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FRANCE: Storms gathering for restructuring of group entities underscore need for up-to-date advice

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According to the French financial press[2], there may be signs that the country is on its way to recovery. This optimistic perspective is among other things based on an extract of a recent study made by Trendéo, a company specialized in the gathering of information, according to which the number of production sites opened since the beginning of 2014 increased by a third compared to 2013 and the number of factory closures dropped by 25% compared to the same period in 2013. Despite this improvement, the study also reveals that the net ratio of closures versus creation of production sites remains negative by 34 closures (153 closures and 119 creations) since the beginning of 2014 and that this ratio has been negative since the second quarter of 2011. Optimism also came from reported gross domestic product (GDP) which was higher than expected. Based on information from the National Institute of Statistics and Economic Studies (*INSEE*) published in the French financial press,[3] the French GDP increased by 0,3% in the third quarter after a decrease of 0,1% in the second quarter.

The number of insolvencies also remained high, but stable, during the third quarter of 2014 with approximately 13,000 filings, with an increase of filings for liquidation by small companies, rather than for reorganization[4], threatening the jobs of 53,000 employees, i.e. 1000 jobs more than for the same period last year.

This may not suffice, however, to regain investors', and particularly foreign investors', interest.

Indeed, the combination of recent legislative frenzy, employee friendly laws and co-employment case law, even though the latter seems to have been temporarily ring-fenced, are not likely to contribute to any

[1] The author would like to thank Alexandra Dear from the Reed Smith LLP office, for her help and research in relation to this article.
[2] Les Echos – October 20, 2014, front page and page 17 – Créations d'usines: quand la France remonte la pente
[3] Les Echos – November 17, 2014, page 2 – La vraie reprise attendra encore plusieurs trimestres
[4] Altares

rapid improvement in the image of a depressed economy and a difficult labour environment from the point of view of a foreign investor.

1. The co-employment case law

1.1. Piercing the corporate veil

In several instances, French or foreign parent companies, and in some instances also sister companies, have been ordered to bear the costs and liabilities for certain acts of their French subsidiaries towards their employees, based on the co-employment concept. This is, in essence, because French Labour Courts have ruled that parent companies have acted as employers of their subsidiary's employees, even in the absence of working agreements between the parent and said employees and of instructions to these employees, individually or globally, by the parent.

According to French Labour Courts, three cumulative criteria are required to rule that a parent company is also the employer of the employees of its French subsidiary:

- ***A confusion of activities***. By this criterion, because two companies belonging to the same group with the exact same activity, one company cannot be removed/closed without impacting the other.
- ***A confusion of management***. This situation will occur when the management of the subsidiary and shareholder parent is composed of the same person(s). It may also occur when there is a lack of decision-making autonomy by the subsidiary and the latter has no independence regarding the management of its finance, assets, and accounts as its management is dependent on another company's management, generally the management of the direct shareholder or of another group company.
- ***A confusion of interests*.** This criterion is the most difficult to define as two companies belonging to the same group necessarily have the same interests and so far French courts have considered its existence without really defining it.

French Labour Courts have traditionally favored a broad conception of these criteria in order to facilitate compensation for employees made redundant on economic grounds. As a consequence of this extensive notion, parent companies have regularly been characterized as co-employers alongside their subsidiaries, even in situations where the parent company had no employees and no activity other than being a holding company.

1.2. The Molex case and the ring-fencing of the co-employment case law

Recently, on **July 2, 2014**[5] the French *Cour de cassation* took a more restrictive approach to the co-employment concept in a case which involved a US-Illinois based parent company named Molex Inc. and

[5] Cass. soc. 2 juillet 2014, n°13-15208
http://www.legifrance.gouv.fr/affichJuriJudi.do?idTexte=JURITEXT000029194325&fastReqId=1838851083&fastPos=1

Molex Automotive SARL ("MAS"), the French subsidiary of which had closed in 2009, eliminating approximately 300 positions under a social plan fully funded by the parent.

In November 2008, the Works council of MAS was informed of and consulted on the closing of the French plant. In 2009, a social plan (*plan de sauvegarde de l'emploi*) was finalized and later that same year the employees were made redundant. Some of them brought an action before the Labour Court in order to obtain damages for wrongful dismissal and involved Molex Inc. in the proceedings.

The *Cour de cassation* overturned the decision of the Appeal Court where the judges found the US parent to be the co-employer of the French subsidiary because it considered that there was a confusion of "interests, activities and management" based on the fact that the French management had been replaced with executives of the parent and that the parent took the decision to close the French plant and transfer production elsewhere, a decision that affected the French site and its employees.

According to the French *Cour de Cassation*, running a group necessarily involves some cooperation between the entities. Therefore, the coordination of economic actions among a group as well as the economic dependence that may result from it should not be confused with the notion of co-employment.

The judges further stated that a parent company cannot be characterized as a co-employer merely because it took decisions that affected the subsidiary during the management of the group and offered the necessary financial means for the subsidiary's social plan.

This decision apparently seeks to limit expansion of the co-employment concept and thereby the ability to "pierce the corporate veil" in labour matters.

1.3. Tortious liability for parents also remains open

But in a recent decision, the Cour de Cassation has endorsed another way to achieve an outcome akin to "piercing the veil". Thus, without any reference to co-employment, the *Cour de Cassation* ruled on **July 8, 2014**[6] that it is possible for the employees of a subsidiary to hold its parent liable, in tort, for decisions taken that aggravated the financial situation of the subsidiary and led to its liquidation as well as to the redundancies of the subsidiary's staff.

In 2008, a company named Sofarec, acquired another French company named Capdevielle which was in financial trouble. A year later, Capdevielle filed for insolvency proceedings (*redressement judiciaire*) which led in 2010 to liquidation. All of Capdevielle's employees were made redundant in 2010 after a social plan (*plan de sauvegarde de l'emploi)* had been carried out.

The employees brought an action before the Labour Court. In the meantime Sofarec went into liquidation.

[6] Cass. soc. 8 juillet 2014, n°13-15573
http://www.legifrance.gouv.fr/affichJuriJudi.do?oldAction=rechJuriJudi&idTexte=JURITEXT000029241980&fastReqId=29763440&fastPos=1
Cass. soc. 8 juillet 2010, n°13-15.470
http://www.legifrance.gouv.fr/affichJuriJudi.do?oldAction=rechJuriJudi&idTexte=JURITEXT000029241886&fastReqId=986980525&fastPos=1

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The Supreme Court concluded that Sofarec, directly or through her parent, took decisions (i.e. it had requested that several audits be carried out in relation to the acquisition of Capdevielle and Sofarec's shareholder had made available some employees of the group for considerable amounts of money) that had worsened the economic situation of Capdevielle and which had had no purpose for the latter and had only benefited the parent.

The judges took the view that Sofarec and its parent, by their mistake and 'blameful rashness" (*légèreté blâmable*) contributed to the collapse of Capedevielle. The judges as a consequence found Sofarec and its parent liable, in tort, based on articles 1382 and 1383 of the French Civil code and ordered them both to pay €3000 in damages to each employee.

The judges in their decision did not define the type of fault which can trigger tortious liability, therefore leaving a possible broad scope.[7]

2. The recent legislative frenzy and heavier administrative burdens for French companies

According to a study by the French Ministry of Justice[8], from 2006 to 2009, as a result of the 2008 global financial crisis, the number of insolvency proceedings increased by 46%. With the increased number of insolvent debtor companies some areas of French law were in need of improvement.

As a result, in the past few years many important reforms concerning corporate and insolvency law have been implemented. The beginning of major insolvency reforms started with the law dated July 26, 2005 the goal of which was to promote reorganization at a preventive stage and have creditors play a more active role in pre-insolvency and insolvency proceedings.

During 2014, no less than 16 reforms can be counted in the corporate/insolvency area. A law **empowering the Government to facilitate and secure companies' lives** *(loi habilitant le Gouvernement à simplifier et sécuriser la vie des entreprises)* was enacted on January 2, 2014 under which several pieces of secondary legislation (*ordonnances*) were issued without debate in Parliament:

- An order dated January 30, 2014 **which reduces the accounting obligations of small companies**. This order was completed by further decrees dated February 17, 2014 and September 18, 2014.

- An order, consisting of 117 articles, dated March 12, 2014 **regarding the prevention of financial distress and insolvency procedures** applicable as from July 1, 2014. This order was complemented by implementing decrees, the first one being dated June 30, 2014 and consisting of 145 articles. A second decree, dated September 26, 2014 made up of 14 articles, among which 3 are related to the entry into force of the order and its applicability in the French territories.

[7] Article 1382 of the Civil Code, invoked on behalf of the employees, is the foundation stone of the vast majority of fault-based liability in tort under French law. It is notoriously malleable by judges in any given factual circumstance.
[8] Ministère de la Justice – 2013 - La sauvegarde, le redressement judiciaire et la liquidation judiciaire devant les juridictions commerciales de 2006 à 2012, page 5.

Concerning the other 11 articles of this decree, they replace the wording of some provisions of the French Commercial code regarding fast-track safeguard measures (*sauvegarde accélérée*), the opening of safeguard proceedings, liquidation proceedings and other insolvency proceedings (i.e *redressement judiciaire*).

- An order dated July 31, 2014 **regarding corporate law**, which consists of 40 articles. Some of which bring changes in areas such as limited liability and partnership companies, regulated agreements *(conventions règlementées)*, preferred shares, transfer of shares. The main goals of this order were to enhance transparency in limited liability companies, secure certain operations in which companies can be involved and also improve operating rules of business companies.

There were also laws dated July 31, 2014 named *loi sur l'Economie Sociale et Solidaire* and the *loi Florange* dated March 29, 2014 which will be commented below. More recently, a draft bill in relation to the merger of the profession of trustees/creditors' representatives (*mandataires judiciaires*), bailiffs and auctioneers (*commissaires-priseurs*) triggered a strike before the bill was even presented to the Council of Ministers.

Several articles of the *loi Florange*, were declared contrary to the French constitution, adding the impression of a lack of preparation and consultation in these key reforms.

2.1. The closing or the transfer of a company in France

2.1.1. The complexity added by the loi Florange regarding the closing of companies

When it comes to closing a plant, companies of a certain size have the duty to search for a purchaser[9] in order to avoid or limit redundancies. These rules necessarily impact shareholders/groups.[10]

As per the *loi Florange*, companies – including groups of companies with a registered office in France and European companies with a plant of 150 workers in at least two member states – employing at least 1,000 workers, that propose to close a plant possibly leading to a collective dismissal must:

1. Inform and consult their Works council of their intent to close the plant no later than the consultation process for the contemplated collective redundancy exercise;
2. Inform, by any appropriate method, the potential purchasers of their intent to sell the plant and to draft documents presenting the plant.
3. Provide access to any necessary information to potential acquirers of the plant, except those that if communicated might jeopardise the interests of the company.
4. Take into consideration any purchase offers and provide a reasoned response to each of the purchase offers.

[9] http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000028811102&categorieLien=id

[10] For further details on the loi Florange: International Corporate Rescue – April 10, 2014, A. Sorensen: *The "Florange Law" Deprived of its Main Significance by the French Conseil Constitutionel in its Decision of 27 March 2014*, page 141-142

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The French *Conseil Constitutionel* in a decision from March 27, 2014[11] declared that those requirements were compliant with the French Constitution. However, the law lost its strength when the provision imposing Court sanctions for companies that failed to comply with the obligation to search for a purchaser or that declined serious acquisition offers without a legitimate reason, were deemed contrary to the French Constitution and struck down, on the ground that it violated the freedom accorded under the Constitution to private enterprise.

However, sanctions for non-compliance with the requirements of the *loi Florange* have been completed by the *Loi sur l'Economie Sociale et Solidaire* from July 31, 2014. In case of non-compliance, the authorities can refuse to confirm the social plan (*plan de sauvegarde de l'emploi*). Another possible sanction is that the authorities may require reimbursement of diverse financial aids that the company benefited from.

2.1.2. The further duties added by the loi sur l'Economie Sociale et Solidaire regarding the transfer of a company/business

2.1.2.1. Scope of application

An alternative to closure and a way to reduce the issues related to co-employment, is to effect a transfer of a subsidiary, particularly when it does not perform at expected levels. But this option has also been regulated and made more time consuming for companies.

According to a decree dated October 28, 2014[12] regarding the application of the *Loi Sur l'Economie Sociale et Solidaire*,[13] as of November 1, 2014, transfers of i) shares or other securities granting access to their acquirer of the majority of the shareholdings of a company, (essentially limited liability and joint stock companies) and of ii) a business (*fonds de commerce*), need to be disclosed to employees as well as their right, individually or collectively, to submit an offer for the shares or the business.

The companies falling under the scope of this duty to inform the employees are those which employ less than 250 people except:

- Companies that employ between 50 and 249 people and that do not fit within the definition of small and medium-sized firms given in the *loi de Modernisation de l'Economie* dated August 4, 2008 (i.e. companies which employ less than 250 people and which have a turnover that does not exceed 50 million Euros and/or a balance sheet not exceeding 43 million Euros).

- In case of succession, settling out of property rights in consequence of the dissolution of the marriage or transfer of the holding to a spouse, ascendant or descendant (*en cas de succession, de*

[11] http://www.conseil-constitutionnel.fr/decision/2014/2014-692-dc/decision-n-2014-692-dc-du-27-mars-2014.140367.html

[12] http://www.legifrance.gouv.fr/affichTexte.do;jsessionid=?cidTexte=JORFTEXT000029646653&dateTexte=&oldAction=dernierJO&categorieLien=id

[13] http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000029313296&categorieLien=id

liquidation du régime matrimonial ou de cession de la participation à un conjoint, à un ascendant ou à un descendant).

- Companies subject to specific preventive measures (*conciliation*) and insolvency proceedings (*sauvegarde, redressement judiciaire, liquidation judiciaire*)

2.1.2.2. The duty to inform employees

The duty to inform the employees of their right to submit an offer varies according to the number of employees in the relevant company:

- For companies not under a duty to operate with a Works council, who employ less than 50 people or small and medium-sized firms, the employees should be informed of the intended transfer (*projet de cession*) and their right to submit an offer, at the latest 2 months before the transfer. This 2 months' time period is determined by reference to the date of transfer, meaning the date at which the transfer of ownership takes effect. In the normal course, transfer cannot occur until this time-period has elapsed, unless each employee has notified the transferor that they do not wish to submit an offer.

- For companies which are under a duty to operate with a Works council and who employ between 50 and 249 people, the employees should be informed at the latest at the beginning of the consultation process with the Works council.

Whatever the size of the company, the methods by which the information may reach the employees are the same in both cases.

According to article 1 of the decree, notification by registered letter with acknowledgement of receipt is a permitted method by which employees can be informed.[14] Nevertheless when employees are notified by registered letter with acknowledgement of receipt, there could be delivery issues[15] and one of the main concern for companies will be to notify all the employees and this at the same time so that the 2 month period to make an offer elapses on the same date for all of them. For this reason, this method will probably not be the best way to notify because there may be situations where some employees will on purpose refuse to acknowledge receipt of the information so that the company is blocked or is forced to delay the contemplated transfer.

Although employees have the right to submit an offer after being informed, the seller can always decline it and opt for another proposal.

[14] Other methods include: notification during an information meeting whereby all employees will have to sign the attendance register, displaying the information with the employee signing a register to acknowledge he received the information, by electronic mail as long as the date of receipt can be certified, by direct delivery against signature of receipt, extrajudicial process, any other method which can certify the date of receipt.

[15] Changes of address, refusal to pick-up the registered letter are issues that may arise.

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2.1.2.3. Sanctions

These new rules will have an impact on future transfers as, if the information is not disclosed, any employee can apply to the Court for annulment of the transfer. The employee(s) will have 2 months from the date of the publication of the notice of transfer or the date at which all the employees are informed, to apply for annulment. This might also delay transfers as the starting point of this 2 months' time period is as from notification of all the employees.

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For those looking at turning around companies in France, mixed messages are coming from the French Courts and the current Government. Hopefully greater clarity will come in the near or medium term.