

Practice area	Country	Firm	Title	Summary	Contact person
Insolvency law	France	Vovan & Associates - France	General overview of French insolvency law	The recent legislative evolutions in French insolvency law allow for preventive procedures at the debtor's request to avoid an insolvency situation, while at the same time increasing the role of creditors in insolvency proceedings, and providing for simplified forms of liquidation proceedings.	Julien Rolland-Piegue julien.rolland-piegue@vovan-associates.com

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#### Introduction

France has amended its insolvency law no less than six times in the past fifty years. Consequently, particular attention should be paid to determination of applicable law, which depends on the commencement date of the concerned bankruptcy proceedings.

Since 2006, most regulations governing insolvency have been incorporated in the French Commercial code. The latest modifications, enacted on December 18, 2008 and supplemented by the decree No.2009-160 dated February 12, 2009, apply to insolvency proceedings open from February 15, 2009 (with the exception of article 38 of said implementing Decree, which applies to safeguard plans that were open before February 15, 2009 and still pending on this date).

The tendency is to promote preventive measures, which aim at providing assistance to business if it is likely to be saved. Participation of the creditors in restructuring the business has also been enhanced. Finally, when reorganization turns out to be impossible and liquidation is the only way to go, the latest rules favour simplified proceedings.

#### Debtors - Insolvency test

French insolvency law applies to « businesses in difficulties », i.e. to any of the following persons ("Debtor") when encountering such financial difficulties, as they are, or are likely to become, insolvent:

- private law entities (e.g. companies, associations, trade unions, foundations etc.);
- natural persons referred to as "professionals" i.e. persons carrying out commercial or craft activities, farmers, as well as, since 2005, any person running an independent professional activity, including, but not limited to, independent professional persons with a statutory or regulated status or whose title is protected.

A Debtor is said to be insolvent when it is unable to pay its accrued liabilities with its available assets (*état de cessation des paiements*).

### Creditors

- French civil law establishes a difference between secured creditors (*créanciers privilégiés*) and unsecured creditors (*créanciers chirographaires*). Secured creditors hold preferential rights on some of the Debtor's assets, and must be satisfied before unsecured creditors. Under French insolvency law and civil law, an order of priority is set between secured creditors, whereas unsecured creditors are paid on a pro-rata basis, and only after all secured creditors have been satisfied.
- In practice, this division is often superseded by another difference between creditors, depending on whether their respective claims arise (i) prior or (ii) after the commencement date of the relevant bankruptcy proceedings.

(i) French insolvency law grants privilege to creditors holding claims arising after the opening of the proceedings for the needs of insolvency proceedings, or as consideration for goods and services provided so as to allow the Debtor to pursue its profession or activity during said proceedings.

Such creditors are entitled to receive payment of said claims when they fall due. In case their claims are not paid, such creditors shall be better ranked in the order set for the distribution of the Debtor's assets, when made available to its creditors.

(ii) On the contrary, payment of claims originated prior to the commencement date is strictly prohibited after said commencement date, with very few exceptions (e.g. claims related to the Debtor's daily necessities of life and alimony debts, and when caused by the withdrawal of pledge or possession of a property that is necessary to the continuation of the business operations).

Consequently, any actions filed by such creditors against the Debtor (except for some claims, such as those arising from an employment contract) are stayed, as long as the bankruptcy proceedings are not terminated.

Such creditors are under the obligation to submit their claim officially within two months from the publication of the judgment ordering the commencement of insolvency proceedings in a legal newspaper (*Bulletin Officiel des Annonces Civiles et Commerciales*). The said two-month time limit is extended for some creditors, and notably for all creditors having their domicile outside Metropolitan France, who benefit from a two-month extension.

The court examines each of the submitted claims and publishes a list drawing up the decision of the court for all said claims (*état des créances*), which may be appealed by creditors.

- Influenced by Chapter 11 of the US Bankruptcy Code, creditors' committees have been implemented in 2006, so as to reinforce the participation of creditors in bankruptcy proceedings when it appears that cancellation of certain debts and/or extension of the terms of payment may save the business and allow for the settlement of the Debtor's liabilities.

Credit institutions, as well as creditors holding claims acquired from any such institutions and entities that entered into a credit transaction with the Debtor, goods suppliers or service providers, are members of a first committee, whereas main suppliers of goods and services, i.e., since the latest evolution of 2009, those holding claims representing at least 3% of the aggregate amount owed by the Debtor to its suppliers, are grouped in a second committee.

The consultation of creditors' committees is compulsory for companies having more than 150 employees, or where sales turnover exceeds twenty millions euros. Although majority rules for the adoption of decisions by creditors' committees are set by the French Commercial code, the bankruptcy court shall ensure that the interests of all creditors are sufficiently protected when it approves such decision. Further to court approval, said decision shall be binding on all creditors' committees members.

In joint-stock companies, the safeguard plan may include debt-equity swap.

#### Competent court

Insolvency proceedings fall within the jurisdiction of commercial courts (*Tribunal de commerce*) in case the Debtor carries out commercial or craft activities. In other cases, insolvency is under the jurisdiction of the civil trial courts of general jurisdiction (*Tribunal de Grande Instance*).

## Preventive measures

Whereas insolvency proceedings used to apply only when a business had become insolvent, preventive measures have been available to Debtors since 2006, with a view to avoiding them becoming insolvent.

Preventive measures may only be requested by a Debtor and consist in (i) a special commission, (ii) a conciliation procedure and (iii) a safeguard procedure.

- Any Debtor may request from the President of the competent court to appoint a special commissioner (*mandataire ad hoc*) whose role is to assist the Debtor by providing help to remedy the situation. Since the latest evolution of December 2008, the name of the special commissioner may be suggested to the court by the Debtor.

The mission and remuneration of such special commissioner are set by the court.

Such preventive measure allows the Debtor to keep its difficulties secret, since the special commissioner and any person aware of the existence of such special commission are bound by a duty of confidentiality.

- The conciliation procedure (*procédure de conciliation*) aims at the Debtor and its main creditors entering into an amicable settlement that shall put an end to the difficulties causing the Debtor to apply for such procedure.

A conciliation procedure may apply provided (i) the Debtor is not insolvent or has been insolvent for less than forty-five days and (ii) a period of at least three months has elapsed after a former conciliation procedure has ended.

The judge who has commenced the conciliation procedure may, within a two-year limit, defer payment of creditors' claims.

The conciliation procedure is conducted by a court appointed conciliator (*conciliateur*), whose name, since the legislative evolution of December 2008 changes in insolvency law, may be proposed by the Debtor, for a four-month period that may be extended by one month. Should it prove impossible to reach an agreement with creditors, the conciliator shall immediately revert to the court and the conciliation procedure shall be forthwith terminated.

When the contemplated agreement is reached, the parties decide whether they submit it to official approval of the court (*homologation*), or merely record it with the court (*constatation*).

In case the parties prefer to keep said agreement secret, it is provided to the court for record, so as to make it enforceable between the parties thereto. It

will not apply to third parties and may therefore be detrimental to creditors, in case the insolvency comes to a further stage.

On the contrary, the decision by which said agreement is officially approved by the court shall be available to third parties through statutory publication and may be opposed to them. Consequently, it offers a better protection to creditors.

- The safeguard procedure (*procédure de sauvegarde*) is inspired by Chapter 11 of the US Bankruptcy Code. When initiating such procedure, the Debtor must prove that it is facing difficulties it cannot overcome, although it is not insolvent yet. This preventive measure aims at reaching, in cooperation with creditors, the approval of a safeguard plan (*plan de sauvegarde*), if it appears possible to settle the Debtor's difficulties and save its business.

Once the safeguard procedure has been initiated, a six-month observation period (*période d'observation*) begins, renewable once, with a very similar regime to that applicable to reorganization proceedings (see below).

The Debtor remains in charge of managing its business without the assistance of an administrator. Nevertheless, the Debtor must obtain court approval before engaging in transactions deemed to exceed the ordinary course of business.

When an administrator is appointed, his duties are fixed by the court and consist either in the supervision of the Debtor's management operations, or in the assistance in all or some of said operations.

In the course of safeguard procedure the managers of the business (and/or his family members) who have pledged their property to secure the Debtor's debt may benefit from stay of actions by creditors and the interests will cease to accrue. They shall also benefit from the provisions of the safeguard plan.

Moreover, claims that would not have been notified officially cannot be claimed from the Debtor, as long as the safeguard plan is being carried out. The same shall apply after its completion provided the commitments pursuant to the safeguard plan have been fulfilled.

In case the Debtor becomes insolvent in the course of the observation period, the safeguard procedure is converted into either reorganization proceedings or liquidation proceedings. Since the latest evolution of French insolvency law, the Debtor may also request safeguard proceedings to be converted into reorganization proceedings even though it is not insolvent, in case the adoption of a safeguard plan turns out to be impossible and would certainly lead to insolvency within a short period of time.

## Insolvency occurrence (*état de cessation de paiements*)

When a Debtor becomes insolvent, the available bankruptcy proceedings are reorganization proceedings (*redressement judiciaire*) or, if the reorganization of its business is obviously impossible, liquidation proceedings (*liquidation judiciaire*).

The Debtor must file a motion with the competent court within forty-five days from the date of occurrence of its insolvency, for the purpose of commencing either reorganization or liquidation proceedings. Within the same forty-five day limit, the Debtor may also elect to request the commencement of a conciliation procedure. Should the latter fail, the relevant bankruptcy proceedings will be initiated by the court of its own motion. Any Debtor, represented by its manager or other authorized representative in case of legal entity, failing to file a motion for insolvency within the said time limit may be prohibited from managing, administrating, or controlling any commercial or craft business, farm, or any legal entity, for the period set by the court, which shall not exceed fifteen years.

It shall be noted that for certain acts performed before or after the date of its insolvency, the Debtor may incur not only (i) civil liability, which may lead notably to personal disqualification (*faillite personnelle*), e.g. for entering, without consideration, into commitments deemed to be disproportionate at the date they were entered into, given the situation of its business, or using ruinous means to procure funds with the intention of delaying the commencement of bankruptcy proceedings, but also (ii) criminal liability, e.g. for embezzling all or part of its assets, or fraudulently increasing its liabilities.

Unless requested by the insolvent Debtor as prescribed, the commencement of reorganization or liquidation proceedings, as the case may be, may be initiated upon a writ of any of its creditors or by the competent court, either of its own motion or on motion of the Public Prosecutor.

## Reorganization proceedings (*redressement judiciaire*)

Reorganization proceedings, just like safeguard proceedings, begin with a six-month observation period (*période d'observation*), renewable once, with a view to assessing the situation of the Debtor and deciding whether or not its difficulties may be overcome.

The judgment issuing the commencement order appoints a supervisory judge (*juge-commissaire*), a court nominee in charge of representing the creditors' interest (*mandataire judiciaire*) and one or several administrator(s) (*administrateur judiciaire*).

Such decision also sets the date of insolvency occurrence (*date de cessation des paiements*), that is the starting point of a period said to be "suspect" (*période suspecte*), ending on the date of the judgement declaring the commencement of bankruptcy proceedings, and in the course whereof any payments made and/or guarantees provided by the Debtor are void or may be declared void.

The Debtor handles the ordinary management of its business, with the assistance of the administrator, unless it is entirely entrusted to the administrator by court order. Certain operations shall be declared void if they have not been authorised by decision of the supervisory judge (such as the granting of mortgages or collaterals, or entering into a settlement agreement with certain creditors).

As for ongoing contracts, the administrator has the option to either (i) require the Debtor's contracting parties to perform their obligations, in exchange for the performance of the Debtor's obligations under the same contract, or (ii) terminate any such contracts (except for employment agreements).

A reorganization plan (or a safeguard plan under a safeguard procedure) shall be decided by the court if it appears, at the end of the observation period, that the business is likely to be saved. Otherwise, the reorganization proceedings shall be forthwith converted into liquidation proceedings. The duration of such plan shall be fixed by the court, but shall not exceed ten years.

Such reorganizations plan shall set the prospects for employment, the terms and conditions for settlement of liabilities (including all moratoriums and cancellation of debts as accepted by the creditors), as well as the guarantees to be provided by the Debtor for the performance of the plan.

Various provisions may also be included thereto, such as, for instance, amendments to the articles of association, with the reorganization (or safeguard) of the business in view. It shall be noted that, in an attempt to favour the entrance of new investors, clauses possibly requiring the approval of new shareholders by current shareholders shall not be applicable.

Should the Debtor fail to comply with its commitments under said plan, the court may order the rescission of the plan and, in case the Debtor is insolvent, its judicial liquidation.

#### Liquidation proceedings (*liquidation judiciaire*)

Since 2006, liquidation proceedings may provide for an assignment, either total or partial (for activities which may be operated autonomously), of the Debtor's business (*plan de cession*).

Purchase offers with a view to totally or partially assigning the business are strictly regulated by the French Commercial code. The court will accept the purchase offer which allows for the best preservation of employment on a long-term basis, as well as payment of the creditors, and offers the best guarantees of implementation.

Except when such assignment is considered, business activities are commonly discontinued when liquidation occurs, although by law such activities may be temporally maintained up to three months, renewable once.

The Debtor is no longer in charge of the management of its business that is devoted to a liquidator (*liquidateur*) appointed by the court, with the assistance, under certain circumstances, of an administrator.

In order to speed up the liquidation process, the French Commercial code also provides for simplified form of liquidation proceedings, on court order, that is compulsory for Debtors (i) having either no or only one employee in the course of the last six months preceding the opening of the liquidation proceedings, and (ii) whose assets do not include immovable property, and (iii) with yearly turnover (before tax) not exceeding €300,000.

Under such compulsory simplified liquidation proceedings, the Debtor's assets may be sold either through private sales or public auction, within three months from the judgement ordering liquidation. After that time limit has elapsed, public auction is required.

The liquidator is entitled to decide on the continuation of current contracts, provided the Debtor is in a position to perform its duties under said contracts. In such a case, the Debtor must timely fulfil its payment obligation, unless the co-contractor has accepted other terms of payment.

Should the liquidator fail to answer within one month from the co-contractor's official letter on the issue of the continuation of the contract, the latter will be automatically terminated.

The verification of creditors' claims shall be limited to (i) claims whose ranking may enable payment on the liquidation proceeds, or to (ii) those resulting from an employment contract. The liquidator shall then draw up a proposal of allotment of the liquidation proceeds to pay the creditors to be filed with the court for publication. Any interested party may dispute the same before the supervisory judge.

The closing of simplified liquidation proceedings shall intervene within one year from the judgement ordering their commencement.

Since the December 2008 changes in the law, this simplified regime is facultative for Debtors (i) whose assets do not include immovable property, (ii) who have up to five employees and (iii) whose yearly turnover (before tax) does not exceed €750,000. Under such facultative simplified liquidation proceedings, the court may decide which of the Debtor's assets shall be sold through private sales, instead of public auction as otherwise required, within three months from the court decision.

As for closing of standard liquidations proceedings (i.e. other than simplified ones), the court order opening such proceedings sets a period of time at the end whereof their closing shall be considered. Such a time period may later be extended by the court.

The closing of judicial liquidation proceedings will be ordered by the court either by decision made *sua sponte* or upon request of either the liquidator, the Debtor, the office of the prosecutor, or, at the expiry of a two-year period from the date of the court order which opened the liquidation proceedings, upon request of any of the creditors, where (i) there are no due liabilities anymore, or where (ii) the liquidator has sufficient sums at his disposal to satisfy all creditors, or, more likely, where (iii) the continuation of liquidation operations has become impossible due to excessive liabilities over the Debtor's assets.

### *Conclusion*

French insolvency law tends to preserve the fragile balance between the protection of creditors and the pursuance of the reorganization of the Debtor's business, by allowing reorganization unless the difficulties encountered by the Debtor are obviously insuperable.

Reorganization is favoured because, if the Debtor's business turns out to be viable, the value it will generate shall be beneficial to creditors. Indeed, creditors are likely to receive higher amounts than any proceeds that would have been generated by liquidation at the time insolvency appeared, not to mention the outcomes in respect to employment and economic activity as a whole.

Correlatively, unviable businesses shall be liquidated as efficiently as possible. Simplified proceedings, as those newly implemented, may allow for the completion of bankruptcy proceedings within shorter periods of time.

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