Pre-Insolvency Procedings
The French Perspective

By Sophie VERMEILLE
Corporate & Restructuring lawyer at DLA Piper
Researcher at Paris II (Paris II Panthéon-Assas)

Bruxelles - 24 juin 2015

I. Context

- The EU recommendation urges Member States to ensure the availability of a debt restructuring procedure that complies with the Commission's core principles:

▪ pre-insolvency recourse (provided debtor already in "financial difficulties" such that there is a "likelihood" of insolvency)

▪out-of-court initiation and minimised court involvement (except as necessary and proportionate to safeguard interests of those likely to be "affected")

- From this perspective, France seems to meet the requirements set forth by the Commission, as France has introduced several pre-insolvency over the last ten years, the idea was to encourage out-of-court restructuring by relaxing the unanimity rules which are provided for in the various contractual agreements

- However, as we will see, the results are not satisfying, France is a good example of the drawdowns on an approach focused too much on pre-insolvency proceedings, flaws of formal bankruptcy proceedings are much more a priority


"No offense, Your Honor, but we've decided to settle out of court."

II. The various French pre insolvency proceedings

- The ad hoc mandate is a preventive and confidential procedure aimed at settling disputes out of court to improve the prospects of the company before it becomes cash insolvent

- This procedure is available to the debtor only, by requesting the appointment of an ad hoc administrator

- The mission of the ad hoc administrator is to assist the debtor with the negotiation of an agreement with its main creditors to obtain an extension of the term of its debts and does not include assistance with other problems of the debtor

- The managers remains the company's sole manager

II. The various French pre insolvency proceedings

- The conciliation procedure is confidential and is aimed at reaching an out of court agreement between the company and its main creditors

- This procedure is available to the debtor upon request

- The settlement agreement should allow the company to obtain an extension of the term or a partial forgiveness of its debts, as well as loans necessary to continue its operations or to consider a restructuring

- In order to give the agreement greater enforcement security, the debtor may request the Court to acknowledge the agreement if several conditions are met

- The creditors or partners, who, during the conciliation procedure, agree to contribute new money are granted a preference in the form of a priority rank for the repayment of their loan over other creditors. Further, the the debt owed to these creditors may not be rolled over should the company later file for bankruptcy proceedings

II. The various French pre insolvency proceedings

- The accelerated Safeguard is available only to large companies meeting minimum turnover and number and employee thresholds

- It is available at the request of the company only and while the company is already following a conciliation procedure

- The company must have reached a draft plan with its largest creditors during the conciliation procedure

- The term of the procedure is limited to three months during which the plan must be approved

- The plan must be approved by a majority of creditors representing at least 2/3 of the debt in each committee

- The accelerated safeguard is effective against all creditors existing prior to the date of the opening judgment, except employees.

II. The various French pre insolvency proceedings

- The Accelerated Financial Safeguard (SFA) is a variant of the Accelerated Safeguard procedure which is available for financial creditors and companies who are overleveraged with banks and have obtained the support of the majority of their financial creditors, during a conciliation procedure

- The objective is to quickly solve the issue of a minority of creditors refusing to enter into the settlement agreement

- The opening requirements are the same as for the accelerated safeguard procedure

- The SFA must be conducted over a shorter period of 1 month, which may be extended for no longer than one month

- Once opened, the SFA procedure is effective (stay of payments, interests and lawsuits) only against some financial creditors and, in some cases, bondholders.

Parties negotiate in the shadow of bankruptcy proceedings > if the formal bankruptcy proceedings results in an unefficient result, the out-of court negociations and the pre-insolvency proceedings are likely to produce an unefficient result

Change in the rules of the game > exacerbate antagonisms > suboptimal agreements during out of court negotiations and pre-insolvency proceedings

III. The main flaws of French bankruptcy law

"France differs greatly from the other countries in the arena of bankruptcy law
This is due to a weak protection of creditors' rights compared to
other stakeholders' rights, including shareholders' .
[...] We recommend
a moderate evolution of French bankruptcy law towards better
creditors' protection, inspired by the US bankruptcy law."

Jean Tirole (Laureate of the Nobel Price in Economy),
Guillaume Plantin & David Thesmar
Conseil d'Analyse Economique
4 June 2013

III. The main flaws of French bankruptcy law

- While insolvency law facilitates the coordination of creditors by relaxing the unanimity rule and replacing it with a majority rule of 2/3

- The distribution of the creditors in the various committees is not consistent and disregards the priority rules (trade creditors / banks / bonds)

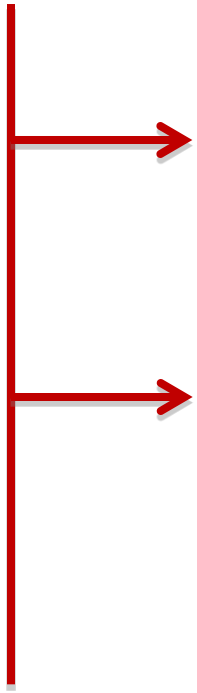
  - Secured creditors and unsecured creditors are in the same committee and vote together!

  - Junior and senior creditors vote together!

- The only possibility to exclude the shareholders is during an asset sale process, however such asset sale (equivalent of Sec 363 Sales) process can only occur after a liquidity crisis and courts are not compelled to sell the assets to the highest bidder, secured creditors in France can be made worse off than they would have been, had the company been liquidated

- Valuation issue is not something which is properly addressed in France

III. The main flaws of French bankruptcy law



Allows junior categories monetize their vote

Violation of priority rules, whether during bankruptcy proceedings or during out-of-court negotiations

IV. What should be done in order to have more efficient pre-insolvency proceedings?

❖Valuation issues during formal bankruptcy proceedings must be properly addressed

- A consistent framework should be created for fast judicial resolution of valuation disputes in restructurings, short of formal insolvency proceedings

- This would enable practice and precedent to develop in restructuring valuations providing stakeholders with relative certainty of outcome, whilst avoiding the value loss that arises through administration and/or liquidation

❖An “Absolute Priority rule” must be introduced

- Shareholders in particular in France often hamper out-of-court negotiations and prevent a sound restructuring of the balance sheet of the company which emerges from the bankruptcy proceedings with too much debt

V. What is going on in France right now ?

- The current draft « Macron » law introduces a shareholder cram-down principle and is currently reviewed by the French Parliament

- Shareholders' hold out has been the main concern of the Ministry of the Economy over the last two years; same issue arises in other Member States even if shareholders' hold outs are much more noticeable in France

- However, many flaws are noticeable in the law (cram down is only possible during redressement judiciaire valuation is not adressed etc.)

Contact

Sophie VERMEILLE

Droit & Croissance
Rules for Growth Institute
+ 33 (0) 6 73 04 89 90

svermeille@droitetcroissance.fr
www.droitetcroissance.fr
http://fr.linkedin.com/in/sophievermeille

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