



INSOL INTERNATIONAL

International Association of Restructuring, Insolvency & Bankruptcy Professionals

Directors in the Twilight Zone IV

FRANCE¹

QUESTION 1

1. The start and duration of the “twilight” period

What is the length of the period ending with formal insolvency proceedings during which transactions entered into by a company are vulnerable to attack or are liable to give rise to personal liability on the part of directors and/or others involved in the management of the company?

1.1 Overview

1.1.1 For the purposes of assessing which transactions are vulnerable to attack (as opposed to possibly giving rise to the directors incurring personal liability), the “twilight” period is known in France as the “suspect period”². Under French law, this is different to the observation period during which the directors undergo supervision and/or direct involvement of a court-appointed administrator, liquidator or receiver, as appropriate. (See further the Appendix below).

1.1.2 The date on which the suspect period is deemed to begin is the date on which the company first became unable to pay its debts as they fell due or, to use the French terminology, the date on which it entered in a state of cessation of payments – a cash-flow insolvency test³. The “twilight” period ends on the date on which the court opens formal insolvency proceedings, being either judicial reorganisation or liquidation. In principle, there is no suspect period prior to the safeguard procedure (*procédure de sauvegarde*) as only debtors that are not yet in cessation of payments are permitted to enter safeguard proceedings.⁴

1.1.3 The “twilight” period ends with the opening of judicial reorganisation or liquidation since on this date the court appoints either an administrator or a liquidator who will be involved in and control the management of the insolvent company.

1.1.4 The date on which the company first became unable to pay its debts (and therefore, the date on which the “twilight” period commences) is determined in one of three ways (in each case by the court with jurisdiction over the insolvency proceedings concerned). The court may:

- (a) find that the date is the same as the date of the judgment opening the proceedings. In such a case, there is no “twilight” period;
- (b) find, as a question of fact, that the date occurred prior to the date of its order to open formal insolvency proceedings (i.e often the date when the filing was made in court);
- (c) subsequent to the opening of judicial reorganisation or liquidation, decide (after a prior summons and hearing of the debtor and eventually after ordering an expertise for the purpose of gathering any useful information⁵) to revisit its original decision on the basis of new facts and modify the date of cessation of payments. An application for such a judicial deferral of the date of cessation of payments may be made by one or more of the following: the court-appointed administrator, the *mandataire judiciaire*, the public prosecutor⁶ or the court-appointed liquidator as appropriate⁷. The application must be made within one year of the judgment opening the procedure.

¹ This Chapter is up to date as of 10 April 2013 and has been specifically adapted for educational or for information purposes only. As such, the answers are limited to the questions raised and do not go into detail on specific subjects of French insolvency law. The chapter is not intended to be a substitute for professional advice.

² Articles L. 632-1 et seq. and L. 641-14 of the French Commercial Code.

³ Pursuant to Article L. 631-1 of the French Commercial Code, the company is in cessation of payments whenever it is unable to meet its current liabilities with its available funds.

⁴ Noting in the event the court determines the debtor is in cessation of payments, regular safeguard proceedings must be converted into formal insolvency proceedings. Indeed, as for the new Rapid Financial Safeguard Procedure, the “Sauvegarde Financière accélérée” (SFA), there is no such “twilight” period.

⁵ Commercial chamber of the Cour de cassation, 15 February 2000 n° : 97-16770 & 97-14415.

⁶ Article L. 631-8, paragraph 3 of the French Commercial Code.

⁷ Article L. 641-5 of the French Commercial Code.

- 1.1.5 The maximum duration of the “twilight” period is 18 months⁸. This means that acts passed by the company 18 months before the opening of the procedure can be cancelled. This 18 months period may be extended to 24 months only in the case of transactions for no consideration (see section 1.1.7). If the parties have concluded a settlement (a *conciliation* agreement) approved (*homologué*) by the court (see the Appendix), the date of the cessation of payments cannot be set to a date prior to the date of the court’s approval, except in the event of fraud⁹.
- 1.1.6 In the case of conversion into formal insolvency proceedings (i.e. conversion of a safeguard into a judicial reorganisation), any judicial deferral of the date of cessation of payments will need to be brought within one year of the conversion judgment. The court may not set the date of cessation of payments earlier than 18 months prior to the judgment opening the safeguard¹⁰.
- 1.1.7 With respect to transactions made for no consideration, the court may treat these as null and void if concluded in the six months prior to the date of cessation of payments¹¹. Each type of transaction which may be subject to attack and the conditions which would render such a transaction void are considered in Question 4.
- 1.1.8 The duration of the period during which transactions entered into by the company are liable to give rise to personal liability on the part of directors and/or others involved in the management of the company is not specifically determined by law. Each case of liability is considered in more detail in response to Question 2. In certain circumstances, the risk of liability arises only after the date of cessation of payments. In other circumstances, liability may arise if there is a causal link between the relevant act of the director and the company’s difficulties.

1.2 Summary

- 1.2.1 If a company is cash-flow insolvent and thereafter goes into judicial reorganisation or liquidation, certain specifically defined transactions may or must be declared null and void.
- 1.2.2 Furthermore, directors and/or others involved in the management of the company may be personally liable for certain types of actions during the “twilight” period or at any other time even after the opening of insolvency proceedings.

QUESTION 2

2. Actions potentially giving rise to liability for directors

- (a) In respect of which acts during the “twilight” period may a director be held personally liable or which may otherwise have adverse consequences for him?
- (b) In relation to each act identified in (a) above:
- (i) is any resulting liability against a director civil, criminal or both?
 - (ii) can a director be made personally liable in respect of the whole loss caused to the company or the deficit to creditors?
 - (iii) will liability attach to individual directors in proportion to their specific involvement?
 - (iv) is there a specified period before commencement of a subsequent insolvency procedure within which the relevant act must have been undertaken in order for liability to attach to a director?
 - (v) what defences, if any, will be available in relation to each offence?

2.1 General

French law does not address the potential liability of directors and/or others involved in the management of a company in formal insolvency proceedings on the basis of the type of act performed. Rather French law starts from the causes of action available against such persons based on their behaviour. The responses to this question are therefore explained below on the basis of the main types of causes of action available.

2.2 Action “*en responsabilité pour insuffisance d’actif*” (based on the shortfall of assets on the date the court rules on the sanction)

- 2.2.1 *De jure* and *de facto* directors¹² of the debtor may be subject to personal liability in the case of judicial liquidation proceedings in the event of a shortfall of assets arising as a result of an act of “mismanagement” of the directors. Claiming against the directors for the shortfall of assets is commonly used by liquidators as a means of augmenting the assets available to cover the debts of the insolvent company.

⁸ Article L. 631-8, paragraph 2 of the French Commercial Code.

⁹ Article L. 631-8 of French Commercial Code.

¹⁰ Article L. 631-8, paragraph 5 of the French Commercial Code.

¹¹ Article L. 632-1, II of the French Commercial Code.

¹² *De jure* directors who are appointed in accordance with the company’s articles of association of the company and with the law . Please refer to Question 3, below for an explanation of *de facto* directors.

For a director to be held personally liable for the shortfall of assets, the following criteria must be met:¹³

- (i) there must have been an act of “mismanagement”. However, under French law, “mismanagement” is not defined. Instead, it has been left to the relatively broad interpretation of the courts. Each case is determined on its own facts. The most common examples of mismanaging a business are failing to put adequate measures in place whilst operating the business at a loss and the management granting excessive remuneration to itself during financially turbulent times for the company. Other examples of mismanagement include: corporate asset misappropriation (*abus de biens sociaux*¹⁴), the distribution of fictitious dividends (*distribution de dividendes fictifs*) and management making decisions which prima facie are badly prepared and destined to fail (for example burdensome investment decisions taken in an uncertain and difficult economic climate or acquisitions made as a result of poor negotiations), failure to comply with fiscal legislation (for example failing to comply with compulsory taxation requirements, as a result of a failure to declare tax obligations¹⁵ including the failure of a director to notify the non-compliance with tax legislation by other directors, including, previous directors, even if the failure to comply with fiscal legislation occurred prior to the director’s nomination)¹⁶, failure to comply with social legislation (for example, failing to comply with compulsory taxation requirements, as a result of a failure to declare social taxes¹⁷), favouring one creditor over another (for example, paying a specific creditor who was aware that the debtor was in cessation of payments¹⁸). Such acts (and many others) that result in a shortfall of assets may be considered as acts of mismanagement and may consequently result in sanctions against individual directors of the company;
- (ii) the liabilities of the company must exceed the value of its assets (ie there must be a shortfall of assets), to be assessed at the time the court determines liability. Debts that arise after the opening of judicial liquidation are not included in the company’s liabilities for the purposes of this analysis;
- (iii) the claimant must demonstrate that the act or acts of mismanagement contributed to the shortfall of assets. However, the act(s) need not have been the sole and exclusive, unique or principal cause of the shortfall. It is enough that the act or acts of mismanagement were one of a number of causes that contributed to the shortfall. The question as to how much an act or acts contributed to the shortfall is for the courts to decide. The courts’ decision is based on the facts of each case and this can sometimes lead to varied and unpredictable results. Furthermore, the acts and omissions of one director do not automatically exonerate the other directors because, as stated above, an act of mismanagement is not required to be the sole and exclusive cause of the asset shortfall;
- (iv) at least a partial¹⁹ causal link must exist between the act of mismanagement and the shortfall of assets²⁰.

Pursuant to Article L 651-3 of the French Commercial Code, only the liquidator or the public prosecutor has the right to bring a claim for the shortfall of assets and within three years from the date of the court decision opening the judicial liquidation of the company²¹. But should the liquidator decide not to bring such a claim, the majority of the court-appointed *contrôleurs* (a creditor representing the interests of all creditors, usually a large creditor) will have the right to bring this claim²².

2.2.2 If (i) to (iv) of 2.2.1 above are satisfied:

- (i) it is for the court to decide, on the facts presented before it, whether the directors are to be held personally liable for the shortfall of assets;
- (ii) directors found liable will be required to pay damages, which will form part of the assets of the debtor available for distribution to creditors. It is up to the court to decide, on the basis of the seriousness of the act of mismanagement and the strength of the causal link, whether the director in question should pay damages or not. That is, even if (i) to (iv) of 2.2.1 above are satisfied, the court is not required to impose a sanction;
- (iii) it is up to the court to decide the amount of damages that the director must pay. The amount is not necessarily proportionate to the level of contribution caused to the debts of the company. The maximum amount of damages that a director can be ordered to pay is the total liabilities of the company less the available assets. If more than one director is liable, they may be held severally liable if the court considers this reasonable and justifiable;
- (iv) there is no specific time period prior to the commencement of formal insolvency proceedings during which an act of mismanagement must have occurred. In practice, the period is limited by the need for there to be a causal link between the act of mismanagement and the insolvency of the company. In the vast majority of cases, the last possible act is the failure to file the declaration of cessation of payments within the requisite (45) days after the date of cessation of payments²³;
- (v) other than the general defence of absence of act of mismanagement (including, in the case of an alleged *de facto* director, absence of the person’s implication in the management of the company) or absence of causal link or a shortfall of assets, there are no specific defences to this allegation;
- (vi) the claim must be brought within three years from the date of the court decision opening the judicial liquidation of the company²⁴.

¹³ Article L. 651-2 of the French Commercial Code.

¹⁴ Commercial chamber of the Cour de cassation.21 february 2012 n° 11-13.513.

¹⁵ Commercial chamber of the Cour de cassation 13 November 2007, n°06-13.212.

¹⁶ Paris, 3° ch.A, 16 mai 2006, RG°2005/15820.

¹⁷ Commercial chamber of the Cour de cassation 13 November 2007, n°06-13.212.

¹⁸ Commercial chamber of the Cour de cassation 11 June 1996, n°94-16.067.

¹⁹ Commercial chamber of the Cour de cassation, 17 February 1998, no 95-18.510.

²⁰ Commercial chamber of the Cour de cassation, 14 May 1991, no 89-19.081.

²¹ Commercial chamber of the Cour de cassation, 6 June 1995, no 91-21.173.

²² Commercial chamber of the Cour de cassation, 11 May 1993 : Bull. civ. IV, n°187; D. 1993. IR 195.

²³ Pursuant to article L. 631-1 of the French Commercial Code, the company is in cessation of payments whenever it is unable to meet its current liabilities with its available funds.

²⁴ Commercial chamber of the Cour de cassation, 19 May 2004, no 02-11.199.

2.3 Liability for the debts of the company

Since the entry into force of law n°2008-1345 dated 18 December 2008, claims against directors having committed faults pursuant to Article L.624-5 of the French Commercial Code may only be brought in judicial reorganisation or judicial liquidation which were opened prior to 15 February 2009. This permitted the court to hold an individual *de jure* or *de facto* director liable for the debts of the insolvent company if there was a fault pursuant to the old Article L.624-5 of the French Commercial Code and if the fault had a causal link with the cessation of payments.

2.4 Personal bankruptcy – prohibition on management

2.4.1 Personal bankruptcy is a professional sanction which, in essence, prevents a director from being involved in the management, administration or control of any commercial or business entity or any company engaged in economic activity. In some ways, it is similar to director disqualification in the UK but in addition, French personal bankruptcy may prevent a director from being elected in any public election and holding any public function (see below). An individual *de jure* or *de facto* director may be subject to personal bankruptcy during the course of judicial reorganisation or judicial liquidation against the company²⁵; personal bankruptcy may not therefore be sought during safeguard proceedings nor accelerated financial safeguard proceedings²⁶. The sanction of personal bankruptcy may be imposed on an individual as a result of him or her:

- (i) abusively (wrongfully) carrying out an unprofitable business activity that would necessarily lead to the company's insolvency;
- (ii) misappropriating or concealing all or part of the assets of the company or fraudulently increasing the liabilities of the company;
- (iii) committing any of the violations listed under Article L. 653-4 of the French Commercial Code which are as follows:
 - (a) using property of the company as his or her own. This concept covers a wide range of behaviours including, most typically, excessive remuneration, withdrawals from the company's bank account for personal ends, performance of renovation or other works by the company for personal ends, payment of personal expenses, etc.
 - (b) undertaking commercial transactions for his or her own interests in the name of the company. This typically applies to directors who abuse of their majority position in the company and manage the company for their own personal interests
 - (c) using property or assets of the company in a manner contrary to the company's own interests for personal ends or the ends of another company in which the director has a direct or indirect interest. This type of behaviour is in practice very similar to that covered by (b)
 - (d) pursuing abusively and for personal ends a loss-making activity which would inevitably lead to the company falling into a state of cessation of payments. This concept typically covers directors who, using artificial financial methods, maintain a company afloat for the purpose of continuing to receive remuneration, to reduce the amount of a personal shareholder loan or to pay off company debts that he or she has guaranteed
 - (e) misappropriating or concealing all or part of the assets of the company or fraudulently increasing the liabilities of the company. This is the most serious type of behaviour, where the director may seek to organise the insolvency of the company or to deal with the assets of the company to the detriment of the company's creditors
- (iv) carrying out a management role in the company when prohibited from doing so;
- (v) with the intention of avoiding or delaying the opening of formal insolvency proceedings, entering into purchases with a view to resale at below market price or using other inappropriate means to obtain funds;
- (vi) entering into, for the account of a third party, and without consideration, undertakings judged to be too significant or important at the time given the situation of the company;
- (vii) paying or causing to be paid, after the date of cessation of payments, one creditor in preference to others;
- (viii) intentionally failing to co-operate with the good progress of the insolvency proceedings; and/or
- (ix) keeping accounts that are fictitious, manifestly incomplete or irregular according to applicable law, not keeping accounts when required by applicable law, or causing accounting books and records to disappear.

Although the provisions of the law do not specifically require, typically there must be a link (if not the cause) between the wrongful act in question and the insolvency of the company – apart from those cases where, by definition, no link is necessary, for example, in respect of (vii) and (viii) above.

2.4.2 If any of (i) to (ix) are satisfied:

- (i) the court is not required to impose sanctions on the director liable. If it does, liability is civil, whether the sanction imposed is personal bankruptcy or prohibition on management (see further below);
- (ii) although liability is civil, certain characteristics of personal bankruptcy are penal in nature:

²⁵ Article L. 653-1 of the French Commercial Code.

²⁶ Article L. 628-1 of the French Commercial Code.

- (a) the sanction of personal bankruptcy carries with it a prohibition on directly or indirectly managing, administrating and/or controlling a commercial business or any form of company which has an economic business activity. Furthermore, the court may also prohibit a director from carrying out certain professions or functions which have a public nature (for example, the judiciary, the legal profession, and activities as a financial intermediary, insurance agent, etc.), meaning that a director sanctioned by personal bankruptcy may not take part in public elections;
- (b) alternatively, the court may impose a prohibition on management, which is a diluted form of personal insolvency. The most severe form of this sanction is the prohibition on managing, administrating and controlling a commercial business or any form of company which has an economic business activity.
- (c) It must be noted however that a director held liable for personal bankruptcy may request that instead of being subject to the sanctions of personal bankruptcy or prohibition of management, he/she/it will instead incur personal liability for the shortfall of assets of the insolvent company that he/she/it manages²⁷.
- (iii) the court has discretion over the duration of the personal bankruptcy or the prohibition on management, subject to a maximum of 15 years²⁸ and a maximum of 5 years for any prohibition on public functions, professions and office²⁹;
- (iv) except in certain limited circumstances, there is no specific time period prior to the commencement of formal insolvency proceedings during which the wrongful action must have occurred. In practice the period is limited by the “informal” requirement that there be a link between the act in question and the insolvency of the company. In respect of (vii) and (viii) above, by definition the wrongful act must have taken place after the date of cessation of payments which, as explained above, depends upon a finding of fact by the court. This date cannot be more than 18 months prior to the date of the court order opening formal insolvency proceedings.

Other than the general defence of absence of one or more of the specific requirements for the offence, there are no specific defences to this action. A person may have some or all of the prohibitions lifted if he/she can show that they have made a sufficient contribution to the payment of the insolvent company's debts.

2.4.3 The following persons may also be subject to personal bankruptcy:

- (i) any director who has been found liable for having contributed to the shortfall of assets³⁰;
- (ii) any director who has been found guilty of criminal bankruptcy.

In both cases, personal bankruptcy or prohibition on management is a complementary penalty decided upon by the criminal court and, can be either permanent or temporary and, if temporary, must not exceed five years³¹.

2.5 Criminal bankruptcy (Banqueroute)

2.5.1 An individual *de jure* or *de facto* director may be subject to criminal bankruptcy in any of the following cases during the course of judicial reorganisation or judicial liquidation³² opened against the company³³:

- (i) where the person, with the intention of avoiding or delaying the opening of formal insolvency proceedings, has made purchases with a view to resale below market price or has used other inappropriate means to obtain funds;
- (ii) where a person has misappropriated or concealed all or part of the company's assets;
- (iii) where a person has fraudulently increased the debts of the company;
- (iv) where a person has kept fictitious accounts or caused accounting books and records to disappear or failed to keep accounts contrary to legal requirements;
- (v) where a person has kept manifestly incomplete sets of accounts or kept accounts that do not comply with legal requirements.

It should be noted that there is no offence of attempted criminal bankruptcy.

2.5.2 If any of (i) to (v) are satisfied and the company is in a state of cessation of payments:

- (i) it is for the court to decide if the directors are personally liable and guilty of the offence of criminal bankruptcy;
- (ii) a person guilty of this offence is liable to imprisonment (maximum of five years or seven years for a company providing investment services) or a fine (maximum of 75,000 euro, or 100,000 euro for a company providing investment services) or both.

In addition, the court can impose any of the following:

- (a) deprivation of civic, civil and family rights;
- (b) prohibition (for a maximum period of five years) on having a public function or conducting a professional activity in the same field as that in which the offence was committed;

²⁷ Article L 653-11 of the French Commercial Code

²⁸ Commercial chamber of the Cour de cassation, 15 February 2000 n°97-16770.

²⁹ Article L. 653-10 of the French Commercial Code.

³⁰ Article L. 653-6 of the French Commercial Code.

³¹ Commercial chamber of the Cour de cassation 22 March 2011 n°10-14889; of the Cour de cassation 22 May 2012 n°11-14366.

³² Article L. 654-2 of the French Commercial Code.

³³ Ibid.

- (c) exclusion from being permitted to bid for public tenders for a period of at least five years;
 - (d) prohibition for a maximum period of five years from issuing cheques other than those enabling the drawer to draw funds deposited with the drawee or certified cheques;
 - (e) publication of the judgment;
 - (f) personal bankruptcy or prohibition on management;
 - (g) furthermore, if there is a civil party to the criminal proceedings, the court may award damages to the civil party if it is the victim of the offending behaviour – typically the company – on the basis of the principles of tort (Articles 1382 et seq. of the French Civil Code).
- (iii) The gravity of the offence will be reflected in the length of imprisonment or the amount of the fine ordered and in the nature and extent of any of the other sanctions imposed. In exercising its punitive jurisdiction, the court is not seeking to compensate the company. The amount of damages that may be awarded will depend upon the extent of the loss caused by the offending act.
 - (iv) Except in the case of misappropriation or concealment of the company's assets (for which the acts in question must have been committed while the company was in a state of cessation of payments), there is no specific time period prior to the commencement of formal insolvency proceedings during which the acts concerned must have been committed.
 - (v) Absence of intent to defraud is a defence to a charge under 2.5.1(i) and (iii). Absence of a voluntary and positive act of disposal is a defence to a charge under 2.5.1(ii).

2.6 Fraudulent organisation of insolvency

- 2.6.1 Any director or associated person can be held liable for this offence if³⁴:
- (i) he or she fraudulently misappropriates or conceals part of his or her own personal property to avoid paying the debts of the company in insolvency;
 - (ii) he or she fraudulently acknowledges and accepts debts that do not exist.
- 2.6.2 If (i) or (ii) are satisfied:
- (i) liability is criminal. The answers to 2.5.2 (ii) and (iii) are applicable.
 - (ii) The offence can only be committed once a company is in a state of cessation of payments.
 - (iii) Absence of intent to defraud is a defence.

QUESTION 3

3. **Other persons involved with the company's affairs that may become liable in respect of their actions during the "twilight" period**
- (a) In addition to the formally appointed directors of the company, can others be held liable in respect of the company's activities during the "twilight" period if the company were to become subject to a formal insolvency procedure?
 - (b) In respect of which acts may other persons be held liable and to what extent does the liability of third parties differ from that for directors identified in Question 2 above.
 - (b) Will liability be limited to that resulting from involvement with a particular transaction or more generally in relation to the overall loss suffered by creditors?
- 3.1 **Introduction**
- 3.1.1 French insolvency law provides expressly that liability that may attach to a formally appointed director of a company, also known as a *de jure* director, extends to "*de facto*" directors – known in French as "*dirigeants de fait*". The definition of *de facto* director is explained below.
- 3.1.2 In certain circumstances, third parties may be found liable to a company subject to formal insolvency proceedings. For example, third parties who commit certain faults, in particular if their behaviour has provoked the insolvency of the company or aggravated its consequences, may be liable for the damage they have caused.
- 3.2 ***De facto* directors (dirigeants de fait)**
- 3.2.1 Before going into any detail, it is important to note that being qualified as a *de facto* director does not make such individual or legal entity liable *per se*.

³⁴ Criminal chamber of the Cour de cassation, 22 November 2011, no 10-81.562.

3.2.2 French legislation offers no definition of a *de facto* director. In absence of such a definition, French case law fills the gaps. According to the Court of Appeal of Paris³⁵, a *de facto* director is an individual who, or legal entity which, is not a *de jure* director but assumes similar functions and has similar powers in the management of the company that he/she/it exercises independently and has an influence on the decisions made within the company.

Hence, whether an individual or a legal entity is a *de facto* director is a question of fact for the French lower courts to determine, subject to the control of the Cour de cassation³⁶.

3.2.3 In establishing the question of fact based on a body of corroborating evidence, the two criteria below are the most significant:

- (i) the management or administrative acts of the *de facto* director have been carried out without restriction and independently, so that the director had autonomous decision-making power. This implies that the *de facto* management situation is inconsistent with a position of subordination, such as it results from an employment contract (for example, if the claimed *de facto* director is given orders by another person to whom he is subordinated, such other person is the real *de facto* director)³⁷;
- (ii) an active and positive decision-making role, implying that the *de facto* director has directly intervened in the management of the company, behaved as the master of the business and “unofficially” ran the company. There is no need to find that the person was treated as a director by the other directors. The key is the active involvement by the person in the determinative management of the company³⁸.

3.2.4 Examples of other corroborating evidence that may be taken into account by the French courts are the nature of the technical functions granted to the alleged *de facto* director (for example, commercial management, supply management), the powers granted to the *de facto* director (for example, placing orders with suppliers, signing cheques, hiring or dismissing employees) and the *de facto* director’s behaviour (for example, the fact that he/she/it considers that the company belongs to him/her/it, that he/she/it behaves as a director of the company).

3.2.5 Based on such evidence, shareholders of the company are often targeted by liquidators as *de facto* directors to compensate for the shortfall of assets.

Shareholders who are regularly involved in the daily management of a company, which later files for insolvency, may be considered *de facto* directors. Having a majority shareholding will not in itself be regarded as evidence of intervention in the management of a company. It is for the French lower courts to determine whether or not a shareholder is a *de facto* director. The following are examples of where shareholders have been held to be *de facto* directors:

- the Paris Court of Appeal concluded that multiple factors such as attending a number of board meetings without being a board member, signing letters as a director without having the appropriate status and authority to do so and granting oneself the benefit of a company car meant that a shareholder with 38% of the share capital was considered a *de facto* director³⁹;
- the Paris Court of Appeal, in a different matter, ruled that a parent company was a *de facto* director of its subsidiary, not on the basis of the two criteria mentioned above, but on the basis that the business unit that the parent company transferred to its subsidiary continued to be operated by the parent company⁴⁰ as if it had remained within the parent company’s scope of activities. In doing so, the court took into account the common operating mechanisms which often exist within group companies (such as paying for raw materials and packaging for products, making personnel available to the subsidiary as well as administrative accounting services). One may therefore conclude that the court held that what the parent company did went beyond just providing administrative and technical support in respect to the transferred business unit to determining the distribution strategy of the trademarked products of the transferred business unit, requesting the sale at a fixed price for each unit sold and invoicing for products in its own name without indicating that the sales were carried out in the name of its subsidiary.

3.2.6 Shareholders holding external roles with a company have also, albeit rarely, been considered *de facto* directors. Two examples are as follows:

- statutory auditors: the French courts have held that a founding partner of a company who also acted as the statutory auditor for that company was a *de facto* director as he did not act solely as the auditor of the company, but took important decisions, in particular, concerning the company’s financing and the attempt to wind-up the company when he acknowledged that the company was in debt by as much as three thirds of its capital⁴¹;
- lawyers: it has been held by the French courts that a lawyer who was also the majority shareholder of a company could be considered a *de facto* director where he held a decisive role in the management of the company, especially where: he fixed the price for the purchase of the business as a going concern; the registered office was located at his domicile whilst the activity of the company was located elsewhere; he decided on the financial and economical functioning of the company; and the *de jure* director was actually in a position of subordination⁴².

³⁵ Court of Appeal of Paris, 16 December 1997, JCP E 1998, 718 p 250.

³⁶ Commercial chamber of the Cour de cassation, 16 March 1999, n° 95-17.420.

³⁷ Commercial chamber of the Cour de cassation 12 July 2005, n° 02-19.860.

³⁸ Commercial chamber of the Cour de cassation 30 May 2006, n° 05-14.958. Commercial chamber of the Cour de cassation, 27 June 2006, n° 04-15.831.

³⁹ Court of Appeal of Paris, 11 October 1996.

⁴⁰ Commercial chamber of the Cour de cassation 23 November 1999 n° 1860 : RJDA 3/00 n° 270.

⁴¹ Criminal chamber of the Cour de cassation June 27, 1983 n° 81-94465.

⁴² Commercial chamber of the Cour de cassation 15 February 2011 n° 10-11.781.

3.2.7 Other individuals or legal entities that may be considered by the French courts as *de facto* directors include:

- banks: the Cour de cassation held on 30 October 2007 that the exercise by a banking institution of its obligation to advise its clients (see below) on the use of loaned funds may not be considered in itself as *de facto* management of the borrower company. However, a situation where the bank takes over the control of the company in financial difficulties by artificially maintaining credits in the current account and covering all its expenses where the *de jure* director could not hold the company's cheque books could amount to *de facto* management⁴³;
- franchisers: a franchiser who interfered in the management of its franchisee by giving orders to the franchisee, firing one of its employees and by deciding the working conditions of the franchisee's employees⁴⁴;
- suppliers/clients: a supplier has been held to be *de facto* director due to its intrusion in the management of its client. In one instance, this interference was characterised by the fact that the supplier sold the client's registered office, put the client's shop in his building and the client was obliged to pay his supplier in priority⁴⁵;
- family: the brother of the *de jure* director of a company, who negotiated and signed the quote for the company and the commitment it represented, negotiated payment terms with customers depending on the precise progress of the work and the release of funds to customers and who negotiated payment terms with the supplier and had free access to the cheque books of the company which he could sign to pay suppliers⁴⁶.

3.3 Third party liability during formal insolvency proceedings

3.3.1 Third parties who are involved with a company that enters into formal insolvency proceedings may be subject to liability in tort if all or part of the loss suffered by the insolvent company's creditors is caused by the wrongful action of those third parties. The existence of a fault (tort), damage and a causal link between the fault and the damage must be established by the claimant (for example, the company or the creditors) seeking recovery⁴⁷.

3.3.2 Financial and Banking Institutions

3.3.2.1 Duty to Inform

Articles 111-2 of the French Consumption Code and 1134 of the French Civil Code impose a duty on financial and banking institutions to provide certain information to their clients. For these purposes, three different types of information exist: (i) advice, (ii) information construed as orders and (iii) information given as a warning. Advice may be given to clients under French law, but information that is interpreted as a request or order may not be given by banks to clients. As for the third type of information, the duty of "mise en garde" (cautionary duty), a banker is required to ensure that the client is aware of all the risks that may be incurred carrying out the operation in question.

The banker must choose the best way to advise the client, bearing in mind the knowledge of the client⁴⁸.

3.3.2.2 Wrongful termination of credit facility

Article L. 313-12 et seq. of the French Financial and Monetary Code governs the right of banks to terminate their credit facilities.

This Article provides that a bank may only reduce or terminate an open-ended facility on expiry of the written notice period provided in the facility. The notice period may not be less than sixty (60) days.

If the bank wrongfully terminates the credit facility in breach of this Article, the bank may be found liable for breach of contract and liable in tort to third parties, including the creditors of the company in insolvency proceedings acting through the *mandataire* judiciaire procedure.

The bank's liability under this head of challenge may be the full amount of damages suffered by the creditors if it is proved that the wrongful termination of the credit facility was the sole cause of the company being in insolvency proceedings⁴⁹.

That said, the second paragraph of Article L. 313-12 of the French Financial and Monetary Code provides for two exceptions where the bank may immediately and unilaterally terminate or reduce a credit facility granted to a company (in other words without any notice period.) These are as follows:

- where there has been seriously reprehensible conduct on the part of the company including: where the company is found guilty of an offence, where the company intentionally tried to or did mislead the bank as to its real financial situation and where there has been a serious breach of contract (such as refusing to give promised guarantees and to hand over the documents requested by the bank⁵⁰); and
- where the company's situation has been irreparably compromised. It appears through case law that this does not mean where a company finds itself in a state of cessation of payments but where the company cannot restructure itself (for example where the company can no longer pay the premiums provided for in its restructuring plan, is only receiving a very limited amount of orders and/or is doomed to go into liquidation and be dissolved)⁵¹.

3.3.2.3 Wrongful credit transactions (*octroi et soutien abusif de crédit*)⁵²

⁴³ Commercial chamber of the Cour de cassation, 23 September 2010, n° 09-83.274.

⁴⁴ CA Rouen 23 May 1978 :JCP 1979 II n°19235 note Notté.

⁴⁵ Commercial chamber of the Cour de cassation 4 April 1962, Rauscher c/ Ferrari : Bull. civ. III n° 215.

⁴⁶ Commercial chamber of the Cour de cassation 17 September 2002 n°1427 : RJDA 12/02 n°1307.

⁴⁷ Criminal chamber of the Cour de cassation, 11 oct. 1993, n° 92-81.260.

⁴⁸ Commercial chamber of the Cour de cassation, 4 June 1991 : RD bancaire et bourse 1992, n° 32, p. 151, obs. F.-J. Crédot et Y. Gérard. – Commercial chamber of the Cour de cassation, 22 May 2001, n° 98-14.741.

⁴⁹ Commercial chamber of the Cour de cassation, 23 October 2001, n° 98-18.788.

⁵⁰ Commercial chamber of the Cour de cassation, 2 June 1992, n° 90-18.313.

⁵¹ Commercial chamber of the Cour de cassation. 21 November 2006, n°05-18.979.

Pursuant to Article L.650-1 of the French Commercial Code, when a company is in insolvency proceedings, including safeguard, reorganisation or liquidation, creditors may not be held liable for credit facilities granted to the company except in the case of:

- fraud: an event of fraud implies a criminal offence in the granting of the credit facility such as. extravagant financial operations (cavalerie financière). Fraud can also be characterised if the credit facility is given to the company for a purpose other than to start-up or maintain the business. A credit facility granted with the negligence of the banker will not be considered a fraudulent credit facility such as when the bank omits to request the provision of the company's accounts or to obtain the opinion of experts before granting the credit facility⁵³;
- interference in the company's management: this event relates to the event of *de facto* management; however, the influence of the bank on the management of the company needs to be "characterised", meaning that if the bank did not interfere, the company would not have made such or such decision. French academics believe that the wrongful (abusive) grant of a credit facility may be "characterised" where the bank is party to an oversight board or to a LBO where the bank grants the credit facility on the condition that the ratios are not violated. The Cour de cassation does not consider there to be interference in the company's management when, in accordance with a facility agreement, the bank reviews transfers which may not be carried out without being evidenced by invoice⁵⁴; or
- if the guarantees given are disproportionate to the credit facility for which they were granted: most French academics believe that this example of a wrongful grant of credit facility is intended to target the practice of unusual requests for guarantees within the banking sector. For example, in order to obtain a facility to finance the purchase of freehold, banks normally require a mortgage over all the freehold even though the facility only finances part of the purchase of the freehold. Some academics believe that this rule against the wrongful granting of credit facilities is actually intended to deter banks from proceeding with what is called a "coup de râteau", meaning obtaining an excessive number of guarantees so as to have an unfair advantageous position relative to other creditors in the event of the borrower company entering into insolvency proceedings. The courts will determine whether the guarantees were disproportionate or not on the date the guarantee was given by reference to the maximum amount owing by the company to the bank, including interest, fees and accessory amounts.

If the court holds that one or more of the above events exists, the court must then determine whether there is a causal link between the wrongful granting of the credit facility and the prejudice caused to the borrowing company, other creditors or even other third parties such as guarantors.

According to the majority of French academics, this Article implements a presumption that creditors that grant credit facilities (that is, mostly banking institutions) are not liable for the facilities granted except where the credit facility is considered abusive (wrongful) in one of the three circumstances outlined above. This would mean that even if the bank committed a fault in respect to the credit facility granted, the bank would be immune from tortious liability unless, the facility was considered abusive under either fraud, 'characterised' interference in the management of the company or disproportionate guarantees. This, however, is not the view of the French Constitutional Council that considers that banking institutions are not immune from liability as this Article of the French Commercial Code specifically provides for the three cases where banking institutions may be held liable⁵⁵. 3.3.3 Auditors Pursuant to Article L. 822-17 of the French Commercial Code: *"Auditors are responsible, in respect of a person or entity or third parties, for the consequences of errors and omissions committed by them in the exercise of their functions. Responsibility may not be sought for any information or disclosures of fact on which they proceed in the execution of their mission. They are not civilly liable for offences committed by directors and officers unless, having knowledge, the offences are not indicated in their report to the General Assembly or the competent authority referred to in Article L. 823-1"*.

French courts will hold statutory auditors liable if they have committed a fault which has caused damage. This means that a creditor will have to prove damage and a causal link between the fault and the damage. A claimant has three years in which to commence a claim pursuant to Article L. 225-254 of the French Commercial Code. The three year period starts on the date of certification of the company's accounts except if the statutory auditors concealed the fault, in which case, the three year period commences on the date when the damage is suffered⁵⁶.

The three year limitation period is applicable to insolvency proceedings⁵⁷. For example, a statutory auditor was held liable when he certified accounts of the company without undertaking any serious inspection⁵⁸. However, he cannot be held liable for a shortfall of assets resulting from his failure to inform the relevant parties of the problems discovered upon completion of the company's accounts.

- 3.3.4 The end of the insolvency proceedings does not bar a creditor from claiming against third parties if the claim can be formed outside of its rights against the debtor.

For example, it was found that the initiation of proceedings against the licensor did not interrupt the proceedings in respect of the patent owner who had conceded the operation⁵⁹.

- 3.3.5 Furthermore, creditors have a direct right to claim (action directe) against the insurers of the company⁶⁰ or against third parties even if the proceedings are closed⁶¹. Guarantors of the debtor are included within the pool of third parties against whom creditors have a direct right of claim.

⁵² Law applicable to insolvency proceedings opened after 1st January 2006.

⁵³ Commercial Tribunal of Nanterre, 7th chamber, 19 June 2009, RG n° 2008F00426.

⁵⁴ Commercial chamber of the Cour de cassation, 30 October 2007, n°06-12.677.

⁵⁵ Constitutional Council 22 July 2005 n° 2005-522.

⁵⁶ Commercial chamber of the Cour de cassation, 15 September. 2009, no 08-18.876, Commercial chamber of the Cour de cassation., 1st July. 2008, no 07-17.729.

⁵⁷ Commercial chamber of the Cour de cassation, 13 February 2007, no 03-13.577.

⁵⁸ Commercial chamber of the Cour de cassation, 18 May 2010, no 09-14.281.

⁵⁹ Commercial chamber of the Cour de cassation, 11 March 2008, n° 06-19.616

⁶⁰ Mixte Chamber of the Cour de cassation, 15 June 1979 : D. 1979, jurispr. p. 561, note F. Derrida et A. Honorat; JCP G 1979, II, 19197, note A. Besson et J. Bigot.

⁶¹ Commercial chamber of the Cour de cassation, 17 December 2003, n° 02-12.891 Commercial chamber of the Cour de cassation, 4 oct. 2005 : JurisData n° 2005-030100; Act. proc. coll. 2005, comm. 240.

However, pursuant to Articles L. 622-28 (safeguard proceedings), L. 631-14 (reorganisation proceedings) and L. 641-3 (liquidation proceedings) of the French Commercial Code, claims against guarantors who guarantee a security (*caution*), are co-debtors, autonomous guarantors or have granted a personal security are suspended as from the date of the court decision opening the insolvency proceedings up until the adoption of a business restructuring plan or the judicial winding-up of the company.

- 3.3.6 The loss may be general – suffered by all of the creditors – in which case only the representative of the creditors can bring the claim. Alternatively, the loss may be specific to one creditor in which case the claim can only be brought by the injured creditor. In order to be allowed to bring such a specific claim, the creditor must be capable of establishing, to the satisfaction of the court, the existence of a prejudice which is (i) specific and (ii) personal to him/her/it. These claims are of a civil nature for which damages may be awarded (either to the company in the event of a general claim or to the injured creditor in the event of an individual claim).

QUESTION 4

4. Counterparties dealing with the company during the twilight period

- (a) From the point of view of a counterparty dealing with the company during the twilight period, what are the potential heads of challenge which may lead to transactions with the company being set aside?
- (b) What defences, if any, to the areas of vulnerability identified above will be available to a counterparty seeking to protect a transaction from being attacked?

4.1 Introduction

- 4.1.1 Like many other legal systems, out of a concern to protect creditors and the company itself, French law recognises the right to bring proceedings to render void certain payments and transactions made during the *suspect period* (which, as explained in Question 1, begins with the date on which the company finds itself in a state of cessation of payments and ends on the date of the order commencing formal insolvency proceedings). The basis of such concern is the risk that the company facing financial difficulties may, because of the unequal bargaining power that exists on account of its situation or in an attempt to use whatever means it can to face up to its financial difficulties, grant certain favours and enter into certain transactions which are to the detriment of the company and/or unfairly beneficial to a creditor or counterparty and thus are detrimental to the overall body of creditors.
- 4.1.2 Actions to avoid (*actions en nullité*) payments or transactions (*actions en nullité*)⁶² are intended to reconstitute the assets of the company by either imposing a sanction on the company or reversing the inequality created as between creditors. A third party contracting with the company may therefore see transactions that it entered into with the company during the suspect period held void.
- 4.1.3 An action to avoid based on Articles L. 632-1 and L. 632-2 of the French Commercial Code may not be brought by a creditor since Article L. 632-4 of the French Commercial Code provides that it may only be brought by the administrator, the *mandataire judiciaire*, the person appointed by the court to execute the plan or the public prosecutor (acting jointly or individually).
- 4.1.4 In addition to the statutory basis for an action to avoid, French civil law also recognises a claim, known as the “*action paulienne*” (a right of claim, which Article 1167 of the French Civil Code provides to the creditors of a debtor, to challenge transactions or other acts undertaken by the debtor defrauding creditors’ rights). Such a right of claim is not linked to the suspect period and can be used by creditors who do not have the right to bring an action to avoid.

4.2 Summary of heads of challenge

- 4.2.1 The transaction or payment must have occurred during the suspect period (that is, after the date of cessation of payments and prior to the judgment opening formal insolvency proceedings). It must have been undertaken by the company and not by a third party. It must fall within one of the eleven heads of challenge enumerated in Article L.632-1 of the French Commercial Code (applicable during judicial reorganisation and judicial liquidation under Article L. 641-14 of the French Commercial Code). It is not, however, necessary for the person bringing the action to evidence that the act has caused loss to the company. The heads of challenge fall into two different categories: (a) those which must be held automatically void by the court if the legal requirements are met; and (b) those which, if the legal requirements are met, may be held void by the court at its discretion.
- 4.2.2 The potential heads of challenge are the following:
- (a) Transactions which are automatically held null and void:
- (i) any transaction under which the ownership of a fixture, any real estate or a chattel is transferred for no consideration (transactions for no consideration);
 - (ii) any “commutative” transaction in which the company’s obligations far exceed those of its counterparty (an unequal transaction);
 - (iii) any payment of debts made by any means whatsoever which are not due as at the date of payment (payment of debts not due);

⁶² Commercial chamber of the Cour de cassation, 21 February 2012, n° 11-13.513.

⁶³ Article L. 632-1 of the French Commercial Code.

- (iv) any payment of debts which are due, but made in a manner not commonly admitted in business relationships;
 - (v) all deposits and “consignments” of sums of money given, pursuant to a court order, as guarantees during the suspect period, unless given as a result of a final and binding court decision which was issued prior to the opening of bankruptcy proceedings;
 - (vi) security granted over the debtor’s assets for existing debts;
 - (vii) all “conservatory measures”, unless the filing or the act of seizure pre-dates the date of cessation of payments;
 - (viii) any authorisation, exercise or resale of options defined in Articles L. 225-17 et seq. of the French Commercial Code (that is, “stock-options”);
 - (ix) any transfer of assets or rights into a “fiducie” (a sort of French statutory quasi-trust) unless the transfer took place as a guarantee of a debt that was entered into at the same time;
 - (x) any amendment to a fiducie contract affecting rights or assets already transferred into a *fiducie* as a guarantee of debts entered into prior to the amendment;
 - (xi) where the debtor is an individual businessman with limited liability (*entrepreneur individuel à responsabilité limitée*), any allocation or modification in the allocation of an asset (save for the payment of revenues mentioned under Article L. 526-18) which results in a decrease in the assets of the estate of the insolvent business for the benefit of the businessman’s personal assets.
- (b) Transactions which may be avoided at the court’s discretion:
- (i) transactions mentioned in (a)(i) may be avoided where they were entered into during the six-month period prior to the date of cessation of payments⁶³. As stated above, however, such transactions must be avoided if made during the suspect period;
 - (ii) any transaction for consideration entered into and any payment made for debts that have fallen due during the suspect period if the counterparty knew that the company was in a state of cessation of payments. In addition, any notice to a third-party holder, seizure or objection may also be avoided where it has been delivered or undertaken by a creditor with knowledge of the state of cessation of payments⁶⁴.

Each head of challenge is considered briefly below.

4.3 Transactions for no consideration

4.3.1 The statutory text defines such transactions as “*les actes à titre gratuit translatifs de propriété mobilière ou immobilière*” (transactions under which ownership to fixtures, or any real estate, or chattels is transferred for no consideration). This type of transaction is automatically void if entered into during the suspect period, but the court may also decide that such transactions are void if entered into during the period of six months prior to the date of cessation of payments.

4.3.2 Included in this type of transaction are:

- (a) relief from debt: granting relief from debts will be treated as reducing the assets of the insolvent company. Granting relief from debts, including relief from debts forming part of another transaction, will be voidable if granted for no consideration. If the relief is granted in respect of a debt included in another transaction, it may be hard to demonstrate that it was given without consideration; alternatively, the transaction may be void under a different head of challenge, for example, if its terms strike a poor balance between the parties;
- (b) gifts: regardless of whether the purchaser acted in good faith, or whether the transaction was notarised, in the case of a gift given in person (or by any other means), the gift (and even the on-sale of the gift) during the suspect period will be held void unless the gift was given for consideration. To determine whether the gift was made during the suspect period, the date that will generally be taken into account is the date the gift was accepted;
- (c) “disguised gifts”: a number of transactions may be considered as disguised gifts, which will be held as void if concluded during the suspect period. An example of a ‘disguised gift’ is the transfer of shares in consideration of a loan where the lender has no intention of requesting repayment of the loan⁶⁵.

4.4 Unequal transactions

4.4.1 The statutory text defines such transactions as “*tout contrat commutatif dans lequel les obligations du débiteur excèdent notablement celles de l’autre partie*” (any bilateral “commutative” transaction in which the debtor’s obligations clearly exceed those of the counterparty). A contract is “commutative” if, at the time of signature, the nature of the advantage that each party obtains from the contract can be clearly ascertained. It covers, for example, the sale of personal property, the sale of goods, the creation of a guarantee, and the transfer of a trademark.

4.4.2 The advantages drawn from the contract by each of the parties must be clearly unequal as at the date of the transaction (taking into account all assets and debts forming part of the transaction i.e. not only the price) and to the detriment of the company. The difference must (a) be objectively ascertained and ascertainable and (b) be economically and mathematically clear. There must be no room for the parties to obtain a more or less advantageous position.

⁶⁴ Article L. 632-2 of the French Commercial Code.

⁶⁵ Civil chamber of the *Cour de cassation*, 2 March 2004, n° 01-13.767.

4.4.3 An example of an unbalanced/unequal transaction is where the obligations of the purchaser of a business are unbalanced as compared with the obligations of the seller such as where the business is only composed of a few assets and the purchaser is being obliged to proceed with the redundancy of employees dedicated to the business⁶⁶.

4.5 Payment of debts which have not yet fallen due

The statutory text defines this head of challenge as *“tout paiement, quel qu’en ait été le mode, pour dettes non échues au jour du paiement”* (any payment, regardless of the manner in which it is carried out, of debts which are not due at the date of payment).

As any payment made which is not due will be void regardless of how the payment was made, a payment made during the suspect period may be held void even if made by transfer, novation or contractual compensation of debts.

4.6 Payments not normally recognised in business relations

4.6.1 The statutory text provides: *“tout paiement pour dettes échues, fait autrement qu’en espèces, effets de commerce, virements, bordereaux de cession visés par la loi n° 81-1 du 2 janvier 1981 facilitant le crédit aux entreprises, ou tout autre mode de paiement communément admis dans les relations d’affaires”* (any payment of debts that have fallen due made in a manner other than in cash, commercial instruments, wire transfer, deposit slip of transfer in accordance with Law 81-1 dated 2 January 1981 facilitating credit to business (codified under Article L. 313-23 et seq. of the French Monetary and Financial Code), or by any other method of payment commonly recognised in business relations).

4.6.2 The purpose is to avoid payments that, on account of their unusual nature, grant an advantage to one creditor. The notion of payments commonly recognised in business relations covers any method of payment which is generally and habitually used in the appropriate field of business affairs.

4.6.3 The burden is on the defendant to bring sufficient evidence that the payment is commonly recognised in business relations. An example of a payment that was considered uncommon in business affairs, and therefore void, was the payment of the cost of works by the resale of parking spaces in the building⁶⁷.

4.7 Deposits and consignments

4.7.1 The statutory text provides: *“tout dépôt et toute consignation de sommes effectués en application de l’article 2350 du Code Civil, à défaut d’une décision de justice ayant acquis force de chose jugée”* (any deposit or consignment of monies pursuant to Article 2350 of the French Civil Code unless made pursuant to a final and binding court ruling). Article 2350 of the French Civil Code relates to any deposit or consignment of money, commercial instruments, or securities which an entity has been ordered to make as a guarantee (or as a conservatory measure). The deposit or the consignment will not be avoided if it was ordered by a final and binding court decision.

4.7.2 The purpose is to avoid the priority right that such deposit or consignment grants to the creditor in question in accordance with Article 2333 of the French Civil Code.

4.8 Creation of security for existing debts

4.8.1 The statutory text provides: *“toute hypothèque conventionnelle, toute hypothèque judiciaire, ainsi que l’hypothèque légale des époux et tout droit de nantissement constitués sur les biens du débiteur pour dettes antérieurement contractées”* (any mortgage whether contractual, judicially-ordered or pursuant to law as between spouses, and any pledge over assets of the debtor granted for debts previously incurred). The text covers all forms of security over property, whether real or personal. The key is the date on which the security was granted as compared to the date on which the debt in question was incurred by the company. If the debt was incurred before the grant of security and if the security has been granted during the suspect period, the action to avoid must succeed.

However, it has been held by the French courts that this text is not applicable to a mortgage granted to a creditor in consideration of a guarantee granted simultaneously by the debtor even if the mortgage was granted in respect of a credit facility which had already been drawdown. The courts have held that this text is not applicable as the guarantee, granted simultaneously with the grant of the mortgage, is not a debt incurred prior to the granting of the security⁶⁸.

4.8.2 Again, the reasoning behind the existence of this head of challenge is clear given the absence of any justifiable rationale for granting security over a debt that already exists, such security not having been a sine qua non condition for the creation of the obligation. The existence of an advantage to the creditor in question, through the grant of additional or new security, is presumed.

4.9 Conservatory measures

4.9.1 The statutory text provides for the avoidance of: *“toute mesure conservatoire, à moins que l’inscription ou l’acte de saisie ne soit antérieur à la date de cessation des paiements”* (any conservatory measure unless the filing or the act of seizure took place prior to the date of cessation of payments).

4.9.2 Where the recovery of a creditor’s claim appears threatened, the court may make an order to seize the debtor’s assets or to grant judicial security over the debtor’s assets (a ‘conservatory measure’). Assets seized or judicial security enforced after the date of cessation of payments are void.

⁶⁶ Commercial chamber of the *Cour de cassation*, 27 June 2006, n°04-19.423.

⁶⁷ Commercial chamber of the *Cour de cassation* 13 May 2007, n°06-15.619.

⁶⁸ Commercial chamber of the *Cour de cassation* 10 December 2002, n° 99-19.300.

As a general rule, judicial security can only be enforced once it has been publicised – a two stage filing process. Judicial securities granted over the assets of a debtor become enforceable on the date all publicity measures have been fulfilled in accordance with Articles L. 532-1 and L. 533-1 of the French Enforcement of Civil Procedures Code. Publication of such judicial measures is undertaken in two steps: (i) a temporary filing and (ii) a definitive (final) filing; publication is not effective until the definitive filing. Once the definitive filing has been carried out, the effective date is backdated to the date of the temporary filing. Therefore, a judicial security will only be held void if the two steps have been carried out but only when the temporary filing took place during the suspect period.

As an exception to the above, should the court authorise a pledge over the shares or securities held by the debtor, this pledge is not subject to filing but only to notification to the entity in question. In this case, French academics appear to agree that such conservatory measure is considered void if the notification takes place during the suspect period.

The purpose of this action to avoid is to protect the company against conservatory measures obtained by a creditor which would have the effect of giving that creditor an advantage. The reasoning behind this head of challenge is similar to that for security granted for existing debts.

4.10 Transactions on Stock-options

- 4.10.1 Stock-options granted by the company or exercised by an employee during the suspect period are held void.
- 4.10.2 The purpose of this provision is to prevent directors from using their insider knowledge of the company's financial difficulties to dispose of stock just before the opening of formal insolvency proceedings.

4.11 Transfers to a fiducie

- 4.11.1 The French version of a quasi-trust, *fiducie*, has only existed since 2007. The statutory text defines the head of challenge as “*tout transfert de biens ou de droits dans un patrimoine fiduciaire à moins que ce transfert ne soit intervenu à titre de garantie d'une dette concomitante*” (any transfer of assets or rights to a fiducie unless the transfer was given as a guarantee of a debt simultaneously incurred).
- 4.11.2 The purpose is to protect creditors against the company transferring assets or rights into a fiducie, which would shelter the assets or rights in the event of insolvency.
- 4.11.3 Any amendment to a contract of fiducie which would affect rights or goods already transferred to a fiducie as guarantee of debts incurred prior to the amendment will also be held void if made during the suspect period.

4.12 Allocations (or modifications to allocations) of rights and assets by an individual entrepreneur

This head of challenge is fairly recent and renders void the allocation (or modification of an allocation) of assets during the suspect period to the detriment of creditors (i.e. reducing the assets of the insolvent business for the benefit of another business, or the owner of the business).

This avoidance provision may apply, not just to assets, but also to the allocation of liabilities to the insolvent business, although the latter would also be an act of mismanagement for which the individual entrepreneur could be held personally liable (see Question 2).

4.13 Counterparty aware that the company was in a state of cessation of payments

- 4.13.1 Under this head of challenge a court may, at its discretion, render void certain payments and transactions entered into during the suspect period. In other words, these transactions may be avoided by the court but are not automatically null and void. The statutory text⁶⁹ provides: “*les paiements pour dettes échues effectués à compter de la date de cessation des paiements et les actes à titre onéreux accomplis à compter de cette même date peuvent être annulés si ceux qui ont traité avec le débiteur ont eu connaissance de la cessation des paiements*” (payments for debts that have fallen due on or after the date of cessation of payments and transactions for consideration entered into on or after the date of cessation of payments may be held void if those dealing with the debtor were aware of the cessation of payments).
- 4.13.2 The transaction or payment must have taken place during the suspect period. There is no need to show that the company suffered a loss as a result of the transaction. The key element is the counterparty's knowledge that it was dealing with a company that was in a state of cessation of payments; it is not enough that the counterparty knew that the company was in financial difficulties. In practice, it will be easier to prove that certain creditors (such as a company's bankers, lawyers, accountants, statutory auditors, etc.) had knowledge of the date of cessation of payments as their appointment grants them greater knowledge of the functioning and the financial situation of the insolvent company.

4.14 “Action Paulienne”

Unlike an action to avoid, creditors, the *mandataire judiciaire*, the person appointed by the court to execute the plan and the *contrôleurs* may all bring a claim, known as the “*action paulienne*”, pursuant to Article 1167 of the French Civil Code if any transaction or act was carried out by the debtor with the intention of defrauding creditors. The claim will be available regardless of whether the company is in a state of cessation of payments and therefore can be made in respect of any transaction or act of the debtor, whether entered into during the suspect period or not. Fraudulent intent must be shown to have existed on the part of the debtor – such fraudulent intent aimed at harming the creditor. If such fraudulent intent can be shown to exist and if the creditor can show that it has a valid and existing debt against the company that has been declared, the creditor can request that the transaction be held unenforceable against him/her/it.

⁶⁹ Articles L. 632-2 and L. 641-14 of the French Commercial Code.

An *action paulienne* can only lead to the fraudulent act or transaction being held unenforceable against the creditor; it does not render the act or transaction void. Accordingly, the transaction or act carried out by the debtor remains valid and binding between the debtor and third parties (other than the party to the *action paulienne*) including co-contracting parties to the transaction in question⁷⁰.

In the event the *action paulienne* is brought in respect of a transaction between the debtor and co-contracting parties, this will give rise to a conflict between protecting the interest of the creditor against the fraudulent transaction and protecting the co-contracting parties for whom the transaction remains binding.

French courts have resolved this issue by determining whether the co-contracting parties were the accomplices of the debtor in the fraudulent transaction or whether they entered into the transaction in good faith.

Here, French case law observes a distinction between gratuitous transactions and transactions for consideration. If the fraudulent transaction was a gift, the co-contracting party will be deemed to be an accomplice of the debtor, without the creditor having to satisfy any burden of proof⁷¹. But if the fraudulent transaction was for consideration, the creditor will be required to prove bad faith on the part of the co-contracting party⁷². The court will not sanction an *action paulienne* if the creditor has not satisfied this burden of proof.

If the court holds that the co-contracting party was an accomplice to the debtor as regards the fraudulent transaction, the *action paulienne* will deprive the co-contracting party of the benefit of the fraudulent act (so as to protect the defrauded creditor). In this event, the third party co-contractor will be entitled to a warranty claim against the debtor but in practice such claims are rarely used when the debtor is insolvent or in financial difficulties.

QUESTION 5

5. Enforcement

By whom may action be brought against directors (and/or others identified in Question 3 above) and before which courts?

5.1 Introduction

- 5.1.1 The persons who may bring proceedings, whether civil or criminal, against the directors or associated persons are defined in the French Commercial Code.
- 5.1.2 Civil liability claims for the shortfall of assets and personal bankruptcy can only be brought by the liquidator, the public prosecutor or by the majority of the *contrôleurs* (appointed by the court from among the creditors to help the *mandataire judiciaire*) in the event the liquidator fails to bring such a claim after formal notice to do so⁷³. These civil claims are brought before the commercial court (*Tribunal de Commerce*) or the civil court (*Tribunal de grande instance*) depending upon which has jurisdiction over the insolvency proceedings in respect of the company⁷⁴. Should the debtor be a company which carried on a commercial activity, the commercial court has jurisdiction and in all other cases, it is that of the civil court.
- 5.1.3 Criminal claims based on criminal bankruptcy (*banqueroute*) or on the fraudulent 'organisation' of bankruptcy may only be brought by the public prosecutor. However, other persons may initiate the criminal claim if the public prosecutor decides to not bring a criminal claim by forming a civil party⁷⁵ which will seize the relevant Juge d'Instruction who will then proceed with criminal investigations⁷⁶. In the case of criminal bankruptcy, only the liquidator, the administrator, the *mandataire judiciaire*, the employees' representative and the person appointed by the court to execute the plan of reorganisation may form a civil party⁷⁷. Furthermore, in the event the judicial representative fails to initiate such a claim, the majority of the court-appointed *contrôleurs* may initiate such a claim after formal notice from the judicial representative to do so. These criminal claims are brought before the criminal court (*tribunal correctionnel*). Any creditor may also join the criminal proceedings as civil party if the criminal claim has already been brought and if he or she is able to establish an individual specific loss that is different from the amount of the creditor's claim and results directly from the offence

⁷⁰ Commercial chamber of the Cour de cassation, 14 May 1996, no 94-11.124.

⁷¹ Commercial chamber of the Cour de cassation, 24 January 2006, n° 02-15.295.

⁷² Commercial chamber of the Cour de cassation 20 February 2007, n° 05-18.241.

⁷³ Article L. 651-3 of the French Commercial Code.

⁷⁴ Article L. 621-2 of the French Commercial Code.

⁷⁵ Articles 1 and 2 of the French Criminal Procedure Code: criminal proceedings may be initiated by civil parties, meaning all those who have personally suffered damage directly caused by an offence, it being a felony, misdemeanour or a petty offence, in accordance with the provision of the French Criminal Code. May only form a civil party, those who have filed a prior complaint in front of the public prosecutor or the French police services (Article 85 of the French Criminal Procedure Code).

⁷⁶ Article 85 of the French Criminal Procedure Code.

⁷⁷ Article L. 654-17 of the French Commercial Code.

QUESTION 6
6. Remedies: orders available to the domestic court

In respect of the heads of challenge and liability of *de jure* or *de facto* directors identified in Questions 2, 3 and 4 above, what sanctions may be ordered against such directors by a French domestic court?

Heads of Challenge	Sanctions available
Liability for shortfall of assets	<p>Liability is civil.</p> <p><i>De jure</i> and/or <i>de facto</i> directors may be ordered to compensate from their own pockets all or part of the shortfall of assets that their mismanagement contributed to.</p> <p>The court may also order professional sanctions (see below) for ‘personal bankruptcy’ in the event a director held liable for the shortfall of assets has not paid the compensation ordered in relation to that liability⁷⁸.</p>
Personal bankruptcy	<p>Liability is civil.</p> <p>If the court holds <i>de facto</i> and/or <i>de jure</i> directors liable for personal bankruptcy, they will be prohibited from managing, administrating and controlling any commercial business and any form of company which carries on an economic activity⁷⁹.</p> <p>The court will also decide to order that they may not hold any elective public office for the same period as the prohibition but subject to a maximum period of five years⁸⁰.</p> <p>As mentioned in Question 2, as an alternative to a personal bankruptcy ruling, the court may decide instead to solely order prohibition on a management⁸¹ and may tailor such prohibition to cover certain types of activity only.</p> <p>The maximum period for which personal bankruptcy or prohibition of management may be ordered is 15 years⁸².</p> <p>It must be noted however that a director held liable for personal bankruptcy may request that instead of being subject to the sanctions of personal bankruptcy or prohibition of management, he/she/it will instead incur personal liability for the shortfall of assets of the insolvent company that he/she/it managed⁸³.</p>
Heads of Challenge	Sanctions available
Criminal bankruptcy	<p>Liability is criminal.</p> <p>When <i>de jure</i> or <i>de facto</i> directors, who are individuals, are held liable, they may be sentenced up to a maximum term of five years imprisonment and/or a fine up to 75,000 euro (seven years and 100,000 euro for investment service providers⁸⁴). If the <i>de jure</i> or <i>de facto</i> directors are corporate or other such legal entities, then (i) pursuant to Articles 131-38 of the French Criminal Code, they may incur a fine up to a maximum of five times the amount of the maximum fine for an individual which gives a maximum of 375,000 euros, and (ii) pursuant to Article 131-39 of the French Criminal Code, they may, amongst other sanctions, be dissolved, prohibited from carrying on the activity in the course of which the offence was committed for a maximum period of five years and being placed under judicial control⁸⁵.</p> <p>In addition, should the <i>de jure</i> or <i>de facto</i> director held liable for criminal bankruptcy be an individual, his or her sentence may include any of the following orders⁸⁶:</p> <ul style="list-style-type: none"> – deprivation of civil rights; – prohibition for a maximum period of five years from having a public function or conducting a professional activity in the same field as that in which the offence was committed; – exclusion from participating in public tender offers for a period of at least five years; – prohibition for a maximum period of five years from issuing certain forms of cheque; – that the judgment be published, <p>and, at the court’s discretion and unless the civil courts have already made such civil orders, incur civil liability for personal bankruptcy or prohibition of management, for which the possible sanctions are mentioned above⁸⁷.</p> <p>If civil proceedings are associated with the criminal proceedings, the <i>de jure</i> or <i>de facto</i> director in question may be ordered to compensate the company for any loss that his offending conduct has caused.</p>
Fraudulent organisation personal of insolvency	<p>Pursuant to Article L. 654-9 of the French Commercial Code, the same sanctions for bankruptcy may be ordered in the event of fraudulent organisation of insolvency.</p>

⁷⁸ Article L. 653-6 of the French Commercial Code.

⁷⁹ Article L. 653-2 of the French Commercial Code.

⁸⁰ Article L. 653-10 of the French Commercial Code.

⁸¹ Article L. 653-8 of the French Commercial Code.

⁸² Article L. 653-11 of the French Commercial Code.

⁸³ Article L. 653-11 of the French Commercial Code.

⁸⁴ Article L. 654-3 of the French Commercial Code.

⁸⁵ Article L. 654-7 of the French Commercial Code.

⁸⁶ Article L. 654-5 of the French Commercial Code.

⁸⁷ Article L. 654-6 of the French Commercial Code.

QUESTION 7

7. Duty to co-operate

- (a) To what extent are directors (and others identified in Question 3 above) obliged to co-operate with an investigation into the company's affairs following its insolvency?
- (b) Are any human rights laws applicable in the domestic jurisdiction in relation to any obligations (for example, in the UK and other European jurisdictions Article 6 of the European Convention on Human Rights may apply if domestic law compels a person to provide potentially self-incriminating information at the request of the office-holder appointed under the relevant insolvency procedure adopted)?

7.1 Obligation to commence insolvency proceedings

7.1.1 Pursuant to Articles L. 631-4 and L. 640-4 of the French Commercial Code, the company, through its director(s), meaning:

the general director in a traditional *société anonyme* who may also have the role of president of the board (*Conseil d'administration*);

- the president of the management board (*directoire*) of a two-tier managed *société anonyme* with a supervisory board and a management board;
- the president, and as the case may be, the general directors of a *société par actions simplifiée*; and/or
- the director (*gérant*) of a *société à responsabilité limitée*,

must request the opening of judicial reorganisation or judicial liquidation proceedings by the court within 45 days of the date of cessation of payments (except where the company has requested the opening of *conciliation* proceedings). Pursuant to Article L. 653-8 of the French Commercial Code, if the director of the company in cessation of payments fails to make the request, he/she/it may be prohibited from exercising any management role (see Question 2).

Pursuant to Article L. 2323-44 of the French Employment Code, before filing for judicial reorganisation or judicial liquidation, the company, through its directors, must inform the workers' council and call and hold a meeting of the council. Article 2323-4 of the French Employment Code also provides that when consulting the workers' council, the council ought to have sufficient time to be able to form and give an opinion on, in this case, the opening of insolvency proceedings.

However, in practice the seriousness of the financial situation of the company normally leads to informing, and consulting with, the workers' council in a very short timeframe so that the company does not breach its obligation to open formal insolvency proceedings within 45 days of the cessation of payments.

Despite this timeframe to open insolvency proceedings, the company must comply with the legal timeframe to consult the workers' council otherwise the directors in place may be held guilty of a "délit d'entrave" which was the case when a director only consulted the workers' council one day before declaring the cessation of payments in its filing for insolvency proceedings⁸⁸.

This legal timeframe allows the representatives of the employment bodies of the company to either participate in the process of opening insolvency proceedings or to bring claims against the opening of such proceedings⁸⁹.

7.1.2 Thereafter, the request to open judicial reorganisation or judicial liquidation is made at the registry of the commercial court where the company is registered (save where the company has commenced court-supervised *conciliation* proceedings when the court supervising the *conciliation* proceedings is the appropriate court).

7.1.3 The request must be accompanied by a number of documents that the director will need to put together. These documents are listed under Articles R. 631-1 and R. 640-1 of the French Commercial Code. Examples of such documents include a Kbis extract (commercial extract) of the company from the relevant Trade and Company Registry and the annual accounts of the company for the last financial year

7.1.4 It should be noted that insolvency proceedings, being judicial reorganisation or judicial liquidation proceedings, may also be commenced in a number of different ways by persons other than the director of the company (for instance, by one or more creditors of the company or by the public prosecutor), provided that the company is not under *conciliation* proceedings⁹⁰.

7.1.5 The director of a company which is not yet in a state of cessation of payments may file for the opening of safeguard proceedings (it is not obligatory as is the case when a company is in a state of cessation of payments). Safeguard proceedings may only be commenced by the company's director on a voluntary basis; they cannot be commenced by third parties as for judicial reorganisation and judicial liquidation. For more information on safeguard proceedings, see Appendix.

⁸⁸ Criminal chamber of the Cour de cassation. 15 October 1991, n°89-83.950.

⁸⁹ Commercial chamber of the Cour de cassation. 3 July 2012, n° 11-18.026.

⁹⁰ Articles L. 631-5 and L. 640-5 of the French Commercial Code.

7.2 Obligation to communicate information in the initial stages of the proceedings

7.2.1 Pursuant to Article L. 622-6 of the French Commercial Code (applicable to safeguard proceedings), also applicable to judicial reorganisation based on Article L. 631-14 of the French Commercial Code and to judicial liquidation based on Articles L. 641-1, L. 641-4 and L. 641-14 of the French Commercial Code, the company, through its director, must assist the administrator or liquidator in drawing up an inventory of the company's assets, liabilities and encumbrances. To this effect, a director is under an obligation to cover the following:

information on assets that the company holds that may be claimed by third parties: pursuant to Article R. 622-4 of the French Commercial Code; this must include encumbered assets as well as assets held on deposit, rented or under a leasing contract, or subject to a retention of title clause or that may otherwise be claimed by third parties;

a list of creditors: pursuant to Article R. 622-5 of the French Commercial Code, this list must be filed with the administrator and the *mandataire* judiciaire within eight days of the opening of the proceedings and must include the names and addresses of the creditors of the company, the amounts due and owing at the date of the commencement of the insolvency proceedings, the amounts becoming due and their due date, the nature of the debts and any guarantees or charges relating to them, and the object of the main on-going contracts;

- the amount of liabilities;
- the main on-going contracts; and
- information on pending proceedings.

Pursuant to Article L. 653-8 of the French Commercial Code, the director must provide these documents and this information to the administrator or liquidator within one month of the opening of judicial reorganisation or judicial liquidation, or risk a prohibition on management. However, for a director to be liable, he/she must be acting in bad faith and not merely being negligent. In order to evidence such bad faith, it is advisable for the administrator or liquidator to send a formal notice to the directors requiring them to provide such documentation.

7.2.2 Article L. 622-5 of the French Commercial Code also provides that as from the opening of the insolvency proceedings, any third party is obliged to provide the administrator, on his/her request, with any document relating to the company's accounts.

7.2.3 During safeguard proceedings, it is provided under Article L. 622-6-1 of the French Commercial Code that if no public officer is *mandated* to draw up an inventory, the company, through its director and employees, is to draw up the inventory which then has to be certified by the statutory auditors. If the company does not draw up the inventory within eight days from the opening of the safeguard proceedings or within the period determined by the court, the *juge-commissaire* will appoint a qualified professional (listed in the Article) to draw up the inventory.

7.3 Right to be heard during the proceedings

7.3.1 Throughout the insolvency proceedings, the company, through the directors, has a number of specific rights to be informed, intervene and put forward his/her/its observations either to the administrator, the liquidator, the *juge commissaire* or the court.

7.3.2 An example of being heard is Article L.623-3 of the French Commercial Code which provides that the company, through its directors, may be consulted by the administrator and must be at least informed by the administrator of the reorganisation measures the administrator will propose based on the information and offers received.

7.4 Obligation to collaborate during the proceedings

7.4.1 Given that the director of the company in question is often the person best placed to know and understand the company and its activities, his or her or its collaboration with the judicial organs/officers conducting the insolvency proceedings will be invaluable. French law thus provides for the involvement of the director of the company at all stages of the proceedings.

7.4.2 Besides the collaboration of the director in the initial stages of the proceedings provided above, pursuant to Article L.623-1 of the French Commercial Code, under safeguard and judicial reorganisation proceedings (Article L.631-18. of the French Commercial Code), the company, through its directors, must assist the administrator appointed by the court in drawing up a report on the economic and social position of the company. The report must identify the origin, nature and significance of the difficulties affecting the company. The administrator must also propose in the report either a plan for the reorganisation of the company or its judicial liquidation.

7.4.3 Other examples where the company, through its directors, must collaborate with the organs/officers appointed by the court, during insolvency proceedings are the following:

at the request of the administrator, the directors of the company must perform all steps and acts necessary to preserve the company's rights against its debtors and to preserve the production capabilities of the company (Article L.622-4 of the French Commercial Code);

as from the date of opening the proceedings, the company, through its directors, must inform the administrator of all the establishments of the company and assist in accessing such establishments, provide a list of employees as well as any information that may determine salaries and indemnities to be paid (Article R. 622-2 of the French Commercial Code);

on the order of the *juge-commissaire*, during liquidation proceedings, the liquidator may request the directors or any employee of the company that may have useful information to automatically forward their electronic mail from their professional email service to the email address designated by the liquidator (Article R. 641-40 of the French Commercial Code).

7.4.4 Should a director intentionally not fulfil his/her obligations to collaborate with the organs and officers appointed under the insolvency proceedings to which the company is subject and that non-cooperation interferes with or prevents the smooth conduct of the insolvency proceedings, he/she/it may be sanctioned and held liable for personal bankruptcy under Article L. 653-5, paragraph 5, of the French Commercial Code (see Question 2).

7.5 Rights granted to directors (applicable in both safeguard and judicial reorganisation proceedings)

7.5.1 The director of the company in question has the right (*locus standi*) to request the *juge-commissaire* to seize the court to replace the administrator or expert(s) appointed by the court during the safeguard proceedings (Article L.621-7 of the French Commercial Code). Naturally, any decision to use this right needs when using it, careful consideration since if the court refuses to change the administrator, co-operation between the director and the administrator may be jeopardised by the conflict.

7.5.2 At any time during the proceedings, the director has the right (*locus standi*) to file a request with the court for the total or partial cessation of the company's activities or the judicial reorganisation or judicial liquidation of the company (Articles L. 622-10 and L. 631-15 of the French Commercial Code).

7.5.3 A director has the power to challenge, on behalf of the company, any decision taken by judicial organs during the procedure that by law is open to challenge (for example, the decision of the *juge-commissaire* to admit, reject or contest debts of the company submitted by creditors in the course of the insolvency proceedings (Articles L.624-3 and L. 631-18 of the French Commercial Code)).

7.5.4 The director has the right (*locus standi*) to request that the court extends the observation period (Articles L.621-3 and L. 631-15 of the French Commercial Code).

7.5.5 Throughout the observation period, the director has a right to be informed by the administrator of the progress of the administrator's objectives (see 7.6.4 below).

7.5.6 The *mandataire judiciaire* must seek the director's observations on proposals to admit, reject or contest before the competent court debts owed by the company and duly submitted by the creditors (Articles L.624-1 and L. 631-18 of the French Commercial Code).

7.5.7 The court must summon to appear before it the director of the company before it takes a decision to: (i) extend the observation period (Articles R.621-9 and Article R. 631-7 of the French Commercial Code), (ii) modify the objectives granted to the administrator (Articles R.622-1 and R. 631-17 of the French Commercial Code), (iii) order the judicial liquidation of the company following the commencement of an observation period or (iv) order a plan of reorganisation (Articles L.622-10 and L. 631-15 of the French Commercial Code).

7.5.8 Pursuant to Articles L. 621-4, L. 627-1 et seq., L. 631-9 and L.631-21 of the French Commercial Code, during either safeguard or judicial reorganisation proceedings where an administrator has not been appointed, the director is to exercise all the powers that are normally granted to the administrator so that, generally speaking, the directors carry on the management of the company during the observation period and proceed with the restructuring of the company.

7.6 Rights retained by directors

7.6.1 In the event that the court orders the immediate judicial liquidation of the company at the commencement of the proceedings, pursuant to Article L. 641-9 of the French Commercial Code, a director of the company is not removed from his/her/its position but is immediately stripped of all rights of action, power and authority with respect to the activities of the company. All such rights of action, powers and authorities are vested in the judicially-appointed liquidator⁹¹. However, the Article provides certain exceptions. The company, through its directors, may form a civil party to criminal proceedings where the company has been the victim of the offence, and may carry out the acts and exercise the rights that are not included in the powers of the liquidator or the administrator when appointed. As the director remains in his/her/its office, there is no need to appoint an *ad hoc* representative to exercise these rights⁹². In practice, this scope of action is relatively limited as the liquidator will, among his/her other powers, usually be granted all powers, in respect of the assets of the company.

7.6.2 In all other insolvency proceedings (safeguard and judicial reorganisation), the director remains at the head of the company with varying degrees of power and authority over the conduct of the company's activities, depending upon the nature of the objectives granted to the judicially-appointed administrator (see 7.6.4 below).

7.6.3 Within this scope, the principal powers retained by directors are the power to take conservatory measures and the power to undertake acts in the ordinary course of business:

- (i) The power to take 'conservatory measures': conservatory measures in this context means those measures necessary to protect the rights of the company and to preserve the production capabilities of the company. Measures to protect the rights of the company include acts to stop statutes of limitation from running, sending formal notices (*mises en demeure*) to debtors of the company, and the creation or renewal of guarantees, charges and other encumbrances. Measures to preserve the company's production capabilities include the renewal of the company's stocks, replacement of used or worn material, repair of damaged machinery and acts to prevent the theft or other wrongful disappearance of the assets of the company.

⁹¹ Article L. 641-9 of the French Commercial Code.

⁹² The director is allowed to receive the judgments' notifications and the notification of a certificate for the admission of a claim.

- (ii) The power to undertake acts in the ordinary course of business of the company: Articles L. 622-3 and L. 631-14 of the French Commercial Code (applicable to both safeguard and judicial reorganisation proceedings) provide that subject to the prohibited acts listed below under section 7.7.1 and the acts considered within the scope of the administrator's objectives, acts taken in the ordinary course of business by the company alone, through its directors, "are deemed valid vis-à-vis third parties acting in good faith". Acts in the ordinary course of business in the sense of Article L.622-3 of the French Commercial Code are those which fall within the scope of the normal business activities of the company, which are of such a nature as to occur and recur on a regular and frequent basis, which do not have a significant financial impact on the company and which would not be likely to be detrimental to the reorganisation of the company. Examples include the issuing of orders for office supplies of minor financial significance, the issuing of orders for materials necessary for the conduct of the company's business for amounts that are ordinary for the company, and the sale of goods typically sold by the company on normal terms and conditions. The third party must be act good faith which means that it must not be aware of any restrictions on the director of the company undertaking the act in question. It is not however typically necessary for the third party to have undertaken any specific investigation into the powers and restrictions actually affecting the director to prove its good faith.

7.6.4 The extent and nature of the other powers of directors with respect to the activities of the company in question depend upon the nature of the objectives granted to the administrator. These objectives will differ depending on whether the company is subject to safeguard or judicial reorganisation proceedings.

During safeguard proceedings, the court determines the extent of the objectives of the administrator which will be limited to two powers (Article L. 622-1-II of the French Commercial Code):

- (i) the power to supervise the director in his/her/its management of the company: under this power, the administrator has as objective to prevent damaging decisions being taken by the director of the company; and
- (ii) the power to assist the director in all or some of his/her/its management powers; the court exercises its discretion in this respect, taking into account the needs of the company: here, the company is truly managed by means of strict collaboration between the administrator and the director. This power may involve areas such as the redundancy or dismissal of employees, the management of bank accounts and the bringing and defending of claims.

During judicial reorganisation proceedings, the court also determines the extent of the powers of the administrator to either:

- (i) fully manage the business and represent the company: even though Article L. 631-12 of the French Commercial Code does not specifically provide that the administrator will represent the business, the power of full management of the company means that the administrator will be fully and solely managing, and therefore representing, the company. (This means for example that the administrator will be the one bringing claims on behalf of the company, and claims against the company should be addressed to the administrator); or
- (ii) assist in all or part of the management of the business: as with safeguard proceedings (Article L. 631-12 of the French Commercial Code) but will not include the power to supervise as with safeguard proceedings.

7.7 Acts that directors cannot undertake

7.7.1 The acts which the director is prohibited from taking as a general matter are the following:

- (i) the director cannot pay debts incurred prior to the opening of insolvency proceedings except by way of set off of related claims, and any such payment is at risk of being held void (Article L.622-7 of the French Commercial Code). Except for a very limited number of exceptions specifically provided for by law, the payment of any such debts must receive the prior approval of the *juge-commissaire*;
- (ii) Article L. 622-7 of the French Commercial Code also provides that the director cannot pay debts incurred after the opening of the insolvency proceedings which are not mentioned under Article L. 622-17 of the French Commercial Code which requires that they have to have been incurred in the sole interest of carrying on the business activities of the company;
- (ii) the director cannot pay any debts incurred outside the ordinary course of business of the company in question (Article L.622-7 of the French Commercial Code). This prohibition is of course the corollary to the right of the director to undertake acts that fall within the ordinary course of business of the company noted above. If such an act, such as the sale of assets (as opposed to stock) of the company or the entering into settlement of a dispute becomes necessary, it must receive the prior approval of the *juge-commissaire*;
- (iii) the director is prohibited from granting any form of security over the assets of the company without the prior approval of the *juge-commissaire* (Article L.622-7 of the French Commercial Code);
- (iv) the director cannot take any decision with respect to the continuation or cessation of existing contracts binding the company to its customers or suppliers, such right of decision being vested in the administrator (Article L. 622-13 of the French Commercial Code);
- (v) in the context of reorganisation proceedings, lay-offs may be made only after consultation with the *juge-commissaire* (Article L. 631-17 of the French Commercial Code);
- (vi) the administrator, in agreement with the debtor, or the debtor alone with the authorisation of the liquidator, has the power to pay the price for goods purchased prior to the commencement of the insolvency proceedings but subject to a retention of title clause⁹³. This is due to the fact that a contract with a retention of title clause is treated the same as a claim that is incurred after the opening of the proceedings.

⁹³ Article L. 624-16 of the French Commercial Code.

7.8 Human rights

7.8.1 France is a contracting party to the European Convention for the Protection of Human Rights and Fundamental Freedoms (signed in Rome on 4 November 1950) (the Convention), the provisions of which are incorporated into French law.

7.8.2 The persons identified in response to Question 3 will thus be entitled to rely upon the rights contained in the Convention (the Convention Rights). This is the case whether such persons are individuals or companies. In an insolvency context, a director or other person with Convention Rights under the Convention will be able to:

- (i) require that a particular provision of insolvency law is construed in accordance with those rights or otherwise declared incompatible; or
- (ii) claim that the judicial organs are each a public authority and are acting unlawfully in breach of that person's Convention Rights.

7.8.3 It should be recognised that the Convention Rights are not absolute and may well be limited by authorised interference by the state where such interference is justified by a limited aim and/or is proportionate to the need in hand.

7.8.4 In the context of insolvency, and the duties of co-operation discussed above, certain Convention Rights may be particularly relevant. These include:

- (i) Article 6 – the right to a fair trial;
- (ii) Article 4 – prohibition of slavery and forced labour;
- (iii) Article 8 – right to privacy; and
- (iv) Protocol 1, Article 1 – right to protection of property.

7.8.5 An example of certain inconsistencies between the Convention Rights and French insolvency proceedings relates to the right to a fair trial provided for under Article 6 of the Convention, where individuals or companies enjoy a range of rights, including in particular: (i) to be heard before a tribunal in order to determine their civil rights and obligations, and (ii) for the judge to be independent and impartial, which are two notions that may be seen as limited in the context of French insolvency proceedings.

- (i) Right to access the French court in insolvency proceedings

Under French insolvency law, the right to bring claims and rights of appeal are in some circumstances limited; for example, the absence of the right for creditors to bring individual claims after the opening of insolvency proceedings against the insolvent company (with limited exceptions) (Article L. 622-21 of the French Commercial Code).

France was held liable by the European Court of Human Rights (the ECHR) in its decision *Arma v. France*, dated 8 March 2007, where the French court held that a director could not appeal against a decision opening judicial liquidation proceedings against the company. The French court based its decision on the fact that the decision opening judicial liquidation also ordered the dissolution of the company and this constituted the end of the office of directorship and that therefore the director did not have the power or interest to form an appeal against the decision. The ECHR held that this was contrary to Article 6 of the Convention. Reform of French law in 2006 rectified this point; for proceedings opened after 1 January 2006: the director remains in office on the opening of liquidation proceedings unless provided otherwise in the articles of association or by a shareholders' decision.

- (ii) Right to an independent and impartial judge

The question of whether a person's right to an independent and impartial judge is respected during French insolvency proceedings involves consideration of the jurisdiction of the *juge-commissaire* and the insolvency court and also the make-up of the insolvency court itself.

Under French law, the *juge-commissaire*, an organ in the insolvency proceedings that is also referred to in practice as the "*orchestra conductor*", has certain powers including, for example, the power to approve creditor claims. This *juge-commissaire*, outside of this role may also be part of the composition of the insolvency court. The ECHR will review all facts to evaluate whether the presence of the *juge-commissaire* in the composition of the insolvency court breaches the right to a fair trial. It will be regarded as relevant that the *juge-commissaire* granted orders relating to the management of a group of companies during an observation period and at the same time presided over the insolvency court in charge of determining whether the business plan (plan de continuation) is itself viable⁹⁴. The *juge-commissaire* will not always have a dual role. Pursuant to Article L. 651-3 of the French Commercial Code, the *juge-commissaire* may not be a member of the insolvency court for claims against directors in respect of a shortfall of assets.

In most cases, the insolvency court is the commercial court which is composed of practitioners being business men and women, who may be competitors or friends of the directors or shareholders of the insolvent company. This danger of being seen to be potentially partial was highlighted in a case where a number of members of the commercial court actually participated in the operations of the company that was placed in judicial reorganisation⁹⁵. In this case, the court decided to quash the decision of the Commercial Tribunal of Carcassonne because the judges were not impartial and independent on the basis of the Article 6 of the ECHR.

⁹⁴ ECHR, 6 June 2000, *Morel v. France*: Here the ECHR decided that it needed to be determined objectively on the facts whether the *juge-commissaire* was impartial due to the fact he had taken measures during the observation period and he was also seated as president of the insolvency tribunal deciding on the outcome for the company. On this basis, the ECHR held that the impartiality of the *juge-commissaire* depended on the extent of the measures ordered during the observation period and that on the facts the *juge-commissaire* in this case was impartial.

⁹⁵ Court of Appeal of Montpellier, 8 July 1992, *Société Le Vicomte v. Rey*.

QUESTION 8

8. Appeals and limitation periods

- (a) What limitation period, if any, will apply to actions brought against directors (and/or others identified in Question 3) in connection with the offences in Question 2?
- (b) Please indicate whether an appeal is available from the decision of the lower court.

8.1 Limitation periods*Limitation period for criminal proceedings*

- 8.1.1 Criminal bankruptcy (banqueroute) and fraudulent organisation of insolvency fall within the category of offences known as délits correctionnels. The applicable limitation period is three years. Article L. 654-16 of the French Commercial Code provides that the limitation period starts to run only from the date on which formal bankruptcy proceedings have been opened if the incriminating facts occurred prior to that date. This Article of the Commercial Code, however, does not indicate the date from which the limitation period begins to run for such criminal proceedings where the incriminating facts occurred after the commencement of formal insolvency proceedings. For criminal proceedings, the limitation period is of utmost importance and therefore, the majority of French academics believe this omission to be deliberate so that the limitation period for such incriminating facts would be the period provided under general principles of criminal law. This is the period starting on the date on which these incriminating facts were discovered or took place. If the view is taken that it should be the same date as for other similar corporate offences, the limitation period would commence on the date the incriminating facts were discovered.

Limitation period for civil proceedings

- 8.1.2 Civil liability claims for the shortfall of assets are barred three years after the date on which the court orders judicial liquidation.⁹⁶

It should be noted that if a claim is brought against one director, this claim does not bar the possibility of bringing another civil liability claim for the shortfall against another director of the same insolvent company if the directors are not severally liable⁹⁷.

- 8.1.3 Civil liability claims for personal bankruptcy are also barred after three years from the date of the court decision opening the judicial reorganisation or judicial liquidation, as appropriate⁹⁸.

8.2 Appeals*Appeal in criminal proceedings*

- 8.2.1 Appeal from a decision at first instance (before the *correctionnel* court) in respect of *délits correctionnels* is to the Court of Appeal of the district in which the court at first instance was sitting⁹⁹. Only the director in question, the civil party, the public prosecutor or the general public prosecutor of the Court of Appeal may bring an appeal. Where the director is present at the hearing at which the judgment is rendered at first instance, the period for appeal is 10 days from the date of the judgment¹⁰⁰. However the period of appeal runs from the date the judgment was served where the director in question was judged in his or her absence (but after having heard a counsel that was present to ensure the director's defence without having the letter of instruction signed by the director).

Appeal in civil proceedings

- 8.2.2 Pursuant to Article R. 661-6 of the French Commercial Code, judgments holding directors liable for the shortfall of assets or personal bankruptcy may be subject to appeal by the director in question by application of the applicable general civil procedural rules. The director's appeal must be made to the Court of Appeal of the district in which the first instance court was sitting. The appeal must be filed within ten days of the date on which the judgment at first instance was notified to the director¹⁰¹.

Pursuant to Article L. 661-11 of the French Commercial Code, judgments holding directors liable for the shortfall of assets or personal bankruptcy may be subject to appeal by the public prosecutor and the general public prosecutor of the Court of Appeal even if neither of them were the main claimants in the case¹⁰². The appeal must also be filed within ten days, but ten days from the date the public prosecutor receives notification of the judgment from the court clerks¹⁰³.

⁹⁶ Article L. 651-2 of the French Commercial Code.

⁹⁷ Cour de cassation, 7 November 2006, n° 05-16.693.

⁹⁸ Article L. 653-1 of the French Commercial Code.

⁹⁹ Article 496 of the French Criminal Procedural Code.

¹⁰⁰ Article 498 of the French Criminal Procedural Code.

¹⁰¹ Article R. 661-3 of the French Commercial Code.

¹⁰² Articles L. 661-11 and L. 661-12 of the French Commercial Code.

¹⁰³ Article R. 661-3 of the French Commercial Code.

QUESTION 9

9. Foreign corporations

Do the legal provisions and procedures outlined above apply to both domestic and foreign corporations?

9.1 Introduction

The court which has jurisdiction over civil claims brought against directors is the court which has jurisdiction over insolvency proceedings.

The French criminal court has jurisdiction over criminal claims against directors of a company under formal insolvency proceedings commenced in France.

Given the above it is essential to determine which court has jurisdiction over insolvency proceedings.

Insolvency proceedings can be commenced in France in respect of a foreign corporation pursuant to:

- (i) the EU Regulation on European insolvency proceedings (the EU Regulation), and
- (ii) international treaties; or
- (iii) French laws on insolvency matters¹⁰⁴ for international non-European insolvency proceedings (French private international law).

9.2 European insolvency proceedings

9.2.1 Since 31 May 2002, EU Regulation n° 1346/2000 has replaced the former law, that is, international treaties and national French laws on insolvency matters concerning entities located in the EU. The EU Regulation applies to "European Insolvency Proceedings"¹⁰⁵ (that is, insolvency proceedings which are included within the scope of the EU Regulation in relation to a company¹⁰⁶ which has its centre of main interest or COMI in a Member State of the EU, with the exception of Denmark). An insolvent company's COMI will therefore determine in which country the main insolvency proceedings can be commenced.

The EU Regulation provides for two distinct sets of proceedings: main proceedings and secondary proceedings. Main proceedings concern all of the insolvent company's assets, whether they are located in the jurisdiction in which the main proceedings have been opened, or are located in another EU Member State. Secondary proceedings concern only the assets of the insolvent company located in the Member State where the secondary proceedings have been commenced. The debtor's COMI is of critical importance in determining where the main proceedings take place, but COMI is not defined by the EU Regulation.

9.2.2 Despite the lack of a definition of COMI, the EU Regulation provides some guidance in its recitals that a debtor's COMI "should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties"¹⁰⁷ and that where the debtor is a company, its COMI is to be deemed to be located at the place of the company's registered office¹⁰⁸.

One of the questions that previously remained unanswered concerned how strong the registered office presumption was where, in the objective view of third parties, the registered office was not located in the place where the company operates its business. This question was answered by the Court of Justice of the European Union (CJEU) in the *Eurofood* case¹⁰⁹ where it firstly held that the COMI should be an autonomous and uniform concept, meaning that the COMI should be applied and interpreted in each Member State, independently of any national legislation. Secondly, the CJEU in *Eurofood* to an extent limited the scope of the rebuttal of the registered office presumption by stating that the presumption may only be rebutted "if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect."¹¹⁰

The position of the CJEU in the *Eurofood* case was confirmed and expanded upon by the CJEU in the *Interedil* case¹¹¹. The CJEU held that:

¹⁰⁴ See (commercial chamber of the Cour de cassation, 15 February 2000 (appeals number: 97-16770 & 97-14415), 22 March 2011 (appeal number : 10-14889), 22 May 2012 (appeal number : 11-14366).

¹⁰⁵ The EU Regulation only applies to proceedings of insolvency which involve the appointment of an administrator, that is to say, as far as French proceedings are concerned, liquidation and judicial reorganisation, i.e. *redressement judiciaire* (Annex A of the EU Regulation).

¹⁰⁶ Credit institutions, insurance undertakings, investment undertakings holding funds or securities for third parties and collective investment undertakings are excluded from the scope of the EC Regulation. (Considering (9) of the EC Regulation's preamble). Credit institutions are subject to EC Regulation 2001/24/CE dated 4 April 2001 (see articles L. 613-31-1 et seq. of the French Monetary and Financial Code); insurance companies are subject to EC Regulation 2001/17/CE dated 19 March 2001 (see Order n° 2004-504 dated 7 June 2004); investment undertakings holding funds or securities for third parties and collective investment undertakings are subject to EC Regulation 2004/39 dated 21 April 2004 and EC Regulation 2009/65 dated 13 July 2009.

¹⁰⁷ Recital 13 of the EU Regulation.

¹⁰⁸ Article 3(1) of the EU Regulation.

¹⁰⁹ CJEU, *Eurofood*, number C-341/04, dated 2 May 2006.

¹¹⁰ *Ibid.*

¹¹¹ CJEU, *Interedil*, number C-396/09.

A debtor's COMI must be determined by attaching greater importance to the place of the company's central administration, as may be established by objective factors which are ascertainable by third parties. Where a company's registered office and place of central administration are in the same jurisdiction, the registered office presumption cannot be rebutted. Where a company's central administration is not in the same place as its registered office, the presence of assets belonging to the debtor and the existence of contracts for financial exploitation of those assets in a Member State, other than that in which the registered office is situated, are not sufficient factors to rebut the registered office presumption, unless a comprehensive assessment of all the relevant factors makes it possible to establish, in a manner that is ascertainable by third parties, that the company's central administration is located in that other Member State.

- 9.2.3 One common issue that directors can face, when they are a director of various companies within the same group that are registered in different States, is that different legal regimes are likely to govern their duties as director of each company. The EU Regulation does not make any reference to group companies and, therefore, it was debatable whether the EU Regulation could be used to place all companies within the same group into insolvency proceedings in the same jurisdiction (thus potentially avoiding the problem highlighted above). However, where each group company has its COMI in the same Member State (normally the State where the parent company is located) the courts of that Member State have on a number of occasions been able to place each company into insolvency proceedings in the same jurisdiction - rebutting the registered office presumption when doing so. This approach was found to be valid by the CJEU in *Eurofood*.

The French courts are a good example of courts that refer to the decisions of the CJEU and will rebut the registered office presumption in appropriate circumstances. A good example of the French court rebutting the registered office presumption was the Eurotunnel case.

The Eurotunnel group, comprised of seventeen companies with the parent's registered office located in France, was experiencing financial difficulties where every company of the group was unable to reimburse the loans to which they were subject. This case has been debated extensively by numerous academics on the basis that, arguably, the Commercial Court of Paris, ruling on the facts, overlooked certain facts that could have led to the conclusion that the COMI of a number of the subsidiaries should have been located at their own registered office (ie not in France but in another Member State).

Of course, the court decision ruling that the COMI of all subsidiaries was located at the registered office of the parent company facilitated the efficient and effective restructuring of the group.

Another example of a case in front of the French courts is the *Coeur Défense* case where the French subsidiary of a Luxembourg parent company found itself in financial difficulty and in breach of its financing agreements. The French subsidiary and the Luxembourg parent company both requested the opening of safeguard proceedings which were opened by the Commercial Court of Paris. This case was concluded by the Court of Appeal of Versailles on 19 January 2012 after being referred back to it from the Cour de cassation. The Court of Appeal referred to the *Eurofood* and the *Interedil* decisions of the CJEU to come to a ruling that, based on "a global appreciation of the pertinent elements", the Luxembourg-based parent company was actually managed from Paris.

In light of the lack of definition of COMI, the absence of any reference to group companies and the resistance of certain national courts, including French courts, to comply strictly with the CJEU's interpretation of the EU Regulation, the EU Regulation is in the process of being reformed.

On 12 December 2012, the European Commission submitted a proposal to amend the EU Regulation. These proposals contain, among others, provisions which would essentially provide legislative confirmation of the CJEU decisions in *Eurofood* and *Interedil*. The proposals would not create a separate procedure for EU group insolvencies.

The proposal will be reviewed by the European Council and Parliament and any amendment to the Regulation will be adopted following the procedure provided in European Union Treaty. Any reforms to the EU Regulation will most certainly take in excess of two years to come into force¹¹².

9.3 International non-European insolvency proceedings

- 9.3.1 Where the EU Regulation does not apply, the question of whether insolvency proceedings can be commenced in France will depend on whether there is an international treaty governing the matter. If there is no international treaty the matter will be governed by French private international law. The number of treaties that remain in force has considerably decreased since the EU Regulation came into force; as this Regulation has replaced all the bilateral treaties concluded by EU Member States. To our knowledge, the only bilateral treaty that remains applicable is the treaty entered into between France and Monaco dated 13 September 1950 and effective since 12 July 1952. Pursuant to Article 2 of this bilateral treaty, jurisdiction to commence insolvency proceedings lies with the court with jurisdiction in the location of the registered office of the insolvent company. If the registered office of the insolvent company is, however, not located in France or in Monaco, then the court having jurisdiction is the court that has jurisdiction in the location of the insolvent company's principal establishment.

- 9.3.2 French private international law adopts a mixed approach to cross-border insolvencies, being more favourable to the jurisdiction of the French courts and therefore to the application of French law. Under French private international law, the French courts may be able to open insolvency proceedings in respect of a company with its registered office located in France or where the insolvent company has its centre of main interests (as defined in French law "*le centre principal de ses intérêts*") meaning, in most cases, that its main establishment (*établissement principal*) is in France,

Pursuant to Article R. 600-1 of the French Commercial Code, French courts may have jurisdiction over cross-border insolvency proceedings effective over all assets of the insolvent company, even those located abroad.

¹¹² Article 251 of ECT, 24 December 2002.

Furthermore, even though the minimal condition to commence insolvency proceedings in France is for an establishment to be on French soil, in order to protect rights of French creditors, the French courts have held in the past that they had jurisdiction resulting from the “presence of commercial relations”¹¹³ or even the presence of real estate that may not even be allocated to a business activity of the insolvent company¹¹⁴. Nevertheless, these cases were one-off cases that have not been followed since. In more recent times, the French courts have been more cautious when applying national law to cases with an international dimension and therefore, it is questionable whether the case law from these two cases would still apply today.

- 9.3.3 Despite the will of French law and French courts to have jurisdiction and apply French national law to cross-border insolvency proceedings, French courts are limited by decisions of foreign courts ruling on the cross-border insolvency that have been granted *exequatur*, requiring the acknowledgement and enforcement of the foreign court decision in France.

QUESTION 10

10. Insurance

Is directors' and officers' insurance available in your jurisdiction? If so, to what extent will the availability of such insurance provide effective protection to directors against personal liability which may arise in connection with the issues raised in Questions 1-9 above.

10.1 Insurance Coverage

Under French law, a company may take out insurance and pay insurance premiums in respect of the civil liability of its directors. Insurance policies for directors are called RCMS or D&O (Directors and Officers Liability). These types of insurance policies are not considered as contracts which are regulated by Article L. 225-38 of the French Commercial Code and therefore, do not need the prior approval of the board if the company is incorporated in France.

10.2 Insurance and Criminal Liability

Pursuant to Article L. 113-1 of the French Insurance Code, which provides: “[...] *the insurer shall not be answerable for loss and damage caused by the insured's deliberate tortious, intent or fraud*”, these insurance policies do not cover intentional fault. French courts interpret strictly this notion of the insured's deliberate tortious, intent or fraud. Directors who act with the intention/purpose of causing damage will not be covered by the insurance policy. As the intention relates to the damage, directors who take risks associated with the operation of their duties will still be covered by such insurance policies as long as their intent was not to damage the company¹¹⁵. Insurance policies shall at all times cover *de jure* directors and their heirs (for example, the liability of a deceased director). Insurance policies may also cover *de facto* directors depending on how the insurance policy is drafted. If the policy states the names of the *de jure* directors, only those who are named will be covered. It is recommended that insurance policies expressly provide for which types of directors are covered by the policy, and this should be negotiated at the time of taking out the coverage. Insurance policies can therefore cover (if expressly provided for): *de jure* directors, *de facto* directors, newly appointed directors, as well as retired directors¹¹⁶.

These insurance policies do not cover directors who are found guilty of criminal offences or for fines ordered by the criminal courts. However, insurance policies may cover:

the legal fees incurred for legal assistance to the director in court; but if the director in question is found guilty from a criminal perspective, the insurance company may bring a claim against the director to cover the costs it incurred by covering the legal fees paid out to the director's lawyers; and

compensation granted by the criminal court to the civil party that attached their civil claim to the criminal proceedings, but only if there is no presence of intentional fault as mentioned above (i.e. Art. L.113-1 of the French Insurance Code).

The coverage by insurance policies of civil liability consequences arising out of a criminal claim in front of a criminal court is further justified by the reform of Article 4 of the French Criminal Procedural Code by law n°2007-291, dated 5 March 2007, making the principle that “*criminal prevails over civil*” more flexible. As a result of this reform, a second paragraph was added to Article 4 of the French Criminal Procedural Code to temper the above principle. This paragraph states “*the public prosecution's initiative of the proceedings does not enjoin the suspension of judgment of the other actions of any kind exercised before the civil courts, even if the decision of the criminal court may directly or indirectly influence the decision to be held in the civil proceedings*”¹¹⁷.

- 10.3 The insurance policy will usually cover all actions of the directors although some actions may be specifically excluded. These kinds of contracts are referred to as “*assurance tout sauf*” (insurance with full coverage with limited listed exceptions where the policy will not apply). Normally, mismanagement is covered in the General Conditions of such insurance contracts, but it may be more prudent to specifically state that mismanagement is covered by the specific policy, regardless of whether the mismanagement was committed within or outside of the director's management role.

10.4 Existence of a cap and possible reimbursement

All insurance policies have a cap on liability for damages. Where an insurance policy does not provide comprehensive cover of all risks, it is permissible to enter into several insurance policies to ensure comprehensive coverage. This kind of process is called *assurances multilignes*.

¹¹³ Cour de cassation 14 April 1934.

¹¹⁴ Commercial Chamber of the Cour de cassation 26 oct. 1999, n°96-12.946.

¹¹⁵ Civil Second Chamber of the Cour de cassation, 1st July 2010, n° 09-10.590.

¹¹⁶ G.Greff, La responsabilité des dirigeants retirés RTD Com. 1978.

¹¹⁷ Article 4 of the French Criminal Procedure.

It is important to note that any person who has suffered a loss due to a director's mismanagement has a direct right to claim for damages against the insurance company¹¹⁸. Where such a direct claim is brought by a victim, if the mismanagement of a director is not covered by the policy, the insurance company is subrogated to the rights of the victim, and can seek reimbursement from the director.

Where an insolvency procedure is opened, the risk for the insurance company of having to pay for a mismanagement claim increases. That is why in some policies, a specific termination clause is inserted with regard to the opening of an insolvency procedure. However, despite the fact that this clause is present in many insurance policies, the mechanisms of Article 80 of the Law n°2003-706 on Financial Security, dated 1 August 2003 mean that this type of clause is no longer effective.

QUESTION 11

11. How safe is it for directors and others to incur further credit during the twilight period

11.1 Overview

- 11.1.1 The duties of directors and *de facto* directors are considered above in the response to Question 2. As noted in that answer, French law does not focus on the types of transactions but rather on sanctions that may be imposed on directors and persons in similar *de facto* positions for particular types of conduct. In other words, if a director incurs further credit during the twilight period, the risk of such director being exposed to liability lies in the circumstances in and the reasons for which such further credit was incurred, rather than in the type of transaction through which such credit was obtained.
- 11.1.2 Consequently, if by incurring further credit, a director commits an act of mismanagement (for example, there was no good reason for the company to incur such credit or to acquire a costly asset financed by credit) or did so for his or her own personal ends and not for the company, that director would be exposed to a civil liability claim for the shortfall of assets or personal bankruptcy respectively.
- 11.1.3 A director must therefore be sure of the reasons for entering into any new transaction once the company in question is in a situation where, from a cash flow point of view, the assets of the company are, or risk being, insufficient to cover its due and owing debts.
- 11.1.4 Given the technical nature of the definition of cessation of payments and the risk that the date of cessation of payments may be fixed retroactively by the insolvency court, it is possible (generally only for companies which do not have appropriate financial monitoring processes) for a director to be running a company in a state of cessation of payments without knowing that to be the case. Directors should therefore be particularly careful of their intentions when entering into new transactions whenever the company is facing financial difficulties.
- 11.1.5 In practice, in France, well-advised directors will get independent professional help, whether from insolvency practitioners, legal professionals, accountants and/or the courts in voluntary reorganisation proceedings to assist them in any difficult decisions they may make to avoid insolvency. They will also often seek the support of their creditors and in particular, their banks and major suppliers.
- 11.2 Can an unconnected third party rely on the validity of transactions entered into by the company (in particular guarantees and securities) during the twilight period?
- 11.2.1 Articles L. 632-1 and L. 632-2 of the French Commercial Code provide for a series of different types of acts which will either be null and void or voidable at the discretion of the court if undertaken during the "twilight" or, in French terminology, the "suspect" period – a period which can extend to 18 months prior to the date of the commencement of formal insolvency proceedings or 24 months in the case of transactions for no consideration.
- 11.2.2 The types of transaction which are automatically null and void if entered into during the twilight period are described in the response to Question 4 above. It is thus clear under French law that a party transacting with a company that is or is likely to be in a state of cessation of payments must avoid each of the 11 different types of transaction listed in Article L. 632-1 of the French Commercial Code. Failure to do so will result in the automatic avoidance of the transaction and the concomitant measures of restitution required against the third party. It should be noted that the causation of loss to the company is not a condition for the applicability of Article L. 632-1 of the French Commercial Code, neither is bad faith nor any form of wilful intent or knowledge that the company is in a state of cessation of payments on the part of the third party.
- 11.2.3 Again as noted above in response to Question 4, the courts have a discretionary right to avoid any transaction entered into during the twilight period in circumstances where the other party was aware of the fact that the company was in a state of cessation of payments. The apparently draconian nature of this power is tempered by the need to show that the counterparty was aware not only that the company was in financial difficulties but that it was in the technical and special position of having an amount of available assets less than the amount of its due and payable debts. According to French case law, available assets comprise assets that are available immediately or within a short period of time¹¹⁹. For example, any claims that need to be recovered are in principle excluded from the notion of "available assets"¹²⁰.

¹¹⁸ Article L. 124-3 of the French Insurance Code.

¹¹⁹ Rapport drafted by Mr.Xavier de Roux, n°2095, p.339.

¹²⁰ Paris, 3° ch. B, 8 November 2007, RG n°07/08101.

Appendix

Overview of French Pre-Insolvency and Insolvency Procedures

I. Preventive measures before insolvency proceedings

With the aim of preventing businesses going into insolvency, French law provides for two different but similar proceedings for companies experiencing financial difficulties or anticipating foreseeable financial difficulties: the *mandat ad hoc* and *conciliation* proceedings.

1. *Mandat ad hoc*

The *mandat ad hoc* is a procedure (a special mediation process) which enables companies experiencing difficulties to avoid insolvency proceedings by instigating confidential negotiations, usually with their main creditors, with the assistance of a third party, the *mandataire ad hoc*.

1.1 Filing¹²¹

Any debtor¹²² facing difficulties, usually of a financial, economic or legal nature but without being in cessation of payments, may file a motion (*requête*) with the president of the local court to appoint a *mandataire ad hoc*. The motion must be in writing and set out the grounds for the request. Certain other documents must also be filed which are along the same lines as for the *conciliation* procedure below.

1.2 Appointment and Remuneration of the *Mandataire ad hoc*

If a company requests the appointment of a *mandataire ad hoc*, it can propose the appointment of a specific person. However, the president of the local court can refuse the proposal. This will depend on the practice of local court. The president of the court is nevertheless limited in its choice of *mandataire ad hoc*. A person who has received, directly or indirectly, a remuneration or payment from the debtor, or a person who controls or is controlled by the debtor, (or has done so within the last 24 months) may not be appointed as *mandataire ad hoc*¹²³.

The president of the court will also fix the remuneration of the *mandataire ad hoc*, having approved this with the debtor.

1.3 Objectives of the *Mandataire ad hoc*¹²⁴

On the appointment of the *mandataire ad hoc*, the president of the court will determine its objectives and powers. These will normally be to:

- assist the company in its negotiations with creditors, employees and all other relevant commercial partners, including, when required, the main shareholders;
- help the company to evaluate its financial situation;
- try to resolve these difficulties; and,
- report back to the president of the court.

1.4 The main advantage of the *mandat ad hoc* procedure

The main advantage of this process is that it remains confidential and is very flexible - the process is not legally limited in time¹²⁵ and the *mandataire ad hoc* is appointed to assist the directors who remain in charge of the company's management.

1.5 Stay of proceedings

Under a *mandat ad hoc*, the only way a debtor can stay proceedings is by contractual agreement with the creditors concerned.

1.6 Outcome of *mandat ad hoc* proceedings

Even if the company comes to an agreement with some of its creditors, this will not affect the company's other creditors or commercial partners who remain outside the agreement and who will be entitled to take legal action as they see fit to recover sums due to them.

Therefore, it is common for the *mandat ad hoc* to be followed either by *conciliation* proceedings to render these agreements enforceable by court or by safeguard proceedings under which a restructuring plan may be adopted. (See section II 1.4.1 below.)

¹²¹ Article L. 611-3 of the French Commercial Code.

¹²² For the sake of simplicity, we will consider hereafter that the debtor is a commercial company.

¹²³ Article L. 611-3 of the French Commercial Code.

¹²⁴ Article R. 611-19 of the French Commercial Code.

¹²⁵ Article R. 611-21 of the French Commercial Code.

2. Conciliation proceedings

Conciliation is a confidential procedure¹²⁶ available to companies experiencing legal, economic or financial difficulties or likely to experience such difficulties in the future. Unlike the *mandat ad hoc*, *conciliation* is also available to companies which have been in cessation of payments for less than 45 days¹²⁷.

2.1 Filing¹²⁸

The director of a company may file a motion (*requête*) with the president of the local court requesting the appointment of a conciliator. The motion must be made in writing and set out the financial, economic and social difficulties of the company, its financing needs and proposals to deal with its difficulties.

Certain corporate and financial information must be filed with the motion, as set out in Article R. 611-22 of the French Commercial Code. If the company is in cessation of payments, this will also need to be mentioned in the motion, including the date on which cessation of payments began.

2.2 Appointment and Remuneration of the Conciliator¹²⁹

The appointment of the conciliator is very similar to the appointment of the *mandataire ad hoc* whereby the president of the local court:

- appoints a conciliator of its choice (within the limits provided by the Commercial Code¹³⁰); and,
- determines the remuneration of the conciliator, having agreed this with the director of the company¹³¹.
- The debtor may suggest a conciliator but the president of the local court is not obliged to take this suggestion into account.

2.3 Objectives of the Conciliator¹³²

The conciliator's role is to put an end to the company's difficulties by promoting and encouraging the debtor company to enter into an amicable agreement with its main creditors and, if applicable, its usual commercial partners.

It is not the conciliator's role to assist the directors in managing the company or to supervise the company, nor does the conciliator have the power to impose a *conciliation* agreement, although the conciliator may put forward suggestions regarding running the business and maintaining employment levels.

The conciliator must report back to the president of the local court on the progress of the *conciliation* and on any useful information concerning the debtor.

2.4 Duration

2.4.1 Time Constraints¹³³

The conciliator is appointed for a maximum of four months, with a possible one month extension.

At the end of this period, it is not possible to open another *conciliation*, until three months have passed. It is therefore not uncommon for companies to file for a *mandat ad hoc* during this three month period or to start with a *mandat ad hoc* and then open *conciliation* proceedings.

2.4.2 Stay of proceedings

Since *conciliation* proceedings are not insolvency proceedings, there is no stay on individual proceedings. Creditors may bring individual proceedings against the debtor during *conciliation*, including enforcement proceedings. However, creditors will often agree to a temporary postponement of proceedings.

Furthermore, the French Commercial Code provides companies with limited protection against creditor claims during the *conciliation* by permitting a company to request the president of the local court to postpone or spread out payments due to creditors for a period of up to two years¹³⁴.

2.5 Outcome of conciliation proceedings

2.5.1 Conciliation Agreement

When the company reaches an agreement (a *conciliation* agreement) with one or more of its creditors or commercial partners, it may apply to the president of the local court or to the local court to have the agreement acknowledged (*constaté*) or approved (*homologué*).

¹²⁶ Article L. 611-15 of the French Commercial Code.

¹²⁷ Article L. 611-4 of the French Commercial Code.

¹²⁸ Article L. 611-6 of the French Commercial Code.

¹²⁹ Article L. 611-6 of the French Commercial Code.

¹³⁰ Article L. 611-13 of the French Commercial Code.

¹³¹ Article L. 611-14 of the French Commercial Code.

¹³² Article L. 611-7 of the French Commercial Code.

¹³³ Article L. 611-6 of the French Commercial Code.

¹³⁴ Articles L. 611-7 of the French Commercial Code and 1244-1 of the French Civil Code.

2.5.1.1 Acknowledgement of the *conciliation* agreement

The debtor may opt for the acknowledgement of the *conciliation* agreement by filing a joint motion with those creditors who are party to the agreement with the president of the local court. To accelerate the process, creditors may authorise the company to file the motion on their behalf.

Before acknowledging the agreement, the president will check that the *conciliation* agreement exists and that the company has declared that it is not in cessation of payments or will no longer be by entering into the agreement. The president does not look into the content of the agreement so it remains confidential.

On acknowledgement of the agreement, it is filed at the court registry where all parties to the agreement may obtain an official copy. The content of the agreement remains confidential as the court registry will not provide copies to third parties¹³⁵.

The acknowledged agreement does not affect third parties, including creditors who are not a party to it. Such creditors may still bring claims against the company for payment of sums due to them.

The main purpose of the acknowledgement of the *conciliation* agreement is to make the agreement enforceable against the creditors who are party to it, whilst the content and existence of the agreement remains confidential.

2.5.1.2 Approval of the *conciliation* agreement¹³⁶

Alternatively, the company may opt for the approval of the *conciliation* agreement. In this case, the existence of the agreement will be published by the court but the content will remain confidential¹³⁷.

The motion for approval must be filed before the end of the *conciliation* period.

The directors of the company, the creditors who are party to the *conciliation* agreement, the directors of the workers' council, the conciliator and the public prosecutor¹³⁸ must all be given notice of the approval proceedings.

To obtain approval, the company must satisfy three conditions:

- the company is not in cessation of payments or will no longer be in this state by entering into the agreement;
- the terms of the agreement will achieve continuity of the company's business;
- the interests of creditors who are not party to the agreement are protected.

Once satisfied in respect of these three conditions, the court's judgment containing its approval of the *conciliation* agreement will be filed at the court registry, where any interested party can access it¹³⁹.

The main reason for getting the *conciliation* agreement approved is because of the consequences/benefits (see below) if the debtor subsequently goes into formal insolvency proceedings.

To this effect, debtors and creditors will normally seek to obtain the approval of a *conciliation* agreement (as opposed to an acknowledgement) for the following reasons:

- if creditors grant any new financing, services or goods to keep the company afloat, they will benefit from priority if the company subsequently enters into insolvency proceedings (a 'New Money Privilege')¹⁴⁰; and
- if the company enters into insolvency proceedings, the date of cessation of payments decided by the court will not pre-date the court's approval of the agreement¹⁴¹ and therefore, the payments made and securities granted under the *conciliation* agreement cannot be declared null and void;
- certain guarantors of the company, may invoke the approved *conciliation* agreement against creditors who are party to the agreement. This applies to guarantors who have guaranteed a security (caution), are co-debtors, autonomous guarantors or have granted a personal security¹⁴².

2.5.1.3 Waiver of part of the claim of creditors in the public sector

In certain circumstances, the debtor may obtain a waiver from its public creditors as to part of their claims, pre-emption rights, and position in the ranking of creditors as holders of a charge or mortgage (See Section 3.3.2).

2.5.2 Failure of the proceedings

2.5.2.1 No *Conciliation* Agreement

In the event the conciliator does not obtain creditor approval to enter into a viable *conciliation* agreement, the president of the local court will bring the *conciliation* proceedings to an end¹⁴³.

If the conciliator concludes in his report that the company is in cessation of payments, the court will, on its own initiative, open judicial reorganisation proceedings or judicial liquidation proceedings (where it concludes that judicial reorganisation proceedings will not save the business)¹⁴⁴.

¹³⁵ Articles L. 611-8 of the French Commercial Code and R. 611-39 of the French Commercial Code.

¹³⁶ Article L. 611-8, II of the French Commercial Code.

¹³⁷ Article R. 611-40 of the French Commercial Code.

¹³⁸ Article L. 611-9 of the French Commercial Code.

¹³⁹ Article L. 611-10 al 2 of the French Commercial Code.

¹⁴⁰ Article L. 611-11 of the French Commercial Code.

¹⁴¹ Article L. 631-8 of the French Commercial Code.

¹⁴² Article L. 611-10-2 of the French Commercial Code.

¹⁴³ Article L. 611-7 al 6 of the French Commercial Code.

¹⁴⁴ Articles L. 631-4 and L. 640-4 al 2 of the French Commercial Code.

If the company is not in cessation of payments, the conciliator may file a motion to open accelerated financial safeguard proceedings which will force recalcitrant financial creditors to come to an agreement¹⁴⁵.

2.5.2.2 Refusal to approve the *conciliation* agreement

If the conciliator concludes in his report that the company is in cessation of payments, the court will, on its own initiative, open judicial reorganisation proceedings or judicial liquidation proceedings (where it concludes that reorganisation proceedings will not save the business)¹⁴⁶.

If the company is not in cessation of payments, it may still be possible to file a motion to obtain the acknowledgement of the *conciliation* agreement even where the approval of the *conciliation* agreement has failed.

II. Insolvency proceedings

1. Safeguard proceedings

When considering whether to enter into safeguard proceedings or to use pre-insolvency proceedings, it is important to evaluate the difference in level of assistance and interference in the company's management.

Safeguard proceedings are public proceedings, benefiting from more powerful tools than the pre-insolvency proceedings whereby recalcitrant creditors can be bound by the terms of a restructuring plan.

1.1 Filing

1.1.1 Motion¹⁴⁷

Under safeguard proceedings, a company in difficulty but without being in cessation of payments may file a motion for the court's assistance and protection in order to turn itself around.

- Only the director of a company can file a motion to open safeguard proceedings.
- Safeguard proceedings may only be opened when the debtor is experiencing difficulties which it cannot overcome alone ("*difficultés qu'il n'est pas en mesure de surmonter*").
- The court will look into the financial, economic, social and legal situation of the company (the turnover, the annual income, the implementation of a restructuring plan, etc.) as on the day of opening proceedings and not on the day the motion is filed¹⁴⁸.

1.1.2 Filing¹⁴⁹

Certain corporate information and documents must be filed with the motion to open proceedings which must be dated, signed and certified as true by the company.

1.2 Players in the safeguard proceedings

1.2.1 The court-appointed administrator¹⁵⁰

A court-appointed administrator will assist or supervise the company during safeguard proceedings. As with the *mandat ad hoc* and *conciliation* proceedings, the company may propose an administrator, but the court has the right to refuse this proposal and appoint an administrator of its choosing.

During the observation period, (see below), the company's business continues to be run by its directors under the supervision of the administrator. However, certain powers are vested in the administrator including whether the company's ongoing contracts (other than employment contracts) should be terminated.

1.2.2 The *juge-commissaire*¹⁵¹

Certain decisions (those not in the ordinary course of business or decisions as to sale of assets) require the prior approval of the *juge-commissaire*, the judge nominated to monitor the proceedings.

1.2.3 The *mandataire judiciaire*¹⁵²

As well as the administrator, the court will also appoint a *mandataire judiciaire*, from the list of *mandataires judiciaires* registered within the court's jurisdiction.

The *mandataire judiciaire* has one objective: to represent creditors' interests and, more specifically, to receive their claims and verify whether they exist.

1.2.4 The *controleurs*¹⁵³

Additionally, up to five creditors may be appointed by the *juge-commissaire* as *controleurs*, if requested. The *controleurs* complement the role of the *mandataire judiciaire* in protecting the interests of creditors and assisting the *juge-commissaire* in its mission to supervise the running of the business.

¹⁴⁵ Articles L. 628-1 to L. 628-7 of the French Commercial Code.

¹⁴⁶ Articles L. 631-4 and L. 640-4 al 2 of the French Commercial Code.

¹⁴⁷ Article L. 620-1 of the French Commercial Code.

¹⁴⁸ Commercial chamber of the Court de cassation 26 June 2007, n° 06-20.820.

¹⁴⁹ Articles R. 611-22 and R. 621-8 of the French Commercial Code.

¹⁵⁰ Articles L. 621-4 and L. 622-1 of the French Commercial Code.

¹⁵¹ Articles L. 621-4 and L. 621-9 of the French Commercial Code.

¹⁵² Articles L. 621-4 and L. 622-20 of the French Commercial Code.

1.3 During the proceedings

The court will automatically stay all payments and all ongoing interest on payments (with limited exceptions, such as the enforcement of retention of title clauses and loans of more than one year), to grant the company a breathing space to draw-up a restructuring plan to be submitted to the court for approval.

The court will open an observation period which lasts six months and may be renewable once and in very limited circumstances, twice, for the purposes of preparing and obtaining the approval from the court on a restructuring plan. The observation period comes to end upon approval of the restructuring plan by the court.

1.3.1 Creditors' committees

Usually under safeguard proceedings, creditors' committees will be formed. The court has a discretion to create creditors' committees even where the required thresholds are not met (the same thresholds as for accelerated financial safeguard proceedings)¹⁵⁴.

The committees are composed as follows¹⁵⁵:

- the first committee: trade creditors (suppliers who individually are owed receivables representing at least 3% of the total amount of the company's supplier liabilities);
- the second committee: banking establishments and financial and credit institutions (including hedge funds)¹⁵⁶ regardless of the size of their claim; and
- the third committee: bondholders, if any.¹⁵⁷

The purpose of the committees is to allow the creditors to discuss and vote on the proposed restructuring plan¹⁵⁸.

1.3.2 Safeguard restructuring plan

With the assistance of the administrator, the company (through its directors) draws up a draft restructuring plan¹⁵⁹. The term of the plan will be fixed by the court, subject to a maximum of ten years¹⁶⁰.

The plan is very flexible, for example by allowing the company to treat each committee differently if economically justifiable to do so.

The restructuring plan may provide for¹⁶¹:

- the postponement of repayment of claims;
- the reduction or full relief from interest payments;
- debt forgiveness also known as "debt cram down";
- debt for equity swaps, meaning the conversion of claims into equity/shares if the debtor is a joint stock company (société par actions);
- reserved increase of share capital; and
- the issuing of convertible bonds (obligations convertibles en actions).

1.3.3 Partial waiver of claims of creditors in the public sector¹⁶²

The debtor may obtain a waiver from its public creditors as to part of their claims, pre-emption rights, and their ranking between creditors holding a charge or mortgage.

1.4 Outcome of the safeguard proceedings

1.4.1 Approval by creditors and the court of the draft restructuring plan

Not all creditors will vote on the proposed restructuring plan. Creditors will not vote if

- the plan does not modify their payment terms;
- their claim is to be fully reimbursed in cash pursuant to the plan¹⁶³.

All committee creditors vote in their respective committee and the approval threshold is two thirds of the total value of the claims of all the creditors who actually vote. If this majority is achieved, the dissenting minority will be bound by the decision of the majority¹⁶⁴.

Voting must take place in each committee within 20 to 30 days of receiving the draft plan¹⁶⁵ and within six months from the opening of safeguard proceedings¹⁶⁶.

¹⁵³ Article L. 621-10 of the French Commercial Code.

¹⁵⁴ Article L. 626-29 of the French Commercial Code.

¹⁵⁵ Article L. 626-30 of the French Commercial Code.

¹⁵⁶ Pursuant to Article L. 626-30 of the French Commercial Code, hedge funds all credit institutions and those assimilated to these institutions, as well as all those that purchased a claim from these institutions, from a supplier of goods or from a service provider also members of the second committee.

¹⁵⁷ Article L. 626-32 of the French Commercial Code.

¹⁵⁸ Article L. 626-30-2 of the French Commercial Code.

¹⁵⁹ Article L. 626-30-2 al 1 of the French Commercial Code.

¹⁶⁰ Article L. 626-12 of the French Commercial Code.

¹⁶¹ Article L. 626-30-2.

¹⁶² Article L. 626-6 of the French Commercial Code.

¹⁶³ Articles L. 626-5 al 4 and L. 627-3 of the French Commercial Code.

¹⁶⁴ Article L. 626-30-2 al 4 of the French Commercial Code.

¹⁶⁵ Article L. 626-30-2 al 3 of the French Commercial Code.

¹⁶⁶ Article L. 626-34 of the French Commercial Code.

Non-committee creditors, including state creditors, are consulted individually. If they cannot come to an agreement, the court cannot reduce their claims but can defer or reschedule the due date for payment¹⁶⁷.

Before approving the plan, the court will ensure that all creditors' interests are protected. The court can reject the restructuring plan in order to protect creditors even though it would safeguard the company's business and clear most of its debts¹⁶⁸.

Once approved by the court, creditors will be bound by the plan and all its terms become enforceable. Individuals or legal entities in their position as guarantors may invoke the terms of the plan. This does not concern every guarantor of the company but only those who guarantee a security (caution), are co-debtors, autonomous guarantors or have granted a personal security.¹⁶⁹

1.4.2 Failure of the safeguard proceedings

The court has the power to convert safeguard proceedings into judicial reorganisation or judicial liquidation in the following circumstances¹⁷⁰:

- if evidence is brought during the observation period that the company was at the opening of safeguard proceedings or is now in cessation of payments
- if it appears manifestly impossible to adopt the plan and/or the company would rapidly become insolvent if the safeguard came to an end.

2. Accelerated Financial Safeguard Proceedings (SFA)

This is a fairly new procedure aimed at implementing a restructuring plan without affecting non-financial creditors. Thus, only financial creditors (mainly banking establishments¹⁷¹ and bondholders) are affected by these proceedings¹⁷².

Trade creditors are not directly affected and their claims will be payable in accordance with their terms.

2.1 Filing

Only debtors who have opened *conciliation* proceedings since 1st March 2011 may file for an SFA.

- A debtor who wishes to invoke these proceedings must convince the court that the restructuring plan will not only address the financial difficulties it faces but will also be adopted by a qualifying majority vote of the banking establishments' committee and bondholders¹⁷³.
- Certain documents must be attached to the motion¹⁷⁴ and certain conditions must be fulfilled by the debtor, as follows¹⁷⁵:
 - the company's accounts must be certified by a statutory auditor or prepared by an accountant; and
 - the company's turnover must equal or exceed 20 million euro per year; or
 - the company has 150 or more employees on the date of filing for the SFA.

In addition, a company may also file for an SFA if its balance sheet total is more than 25 million euro or 10 million euro if the company controls another company for which the number of employees and the turnover are respectively more than 150 employees and 20 million euro. This exception is essentially provided for holding companies that do not necessarily meet the above criteria.

2.2 During the proceedings

Many of the provisions of the French Commercial Code apply to both the SFA and the ordinary safeguard proceedings¹⁷⁶ but, unlike the safeguard proceedings, fast-track proceedings follow directly on from *conciliation* proceedings during which a restructuring is negotiated. On opening SFA proceedings, the court will have taken the conciliator's report into account and will look into the likelihood of the plan being adopted by the financial creditors.¹⁷⁷

One of the main objectives of these proceedings is therefore to act as leverage against dissenting minority creditors by converting a *conciliation* agreement with the key financial creditors, which would require unanimous approval, into a *mandatory* restructuring plan which does not require unanimity.

This was notably the case with the opening of the first SFA on 27 February 2013 by the Commercial Tribunal of Nanterre against the company Soflog-Telis. Here, the company was in *conciliation* proceedings but one of the five banks in a bank pool, creditor of the company, refused to sign the *conciliation* agreement. Due to the dissenting bank, the company decided to file for an SFA, to convert the *conciliation* agreement into a *mandatory* restructuring plan forcing the dissenting bank to abide by what was accepted by the other four banks of the bank pool under *conciliation* proceedings.

¹⁶⁷ Articles L. 626-5 and L. 626-6 of the French Commercial Code.

¹⁶⁸ Article L. 626-31 of the French Commercial Code.

¹⁶⁹ Article L. 626-11 of the French Commercial Code.

¹⁷⁰ Article L. 622-10 of the French Commercial Code.

¹⁷¹ Banking establishments include all legal entities whose customary business activity is the carrying out of banking transactions or linked with such transactions such as banking and financing operations and also institutions which provide means of payment. Basically, this group mainly includes banks, financial institutions, leasing companies etc. Article L. 511-1 of the French Financial and Monetary Code.

¹⁷² Article L. 628-1 al 3 of the French Commercial Code.

¹⁷³ Article L. 628-1 of the French Commercial Code.

¹⁷⁴ Article R. 628-2 of the French Commercial Code.

¹⁷⁵ Articles L. 628-1 al 2 referring to L. 620-1 and L. 626-9 of the French Commercial Code.

¹⁷⁶ Article L. 628-1 al 1 of the French Commercial Code.

¹⁷⁷ Article L. 628-2 of the French Commercial Code.

2.3 Outcome of these proceedings

2.3.1 Adoption of the safeguard plan

The plan will be adopted if approved by at least two thirds of the total value of the claims of all creditors who actually vote¹⁷⁸.

After the court's approval to proceed under an SFA, the financial creditors have one month (possibly extended by one further month) to vote on and adopt the restructuring plan (instead of six months under the standard safeguard proceedings)¹⁷⁹.

2.3.2 Non-adoption of the plan

If the plan is not adopted by the financial creditors within the given time limit, the court will bring the SFA to an end.¹⁸⁰ If the company is in cessation of payments, the court will open judicial reorganisation or liquidation proceedings.

To our knowledge, this procedure has not yet been implemented because, inter alia, of its tight time constraints.

3. Judicial Reorganisation (*redressement judiciaire*)

Judicial reorganisation is very similar to the standard safeguard proceedings except for the fact that the company needs to be in cessation of payments when filing for *redressement judiciaire*.

The purpose of these proceedings is to safeguard the company's business, maintain its activities, preserve as many jobs as possible and clear its debts.

3.1 Filing¹⁸¹

A motion to open reorganisation proceedings may be filed by the company, a creditor or the public prosecutor. The court can no longer bring its own motion to open judicial reorganisation proceedings¹⁸².

The company is under an obligation to file a motion to open either judicial reorganisation or judicial liquidation proceedings when it is in a state of cessation of payments. The motion must be filed within 45 days of the date of cessation of payments (unless the company has already decided to enter into *conciliation* proceedings).

3.2 The Administrators

Occasionally, the court may decide that an administrator should take over the management of the company but generally¹⁸³ the company will continue to be managed by its directors although the administrator will be granted more extensive powers by the court than compared to those granted to the administrator in safeguard proceedings.

The administrator's objective will still be to assist and supervise the company, to assess the company's financial situation, come up with solutions to the company's difficulties and report back to the court¹⁸⁴.

3.3 During the proceedings

Judicial reorganisation provides for a stay on payments upon the opening of proceedings by the court¹⁸⁵ and an observation period of up to 12 months (possibly extended by a further six months)¹⁸⁶.

The purpose of the observation period is to:

- give the company time to implement its own reorganisation plan (the continuation plan), if it can evidence that it will be in a position to repay its creditors over a maximum period of 10 years¹⁸⁷; or
- allow potential acquirers, who must be third parties, to present offers (sales plans) for the company's business¹⁸⁸.

3.3.1 Restructuring Continuation Plan and Sales Plans

3.3.1.1 Restructuring (Continuation) Plan

During judicial reorganisation, a restructuring plan may be drawn up by the administrator with the assistance of the directors. The plan will need the approval of the court, which will be subject to the court being satisfied that all creditors are sufficiently protected under the plan¹⁸⁹.

For the court to adopt the plan, the company must show that the plan will enable it to continue operating its business. If the court determines that the plan is not viable, the court can, unlike under safeguard proceedings, require a sale of business plan (the plan de cession) to be drawn up¹⁹⁰.

¹⁷⁸ Article L. 628-4 of the French Commercial Code with reference to Articles L. 626-30 and L. 626-32.

¹⁷⁹ Article L. 628-6 of the French Commercial Code.

¹⁸⁰ Article L. 628-6 of the French Commercial Code.

¹⁸¹ Article L. 631-4 and L. 631-5 of the French Commercial Code.

¹⁸² Constitutional Council Decision dated 7 December 2012, n° 2012-286.

¹⁸³ Article L. 631-9 of the French Commercial Code.

¹⁸⁴ Article L. 631-12 of the French Commercial Code.

¹⁸⁵ Articles L. 631-14 and L. 622-7 of the French Commercial Code.

¹⁸⁶ Articles L. 631-7 and L. 621-3 of the French Commercial Code.

¹⁸⁷ Articles L. 626-12 and L. 631-19 of the French Commercial Code.

¹⁸⁸ Article L. 631-22 of the French Commercial Code.

¹⁸⁹ Articles L. 631-19 and L. 626-1 to L. 626-32 of the French Commercial Code.

¹⁹⁰ Articles L. 631-15-II, L. 631-21-1 and L. 631-22 of the French Commercial Code.

If the company does not appear to be viable or if no offer is lodged during the observation period, the court also has the power to open judicial liquidation proceedings¹⁹¹.

3.3.1.2 Offers for whole or part of the business – Sales Plan

Before making an offer, potential offerors may obtain limited information about the company from the registry of the court where the company is registered. The register will detail the debtor's assets and liabilities and also state the time within which offers may be made¹⁹².

Offers may be made within a specific period commencing with the date the proceedings are opened until the deadline fixed by the court (or by the administrator in reorganisation proceedings)¹⁹³.

The length of this period varies and is often influenced by the debtor's financial situation and the availability of cash flow. Because the administrator is personally liable for debts incurred during his administration, he will wish to present a report to the court for review and adoption well before funds dry up. The report will analyse and evaluate all offers and recommend one of them to the court¹⁹⁴.

Offers made by directors of the company or their immediate relatives (in the second degree) may not be accepted¹⁹⁵.

The key points when presenting an offer are:

- the court can only consider and choose offers in respect of an autonomous business activity comprising assets and some or all of the corresponding employees. The court will exclude offers in respect of assets only;
- an offer, once filed, is binding until the court makes its decision in relation to the sales plans filed¹⁹⁶;
- an offer must set out all relevant information provided under Article L.642-2-II of the French Commercial Code including a description of the assets and activities in respect of which the offer is made, the price and payment conditions etc;
- although not encouraged by the courts, offers frequently include conditions precedent. Typical conditions may include renegotiating key contracts, confirming orders or supplies or even obtaining authorisations from governmental authorities. Offerors must notify the court by the hearing date whether the conditions have been met and, if not, whether the offer still stands;
- the administrator files all offers made with the court registry, where they are at the disposal of any interested party¹⁹⁷;
- once an offer has been filed, it can only be amended by improving it within two working days before the hearing¹⁹⁸.

If the offer is approved by the court, the payment of the purchase price, which is ratified by the court, clears most securities and charges over the assets sold¹⁹⁹. This, however, will not affect security held by the creditor who financed the acquisition of the assets secured by the charge. In other words, *liability for special securities over assets guaranteeing the repayment of a loan granted to the insolvent company for the financing of the asset sold under the restructuring sales plan shall be conveyed to the purchaser. The Purchaser shall be required to pay to the creditor the instalments agreed with the creditor and that remain due as of the sale of assets under the plan*²⁰⁰.

Only those employees referred to in the offer adopted by the court will be transferred with the business. The court does not have the power to impose the transfer of all employees to the buyer, although the number of employees included in an offer will be a factor taken into account by the court when deciding which offer to accept.

Employees who are not transferred to the purchaser will be made redundant.

3.3.2 Agreement with public creditors to waive their claim²⁰¹

In judicial reorganisation proceedings, as in *conciliation* and *safeguard* proceedings, the debtor may come to an agreement with its public creditors, listed under Article D. 626-9 of the French Commercial Code, with regard to waiving part of their claims.

The types of claims a public creditor may waive are listed and ranked in accordance with the French Commercial Code. Their ranking is as follows:

- legal costs, price increases and fines;
- interest for late payment and moratorium interest; and
- principal sums due (but these cannot be waived in full).

The exact agreement reached with public creditors will depend on the outcome of negotiations with the company's private creditors as the French Commercial Code provides that both efforts must be coordinated.

¹⁹¹ Articles L. 631-15-II of the French Commercial Code.

¹⁹² Article R. 642-40 of the French Commercial Code.

¹⁹³ Article L. 642-2-I of the French Commercial Code.

¹⁹⁴ Article L. 642-5 al 1 of the French Commercial Code.

¹⁹⁵ Article L. 642-3 of the French Commercial Code.

¹⁹⁶ Article L. 642-2-V of the French Commercial Code.

¹⁹⁷ Articles L. 642-2-IV and L. 642-4 of the French Commercial Code.

¹⁹⁸ Article L. 642-2-V and Article R. 642-1 of the French Commercial Code.

¹⁹⁹ Articles L. 642-12 of the French Commercial Code, L. 631-22 of the French Commercial Code with reference to Article L. 631-22 of the French Commercial Code.

²⁰⁰ Article L. 642-12 of the French Commercial Code.

²⁰¹ Articles L. 626-6 and L. 613-19-I of the French Commercial Code.

The decision to waive the claims of public creditors is subject to the prior approval of the CCSF (Committee regrouping the directors of financial services and representatives of the public entities concerned).

Creditors in the public sector can also decide to waive their pre-emption rights, their ranking as holders of a charge or mortgage, to abandon these rights altogether, or even to postpone payment.

3.4 Outcome of the proceedings

3.4.1 Restructuring Continuation Plan

In principle, the rules applicable to the restructuring continuation plan are the same as those that apply to the safeguard restructuring plan (see section 1.4 above), except:

- if the plan provides for redundancies, the workers' council or the workers' representatives will need to be informed and consulted (Article L. 631-19-II of the French Commercial Code);
- if the plan provides for redundancies, the redundancies must take place within one month after the court decision adopting the plan (Article L. 631-19-II of the French Commercial Code);
- the adoption of the plan may be conditional upon the replacement or revocation of the directors at the request of the public prosecutor (Article L. 631-19-1 of the French Commercial Code);
- the court may hold that shares or any other rights giving access to share capital may not be transferred to or held by director(s) and may direct that voting rights will be held for a fixed period by a court agent (Article L. 631-19-1 of the French Commercial Code);
- the court may decide to sell such shares or other rights giving access to the share capital (Article L. 631-19-1 of the French Commercial Code);
- directors and representatives of the workers' council shall be heard or called in front of the tribunal (Article L. 631-19-1 of the French Commercial Code); and
- guarantors who may rely on the safeguard plan may not rely on the provisions of the restructuring plan (Article L. 631-20 of the French Commercial Code).

If the restructuring plan is not adopted or is not held to be viable, the court may impose a sales plan.

3.4.2 Sale of the business – Sales plan

If the offer is approved by the court, the payment of the purchase price ratified by court clears most securities and charges over the assets sold. This however will not affect the security held by the creditor who financed the acquisition of the assets secured by the charge (see section 3.3.1.2 under judicial reorganisation).

Following the sale, creditors will be repaid from the proceeds of the sale depending on their ranking, as determined by the French Commercial Code.

3.4.3 Failure of the reorganisation proceedings

If at any time during the reorganisation proceedings, the court concludes that the company is in a situation where the judicial reorganisation may no longer save the business and that, the business is no longer viable, the court will open judicial liquidation proceedings²⁰².

If the court does not approve the plan, the court will open judicial liquidation proceedings²⁰³.

4. Judicial Liquidation

4.1 Filing

A company in cessation of payments is under an obligation to file a motion to open judicial liquidation proceedings if judicial reorganisation would have no prospect whatsoever of saving the business²⁰⁴.

As with judicial reorganisation, the company, a creditor or the public prosecutor may open judicial liquidation, (provided that the company is not in *conciliation* proceedings)²⁰⁵.

The motion must be filed within 45 days of the date of cessation of payments²⁰⁶.

The documents and evidence which must be filed with the motion are the same as for judicial reorganisation, but must also show that the opening of reorganisation proceeding is "manifestly impossible"²⁰⁷.

4.2 The liquidator

On the opening of judicial liquidation, the insolvency court will appoint one or more liquidators²⁰⁸. If more than one liquidator is appointed, each liquidator has the power to represent the debtor.

²⁰² Articles L. 631-15-II, L. 631-19 and L. 631-22 of the French Commercial Code.

²⁰³ Article L. 631-22 of the French Commercial Code.

²⁰⁴ Article L. 640-1 of the French Commercial Code.

²⁰⁵ Article L. 640-5 of the French Commercial Code.

²⁰⁶ Article L. 640-4 of the French Commercial Code.

²⁰⁷ Article R. 640-1 of the French Commercial Code

²⁰⁸ Article L. 641-1, II of the French Commercial Code.

If the judicial liquidation proceedings supersede a judicial reorganisation, the *mandataire judiciaire* will usually be appointed as liquidator. Unlike the other pre-insolvency and insolvency proceedings, the liquidator not only takes over the management of the company but also represents the creditors.

The liquidator's objective is to sell the assets of the insolvent company in the most profitable way and to pay off the creditors in order of priority out of the sales proceeds²⁰⁹. It is rare for there not to be a shortfall of assets, in which case, as set out in the answer to the questions above, de jure and de facto directors may be held liable²¹⁰.

4.3 During the proceedings

Generally, the business of the company will cease to facilitate the winding-down of the company and to prevent existing debts increasing. However, the business may continue for three months (and possibly a further three months thereafter) with a view to selling the business (in whole or in part) or if it is in the public interest or the interest of creditors for it to continue²¹¹.

The liquidator may sell the assets in two different ways. First by selling the business in whole or in part as a going concern, but if this is not possible, by selling the company's assets on a piecemeal basis.

Two important recent updates in French insolvency law

1. The 2012 Petroplus reform

One of the most recent reforms in French insolvency law is the "Petroplus" Law adopted on 1 March 2012 (Petroplus Law) aimed at preventing the misappropriation of assets of companies in difficulty. The Petroplus Law introduces two important measures:

- for the president of the court to authorise the seizure of assets of third parties during safeguard and reorganisation proceedings;
- on the approval of the *juge-commissaire*, for the seized assets to be sold by the court and the proceeds deposited at the *Caisse des Dépôts et des Consignations*. The proceeds will then be used to pay legal costs and to make good the breach of social and environmental obligations committed by the debtor company.

The Petroplus Law gives rise to a number of questions including what if the assets seized on the court's approval were subject to guarantees in favour of third parties and does the right of seizure conflict with property rights granted under the European Convention of Human Rights (see Question 7).

2. The liability of foreign or French parent companies as co-employer of its French subsidiary.

The French *Cour de cassation* has recently upheld case law developed by the lower courts under which parent companies, foreign or French, may be held liable for the redundancies of employees of their underperforming subsidiaries as a "co-employer".

The French *Cour de cassation* has laid down three criteria for considering whether a parent company may be a "co-employer": (i) an interest in the subsidiary (for example, an 80% holding in the subsidiary's share capital or a lack of real autonomy by the subsidiary); (ii) activities (for example, the parent and the subsidiary being involved in the same business activity); and (iii) shared management (for example, one or more directors sitting on both the parent's and the subsidiary's board).

The most debated cases are *Jungheinrich*, *Jungheinrich A.G.*, *Jungheinrich Finance Holding* and *Aspocomp* in 2011, in which the *Cour de cassation* challenged the principle that companies are separate legal personalities. (This case law is especially relevant in the context of jurisdiction and applicable law in a cross-border scenario under Article 19 of the EC Regulation n° 44/2001 dated 22 December 2000, which provides that the "employer" can be brought before the tribunal where the employment was usually performed). Elevating the notion of "employer" to that of "co-employer" has never been referred to or upheld by the CJEU.

The case law on co-employment has continued to be applied by the *Cour de cassation*, notably in co-employment cases brought by employees against Metal Europe in 2012 and also recently against Molex, an American company, in 2013.

²⁰⁹ Article L. 641-4 of the French Commercial Code.

²¹⁰ Article L. 651-2 of the French Commercial Code.

²¹¹ Article L. 641-10 and R. 641-18 of the French Commercial Code.

