or is particularly qualified given the nature of the business. Moreover, since the 2008 reform, the debtor may propose an administrator to be appointed by the court. Similar provisions apply in favour of the public prosecutor who may in the same way propose the name of the creditors' representative to be appointed. If the public prosecutor's proposal is rejected, the court must give specific reasons. When proceedings are commenced in connection with a debtor subject to, or who has been subject to, ad hoc representative or conciliation proceedings at any time within the preceding 18 months, the public prosecutor is entitled to object to the ad hoc representative or conciliator being appointed as administrator or creditors' representative.<sup>91</sup>

Conversely, numerous persons have standing to ask the court to replace the professionals appointed if they consider that they are not properly attending to their tasks.<sup>92</sup>

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<sup>90</sup> Article L.811-2 Commercial Code.

<sup>91</sup> Article L.621-4 Commercial Code (which now includes a 5th paragraph added by the December 2008 order).

<sup>92</sup> The December 2008 order replaced the original wording of article L.621-7 Commercial Code with the following:

“The court may, either of its own motion, or at the suggestion of the supervisory judge or at the request of the public prosecutor, move to replace the administrator, the expert or the creditors' representative or otherwise add one or several administrators or creditors' representatives to the ones already appointed.

The administrator, the creditors' representative or a creditor appointed as controller can request that the supervisory judge submit the matter to the court in this regard.

Where the debtor carries on a liberal profession subject to a special legislative or regulatory regime or which is protected, the professional or governing body may submit the matter to the public prosecutor in this same regard.

The debtor can request that the supervisory judge submit the matter to the court with a view to replacing the administrator or expert. Subject to the same conditions, any creditor can request that the creditors' representative be replaced.

By way of exception to the preceding paragraphs, where the administrator or the creditors' representative asks to be replaced, the president of the court, to whom the matter is submitted by the supervisory judge, has jurisdiction. He rules on an *ex parte* basis.”

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### (II) The Creditors' Representative

His first and foremost role is to represent creditors. He is thus the special liaison person for creditors of a company in difficulty. However, if the collective insolvency proceedings do not result in an effective recovery of the company in difficulty, in practice, he will be appointed liquidator.

There cannot in principle be any confusion between the roles of administrator and creditors' representative. Administrators are not registered on the same professional list as creditors' representatives. The latter are registered on a different national list and are a registered profession.<sup>93</sup>

### (III) The Commissioner of the Plan

He is either an administrator or a creditors' representative who, when a safeguard or reorganisation plan has been ordered by the court, is responsible for checking that the company subject to the plan implements the plan correctly. He must produce a report at least every 6 months.

### (c) Representation of Stakeholders

Amongst stakeholders, in the corporate social responsibility sense, not all are represented in collective insolvency proceedings. For example, there is no representation (yet) for consumers of goods manufactured by the company in difficulty, nor is there representation for residents who may sometimes be affected by possible acts of pollution by the company.<sup>94</sup> Other stakeholders are represented by the entities involved in the proceedings, not least of which the creditors, as is classically the case. They are represented by the creditors' representative, as well as by the controllers. They are sometimes assembled into committees. Employees also have the advantage of special representation.

### (I) Controllers

Controllers are creditors of the company that the supervisory judge appoints to play a specific role. While theoretically there to assist the creditors' repre-

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<sup>93</sup> Article L.812-1 *et seq* Commercial Code.

<sup>94</sup> Prior to February 2009, pursuant to article L.623-1 paragraph 3 of the Commercial Code, an environmental report had to be drawn up if the debtor company operated an *Installation Classée pour la Sauvegarde de l'Environnement (ICPE)*—"Facility Classified for the Safeguarding of the Environment". That is to say, a company presenting danger or considered as a potential pollution hazard. The December 2008 order (article 36) has done away with this provision.

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sentative and the supervisory judge, controllers seek out this unremunerated role in order to check that the persons appointed by the court are indeed carrying out their duties with due regard to the creditors. As well, they check that the proceedings progress at a normal speed. They vary in number between 1 and 5 in each proceeding.<sup>95</sup> If the supervisory judge appoints several, at least one controller is selected from amongst secured creditors and at least one from amongst unsecured creditors. Since the 2005 reform, where the debtor carries on business as a liberal profession subject to a legislative or regulatory regime, the professional body is automatically appointed as a controller.

The controllers do not play an important role. Nevertheless, they have a strategic position amongst the creditors that allows them to easily access information and to influence, by their requests, the course of the proceedings. For example, they can request partial termination of activity at any time during the observation period.<sup>96</sup> One disadvantage of being a controller is that he is prohibited from buying up the assets of his debtor.<sup>97</sup>

### (II) Creditors' Committees

In large companies (more than 150 employees or whose before tax turnover exceeds 20 million Euros<sup>98</sup>), a creditors' committee must be consulted.

Since the 2005 reform, the creditors' committees vote for or against allowing the company to restructure. However, their vote does not bind the court. In the event of a negative vote, the court can nevertheless adopt the reorganisation plan proposed by the debtor.<sup>99</sup> The vote by the assemblies of creditors serves in this way to inform and direct the court but without binding it in any way, except where the creditors' committees approve the proposed plan. In this scenario, which is favourable for the debtor, the court approves, that is to say, validates

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<sup>95</sup> Article L.621-10 Commercial Code.

<sup>96</sup> Article L.622-10 Commercial Code.

<sup>97</sup> Articles L.642-3 and L.642-20 Commercial Code.

<sup>98</sup> Article R.626-52 Commercial Code.

<sup>99</sup> By applying the procedure applicable when there are no creditors' committees. Thus the creditors' representative will consult with the creditors in the manner prescribed in article L.626-5 Commercial Code. He can consult them individually, by writing to them, or collectively, and propose that they accept certain extensions of time for payment and/or reductions in the debts. Taking into account the express or implied responses, the court will make a decision.



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the plan. In French legalese, the expression used is «*le tribunal arrête le plan*», which means that the court accepts the plan and renders it enforceable.<sup>100</sup>

Proposals that are accepted by each of the creditors' committees are applicable to all their members, even if the vote took place with a qualified majority. Decisions are taken in each committee by majority vote comprising two-thirds of the total amount of claims made by the members who vote.<sup>101</sup>

There are two creditors' committees plus an assembly of bondholders.

As drafted following the December 2008 order, article L.626-30 of the Commercial Code provides that:

Credit institutions and similar institutions, as defined by decree of the State Council («*décret en Conseil d'Etat*»), as well as the principal suppliers of goods and services, shall be grouped into two creditors' committees by the administrator. The committees are made up of creditors whose claims arose prior to the commencement order relating to the proceedings.

Credit institutions and similar institutions, as well as all those who derive a claim acquired from them or from a supplier of goods and services, are members as of right of the credit institutions committee.

With the exception of territorial authorities and their public institutions, every supplier of goods or services is a member as of right of the principal suppliers committee provided that their claim exceeds 3% of the total claims made by suppliers. Other suppliers, at the administrator's request, may be members of the committee.

The voting procedures have been simplified: the December 2008 order has removed the requirement of voting by a show of hands<sup>102</sup> retaining the one

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<sup>100</sup> The court is not bound by the responses given by the creditors' committees. Nevertheless, it will of course take them into consideration because the principal economic partners of the company in difficulty are to be found within these committees. But it can also take into account other issues such as employment aspects or information that reaches the court at the last minute. In contrast with compositions with creditors, as existed in France at the time of the 1967 law, the present system allows the court alone to judge and take the decision whether or not to approve or reject the safeguard plan. Nevertheless, in practice, the decision of these committees will of course usually be determinative of whether the company has any chance of restructuring itself.

<sup>101</sup> Article L.626-30-1 Commercial Code, added by the December 2008 order.

<sup>102</sup> The amendment was introduced to counter the risk of fraud by subdividing claims.

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method of voting by a qualified majority. Today, the vote is carried by a two-thirds majority of the votes as passed, based solely on the amount of claims.<sup>103</sup>

In this day of dematerialised finance, transactions involving debt can be completed very quickly. By their nature, certain debts are assignable: for example factoring. Difficulties therefore arise where the respective weighting of creditors changes between the time of calculating the right to vote and the time of voting the safeguard or reorganisation plan. Thus “in rather pernicious manner, certain factors with an initially large weighting in the credit institutions committee would adopt all the more inflexible attitude to the solutions proposed by the court-appointed nominees to restore the debtor in difficulty to health, with the result that they recovered, in the meantime, the larger part of their financial assistance.”<sup>104</sup> That is why, with the 2008 reform, a creditor whose claim expires loses his status as a member of the committee.<sup>105</sup> Because claims can be bought and sold, the right to participate in a committee is attached to the claim, in order to clarify the position of creditors who may sometimes be important, such as hedge funds.<sup>106</sup> Hedge funds are now likened to credit institutions and therefore form part of the credit institutions committee.

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<sup>103</sup> Article L.626-30-2 Commercial Code, added by the December 2008 order. It stipulates:

“The decision is taken in each committee by a two thirds majority of the amount of claims held by members who vote, as stated by the debtor and certified by his auditor or auditors or, where none has been appointed, as found by his chartered accountant. For creditors who are beneficiaries of a trust (“*fiducie*”) established by way of guarantee by the debtor, only the amounts of such claims not covered by the security are taken into account.”

<sup>104</sup> Report no 3651, done in the name of the Law Commission by M. Xavier de Roux, filed with the office of the National Assembly, 20 January 2007 (XXII legislation), p54.

<sup>105</sup> New article 626-30-1 Commercial Code, *in fine*.

<sup>106</sup> See the opinion of parliamentary member Eric Ciotti—opinion for the Parliamentary Law Commission, examined 15 May 2008, in relation to the bill before Parliament for the modernisation of the economy (available on the web site of the National Assembly). Hedge funds are most often specialized in a very specific type of operation (derivative products or restructuring companies, for example). They exhibit performance that is often dissociated from trends in the general stock and bond markets. The banks themselves, whose sensitivity—not to say aversion to risk, is well known, do not hesitate before assigning their claims against large companies in serious difficulty, even significant medium sized companies, to these investment funds which operate in the same way as mutual funds (*Organismes de Placement Collectif en Valeurs Mobilières —OPCVM*). In 2005, some 8,000 hedge funds were managing total outstanding debts in the order of 1,070 billion Euros and 5% of the assets of European funds were invested in France, France as a result qualifying in second place

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As for bondholders, they now make up a sort of third committee. The December 2008 order provides in a new article L.626-32 that, where there are bondholders, a general meeting must be called<sup>107</sup> made up of all creditors holding bonds issued in France or overseas, with a view to deliberating on the draft plan adopted by the creditors' committees.<sup>108</sup>

### (III) Employees' Representative

An employees' representative must be appointed where the business has any employees. If the company has a works council (*«comité d'entreprise»*), the works council will elect the employees' representative in the collective insolvency proceedings. In small businesses, if there is no works council but at least a staff representative (*«délégué du personnel»*), that person will be appointed. And if there is no habitual employee elected, then a direct election

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in European rankings. The safeguard proceedings involving Eurotunnel, a paradigm case study on a number of levels, raised the important question as to how these particular creditors should be legally characterized. At stake was the application of the same majority voting rules and liability (in the case of abusive manoeuvres to prevent the conclusion of a safeguard plan) as applied to creditors belonging to committees formed pursuant to article L.626-30 of the Commercial Code. Whereas the wording used by the legislator in the statute was sufficiently wide to allow hedge funds to be likened to credit institutions, article R.626-55 of the Commercial Code had given them a restrictive interpretation, by making reference to articles L.511-1 and L.518-1 of the Monetary and Financial Code, that is to say to institutions carrying on business as banks, in the most traditional sense of the word, approved by the economics and finance minister. The funds concerned in the Eurotunnel proceedings did not hesitate to rely on these provisions to demand that they be treated in the same way as bondholders, governed by article L.626-32 of the Commercial Code. If the court had demurred to their request—which it did not do on the grounds that having purchased current claims, the speculative funds were engaged in banking operations and were therefore to be likened to credit institutions and governed by article L.626-30—the chances of adopting the safeguard plan would have been quasi inexistent, having regard to the ambiguities surrounding consultation of bondholders.

<sup>107</sup> In accordance with conditions set by State Council decree.

<sup>108</sup> The order adds: "The deliberations can for example consider extensions of time for payment, total or partial abandonment of the bonds and, where the debtor is a company limited by shares whose shareholders only bear losses in the amount of their contributions, conversion of the bonds into stock giving or capable of giving access to capital. The draft plan can allocate different treatment as between bondholders if justified based on the differences in their situations."

The decision is taken on a majority vote comprising two thirds of the total amount of claims represented by the bondholders who vote, notwithstanding any clause to the contrary and irrespective of the law applicable to the contract pursuant to which the bonds are issued."

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must be organised among the employees. The employer must take the initiative in this regard and, if no candidate stands for election, the employer must draw up an official account of the failure in order to show that he complied with this obligation, but that the election did not lead to appointment of an employees' representative.

Only the works council or, if none, the staff representative, or if none, the company employees, may apply to replace the employees' representative.<sup>109</sup>

The role of the employees' representative is simple. He will check that the wages claimed which remain to be paid by the company in difficulty are properly claimable. Indeed, the employer must draw up a list of unpaid wages when declaring a payment failure situation. The employees' representative will check that it is accurate and that there have been no omissions. The employees' representative's legal safeguard against being dismissed is comparable to that of staff representatives—approval from the labour inspector is required before he can be dismissed.

### (d) Other Figures in Collective Insolvency Proceedings

There are a number of other figures in typical collective insolvency proceedings, which should be mentioned.

#### (I) Public Officers

Public officers are the court auctioneers, bailiffs, notaries public or court-approved goods brokers who are occasionally commissioned to accomplish a particular role in the collective insolvency proceedings,<sup>110</sup> in particular, where it is necessary to make a summary estimate of the value of the debtor's assets<sup>111</sup> or to draw up an inventory of his goods.<sup>112</sup>

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<sup>109</sup> Article L.621-7 *in fine* Commercial Code.

<sup>110</sup> December 2008 order: L.621-12 Commercial Code is supplemented by the following:

“In order to complete the official pricing of the debtor's assets in light of the inventory drawn up during the safeguard proceedings, the court shall appoint a court auctioneer, a bailiff, a notary public or a court approved goods broker, taking into account their respective legally recognized areas of expertise as set out in the provisions applicable to each of them.”

<sup>111</sup> An official pricing process—in French «*la prisée*».

<sup>112</sup> Article L.622-6-1 Commercial Code, supplemented in 2008 as follows:

“Unless a public officer was appointed to draw up the inventory in the commencement order relating to the proceedings, this must be drawn up by the debtor and validated by an auditor (*commissaire aux comptes*)” or witnessed by a chartered accountant

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### (II) Insolvency Expert and Other Court Approved Experts

A court-approved expert is a person registered on a list held with the Court of Appeal. The expert enlightens the judges on technical issues that fall outside the scope of expertise of the lawyers. An example is where a business or an asset belonging to the debtor needs to be valued. In any event, the expert is appointed for a very particular task. Insolvency experts<sup>113</sup> also exist. They are specialists in management and accounting. They can provide an analysis, not only on the cause of the difficulties, but on the future development of the debtor's situation. Estate agents may also be court-approved experts. In collective insolvency proceedings, their role is to value real estate belonging to the debtor.

The court can appoint experts in the commencement order.<sup>114</sup> However, in practice it is often the supervisory judge who appoints them as required in the course of the proceedings.<sup>115</sup>

### The Entities Involved in Liquidation Proceedings

The same entities appear as are found in the preceding section except that, as there is no possibility of reorganisation, no administrator is appointed and the creditors' committees are not convened. A new player appears—the liquidator.<sup>116</sup> He purely and simply represents the dispossessed debtor.<sup>117</sup>

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(*expert-comptable*). In such a case, the provisions of the fourth paragraph of article L.622-6 are not applicable.

If the debtor does not proceed to draw up an inventory within 8 days of the commencement order or does not complete it within the time fixed in the order, in order to thus proceed or complete matters, the supervisory judge shall appoint a court auctioneer, a bailiff, a notary public or a court approved goods broker, taking into account their respective legally recognized areas of expertise as set out in the provisions applicable to each of them. The supervisory judge can extend the time within which the drawing up of the inventory must be completed. The administrator, the creditors' representative or the public prosecutor may submit the matter to him. He can also deal with the matter of his own motion."

<sup>113</sup> The French term is «*expert en diagnostic d'entreprises*».

<sup>114</sup> Article L.621-4 paragraph 3 Commercial Code. Refer as well article L.623-3 and, in the case of conciliation, article L.611-6. In the case of compromise arrangements applicable to agricultural businesses, refer articles L.351-3 and L.351-6 of the Rural Code.

<sup>115</sup> Article L.621-9 Commercial Code.

<sup>116</sup> §2 of article L.641-1 Commercial Code is has been amended by the December 2008 order:

"II. In the commencement order that pronounces liquidation proceedings, the court

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In practice, the court will nominate as liquidator the creditors' representative initially appointed in the context of reorganisation proceedings. Indeed, very often in practice, collective insolvency proceedings commence in the form of reorganisation proceedings, which are later transformed into liquidation proceedings. It is a classic scenario. Today this traditional scenario is more complex. It may be safeguard proceedings that are transformed into liquidation proceedings. It could be conciliation proceedings, which lead to safeguard or reorganisation proceedings, that one day turn into a liquidation. In reality, sequencing of different collective insolvency proceedings is a frequent occurrence.

### **The Observation Period Specific to Safeguard and Reorganisation Proceedings**

Collective insolvency proceedings are structured around not only a division of tasks attributed to each entity in the proceedings, but around the different phases in the proceedings. It has been seen that the suspect period is a period that comes before the commencement order. After the suspect period comes a period of observation, known as the "observation period", which may vary in length. The observation period begins after the commencement order. The start of the observation period is therefore conditioned by the first judgment given in the insolvency proceedings under consideration. One of the principal effects of collective insolvency proceedings is to "freeze" claims during the observation period. The observation period will be followed by a period in which the reorganisation plan is put into effect or by transformation of the proceedings into liquidation proceedings.

We will first look at the length of the observation period, before detailing the legal position of the debtor company throughout the period.

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appoints the supervisory judge. He can, if required, appoint several.

In the same judgment, without prejudice to any eventual appointment of one or a number of experts with a view to accomplishing a task set by the court, the court shall appoint to the position of liquidator, a registered creditors' representative or a person selected on the basis of the first paragraph of article L.812-2(II). It may, at the request of the public prosecutor or of its own motion, appoint several.

The public prosecutor can propose a liquidator to be appointed by the court. If the proposal is rejected, the court must give specific grounds. Where the proceedings are commenced against a debtor who is or has been taking advantage of an ad hoc representative or a conciliation proceeding within the preceding 18 months, the public prosecutor can also object to the ad hoc representative or conciliator being appointed as liquidator."

<sup>117</sup> Article L.641-9 Commercial Code.

***Length of the Observation Period***

In the commencement order, the court must set the length of the observation period during which the debtor will be examined, a period that must be used to draw up a safeguard or reorganisation plan. The observation period commences on the date of the commencement order. The length of the observation period is determined by article L.621-3 of the Commercial Code. This provision defines a series of maximum lengths, including the initial period that is limited to a maximum of 6 months. This implies that the court may set a shorter observation period. But it cannot initially set a period longer than 6 months, albeit that this is a somewhat theoretical restriction as the court can extend the observation period for a further 6-month maximum. Even this maximum is theoretical as the court can extend the observation period for a further 6 months, but only at the request of the public prosecutor.

The observation period can thus potentially last for a maximum of 18 months (6+6+6), which is a long time for creditors of a company in difficulty. They are in an invidious position, as they cannot demand payment of what is due to them. Their claims are “frozen”. A creditor wishing to reduce the length of the observation period must elicit support from the controllers and show that the length is not appropriate. To do this, the controllers must show that “reorganisation is obviously impossible”.

In an attempt to balance matters, given the economic and financial repercussions of freezing claims, the court must periodically check that maintaining the observation period, and thus the company’s business, is in practical terms justified. In the case of reorganisation proceedings, the court must do this within two months from the date of the commencement order. Even if the court has ordered an observation period of 6 months, it can still bring it to an end if it finds that the situation of the debtor has deteriorated. The practice of some courts is to carry out monthly checks of this type.

In the case of safeguard proceedings, article L.622-10 of the Commercial Code gives the court power, either of its own motion or at the request of an entity in the proceedings (administrator, controller, creditors’ representative, public prosecutor or the debtor himself) to order partial termination of the business or transformation of the safeguard proceedings into reorganisation or liquidation proceedings.

In the case of reorganisation proceedings,<sup>118</sup> the court has the same powers provided “reorganisation is obviously impossible”. The word “obviously”,

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<sup>118</sup> Article L.631-15 §2 Commercial Code.

added by the December 2008 order, shows the French legislator is seeking to favour reorganisation of the debtor as far as possible.

There are specific provisions for agricultural businesses. Where an agricultural business is in difficulty, the observation period lasts until the end of the “current agricultural year”, depending on the particular practices relating to what is produced by the business in question.<sup>119</sup> This is a logical solution given the production cycles that exist in agricultural production.

### ***Legal Position of the Debtor During the Observation Period***

The aim is to protect the debtor’s assets. To this end, the situation is frozen. By freezing the position, the debtor is able to determine the extent of claims against him without having to pay debts. In the economic battle in which the debtor company is involved, the observation period acts as a shield that allows the company to hold itself together until a court decision is made to determine its fate. The position must therefore be frozen, maintained as it is. This notion leads to a number of technical consequences in relation to the observation period.

### ***Business Activity Continues***

This principle is found at article L.622-9 of the Commercial Code: the business of the company continues throughout the observation period. This business continuance is done with the same directors, but they are less constrained in safeguard proceedings than is the case under reorganisation proceedings.

In safeguard proceedings, by virtue of article L.622-1 of the Commercial Code, the directors remain in place and manage the business. While it is the case that an administrator will oversee or assist if the appointment thresholds are reached, the directors are nevertheless guaranteed to remain in place. Following the 2008 reforms, it is impossible to make approval of a safeguard plan subject to removal of directors. This incentive to make use of safeguard proceedings is also reinforced by the fact that, from now on, the debtor may propose his preferred administrator to the court.

In reorganisation proceedings, the directors do not have the same advantages. Adoption of the reorganisation plan can be made conditional on them being replaced. Nevertheless, even in reorganisation proceedings, the debtor may see advantage. For example, it may happen that a director is banned from

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<sup>119</sup> Article L.631-15 §1 Commercial Code.



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using a chequebook,<sup>120</sup> or that the debtor company finds itself in this position. In this scenario, the administrator can continue to operate the accounts against his signature.<sup>121</sup>

### *No Acceleration of Debt*

In contrast to the situation in liquidation proceedings, the commencement of safeguard or reorganisation proceedings does not render term payments immediately due and owing. Credit terms, that is to say their normal due date, are maintained. Of course, those who draft contracts sometimes think to include a clause whereby repayment is accelerated in the event of insolvency proceedings being commenced against one of the contractual parties. However, the law of collective insolvency proceedings renders such clauses null and void.

### *Maintaining Current Contracts*

The company in difficulty can ensure “performance of current contracts by providing the promised service to the debtor’s contracting party”. The company is of course in contractual relations with other parties. At law, where a contracting party has not been paid for services rendered in the past, he can invoke the non-fulfilment exception contained in the Civil Code.<sup>122</sup> Based on this provision, he can, in normal circumstances, cancel the contract and seek damages. But the law applicable to collective insolvency proceedings constitutes an exception to the general law. Article L.622-13 of the Commercial Code allows the debtor company, in the course of an observation period during safeguard or reorganisation proceedings, to demand that the other party continue to perform the contract.

The administrator is authorised to make this demand. In the case of small companies in difficulty, where an administrator has not been appointed, a director may make the demand provided he is authorised by the creditors’ representative.<sup>123</sup>

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<sup>120</sup> The French expression for this is «*interdit bancaire*». Most often, this occurs where a bank refuses to honour a cheque. The account holder is then said to be «*interdit bancaire*». There is a central registry in which the names of those affected are recorded—*Le Fichier Central des Chèques*.

<sup>121</sup> Article L.622-1 §V Commercial Code.

<sup>122</sup> Article 1184 Civil Code.

<sup>123</sup> In the case of any dispute, the supervisory judge will need to settle the matter (article L.627-2 Commercial Code).

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Although he has not been paid for past services, the other contracting party must nevertheless continue to provide the contracted services. As this rule appears unfair, the contract can only be maintained if the debtor is ready to pay for the requested services. That is to say, the debtor must be ready to pay for services provided during the course of the observation period. The debtor will be required to pay invoices relating to the continuation of the contract, and he will have to pay in cash, unless he obtains credit from the other party by means of a new contract. Accordingly, when he demands performance of the services, the administrator must check that he has sufficient funds to cover payment. If the administrator is faced with an executory contract or staggered payments, he will cancel the contract if he thinks he will not have sufficient funds to meet the next payment when it falls due.

As for sums due for services rendered to the debtor before the commencement order, the contracting party will need to lodge a claim in the proceedings.<sup>124</sup> In this respect, he will be treated like any other creditor whose claim arose before the commencement order.

These provisions do not apply to employment contracts. They also do not apply to trust deeds, with the exception of performance of any agreement that would allow the debtor to retain use or enjoyment of property or rights that form part of the trust property. The Intellectual Property Code also contains exceptions to protect authors of literary or audiovisual works against possible difficulties encountered by publishing companies.<sup>125</sup> But apart from these exceptions, the rule has a wide scope of application. Thus, a sale contract is a current contract so long as delivery has not taken place. Current accounts,<sup>126</sup> leasing arrangements, and of course property leases are also included.<sup>127</sup>

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<sup>124</sup> Paragraph §1 of article L.621-13 Commercial Code, as amended by the December 2008 order, provides as follows:

“Notwithstanding any legal provision or contractual clause to the contrary, no rescission or cancellation of a contract in force can result from the mere fact that safeguard proceedings have been commenced. The contracting party must fulfil his obligations despite any failure to perform by the debtor of obligations that pre-date the commencement order. Non-performance of such obligations only gives creditors the right to lodge a claim in the proceedings.”

<sup>125</sup> Article L.132-15 and L.132-30 of the Intellectual Property Code.

<sup>126</sup> For current accounts held with a bank, the balance must be determined at the date of the commencement order.

<sup>127</sup> On the notion of current contracts, see for example the article by Philippe Pétel, *Dalloz*, 4th Ed., p114 *et seq.*

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It can be seen that the company in difficulty has an option. It can demand performance of one current contract without making similar demand in respect of another. A contracting party, in some cases, will have every interest in eliciting a decision from the administrator on the subject. He can put the administrator on notice by sending him a registered letter with acknowledgment of receipt. If the administrator fails to reply within a month of being put on notice, the contract is automatically cancelled. However, the administrator can seek an extension of time up to a maximum of two months from the supervisory judge.<sup>128</sup> Conversely, the administrator can request cancellation, which will be granted by the supervisory judge if it is necessary for the safeguard of the debtor and does not excessively prejudice the interests of the other contracting party. If the administrator does not make use of his option to continue with the contract or if the contract is cancelled at his request, the non-performance gives rise to damages in favour of the other contracting party. The amount of the damages must then be claimed in the proceedings.<sup>129</sup>

### *Stay of All Claims*

In classic fashion, the commencement order stays any claims being brought by any creditor whose claim arises prior to the commencement order.<sup>130</sup>

Court proceedings underway are stayed at least until the creditor has lodged his claim. They can be continued after the claim is lodged but only to determine that the claim is well-founded and to set the amount of the claim.

Individuals in the position of sureties enjoy the benefit of the stay of proceedings.<sup>131</sup> As do individuals who are jointly liable or who have provided an independent guarantee.

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<sup>128</sup> Paragraph §III of article L.621-13, as amended by the December 2008 order: “The contract is automatically cancelled”.

<sup>129</sup> Where advances were made to the contracting party by the company in difficulty, the contracting party may “*delay paying back any surplus paid over by the debtor in performance of the contract until there has been a ruling on damages*”—new §5 of article L.621-13 Commercial Code.

<sup>130</sup> Article L.622-21 Commercial Code. This stay of claims does not apply to claims listed in article L.622-17 I. This important provision, considered *infra*, describes a specific legal regime that applies to new claims (claims that arise after the commencement order).

<sup>131</sup> Article L.622-28 Commercial Code.

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### *Ban on Paying Debts*

Not only are creditors unable to demand payment for debts arising before the commencement order, but the debtor is not entitled to pay them. If the debtor pays them in breach of the rules contained in article L.622-7 of the Commercial Code, he is guilty of a criminal offence, punishable by two years imprisonment and a fine of 30,000 Euros.<sup>132</sup>

However, there are exceptions to this ban on paying prior debts. For example:

- payment by way of set off of connected claims is allowed;<sup>133</sup>
- where warranted for the continuance of the business, the supervisory judge can authorise the debtor to pay to obtain a thing pledged or any other thing legally retained or otherwise to procure return of any goods or rights transferred by way of guarantee into a trust; and
- the supervisory judge can authorise the debtor to pay in order to exercise an option to buy contained in a leasing agreement, where the option to buy is warranted for the continuance of the business and if the payment to be made is less than the value of the leased goods.

For claims that arise after the commencement order, the principle is that where they are properly incurred for the conduct of the proceedings or of the observation period, they should be paid without delay, unless contractually provided otherwise. In the case of an individual in the position of debtor, he must also continue to make maintenance payments, such as alimony.<sup>134</sup> He has the right to pay daily living expenses, which allows him to subsist.

The ban on payments may lead to the setting aside of illegal payments. In this regard, any interested person (including the public prosecutor) can apply to set aside infringing payments, but must do so within 3 years from the drawing up of the relevant agreement or payment of the claim in question. Where the relevant agreement is required to be published, the time limit runs from the date of publication.<sup>135</sup>

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<sup>132</sup> Article L.654-8 Commercial Code.

<sup>133</sup> In French, «paiement par compensation de créances connexes»—refer to article L.622-7 paragraph 1 Commercial Code.

<sup>134</sup> Moreover, a maintenance creditor is not required to lodge a claim in the proceedings.

<sup>135</sup> Article L.622-7 §III Commercial Code, as modified by the December 2008 order.

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### *Stay of Enforcement Proceedings*

The commencement order stays or prohibits any enforcement proceedings on the part of creditors as against both real and personal property, as well as any distribution proceedings that have not resulted in any transfer before the commencement order.<sup>136</sup>

### *Ban Against Registering Securities*

After the commencement order, it is impossible to register any mortgage, pledge, general security or lien as against the debtor's property.<sup>137</sup>

### *Stay of Interest*

Pursuant to article L.622-28 of the Commercial Code, the commencement order stays the running of interest on claims, whether by contract or by operation of law. The same applies to late payment interest and surcharges (as would otherwise apply, for example, in the case of social security contributions). The effect is to freeze the amount of claims as at the date of the commencement order.

There are exceptions. Interest continues to run in the case of loans of longer than one year. Included within this category are all manner of deferred payments (such as, for example, overdraft facilities) of one year or more. This approach benefits banks in particular, and more generally encourages medium and long-term credit. Sureties, if they are individuals, also benefit from this advantage. Except where they have guaranteed repayment of a loan of a year or longer, interest will not run. The same applies for individuals who are jointly liable and those who have agreed to provide independent guarantees.

When the economic situation of the debtor is frozen, this does not help creditors. More generally, all the stakeholders find themselves affected by the collective insolvency proceedings involving the debtor. We therefore consider the situation of each stakeholder.

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<sup>136</sup> Article 622-21 §II Commercial Code.

<sup>137</sup> Article L.622-30 Commercial Code. By way of exception, there is provision to maintain the preference of the tax authorities in respect of certain claims, and to permit a seller of a business to register a seller's lien over his "*fonds de commerce*" for part or all of the unpaid purchase price. The "*fonds de commerce*" is a term used to describe the bundle of tangible and intangible personal property rights that go to make up the business of a commercial or industrial entity and by which its market value is assessed.

## **Legal Position of Each Stakeholder**

We have looked at how the stakeholders are represented in collective insolvency proceedings. However, it is necessary to detail the many legal rules that apply to them.

### ***Legal Position of Creditors***

As soon as collective insolvency proceedings are commenced, the most urgent matter for the creditors is to declare what they are owed. For some creditors, the aim is to get paid as best they may through the medium of the collective insolvency proceeding. However, because a proceeding will often result in little or no payment to certain creditors, others will try to circumvent the effects of the collective insolvency proceeding. We consider each category of creditor in turn.

#### *Legal Position of Creditors Who Seek to Obtain Payment through the Collective Insolvency Proceedings Process*

##### Lodging Claims

Lodging of a claim is the act by which the creditor of a company in a collective insolvency proceeding shows his intention of obtaining payment, in the context of the proceedings, of what is due to him from the debtor company.

All claims that arose before the commencement order must be lodged, except wage claims or claims to maintenance.<sup>138</sup> It is prudent to lodge a provisional claim, on the basis of an estimate, where the claim has not yet been definitively determined.

The claim must be lodged with the creditors' representative who represents creditors' interests. His contact details are set out in the commencement order and the order is published in the BODACC.<sup>139</sup> In this way, creditors know precisely who to contact.

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<sup>138</sup> Article L.622-24 Commercial Code, as completed by regulation articles R.622-21 *et seq.*

<sup>139</sup> *Bulletin Officiel des Annonces Civiles et Commerciales*—The official list of civil and commercial announcements. The order, together with the creditors' representative's details, is also published in a local paper approved for legal announcements and at the RCS, if the debtor is registered there.

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The person who lodges the claim must be the creditor himself. Where the creditor is a legal entity, its legal representative must lodge the claim. However, the claim may be lodged by an agent, for example by a creditor's lawyer, or by an employee of the creditor.<sup>140</sup>

The claim must be lodged within strict time limits. The time limit is 2 months from the date the commencement order is published at the BODACCC. Pursuant to article R.622-22 of the Commercial Code, it is set at 4 months for creditors who reside outside mainland France where the collective insolvency proceedings have been commenced on French mainland territory. It is also set at 4 months when the proceedings have been commenced in an overseas department or territory ("DOM/TOM" – French overseas departments and territories) and where the creditor does not reside in the overseas department or territory concerned.

There is special provision for creditors with registered securities. Indeed, where a creditor is the beneficiary of a properly registered security interest, the creditors' representative must send him a letter. The secured creditor must be unequivocally notified of the collective insolvency proceedings affecting the debtor. The same applies to contracting parties connected with the security interest by virtue of a registered contract, such as a leasing agreement, for example. The time limit within which they must lodge their claim does not run until they have been so notified. They therefore have an advantage over other creditors, who must be vigilant and stay informed of their debtor's situation. Of course, the creditors' representative will notify all creditors of which he is aware.<sup>141</sup> However, the creditors' representative will need to rely on the debtor in this regard. If the debtor omits to mention certain creditors, they risk not being informed about the collective insolvency proceedings involving the debtor, and may in consequence fail to lodge their claims in time.

The penalty (a civil penalty) for not lodging a claim in time is severe, although it was alleviated somewhat by the 2005 law. Until 1 January 2006, the sanction was to bar the creditor's claim, resulting in loss of the claim. This strict solution surprised overseas parties. Currently, claims that are not lodged in time are, in theory, no longer extinguished but the failure to lodge in time deprives the creditor of the fruit of any distribution or dividend in the collective insolvency proceedings. The practice of referring to the creditor's claim as

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<sup>140</sup> Anybody may lodge a claim or claims in the name of a creditor, provided he has special power of attorney in writing. By way of exception to this, and because the lodging of claims is equated to filing a claim in court, lawyers ("*avocats*") may lodge a claim for their clients without the need for a special power of attorney.

<sup>141</sup> Article R.622-21 Commercial Code.

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being “barred”<sup>142</sup> has therefore been retained. In matter of fact, when the debtor company makes payments to settle creditors’ claims through the administrator (if one exists) or through the creditors’ representative, he will distribute dividends to the various creditors, except to those whose claims are “barred”. The creditor whose claim is “barred” retains the right to his claim, but his claim cannot be invoked within the collective insolvency proceedings. For as long as the collective insolvency proceedings are alive, he cannot bring an action against either the company or the creditors’ representative. To have any chance of being paid, he will have to wait out the end of the collective insolvency proceedings and then bring an action against the debtor to try and recover his claim. In reality, a large percentage of safeguard and reorganisation proceedings will fail and be transformed into liquidation proceedings. In such cases, at the end of the proceedings, a debtor company will often have been dissolved and an individual debtor will often be insolvent. Creditors who are “barred” in such cases will obtain nothing, and will only be able to wait out the return to fortune of their debtor.

As the civil sanction for exceeding the time limit for lodging claims remains severe, there is an exception. By way of *ex parte* application to the supervisory judge, the creditor whose claim is barred can seek relief. If he succeeds in his application, his claim will be admitted and he will share in the distribution of dividends. This request for relief is based on article L.622-26 of the Commercial Code. This article provides that the request must be brought within 6 months following publication of the commencement order. For secured creditors, the 6 month time limit runs from the date of service of the notice by the creditors’ representative.

The same article provides that, by way of exception, the time limit is one year if the creditor was incapable of knowing about the existence of his claim within the six-month time limit. It sometimes happens that a creditor is unaware of the fact that he is a creditor. For example, the debtor company may have carried out works that are later revealed to be defective. In such a case, the client becomes a creditor entitled to damages based on the company’s civil liability, but only discovers this belatedly.

In order to succeed in front of the supervisory judge, the barred creditor will need to meet one of two conditions:

- show that his failure was not due to his fault, which would be the case in the above example (belated discovery of defects); or

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<sup>142</sup> In French, «*forclos*».



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- show that the debtor omitted his name on purpose from the list of debts he drew up at the time of the declaration of payment failure.

As can be seen, missing the time limit for lodging claims remains disastrous for creditors. Their claims are likely to be irretrievably barred as against the debtor. Their only remaining hope may be to bring proceedings on a guarantee, if one exists. This possibility is considered in the later section covering sureties and other guarantors.

### Checking and Approving Claims

Certain partners of the business in difficulty may be tempted to overstate the value of their claims, or may be tempted to invent a claim that does not exist. Claims are therefore checked before they are either accepted or rejected.

The creditors' representative has the task of drawing up a list of lodged claims in consultation with the debtor and, in some cases, the controllers. If a claim is contested, the creditors' representative must notify the claimant by letter, detailing the grounds on which the claim is contested. The claimant has 30 days to respond to the letter<sup>143</sup> sent by the creditors' representative. In the absence of a response within the time limit, the claimant is barred from making any later challenge.<sup>144</sup> The creditors' representative then makes his proposals as to which claims should be accepted or rejected.

When the creditors' representative has drawn up the list of claims that he propose be accepted, this list is sent to the supervisory judge. The supervisory judge will fix the existence, amount and nature of each claim, noting where any particular claimant enjoys security for his claim, so as to differentiate the secured from unsecured creditors. In practice, the supervisory judge will most often approve the list as presented by the creditors' representative. Any interested party may challenge the judge's ruling by filing claim with the supervisory judge within 30 days from the publication in BODACC<sup>145</sup> of a note that assessment of the lodged claims has been filed with the court.<sup>146</sup>

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<sup>143</sup> The letter must be sent by registered post with acknowledgement of receipt. The 30 days runs from the date of receipt of the letter—article R.624-1 Commercial Code.

<sup>144</sup> Article L.622-27 Commercial Code.

<sup>145</sup> *Bulletin Officiel des Annonces Civiles et Commerciales*: The official list of civil and commercial announcements.

<sup>146</sup> Article L.624-8 *in fine* Commercial Code.

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However, the supervisory judge is not competent to rule on any challenge relating to wage claims. Any dispute in this area must be referred to the employment court.<sup>147</sup>

More generally, where there is any doubt about the merits of a claim, for example following a cancellation notice under a contract from which a claim arises, the dispute must be referred to the competent court<sup>148</sup>. The court registrar completes the list of accepted claims when the outcome of the ensuing litigation is known.<sup>149</sup>

When the supervisory judge has made his ruling fixing the list of admitted claims, it must be notified to each creditor who lodged a claim and to the debtor.<sup>150</sup>

It is possible to appeal the ruling of the supervisory judge. The competent court is the Court of Appeal.<sup>151</sup>

### Proposal to Settle Debts

The debtor must put forward proposals for the settling of its debts. It does this through the administrator, if one has been appointed, otherwise directly to the creditors' representative.<sup>152</sup>

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<sup>147</sup> The specialist employment court in France is known as *Le Conseil de Prud'hommes*.

<sup>148</sup> Where cancellation of a contract is in issue, it is generally the High Court that will have jurisdiction. Concerning recourse against any decision relating to the competency of the supervisory judge, refer articles R.624-4 and R.624-5 Commercial Code. In the absence of any challenge against a ruling that the supervisory judge is not competent, service of the ruling triggers a two month time limit during which the claimant must commence proceedings in the competent court, failing which his claim is barred (decree no 2007-431 25 March 2007, article 4).

<sup>149</sup> Article R.624-2 Commercial Code. The Registrar also completes the list by including claims of those persons who have obtained relief from the "barring" of their claim (refer above).

<sup>150</sup> This notification must take place within 10 days of the ruling.

<sup>151</sup> Article R.624-7 Commercial Code. The time limit for bringing the appeal is not determined without some difficulty. Article 4-3 of decree No 2007-431 dated 25 March 2007 cross-refers to article 3 of decree no 85-1388 dated 27 December 1985, which sets the time limit at 15 days for any appeal against the ruling, with time running from the publication in BODACC of a note that assessment of the lodged claims has been filed with court.

<sup>152</sup> Article L.626-5 Commercial Code. The proposals are also notified to the controllers and to the works council or, in the absence of a works council, to the staff representative.

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The creditors' representative confers with each creditor who has a validly filed claim, with a view to obtaining his agreement to some form of sacrifice with respect to each claim. At issue will be whether the creditor is in a position to agree either to a reduction of his claim, or to a deferred payment arrangement. This exchange is normally done in writing.<sup>153</sup> The creditors' representative will not limit himself to soliciting an offer. He will send a letter making a specific proposal to each creditor inviting a particular reduction or relaxation of payment terms. In this respect, article L.626-5 of the Commercial Code can be a trap for the unwary creditor because failure to respond within 30 days from receipt of the letter is deemed to be acceptance on the part of the creditor of the proposals put forward by the creditors' representative.

At stake is the reduction of the struggling company's liabilities. But a creditor can always refuse to agree to any proposed reductions. The court cannot impose a reduction of his claim on any creditor. For this reason, the creditor must not omit replying to the creditors' representative and, generally speaking, his interests are usually best served by refusing the proposed reductions. His entire claim thus remains due and owing. However, the court can order that the debtor have further time to pay the creditor's claim. This is a feature of the process that can be used by the debtor to encourage a creditor to agree a reduction in his claim, in return for which his claim will be paid more promptly.

Is there any interest for the creditor in agreeing to a reduction in his claim? Generally, no, but the answer will depend upon the circumstances. For example, within a company group, where a company is a creditor of one of its subsidiaries, or of its parent company, it may be in a position to agree to a reduction in the claim. Another example is where the creditor has a large client that he does not want to lose. In that situation, he may be willing to agree significant reductions.

Since the 2005 law, public authorities in the position of creditor may now agree to reduce their claims. This affects tax authorities and social security agencies. In practice, such organisations are very reluctant to agree to any sacrifices.<sup>154</sup>

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<sup>153</sup> It can be done orally, provided each creditor consulted is made to sign a note.

<sup>154</sup> This system, provided for in article L.626-6 of the Commercial Code, is complemented by various decrees and administrative memoranda. It allows public authorities to agree to reductions but only if general creditors have agreed to the same sacrifices. In practice, the company in difficulty will make a request to the CCSF (*Commission des Chefs de Service Financiers et des Représentants des Organismes de Sécurité Sociale*)— a commission made up of the heads of finance departments and representatives of social security agencies. These days, the acronym CCSF has been retained. However, in the jargon of common parlance, practitioners often use

### Sacrifices Imposed on the Creditors

The court will officially record any time extensions and reductions agreed by the creditors who have so consented.<sup>155</sup> For other creditors, the court imposes “uniform payment terms”.<sup>156</sup> This means that creditors, even if they do not consent, will be paid at times that are fixed by the court during the life of the safeguard or reorganisation plan. Such plans can last up to 10 and even 15 years if the debtor business is an agricultural business. Creditors must therefore be patient. Only employees avoid having to wait, as well as creditors with small claims up to €300,<sup>157</sup> which are paid immediately.

Creditors will receive partial payments,<sup>158</sup> spread over the whole duration of the plan. By way of reference to such payments, certain practitioners still talk in terms of “scheme of arrangement dividends” («*dividendes concordataires*»), even though the term “scheme of arrangement” («*le concordat*») is no longer the current terminology.<sup>159</sup> However, it is still correct to talk in terms of dividends (without any qualifying adjective) as the word is found in the Commercial Code.<sup>160</sup>

Equality must be respected as between creditors, in the sense that they will periodically receive the same percentage of what is due to them.<sup>161</sup> The first

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the term “COCHEF” or “CODECHEF”). The Commission is chaired by the TPG (*Trésorier Payeur Général* – a high placed public official regionally responsible for public finances). The request must be sent to the Commission within 2 months of the commencement order marking the start of the collective insolvency proceedings. In the absence of any response from the Commission within 10 weeks, the request is deemed rejected. This system does not work, in particular because of the time limits that are too short but also because of the relatively intransigent mentality of the public authorities.

<sup>155</sup> In theory, the court can reduce the time extensions and reductions.

<sup>156</sup> Article L.626-18 Commercial Code.

<sup>157</sup> The specific regime applicable to small claims, as contained in article L.626-20 §II of the Commercial Code, is a simplification measure designed to streamline the procedure involved in implementing the plan.

<sup>158</sup> Payments under the plan are payable without demand from the creditor (in French, the payments are said to be “*portable*”, as opposed to “*quérable*”) (article L.626-21 Commercial Code).

<sup>159</sup> See above, under creditors’ committees.

<sup>160</sup> Article L.626-1 paragraph 3 Commercial Code: “The court sets how the dividends fixed in the plan should be paid. Dividends are paid into the hands of the commissioner in charge of implementing the plan, who then distributes them.”

<sup>161</sup> With the exception of those who are entitled to accelerated payment, in consideration of their agreement to reductions in their claims. Article L.626-19 of the Commercial

## Insolvency Law in France

payment must take place within a year of commencing implementation of the plan. However, the law imposes no minimum amount for the first payment. “Beyond the second year, the amount of each annual payment provided for in the plan cannot, except in the case of a farming business, be less than 5% of the accepted claims.”<sup>162</sup> Creditors who are subject to a plan therefore have very little by way of guarantee.

However, secured creditors can have some hope that the collateral guaranteeing that their claim will be sold. In which case, they will be paid from the price obtained after payment of wage claims,<sup>163</sup> if any. In this way secured creditors may escape the otherwise uniform payment terms that are imposed by the court. For this to happen, the collateral must not be indispensable for the continuation of the debtor’s activity, which is a matter for the supervisory judge to assess.

As can be seen, it is frequently the case that creditors have every reason to seek escape from the effects of safeguard or reorganisation proceedings affecting their debtor.

### Legal Position of Creditors in Liquidation Proceedings

It is rare that liquidation proceedings are brought against a company directly without first passing through a reorganisation phase. Indeed, reorganisation must be “obviously impossible”<sup>164</sup> if liquidation proceedings are to be commenced. Thus, creditors often find themselves in the situation just described—in reorganisation or, less frequently, safeguard proceedings. If that process fails, it is transformed into liquidation proceedings. Where a safeguard or reorganisation plan is terminated, “creditors who are subject to the plan are not required to lodge their claims or declare their security interests. The claims listed in the plan are admitted as of right, adjusted for any amounts already received.”<sup>165</sup>

Whether it is a case of transformed liquidation proceedings or liquidation proceedings commenced directly, without going through any other phase, creditors expect to be paid from the amounts realised from the sale of the debtor’s assets. There is no possibility of reorganisation. The debtor’s business is sold either as a going concern, or on an asset basis.

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Code stipulates that the reduction in any claim is not final until after payment, at the time set, of the last payment due under the plan.

<sup>162</sup> Article L.626-18 paragraph 3 Commercial Code.

<sup>163</sup> Refer article L.626-22 Commercial Code.

<sup>164</sup> Article L.640-1 Commercial Code.

<sup>165</sup> Article L.626-27, §III Commercial Code.

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Publication of the liquidation commencement order triggers the two-month time limit within which creditors must lodge their claims. But all claims become immediately payable on the day of the commencement order. Claims are “accelerated”. With respect to other matters, the consequences are as already described in the section on reorganisation/safeguard proceedings. In short, a court nominee, appointed as liquidator, receives the lodged claims and is responsible for checking them in the same way already described. However, the liquidator is not required to check unsecured claims “if it appears that the proceeds of sale of the assets will be entirely accounted for by the legal costs and by creditors with priority.”<sup>166</sup>

For as long as the debtor continues its activities, claims properly arising after the liquidation commencement order, are paid according to their terms.<sup>167</sup> Also paid in accordance with its terms is any claim properly arising<sup>168</sup> after any commencement order relating to safeguard or reorganisation proceedings, even where those proceedings may have been transformed into liquidation proceedings.

In all liquidation proceedings, the liquidator draws up the “order of creditors”.<sup>169</sup> The order of priority is as follows:<sup>170</sup>

- employee wage claims guaranteed by the super priority accorded to employees;<sup>171</sup>
- legal costs properly incurred after the commencement order where

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<sup>166</sup> Article L.641-4 Commercial Code. By way of exception to this, the law still requires that unsecured claims be checked where personal liability of directors of a legal entity is at issue, with a view to holding them responsible for part or all of the entity’s liabilities.

<sup>167</sup> Provided that the claims arose “for the requirements of the conduct of the proceedings or the provisional continuation of permitted activity pursuant to article L.641-10 or in consideration of any service provided to the debtor during the continuation of activity”, (refer article L.641-13 Commercial Code, as amended by the December 2008 order).

<sup>168</sup> This is any claims as described in §I of article L.622-17c Commercial Code.

<sup>169</sup> Article L.641-5 Commercial Code.

<sup>170</sup> Article L.641-13 Commercial Code.

<sup>171</sup> Article L.3253-2 Employment Code: “Where safeguard, reorganisation or liquidation proceedings are commenced, remuneration of any type due to employees for the last 60 days of work is paid, taking account of any advance payments already made, notwithstanding the existence of any other priority creditors, limited to a monthly ceiling identical for each category of beneficiary”.

Former articles L.143-10 and L.143-11 of the Employment Code were applied until May 2008, the date of entry into force of the new Employment Code.

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required for the conduct of the proceedings, which includes remuneration due to the court appointees (creditors' representative, liquidator, etc);

- priority for “new money”;<sup>172</sup>
- claims which, although arising before the commencement order, are guaranteed by security over real property<sup>173</sup> or over particular personal property accompanied by a right to retain possession,<sup>174</sup> as well as claims guaranteed by general security over the business<sup>175</sup> and security over professional tooling and equipment;<sup>176</sup>
- wage claims of employees arising after the commencement order, which have not been advanced by the wages guarantee fund;<sup>177</sup>
- claims arising from current contracts, where the party that has contracted with the company in difficulty has agreed to defer receipt of payment for its services;<sup>178</sup>
- amounts advanced by the wages guarantee fund;
- claims arising after the commencement order, according to their ranking in the Civil Code;<sup>179</sup>

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<sup>172</sup> Article 611-11 Commercial Code provides that in conciliation proceedings, where a party brings in money or provides goods or services without demanding cash payment, he will benefit from this significant priority if later the debtor finds himself in liquidation.

<sup>173</sup> Most commonly mortgages (*«hypothèques immobilières»*).

<sup>174</sup> For example, a pledge, or a garage owner's lien for repairs.

<sup>175</sup> In French, *«le nantissement du fonds de commerce»*—The *fonds de commerce* is a term used to describe the bundle of tangible and intangible personal property rights that go to make up the business of a commercial or industrial entity and by which its market value is assessed.

<sup>176</sup> In French, *«le nantissement de l'outillage et du matériel d'équipement professionnel»*—a special secured right available to a seller, or lender who advances the necessary funds to pay the seller, to secure payment for tools and equipment supplied to a business (refer L.525-1 *et seq* Commercial Code).

<sup>177</sup> There is a guarantee fund, known under the acronym AGS, which advances amounts due to employees where the employer fails to do so, under certain conditions. See *infra* under Legal Position of Employees.

<sup>178</sup> More generally, loans granted during the observation period in safeguard or reorganisation proceedings will benefit from this priority. This type of priority payment, provided for today in articles L.622-17 and L.641-13 of the Commercial Code, is often termed “article 40 priority” (*«privilege de l'article 40»*) because it was introduced by article 40 of the 1985 law and referred to in this way for twenty years. It is also sometimes referred to as “procedural priority” (*«privilege de procédure»*).

<sup>179</sup> The Civil Code describes a number of general and particular liens that may arise over a debtor's personal and real property. In relation to personal property, the relevant articles are articles 2329 *et seq* while in relation to real property, the relevant articles are articles 2373 *et seq*.

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- claims arising prior to the commencement order and secured by general liens;<sup>180</sup>
- claims arising before the commencement order, according to their ranking in the Civil Code; and
- unsecured creditors.<sup>181</sup>

These priority rules illustrate that many creditors' interests are best served by trying to avoid the effects of collective insolvency proceedings.

### *Legal Position of Creditors Who Are Able to Escape the Effects of Collective Insolvency Proceedings*

Some creditors are in a position to escape the effects of safeguard or reorganisation proceedings affecting their debtor. Falling into this category are owners of any personal property in the possession of the debtor. Subject to certain conditions, the rightful owner will be able to demand back his property. This approach is usually much more effective than demanding payment of the price. Others who fall into this category are creditors who are able to set off their claims. Finally, in this category, some creditors will have the option of seeking payment from a third party.

### Circumventing Insolvency Proceedings—Demanding the Return of Movable Property

Any demand for return of property must be made within three months following publication of the commencement order.<sup>182</sup> This concerns parties who have remained owners of property in the possession of the debtor. For example, equipment hired by the debtor company for use on a work site or intellectual property rights to which it had rights of use without being the owner. Indeed, the rule applies as much to tangible personal property as to intangible personal property. The owner of the property is entitled to retake possession because he is the true owner.

The three-month time limit cannot be extended. If the owner does not act within the requisite three months, he will have no remedy. In particular, he will not be able to seek relief from forfeiture.<sup>183</sup>

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<sup>180</sup> For example, legal costs arising before the collective insolvency proceedings, claims by the tax authorities and claims for social security contributions.

<sup>181</sup> It is rare that anything significant remains for unsecured creditors.

<sup>182</sup> Article L.624-9 Commercial Code.

<sup>183</sup> Unless he can show that it was impossible for him to act because of *force majeure*, by reason of the maxim *contra non valentem agere non currit praescriptio*. Cf H.



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The party seeking return of his property must make demand by registered letter with acknowledgement of receipt addressed to the administrator.<sup>184</sup> Before acceding to the demand, that is to say approving it, the administrator must solicit agreement from the debtor. Failing approval within one month from receipt of the demand, the party who has demanded return of his property must refer the matter to the supervisory judge. He must refer the matter within one month following expiry of the one-month time limit initially allowed for the administrator to respond to the demand.<sup>185</sup> The supervisory judge then rules on the matter. He must rule with urgency and his order must be handed down within a reasonable time.<sup>186</sup> If the supervisory judge does not hand down his order within this time, then the court has jurisdiction to rule on the demand.

A demand for return of movable property is often based on retention of title. In sale and supply contracts, a clause often exists whereby the purchaser does not become owner until after payment of the total price. The supplier has a right to be paid but also has property rights. As owner, he has a right which is good as against the world,<sup>187</sup> and which allows him to escape having to compete with other creditors. He is rewarded for precautions taken well before the collective insolvency proceedings.

The disadvantage of this real right is that it is generally occult, invisible and not subject to any publicity. It has the effect of making the debtor company appear apparently, but falsely, solvent. It was for this reason that retention of title clauses were for a long time of no effect in France, if the buyer became subject to collective insolvency proceedings. However, the law changed in 1980. Since then, demand by a creditor for return of his property is possible, and is routine in the case of credit sales,<sup>188</sup> even if the debtor finds himself the subject of collective insolvency proceedings.

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Roland and L.Boyer, *Adages du Droit Français* ("Maxims of French Law"), Litec, 3rd Ed. n° 58.

<sup>184</sup> If no administrator has been appointed, it is the debtor who accedes to the demand after obtaining agreement of the creditors' representative (article L.624-17 Commercial Code).

<sup>185</sup> Where the supervisory judge refuses the demand, the party demanding return of his goods can still lodge an appeal. The appeal must be brought within 8 days following notification of the supervisory judge's decision, by registered letter with acknowledgement of receipt addressed to the court registrar.

<sup>186</sup> The legislation does not set a fixed time but, from case law in this area, it is brief—in the order of 8 days.

<sup>187</sup> However, refer *infra* to practical limitations on this right. For example, as against a pledgee of the goods.

<sup>188</sup> Since 1994, reservation of title can apply to any property. In practice it is applied to personal property but nothing prevents it being applied to real property.

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However, the retention of title clause must be valid. For that, the contract must have been concluded in writing at the latest by the time of delivery, from which it is inferred that the retention of title clause has been accepted by both the supplier and the purchaser.<sup>189</sup>

The demand will only be successful if the goods themselves are in the purchaser's possession, that is to say located in the debtor company's premises. To validly demand the goods back, the sold goods must be identifiable and distinctive in the hands of the purchaser. Conversely, proceedings to demand return of goods are impossible where the goods have been transformed into something else by the purchaser or have been integrated into an assembly line.

Where the goods sold are fungible goods,<sup>190</sup> it is possible to demand them back if the purchaser holds goods of the same type and quality.

Where the demand ends up with the supplier retaking possession of the goods, the supplier must render an account. Where the supplier does not recover sufficient goods to cover what he is owed, he can lodge a claim for any residual amount.

While a person entitled to the benefit of a retention of title clause need not lodge a claim in due form, lodging a claim is nevertheless a prudent step to take. Indeed, between the date of sale and the date of demand for return of the goods, the goods will often have deteriorated in value,<sup>191</sup> with the result that even where the goods are claimed back successfully, the return of the goods does not cover the price invoiced by the seller at the time of sale. The seller is therefore well advised to lodge a claim for the loss of value. Sometimes, it is as well to lodge a claim for the full invoiced price, in anticipation of a possible

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<sup>189</sup> The written document need not be drafted in any particular way and can take the form, for example, of the seller's commercial documents (*inter alia*, delivery notes, order forms and invoices, provided they are handed to the buyer no later than the time of delivery). The relevant documentation could be a written agreement governing a series of commercial matters between the parties, or simply a clause appearing in the seller's standard terms of sale. The prudent approach is to have the retention of title clause appear in the order form. That will allow the claimant to easily prove that the written document forms part of the agreement and was accepted no later than the time of delivery. If the retention of title clause is only noted on the invoice, proof that it forms part of the contract will be harder. As well, the seller should be careful to detail and reference with precision each of the goods sold with retention of title, so that they can easily be identified when the time comes to demand their return.

<sup>190</sup> Fungible goods are goods that are interchangeable. For example, a certain quantity of wheat mentioned in a sale contract, a particular model of car etc.

<sup>191</sup> In French, «une décote».

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challenge to the validity of the retention of title clause. In the event he fails to impose his retention of title clause, the seller can hold out hope for part repayment of what he is due, in his capacity as creditor.

It sometimes happens that, when collective insolvency proceedings are commenced, the goods are to be found in the hands of a pledgee. In such circumstances, the seller may not demand their return. He may only lodge his claim in the insolvency proceedings.

It sometimes happens as well that, at the moment collective insolvency proceedings are commenced, the goods are in the possession of a sub-buyer to whom the purchaser has resold. The seller in such cases may successfully demand return of the goods unless the sub-buyer has acquired them in good faith, that is to say in ignorance of the retention of title clause. If the sub-buyer is in good faith, the initial seller cannot demand return of the goods. However, in such circumstances, the initial seller can demand that the sub-buyer pay him the resale price direct if the sub-buyer has not yet paid the company in difficulty that resold him the goods.

Where demand for payment of the resale price is made, the situation can be complicated if demand is made at the same time, both by the initial seller and by a person subrogated to the rights of the reseller in difficulty. Indeed, the initial seller can find himself in direct competition with other creditors, for example the bank to whom the debt for the resale price has been assigned. It is not uncommon that a factor to whom the buyer/reseller (i.e., the company in difficulty) has assigned the debt, finds himself in this way subrogated to the rights of the reseller. The approach of the courts has been to recognise that the seller who can show retention of title has priority over the bank assignee of the debt and over the subrogated factor.

### Circumventing Insolvency Proceedings—Applying Set-off

Pursuant to article L.622-7 §1 of the Commercial Code, “the order marking the commencement of proceedings gives rise, *ipso jure*, to a bar against paying any claim arising before the commencement order, with the exception of payment of connected claims by way of set-off.”<sup>192</sup>

Article 1289 of the Civil Code provides that “where two persons are mutually indebted to one another, set-off operates between them so as to extinguish the two debts”, in the manner and in the situations detailed in the Code. Set-off

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<sup>192</sup> The French term is «*compensation de créances connexes*». Any contractual clause that seeks to allow set off for claims that are not connected will be null and void.

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operates as of right. The two debts are reciprocally extinguished to the extent of their respective amounts due. Set-off is not dependent on the intention of the parties. It is automatic. Collective insolvency proceedings do not affect the operation of set-off so long as the two debts are due, liquid and certain before the commencement order. Conversely, where the conditions for set-off are only met in the period after commencement of the collective insolvency proceedings, set-off is not available.

If set-off is not available, the party that has contracted with the debtor in difficulty must pay what he owes to the debtor and he is then limited to lodging a claim in the proceedings. On the other hand, if set-off applies the creditor is not subject to the risks inherent in the collective insolvency proceedings. In practice, contracting parties escape collective insolvency proceedings where the mutual debts arise out of the same contract or series of related contracts. For example, set-off applies after the commencement order if the mutual debts are recorded in the same account. This could be a running account between two companies or a current account between a bank and its client. If there is a debit balance, the party who has contracted with the debtor in difficulty only lodges a claim for the final debit balance.

### Circumventing Insolvency Proceedings—Bringing Action against a Third Party

If a debtor is subject to collective insolvency proceedings, what better for a creditor than to be paid by a solvent third party? For example:

- Where the creditor is a victim of an accident caused by the debtor, whether before or after the commencement of insolvency proceedings, the debtor is liable. Provided the debtor is insured, the insurance company will have to compensate the victim. Legally speaking, the compensation payable does not constitute part of the debtor's assets. This rule is found in article L.124-3 of the Insurance Code.
- The debtor is a credit institution in reorganisation. The subject of bank failures is a topical subject. The client depositors become creditors. In France, they benefit from an interbank guarantee, up to €70,000.<sup>193</sup> The “bankruptcy” of the bank leads to the Banking Commission ap-

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<sup>193</sup> Article L.312-4 Monetary and Finance Code: “Approved credit institutions in France must subscribe to a guarantee fund for deposits which is intended to compensate depositors in the event their deposits or other repayable funds become unavailable.” Every depositor is entitled to the benefit of this guarantee. If there are joint accounts, or separate accounts with a spouse or cohabitee, each is considered to be a distinct depositor. The implementation of the guarantee fund is governed by articles L.312-15 *et seq* of the Monetary and Finance Code.

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pointing a provisional administrator. The depositor need take no steps as the guarantee fund, seized by the Banking Commission, proceeds to audit the accounts. Within 15 days, the guarantee fund must send a letter to each depositor, setting out the assets held. On demand, it must transfer the amount claimed (up to the €70,000 limit) to the account opened by the creditor client in another bank.

- The most common hypothesis is that of a creditor who has the benefit of an independent guarantee. The creditor will seek to be paid by the guarantor. However, we shall see that in certain cases the guarantor is not required to pay, or not immediately.

### *Legal Position of Guarantors*

French law draws a distinction between sureties and those who agree to give independent guarantees.<sup>194</sup> For the purposes of determining when they are deemed discharged of their obligations or when they must honour their obligations, the 2005 law applies the same rules for both types of guarantor.<sup>195</sup>

In principle, the guarantor cannot invoke the existence of collective insolvency proceedings to resist a demand for payment to the creditor under the guarantee. But this principle is subject to numerous exceptions.

### *Guarantors and Conciliation Proceedings*

Added by the December 2008 order, article L.611-10-2 of the Commercial Code states that “persons jointly liable, or who have agreed to give a personal guarantee, or who have pledged or assigned goods by way of guarantee, may

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<sup>194</sup> Under French law, a surety undertakes to be responsible, in addition to his principal, for the due performance by the principal of his obligations to the creditor. The surety's liability only arises if there is a failure to perform by the principal. The surety's liability is thus ancillary or secondary to that of his principal but inextricably linked. For this reason, the surety can raise any defence that would be available to his principal, including set-off (refer article 2288 *et seq* Civil Code).

The independent guarantor, on the other hand, will be liable to the creditor irrespective of the contractual position between the creditor and guaranteed party. The guarantor cannot invoke any defences available to the guaranteed party under his contract with the creditor. The guarantor must pay either on first demand, or otherwise as agreed in the guarantee (refer article 2321 Civil Code).

<sup>195</sup> Also included is the situation of debtors who are jointly liable.

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take advantage of the terms of the agreement officially noted or approved.”<sup>196</sup> Indeed, the conciliation procedure can end up with agreement being reached between the debtor and its principal creditors. The surety, and guarantors generally, can rely on deferral of time for payment and any eventual debt reductions negotiated into the agreement.

In a small or medium sized business, the director of the company will often personally guarantee his company, because credit establishments routinely require this. The individual director will agree to risk his personal assets in order to obtain finance for his company. As a result, there is no incentive for a director in such a position to invoke conciliation proceedings, as that would risk exposing him to immediate personal liability for the guaranteed amounts. To encourage use of conciliation, the French legislator has therefore allowed the guarantor to take advantage of any payment deferrals or reductions negotiated during the conciliation process between his company and its creditors.

### *Guarantors and Safeguard Proceedings*

In theory, only the debtor can benefit from the stay of individual claims that operates in his favour during collective insolvency proceedings. In theory therefore, guarantors do not enjoy this safeguard. This applies where the guarantor is a legal entity. Within a group of companies, if one stands guarantee for another, this is an excellent form of guarantee for the creditor who stands to benefit. It is only fair that he should be able to take action where collective insolvency proceedings are commenced against the principal debtor.

Conversely, small organisations that need credit have difficulty offering solid forms of repayment guarantee to their lenders. In practice, the bank concerned will require that a personal guarantee be given by the individual who is most implicated in the company. As a result, a director whose responsibility is in theory limited by the form of the legal structure of his company finds that he has to risk his personal assets through a guarantee. The French legislator did not overlook this. It was necessary, through amendments to the law, to ensure that directors were not frightened off from using safeguard proceedings. Indeed, this procedure can only be commenced at the request of the legal entity’s

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<sup>196</sup> Before the 2008 reform, only if the court approved (*«homologuer»*) the agreement could the guarantor benefit from the deferred payment and reductions agreed by the creditors in favour of the principal debtor. However, such court approval would necessarily result in the agreement becoming public. Now the court need only officially note (*«constater»*) the fact of the agreement in order for the guarantor to benefit, without the agreement needing to become public.

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directors. If their request served to immediately put their personal assets at risk, they would certainly refrain from going down this route.

For this reason, an individual guarantor may take full advantage of the freezing of claims during the observation period. As well, he will benefit from the automatic stay of proceedings and the suspension of any accrual of interest (legal, contractual, late payment, surcharges).<sup>197</sup>

Furthermore, an individual guarantor also benefits from the safeguard plan. For this reason, payment deferrals and possible reductions in debt provided for in the plan are determinative not only for the debtor company but also for directors and any other individuals who have guaranteed loans granted to the company. This is a significant incentive to use safeguard proceedings.

Finally, guarantors will benefit from any “barring” of claims that are lodged out of time. Indeed, the December 2008 order provides:

Claims that are not properly lodged within time are of no effect as against the debtor during implementation of the plan and after implementation where the commitments listed in the plan or decided on by the court have been respected. During implementation of the plan, they are also of no effect as against individuals who are jointly liable, or who have agreed to give a personal guarantee, or who have pledged or assigned goods by way of guarantee.<sup>198</sup>

In this provision, directors can find very real incentive to succeed in resuscitating the business through the medium of safeguard proceedings.

### *Guarantors and Reorganisation Proceedings*

An individual who stands guarantee or who is jointly liable for the debts of the company in difficulty can take advantage of the stay of proceedings during the observation period in reorganisation proceedings. However, the individual does not benefit from suspension of accrual of interest.<sup>199</sup> Nor does the individual benefit from the sacrifices imposed on creditors in the reorgani-

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<sup>197</sup> Article L.622-28 of the Commercial Code provides that “the commencement order suspends accrual of legal and contractual interest, as well as all late payment interest and surcharges”. This rule does not apply either to interest arising from loan agreements for a term of 1 year or more, nor to contracts in which payment is deferred for a year or more.

<sup>198</sup> Completing article L.622-26 Commercial Code.

<sup>199</sup> Article L.631-14 *in fine* Commercial Code.

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sation plan, nor from any sacrifices volunteered by the creditors.<sup>200</sup> However, the court may extend time for payment for up to two years.<sup>201</sup>

Where the surety, and more generally the guarantor or person jointly liable, is a legal entity, the guarantee may be called upon at any time by the creditor, as soon as the principal debtor finds itself in reorganisation proceedings. The December 2008 order provides that “persons jointly liable, or who have agreed to give a personal guarantee, or who have pledged or assigned goods by way of guarantee, may not benefit from the lack of effect provided for at paragraph 2 of article L.622-26.” In short, although the creditor’s claim is barred, the surety’s obligation as guarantor of payment is not discharged and the creditor may look to the guarantor for the whole debt. The same applies for a legal entity that is jointly liable or which has provided an independent guarantee.

### *Guarantors and Liquidation Proceedings*

The full effect of a personal guarantee comes to the fore when the principal debtor is in liquidation. The surety, the provider of an independent guarantor or the person jointly liable must pay the creditor. This is an incentive for the creditor to serve notice of liquidation proceedings on the principal debtor.

Where a guarantor has paid in place of the principal debtor, he may lodge a claim in the liquidation for what has now become his own claim, albeit unsecured.

When the court makes a ruling bringing the liquidation proceedings to an end, the unpaid guarantor who paid in place of the principal debtor is entitled to claim against the debtor for the debts it guaranteed and paid.<sup>202</sup> In reality, any such claim is generally hopeless, the debtor company having disappeared. From time to time, it does happen that the debtor still legally exists (in particular if the debtor is an individual), but it is still necessary that he be solvent, that is to say come into good times.

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<sup>200</sup> Article L.631-20 Commercial Code.

<sup>201</sup> Article L.622-28 Commercial Code, by reference to the time allowances in article 1244-1 Code Civil. Applicable to reorganisation proceedings per article L.631-14 Commercial Code.

<sup>202</sup> Article L.643-11 Commercial Code.



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### *Legal Position of Employees*

We have seen how employees have the benefit of particular representation during collective insolvency proceedings. We have also seen how wage claims are ranked among the body of creditors.

It is often the case that employees of companies in difficulty have not been paid for the last few days or weeks of work. They are entitled to receive their wages from their employer and are thus creditors. However, they must fear the spectre of dismissal. These two issues are governed by the French Employment Code. New provisions are in force since 1 May 2008.<sup>203</sup>

### *Employees as Creditors*

Unpaid employees are of course creditors with respect to their wages and all compensation that the law equates to wages.<sup>204</sup> They are not required to lodge a claim and they therefore run no risk of seeing their claims forfeited.<sup>205</sup>

In collaboration with the debtor employer, the list of wage claims is drawn up by the administrator or liquidator and checked by the employees' representative. The supervisory judge will see the list but any challenges are a matter for the Employment Court.<sup>206</sup> In principle, the administrator or liquidator must draw up the list within 10 days from the commencement order.<sup>207</sup> If available

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<sup>203</sup> Order 2007-329 dated 12 March 2007, which profoundly modified the structure of the Employment Code.

<sup>204</sup> Article L.3253 of the Employment Code: "The remuneration provided for in the first paragraph of article L.3253-2 includes:

1. Salary and wages, pay or commission properly so called;
2. All that is accessory including, *inter alia*, the compensation payment provided for in article L.1226-14, the notice period compensation payment provided for in article L.1234-5, the contract termination payment provided for in article L.1243-8 and the assignment termination payment provided for in article L.1251-32."

<sup>205</sup> Except for wage claims that are five or more years old.

<sup>206</sup> *Le Conseil de Prud'Hommes*.

<sup>207</sup> Article L.3253-19 Employment Code: "The administrator must draw up the list of claims in accordance with the following conditions:

1. For claims listed in articles L.3253-2 and L.3253-4, within 10 days following announcement of the commencement order relating to the proceedings;
2. For other claims that are payable at the date of the commencement order relating to the proceedings, within 3 months following announcement of the order;
3. For wages and compensation for paid holidays covered by 3° of article L.3253-8 and wages covered by the last paragraph of the same article, within 10 days

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funds are sufficient to pay the employees, the debtor or the administrator or the liquidator must pay.

If there are insufficient funds, employees have the benefit of payment guarantees so that they have every chance of receiving their wages. Firstly, they have a general lien over the employer's real and personal property, which stands as guarantee for the last 6 months of wages and compensation equated to wages. But this lien is not well ranked in the order of priority. For this reason, since 1973, employees have had the benefit of "super priority" for a limited part of their claim. The super priority ranks above all other claims (including claims by secured creditors) and allows employees to avoid the disruption of collective insolvency proceedings, and to be paid quickly. It covers the last 60 days of work before the commencement order (or before the date the employee effectively ceased work for contracts that are broken before the commencement order).<sup>208</sup>

In principle, the problem of unpaid employees does not arise in a safeguard proceeding. The court can only order safeguard proceedings after having checked that the company is not in a payment failure situation. Conversely, where a reorganisation or liquidation proceeding is commenced, it is often impossible to release the funds necessary to pay employees as, in theory, the company is in a payment failure situation. It is for this reason that a guarantee fund was instituted—AGS.<sup>209</sup> AGS assumes responsibility for paying employees' wages. Financed by employer contributions,<sup>210</sup> even employees of companies that have not contributed are covered.<sup>211</sup>

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following expiry of guarantee periods provided for in 3°, up to the limits provided for in articles L.3253-2, L.3253-4 and L.7313-8 of the Employment Code;

4. For other claims, within 3 months following expiry of the guarantee period.

The lists of claims must detail the amount of any subscriptions and contributions listed in the last paragraph of article L.3253-8 that are due in relation to each of the affected employees."

<sup>208</sup> However, there is a ceiling to this guarantee that is set at twice the monthly ceiling used for the calculation of social security contributions

<sup>209</sup> *Association pour la Gestion du Régime d'Assurance des Créances des Salariés.*

<sup>210</sup> Article L.3253-6 Employment Code: "Any private sector employer must insure his employees, including those on missions abroad or expatriates as noted in article L.5422-13, against risk of non-payment of amounts due to them under a contract of employment, in the event of any safeguard, reorganisation or liquidation proceedings."

<sup>211</sup> Article L.3253-7 Employment Code.

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The AGS guarantee covers not just wages that arose before the commencement order but wages that arise after, provided certain conditions are met.<sup>212</sup> In practice, the issue turns around whether the claims are being made by employees on the basis they are redundant due to the increased difficulties being encountered by the employer or because they have been dismissed. For AGS to assume responsibility for the claims arising from the fact that an employment contract has been broken, that is to say responsibility for the various compensation payments due to the employees, the contract must be terminated during the observation period, or within the month following the judgment approving the safeguard or reorganisation plan or the transfer of the business, or within fifteen days of a liquidation commencement order or during the period allowed in liquidation proceedings for the provisional continuation of the company's activity.

In the case of liquidation proceedings, AGS assumes responsibility, up to a ceiling of one and a half months' work, for unpaid wages earned during any observation period,<sup>213</sup> during the fifteen day period following the liquidation commencement order (a month for the employees' representative), or during the period allowed in liquidation proceedings for the provisional continuation of the company's activity.

Naturally, AGS has a subrogated cause of action against the defaulting employer each time it pays in place of the employer.

### *Employees as a Disposable Work Force*

When a company encounters financial difficulties, this often leads to redundancies<sup>214</sup> amongst employees. French terminology in this area can be confusing. The concept of an "employee safeguard plan"<sup>215</sup> is used, which must not be confused with the plan put in place at the end of safeguard proceed-

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<sup>212</sup> Refer article L.3253-8 of the Employment Code that details the many requirements for cover under the AGS guarantee.

<sup>213</sup> As safeguard or reorganisation proceedings may have been transformed into liquidation proceedings, which explains how liquidation proceedings may have been preceded by an observation period.

<sup>214</sup> The French terminology is «*licenciement pour motif économique*», as opposed to «*licenciement pour motif personnel*». In the former case, the dismissal is linked to reasons that related not to the person dismissed but, rather, to external causes. In the latter case, the reasons for dismissal relate to the individual concerned. Where the term «*licenciement*» is used on its own, it may refer to either a redundancy or dismissal situation

<sup>215</sup> In French, «*plan de sauvegarde de l'emploi*».

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ings—the “safeguard plan”.<sup>216</sup> Where a business has 50 or more employees, if the number of dismissals reaches 10 or more in a single 30-day period, the employer must draw up and implement an employee safeguard plan. This is the case even where the business is not subject to collective insolvency proceedings. It is the position under employment law generally.<sup>217</sup>

When collective insolvency proceedings are in place, any dismissals are subject to the following conditions:

- **safeguard proceedings:** The general law on redundancy applies. Proposals were put forward in France to create simplified redundancy procedures in the context of safeguard proceedings. These proposals were not taken up. Article L.626-2 of the Commercial Code, relating to the drawing up of the safeguard plan, requires that the draft plan contain details on:

the level of and prospects for employment as well as the anticipated terms and conditions of employment for the future of the business. Where the draft plan provides for redundancies, it must describe the measures that have already been accomplished and define the steps that will in the future be undertaken to help redeploy and compensate employees whose positions are threatened.

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<sup>216</sup> In French, «*plan de sauvegarde*».

<sup>217</sup> Articles L.1235-10, L.1233-61 to L.1233-64, R.1233-6 and R.1233-9 of the Employment Code. The plan may contain provision for internal redeployment of employees within the same or equivalent category or, provided they expressly agree, to a lower category; for the creation of new activities by the business; for steps which favour redeployment outside the business, for example to support regeneration of an employment area; for steps to support the creation of new activities or the taking over of existing activities by the employees; for training, formal recognition of experience or retraining likely to help internal or external redeployment of employees to equivalent positions; for measures to reduce or reorganize working hours; for measures to reduce the amount of extra time carried out on a regular basis where this amount shows that the company’s work is organized in such a way that the collective time worked is manifestly more than 35 hours per week or 1,600 hours per year and that its reduction may serve to preserve all or some of the jobs that it is otherwise anticipated will disappear.

In the course of a calendar year, if a business has made more than 18 persons redundant without having had to present an employee safeguard plan, it must prepare such a plan for any anticipated redundancy in the following three months from the end of the calendar year. If the business has made more than 10 persons redundant in total over three consecutive months, without reaching the threshold of 10 persons in any 30 day period, any further anticipated redundancy in the following three months must be done with regard to the rules applicable to employee safeguard plans.

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- **Reorganisation proceedings:** The law provides for exceptions to the general law on redundancy. During the course of the observation period, the supervisory judge can authorise the administrator to make redundancies which by their “nature are urgent, inevitable and indispensable”.<sup>218</sup>

During implementation of the reorganisation plan, redundancies provided for in the plan can take place within one month of the judgment. In this time, redundancies are deemed properly done by the simple expedient of the administrator giving notice to the employees concerned (subject to notice rights provided for in the Employment Code or in the collective bargaining agreements).<sup>219</sup> It is thus a simplified form of redundancy procedure. Conversely, if the redundancies are notified more than a month after the judgment approving the plan, the general law applicable to redundancies must be followed.

- **Transfer of business in difficulty:** Where the court considers that the transfer of part or all of the business may be a viable outcome, it of course authorises the continuation of business activity. It sets a time limit within which offers to purchase must reach the liquidator. Candidates must submit offers in writing. They must include details, *inter alia*, on “the level of and prospects for employment of the activity being considered”.<sup>220</sup> Before approving a proposed sale of the business, the court must solicit, *inter alia*, the opinion of the works council or of the staff representatives.

Very often, a transfer plan provides for redundancies. In the same way as for reorganisation proceedings, redundancies must be notified within a month of the judgment approving the plan if they are to be deemed properly done. They are notified by simple notice from the

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<sup>218</sup> Article 22 L.631-17 Commercial Code, which provides that, prior to submitting the matter to the supervisory judge, the administrator must consult the works council or, if none, the staff representatives and must inform the competent administrative authority. He must attach, in support of the request addressed to the supervisory judge, the comment received and proof of his diligence, with a view to facilitating compensation and redeployment of the employees.

<sup>219</sup> Article L.631-19 Commercial Code, which provides as well that the administrator must consult with the works council, or if none, the staff representatives and must inform the competent administrative authority.

<sup>220</sup> Article L.642-2 §II, 5° Commercial Code—this article provides at §IV that the employees’ representative must be informed of the content of the offers received.

liquidator to the employees concerned.<sup>221</sup> In the event that the transfer plan derives from and forms part of safeguard or reorganisation proceedings, the administrator gives notice of the redundancies subject to the same conditions.<sup>222</sup> There are specific rules applicable to protected employees.<sup>223</sup>

- **Liquidation, and other than the case of transfer of the business in difficulty:** In applying the judgment pronouncing liquidation of the company, the liquidator can legally proceed to make the employees redundant. He does not need to obtain prior authorisation.<sup>224</sup> He must state that the redundancy arises in application of the liquidation judgment.<sup>225</sup> As noted above, AGS covers payment of redundancy payments where they occur within 15 days following the liquidation judgment, or during the provisional continuation of activity where this continuation has been authorised in the liquidation judgment.<sup>226</sup>

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<sup>221</sup> Article L.642-5 Commercial Code which provides, in the same way as for reorganisation proceedings, that notice rights provided for in the Employment Code or in the collective bargaining agreements must be respected by the liquidator.

<sup>222</sup> Article L.642-5 Commercial Code.

<sup>223</sup> These rules concern members of the works council and the *Comités d'Hygiène, de Sécurité et des Conditions de Travail* (CHSCT—Councils for Hygiene, Safety and Work Conditions), staff representatives, union representatives, and the employees' representative appointed during the collective insolvency proceedings. Article L.642-5 has been modified by the December 2008 order to include the following: "Where the dismissal/redundancy concerns an employee who benefits from special protection in relation to dismissal/redundancy, the one month time limit post judgment is the time within which the intention to bring an end to the employment contract must be made known". In other words, the liquidator (or administrator) must put the Labour Department on notice within this time, and not just give notice to the employee concerned.

<sup>224</sup> However, if the liquidation judgment is overturned, any redundancies announced by the liquidator on the strength of the liquidation judgment no longer have any basis. Such redundancies will therefore be considered wrongful ("*sans cause réelle et sérieuse*") (Cass. Soc. 16 December 2008 n°07-43-285).

<sup>225</sup> As grounds, this appears to be sufficient (cf Cass. Soc. 2 March 2004, Rev. Proc. Coll. 2004, p.250, N°16, obs Taquet; JCP E 2004, chron. 1292, p. 1390, N° 15, obs Pétel. This case law seems to be capable of application to the current regime).

<sup>226</sup> Article L.3253-8 of the Employment Code applicable as from 15 February 2009. This law also provides for the guarantee fund to assume liability for claims arising from termination of any employment contract with employees to whom a personalized redeployment agreement was proposed, on condition that the administrator, employer or liquidator, as the case may be, proposed this agreement to those concerned during the course of one of the periods just described.

***Legal Position of Directors Who Have Committed Actionable Faults***

A company may be healthy but have directors that need to be removed because they are incompetent or dishonest. Conversely, competent and honest directors may have suffered economic setbacks without having been at fault. It is not simply because the company is in financial difficulty that directors should be sanctioned. Only those who have been guilty of certain actionable management faults or offences need be punished.

Directors of legal entities who have committed actionable faults risk a number of criminal sanctions. Moreover, any director, whether a director of a legal entity or otherwise, can be the subject of personal sanctions such as “bankruptcy” (*«la faillite»*)<sup>227</sup> and more minor sanctions which constitute a lesser form of bankruptcy. Finally, there are criminal sanctions that can fall on individuals who are held responsible for certain offences.

***Risk of Financial Penalties for Certain Actionable Faults by Directors of Legal Entities***

Under the general law applicable to companies, directors of a legal entity with limited liability would not normally be required to pay the company’s debts from their personal wealth. However, by way of sanction, the law applicable to collective insolvency proceedings introduces a partial exception to this principle.

The key provision is article L.651-2 of the Commercial Code that reads as follows:

Where the liquidation of a legal entity reveals that there is an excess of liabilities over assets, the court may, where there has been actionable fault which has contributed to this insufficiency of assets, hold that the amount of this insufficiency be borne, in whole or in part, by all *de jure* and *de facto* directors, or by a number of them, who contributed to the actionable management fault. Where there is more than one director, the court may, by properly justified decision, order them jointly and severally liable.

The right of action shall be barred after three years from the date of the order pronouncing the liquidation proceedings.

Any amounts paid by the directors shall form part of the debtor’s assets. These amounts shall be distributed *pro rata* between all creditors. Directors may not share in any distribution up to the amounts that they were ordered to pay.

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<sup>227</sup> Refer to definitions sections at beginning of chapter.

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This article thus institutes a right of action to make a director liable if there is an excess of liabilities over assets.<sup>228</sup> The sanction for certain faults therefore consists in shifting all or part of the company debts personally onto the directors.

The law speaks of actionable management fault. This does not necessarily mean criminal fault. It is for the court to assess fault. In any event, it is necessary to establish an actionable fault and a causal link between the fault and loss or damage suffered: the excess of liabilities over assets of the legal entity, its inability to pay creditors, must be due in whole or in part to the actionable fault of the director.

This right of action must be brought in the court seized of the collective insolvency proceedings. The liquidator or the public prosecutor has standing to bring the claim. The right of action is exercised in the collective interest of all the creditors: they are all going to benefit. Indeed, the law provides for a *pro rata* apportionment of any amounts recovered personally from the director or directors held liable. The fruit of the action will therefore be distributed in an egalitarian way, in proportion to the amount due to each creditor. If the amounts settled by the directors found liable to pay is not enough to discharge the company's total debt, they will nevertheless satisfy a certain proportion of the global amount still due. Creditors will thus receive this proportion of their unpaid debt.<sup>229</sup>

The right of action is time barred after three years from the date of the liquidation judgment. Directors found liable cannot recover any of the sums they may be required to pay, even if they are creditors of the company in liquidation.

Since February 2009, an analogous action has been repealed as it overlapped with this action.<sup>230</sup>

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<sup>228</sup> In French, termed «*l'action en responsabilité pour insuffisance d'actif*». Before the 2005 law, the term used was «*l'action en comblement de l'insuffisance d'actif*», which phrase is still sometimes heard today.

<sup>229</sup> This is the meaning of the French phrase from old French: “*marc le franc*” – meaning “pro rata”.

<sup>230</sup> Articles L.652-1 *et seq* Commercial Code, now repealed, provided for an “obligation to pay company debts”, a specific action available where a director was guilty of misappropriation of funds. The sanction was analogous to the current provision as the director found liable had to answer personally for the company debts, in part or in whole, in accordance with the court's ruling. The type of fault that was taken into account included, for example, having treated company property as his own, diverting or concealing a part of the assets, and other misappropriations. An action based on



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### *Bankruptcy (La Faillite)*

The meaning of the word “bankruptcy” (*«faillite»*) changed in 1967. Before 1967, it was synonymous with collective insolvency proceedings. After 1967, the word denoted the range of sanctions that may be imposed in collective insolvency proceedings on an individual entrepreneur, or on the director of a company, who has committed certain faults. However, in current parlance, French people still speak in terms of a company being “in bankruptcy” to mean that the company is in a payment failure situation. Technically this is an incorrect use of the term but the expression is still in use among non-lawyers.

In its technical sense, “bankruptcy” is a personal sanction against the “bankrupt” (*«le failli»*) banning him from carrying on in business generally. The sanctioned person is no longer entitled to carry on any commercial, craft or agricultural activity. The person may not practice as an independent professional, such as a liberal profession, nor may he be a director of a legal entity. The ban can last up to 15 years. The court can also impose a ban on occupying a public position for up to a maximum of 5 years (if the person has been elected to a position, he must give it up).<sup>231</sup> A ban on occupying a public position is only ordered in cases of serious fault.<sup>232</sup>

In some cases,<sup>233</sup> the court can choose to hand down a lighter sentence<sup>234</sup> in the form of a ban on being involved in certain types of activity but not all.

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the “obligation to pay company debts” is no longer possible as of 15 February 2009. Conversely, proceedings that are already underway before this date may be continued (article 173, December 2008 order).

<sup>231</sup> Article L.653-10 Commercial Code: this ban is of the same length as the ban on practising as an independent profession, except where the court pronounces bankruptcy for more than 5 years, the court having the power to pronounce bankruptcy in such circumstances for a maximum of 15 years by virtue of article L.653-11 Commercial Code.

<sup>232</sup> Article L.653-4 Commercial Code (as amended by the December 2008 order) and article L.653-5 Commercial Code provide a long list of the types of behaviour that will be considered as actionable fault that may lead to “bankruptcy”. For example, diverting or concealing all or part of the assets or fraudulently inflating the liabilities of the legal entity, or obstructing the collective insolvency proceedings in breach of the applicable rules.

<sup>233</sup> Abusive continuation of a loss-making business, diversion or concealment of company assets, fraudulent inflation of liabilities, non payment of amounts due in terms of liability for excess of liabilities over assets.

<sup>234</sup> Article L.653-8 Commercial Code.

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Such sanctions are only available in the context of reorganisation or liquidation proceedings. They cannot be ordered during safeguard proceedings. If a debtor finds himself in safeguard proceedings, he has every interest in avoiding a payment failure situation that would trigger transformation of the proceedings into reorganisation or liquidation proceedings.

The competent court is the court that is seized of the collective insolvency proceedings.

Fear of bankruptcy and the professional constraints it brings operates as a powerful dissuasive force. This sword is intended to incite those who head up companies to conduct themselves properly. In particular, they will have every good reason:

- To declare a payment failure situation in proper time. For a long time, the mere fact of failing to declare payment failure within the time allowed by the law exposed the director to a finding of bankruptcy. Moreover, prior to the 2005 law, the time limit was 15 days. Since 2005, the time limit has been extended to 45 days and the sanctions have been reduced. Missing the time limit is no longer grounds for bankruptcy. However, the sanctions remains severe as the court can order bans and therefore restrictions on the director's right to pursue his activity.<sup>235</sup>
- To find the necessary funds to settle what they are liable to pay for any shortfall of assets over liabilities. Indeed, where the court holds them liable to pay part or all of the company's liabilities, they run the risk of bankruptcy sanctions if they are unable to pay this personal debt.<sup>236</sup>
- More generally, to settle the company's liabilities or some of them. If the proceedings are declared at an end on the basis that all the company's liabilities have been met, that is to say all debts paid, the company head and the directors are effectively fully restored in their rights. Any restrictions, bans and lack of capacity to carry out elected public office are lifted. Even where unpaid debts remain, such relief can be granted if the individual has "made a significant contribution

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<sup>235</sup> Article L.653-8 Commercial Code, as amended by the December 2008 order. This reduced form of bankruptcy can be ordered against anyone "who omitted to request commencement of reorganisation or liquidation proceedings within the 45 day limit as from the date of the payment failure situation without having, moreover, requested commencement of conciliation proceedings."

<sup>236</sup> Article L.653-6 Commercial Code.

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to payment of the liabilities”. The court has considerable discretion on whether a director should have his freedom to do business restored.

### *Criminal Sanctions*

Fault that is sanctioned by personal bankruptcy can sometimes qualify for criminal sanctions. Criminal sanctions, unlike bankruptcy or bans, can only be pronounced by a criminal court, the *Tribunal Correctionnel*.<sup>237</sup> The principal offence, inextricably linked to the law applicable to collective insolvency proceedings, is referred to as *banqueroute*. It is not the only offence to be found in the Commercial Code, but it is the only one that has a specific name.

### *La Banqueroute*

*Banqueroute* applies to persons who have been guilty,<sup>238</sup> *inter alia*, of diverting or concealing all or part of the debtor’s assets or fraudulently inflating its liabilities or who have maintained fictitious accounts for the business or legal entity in difficulty. The importance of complying with accounting laws is thereby underlined.

The penalty is severe—five years in prison plus a fine of €75,000.<sup>239</sup> The criminal court can also order personal bankruptcy («*la faillite*») or impose a management ban on the guilty party, unless the High Court or Commercial Court has already done this in the collective insolvency proceedings in the form of a final judgment.

Legal entities may also be declared criminally liable for the offence of *banqueroute* either as principal or as accomplice.<sup>240</sup>

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<sup>237</sup> The *Tribunal Correctionnel* handles less serious types of crime, referred to generally in French law as *délits*.

<sup>238</sup> And to those who are accomplices in the *banqueroute*.

<sup>239</sup> The fine is increased to €100,000 and the imprisonment term to seven years if the offence was committed by a director of an investment services company. There are accompanying sanctions for individuals including, *inter alia*, a ban on issuing cheques for five years, publicity with respect to the court order and loss of right to deal in public markets.

<sup>240</sup> L.654-7 Commercial Code, as amended by the December 2008 order:

“Legal entities found criminally liable for offences provided for in articles L.654-3

### Other Offences

This section includes offences, punishable by two years in prison and a fine of €30,000, for conduct in breach of the rules governing the collective insolvency proceedings. For example, entering into a transaction or making a payment in breach of article L.622-7 of the Commercial Code, which prohibits the debtor from paying creditors after the commencement order. Another example is where the debtor, during the observation period, grants a mortgage or security or where he disposes of property without permission from the supervisory judge.

The criminal court is seized of the matter either on the initiative of the public prosecutor, or on application to join in the criminal proceedings by the administrator, the creditors' representative, the employees' representative, or the commissioner charged with carrying out the plan. As well, if the creditors' representative fails to do so, the court can be seized of the matter on the initiative of the majority of creditors named as controllers, provided they first give notice to the creditors' representative.

### ***Legal Position of Small Businesses in Liquidation***

A simplified liquidation procedure is applicable to small businesses<sup>241</sup> if the debtor's assets do not include any real estate. Provided the number of employees in the course of the last six months prior to commencement of the proceedings and turnover before tax, do not exceed the limits provided for in the February 2009 decree, then the simplified procedure will apply.

In short, the procedure applies compulsorily if the business in difficulty employs no more than one employee and has turnover before tax that does not exceed €300,000. The same procedure is optional, that is the court may order it, if there are between 2 to 5 employees and turnover before tax is between €300,001 and €750,000.<sup>242</sup>

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and L.654-4 of the Commercial Code, incur the following penalties:

1. A fine, under the conditions provided for in article 131-38 of the Penal Code;
2. The penalties listed in article 131-39 of the Penal Code

The prohibition mentioned at 2° of article 131-39 of the Penal Code applies to the activity during which or on the occasion of which the offence was committed.”

<sup>241</sup> Article L.641-2 Commercial Code.

<sup>242</sup> Amendments introduced by article D.641-10 Commercial Code, which replaces article R.641-10, pursuant to the February 2009 decree.

## Insolvency Law in France

Where the procedure applies, the liquidator proceeds to sell all personal property privately or at public auction within the three months following the judgment pronouncing liquidation. If the court orders the simplified procedure in a situation where it is optional, the court or its president, as the case may be, determines which of the debtor's goods may be sold privately within the three months following his decision. Subject to that determination, the goods are then sold at public auction.<sup>243</sup>

The simplification of the procedure is evident as well in the fact that only potential priority ranking claims and wage claims are checked.<sup>244</sup>

Finally, the process must come to an end no later than one year after the court decision ordering or determining application of the simplified procedure.<sup>245</sup>

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<sup>243</sup> Article L.644-2 Commercial Code.

<sup>244</sup> Article L.644-3 Commercial Code.

<sup>245</sup> Article L.644-5 Commercial Code.