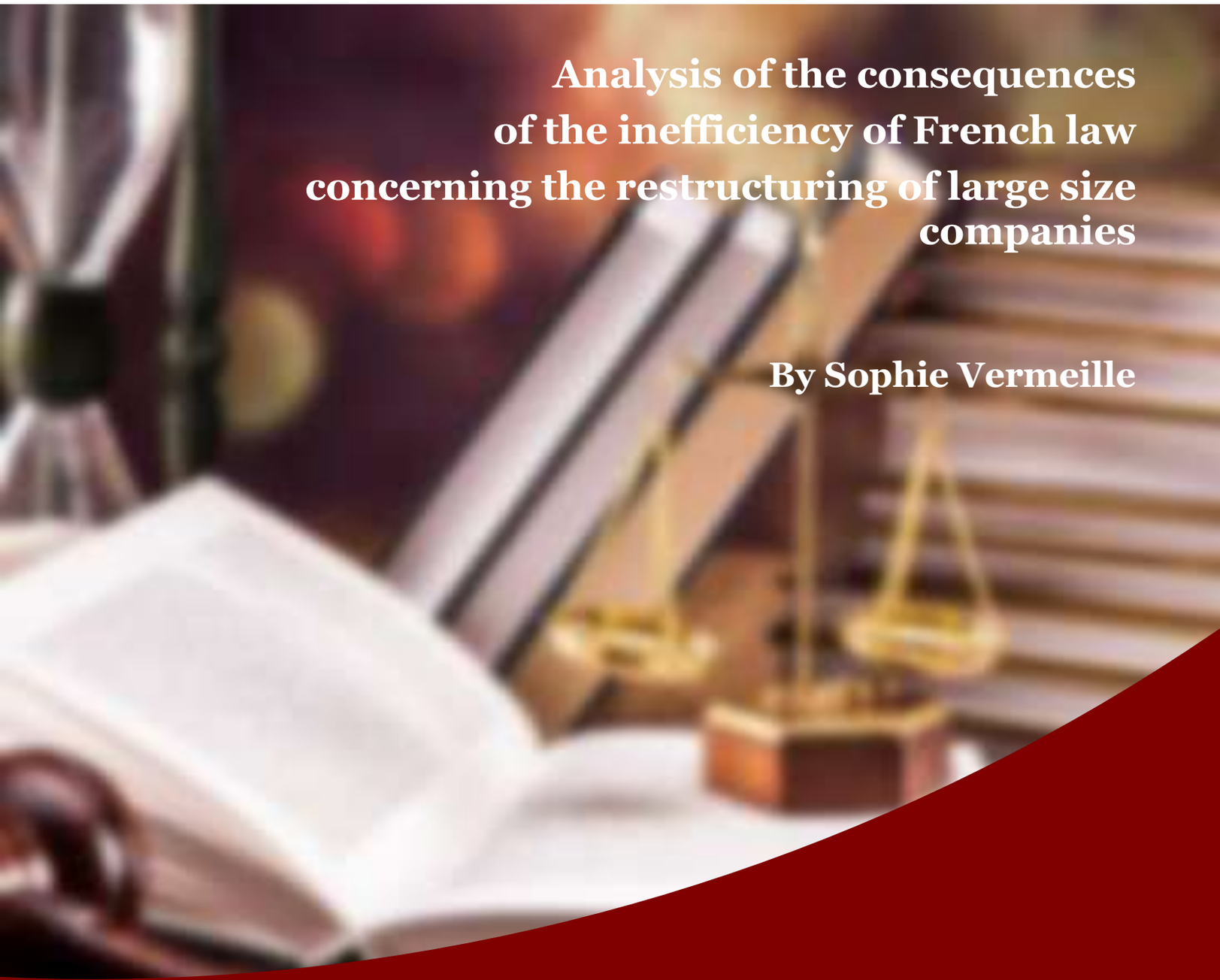
BOND WORKOUTS, DISTRESSED EQUITY OFFERINGS AND STATE INTERVENTIONISM



Analysis of the consequences of the inefficiency of French law concerning the restructuring of large size companies

By Sophie Vermeille

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Sophie Vermeille is the founder and president of the Droit & Croissance (Rules for Growth) Institute. She is also an attorney specialized in mergers and acquisitions, as well as restructurings and special situations. Sophie Vermeille is connected to the *Centre de recherches en économie du droit* (research center for law and economics) at the University of Paris II, Panthéon Assas; she is also a member of the Conference of European Restructuring and Insolvency Law (CERIL) since its foundation in 2015. Her research principally involves the economics of corporate insolvency law, and stock market and banking regulations, as well as corporate governance. She currently teaches these subjects at HEC [*Ecole des hautes etudes commerciales* (grande école for business and management studies)] Paris and the ESCP [*école superiére de commerce de Paris* (Paris graduate school for management)] Europe. Since 2009 Sophie Vermeille has published numerous articles highlighting, by means of the economic analysis of French law, the deficiencies leading to its economic inefficiency. Many of her publications are translated into English and are accessible on the Social Science Research Network site (www.ssrn.com).

She takes part on a regular basis at international conferences at the request of public institutions such as the IMF, the World Bank, the European Commission, the European Central Bank or the European Investment Bank as well as national institutions such as the *Autorité des marchés financiers* (French financial markets authority (AMF)), the *Autorité de contrôle et de résolution* (French prudential supervisory authority (ACPR)) or the *Banque de France* (French central bank). She also takes part in conferences world-wide intended for professionals in the restructuring of companies in difficulty, in particular in connection with the INSOL (International Association of Restructuring, Insolvency and Bankruptcy Professionals) and the Turnaround Management Association.

Declaration of interests:

The views expressed in this article are exclusively those of the author. The author certifies that no relationship exists liable to influence the content of the views expressed herein in one way or another.

In her capacity as an attorney Sophie Vermeille has defended the interests of:

- the Regroupement PPlocal association, one of two associations for the defense of the interests of individual shareholders of the Solocal Group, between September 2016 and January 2017, subsequently to the finalization of an initial version of this article,

- the association of individual shareholders of CGG as of May 15, 2017, that is, fifteen days before this article was submitted for publication on June 2, 2017.

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SUMMARY

Between 2009 and 2017, 82 capital increases were carried out by companies in difficulty listed on the Euronext exchange following cash contributions by their existing shareholders. Out of these 82 transactions 30 were carried out by companies seeking to raise more than 50 million euros during this same period. The French State played a role in more than one-third of these major transactions.

Except in those cases where creditors agree to major concessions in the form of debt waivers entailing, as the case may be, a significant dilution of shareholders' rights, such recapitalizations result in a massive transfer of wealth from subscribers to creditors, who are thus distanced from the risk of corporate default. An analysis of the stock market performance of those shares issued in connection with the 30 most significant transactions confirms that this type of transaction often constitutes a risky gamble for their subscribers and sometimes unnecessarily delays in-depth restructuring of the company's debt.

The risk that these distressed equity offerings prove to be ruinous for shareholders and, in the end, contrary to the interest of the companies, is even greater when their balance sheet is complex and their debt is dispersed over financial markets. Such situation renders obtaining concessions from creditors in exchange for a contribution of fresh money more difficult. In this respect, it is symptomatic that no company listed in France has ever carried out a public offer for the exchange of bonds for shares, which, aside from insolvency proceedings, is the only means of realizing a significant waiver of bond debt.

In a context which is propitious for the development of European bond markets and the optimization of the financial structure of companies, the risk of a future multiplication of ruinous distressed equity offerings as well as costly insolvency proceedings is very high.

The purpose of this study is to demonstrate that the deficiencies in French law render the latter responsible for these negative effects:

1) it is impossible for a large French company to organize public offers for the exchange of bonds for shares in order to obtain significant concessions from their creditors since it cannot use the opening of insolvency proceedings as a credible threat,

2) the rules relating to corporate governance inadequately protect creditors, as well as minority shareholders, from the risky choices of their managers, often put in a state of denial confronted with the magnitude of the difficulties, and

3) the obligations of transparency and information of financial markets incumbent upon companies are inadequate for enabling investors to truly assess the risks of distressed equity offerings.

The intervention of the State, again acting too systematically as shareholder of last resort, serves as a stop gap measure for the inefficiency of French law.

Whenever State intervention takes the form of aid, the European Commission is obliged to force companies to make painful concessions in order to avoid distortion of competition on the Common Market.

Moreover, State intervention is such as to misleadingly encourage minority shareholders, who are not as well informed, to take unnecessary risks in order to reinforce a company's equity.

For all of these reasons, France has everything to gain by a major reform of its law, in particular insolvency law. In order to do so, it must rely on the initiative of the European Commission acknowledging the fundamental importance of adopting minimum standards concerning insolvency law for growth in Europe, made public on November 22, 2016.

Such reform would allow a market to develop for the acquisition of control of large companies in difficulty by the purchase of their debt on the secondary market and promote the intervention of private investors capable of becoming majority shareholders of companies in difficulty, irrespective of their size.

Ultimately, only the creation of such a market for controlling large companies in difficulty will allow the fatality of certain «distressed» equity offerings to be avoided, thereby reducing the losses incurred by poorly informed minority shareholders, as well as the unnecessary risks that the State is often forced to assume by acting as shareholder of last resort.

This empirical study is completed by a detailed analysis of the restructuring of Bull, Technicolor, CGG, the Solocal Group, Eurotunnel, Alcatel, Alstom, PSA Peugeot Citroën, Areva and General Motors.

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INTRODUCTION

1. – **Thirty major recapitalizations of listed companies between January 2009 and May 2017.** Between January 2009 and mid-May 2017, not less than 101 recapitalizations of listed companies took place on the Euronext market as a result of financial difficulties. Amongst such transactions 82 gave rise to the issuance of new common shares, with maintenance of preferential subscription rights (PSR), authorizing existing shareholders to take part in the reinforcement of their equity. These 82 transactions concern 62 companies amongst which only 21 involved transactions, the amount of which exceeded 50 million euros[1]. Furthermore, these 21 large companies were at the origin of 30 recapitalization transactions with maintenance of preferential subscription rights (out of our sample of 82 companies), a certain number of them having made several public offers in order to resolve their financial difficulties[2].

2. – **These thirty transactions are listed hereinafter and are mentioned in greater detail in Annex 1**: Faurecia in May 2009, Club Méditerranée in June 2009, Imerys in June 2009, Mersen (formerly Carbonne Lorraine) in October 2009, Technicolor in May 2010, Futuren (formerly Theolia) in July 2010, Michelin in September 2010, Groupe Partouche in August 2010, then again in May 2011, Soitec in July 2011, PSA Peugeot Citroën in March 2012, Sequana in July 2012, Technicolor again in July 2012, Soitec again in July 2013, Alcatel-Lucent in December 2013, Gascogne in May 2014, PSA Peugeot Citroën again in June 2014, Solocal Group in June 2014, Soitec in July 2014, Sequana again in July 2014, Futuren again in December 2014, Eurodisney in February 2015, Monte-Carlo Société Anonyme des Bains de Mer in March 2015, OL-Groupe in June 2015, Latécoère in September 2015, CGG in February 2016, Vallourec in May 2016, Soitec again in June 2016, Solocal Group again in May 2017 and soon EDF in June 2017. In the next few months Air France[3] and again CGG[4] should be added to the list. Before 2009 we shall recall certain resounding recapitalizations, such as those of Eurotunnel in the 1990s-2000s[5], France Telecom in March 2003[6], and Alstom in May 2004[7].

3. – **Definition of a distressed equity offering**. The recapitalization of the 21 large companies, appearing in our sample, often took the form of a distressed equity offering. For the purposes of this study we shall classify as such any capital increase carried out by means of contributions in cash, to the exclusion of any conversion

1 - A more detailed description of the sample of companies appears hereinafter at paragraphs 17 et seq. This study was made based on the analysis of 218 prospectuses between 2009 and May 19, 2017, concerning 213 distinct transactions, the purpose of which is the issue and admission of capital securities on the Euronext market (as well as, in the special case of Vallourec, securities giving right to the company's capital to the extent that the issuance, at first, of bonds redeemable for shares and not shares, was intended to very temporarily mitigate the absence of authorization of the transaction by the Brazilian competition authority at the time of issuance). These prospectuses are all available on the French Financial Market Association "AMF" site: www.amf-France.org. Out of the 101 transactions addressed to existing shareholders, a small number gave rise to warrants that could be exercised immediately at the time of the recapitalization and for a short period, which was nevertheless greater than that of a preferential subscription right. For the purposes of this study, such transactions were considered to be transactions with maintenance of preferential subscription rights.

2 - Certain recapitalization transactions are less than 50 million euros but were retained in the sample of the 30 major transactions in order to highlight what became of the 21 companies in difficulty that sought market-based financing at least once, in order to recapitalize themselves for a total amount in excess of 50 million euros, taking into account other capital increases carried out concomitantly with the issuance of new shares with the maintenance of preferential subscription rights. The restructuring of the Belvédère company in 2013 was not retained in the sample in spite of the massive conversion of debt into shares leading to a change in control to the extent that it did not lead to the issuance of shares with preferential subscription rights. The restructuring of Belvédère led instead to the free attribution of relutive warrants for the benefit of the shareholders, which may be exercised over time over several years. Cf. Prospectus of the Belvédère company, approval no. 13-162 of April 16, 2013. Areva was also not retained in the sample. This is also a special case to the extent that the company is about to be split in three. Thereafter it shall be the subject of a public buy-out offer followed by a mandatory squeeze-out before being recapitalized.

3 - BFM TV, «*Air France n'échappera pas à une recapitalisation de capital*» [Air France shall not escape a recapitalization of capital], February 16, 2017. Furthermore, in 2014 Air France had already benefitted from the support of its parent company, Air France KLM, in order to issue a loan on the market thereby facilitating its debt reduction. See, Prospectus of the Air France company, approval no. 13-0077 of March 19, 2013.

4 - Le Figaro, «*La valeur du jour à Paris – CGG : l'augmentation de capital se rapproche*» [The security of the day in Paris – CGG: the capital increase is drawing near], February 22, 2017.

5 - Challenges, «*La chronologie d'Eurotunnel*» [The chronology of Eurotunnel], December 1, 2010.

6 - Libération, «*1000 millions d'actions pour France Telecom*» [1,000 million shares for France Telecom], March 25, 2003.

7 - Nouvel Obs, «*Alstom : les banques donnent leur soutien*» [Alstom: the banks lend their support], June 3, 2014.

of debt into shares, implemented for the benefit of a company, complying with at least three of the five following criteria: (i) the transaction is presented on the market as being essential to the immediate survival of the company, (ii) the company has a high level of indebtedness leading to a speculative rating or close to being so, (iii) the company has interrupted the payment of dividends or has not distributed dividends in the course of the last three years, (iv) the subscription price of the new shares has a greater than 30% discount in relation to the face value of the market price immediately before the announcement of the transaction, (v) the issuance of shares leads to a significant dilution (greater than 25%) of the rights of those shareholders not having taken part therein. According to this definition, 25 out of the 30 transactions listed in Annex 1 can be classified as distressed equity offerings.

4. – **A distressed recapitalization without significant concessions by the creditors.** In all distressed equity offerings creditors make little or no significant concessions. For the purposes of this study we shall use this term for any form of debt waiver carried out in the form of a loan or simple bond, granted by the creditors, with or without compensation.[8]. In the absence of significant concessions, a distressed recapitalization transaction results in a transfer of a part of the financial risk borne by the company's creditors to its shareholders. The proceeds from a distressed equity offering may be used for multiple purposes, such as (1) wiping off prior liabilities, leading to increasing the transfer of wealth brought about by the shareholders for the benefit of the creditors, (2) financing the operational restructuring plan of the company (lay-offs, reorganization of activities, etc.), or (3) financing investment projects indispensable to continuing the company's activity, which cannot be financed by debt considering the level of indebtedness of the company.

5. – **The decisive factors of the risky gamble of shareholders who take part in distressed equity recapitalization transactions.** By taking part in such transactions, the minority shareholders of the company must have two hopes:

> 1°) that in spite of its momentary difficulties, the mid-term cash flow prospects of their company are greater than the amount of its debt; such prospects may depend on the implementation of restructuring and/or investment transactions as announced by the company. In other words, the recapitalization transaction is liable to be financially beneficial for the shareholders provided the company is solvent. For that reason, the capital increase must be carried out sufficiently upstream from the difficulties, and
>
> 2°) that the recapitalization transaction will create adequate positive net value in order to satisfy their performance requirements. Considering the risks incurred they should be legitimately high. It should be recalled that the higher the investment risk the greater the shareholder's right to hope for high remuneration. In an open economy a shareholder disposes of investment opportunities having varied risk profiles.

6. – **Inadequate stock market performance of shares issued in connection with distressed equity offerings in relation to performance of the CAC 40 over the same period.** Our analysis of the 25 distressed equity offerings, concerning only 18 different companies, highlights a failure rate of approximately 30% (bearing in mind that four issuances were carried out between 2016 and 2017). For the purposes of this study, any distressed equity offering is a failure if followed, within less than four years, by a new distressed equity offering or an in-depth restructuring of the balance sheet, entailing a massive conversion of debt into shares, itself leading to a dilution of more than 80% of shareholders' rights. Our study also points out the weak profitability for shareholders of distressed equity offerings. Using as our reference the evolution of the CAC 40 for each of the shares issued over an identical period, it can be seen that in half of the cases (12 out of 24[9]), the stock market performance of the shares remains less than 1.5 times than that of the CAC 40, which may be considered as a reference

8 - Also excluded from the definition is a modification of the terms and conditions of debt instruments giving right to capital with maintenance of preferential subscription rights. Moreover, whenever the consideration for the waiver of debt is the issuance of new shares, the subscription price of said shares is necessarily greater than the subscription price of the shares issued, as the case may be, in exchange for a cash contribution.

9 - EDF (French national electricity board) is excluded to the extent that the clearing and settlement of the shares, issued in connection with a capital increase with maintenance of preferential subscription rights, shall take place in June 2017.

of the performance of a share having a standard risk profile. This situation is not without effect with respect to companies that unnecessarily delay in-depth restructuring of their balance sheet.

7. **– A risky gamble of the shareholders with respect to the average return offered by shares of companies in difficulty.** Empirical studies confirm the poor investment choices of shareholders who take part in distressed recapitalizations, in spite of the transfer of wealth to the detriment of shareholders who did not take part therein. These studies highlight that the average return on a share of companies in difficulty is indeed too low in relation to the average return observed in companies in good health in an identical sector of activity[10]. The academic world has thus classified as a «distressed puzzle», the persistent query with respect to the reasons liable to explain the existing discrepancy between (i), on the one hand, the theory according to which the shareholders of a company in difficulty necessarily require a higher return considering the risks incurred, and (ii), on the other, the observed reality as appears from empirical studies. As mentioned, companies structure their distressed recapitalization transactions so as to encourage their shareholders to take part therein[11]. The issuance of new shares is carried out at a price that brings to light a significant discount in relation to the market price. However, often such discount does not appear adequate with a view to reducing the risk taken by shareholders subscribing to the transaction considering the existence of transfers of wealth made for the benefit of the creditors.

8. – **An omnipresent French State in the restructuring of large French companies**. The State shareholders, understood here in the broadest sense of the term, was led to play a role in 12 out of the 30 transactions in the sample, either as an existing shareholder at the time of their recapitalization or, most often, as «shareholder of last resort»[12], contributing its financial support at the time of recapitalization. The guarantee granted by the State to PSA Finance constitutes a thirteenth intervention. The State is understood here as meaning the State *stricto sensu*, acting through the *Agence des participations de l'État* (French government shareholdings agency (APE)), the *Caisse des Dépôts et consignations* (French deposits and consignment office (CDC)), a *sui generis* public body or Bpifrance (BPI), a stock corporation jointly held by the State and the CDC. Regardless of size, the State shareholder was led to play a role, between 2009 and mid-May 2017, in 16 out of the 82 transactions giving rise to the issuance of new shares with preferential subscription rights. This is not surprising considering the State's level of intervention and commitment in the economy, which, according to the *Cour des Comptes* (French court of auditors) has no equivalent in the OECD[13].

9. – **A State shareholder that is too rarely a winner.** In such context, one may question the conditions and motivations of such recapitalizations; thus by providing emergency funding as shareholder of last resort, the State agrees to taking a much higher risk than that of all the other investors due to its more unfavorable position in the order of priorities. The State thus subscribed to 11 out of the 30 recapitalization transactions in our sample (excluding EDF as the clearing and settlement is to take place in June 2017). It received fair compensation for the extreme risk it incurred (more than 1.5 times than that of the CAC 40) in less than half of the cases (four out of eleven). These were: PSA Peugeot Citroën in 2014, Vallourec in 2016 and, to a lesser extent considering the amount of its participation, Gascogne in 2014 and Soitec in 2016 (the latter having recorded a spectacular success following numerous failures)[14]. Before 2009, one must also remember the capital gains realized by the State in 2004 in respect of Alstom, even if we may question the conditions of this sale to Bouygues which hoped to also recover Areva by means of this acquisition[15]. Aside from certain rare securities having enjoyed a speculative success and in which the State is not intended to be substituted for specialized funds, the State consistently loses large sums in this type of transaction, as was notably the case in CGG in 2016, Sequana in

10 - Ch. C. Opp, «*Learning, Optimal Default, and the Pricing of Distress Risk*», 2015, available on SSRN: http://ssrn.com/abstract=2181441. J. Park, «Equity Issuance of Distressed Firms», 2015; J. Campbell, J. Hilscher, J. Szillagyi, «*In search of distressed risk*», 2016, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract _id=2785210.

11 - Cf. § 102 et seq.

12 - As opposed to the expression of the role of «lender of last resort» of the European Central Bank for the refinancing of banks.

13 - Cour des comptes, «*L'État actionnaire*» [The State shareholder], 2017, p. 52.

14 - See, Annex 1 of the study.

15 - The restructurings of PSA Peugeot Citroën, Alstom and Areva are the subject matter of a detailed description.

2012 and 2014 but above all Areva and soon EDF and SNCF (French national railway company) according to the opinion of certain specialists. Even if the public undertaking status of the company requires a different approach to the handling of difficulties, it must not obscure the importance of conditioning State intervention in insolvent companies on the absorption of losses by creditors, as long as the State may not be criticized for having directly interfered in the management of the companies in which it is investing.

10. – **Questions concerning the terms and conditions of such recapitalization transactions.** Distressed recapitalizations of large companies constitute a French exception in several respects and raise the following questions:

1°) Why are large French listed companies so prompt to launch themselves into risky distressed recapitalizations without previously requiring significant concessions on the part of their creditors, as is the custom in numerous countries?

2°) For what reasons do creditors of such large companies not impose greater requirements on managers to carry out in-depth restructuring of the company's debt, as in done in numerous countries, in order to avoid the failure of the company in which they shall bear the losses?

3°) For what reasons do minority shareholders of such companies agree to take part in distressed recapitalizations that are so risky for the shareholders?

4°) What is the liability of the managers of French companies who cause their shareholders and their companies to incur such risks?

5°) What are the reasons compelling the State to assume, in France, the role of shareholder of last resort in both public and private companies?

6°) Why does the State not systematically compel creditors to make concessions in order to reduce its risk and limit the cost for public finances of this type of recapitalization?

11. – **Deficiencies in French law that increase the risk of shareholders' losses.**

This study shall attempt to demonstrate the existence of a causal connection between the specificities of the handling of the difficulties of large French companies, such as the elevated risks incurred by shareholders taking part in recapitalizations and certain well identified deficiencies of French law, in particular insolvency law. We shall use a comparison with American law since several empirical studies have already demonstrated that recapitalization transactions carried out by companies in difficulty were more frequent in Europe than in the United States[16]. Assuming that French law is in line with the average of European companies, minority shareholders *a priori* run a greater risk of taking part in a distressed recapitalization in France than in the United States.

12. – We shall seek to highlight the connection existing between legal deficiencies and:

1°) the difficulties encountered by large French companies, whose bond debt is dispersed over French markets, in restructuring their debt in-depth, other than by means of any insolvency proceeding; this

16 - J. Franks, S. Sanzhar, «*Evidence on debt overhang from distressed equity issues*», 2006, EFA 2005 Moscow Meetings Paper, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm? abstract_id= 570068. An American study reports a quasi-inexistent number of recapitalization transaction in 1995 carried out by American companies, L. Senbet, J. Seward, «*Financial distress, bankruptcy and reorganization*», 1995, in R. Jarrow, et al., Eds., Handbook in OR & MS, Vol. 9, Chapter 28. Nevertheless, this last study has been contradicted by others. See, E. Fama, Kenneth French, «*Financing Decisions: Who Issues Stock?*» 2003, CRSP Working Paper No. 549.

analysis will enable us to highlight the deficiencies of French insolvency law;

2°) the difficulties encountered by creditors in exercising control over company managers allowing them to compel them to give priority to in-depth debt restructurings; this analysis will enable us to highlight the deficiencies of French insolvency law as well as French corporate law, in particular deficiencies in the rules of corporate governance;

3°) the inadequacy of the protection afforded minority shareholders in connection with distressed recapitalizations; this analysis will enable us to highlight the deficiencies of French law in respect of financial markets;

4°) the ease with which the managers of French companies put their minority shareholders at very high risk by requesting them to subscribe to distressed recapitalizations without incurring their own liability; this analysis will enable us to highlight the deficiencies of French corporate law, in particular in respect of corporate governance;

5°) the frequency of the intervention of the French State in distressed recapitalizations is explained by the absence of a market enabling opportunistic investment funds to play the role that is theirs in other countries; this analysis will enable us to highlight the causal connection between the absence of such market and the deficiencies of French insolvency law;

6°) the terms and conditions of the intervention of the French State which often accepts the risk of a shareholder of last resort, rather than the lower risk of lender, thereby causing considerable public financial losses to be incurred, sometimes in violation of European rules concerning State aid.

13. – **A field of study not yet adequately explored**. We intend to highlight the negative effects of French law, in particular those, well known today, of insolvency law, in the handling of difficulties of large listed companies, on complex balance sheets. These negative effects can be seen in the major difficulties encountered by listed companies having recourse to bond markets for in-depth restructuring of their debt as well as in the losses that such difficulties cause companies, their minority shareholders and the State shareholder to bear. We shall show that these losses are also the consequences of deficiencies in corporate governance rules and in securities law that, in France, offer investors inadequate protection. To our knowledge all such negative effects have never been studied from this perspective, whether in French or foreign academic publications. Empirical studies, however, have already established a direct connection between the deficiencies in respect of corporate governance, on the one hand, and the frequency of distressed recapitalization transactions, on the other. [17]. We intend, however, to go further in this study in order to establish a causal connection between the inefficiency of insolvency law and the frequency of these transactions. The existence of such connection would partially explain the dissonance of the «distressed puzzle» mentioned earlier.

14. – **A demonstration in nine observations**. We will attempt to demonstrate the existence of a causal connection between the deficiencies of French law and the above-mentioned negative effects by relying on nine empirical observations resulting from the economic analysis of traditional law as applied to French law:

1st observation: The power of negotiation of a company manager, desirous of obtaining from bond creditors an exchange of their bonds for shares in connection with a public offer, depends greatly on the credibility of the threat of the opening of insolvency proceedings if the offer fails. The absence of public offers of exchanging of bonds for shares in France is indicative of the inability of insolvency proceedings to reinforce a manager's negotiation power upstream from the insolvency proceeding. If the law offers no leverage to a manager in order to both compel and convince the bond creditors to accept his public exchange offer, the manager remains condemned to revising his ambitions downwards

17 - J. Park, «*Equity Issuance of Distressed Firms*», op. cit.

and satisfy himself with a mere rescheduling of the debt.

2nd observation: An insolvency proceeding does not enable a manager to compel bond creditors to agree to significant concessions since it offers no means of unilaterally authorizing a decrease in the amount of the company's bond debt. Moreover, French insolvency proceedings do not afford any protection for facilitating the financing of the company during its observation period, which period is, however, crucial for preparing an alternative plan in case of failure of the public offer. Under such circumstances a manager has no incitement in obtaining significant concessions from the bond holders.

3rd observation: French insolvency proceedings, which are characterized by complex and uneconomical rules and a highly uncertain outcome do not enable creditors to determine the financial gain for them of an alternative to an insolvency proceeding. Managers, therefore, do not dispose of any means for convincing bond creditors of the advantage for them of a public offer of exchange. The absence of clear rules for anticipating and understanding how a French insolvency proceeding would distribute risks in a foreseeable, equitable and transparent manner considerably increases the risk of rejection by the bond holders of an alternative offer of exchange, sometimes letting them be convinced that the opening of an insolvency proceeding will be more favorable for them.

4th observation: The rules of French insolvency proceedings do not allow for ensuring the conditions necessary for the emergence of a market for control of large companies in difficulty, the debt of which is dispersed over financial markets. The absence of opportunistic investment funds liable to consolidate the debt of such companies concentrated in a few hands in order to eventually take control, created a negative effect on French managers. Such situation sometimes enables them to enjoy a privilege rarely afforded their American counterparts: freeing themselves from any financial discipline. The absence of managers' duty of loyalty vis-à-vis their creditors is also such as to exacerbate such irresponsibility considering the natural propensity of managers to put off making difficult decisions.

5th observation: Failing incitement or means of significantly reducing the level of debt, a French manager is more easily inclined to have recourse to distressed recapitalizations. The economic theory known as «debt overhang» postulates that rational shareholders should normally refrain from taking part in transactions presenting such a considerable financial risk. Nevertheless, empirical studies carried out in Europe as well as our analysis of French cases show a discrepancy between theory and practice.

6th observation: The discrepancy between theory and practice is explained firstly by the difficulty for minority shareholders, who are in an asymmetrical information situation, to correctly assess their property interest in such transactions. This discrepancy is also explained by the propensity of a minority shareholder to be trapped by his own cognitive biases which sometimes prevent him from adopting rational behavior.

7th observation: The discrepancy between theory and practice is also explained by the conflict of interests in which the manager finds himself, frequently finding a personal interest in organizing a distressed recapitalization in order to maintain his benefits, in particular his employment and/or to avoid marring his resume with an insolvency proceeding with respect to a company he is responsible for. More generally, the discrepancy is explained by the inadequacy of French rules of corporate governance which do not afford minority shareholders with any effective tool for protecting themselves against the natural tendency of managers to have a company in difficulty run an excessive risk under such circumstances.

8th observation: The discrepancy between theory and practice can finally be explained by the frequent participation of the French State in distressed recapitalizations and the absence of a transparent and competitive market for acquiring control of large companies in difficulty. Up until now, the State often assumed the role of shareholder of last resort without adequately seeking to reduce the cost for public finances of its intervention. The intervention of the State is such as to misleadingly encourage less well

informed minority shareholders to take unnecessary risks in order to reinforce a company's equity.

9th observation: The American insolvency proceeding known as «Chapter 11» affords the manager of a company in difficulty powerful leverage for both compelling and convincing bond creditors to accept significant concessions. Chapter 11 thereby avoids having the U.S. Treasury contributing its aid to companies by assuming the maximal risk borne by a shareholder of last resort.

15. – **Outline**. For all of these reasons the French lawmaker must cause our law to evolve and our legal framework in order to be more efficient. He may profitably take inspiration from recent initiatives of the European Commission which has already identified insolvency law as an absolutely essential factor in stabilizing company debt as well as the development of investment and growth in Europe.

16. – Our study in thus structured in **three parts**:

1°) In the **first part**, we will evoke the factors that are decisive for the success of recapitalization transactions which depends essentially on obtaining significant concessions from creditors,

2°) In a **second part**, we will show, in nine stages, the causal connection between the deficiencies of French law and the negative effects of the financing of companies on the bond markets, as well as distressed recapitalization transactions for shareholders, growth and public finances.

3°) Lastly, in a **third part**, we will call upon the lawmaker to definitively change approach and propose a certain number of recommendations in three main legal fields (i) insolvency law, (ii) securities law, and (iii) corporate law, notably corporate governance.

PART I: ANALYSIS OF THE FACTORS THAT ARE DECISIVE FOR THE SUCCESS OF DISTRESSED EQUITY OFFERINGS

A) HIGH NUMBER OF FAILED CAPITAL INCREASES DUE TO INADEQUATE CONCESSIONS BY CREDITORS

17. – **Capital increases carried out by companies in difficulty? Due essentially to difficulties encountered in their sector of activity.** Over the period that was observed, between 2009 and May 2017, a fairly clear distinction may be made between capital increases carried out in the midst of financial crisis during the first years, from capital increases carried out between 2012 and 2017 during the sluggish phase of growth. In 2009, the number of recapitalizations was significantly greater than during the other years for the same period. Sixteen capital increases with maintenance of preferential subscription rights were carried out in 2009, out of a total of 82 transactions between 2009 and May 2017. The propagation of the financial crisis to the real economy and the closing of the banking market forced listed companies to have recourse to equity markets in order to (i) finance their ongoing activities, (ii) observe their commitments in terms of financial ratios, and (iii) mitigate the risk of the non-refinancing of their debt that was soon maturing. As shown in our table in Annex 1[18], Faurecia and Club Méditerranée were in such a situation. Companies in difficulty, having carried out capital increases in the course of the last four years, were confronted with greater structural problems related to the situation of their sector of activity, such as the paper industry or energy sector. Such difficulties led them to more rapidly contemplating an in-depth restructuring of their debt, by means of an insolvency proceeding if necessary.

18. – **Capital increases by companies in difficulty definitely differ from other capital increases**. Capital increases organized by listed companies, meeting the following criteria, shall not be included within our analysis:

(i) Capital increases by companies in relative good health for the purposes of financing major acquisitions. For example, the capital increases following the acquisition by Airgas of Air Liquide for 10.7 billion euros[19] or the acquisition of the Groupe Bostik by Arkemu for 1.74 billion euros[20]. The partial financing of major acquisitions by means of equity rather than debt enables the purchaser to maintain its rating vis-à-vis investors;

(ii) Capital increases organized by growing companies that have never had profits in the past are consequently financially fragile. These companies essentially develop products, notably pharmaceutical products, the success of which is uncertain and relatively remote. The uncertainty weighing on the market prevents financing the activity by means of debt;

(iii) Capital increases carried out by companies in order to improve their rating. These increases mainly concern small listed companies; larger companies have the possibility of recourse to the issuance of hybrid securities having a less dilutive effect on the capital[21]. In this way the issuer hopes to compensate the cost for the shareholders taking part in such capital increase by savings resulting from the interest rate applicable to lower debt. It is not always easy to make a distinction between this type of transaction and the capital increases of companies in difficulty used in our study.

18 - See, also, the prospectus of the Faurecia company, approval no. 09-109, dated April 27, 2009 and Club Méditerranée, approval no. 09-124, dated May 6, 2009.

19 - Prospectus of the Air Liquide company, approval no. 15-426 of September 12, 2016.

20 - Prospectus of the Arkema company, approval no. 14-602 of November 18, 2013.

21 - Cf. infra § 65.

19. – **A transfer of wealth inuring to shareholders taking part in the capital increase and to the detriment of shareholders who do not.** According to a British study of approximately two thousand listed companies located in the United Kingdom, the announcement by a listed company of a recapitalization transaction entails, on average, a decrease of more than 10% of its market price[22]. The decrease reflects the existence of a considerable transfer of wealth from the historical shareholders of the company to the shareholders subscribing to the capital increase [23]. This transfer is even greater with respect to companies in difficulty. The price of subscription to a distressed equity offering is practically always significantly less than the market price. Our empirical study shows that the subscription price may be up to 72% less than the face market price of the share (CGG establishing a record in 2016), before the announcement of the transaction, even though the transaction may be extremely dilutive for existing shareholders, going as high as 75% (CGG establishing a new record in 2016)[24]. Except in the case where the distressed equity offering is guaranteed by the support of a majority shareholder, the greater the company's financial difficulties, the greater the discount applied to newly issued shares and the more likely the company is to issue large quantities of shares in relation to the number of shares existing at the time the transaction is announced.

20. – **A risk of transfer of wealth inuring to creditors absent adequate concessions**. Whenever an issuance is carried out by a company in difficulty there also exists a high risk that the capital increase will affect a transfer of wealth between the subscribing shareholders, on the one hand, and the creditors, on the other, for whom, owing to this equity contribution, the risk of default is kept at a distance[25]. Such risk does not prevent companies in difficulty from carrying out distressed equity offerings. On the contrary, the more the company is in difficulty, the higher the probability it will have recourse to capital increases[26]. As mentioned earlier, this phenomenon, observed both in the United States and Western Europe, is, however, more pronounced in Europe[27]. According to our sample, in France, out of the 213 recapitalizations giving rise to the admission of shares on the regulated market, 101 took place due to the company's financial difficulties. Nevertheless, unless the creditors make significant concessions to the company, shareholders should renounce taking part in such capital increases that affect a transfer of wealth for the benefit of the creditors.

21. – **Empirical studies that confirm a relatively low number of significant concessions by creditors**. In the afore-mentioned British study[28], two-thirds of the capital increases correspond to capital increases that could be classified as distressed equity offerings, without a significant concession by the creditors. An empirical study carried out in Germany involving 54 companies pointed out significant concessions in only 26% of the cases[29]. In our more reduced but more recent sample, out of the 82 transactions giving rise to the issuance of shares with maintenance of preferential subscription rights, due to company difficulties, regardless of size, 27% gave rise to significant concessions.

22. – **The difficulty of comparing the results of the empirical studies**. It is not obvious to compare results as the empirical studies carried out in the United Kingdom and Germany were carried out more than ten years ago, that is, before the eruption of the financial crisis and the beginning of the stagnation of growth in Europe. It was a period where confidence in the future justified the small number of concessions by creditors. As we shall see, since then the level of company debt has considerably increased and the macroeconomic stakes have never so required a decrease in the level of company indebtedness. For these reasons we had to raise more

22 - J. Franks, S. Sanzhar, «*Evidence on debt overhang from distressed equity issues*», op. cit.

23 - Ibid.

24 - See, Annex 1

25 - S. Myers, «*The Determinants of Corporate Borrowing*», 1977, Journal of Financial Economics 5, 147-175.

26 - J. Franks, S. Sanzhar, «*Evidence on debt overhang from distressed equity issues*», op. cit. E. Fama, K. French, «Financing Decisions: Who Issues Stock?», 2004, CRSP Working Paper No. 549, available on SSRN: https://ssrn.com/abstract=429640 or http://dx.doi.org/10.2139/ssrn.429640.

27 - J. Franks, S. Sanzhar, «*Evidence on debt overhang from distressed equity issues*», op. cit.

28 - J. Franks, S. Sanzhar, «*Evidence on debt overhang from distressed equity issues*», op. cit.

29 - R. Keifer, «*Essays in corporate finance*», London Business School PhD Thesis, University of London.

significant concessions in our empirical study, made based on data collected on the most recent French company capital transactions.

23. – **A risky gamble for shareholders in light of the high number or failed distressed equity offerings.** Certain companies knew perfectly how to recover following a distressed equity offering. More recently, the recapitalization of the Vallourec group was a real success and enabled the group to surmount the oil crisis that severely affected the financial situation of the group's customers. Vallourec's shareholders, who took part in the capital increase in March 2016, realized a latent capital gain in excess of 160% as of the date hereof. Major successes are, however, rarer than resounding failures [30]. The Solocal Group company also carried out a distressed equity offering in 2014[31], whose sole purpose was the reimbursement of existing liabilities. Less than two years later its difficulties necessitated the opening in June 2016 of an *ad hoc* mandate, which in March 2017 gave rise to an in-depth restructuring of the balance sheet and a very considerable dilution of shareholders' rights. The failure of CGG's recapitalization in January 2016 is another resounding example. Beginning in November 2016 the company announced that it contemplated the massive conversion of its bonds into shares[32]. The failure of a distressed equity offering rarely enables the company involved to thereafter recover. Of all the distressed equity offerings that failed at least once, in our sample the Soitec company alone enjoyed a very significant and drastic recovery following a fourth recapitalization transaction[33].

B) A LEGAL FRAMEWORK THAT LEAVES SHAREHOLDERS FREE TO TAKE PART IN DISTRESSED EQUITY OFFERINGS

24. – **The absence of legal constraints encumbering shareholders taking part in recapitalizations.** Some justify the carrying out of distressed equity offerings in the name of the order of priority of absorption of existing losses between shareholders and creditors[34] and an alleged duty of shareholders to reinforce a company's equity. However, this duty incumbent on the shareholders is not reflected in law. In fact:

1°) on the one hand, the contribution to the losses of a company, as provided by law [35], means as it does, at the time of liquidation, to be paid secondarily following the wiping off of liabilities,

2°) on the other, the obligation to restore a company's equity in the case of losses in excess of half of the capital[36] does not mean that shareholders must redress a company's financial difficulties under all circumstances. The law allows them to dissolve the company instead. The formation and development of a veritable market for controlling large companies requires, however, a more modern reading of the laws. Henceforth, the alternative to shareholders' refusal to recapitalize the company is not its dissolution but a) either the forced dilution of shareholders' rights, or b) the sale of all of the assets to a third party or its own creditors[37]. Any other interpretation of the duty of shareholders would amount to calling into question the principle of the limited liability of shareholders in capital companies, which

30 - Prospectus of the Vallourec company, approval no. 16-126 of April 7, 2016.

31 - See, Annex 1 and Capital, «*Solocal Group ne respectera probablement pas ses covenants bancaires en juin et septembre*» [The Solocal Group shall probably not observe its banking covenants in June and September], June 23, 2016. It will be noted that only one year earlier the company had also proposed a subscription to the capital increase to its own employees.

32 - BFM Business, «*CGG se prépare à une restructuration de sa dette*» [CGG is preparing to restructure its debt], November 10, 2016.

33 - Le Revenu, «*Soitec poursuit son rebond spectaculaire*»[Soitec is continuing its spectacular recovery], December 9, 2016.

34 - In spite of the contractual commitment undertaken by the company to repay its creditors, the violation of which may be sanctioned by the opening of insolvency proceedings, by definition creditors, just as the shareholders, assume a financial risk. Creditors, however, are presumed to absorb losses after the shareholders. The order of absorption of losses to the bias of shareholders is the counterpart of the shareholders' unlimited right to receive the profits of the company. Conversely, creditors' economic interest in a company is capped in principle; this is the very essence of the status of the holder of a debt obligation.

35 - French Civil Code, Art. 1832.

36 - French Commercial Code, L.225-248 with respect to simplified joint-stock companies, simplified joint-stock companies with a sole shareholder and stock corporations, L.223-42 with respect to limited liability companies and limited liability companies with a sole shareholder.

37 - Once a market exists for control of company in difficulty, the fate of its shareholders must be dissociated therefrom. Accordingly, the company must continue its activity if such activity is viable in spite of the inadequate support of its shareholders. The development these last few years of a market for the control of companies in difficulty, in particular owing to the development in finance, must lead to making a summa divisio concerning the handling of company difficulties between, on the one hand, small companies for which there is no market and for which liquidation is often the only option that may be envisaged and,

principle is essential to the economy[38]. Legal exceptions to this principle are limited, as in the case of direct interference of a shareholder in a company's business, which is at the origin of the difficulties.

25. – **Lack of monitoring is inadequate for justifying the taking part of a shareholder, even a majority shareholder, in a ruinous capital increase.** Apart from those cases in which a company's financial difficulties are directly attributable to a shareholder's direct interference in the management of its business, a shareholder should not be compelled to recapitalize a company. Lack of monitoring is an inadequate reason. Such exoneration of liability is the offshoot of the principle of the limited liability of shareholders, indispensable to the investment and economic development of a company[39]. Moreover, in a difficult macroeconomic context, the support of a majority shareholder of a ruinous capital increase is not the solution for the lasting recovery of the company (except if the majority shareholder is at the same time the principal creditor of the failing company). Under such circumstances, it is often preferable to sell their companies under conditions allowing for a veritable reduction of debt.

26. – **Undue payment of dividends is one of the rare exceptions justifying the taking part of a majority shareholder in a ruinous capital increase.** The support by a majority shareholder of a ruinous capital increase may be explained by his concern for protecting his reputation. Without actually being legally bound to do so, a majority shareholder may be desirous of taking part in a distressed recapitalization in spite of the insolvency of the company and thereby agree to take part in a transfer of wealth to the creditors. Let us take the example of a private equity fund that acquired a target company in connection with an LBO (leveraged buy-out) almost exclusively with the use of loans. At the time of acquisition, the private equity fund could have overestimated the target's capacity to generate future profits, or could not have anticipated major operational upheavals, significantly calling its target's business plan into question. Aside from the initial error in the choice of the target, the private equity fund may also commit an error in requiring the early repayment of its equity investment by obtaining payment of extraordinary dividends. The fund thereby benefits from the cash reserves of the latter at the time of its acquisition, but correlatively weakens the financial situation of the target company. Under these circumstances, the pressure of creditors on the private equity fund is great. In order to protect its reputation, the latter may agree to subscribe to a capital increase at the level of its target company, for the sole purpose of reducing the loss of the creditors. The Solocal Group matter is a topical illustration of a case of the taking part by the sponsors of an LBO transaction in a recapitalization transaction whose sole purpose is to reimburse existing liabilities. Following the transactions, the sponsors of the funds progressively sold their stakes on the market.

C) AN ECONOMIC CONTEXT INCREASING THE RISK OF RUINOUS DISTRESSED EQUITY OFFERINGS AND NECESSITATING, RATHER, IN-DEPTH RESTRUCTURINGS OF THE BALANCE SHEET

27. – **Up until now a small number of in-depth balance sheet restructurings of companies.** Between 2009

on the other, large companies for which such a market exists. The latter may take the form either of the taking of control by debt, or the acquisition of all of the assets of the company, freed of its liabilities, by a third party or most often by the creditors, in exchange for the abandonment of at least part of their debts.

38 - To systematically require shareholders to reinvest in a company in order to wipe off its losses would have extremely disastrous effects for our economy. Companies would see themselves closed to outside capital which condition, however, is essential to the growth of companies. Shareholders may indeed often be criticized for poor monitoring of its managers. Such poor monitoring, however, may not justify in and of itself an obligation incumbent upon shareholders to bail out the company.

39 - In principle, each company is liable for its own debts only: a parent company is not liable for the debts of its subsidiary, any more than a subsidiary can be held liable for the debts of its parent. Case law frequently calls this principle into question in order to reduce the consequences of a company closing with respect to its employees. Recently, in the Metaleurop matter, the Appellate Court of Douai ordered the parent company, Recyclex, to compensate the ex-employees of Metaleurop Nord, its subsidiary in the process of being wound up. The ratio legis lay in the fact that the parent company had made «damaging decisions» for its subsidiary «which aggravated its economic situation». The arguments of the Appellate Court are questionable since the damaging fault could not call into question the principle of limited liability of shareholders. It would be necessary to demonstrate fraud (CA Douai, Chambre sociale, January 31, 2017, no. 13/03983; La Voix du Nord, «*Recyclex condamnée en appel à indemniser 189 ex-salariés licenciés de Metaleurop*»[On appeal Recyclex ordered to compensate 189 laid-off former employees of Metaleurop], January 31, 2017). If the principle of the limited liability of shareholders is not observed, investors would renounce investment decisions on the pretext that they are too risky. Another way to «punish» the majority shareholder is to modify the legal framework in order to be able to assess certain distributions of undue dividends. The rules of stock capital are today obsolete in this regard and the scope of application of the nullity of suspect periods must be improved Cf. S. Vermeille, «*L'inadaptation du droit français à l'évolution de l'économie et de la finance*» [The unsuitability of French law to the evolution of the economy and finance], 2012, RTDF no. 2.

and 2017, few recapitalization transaction, however, have given rise to significant concessions on the part of creditors. In fact, amongst the 30 restructurings of our sample, we can exclude only five transactions (it should be noted, however, that for one of them, Eurodisney, its parent company was at the same time its main creditor[40]). When they succeeded, these transactions have all led to the dilution of shareholders' rights, in such manner that the latter hold less than 14% of the capital following recapitalization (sometimes even less following the conversion of various financial instruments giving future access to the capital). These transactions have therefore given rise to changes in control, except when the debts converted into shares were held by the majority shareholder, as in the case of the restructuring of Eurodisney[41]. In more than one-third of the cases, these transactions were preceded by a distressed equity offering, the companies thus hoping to avoid a change in control and a massive dilution of shareholders' rights.

28. – **In-depth restructurings of balance sheets that facilitate the recovery of the company.** Whenever creditors massively convert their debts into shares, the risk of the transfer of wealth from the shareholders taking part in the recapitalization is limited. Existing shareholders are requested to take part in the recapitalization of a company that was previously considerably out of debt. This was the case, for example, at the time of the issuance of new shares with maintenance of preferential subscription rights carried out by the Latécoère company in 2015[42]. It can be seen that this type of transaction leads to failure (characterized by a second transaction in less than four years) in only one out of five cases (it being noted, however, that certain transactions, such as Solocal in 2016, are still too recent to assess what will become of them). Out of the five transactions that have been studied and appearing in the Annex, four transactions succeeded and led to a stock market performance of between two and five times that of the CAC 40 over the same period. The fifth, Technicolor, was subject to a new capital increase in 2012 for reasons we shall discuss further on [43].

29. – **Macroeconomic conditions rendering in-depth restructurings of company balance sheets increasingly necessary.** Since the major financial crisis of 2008 the need to be able to reduce the debt of viable companies even more has become a major priority. In comparison, in the 1980s, the debt of companies in difficulty that merited the avoidance of liquidation was most often only rescheduled. Rescheduling was adequate to the extent that competition amongst companies was not as great as today. Moreover, economic cycles were short. Accordingly, following a short period of recession, growth rapidly recovered and even heavily indebted companies could meet payments once things improved. It was in this context that the Law of 1985[44] was introduced. It specifically provided for the possibility for courts to impose on all the creditors (including creditors having a security interest) the adoption of a reorganization plan. It did not, however, envisage the possibility of forcing debt reduction by the forced dilution of shareholders' rights. This period is gone. Henceforth, a good number of companies have no other choice than an in-depth restructuring of their balance sheet by reducing the amount of their debt as shown by our empirical study. Amongst the capital increases in an amount in excess of 50 million euros, most of those accompanied by in-depth balance sheet restructurings took place after 2014. The greater need for companies to restructure their debts is the result of a combination of circumstances:

1°) **greater and greater optimization of the financial structure of companies, leading to favoring financing by debt, rather than by equity**: the level of the credit bubble before the 2008 crisis; the magnitude of the credit expansion phase preceding the 2008 crisis was historic, companies never before being able to have such recourse to indebtedness to finance themselves; the financial innovation of the last thirty years upset the practice and increased the capacity of company indebtedness, incited tax-wise in that respect; the amounts of debt to be restructured in balance sheets of companies, although having a viable activity, has never been so great,

40 - See, Annex 1.

41 - Prospectus of the Euro Disney S.C.A company, approval no. 15-021 of January 14 2015.

42 - Prospectus of the Latécoère company, approvals no. 15-452 of August 19, 2015 and no. 15-301 of June 23, 2015.

43 - Cf. *infra* p 27 for a detailed description of the Technicolor matter.

44 - Law no. 85-98 of January 25, 1985 on judicial reorganization and liquidation of companies.

2°) **a world without growth, thereby not allowing debts to be repaid even if their payment is deferred**: the long period of recession/stagnation in Europe subsequent to the bursting of the crisis; France, as the rest of Europe, has undergone a long phase of recession immediately following the triggering of the crisis (with a 3% decrease in GDP in 2009); it thereafter had slight recovery and for more than five years an unusually very long phase of stagnation; for this reason the Anglo-Saxon world has baptized this period since 2008 as the Great Recession,

3°) **several major economic upheavals world-wide**:

a) **the globalization of exchanges and the increase in competition in the goods and services sector** increased pressure on companies, in particular those in capital sectors of activity, such as the telecommunication sectors,

b) **the energy transition** with, in particular, the arrival of shale gas and the sustained drop in the price of oil is also a source of major changes in the oil and oil services sector,

c) **the digital revolution which, following an initial incursion in the sector for the trading of goods, has little by little upset all the sectors of activity of the economy**: under these circumstances, i) business models of companies, even large ones, are called into question, ii) it is difficult for companies to durably maintain an unbalanced balance sheet structure at the risk of having to renounce investment efforts that are indispensable for maintaining their existence, and iii) the value of the tangible assets of companies continues to fall; it should be noted that the switch in the intangible economy is accelerating the destructions of value as soon as there are difficulties.

30. – **Large listed companies whose safeguarding is particularly dependent on the capacity of creditors to make significant concessions**. The explanation of this situation is the following:

1°) **the reorganization of large companies is more likely than mid-size companies to generate surplus value in relation to a liquidation scenario**[45]. It is therefore indispensable for these viable but sometimes insolvent companies to obtain significant concessions from their creditors in order to survive. They must be able to avoid having recourse to distressed equity offerings which only delay difficult decisions and give priority to in-depth restructuring of their balance sheets; with respect to more mid-size companies, the settlement of difficulties most often occurs by a sale of the assets of the company;

2°) **large companies are more likely to optimize their financial structure in order to reduce the cost of the capital**: they are increasingly likely to have recourse to complex financial instruments conferring different rights on their investors, seeking a varied risk/return profile: this situation increases the risk of conflicts of interest amongst the various categories of investors in case of financial difficulties, rendering the obtaining of significant concessions more difficult;

3°) **large companies are more likely to have recourse to financial markets in order to finance themselves, either the Paris stock exchange, or the Luxembourg stock exchange, in order to reduce their capital cost**; considering the evolution of banking regulations and financial markets, the financing of large private companies by bank debt is increasingly rare. In the past, very large amounts could only be financed owing to debt, such as Eurotunnel at the time of the construction of the tunnel under the Channel[46] or Alstom in 2004[47]. These situations no longer exist today. Practically all large listed companies have recourse to bond debt. Certain even have recourse to the high yield market. This situation leads to a large dispersion of the debt amongst a great number of holders; there must therefore be successful coordination amongst all the creditors at the time of negotiations.

31. – Listed companies, for which distressed equity offerings shall be decreasingly adequate for ensuring a continuous future for the company. For all of these reasons, shareholders of listed companies should be less inclined to take part in distressed equity offerings considering the increased risk of the transfer of wealth to creditors. Managers shall have to be more rapidly convinced of the need of in-depth restructuring of their debts.

45 - *Cf. infra* § 66.

46 - *Cf. infra* for a detailed description of the Eurotunnel matter, p. 57.

47 - *Cf. infra* for a detailed description of the Alstom matter, p. 68.

D) THE ABSENCE OF PUBLIC OFFERS OF EXCHANGE OF BONDS FOR SHARES OR THE IMPOSSIBLE IN-DEPTH BOND WORKOUTS

32. – **Several methods for reducing the debt of large companies**: Aside from recourse to a capital increase in order to repay debt, a decrease in the level of indebtedness of large companies may result from:

1°) **a sale of non-strategic assets provided that the proceeds from the sale are used to repay the debt;** there is a non-negligible disadvantage to such solution with respect to listed companies, since potential purchasers, informed of the difficulties encountered by the companies due to the rules of transparency and financial communications imposed on such companies, are in a strong position to negotiate a discounted price[48]; the shorter the restructuring timetable, the greater the risk of the destruction of value.

2°) **a partial cancellation of the debt;** the waiver of debts may sometimes be made without concession, as the creditors often require compensation. A debt waiver without compensation amounts to the sparing of the shareholders whose presence in the capital of large companies is not indispensable to the company's recovery[49]. Such compensation may be financial and be achieved, for example, by an increase in the rate of interest or the payment of a consent fee, that is, remuneration in cash, immediately payable within the framework of the restructuring. Most often this type of remuneration is inadequate. Compensation may also take the form (i) of a debt instrument, whose nominal value is less than that of the instrument delivered in exchange; such new debt instrument may, however, have higher priority than prior debts[50], and/or (ii) the delivery of shares, that is, an economic right to the company's future profits[51].

33. – **Reducing the debt: the choice between an amicable restructuring or a coercive restructuring within the framework of an insolvency proceeding.** Even if the cancellation of debt in compensation for the issuance of new shares was never as necessary as at this time, such transaction, however, remains difficult to implement for large companies having a complex balance sheet. In such companies the debt is in fact often held by a large number of creditors dispersed over financial markets with very different profiles. The companies thus have two ways of restructuring their debt:

1°) amicably, upstream from an insolvency proceeding with the consent of each of the creditors having taken part in the discussions, whether in a purely contractual framework, with the help of an *ad hoc* administrator, as the case may be, appointed by the court upon petition of the company, or within the framework of a conciliation proceeding, ending, as the case may be, by ratification of the plan by the Commercial Court;

2°) in a coercive manner for the creditors, within the framework of an insolvency proceeding (safeguarding proceeding or judicial reorganization); there are a certain number of disadvantages to this solution considering the impact vis-à-vis suppliers, customers or employees.

34. – **Complexity of the French legal framework considering the appearance of «hybrid» proceedings, halfway between an amicable proceeding and an insolvency proceeding**. Over time, this *summa divisio* (amicable/insolvency proceeding) has become very blurred in France. The lawmaker believed he was facilitating the rapid handling of company difficulties by instituting «hybrid» proceedings (accelerated financial safeguarding proceeding, accelerated safeguarding proceeding) which may lead to compelling creditors to accept a plan, without having all the attributes of a veritable insolvency proceeding. In fact, not all creditors are

48 - E. Eckbo, K. Thorburn, «*Economic Effects of Auction Bankruptcy*», 2009, Tuck School of Business Working Paper No. 2009-63, available on SSRN: https://ssrn.com/abstract=1387347; D. Faulkner, S. Teerikangas, R. Joseph. (eds), «*Acquiring Distressed and Bankrupt Concerns*», 2012, The Handbook of Mergers and Acquisitions, Oxford University Press, available on SSRN: https://ssrn.com/abstract =2128535.

49 - Conversely, a waiver of debt without compensation may be justified in smaller-sized companies for which no market exists for their control. Such a waiver allows for encouraging the manager, who is often also the founder, to remain in the company in order to line up the interest of the latter with that of the creditors concerned by the recovery of the company once they measure that the on going concern value is greater than the net asset value. The waiver of debt is, however, rare in practice since, for psychological reasons, banks have a hard time making this type of concession for the benefit of the company manager they consider responsible for the difficulties of the company and therefore the calling into question of the rights of the creditors. In the course of the restructuring of Sequana in 2014, the waiver of debt was forcefully obtained owing to the intervention of the *Comité interministériel des restructurations industrielles* (French inter-ministerial committee for industrial restructurings) (CIRI)). See, prospectus of the Sequana company, approval no. 14-335 of June 27, 2014.

50 - Even if this type of transaction is current in the United States (See, M. Whitman, F. Diz, «*Distressed Investing: Principles and Technique*», 2009, Edition Wiley, paragraph 210), this is not the case in France. The non-observance by corporate law of priority reduces the attractiveness of this type of refinancing once the issuer's assets are located in France.

51 - Whenever a company seeks merely to postpone the maturity date of its debt, it can refinance its bond debt by means of a buy back of its bonds on the secondary market (provided this is authorized by its covenants). The benefit for the company is obvious if: a) the price brings out a discount in relation to the nominal value of the debt, and b) this discount is excessive with regard to the actual state of the debtor's difficulties, to the extent that the latter may have its debt refinanced in parallel by third parties at a lesser price. In practice, this type of buy back is not possible unless the company's difficulties are not too serious. In the alternative, and more rarely, a company may turn to the creditors to whom it is indebted and propose debt instruments in exchange, having a different maturity date and rate. This type of restructuring, however, may prove to not be adequate.

concerned by this type of proceeding. Even if it is a bit too early to draw conclusions concerning their effectiveness, the initial results are very mixed, as testified to by the restructuring of the Solocal Group in 2014. It gave rise to the opening of an accelerated financial safeguarding proceeding, followed by debt restructuring in 2016, this time more of an in-depth restructuring of the balance sheet. This second restructuring then entailed a massive dilution of the shareholders in 2016[52]. For the purposes of simplification of the presentation, in this study we shall treat these «hybrid» proceedings as insolvency proceedings.

35. – **Out-of-court bond workouts require the unanimous decision of the holders**. Apart from an insolvency proceeding, the consent of each of the holders is necessary in order to cancel the principal of the bond debt, just as the conversion of bonds into shares. In this regard, French law, resulting from the Decree-Law of 1935, adopted subsequently to the financial crisis of the 1930s, provides that a certain number of decisions modifying the bond issuance contract may be carried by the qualified majority of two-thirds (in value) of the holders, brought together within a body constituting a legal entity[53]. The bond holders brought together within the body may thus deliberate on any proposal relating to the total or partial waiver of the guarantees afforded the bond holders, to the extension of the due date for payment of interest and to the modification of the terms and conditions of amortization or the rate of interest[54]. Waiver of repayment of the principal of the bond instrument is not one of the prerogatives of the body of bond holders, just as the conversion or exchange of bonds into shares. The rule of unanimity therefore indeed appears to prevail under these circumstances. Case law has never had to confirm this point. Such assertion must be nuanced considering the context in which the law had been introduced. At the time the objective of the Decree-Law of 1935 was to compel holders of bonds to come together within a group, not for the benefit of the issuer with a view to making more flexible the conditions under which the bond loan could be modified, but in the very interest of the holders[55]. The objective was to protect the consent of individual subscribers, although very much in the majority, in order that they are not unduly solicited by the company, one by one, in order to be compelled under pressure to agree to waiving certain of their vested rights as bond holders. It was thus considered preferable that the law impose on the issuers that they bring together their holders all within a body constituting a legal entity before submitting any contract modification to them for their consent. At the time the lawmaker did not think it a good idea to specifically rule on the issue of waivers of the principal of bond instruments and their possible conversion into shares. One could not imagine at that time that companies would solicit their holders to do so. The context has greatly changed since then. Holders of bond instruments are overwhelmingly institutional investors that do not need to be protected by the law, but the Decree-Law has not been modified until very recently. While awaiting this reform which is now imminent and detailed thereafter[56], French law prohibits contractual adjustments to the rules of the body of bond holders with respect to loans made in France. Even if the law does not expressly address waivers of the principal of the debt and conversions into shares, the insertion into bond issuance contracts of what is currently referred to on the sovereign debt market, of «collective clauses»[57], appears prohibited in this regard.

36. – **A rule of unanimity confirmed by international practice.** At the same time, in the 1930s, Americans made a totally other choice than the French lawmaker. In order to protect their investors hit by the financial crisis and numerous frauds, American authorities legislated in order to guarantee, to the contrary of the French lawmaker, that the principal terms and conditions of the contract would not be modified without the consent of each of them[58]. The rules of French law, however, apply only to loans issued in France. French companies are, however, free to issue bonds in accordance with foreign law whenever the loan is intended for investors outside of France. In practice, however, the rule of unanimity almost always applies, the parties waiving using the possibility of making contractual adjustments to the extent that it is international practice to obtain the consent of each of the bond holders[59].

52 - *Cf. infra* p. 30, for a detailed description of the Solocal matter

53 - The Decree-Law of October 30, 1935 was thereafter reiterated *in extenso* by the Law of July 24 1966. The rules relating to the body of bond holders currently appears in Article L.228-46 of the French Commercial Code.

54 - See, French Commercial Code, Art. L. 228-65. It can be understood, nevertheless, that even if the bond issuance contract provides for the deferralt of maturity over several decades and a decrease in the interest rate to 0.1% of the nominal value of the securities at the time of Bull's restructuring, in reality the modification of the issuance contract amounts to a debt waiver, which is legally questionable. *Cf. infra* p. 23, for a detailed description of the Bull matter.

55 - G. Endreo, «*La masse contractuelle des obligataires : état des lieux et pistes de réforme*» [The contractual body of the bond holders: taking stock and exploring reforms], 2014, Bulletin Joly Bourse, December 31, 2014 no. 12, p. 609.

56 - *Cf. infra* §75.

57 - These clauses provide for the possibility of modifying the terms of the bond debt issuance contract with a qualified majority.

58 - *Cf. infra* § 148.

59 - Several situations may be envisaged. Either the company submits the law of the bond issuance contract to a foreign law, often the law of the State of New York or the law of Luxembourg. The rule of unanimity still applies in both cases, in the case of American law. Or the company submits the bond loan to

37. – **Acceleration of the term of bond instruments whenever the unanimous support of holders for a restructuring plan in favor of recapitalization is obtained upstream from the meeting of the bond holders.** Whenever bonds are held by a small number of holders, identified by the issuer, the latter can seek their support, one by one, in favor of a plan providing for an in-depth bond workout. Such scenario is possible whenever a company seeks, for example, to restructure its mezzanine debt held by a small number of investors following a private investment. After having obtained the upstream consent of each of the holders, the issuer proposes the early repayment of the bonds to the meeting of such holders. At the same time, the holders have undertaken to use the proceeds of the repayment for the purpose of subscribing to a capital increase organized in parallel[60]. Such scenario may of course not be envisaged if the debt instruments are dispersed over financial markets and are exchanged in high volumes on the secondary market. The issuer cannot seek the support of its holders, one by one.

38. – **The questionable circumventions of the rule of unanimity, with respect to modifying composite securities giving access to capital, dispersed over financial markets**. In order to restructure bonds, convertible or exchangeable into new or existing shares (OCEANE), certain companies in difficulty submit for the approval of the bond holders, meeting in a general meeting, the conversion of their bonds into shares of the company, under conditions different than those provided for in the initial terms and conditions of the loan, but with the minimum support of the majority in value of the bond holders. In order to compel the minority bond holders to agree to take part in the recapitalization of the company and waive their status of lender, issuers, with the support of the majority of the bond holders, have on several occasions proposed a modification of the terms and conditions of the bond loan. In substance, such modifications led to a partial debt waiver by the bond holders, a ruinous outcome for a holder who is not desirous of making an early conversion of his bond into shares. This circumvention of the prohibition of the rules of the body of the bond holders could be observed on several occasions. In connection with the restructuring of Bull in 2005[61] and to a lesser extent that of Futuren (formerly Théolia) in 2010[62], the circumvention of the rules of the body of the bondholders consisted in (i) extending the maturity of the bond instruments up to 30 years, (ii) reducing the interest rate to 0.1% of the nominal value of the bonds in circulation, and (iii) deleting the early repayment clauses in the hand of the holder. The transaction was justified on the ground that it did not actually harm the holders, to the extent that it was proposed that they convert their bonds under conditions that were more advantageous than initially provided for in the issuance contract (in order to take the exacerbation of the difficulties of the company into account). This method is questionable as the law now stands since the extension of maturity over thirty years and the reduction in the interest rate to 0.1% of the nominal value of the bonds in circulation amounts, from an economic point of view, to a waiver of debt which in principle cannot be imposed (even with a 2/3 majority) on the holders who did not individually consent thereto. In the United States courts have put a brake on the temptation of issuers to circumvent the rule of unanimity following lawsuits initiated by minority holders[63]. Even if this method could have been used for facilitating the restructuring of instruments giving future access to capital, it has never been used for restructuring simple bonds.

The questionable restructuring of Bull

The restructuring of Bull illustrates a case of circumvention of the rules of the body of bond holders, which we will discuss further on in greater detail.

Before being absorbed by Atos in 2014, Bull was a French company specialized in professional IT. The company is synonymous with financial disaster for the French taxpayer. Nationalized in 1982, Bull's turnover was 11.6 billion francs. The State injected capital that reached up to one billion francs per year. In the beginning of the 1990s Bull was in full-blown crisis and incurred 18.4 billion francs in losses in three-and-a-half years. TF1 announced that in three years the taxpayer had lost more than the cost of the Gulf War!

French law, as it has the right to do. However, it can be seen that in practice the parties do not use the right afforded them to make contractual adjustments, probably in order to conform with international practice in such matters. The rules of the French Commercial Code are thus reproduced practically *in extenso*.

60 - By limiting itself to modifying the due date of the bonds, the company thus exempted itself from legally making an offer to buy back the bonds from each of the bond holders. What was involved was a repayment and it is fictitiously considered that the company has the means to repay all of the nominal, enabling the issuance of shares having a nominal value equal to the proceeds of the repayment. If needed, the nominal value of the shares shall have been previously decreased. This technique has its limits whenever what is involved is obtaining the early payability of several series of bonds having different rights. One thus tries to take into account the difference in priority by providing a different price for conversion of the debt into shares for each category of debts.

61 - Boursier.com, «*Bull : précisions sur les Océanes*» [Bull: clarifications concerning the OCEANCES], February 4, 2005.

62 - Prospectus of the Théolia company, approval no. 10-198 of June 23, 2010.

63 - *Cf. infra* § 148.

The Bull group was progressively privatized between 1994 and 1997. The group was fully privatized in 2004. On January 14, 2005 the State injected 517 million euros with a return to better fortunes clause following the green light of the European Commission. Only several million euros have been repaid since then.

In 2004, Bull was recapitalized in the amount of 44 million euros by institutional investors, including France Telecom and Axa Private Equity, subject to modification of the terms and conditions of the contract for issuance of bonds convertible and/or exchangeable into new or existing shares (OCEANE).

In a special meeting of the bond holders, subject to the consent of the European Commission, by a 2/3 majority the bond holders approved the payment by the State of aid in the amount of 517 million euros, extension of the date of repayment of the OCEANCE until January 1, 2033, revision of the annual interest rate to 0.01% of the nominal value as of January 1, 2004, elimination of the repayment premium, as well as waiver of the adjustment of the conversion parity resulting from the implementation of the capital increase.

As compensation for these concessions by the OCEANE holders, the company allowed the latter to take part in the recapitalization transaction alongside the institutional investors. In fact, Bull also proposed a temporary modification of the conversion parity of 10 shares for one OCEANE during 15 days. Beyond this period, the conversion parity was decreased to one share for one OCEANE.

The restructuring of the OCEANE is a circumvention of the mandatory rules of the body of bond holders. It is true that the proposal to modify the terms and conditions of the OCEANE in such manner as to enable the holders to receive a greater share of the capital than that initially provided for may, in appearance, give the impression of improving the lot of the holders (by providing for a more generous conversion ratio of the OCEANE into shares than the previous ratio). In fact, in reality the proposal of the managers with the support of the majority of the bond holders amounts no more nor less than (i) having it being acknowledged that as the company is insolvent, the shareholders have lost everything and must be fully diluted, and (ii) that the OCEANE holders must become the new owners of the company, by converting their bonds into shares.

The plan proposed to the OCEANE holders is not, however, acceptable, from the economic point of view unless (i) said holders can challenge the value of Bull on the basis of which the majority of the bond holders as well as the managers place on record the necessity of having the losses borne by the shareholders and the OCEANE holders thereafter, (ii) the order of priority and absorption of the losses justify requiring the OCEANE holders going from creditor to shareholder, in view of the situation of the other creditors who could be unjustly better treated, and (iii) when a cash contribution is necessary, the OCEANE holders may be able to decide on the conditions of such contribution and not have imposed on them, by the company and the majority of bond holders (who may be in a conflict of interest situation), the arrival of new investors liable to unduly capture the value created by the company in the future, to the detriment of the OCEANE holders.

In the case of Bull all of these conditions were patently not fulfilled. Bull is not the sole case of the circumvention of the rules of the body of bond holders. It is surprising that there has been no litigation.

Bull re-launched its activities in 2008, while continuing to sell numerous assets. In 2014 Atos launched a friendly takeover bid for Bull, valuating the company at 620 million euros.

39. – **Whenever the unanimous consent of the bond holders cannot be envisaged, an amicable restructuring necessitates a public offer of exchange of bond instruments for shares**. Whenever a company has issued one or several series of bonds of more significant size to investors dispersed over the financial markets, it is impossible for the company to address itself directly to each of the bond holders in order to obtain their consent to a bond workout. This is even more difficult in France since often the volumes of exchanges of bonds on the financial markets are significant whenever the issuer has financial difficulties[64]. In such event, in principle the company has no other choice, apart from an insolvency proceeding, than organizing a public offer of exchange of bonds for shares in order to significantly reduce the company's debt.

40. – **A public exchange offer, a solution that in principle is preferable to the *status quo***. The key for guaranteeing the success of a public exchange offer consists of conceiving of an offer in such manner that for each of the bond holders, taking part in the offer is more attractive than foregoing it. In other words, the compensation offered by the company in exchange for the buy back of each bond must be more attractive than maintaining the *status quo*. If the original bonds are exchanged on a secondary market that is sufficiently liquid,

64 - *Cf. infra* § 80.

assessment of the exchange value is easier. The original obligations are exchanged with a discount on the secondary market. This discount is the reflection of the market's anticipation of the loss that the bond holders shall incur, considering the imminence of the debtor's default. The loss of the bond holders is therefore, in principle, already integrated in the price on the secondary market. This loss is also already entered in the accounts of the bond holders which, contrary to the majority of European banks as of the date hereof, keep mark to market accounting. According to this accounting method, the holders are required to enter in their accounts any variation in the price of the debt on the secondary market. This method is the subject of numerous controversies[65]. Applied to debt instruments issued by companies in difficulty it provides important advantages. Once the loss is entered in the accounts it is easier for the creditor to make difficult decisions such as selling his bond on the markets or accepting the delivery of shares in connection with a public exchange offer, in order to crystallize his loss.

41. – **A public exchange offer, a solution in principle preferable to the opening of an insolvency proceeding**. In theory, it is not in the interest of bond holders to await the opening of an insolvency proceeding. They should be inclined to accept a public offer, even more so if their loss is already reflected in their accounts. An insolvency proceeding is costly for them since it is costly for the company; it has an impact on its customers, suppliers and employees. If the company is able to dispense with an insolvency proceeding, the bond holders will indirectly benefit therefrom. Such benefit must therefore be found in the value of the compensation proposed in connection with the public offer. In order for the offer to be successful, the effort requested from the bond holders, reflected by the waiver of the repayment of the nominal value of the bonds in connection with the offer, must be less than the gain made by the bond holder. This gain is equal to the difference between the market value of the compensation offered by the issuer and the market value of the bonds on the secondary market (meaning reflecting the cost of the insolvency proceeding plus the cost of the difficulties of the issuer). This is fully possible if the bond holders, concerned by the public offer, bought their bonds with a deep discount in relation to the nominal value of the bonds. The rotation of the debt between numerous investors is frequent at the level of companies in difficulty considering the fact that numerous investors are prohibited from maintaining bonds of companies in poor financial health in their portfolios. Whenever the rating of the issuer is lowered to the level of speculative securities, this automatically triggers the mass sale of the bond. These new lenders, professionals in investing in companies in difficulty, are less likely to be in denial than the original lenders. If the financial conditions are coherent with regard to the company's financial situation, they have no reason to be opposed to a solution consisting in obtaining shares in exchange for their bonds. Unfortunately for the company things are not so simple. In practice, a certain number of obstacles exist to the success of a public offer[66].

42. – **Risks of failure connected to the asymmetry of information of bond holders vis-à-vis managers, which is greater than that of banking institutions vis-à-vis managers.** One of the first obstacles to the parties reaching an agreement is connected to the asymmetry of information existing between the bond holders and the managers of the company. The greater the asymmetry of information between the parties, the greater the

65 - In order to understand the controversies concerning the benefit and pitfalls of mark to market accounting methods, See,. C. Laux, C. Leuz, «*The Crisis of Fair Value Accounting: Making Sense of the Recent Debate*», 2009, Accounting, Organizations and Society, Vol. 34, 2009, available on SSRN: https://ssrn.com/abstract=1392645 . The benefit of mark to market accounting must be kept in perspective whenever the default of the debtor is imminent. Even if the compensation offered in connection with a public offer is similar to the market value of bond instruments on the secondary market, considering the applicable discount, such compensation may not be adequate for encouraging bond holders to take part in the public offer, even if the holders have already entered their losses in their accounting. Bond holders may not be so easily convinced to crystallize their loss by subscribing to the offer, especially if the debtor's default is imminent and they do not have the certitude that the debtor will avoid an insolvency proceeding even in the case of a successful public offer. In such event, the holders may wish to await the opening of an insolvency proceeding in order to crystallize their loss and assert their right to repayment of the nominal value during the proceeding (and not the market value before the opening of the insolvency proceeding) of their bond instruments.

66 - The risk of refusal of dispersed bond creditors to a restructuring agreement is well known by debtors which are sovereign States, as illustrated by the painful restructuring of Argentina's debt in the 2000s (*Cf.* «*L'Argentine, les vautours et la dette»* [Argentina, the debt vultures], Lettre du Trésor-Eco, September 2014, no. 136). The company encounters two types of risk of refusal by bond holders to take part in the public offer, or the hold our risk. The company must, first of all, avoid the refusal of a minority of bond holders within the same series of bonds the majority of which, however, agrees to take part in the public offer. For the reasons discussed earlier, apart from an insolvency proceeding, such minority may not be compelled by the majority, on the ground that the public offer is beneficial for all of the holders in relation to the *status quo*. Whenever a company issues several series of bond debt, it must also avoid that an entire series of bonds refuse to take part in the public offer. Such refusal risks placing the holders whose securities are part of other series of bonds in a situation where they alone must accept the significant concessions necessary for the recovery of the company. In reality, this situation would not be acceptable for the other creditors since the various series of bonds are *pari passu*, that is to say, having equivalent ranking. It would be even less so if the other series of bonds have senior ranking in relation to the dissident series of bonds that refuse to take part in the offer. In any event, the risk of refusal of a public offer is greater whenever the company seeks to optimize its financial structure. The company must then obtain the endorsement of the creditors, this time placed in different situations from each other, in the order of priority and absorption of losses, considering, for example, the signing of subordination agreements or the granting of different guarantees. The debtor must then propose a different outcome to the holders in connection with the public offer, justified by the different situation in which one or several categories of bond holders find themselves. The debtor must therefore be able to explain its choices at the time the offer is launched. From this point of view, the restructurings of company bond debt is distinguished from the restructurings of sovereign debt in the course of which it is customary that all the bonds are *pari passu* (with the exception of emergency loans granted by the IMF and bilateral loans between sovereign States as is the custom), which does not exclude resounding hold outs.

risk of failure of negotiations. Now, this problem is greater between the debtor and its bond holders than between the debtor and banking institutions. In fact, in principle the latter are better informed in respect of the debtor's financial situation than the bond holders. For this purpose, they have privileged access to confidential information in accordance with the negotiated terms of the syndicated loan agreement binding them to the debtor.

43. – **As of this date, no public offer of exchange of bonds into shares in spite of the development of bond markets**. The AMF Internet site does not record any public offer of the exchange of simple bonds into shares. In France, the AMF, however, would necessarily be informed of such transactions. In fact, it is responsible for supervising public offers whenever the company is listed on a regulated market or a multilateral system of negotiation. The rules it promulgates apply not only to classic public acquisition offers but also to public offers for exchanges of securities admitted for trading on regulated markets, regardless of the compensation. A public offer for the exchange of bond securities in exchange for bonds obeys rules that are different than public offers of bond securities in exchange for shares[67]. In the current macroeconomic context, it is symptomatic that no large French company has attempted to restructure its bond debt by launching a public exchange offer. The market for the restructuring of the bond debt of listed French companies should have evolved like that of debts of unlisted companies on the LBO market which has undergone a wave of debt conversion into shares since the 2008 crisis[68].

44. – **A situation in contrast to the practice of public offers in the United States.** The situation in France is unique in relation to the United States. Studies show that in America, even if in the majority of public offers of exchange being geared to holders of senior debt, it is proposed to the latter repayment in cash (29%) or another senior debt security (38%), the majority of securities offered to junior bond holders are shares (67 %)[69]. Do large French companies have less bond debt than large American companies to the point of not having recourse to exchanges of bonds for shares in order to guarantee their continuity? This is highly unlikely.

45. – **Low recourse of French companies to insolvency proceedings, in spite of the absence in France of the public offer of exchange of bonds into shares**. With the exception of two companies that opened a safeguarding proceeding, Technicolor in 2010 and Groupe Partouche in 2013, the companies appearing in our sample have always been restructured other than by means of an insolvency proceeding, whether a safeguarding proceeding introduced into French law in 2005[70], or judicial reorganization, introduced by the Law of 1985[71]. As concerns the Solocal Group, it was the object of an accelerated safeguarding proceeding introduced by the Ordinance of March 12, 2014[72], which led to the adoption of a negotiated restructuring plan during an *ad hoc* mandate then a conciliation proceeding[73]. Belvédère was a special case. The company opened a safeguarding proceeding in 2008 then a judicial reorganization proceeding in 2012[74]. In the case of Belvédère, the managers were strongly criticized for opening a safeguarding proceeding in that it was opened without prior negotiations with the creditors. In this very special matter, the managers were furthermore shown to be guilty of violating a restrictive covenant prohibiting the company from redeeming its own shares on the markets[75]. In the case of

67 - The public offer of exchange of bond securities for bonds does not necessitate compliance with the rules applicable to exchanges into shares whenever the bonds are not admitted for trading on a regulated market. The general rules of the AMF provide for a special procedure for such purpose. This type of public offer, however, remains relatively rare as debtors prefer, whenever possible, the buying back of bonds. The buy back price on the bond securities market is thus financed by a new issue the conditions of which are necessarily more advantageous. Considering the small number of public offers of exchange of bonds for other bonds, uncertainty exists concerning the application of certain mandatory rules in respect of public offers for share acquisitions. By way of illustration, the rule of single prices in public offers of acquisition, enabling the protection of shareholders to be ensured, could not be applied in the case of a public offer involving bonds. Accordingly, an issuer may propose a higher price at the beginning of a public offer to holders of bond securities who agree to exchange their bond upstream from the public offer.

68 - S. Vermeille, S. Bardasi, «*L'intérêt de l'analyse économique du droit dans le traitement du surendettement des sociétés sous LBO*» [The benefit of an economic analysis of law in the handling of over indebtedness of companies subject to LBOs] 2014, RTDF no. 3.

69 - J. R. Franks, W. N. Torous, «*A comparison of financial recontracting in distressed exchanges and chapter 11 reorganizations*», 1994, Journal of Financial Economics, vol. 35, issue 3, pages 349-370.

70 - Law no. 2005-845 of July 26, 2005 on the safeguarding of companies enabling a company to be able to open an insolvency proceeding in spite of the fact that it is not insolvent.

71 - Law no. 85-98 of January 25, 1985 relating to the judicial reorganization and liquidation of companies.

72 - Ordinance no. 2014-326 of March 12, 2014 on the reform of the prevention of difficulties of companies and insolvency proceedings.

73 - *Cf. infra* p. 30, for a description of the Solocal matter.

74 - Prospectus of the Belvédère company, approval no. 13-162 of April 13, 2013. For the record, Belvédère does not appear in the sample as the restructuring did not give rise to a capital increase with maintenance of preferential subscription rights.

75 - *Cf.* S. Vermeille, R. Bourgueil, A. Bézert, «*L'affaire Belvédère ou les effets contre-productifs du droit français des entreprises en difficulté – Plaidoyer pour une réforme ambitieuse*» [The Belvédére matter or the counter-productive effects of French law on companies in difficulty – Plea for an ambitious reform], 2013, RTDF no. 3, pp. 17-41.

Groupe Partouche, the opening of a safeguarding proceeding in 2016 came about within a similar context of major dissensions between the company and its creditors, following, successively, a distressed equity offering in 2010[76], then the entry into the capital of a turnaround fund in 2011[77]. Before 2009, the year that our empirical study begins, Eurotunnel was the first French company to have recourse to a safeguarding proceeding, in 2006.

46. – **Low recourse to insolvency proceedings due to the mainly banking nature of the debts of large French companies.** During the period between 2009 and 2017 most large companies in difficulty did not have a financial structure forcing them to open an insolvency proceeding in order to force dissident creditors to accept a conversion of their debts into shares with a qualified majority: Sequana[78], Latécoère[79] or also Gascogne[80], which appear in our study, were all financed solely by financial institutions. Consequently, these companies were all able to obtain significant concessions from their creditors without need to open an insolvency proceeding (even if in the case of Sequanda, in 2014, at the time of the second restructuring, the State, via the CIRL, had to step in in order to force the banking institutions to waive their debt).

47. – **Large listed French companies subject to an insolvency proceeding were all exceptions.** French listed companies had recourse to insolvency proceedings:

1°) either because they had a a very important and complex financial structure; under these circumstances, their managers could not envisage a unanimous amicable agreement and had to resort to opening an insolvency proceeding[81]: these were Eurotunnel, Technicolor and Solocal in 2014; it should be noted that neither Technicolor, nor Solocal tried to organize a public offer of exchange of issued bonds for shares, upstream from the insolvency proceeding (Eurotunnel was exclusively financed by debt); or

2°) because their managers had circumvented the rules of insolvency proceedings in order to unduly free themselves from contractual commitments taken vis-à-vis their creditors (Groupe Partouche, Belvédère); or

3°) because the managers could not opt for a distressed equity offering (or their distressed equity offering failed) absent the support of a reference shareholder or even the State; it should also be noted that the State prohibited itself from lending assistance to Eurotunnel, Solocal and Technicolor, considering their particular histories, moreover common with the State itself, as we shall see further on.

48. – **Distressed equity offerings favored by the State taking part in transactions.** Up until now, and with few exceptions, the managers of listed companies have dealt with their financial difficulties by organizing at least one distressed equity offering. Furthermore, the companies often benefitted from the indispensable support of at least one reference shareholder in order to guarantee the success of the capital increase which, as shown in our annexed table, was often the State. In parallel to these capital increases the managers (i) refinanced their bond debt or obtained adjustments by modifying the terms and conditions of their loans, in order, for example, to defer the maturity of the bonds [82] and/or (ii) sold the assets.

76 - *Cf.* prospectus of the Groupe Partouche company, approval no. 10-259, dated July 16, 2010.

77 - *Cf.* prospectus of the Groupe Partouche company, approval no. 11-126, dated April 20, 2011.

78 - Prospectuses of the Séquana company, approval no. 12-255 of June 12, 2012 and no. 14-335 of June 27, 2014.

79 - Prospectus of the Latécoère company, approval no. 15-452 of August 19, 2015.

80 - Prospectus of the Gascogne company, approval no. 14-237 of May 27, 2014.

81 - Low recourse to insolvency proceedings, in spite of the fact that the lawmaker rapidly became aware of the need to facilitate the reduction of company debt following the bursting of the bubble in 2008. As of 2009, the lawmaker introduced creditors 'committees in large companies in order to impose, in insolvency proceedings, and under certain conditions, the conversion of debt into shares. More recently, the Law of August 6, 2015 for growth, activity and equality of economic opportunity authorized the squeeze-out of shareholders «whenever the labor pool justifies it» in order to facilitate the conversion of debt into shares. For the reasons raised hereinafter, these two measures are nevertheless far from being adequate from the point of view of facilitating the in-depth restructuring of large company balance sheets. Clearly, up to now, large companies in difficulty did not consider insolvency proceedings as a desirable option for facilitating dealing with their difficulties, for the reasons we shall discuss hereinafter. See, also, S. Vermeille, «*Les effets pervers du dispositif du projet de loi « Macron » relatif à l'éviction des actionnaires en plan continuation : les limites d'une réforme incrémentale du droit des faillites*» [The negative effects of the operative part of the "Macron" bill relating to the squeezing-out of shareholders in continuity plans: the limits of an incremental reform of bankruptcy law], 2014, RTDF no. 4; F.-A. Papon, J. Martinez, S. Vermeille, «*La constitutionnalité du projet de loi « Macron » et l'éviction des actionnaires : la révolution n'a pas eu lieu*» [The constitutionality of the "Macron" bill and the squeezing-out of shareholders: the revolution did not take place], February 2015, Revue Banque.

82 - Revisions of the terms of loan agreements, limited to the extension of the maturity date by two or three years and an adjustment of the rate of interest were current transactions in the course of the first few years of the last financial crisis. This was particularly the case at the level of heavily indebted unlisted companies following the carrying out of LBOs. In the wake of the bursting of the financial bubble, the extent of the crisis was still unknown. Parties thus preferred putting off difficult decisions. This type of transaction, however, lasted over the years, even when investors could no longer ignore the seriousness of the crisis and its consequences on the activity of companies. An in-depth revision of business plans was necessary, which was to lead to a significant decrease in the level of indebtedness of the companies involved. The denial of managers and creditors confronted with the extent of the difficulties explains the new name given to this type of restructuring, "amend and pretend*"*. Poor habits were thereafter modified and the LBO market underwent a multiplication of in-depth balance sheet restructurings. *Cf. infra* p 52, for a description of the particularity of restructurings of companies subject to an LBO.

The restructuring of Technicolor[83]

The restructuring of the Technicolor group is of interest since it illustrates the difficulties encountered by a company listed in France whenever the latter must carry out an in-depth bond workout, to the very point of not contemplating organizing a public exchange offer. In the present case, faced with the magnitude of its difficulties, Technicolor could not hope to reduce its debt by organizing a distressed equity offering, even more so in that Technicolor could not count on the support of the capital reference shareholders nor even the State, which prohibited itself from again nationalizing Technicolor. A recall of the facts is necessary.

Historically Technicolor was the general public electronic division of Thomson CSF, which company was nationalized in 1982. The division became independent under the name Thomson Multimedia while the electronic defense and space division of Thomson CSF was privatized and became Thalès.

Throughout the entire period between 2003 and 2012 Thomson Multimédia incurred major economic difficulties. Its historic activity, centered on televisions, vastly suffered from competition from the Asian market. Moreover, its financial situation deteriorated considering the high price which it paid for a certain number of disappointing acquisitions, with a high level of leverage.

The company's debt structure was the following: senior bank loans, senior bond issues and an issuance of super-subordinated securities.

The restructuring necessitated the opening of a safeguarding proceeding at the end of 2009 which was rapidly concluded in February 2010, with a certain amount of success, by the conversion into shares of nearly half of its bond debt and its bank debt in an initial total amount of 2.8 billion euros. By eliminating the rule of unanimity, Technicolor's safeguarding proceeding enabled the pre-negotiated plan with the representatives of the creditors to be approved before the opening of the proceeding. This was a first in France.

The pre-negotiated agreement did not, however, receive the consent of the required majority of the creditors, outside of an insolvency proceeding. In the absence of agreement, Technicolor took the risk of finding itself in insolvency proceedings for an indefinite period.

The failure of amicable negotiations was attributed at the time to the fact that a large number of creditors held CDSs. It is true that the subscription by creditors to credit derivatives is such as to perturb negotiations to the extent where the risk of compensation it thus no longer borne by the creditor but by a third party. The holding of a CDS thereby entails a misalignment between, on the one hand, the personal interest of the creditor having a CDS who has an interest in his debtor's default in order to receive the proceeds of the insurance and, on the other, the collective class of creditors who have an interest in avoiding the default of any company. However, the responsibility of holders of CDSs must not be overestimated in the failure of amicable negotiations, even if the absence of clarity at the time concerning the conditions for calling into play of the guarantee pursuant to the terms of European CDSs could play a role. An American study thus highlighted that the failure of public offers of exchange in the United States was practically never imputable to the holders of CDSs[84].

In reality, the inability of a company to obtain the support of the majority of the creditors which is necessary in an insolvency proceeding to guarantee the approval of a plan, was above all related to the deficiencies in the insolvency proceeding, which failed to allow for a foreseeable, equitable and transparent allocation of risk from the creditors' point of view, as we shall see further on. This weakness of French law had profound repercussions on the attitude of holders of CDSs in the Technicolor matter and explains the great volatility of the debt, even if the opening of the insolvency proceeding was imminent.

Following the safeguarding proceeding, Technicolor's shareholders succeeded in maintaining 16% of the capital. Furthermore, the senior bank creditors and senior bond holders were required to convert a significant part of their debts into shares or bonds redeemable for shares. Moreover, the rights of the holders of super-subordinated securities in a position to be able to block voting at meetings of the bond holders (since they were sitting with the senior bond holders) were not reduced to zero. The principle ? principal ? of the debt was maintained, but the holders lost their right to receive interest. In order to compensate such loss, the

83 - *Cf.* S. Vermeille, T. François, «*Le « feuilleton Technicolor» : et si rien n'était vraiment réglé?»* [The «Technocolor serial»: and if nothing was really settled?], October 2012, La Semaine Juridique Entreprise et Affaires, no. 40.

84 - S. Lubben, «*Credit Derivatives and the Resolution of Financial Distress*», 2008, Seton Hall Public Law Research Paper No. 1133623, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abs tract_id=1133623; M. Bedendo, L. Cathcart, L. El-Jahel, «*In- and Out-of-Court Debt Restructuring in the Presence of Credit Default Swaps*», 2011, CAREFIN Research Paper No. 24/2010, available on SSRN: http://ssrn.com/abstract=1799923.

holders received the sum of 25 million euros in damages whereas they would have had the right to nothing if all of the activity of the company had been sold for its value as a company in the process of being reorganized! The 25 million euro amount corresponded to the valuation of the super-subordinated securities on the market, which integrated the violation of the order of priority allowed by law. This situation entailed numerous lawsuits by the holders of super-subordinated securities who protested the fate reserved them[85].

Thereafter, Technicolor had to continue its restructuring efforts outside of an insolvency proceeding failing being able to emerge from the safeguarding proceeding with an adequate level of debt in relation to its future cash flow prospects.

Considering all of the concessions made at the time of its restructuring, Technicolor had to again recapitalize in 2012. It thus carried out a capital increase reserved to one investor, as well as a capital increase with maintenance of preferential rights subscription rights for the benefit of the historic shareholders. These two transactions were again very dilutive for Technicolor's historic shareholders. The reduction of debt of the company remained inadequate subsequent to this transaction. The shareholders who had benefitted from the restructuring in order to again invest in the company again sustained losses since, as of this day, they have a 30% capital loss as shown in Annex 1.

At the price of titanic efforts, Technicolor succeeded in recovering owing, in particular, to the innovative nature of its new activity. The group is today specialized in the provision of audiovisual production solutions and services, and did not maintain its historic industrial activity.

The distressed equity offering of CGG

The restructuring of CGG, which is on-going as of the date of publication of this article, illustrates the impossibility for the managers of a company with a complex balance sheet to reach an amicable agreement with its creditors.

As from the beginning of amicable negotiations, subsequent to the failure of the distressed equity offering, the managers indicated they were opening a safeguarding proceeding, once the required majority of its bond holders consented, in order to thereafter compel the consent of the dissidents in an insolvency proceeding[86]. At no time was the launching of a public exchange offer envisaged. This situation is not satisfactory since the insolvency proceeding is costly for companies and necessarily delays the date on which the company is able to carry out an in-depth restructuring of its balance sheet. Moreover, such situation encourages company managers to have recourse, as did CGG, to risky distressed equity offerings. A recall of the facts is necessary:

CGG, formerly named Compagnie Générale de Géophysique-Veritas, is a French company specialized in underground exploration. CGG is a world-wide geosciences group in the energy industry (principally oil and gas). CGG's products and services are intended for the imaging and interpretation of current and future hydrocarbon reservoirs, using various technologies and skills involving geology, geophysics, characterization and development of reservoirs.

The sustained drop in the price of oil logically considerably affected CGG's activity.

These last years the level of CGG's cash reserves diminished greatly (385 million euros at the end of 2015 whereas it was 1.5 billion in 2012, from 530 million in 2013 and 359 million in 2014). In December 2015, the group was no longer able to comply with its financial covenants and CGG's level of indebtedness at the beginning of 2016 was 2.8 billion euros.

CGG's financial structure was quite complex since the company was indebted both in France and the United States considering the group's extensive set-up in America.

In such context, on January 13, 2016 CGG launched a capital increase with maintenance of preferential subscription rights intended for all of its shareholders. The reinjection of 350 million euros was thus proposed in order to finance a transformation plan of 200 million euros, the remainder to be used for the company's working capital needs. The issuance was carried out with a 38% discount in relation to the theoretical price

85 - R. Dammann, G. Podeur «*Éclairage – Affaire Thomson-Technicolor : le clap de fin*» [Perspective – Thomson-Technicolor Matter: bringing down the curtain], March 2012, *Bulletin Joly Entreprises en difficulté*, no. 2.

86 - CGG's press communiqué of May 15, 2017.

following the capital increase of the share detached from the preferential subscription rights or "TERP". The transaction was extremely dilutive for those shareholders who did not take part in it. Its reference shareholders, BPI France and IFP Énergies Nouvelles, contributed their support to the transaction[87]. CGG's 350 million capital increase was subscribed to in its entirety.

In parallel to the capital increase CGG offered a part of its bond holders the right to exchange their bonds for loans, accompanied by security interests.

As of November 2016, the company announced its intention to again restructure CGG's debt. Currently a massive conversion of the bond debt into shares is contemplated under conditions that remain to be determined. As the structure of CGG's balance sheet is extremely complex, an agreement concerning the reduction of the level of its indebtedness is extremely difficult.

On May 15, 2017, CGG announced that as of this date no agreement had been reached between its creditors and shareholders for the purpose of approving a safeguarding plan once the company is in insolvency proceedings.

The two successive restructurings of the Solocal Group

As CGG, the restructuring of the Solocal Group illustrates the temptation of managers to carry out distressed equity offerings, no matter the cost, failing the obtaining of adequate concessions from their creditors.

The Solocal Group is the parent company, notably of Pages Jaunes, whose activities previously belonged to the France Telecom group. The Solocal Group is a company engaged in local information research, linking and local advertising, on the Internet, cells and printed matter. The Solocal Group is suffering from the increased competition of new digital players in its sector, beginning with Google.

The Solocal Group furthermore suffers from a historically difficult financial situation. In 2006 France Telecom sold its majority stake in the Groupe Pages Jaunes to the KKR investment fund and the Goldman Sachs bank. The latter acquired the company at a high indebtedness price within the framework of an LBO. Following several distributions of extraordinary dividends for the benefit of the shareholders at the initiative of KKR and Goldman Sachs, the company underwent numerous refinancing and restructuring transactions: an initial restructuring in 2011 leading to a partial extension of the maturity of the debt coming due in 2013 to September 2015, together with a bond issue of 350 million euros in order to partially refinance a part of such debt.

The company then underwent a second restructuring in 2012 in order to obtain a second extension of the maturity date for the quasi-totality of the bank debt. Negotiations were held within the framework of an *ad hoc* mandate.

The company then underwent a third restructuring in 2014 leading to the approval of an accelerated financial safeguarding plan. Pursuant to the terms of this plan, the company undertook a refinancing plan including a capital increase of 440 million euros, subscribed to by the shareholders at the the price of 0.5 centimes, i.e., the equivalent of 15 euros following the consolidation of shares (including a reserved tranche of 79 million and anther of 369 million with maintenance of preferential subscription rights) whose sole purpose was to pay off the existing liabilities! This transaction was to lead to a significant dilution for the shareholders who did not subscribe (approximately 76%). Ninety-one percent of the proceeds of the capital increase were allocated to repayment of the debt[88].

In contradiction with the debt overhang theory, the capital increase was subscribed to in the amount of 254.83%[89]. One year later, the company encouraged its employees to subscribe to a capital increase at the price of 16.80 euros. However, as of June 2016 the company opened an *ad hoc* mandate in order to again restructure its debt. The Solocal Group justified this new restructuring of its debt by the closing of the bond market, rendering impossible the refinancing of the debt as provided for by the restructuring established in

87 - Les Echos, «*Opération sauvetage pour le français CGG*» [Rescue operation for the French CGG], December 7, 2015.

88 - The Solocal Group's press communiqué of February 13, 2014.

89 - Boursier.com «*SolocalGroup : l'augmentation de capital a été très largement sursouscrite* [The Solocal Group: the capital increase was very extensively subscribed], June 4, 2014.

2014. In reality, the closing of the market probably resulted from the defiance of the market with regard to the company.

Following several new rebounds, renegotiations enabled the company to carry out in March 2017, the creditors and shareholders agreeing to an in-depth restructuring of its balance sheet, outside of an insolvency proceeding, which provided for:

- a capital increase of 400 million euros, again intended for the quasi repayment of existing liabilities. This capital increase was very dilutive for those shareholders who did not take part in the transaction. The subscription price was set at 1 euro only per share,

- a conversion of a part of the debt into shares, but pursuant to less advantageous terms than the capital increase in cash, thereby placing on record the crystallization of a loss for the creditors who were thus requested to make concessions they had not made in 2014 under similar terms.

Owing to a provision of the terms and conditions of the high yield bond loan contracted by an affiliate of the Solocal Group, Pages Jaunes Finance & Co S.C.A., a majority of the bond holders furthermore authorized the transfer of the loan between the Solocal Group and the company that issued the bonds, thereby enabling them to hold a direct claim against the Solocal Group and no longer against Pages Jaunes Finance & Co S.C.A. Accordingly, the bond holders became the Solocal Group's creditors in an amount in principal equal to the amount in principal of the bonds they held immediately before the allocation. In such manner, the bond holders were able to continue to directly take part in the discussions that the Solocal Group had initiated with all of its creditors. The structural subordination brought about by the effect of causing the bonds to be issued by an entity affiliated with the parent company was therefore totally relative. However, this mechanism greatly facilitated a bond workout.

In spite of the massive conversion of debt into shares, there was no change in governance of the company and as soon as the capital increase was carried out, a large number of shareholders sold their shares on the markets. As of today's date, the price of the share is slightly higher than the subscription price of the capital increase with maintenance of preferential subscription rights.

49. – **A new paradigm or the importance of being able, in the future, of organizing public offers of exchange and reducing the risk of ruinous capital increases.** Considering the macroeconomic changes in progress and the development of the financial markets, the financial restructuring of large companies must change physiognomy in the future. Accordingly, unless French companies succeed in organizing public offers of exchanges of bonds into shares (it being noted that the consent of 90% in value of the bond holders is considered to be a success in the United States):

1°) due to their increasingly complex financial structure, large companies shall be systematically obliged to have recourse to costly insolvency proceedings. Where appropriate, such recourse shall be subsequent to the failure of a distressed equity offering, which by definition is ruinous for the shareholders;

2°) capital increases may decreasingly become a compromise solution for dealing with financial difficulties, in the absence of adequate concessions by creditors; moreover, due to the progressive bursting of the capital structure of French companies, like the situation in the United States and in the United Kingdom, these capital increases would become decreasingly difficult to organize, in the absence of support from the reference shareholders (unless the creditors guarantee the implementation of capital increases in exchange for the use of the proceeds for repayment the liabilities, as in Solocal's case in 2014, which solution is still more ruinous for the shareholders); the State could find itself increasingly requested to lend their help to large companies in difficulty.

50. – **For all these reasons, one must ask oneself what are the reasons for the absence of public offers of exchange in France.** As the framework of the analysis having being laid down, it is now necessary to run through the various phases of reasoning enabling a connection to be made between the deficiencies of French law and the impossible holding of a public offer of exchange of bonds into shares.

Part II: THE CLOSE CONNECTION BETWEEN THE INEFFICIENCY OF THE LAW, ABSENCE OF PUBLIC OFFERS OF EXCHANGE AND DISTRESSED EQUITY OFFERINGS

A) PUBLIC OFFER OF EXCHANGE: AN IMPOSSIBLE SUCCESS IN THE ABSENCE OF EFFICIENT INSOLVENCY LAW.

1st observation**: The power of negotiation of a company manager desirous of obtaining from his bond creditors the exchange of their bonds into shares within the framework of a public offer, is very dependant on the credibility of the threat of the opening of an insolvency proceeding in case the offer fails. The absence in France of public offers of exchange of bonds into shares is indicative of the inability of insolvency proceedings to reinforce the manager's negotiating power upstream from the insolvency proceeding. If the law offers no leverage to the manager to both compel and convince his bond creditors to accept his public exchange offer, the manager remains condemned to revise his ambitions downwards and make do with a mere rescheduling of the debt or, worse, the opening of an insolvency proceeding.**

51. – Considering the probably disastrous consequences of this impossible ambition to adequately reduce bond debt in an amicable manner or the increasingly systematic opening of insolvency proceedings, an analysis of the causes of the absence of public offers of exchanges of bonds into shares is imperative. In order to understand this singularity of the French market for bond workouts, with regard to American practices, it must be recalled that a public offer is, before anything else, a pollicitation at the debtor's initiative. Before being launched, its content gives rise to negotiations between the managers of the company, on the one hand, and the representatives of the bond holders, on the other, provided that the latter are coordinated. It is important to linger on the negotiation dynamic taking place at this time between the parties to the negotiation. To the extent that the alternative to amicable restructuring is the debtor's default, it is logical that this negotiation dynamic is strongly influenced by the rules of insolvency proceedings which must, if necessary, take over in case of the issuer's default (except to think that in such hypothesis the latter would improbably allow its creditors to seize its assets). One may then suspect that the absence in France of public offers has one or several legal causes. The law must indirectly compel the company's managers (but sometimes also the creditors who may also be desirous of pressing in favor of an in-depth restructuring of the balance sheet) to revise their ambitions downwards and merely request modifications of the terms of the issuance contract that may be legally approved by the body of the bond holders[90]. For these reasons a precise evaluation of the influence of the French legal framework on the nature of the concessions requested by large issuers from their bond holders is necessary, in particular corporate law, securities law and insolvency law.

52. – **As concerns corporate law, French rules framing the conditions under which a capital increase may be carried out do not appear to be such as to explain the absence of offers.** Public offers of exchanges of bonds for shares entail a capital increase of the company. In this regard, French law, in accordance with European law, systematically provides that in the case of a capital increase, whether by a contribution in kind or cash or the conversion of debt into shares, the consent of the shareholders meeting in a general meeting is necessary. Such consent may sometimes take the form of a delegation of power to the board of directors; it should be noted that the terms and conditions of such delegation are regulated by law[91]. Therefore, a French issuer desirous of organizing a public offer of exchange of bonds for shares could not be exonerated from calling a meeting of the shareholders, except if it benefits from a delegation of power. In such case, the board of directors would have the right to carry out a public exchange offer, provided it does not lead to a dilution of the shareholders beyond the threshold of the ceiling imposed by its shareholders at the time of the approval of the delegation of power[92]. In practice, investors, in accordance with the recommendations of proxy advisers, always provide for a relatively low ceiling. It would accordingly be difficult to have recourse to a delegation of power whenever creditors are requested to exchange their bonds for shares. In principle, the conversion of debts into shares of a company in difficulty entails a significant dilution of shareholders' rights. The holding of a general meeting will probably be necessary. In other words, at the time of negotiations, though regarding the

90 - A change in the maturity date or the amount of the interest rate must, however, not be significant to the point of being akin to a decrease in the amount of the principal of the bond instrument on an economic level, which, under French law, implies the necessity of the unanimous consent of the bond holders.

91 - French Commercial Code., Art. L. 225-129-1 *et seq.* A delegation may be made in favor of not only the board of directors but also the executive board. The latter may only set the terms and conditions of the issuance of the shares. A delegation is limited to 26 months.

92 - Increases carried out by remuneration in shares of a public exchange offer are governed by Article L.225-148 of the French Commercial Code, thereby enabling them to escape the procedure for contributions in kind governed by Article L.225-147 of the French Commercial Code.

content of the public offer, the manager and the bond holders must necessarily take into account, in advance, the necessity of convincing the shareholders to be diluted, sometimes massively.

53. – An analysis of American rules applicable to the issuance s of new shares confirms, however, that French rules in such matter do not explain the absence of offers. It is true that in the United States managers appear to have more latitude for organizing capital increases without the consent of their shareholders at least with respect to the provisions of corporate law of the State of Delaware[93]. This assertion must, however, be substantially nuanced whenever companies listed on financial markets are involved. In spite of the applicable corporate law, both the rules of the New York Stock Exchange («NYSE») as well as the rules of the Nasdaq, oblige a listed company to obtain the consent of its shareholders before the issuance of common shares (or composite securities) either 1°) whenever they give right to 20% or more of the capital of the company, or 2) whenever such issuance is liable to entail a change in control[94]. These rules do not apply in the event of a capital increase reserved in favor of a third party, provided that the subscription price is not less than the stock market price. The rules of the NYSE, however, provide an exception whenever the holding of a general meeting would put the financial viability of the company in danger considering the time necessary for the holding of the general meeting. At the time of the outburst of the financial crisis in 2008 in the United States, several companies had recourse to such exception in order to facilitate the issuance of new shares reserved to named persons (private investments in public equity or PIPE). In fact, PIPEs allow for rapid injections of fresh money[95].

54. – **As concerns securities law, French rules regulating the public offers of exchange of bonds for shares also does not appear such as to explain the absence of offers.** They are not *a priori* more restrictive than American rules. It should be noted, however, that the rules relating to the holding of mandatory public offers do not have any equivalent in American law. French law, just as European law, imposes an obligation on investors to trigger a public offer in respect of shares of a company admitted to regulated French markets in the case the thresholds are exceeded (30% or a threshold of 1% over twelve months between 30% and 50%)[96] It is not rare that the conversion of debt into shares of a company in difficulty leads to a change in control of the company. The laws, however, provide for a derogation to the obligation to file an offer, precisely whenever the company is undergoing difficulties[97]. In practice, such derogation is easily obtained whenever the seriousness of the company's financial difficulties cannot be denied[98]. A manager who anticipates that the success of the offer should entail a change in control of the company, should not have any difficulty in obtaining, upstream, a derogation from the AMF. The system of public offers, therefore, does not appear to be at the origin of the absence of offers.

55. – **As concerns insolvency law, we think that the origin of the weak negotiating margin of managers of French companies is found essentially at the level of insolvency law.** In the case of failed negotiations between a debtor and its creditors, insolvency proceedings are the first alternative offered the debtor before any other solution. To the extent that bond holders are free to take part in a public offer since the rule of unanimity applies, it is important that a manager can convince creditors that the success of a public offer is a more desirable outcome than the opening of an insolvency proceeding. Bond holders decide to take part or not in the public offer, as it were, "in the shadow of an insolvency proceeding". The absence of public offers in France therefore implies that insolvency law does not allow for the creation of an adequately strong incentive vis-à-vis bond holders, in order to encourage the parties to agree on significant concessions leading to a reduction in debt and not merely its staggering. In other words, if the lawmaker were desirous in the future to encourage the organization of public offers of exchange of bonds for shares, he would have to, by modifying the rules of insolvency proceedings, decide to:

1°) render the threat of the opening of an insolvency proceeding sufficiently credible in the absence or failure of the public offer, in order to place the company manager in a position of strength vis a vis the creditors

93 - M. Ventoruzzo, «*Issuing New Shares and Preemptive Rights: A Comparative Analysis*», 2013, page 519, available on http://elibrary.law.psu.edu/cgi/viewcontent.cgi?article=1279&context=fac_works.

94 - Wachtell, Lipton, Rosen & Katz, «*Distressed Mergers and Acquisitions*», 2013, p. 17: NYSE Listed Company Manual §312.03 (c) and NASDAQ Listing Rule 5635.

95 - *Ibid*.

96 - General regulations of the AMF, Art. 234-2. Fortunately, the granting of a derogation is independent from the insolvency of the company involved. It is, therefore, not at all necessary that its liabilities exceed its assets in order that the derogation be granted; it suffices that the difficulties are proven and that the continuity of its operation is in peril.

97 - General regulations of the AMF, Art. 234-9.

98 - Les Echos, «*Latécoère prend un nouveau départ*» [Latécoère starts over], August 24, 2015.

who could refuse significant concessions at the time of negotiations; if the threat is not credible considering an analysis of the costs-benefits of the insolvency proceeding from the company's point of view, the manager shall have no other choice than to revise his ambitions downwards and propose other alternative solutions to an in-depth restructuring of the company's balance sheet,

2°) make sure that the bond holders can be convinced that by taking part in the public offer they collectively benefit from at least a part of the cost savings realized by the company due to the fact that it would avoid an insolvency proceeding in case of success of the offer; if the advantage of being able to avoid an insolvency proceeding is not perceived as a clear benefit for a certain number of bond holders, the manager must also revise his ambitions downwards, in order to guarantee restructuring.

56. – Now let us see to what extent the rules of insolvency proceedings in France do not help a company to achieve these two objectives: to compel and convince bond holder creditors.

2nd observation: **An insolvency proceeding does not enable the manager to compel bond holders to accept significant concessions since it does not offer any means of unilaterally authorizing a decrease in the amount of the company's bond debt. Furthermore, a French insolvency proceeding offers no protection for facilitating the financing of the company during its observation period, which period, however, is crucial for preparing an alternative plan in case of failure of the public offer. Under these circumstances the manager is not incited to obtain significant concessions from the bond holders.**

57. – **The ability of the manager to credibly threaten the bond holders in order to obtain significant concessions requires that the company derive a certain benefit from opening an insolvency proceeding in case of failure of the public offer.** If the benefit is not obvious, the manager's power of negotiation vis a vis the creditors shall be weaker. In this regard, the cost-benefit balance of the opening of an insolvency proceeding is essentially determined based on three factors:

- in opening an insolvency proceeding, the company must be able to be protected from individual initiatives of creditors seeking to be repaid, as of the very day of the placing on record of the failure of the public offer of exchange («Condition no. 1»),
- the company must be able to impose on the bond holders, in an insolvency proceeding, a significant decrease in the level of their debt («Condition no. 2»),
- the cost of the opening of an insolvency proceeding for a company must be as low as possible in relation to the expected benefits («Condition no. 3»).

58. – **The very low number of insolvency proceedings opened in France by large companies suggests that the cost of the insolvency proceeding greatly exceeds the expected benefits.** The recent introduction of the accelerated financial safeguarding proceeding and the accelerated safeguarding proceeding mitigates the extent of these remarks. Let us thus analyze each of the afore-mentioned conditions:

1°) **Concerning Condition no. 1 requiring that the debtor be protected from actions initiated by creditors as of the opening of a proceeding, we may consider that it is fulfilled.** Starting from the day following the failure of a public offer of exchange or the placing on record of the impossibility of launching a public offer of exchange having a chance of succeeding, a company manager may petition for the opening of a safeguarding proceeding[99]. The law does not impose any specific financial criteria on a company desirous of opening a safeguarding proceeding[100]. From this point of view, a safeguarding proceeding presents an undeniable advantage in relation to a judicial reorganization proceeding the opening of which necessitates awaiting the insolvency of the company, which implies a finding of debt default on the part of the company. Furthermore, an insolvency proceeding protects the debtor company owing to the stay of legal proceedings which, in principle, applies to all the creditors. This stay of proceedings prohibits creditors, for example, from exercising a security interest. Under these circumstances, the manager is ensured that his company is

99 - Cass. Com., March 8, 2011, no. 10-13.988. The law is very flexible concerning the criteria for the opening of a safeguarding proceeding as is illustrated by the *Cœur Défense* matter. In order to not further complicate the explanation, the accelerated safeguarding and the accelerated financial safeguarding proceeding provided by Articles L. 628-1 and L. 628-9 of the French Commercial Code, shall not be discussed in detail. It is a fact that the latter may be opened by the manager of a company, even a large company. They require that a conciliation proceeding has been previously opened. They do not necessarily present a clear advantage for the company in relation to a safeguarding proceeding. Even if the accelerated safeguarding proceeding and the accelerated financial safeguarding proceeding may take place over a short period, the example of the safeguarding proceeding of Technicolor (the term of which was limited to four months), demonstrates that this advantage is not so decisive, even for a listed company. It, however, appears that the stigma connected to the opening of an accelerated financial safeguarding proceeding is less than in the case of the opening of a classic proceeding to the extent that supplier creditors are not involved in the negotiations.

100 - Article L.620-1 of the French Commercial Code requires only that the debtor not be insolvent and that it justifies difficulties that it is unable to surmount.

not dismantled in case of failure of the offer. This assertion, however, must be mitigated considering the multiplication these last few years of exceptions to the rule of the stay of legal proceedings. The introduction, in particular, of security trusts, being henceforth, without tax friction, applicable to company shares, marks a turning point the consequences of which we have not yet mastered.[101]. As of today, to our knowledge no listed company has offered the shares of its operating subsidiaries in trust, which moreover would pose the question of the suitability of such measure with the rules of securities law in respect of the public offer of bonds. In spite of these latest developments, Condition no. 1 must indeed be considered as being fulfilled.

2°) **Concerning Condition no. 2 requiring that the company can impose a reduction in the amount of the debt on its creditors**, we may consider that the condition is not fulfilled for the following reasons:

a) In a safeguarding proceeding (just as in an accelerated safeguarding proceeding, an accelerated financial safeguarding proceeding and a judicial reorganization proceeding), regardless of the extent of its difficulties, a company cannot unilaterally impose a reduction in the amount of the debt of the bond holders absent their consent given at a special general meeting, carried by a two-thirds majority. Even if there is no doubt that future cash flow prospects will not eventually enable the company to repay its bond loan, the company cannot impose such a measure on its bond holders in insolvency proceedings. The consent of the qualified majority of the bond holder creditors meeting in a single special meeting is indispensable. At best, the manager of the debtor may obtain an automatic rescheduling of the bond loan over ten years, at the initially applicable rate of interest, and allow the company to pay practically nothing in the course of the first two years of the plan[102]. By hypothesis, this measure is inadequate for guaranteeing the continuation of the company. An automatic rescheduling of the bond debt by the court may, however, be a more heartening prospect than no agreement whatsoever.

b) The safeguarding proceeding (like the accelerated safeguarding proceeding and the accelerated financial safeguarding proceeding) does not authorize a company manager to proceed with a plan for the disposal of assets leading to a squeeze-out of bond holder creditors (as well as shareholders), although such an alternative could be a means of putting pressure on the bond holders. A judicial reorganization alone authorizes this. In such event, the threat is real for the bond holders to the extent that French law does not oblige the Commercial Court to award the assets subject to a disposal plan to the highest bidder, in order to protect employment[103]. Accordingly, bond holders may lose everything under a disposal plan. To the extent that a listed company is never desirous of awaiting insolvency before opening a judicial reorganization proceeding, which is very painful for it and its reputation, the efficiency of the threat of a disposal plan on bond holders must be relative. The significance of such assertion must be mitigated considering the introduction of «pre-arranged disposals» by the Ordinance of March 12, 2014. This new mechanism allows for the organization of the disposal of the assets of the company upstream from the debtor's insolvency. However, it does not appear adequate with a view to compelling the bond holders of a listed company to make significant concessions. The terms and conditions of the organization of the disposal imposed by law appear too restrictive for a listed company[104]. The obligation contained in the Ordinance to organize a competitive procedure between several potential buyers renders difficult the organization of a pre-arranged disposal in parallel to the organization of a public offer, in order to shield itself from the failure of the latter. For these reasons, Condition no. 2 therefore does not appear fulfilled.

101 - French Commercial Code, Art. L.622-21 and L.622-17 I.

102 - French Commercial Code, Art. L.622-21. The law specifies that the initial payment must take place within the year of the adoption of the plan and beyond the second year annuities may not be less than 5% of the amount of the admitted debt.

103 - French Commercial Code, Art. L.642-5: the «*court shall accept the offer that allows for ensuring, under the best conditions, as long as possible, the employment attached to the unit sold, payment of the creditors and presenting the best guarantees of enforcement*». By putting employment at the beginning of the article, the lawmaker is clearly stating his priority to the court.

104 - This proceeding must be organized within the confidential framework of the conciliation proceeding. It was not thought of for large companies whose shares are admitted for trading on a regulated market. In fact, considering the risk of squeezing-out investors apart from an insolvency proceeding by the effect of the disposal of the assets, the law requires that the court, acting *a posteriori* in order to ratify the asset disposal, verify that a competitive sale procedure, in the form of a call for offers organized by the debtor and its counsel, has indeed taken place. Such a procedure appears very difficult to implement whenever the company is listed, especially vis-à-vis creditors who would want to be able to control the procedure. Furthermore, it is not at all obvious that the company can, in such manner, find a buyer for its assets. Opportunistic funds prefer acquiring a company by means of debt. The law does not specify whether creditors may acquire the assets; it should be noted that credit bids do not exist in France as in the United States, to the extent that it excludes asset disposals in favor of the creditors, known as controllers (such as the manager and shareholders), for fear of fraud (*Cf.* S. Vermeille, A. Bézert, «*Sortir de l'impasse grâce à l'analyse économique du droit : comment rendre à la fois le droit des sûretés réelles et le droit des entreprises en difficulté efficaces?*» [Getting out of the impasse owing to the economic analysis of law: how to render both the law of securities and insolvency law efficient?], RTDF, no. 4 (2013), no. 1 (2014), spec. §61). The greater the size of the company, the lower the probability of finding a third party liable to take over all of the assets. Lastly, the compatibility of these rules with securities law appears difficult in case of use of such procedure which is *a priori* confidential, for a listed company.

3°) **Concerning Condition no. 3 relating to the requirement of a low cost for the debtor of the opening of an insolvency proceeding**, this condition also appears to us equally difficult to fulfill. The stigma of an insolvency proceeding for companies is still very great, even if the success of the safeguarding proceeding, opened by Technicolor, is such as to mitigate the significance of this assertion. In general, the negative signal sent to the company's suppliers and customers varies according to the company's sector of activity, its level of difficulty and the manner in which the manager prepares the opening of the insolvency proceeding, upstream with its creditors. This cost, which is difficult to determine, increases whenever suppliers and customers anticipate that the rules of insolvency proceedings do not truly provide companies with a second chance. This is the case for insolvency proceedings in France to the extent that it is public knowledge that companies emerging from an insolvency proceeding do not recover and are thereafter liquidated[105]. This situation creates a negative spiral that seriously injures the interests of the company. The perception by third parties of the inability of the law to enable the company to truly recover reduces even more so the benefit of an insolvency proceeding. Once the initial difficulties of the debtor are announced, suppliers and banking institutions are incited to take measures in anticipation of the company re-declining, which contributes to exacerbating the consequences of the decline even before speaking of a re-decline[106]. In France, the depressive effect surrounding an insolvency proceeding is so great that it is extremely difficult for a debtor to finance its period of observation in spite of the institution by the lawmaker of a procedural privilege. The consequences are extremely severe for companies, considering the importance of being able during the observation period to finance restructuring measures which, by nature, are difficult. For these reasons Condition no. 3 therefore does not appear to be fulfilled.

59. – **The advantage of a privilege in favour of the contributor of fresh money in an insolvency proceeding**. The importance for the debtor to be able to finance its observation period merits our lingering over the question of the privileges granted the contributors of fresh money in order to properly understand to what extent Condition no. 3 is not fulfilled. Regardless of the country in question, it is frequent that the law encourages the contributor of fresh money in an insolvency proceeding by the granting of a privilege. This privilege enables the contributor of funds to be repaid by priority in relation to the the creditors existing prior to the insolvency proceeding. The priority conferred by law is justified considering the inability of the company's creditors to organize themselves during the first days of the opening of the insolvency proceeding. Even if there is no doubt regarding the viability of the company and it is fully in the creditors' interest to avoid having the debtor undergo a liquidity crisis exacerbating their losses, from the first moments following the opening of an insolvency proceeding a legitimate uncertainty exists concerning the extent of the debtor's difficulties and the considerable problems of coordination amongst the creditors. This situation explains the risk of market failure, that is to say, its inability to spontaneously furnish new financing to the company[107]. The contribution of fresh money is often indispensable to the company in order to prepare its recovery[108]. In this regard, our intuition is the following: in the case of failure of a public offer of exchange, the quasi certitude for a manager to have access to a new source of financing in connection with the insolvency proceeding in spite of the refusal of its creditors existing prior to the proceeding to furnish such financing would be such as to encourage the manager to request significant concessions from bond holder creditors upstream from the insolvency proceeding. The manager thereby knows that during the observation period he disposes of room for maneuvering enabling him, for example, to have the time to organize the disposal of the company's activity.

105 - *Cf. infra* § 153.

106 - This situation explains the temptation of the lawmaker these last few years to resolve the problem by instituting new, more flexible proceedings such as the accelerated safeguarding proceeding and the financial accelerated safeguarding proceeding. This, however, is to forget that the efficiency of preventive measures depends on the efficiency of insolvency proceedings (B. Chopard, S. Vermeille, S. Postmouth. L.G. Sainte Marie, «*Partage des risques, partage de la valeur : étude des effets du droit des procédure collective sur le processus de renégociation amiable de la dette d'une société»* [Sharing of risks, sharing of value: study of the effects of bankruptcy law on the process of amicable renegotiation of the debt of a company], 2011, RTDF no. 1).

107 - This legal privilege is necessary in order to avoid a liquidity crisis connected to the inability of creditors to coordinate themselves in order to themselves furnish the necessary funds enabling their loss to be reduced. This is explained by the existence of a considerable asymmetry of information between the company and the creditors as well as by coordination problems between creditors. Under these circumstances, it is not rare and even frequent that creditors struggle to coordinate themselves in order to finance the company even if there is no doubt that its activity is viable. In fact, the creditors have every reason to do so in order to limit value destructions entailed by an insolvency proceeding and reduce the amount of their losses in case of default.

108 - In general, once a company enters an insolvency proceeding, it is important that the company benefit from a contribution of fresh money in order to finance the restructuring plan and meet an increase in its working capital needs. In fact, suppliers may be inclined to modify the terms and conditions of the performance of their services in the future by decreasing, more particularly, payment deadlines. During this period, the company also has need for a contribution of fresh money in order to finance the initial measures of its restructuring plan. In principle, the company's usual creditors are best placed to finance the company, considering their better knowledge of the company in relation to third parties.

60. – **The absence of fresh money contribution in France during the observation period in spite of the proceeding privilege**. Even if French law has instituted a «proceeding privilege»[109], in practice, the latter is never used in the absence of an investor desirous of making funds available to the company during this period (on the contrary, the privilege known as «new money»[110] in conciliation proceedings, has enjoyed greater success). Insolvency proceedings in France have thus lost a definite interest for a company desirous of using them. The absence of offers of financing for companies going into an insolvency proceeding must therefore be such as to discourage a manager a little bit more from requesting significant concessions. The fear of a liquidity crisis in case of failure of negotiations is a powerful motor in favor of a strategy of avoidance or moving forward very slowly whenever the restructuring of the company's debt is involved. The inefficiency of the legal privilege is due essentially to two reasons. Firstly, the fact that other privileges may prevail over the privilege of insolvency proceedings[111]. Secondly, the unforeseeable nature of the allocation of risk as raised further on. In fact, there can be no financing of the observation period if the lender is not certain to be repaid following such period. Failing this, the investor is requested to wager on the turnaround of the company, even before the adoption of a restructuring plan, which the investor will not be desirous of doing at the time of the opening of the insolvency proceeding since he does not yet dispose of the necessary information[112]. In conclusion, this situation explains the absence in France of a market for financing companies being restructured, equivalent to the American «Debtor In Possession financing market»[113]. This analysis confirms that condition no. 3 is not fulfilled.

3rd observation : **French insolvency proceedings, characterized by complex and uneconomical rules and a highly uncertain outcome which do not enable creditors to determine the financial gain for them of an alternative to an insolvency proceeding. Managers, therefore, do not dispose of any means for convincing bond holders of the benefit for them of a public offer of exchange. The absence of clear rules allowing for anticipating and understanding how a French insolvency proceeding will redistribute risks in a manner that is at the same time foreseeable, equitable and transparent considerably increases the risk of refusal by the bond holders of an alternative offer of exchange. This may, sometimes, lead them to thinking that the opening of an insolvency proceeding will be more favorable for them.**

61. – A manager's power of negotiation and, in particular, his ability to convince his bond holders, necessitates that the manager be able to demonstrate to the bond holders that the proposal made to them in connection with the public offer is better than maintaining the *status quo*, considering the risk of default of the debtor. Only then can the manager demonstrate that by taking part in the public offer the bond holders shall derive a benefit from a part of the cost savings realized by the company due to the fact that, in case of success, it would avoid an insolvency proceeding. These savings correspond to the cost of the insolvency proceeding in respect of the operational activity of the company and, therefore, its future cash flow prospects. The more bond holders are able to make an advanced assessment of the extent of their rights in an insolvency proceeding and the connection between the failure of the public offer and their recovery rate the more likely the manager will be able to persuade them to take part in the public offer

62. – **The three essential conditions for efficient insolvency proceedings**. An insolvency proceeding must therefore not lead to an arbitrary and/or uncertain result from the bond holders' point of view. Any arbitrary or uncertain result is liable to provoke a misalignment between, on the one hand, a part of the bond holders who

109 - French Commercial Code, Art. L. 622-17 and L. 641-13. C. Saint-Alary-Houin, « *Les privilèges de la procédure»* [The privileges of the proceeding], Petites Affiches, June 2007, no. 119.

110 - French Commercial Code, Art. L. 611-11.

111 - Concerning the first reason, the proceeding privilege is overridden by the super-privilege of employees, as provided by Articles L.3253-2 and L.3253-3 of the French Labor Code, as well as by claims for salary subsequent to the opening of an insolvency proceeding, pursuant to Article L.622-17 of the French Commercial Code. These sums may be quite significant. By way of comparison, in the United States employee privileges are limited to $12,000 per annum (D. Baird, *Elements of Bankruptcy*, 6th (Concepts and Insights Series), 2014, Foundation Press).

112 - In this regard, having the certainty of being repaid following the observation period presupposes: (1) in case of adoption of a continuation plan or a safeguarding plan, the concomitant granting of new financing in proportions that are adequate to ensure the repayment of the financing of the observation period, which is often costly for the company, and (2) in case of adoption of a company disposal plan, there is no uncertainty concerning the fact that the asset disposal price will allow for the paying off of the contributor of fresh money who financed the observation period. As French law now stands, the lender cannot have such certainty since: on the one hand, a continuation plan, just as a safeguarding plan, may be adopted contrary to the opinion of the creditors, including creditors holding security interests, the court, if necessary, having the right to bring about the forced rescheduling of the debt over 10 years (French Commercial Code, Art. L. 626-18, and Art. L.631-19, I by cross-reference); under these circumstances, it is highly unlikely that a continuation or safeguarding plan is accompanied by new financing enabling the lender to be paid off during the observation period and, on the other, the court has the right to dispose of all of the assets without any consideration for the price, which may consequently be inadequate for paying off the lender during the observation period (French Commercial Code, Art. L. 626-1, para. 3, and L. 631-22, para. 1).

113 - See, for e.g., S. Chatterjee and U. Dhillon and G. Ramirez, «*Debtor-in-Possession Financing*», 2007, Journal of Banking and Finance, Vol. 28, No. 12, pp. 3097-3112, 2004, available on SSRN: http://ssrn.com /abstract =672321

may benefit from the opening of an insolvency proceeding once there exists a possibility that the outcome of an insolvency proceeding may be more favorable for them than their taking part in a public offer and, on the hand, other company creditors having a collective interest in the company avoiding an insolvency proceeding, considering its negative impact on their debtor's activity and, by extension, on their chances of recovery. For this reason, the rules of an insolvency proceeding must ensure that in the case of failure of the offer, there is no doubt as to the outcome; in other words, that the allocation of the risk borne by the investors is foreseeable, transparent and equitable. In this regard, these are the three essential conditions relied on by the International Monetary Fund in order that insolvency law be considered «efficient»[114]. Accordingly:

1°) a **foreseeable** allocation of the risk presupposes that the bond holders may establish a close connection between the extent of the difficulties of the company and the level of their loss in case the debtor defaults. Accordingly, any improvement, or conversely, any exacerbation of the debtor's situation, must be immediately understood by the bond holders, and in this regard, reflected in the price at which the bonds are exchanged on the secondary market («Condition no. 1»),

2°) an **equitable** allocation of the risks presupposes that the insolvency proceeding contains a certain number of safeguards, protectors of the rights of investors whenever a plan in adopted without their consent; this condition is necessary since failing it, the rules allowing for reorganization by means of an insolvency proceeding without the consent of certain investors, on the sole ground that a majority would have decided otherwise, are liable to be arbitrary from the investors' point of view and, therefore, unforeseeable by nature («Condition no. 2»),

3°) a **transparent** allocation of the risks presupposes that the rules of allocation of risk are understandable for investors, that consequently they can understand the reasoning of any judicial decision involving their application and they may make a third party opposition to any decisions affecting their rights («Condition no. 3»).

63. – Initially we shall return to each of these three conditions, on a theoretical level, in order to measure to what extent compliance with each of these conditions also depends on compliance with the two others. Secondly, we will analyze the reasons for which French law does not fulfill any of these three conditions.

64. – **Concerning Condition no. 1 relating to the foreseeable nature of the allocation of risks, the law facilitates negotiations if the investors can establish a direct connection between the extent of the debtor's financial difficulties and the level of the loss in case of default.** In general, the closer the company is to default, the closer this connection becomes and the more the price of the bonds on the secondary market should become sensitive to the evolution of the financial situation of the company, close to default. In order that such connection is established, the order of priority and the absorption of losses initially agreed upon amongst the financial creditors must be observed. It is only then that the price at which the bonds are exchanged on the secondary market may be used as a valid factor of comparison at the time that the bond holders are asked to take part in the offer initiated by the debtor. The situation presupposes:

1°) that the rights of the investors are not modified according to the outcome of the insolvency proceeding. The fact that the company is subject to a reorganization plan or a disposal plan should be irrelevant, and

2°) the investors are divided by classes before the approval of the restructuring plan, that is, depending on their economic rights in the company. Creditors having different rights because, for example, they have a security interest, should not be part of the same class as unsecured creditors. The insolvency proceeding must ensure that creditors in different situations be treated differently. Observance of the order of priority must be absolute in the sense that a class of junior creditors must not be able to receive a dividend by virtue of a restructuring plan, if the senior creditors have not been fully repaid. It is only then that creditors will be encouraged to make loans to companies (*ex ante* efficiency).

65 - **Concerning Condition no. 2 relating to the equitable nature of the insolvency proceeding, it is equitable vis-à-vis the body of creditors in order to be able to force the approval of a reorganization plan in an insolvency proceeding in spite of the refusal of certain creditors, if the latter unduly create an obstacle to the approval of a plan which, however, improves the fate of the body of creditors.** The certainty of the body of creditors that the insolvency proceeding will enable the company to approve a restructuring plan, in spite of the refusal of certain dissident creditors, is such as to facilitate negotiations upstream from a public offer whenever certain creditors are desirous, for example, of making money from their participation. However, the right to override the refusal of certain creditors must be regulated by law,

114 - See, for example, International Monetary Fund, «*Orderly & Effective Insolvency Procedures*», 1999.

in order to avoid arbitrary expropriations of bond holders. Failing this, Condition no. 1, requiring that the allocation of risks be rendered foreseeable would cease being fulfilled. A fair balance must thus be found. The following conclusions may be drawn:

1°) Whenever a majority of the bond holders, having strictly the same rights as one or more of the dissident bond holders, approves a reorganization plan in an insolvency proceeding, in principle the dissident bond holders should not be able to block the plan. In such hypothesis, the vote of the majority must be able to override the refusal of certain resistant creditors. The majority of the bond holders supposedly act in the interest of the body of the creditors having equivalent rights and therefore the dissident bond holders. Consequently, dissident bond holders should not be able to oppose the plan, except on the condition that they can demonstrate that the allocation of risk is thus truly unfair. In fact, it is understood that the majority of the creditors, having the same rights as the dissident creditors, may not always act in the interest of the body of the bond holders. In fact, they may have hidden personal interests. For example, if a creditor, having a security interest, demonstrates that the economic value of his debt, subsequent to the imposed plan, is less than the market value of the asset underlying his security interest, the creditor should legitimately be able to oppose the plan, although adopted by creditors who also dispose of a right to this same underlying asset. In other words, creditors should be able to oppose the plan if they demonstrate that the recovery rate of their debt would have been less in case of liquidation of the company with termination of its activity. This minimal protection afforded the dissident creditors should not pose any problem once the viability of the company is not in doubt. In this hypothesis the liquidation value of the assets of the company («liquidation value») is necessarily less than the recovery value of the company («on going concern value»). The surplus value generated by the reorganization of the entity is supposed to be redistributed for the benefit of the body of the creditors depending on the order of priority. In this manner, the conditions under which dissident creditor or creditors may oppose the decision of a majority of the creditors who are presumed to represent the interest of the body of the creditors having identical rights remains foreseeable.

2°) Whenever an entire series of bond holders, or even all of the bond holders of the company, refuse to take part in a public offer, whereas other creditors, sometimes more senior than the bond holders, have accepted the terms of the overall restructuring and condition their final consent on the consent of the body of bond holders, the latter must not be able to oppose the approval of the plan, under all circumstances. Accordingly:

a) An insolvency proceeding must not enable an entire class of bond holders to have more rights in an insolvency proceeding vis-à-vis other more senior financial creditors in the order of priority, than it would have had in the absence of an insolvency proceeding. In other words, an entire class of bonds should not be able to cause a restructuring plan to be blocked if it is demonstrated that the recovery value of the company is less than the amount of the senior debt to the bond holders. In this regard, reference to the value of the company in reorganization, and not the liquidation value, allows for guaranteeing that the most senior creditors do not systematically take control of the proceeding on the pretext that they are first in the order of priority. The objective is to avoid that the most senior creditors unduly capture the surplus value generated owing to the reorganization of the company in comparison to a liquidating scenario, to the detriment of more junior creditors. Accordingly, bond holders, often more junior than banking institutions in the order of priority, could sometimes take control of the proceeding, without having to systematically previously purchase the debt of the senior creditors. For this purpose it must be demonstrated that the recovery value is, with respect to future cash flow prospects, greater than the amount of the debts of more senior banking institutions. This reference to the recovery value and not to the liquidation value, in order to be able to oust an entire class of investors, today differentiates English law (which systematically makes reference to the liquidation value and, therefore, favors senior creditors having security interests) and American law (which requires reference to recovery value and therefore improves the rate of recovery of unsecured creditors) [115] In this manner the conditions under which it is possible to approve a plan in spite of the opposition of bond holders remains foreseeable and Condition no. 1 remains fulfilled.

115 - Contrary to American law, English insolvency law provides for the systematic transfer of control for the benefit of senior creditors having first ranking security interests .V. S. Paterson, «*The adaptive capacity of markets and convergence in law: UK high yield issuers, US investors and insolvency law*», 2015, The Modern Law Review, 78 (3). pp. 431-460. ISSN 0026-7961, available on SSRN.: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2601581. *Cf. infra* § 117.

b) The court must, if necessary, settle conflicts concerning the value of the company in reorganization with the help of an independent expert. In order to assist it with this task it is preferable that a supervisor, such as the receiver, be systematically appointed by the court[116].

c) It is also possible, depending on the criteria of the recovery value, to force the consent of shareholders who can be called in order to approve the issuance of new shares to be delivered in exchange for repayment of bonds[117]. It is, in fact, equally important to be able to squeeze-out shareholders. Failing this, the debtor could be tempted, at the time of preparation of the public offer, to request that bond holders make more concessions than necessary, with respect to the debtor's financial situation and the order of priority, in order to ensure the support for the offer of the shareholders meeting in a general meeting. The danger of such a situation is that the bond holders realize, in case of the turnaround of the company's situation, that the fruits benefit the shareholders only. This favorable treatment of the shareholders in violation of the order of priority would be a just reason for the bond holders' refusal to take part in the public offer.

In its proposed Directive of November 22, 2016, the European Commission made similar recommendations. [118]

The issuance of hybrid securities or the risks of pursuing strategies in order to optimize the financial structure of companies

The corporate hybrids market illustrates the advantage of insolvency law that is more observant of the order of priority. Since 2013, the corporate hybrids market, that is, super-subordinated securities and perpetual debt instruments, is very active in France. This market concerns, more particularly, large companies rated A-, BBB+ or BBB- according to the Standard & Poor's («S&P») scale.

Recourse to hybrid instruments is a way of optimizing its financial structure. These instruments enable equity to be reinforced to the extent that they benefit from 50/50 treatment in equity and in debt, on condition of complying with the conditions required by rating agencies (such as Moody's, S&P and Fitch). The issuance of hybrid products may be carried out for the sole purpose of improving the issuer's rating; the second objective is to be able to reduce the cost of the senior debt paid by the company owing to this better rating.

The issuance is accordingly implemented, without any special event in the life of the company justifying such issuance, as in the case of EDF which carried out eight issuances in the course of the last few years [119]. The issuance may also be concomitant with a capital increase implemented for the needs of a major acquisition, as in the case of Suez in May 2017[120]. Other, more fragile companies, which are not rated, sometimes have recourse to these corporate hybrids for accounting reasons[121] or in order to be able to ensure compliance with the financial ratios appearing in their loan documentation.

In the case of the opening of an insolvency proceeding, companies issuing this type of product will have to manage multiple conflicts of interest. Hybrid products in the form of a bond instrument thus enter directly into conflict with more senior bonds, within the single bond holders' meeting. They may be better treated than they should be if they can obtain a blocking minority within the single general meeting of bond holders as in the Technicolor matters. Conversely, they may be less well treated than shareholders whenever their

116 - Such an obligation does not exist in American law. Concerning this point, our recommendation concurs with that of H. Eindemüeller, «*Contracting for a European Insolvency Regime*», 2017, European Corporate Governance Institute (ECGI) - Law Working Paper No. 341/2017, available on SSRN: https://ssrn.com/abstract =2896340.

117 -The essential criticism of this proposal relates to the fact that in such situation shareholders may be squeezed-out whereas legally the company is not yet insolvent. Admittedly, the shareholders are devoid of any legal right over the company which may maintain an option value at this time. *Cf.* S. Vermeille, R. Bourgueil, A. Bézert, «*L'affaire Belvédère ou les effets contre-productifs du droit français des entreprises en difficulté – Plaidoyer pour une réforme ambitieuse*», *op. cit*. The disadvantage of the elimination of shareholders' rights, in spite of their residual value, must be balanced with the advantage for a company of being able to carry out an in-depth restructuring of its balance sheet sufficiently upstream from the difficulties. The objective, thus, is for the company to be rapidly competitive again by making investments that are indispensable to its recovery. *Cf.* S. Vermeille, J. Martinez et F.-A. Papon «*La constitutionnalité du projet de loi « Macron » et l'éviction des actionnaires : la révolution n'a pas eu lieu*» *op.cit*.

118 - The Directive provides, in particular, that if a plan is not approved by the majority of the creditors divided into classes, it may nevertheless be validated and imposed by a judicial or administrative authority, on the classes of creditors which, following determination of the value of the company, would have no right to any payment if the normal classification of liquidation priorities was applied (Art. 11). The conflict concerning the value of the company is settled by the same judicial or administrative authority (Art. 13).

119 - Source Société Générale.

120 - Prospectus of the Suez company, approval no. 17-200 of May 16, 2017.

121 - In IFRS standards, the classification of the hybrid instrument shall be either in debt or equity, depending on the clauses of the agreement, notably the inclusion of an unconditional right to avoid disbursements of the cash reserves for the issuer, whether to pay interest charges or amortization of the debt.

rights may be reduced to zero by virtue of a restructuring plan, by a vote of the majority of the senior bond holders, as is illustrated in the Belvédère matter.[122].

66. – **Concerning Condition no. 3 relating to the transparency of the allocation of risks, company restructurings are often synonymous with coercive attitudes that are sometimes unfair due to the presence of stakeholders having opposing interests.** Negotiations may thus be a place of very hard confrontations. At some point it is important that institutions can reassure investors concerning the effectiveness of the protection afforded their vested interests. Accordingly:

1°) the rules of insolvency proceedings must be understandable from the investors' point of view,

2°) the investors must have an adequate level of information concerning the debtor. They accordingly must dispose of the time necessary for digesting information relating to the debtor. Failing this, it would be difficult for a creditor to agree to rely on the decision of the majority, even if all the other creditors were to have rights similar to those of the dissident creditor,

3°) whenever a court decides to ratify a plan, it must provide reasons for its decision with respect to the applicable rules. If the measures of the Commercial Court, as well as those of the bankruptcy judge, trustees and receivers, are opaque in the course of the observation period from the investors' point of view, the latter cannot verify the effectiveness of the protection afforded them,

4°) each creditor must have the right to be heard by the court, according to the terms and conditions to be determined, so as to not overload the courts, for example, in order to notify the conditions of the sale of an asset of the company at a depreciated price,

5°) creditors must be able to institute third party proceedings to contest any decisions affecting their rights, under conditions that would also enable the interests of the defaulting company to be protected.

67. – **France does not fulfill any of these three conditions. Thus, as concerns the first and second condition, relating to the foreseeable and equitable nature of the allocation of risks,** as French law does not make observance of the principle of the order of priority a general principle of law, mechanically the condition concerning observance of the equitable nature of the allocation of risk is not fulfilled. The terms and conditions of approval of restructuring plans in an insolvency proceeding in fact leads to a systematic violation of the order of priority. For the two following reasons such violation mechanically entails an unfair allocation of risk (whereas one could have Condition 1 without Condition 2):

1°) under French law, bond holder creditors are grouped together in a single meeting even if several series of bonds exist having different rights. Under all circumstances, ratification of a reorganization plan leading to a decrease in the amount of bond debt requires the consent of a two-thirds majority of the single meeting. In other words, holders of bonds representing one-third of the total amount of the bond debt issued by the issuer can create an obstacle to the approval of a plan. If the debtor does not succeed in obtaining the consent of the bond holders meeting in a single meeting, it has no other choice than imposing the re-scheduling of the bond debt over ten years, at the initially applicable interest rate[123]. These terms and conditions of approval of the plan are liable to give rise to violations of the order of priority. Thus, holders of bonds with security interests may find themselves voting within the single meeting of bond holders in an insolvency proceeding alongside other holders, originating from a different series of bonds which, however, do not confer any security interests. Rather than simplifying bond workouts for the debtor, this situation will rather significantly complicate it. In general, the manager will be confronted with two types of problems:

   a) the manager is liable to find himself trapped, confronted with all of the bond holders, which by hypothesis in our example are junior creditors in comparison to banking institutions, whenever they require, upstream form the public offer, being treated *pari passu* with the banking institutions which, however, are more senior. In fact, in such hypothesis, the manager shall have great difficulty in convincing the bond

122 - S. Vermeille, R. Bourgueil, A. Bézert, «*L'affaire Belvédère ou les effets contre-productifs du droit français des entreprises en difficulté – plaidoyer pour une réforme ambitieuse*», *op. cit*.

123 - Other significant legal uncertainties remain with respect to the terms and conditions of approval of the plan. In fact, French law does not consider that corporate law must totally step aside for the benefit of insolvency law. This poses questions regarding the interaction between these two laws. There exist, notably, uncertainties in respect to the rules concerning special meetings within the framework of an insolvency proceeding, in the absence of making company value and not negative equity the decisive factor of the laws. *Cf*. Appellate Court of Paris, June 28, 2011, division 5, chamber 8, Docket no.10/1974 upheld by Cass. Com., July 12, 2012, no. 11-22.898 holding that, in order to implement a reduction of capital in connection with a safeguarding plan, the body of bond holders (ORAs) must be consulted in that the transaction affected the conditions of attribution of shares of capital determined at the time of issuance within the meaning of Article L.228-103 of the French Commercial Code.

holders to take part in the public offer if this leads them to absorbing losses before the banking institutions. Accordingly, considering the obligation for the debtor to obtain their consent in a single meeting, bond holders are in a position to make known to the manager that they do not intend to take part in a public offer the contours of which would not lead to a sacrifice on the part of the banking institutions similar to that required from them, in spite of the initially agreed upon order of priorities[124].In such manner, the bond holders, anticipating the refusal of the banking institutions to convert their debts into shares just as the bond holders, could compel the debtor to limiting itself to requesting that the bond holders extend the date of maturity.

b) the manager is liable to also find himself trapped confronted with a part of the bond holders having no security interests, whenever they require, upstream from the public offer, that they are treated *pari passu* with bond holders having security interests. The manager, in fact, will have great difficulty in such hypothesis in convincing bond holders who do not have security interests that it would be beneficial for them to take part in the public offer, in the event that such offer provides that they must absorb losses before bond holders having security interests. Accordingly, bond holders originating from a series that does not confer any security interests could, upstream from the public offer, provided that they have a blocking minority within the single meeting called during the insolvency proceeding, make known to the debtor that they do not intend to take part in a public offer the contours of which would not lead to an equal sharing of sacrifices between bond holders; it being of little import whether or not they originate from the series conferring security interests on the holders. It is obvious that such a request would displease bond holders having security interests and significantly complicate negotiations[125].

c) The lawmaker has become aware over time of the deficiencies in the rules relating to the conditions for approval of reorganization plans (whether in connection with a safeguarding proceeding or a judicial reorganization proceeding) and the risk of the power to cause harm conferred on certain creditors considering the existence of a single meeting of bond holders, either way. Two measures were thus recently introduced into our law:

   (i) In order to take into account rights specific to certain classes of creditors, Law no. 2010-1249 of October 22, 2010 provided for the right of Commercial Courts to take into account the existence of subordination agreements at the time of ratification of a plan[126]. This measure does not, however, settle the debtor's difficulties since it does not confer a right on Commercial Courts to impose on dissenting bond holders, disposing of a blocking minority within the single meeting of the bond holders, a treatment that is different than that of the other bond holders with respect to the order of priority of payments. This new legal measure allows only for introducing into our law the principle according to which creditors, who are placed in different situations, may be treated differently. This legal measure confirms that the principle of equality of treatment of creditors involved in an insolvency proceeding, originally contained in our law, is not effective ever since the multiplication of subordination agreements. Moreover, the law says nothing concerning the fate of creditors having security interests who, however, merit being treated by priority in relation to other unsecured creditors, up to the amount of the market value of the asset underlying their security interests.

   (ii) The Ordinance of March 12, 2014 furthermore granted court-appointed receivers the power to determine the number of votes of each creditor in connection with the proceeding. The aim of this measure is to counter-balance the consequences of the systematic division of creditors into three committees (suppliers' committee, banks' committee and bond holders' committee), regardless of the initially agreed upon order of priority[127]. The Ordinance does not, however, specify the method of calculation to be applied, nor the features of the debt involved. The court-appointed receiver has total latitude, without any control by the court, in determining the number of voting rights, which is open to criticism with respect to the obligation of foreseeability of risks. Considering the uncertainty of the terms

124 - In practice, in order to avoid such risk, often the issuance of bonds in an affiliate of the debtor is provided for, so as to create a structural subordination between the two categories of creditors. However, as illustrated in the Solocal matter, it is frequent that bond holders provide that in the case of early payability of the bonds, they can have transferred to them the intra-group loan pursuant to which the entity issuing the bonds has lent the proceeds from the issuance to the parent company of the operational entities. Accordingly, the bond holders are in a position to be able to take part in negotiations just as any other lender of the group's parent company.

125 - S. Vermeille, A. Bézert, «*Sortir de l'impasse grâce à l'analyse économique du droit : comment rendre à la fois le droit des sûretés réelles et le droit des entreprises en difficulté efficaces?» op. cit.*

126 - French Commercial Code, Article L.626-30-2.

127 -The Ordinance of March 12, 2014 also deprived certain creditors of their voting rights, notably those whose interests were not aligned with the fate of the company, such as holders of credit default swaps. *Cf. supra* p. 27 for a detailed description of the Technicolor matter.

and conditions for applying such legal measure, it would probably not allow for influencing the behavior of the various parties upstream from the public offer.

2°) French law furthermore provides that, under all circumstances, shareholders must approve the issuance of new shares in connection with a public offer. Even if the Law of August 6, 2015 for growth, activity and equality of economic opportunities authorized, under limited conditions, the possibility of disregarding a refusal by the general meeting, «*whenever the protection of the employment pool so justifies*», (and whenever the company is insolvent), this measure does not allow for the squeezing-out of shareholders, even if there is no doubt regarding the insolvency of the company[128]. Moreover, the criteria relating to the protection of jobs is not adequately foreseeable in order to influence the behavior of the parties upstream from the public offer. These legal deficiencies confer disproportionate weight to shareholders in negotiations. If they succeed in organizing themselves, shareholders may make known to the manager that they do not intend to approve the capital increase enabling new shares to be issued, if the contours of the public offer lead to conferring on the bond holders a number of shares they consider too great, whereas they would have the right to nothing in the event of the sale of the whole of the company's activity for a price equal to its reorganization value. The manager could, consequently, attempt to force bond holders to agree to receive a lesser part of the stock capital than they originally imagined, in consideration for the remittance of their bonds. Under these circumstances, the bond holders may not be convinced of the benefit for them of taking part in the public offer under such conditions.

68. – **The importance of respecting the order of priority**. For all of these reasons, it is therefore more difficult for a manager to convince bond holders upstream from an insolvency proceeding that it is beneficial for them to take part in a public offer providing for an exchange of their bonds into shares. The systematic violation of the order of priority considering the terms and conditions for approval of the plan encourages certain creditors to not take part in the public offer. The absence of respect by French law vis a vis the obligation to observe the order of priority is unique in relation to the rest of Western Europe and the United States. In the beginning the intention of protecting jobs at any price was the main reason justifying the violation of the order of priority by means of, for example, a legal super privilege[129]. Other arguments were added thereto.

1°)**Firstly, there are some which consider that observance of the order of priority may lead to unduly favoring creditors in relation to minority shareholders when it is the creditors who are responsible for the debtor's default.** This is the case, for instance, whenever creditors have lent significant sums to the debtor without having carried out an adequate credit analysis. This idea was advocated by an association of minority shareholders in the Eurotunnel matter. In such case, the financing of the project of the tunnel under the Channel had been ill-conceived by banking institutions from the beginning, without «sponsoring» on the side of the shareholders. The French and English governments had chosen to give a free hand to the banks in respect of the financial structuring of the project. Accordingly, as from the beginning, Eurotunnel was under-capitalized[130]. Even if under such circumstances the conduct of the lenders is blameworthy, in particular whenever they lend without examining the fundamentals of the project, the reality in practice is that often the initial lenders have already sold their securities to other creditors on the financial markets. The secondary market for bond debt, just as bank debt, is very active, even if the bonds are not admitted for trading on a financial market. Violating the order of priority does not, therefore, enable those parties responsible for having committed an analysis error at the time of the structuring of the project to be punished.

2°)Secondly, some consider that strict observance of the order of priority is not justified whenever such observance enables certain creditors, most often opportunistic investment finds specialized in taking stakes in companies in difficulty, to take over control of the company in difficulty cheaply in the course of an insolvency proceeding. The investment funds thus convert their debt instruments into capital, which, however, are purchased with a discount on the secondary market, in relation to their nominal value. Minority shareholders may then consider that the price paid by the funds is inadequate and the amount of the company's debt should be mechanically reduced to the amount of the market value of the debt instruments, without any dilution for the shareholders. What they want is that the new shareholders in control were not, in reality, to incur any loss. It is therefore illegitimate that the shareholders be so severely diluted even if the company is

128 - S. Vermeille, «*Les effets pervers du dispositif du projet de loi « Macron » relatif à l'éviction des actionnaires en plan continuation : les limites d'une réforme incrémentale du droit des faillites*», 2014, *op. cit.* ; F.-A. Papon, J. Martinez, S. Vermeille, «*La constitutionnalité du projet de loi « Macron » et l'éviction des actionnaires : la révolution n'a pas eu lieu*», *op. cit.*

129 - *Cf. infra* footnote, page 103.

130 - *Cf. infra* p. 57, for a detailed description of the Eurotunnel matter.

insolvent. Such criticisms have been put forward by one of the two minority shareholders' associations in the Solocal Group matter, which did not support the December 2016 restructuring plan[131]. In our opinion, the argument is difficult to uphold if we recognize that amongst the company's shareholders there also exist shareholders who acquired their shares following the formalization of negotiations involving restructuring. In the same way that creditors could acquire their shares cheaply, the shareholders of the company could make a belated purchase at a time when the price of the share was low, in such manner that they did not have to sustain the consequences of the lowering of the price during the months preceding restructuring. Under such circumstances, a violation of the order of priority in favor of the allegedly injured shareholders, considering the terms and conditions of conversion of the debt into shares, would mechanically lead to enriching shareholders who were spared any loss.

69. – **The violation of the order of priority between creditors and shareholders is the surest means of leading to an unrealistic plan.** Encouraging violation of the order of priority in the name of equity is not the right way to facilitate a company's recovery. It is the surest means of encouraging the conclusion of restructuring agreements that are untenable for the company considering the necessity of reconciling all of the interests involved. Requiring observance of the order of priority does not mean, however, refraining from sanctioning creditors who blatantly take excessive risks when implementing credit, knowing that they will not have to incur the consequences of their acts, the losses chiefly affecting the shareholders[132]. More targeted recourse against parties responsible for hazardous financial arrangements should be possible. This presupposes, for example, redefining the contours of an action for abusive support of lenders whose scope of application is too limited since the reform of 2008[133] and improving the conditions under which minority shareholders may bring a class action in order to be able to finance such litigation. For all such reasons, Condition no. 1 is not fulfilled. If this condition is not fulfilled, Condition no. 2, which arises from the first, can also not be fulfilled.

70. – **Concerning specifically the second condition relating to the equitable nature of the allocation of risks**, the condition is not fulfilled for the following reasons:

(1°) there does not exist in insolvency law an equivalent to the principle of no worse off or best creditors interest test, allowing for the overriding of creditors' refusal to approve a reorganization plan in insolvency proceedings, providing for a decrease in debt, once the debtor demonstrates that the dissident creditors would not have been treated better than in the case of judicial liquidation. Under French law it is accordingly easy to neutralize dissident creditors whenever the majority of two-thirds of the debtor's bond holders approve a plan; it should be noted that French law systematically brings together all of the bond holders within the same class, whether or not they have different rights. This was the case in the Technicolor matter. The Commercial Court did not have to justify its decision to authorize the reorganization of the company due to the surfeit of generated value. In practice, it most often prefers this solution to a disposal plan (in judicial reorganizations) since it allows for saving more jobs. In the case of a disposal plan, the buyer has the possibility of selecting the employment contracts it does not wish to take over. The no worse off principle exists recently in French law in banking resolution matters[134].

(2°) just as it is not possible to impose a restructuring plan providing for the issuance of new shares in spite of the refusal of the shareholders, it is not possible to force the approval of a plan in spite of the refusal of a whole class of more junior creditors in relation to other bond holders, even in case of the disposal of all of the company's assets at a price that is equal to its value as a company in reorganization, such junior creditors would not have obtained satisfaction given the sale price.

131 - L'Agefi, «*Les actionnaires de Solocal Group comptent peser dans la restructuration du groupe*» [The shareholders of the Solocal Group count on having influence in the restructuring of the group], July 26, 2016.

132 - This is a recurring problem in small financing matters, what is more, when Oséo (private company with delegation of public service that finances small- and medium-sized French companies for employment and growth), counter-guarantees a part of a bank loan made available to a company manager who was the sole shareholder. American and German law know the concept of «equitable subordination», for example, which allows for treating as a shareholder a particular creditor who committed certain faults by interfering in the management of the company. M. Gelter, J. Roth, «*Subordination of Shareholder Loans from a Legal and Economic Perspective*», 2007, Harvard Law and Economics Discussion Paper No. 13, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=998457.

133 - Ordinance no. 2008-1345 of December 18, 2008, Art. 129, French Commercial Code, Art. L. 650-1.

134 - The bail-in procedure allows for the default of a credit institution to be borne by the shareholders and creditors according to a pre-defined order depending on a value determined by the *Autorité de Contrôle Prudentiel et de Résolution* (French authority for prudential control and resolution). French Monetary and Financial Code, Art. L. 613-55. See, Th. Philippon, A. Salord, «*Bail-ins and Bank resolution in Europe – A Progress Report*», 2017, International Center for Monetary and Banking Studies, available on the site of the Center for Economic, Policy Research.

71. – **Concerning the third condition relating to the transparent nature of the allocation of risks**, the condition is also not fulfilled. As Professor Eidenmüller recently recalled in his criticism of the proposed European Directive, an insolvency proceeding must include safeguards in order to avoid abuses, which presupposes a certain degree of formalism and transparency, supervision by neutral and competent experts, under the control of the court[135]. However, the complexity of French law renders incomprehensible the terms and conditions of the allocation of risk in the case of default of a French company. Furthermore, creditors' access to information is limited, unless one is a controller (and even then) in the proceeding. Creditors have a limited right to recourse against court decisions. For the sake of rapidly consolidating the decisions made by the court, their right of recourse is triply limited: firstly, at the level of the decisions for which recourse is available, then at the level of the persons liable to exercise the recourse and finally at the level of the time limit (absent special provisions, both an appeal as well as a third party opposition must be brought within ten days as of notification or its being entered or, as the case may be, its publication when a third party opposition is involved)[136]. It is not surprising under these circumstances that creditors do not feel adequately protected.

The proposal by the *Haut Comité Juridique de la Place Financière de Paris* (high legal committee of the Paris financial center («HCJP»)) to reform insolvency law – July 2016

In its report rendered in July 2016 on the reform of insolvency law, the HCJP concentrated its recommendations on the conciliation proceeding and the improvements that could be made in order to facilitate reaching agreements outside of the courts[137]. In this regard, the HCJP proposed instituting creditors' committees during the conciliation phase based on the model of those existing in safeguarding and judicial reorganization proceedings (credit and assimilated institutions' committee, main suppliers' committee, body of bond holders). If such measure is adopted it would produce equivalent effects for bond holders to the collective clauses currently advocated by the IMF enabling the forcing of the consent of entire series of bond holders once the majority in value of the creditors is favorable. The proposal of the HCJP, however, is open to criticism for the three previously mentioned reasons:

1°) The HCJP's proposal does not allow for a **foreseeable** allocation of risk to the extent that the order of priority of payments cannot be thus guaranteed, as the creditors are divided depending on the nature of their debt. Compliance with the order of priority is hardly a priority of the HCJP, which conforms to the French tradition up until now. However, all economists are in agreement in recalling the importance of this principle, including the strongest advocates of a more coercive approach in the handling of sovereign debt crises with regard to creditors, such as the Nobel Prize winner Joseph Stiglitz[138].

2°) The HCJP's proposal does not allow for an **equitable** allocation of risk. Contrarily to the IMF, the HCJP does not condition the introduction of the possibility of forcing the consent of creditors in a conciliation proceeding, compliance with the safeguards clearly established in such manner that investors have the certainty that the terms and conditions of the imposed restructuring are equitable considering the specificities of the situation of each of the creditors.

3°) The HCJP's proposal does not allow for a **transparent** allocation of risk, since the conciliation proceeding is confidential in nature, unless it leads to a court-ratified agreement.

72. – **A Decree-Law of 1935 on the organization of the body of bond holders unchanged**. In light of the difficulty in organizing public offers of exchange considering the deficiencies in bankruptcy law, a modification of the obligatory rules concerning the body of bond holders should be favorably received. In fact, encouraging contractual adjustments to the law appears necessary in order to authorize the reduction in the nominal amount of the bond debt to the two-thirds majority of the holders of bonds of the same series. The Decree-Law of 1935 limited itself to authorizing contractual adjustments whenever the bond loan is «issued abroad»[139]. The lawmaker did not consider that he had to preoccupy himself with the fate of foreign investors. This distinction has

135 - H. Eindemüeller, «*Contracting for a European Insolvency Regime*», *op. cit.*

136 - French Commercial Code, Art. L.661-1 *et seq.* and R.661-1.

137 - Haut Comité juridique de la place financière de Paris, Report of the insolvent businesses group, July 2016, available on the HCJP site: http://hcjp.fr/avis-et-rapports/.

138 - M. Guzman, J. Stiglitz «*Creating a Framework for Sovereign Debt that Works*», 2016.

139 - See above § 35.

been maintained with time and, as of today's date, bonds issued on the French market may not derogate the provisions of the law.

73. – **Contractual adjustments to the rules of the body of creditors: theoretical approach.** On a theoretical level[140], the transition of the rule of unanimity to the rule of the majority within a class of creditors having similar rights should not be possible unless two conditions are fulfilled:

1°) the creditors are adequately well-informed and are able to make rational decisions on this basis, and

2°) in their voting, the creditors seek an outcome that maximizes the value of the investment, assessed on a group basis including only those creditors of the series of bonds involved, rather than an outcome that maximizes the value of the investment on an individual basis[141]. In other words, if the risk of a conflict of interests within the body of bond holders is too great, which would prevent a vote in the interest of the bond holders as a group, the lawmaker should maintain the rule of unanimity.

74.– **The development of the management of assets on the bond holders' market militates in favor of a reform of the rules of the body of creditors.** These conditions must be able to be fulfilled whenever the holders of bonds are mainly institutional investors. Accordingly, the constant decrease these last few years in the number of individuals who invest directly on financial markets militates in favor of the possibility of introducing contractual adjustments. The holders must be able to freely waive the rule of unanimity if they so desire. Even if the bond holders do not waive it in practice (it should be pointed out that in syndicated bank loan agreements the rule of unanimity is always required by the parties, whereas they are free to waive it), a change in the rule would be advantageous. In the case of a public offer, this change should encourage issuers to more easily have recourse to coercive measures vis-à-vis their bond holders, such as the modification in parallel to the organization of the public offer, of the terms and conditions of the original bonds in order to render the *status quo* less attractive[142], without having the impression of violating a fundamental rule laid down by the lawmaker, aiming at individually protecting the consent of each bond holder, as in the case of Théolia and Bull[143].

75. – **A reform of the rules of the body of the bond holders allowing for contractual adjustments is in progress.** In extension of the «Sapin Law 2[144]», Ordinance no. 207-970 of May 10, 2017, aiming at favoring the development of bonds issued under French law enacts the disappearance of the *summa divisio* between, on the one hand, issuances carried out in France and, on the other, issuances carried out abroad. The Ordinance takes cognizance of the fact that, contrary to the 1930s, having given rise to the institution of the mandatory system of the body of bond holders, the majority of bond holders are institutions, having obvious negotiating power vis a vis the issuers as concerns the negotiation of the terms and conditions of the bond. Henceforth, the Ordinance gives priority to a distinction depending on the nominal value of the bond. Accordingly, above and beyond a certain threshold (*a priori*, 100,000 euros in the draft decree in the *Conseil d'État*[145]), in the issuance contract investors may provide that, «*all or part of the provisions of law and regulation relating to the body of bond holders, the representatives of the body, and the general bond holders' meetings do not apply to them*»[146]. This provision affords a predominant place to the contractual freedom of the parties. Investors can accordingly freely decide to collectively decide, with a majority, to receive shares in compensation for the delivery of their bonds. It remains to be seen whether, in practice, investors shall take advantage of this possibility. Furthermore, such Ordinance shall not settle all problems, to the extent that numerous French issuers issue bonds in accordance with the laws of Luxembourg or the State of New York. The rule of unanimity prevails in such cases. Lastly, the principle of contractual freedom must be tempered with respect to bond issues subject to French law whenever the threshold is reached. With respect to bonds giving access to equity securities, it is not possible to

140 - Z. Goshen, «*Controlling Strategic Voting: Property Rule or Liability Rule?*», 1997, 70 S. CAL. L. REV. 741, 745-46; W. Bratton, A. Levitin, «*The New Bond Workouts*», *op. cit*.

141 - Z. Goshen «*Controlling Strategic Voting Property Rule or Liability Rule?*», *ibid.*

142 - See, The American practice of exit consents, which consists in an issuer desirous of persuading bond holders to accept an offer of exchange with less advantageous bonds, to request the latter, at the same time that they offer their bonds, to vote in favor of the modification at the bond holders' meeting. In this way they devaluate the rights attached to the existing bonds after the modification has been adopted, significantly decreasing their economic value: *W. Bratton, A. Levitin*, «*The New Bond Workouts*», *op. cit*. This subject is also raised further on, *Cf.* §148.

143 - *Cf. supra* p. 23 for a detailed description of the Bull matter.

144 - Law no. 2016-1691 of December 9 2016 relating to transparency, the fight against corruption and modernization of the economy.

145 - Article 10 of the draft decree in the *Conseil d'Etat* (Council of State) available on the site of the *Trésor public* (Treasury) at the following address: http://www.tresor.economie. gouv.fr/15467_consultation-developpement-des-emissions-obligataires.

146 - Ordinance no. 2017-970 of May 10, 2017 tending to favor the development of bond issuances, Art. 20 (French Commercial Code, Art. L. 213-6-3).

derogate from the provisions of the French Commercial Code. The fact that the public powers did not go further in liberalizing the rules of the Commercial Code is regrettable.

4th observation: **The rules of French insolvency proceedings do not allow for ensuring those conditions necessary for the emergence of a market for the control of large companies in difficulty the debt of which is dispersed over financial markets. The absence of opportunistic investment funds liable to consolidate the debt of such companies in a reduced number of hands in order to take future control thereof creates a negative effect for French managers. This situation sometimes enables them to enjoy a privilege rarely afforded their American counterparts: releasing themselves from any financial discipline. The absence of a duty of loyalty of managers vis a vis their creditors is also such as to aggravate such irresponsibility the natural propensity of managers to put off making difficult decisions to a later date.**

76. – **It is in the interest of creditors to provoke an in-depth bond workout and to become shareholders.** A distressed recapitalization is not without inconvenience for the company and its creditors. It may unnecessarily delay an in-depth restructuring of the company's debt, as well as a change in governance, whereas such measures may turn out to be essential for the company's recovery. Admittedly, at first blush, creditors appear to be the principal beneficiaries of a reinforcement of equity. This, indeed, is the case whenever the use of the proceeds of a capital increase is used partially, or even exclusively, to repay prior liabilities. In this regard, in our sample bringing together the 30 largest transactions, the proceeds of capital increases were used 6 times for this purpose. It was even the exclusive objective in certain transactions, such as Solocal in 2014. This being so, whenever the proceeds of a capital increase are used for other purposes, creditors often have much to lose. The amount of such capital increases may appear inadequate to them and not able to afford adequate financial flexibility to the company for the financing of painful reorganizations as well as investment projects that are indispensable for maintaining its competitiveness. The more a company is located in a capital-intensive sector of activities and/or maintains intangible assets in its balance sheet and/or carries out its business in an exacerbated competitive environment, the greater the delay in restructuring its debt is damaging to the company and its creditors, by extension. At the time of determining the terms and conditions of a distressed equity offering, managers of companies in difficulty must take several conflicting interests into account:

1°) the risk that the equity transaction is not carried out in the absence of adequate participation of the shareholders, given the reticence of the latter to make an equity subscription in a company in difficulty, which is often synonymous with the transfer of wealth for the benefit of creditors: this risk should incite managers to reduce the amount of the envisaged distressed equity offering as much as possible so as secure the transaction, save being able to benefit from the support of a shareholder that is sufficiently important in order to guarantee its success; this risk shall be discussed in greater detail further on;

2°) the necessity of enabling the company to be able to secure its future; from this point of view, managers should be able to raise as much money as possible in order to (a) maintain activity during a slump while awaiting a cycle turnaround, and/or (b) making adequate investments in order to enable the company to effect a shift, for example, digital, as was the case for the Solocal Group;

3°) the necessity of not overly penalizing existing shareholders who may have already lost a great deal following a fall in price; they are liable to incur a major dilution; they are not always in a position to be able to take part in the capital increase, especially when they have been requested to reinvest very large sums, in proportion to sums already invested. Admittedly, existing shareholders always have the possibility of selling their preferential subscription rights on the markets; however, they may not always be able to sell them under good conditions, in particular whenever the number of preferential subscription rights is significant in relation to the number of common shares in circulation; from this point of view managers should be incited to reduce the size of the capital increase as much as possible.

77. – **Reconciliation of conflicting interests**. In the end, at the time of deciding the terms and conditions of a distressed equity offering, considerations relating to the preservation of the company's immediate interests take precedence over any other consideration. Managers will be inclined to favor an issuance at a subscription price bringing out a discount in relation to the stock market price before announcing the transaction, in order to compensate for the loss incurred by the subscribers due to the transfer of wealth for the benefit of the creditors (the latter, by assumption, making no or few debt waivers). For this purpose, the managers will have to put forward the gain made by the subscribers to the detriment of existing shareholders, who would decide to not take part. For such reason, the subscription price for such issuances often show discounts that may easily reach 60% -70% of the stock market price (for example, the transactions carried out by Vallourec and CGG in 2016)

and at the same time represent between 65% -75% of the total market capitalization (for example, the transactions carried out by CGG and Vallourec in 2016 as well as by Faurecia in 2009[147]). A discount and a large number of new shares indicate that the company's financial health is very poor and that the transaction is risky.

78. – **It is in the creditors' interest that the distressed equity offering is sufficiently well calibrated in order to avoid having to unnecessarily defer difficult decisions.** It is not in the interest of creditors, who are interested by a company's long term prospects, in leaving managers of companies in difficulty raise money for the sole purpose of playing for time without any real prospect of a turnaround. For this reason, the financial documentation may contain restrictions prohibiting the debtor from recapitalizing without the creditors' consent[148]. The creditors may even take the initiative and approach the manager upstream of a breach of covenant in order to raise a restructuring of the company's debt. Depending on whether the company is about to breach its financial covenants, creditors will or will not have negotiating power to compel managers to initiate discussions[149]. There are a large number of players on such market whose investment strategies may vary greatly. There are numerous ones having objectives that are not clearly established. It is therefore difficult to anticipate their decisions. Certain participants have long-term strategies and others short-term strategies[150].

79. – **The multiplication in Europe of opportunistic funds liable to invest in companies in difficulty.** Opportunistic funds specialized in investing in companies in difficulty (purchase of shares or loans to companies in difficulty) have multiplied. Over the last twenty years the amount of assets under management in this market sector has grown exponentially, first in the United States then in Europe[151]. These investment funds play a central role in the United States in the governance of companies in difficulty, well upstream from the date on which they are likely to become their shareholders, after having converted their debt instruments into shares. They thus deploy a strategy known as «loan to own»[152]. These funds purchase all types of debt instruments issued by the defaulting entity, at prices that always bring out a greater or lesser discount as compared to the face value of the instrument. Certain opportunistic funds are ready to invest very considerable sums in the debt of a target company, so that they are in a position to exercise a market discipline over all the companies, even large ones. Thus, several years ago, the Cerberus fund came to the United States to take control of the Chysler automobile manufacturer[153], unfortunately for the fund, just before the beginning of the financial crisis, which led Chrysler to the abyss.

147 - Prospectus of the Faurecia company, approval no. 09-124, dated May 6, 2009. Faurecia had to organize a recapitalization that was extremely dilutive for its shareholders when market circumstances were not conducive therefor right after the bursting of the financial crisis. The objective of this capital increase was to ensure compliance by the company with its financial covenants appearing in its bank debt and honor its commitments undertaken by virtue of its lines of credit becoming due in 2010. The particularities of the transaction and the Vallourec situation (high discount, high liquidity constraint) explains the performance of the shares issued in connection with this distressed equity offering. These discounts must be compared with the discounts observed whenever the proceeds of the capital increase enables financing of large acquisitions made by companies in good financial health. Thus, recently Air Liquide financed the acquisition of Airgas if needed by a capital increase, at a subscription price showing a discount equal to 20% as compared to the market face value; it should be noted that the increase was to lead to the issuance of a number of shares giving right to a dilution of approximately 11% of the shareholders' voting rights. Prospectus of the Air Liquide company, approval no. 15-426 of September 12, 2016, *op. cit.*

148 - This is the very object of equity cures. Equity cures are clauses found in the financial documentation of an LBO, pursuant to which financial covenants that are not observed are recalculated, retrospectively taking into account a subsequent capital injection by the shareholder (V. J. Stoufflet, «*Commentaire de diverses clauses insérées dans des contrats de financement d'opérations de LBO*» [Commentary on the various clauses inserted in financing agreements of LBOs], March 2008, RDBF, no. 2, file 15). In practice, equity cures are instruments that allow for protecting creditors' rights and avoiding that the sponsor, by its refinancing, does not mask without resolving, a company's profitability problems. For such reason, creditors are not generally favorable to them except whenever they are practically the exclusive beneficiaries of the capital increase.

149 - Most often it is the company that initiates negotiations with bond holders. Sometimes, however, it is the bond holders. This is less frequent since this presupposes that a breach of covenant is imminent or in progress. Failing this, a creditor has no power of negotiation. Managers may then just simply refuse to negotiate. This affirmation must, however, be put into perspective whenever a bond holder has accumulated a significant position. Even in the absence of default, the holder has a certain power of negotiation. Subject to insolvency law acknowledging the powers of creditors in insolvency proceedings, managers will agree to meet with the bond holder, acknowledging that at a given time in the future, the creditor may have a greater power of negotiation.

150 - S. Moyer «*Distressed debt analysis: Strategies for speculative investors*» March 2005, J Ross Publishing. In general, investing in debt instruments of companies in difficulty is a profession requiring special expertise and is reserved for institutional investors for several reasons. Firstly, it is a profession where the risk of significant losses is high. Secondly, it is a sector in which there is significant asymmetry of information between the parties. Lastly, each transaction on the secondary market has a minimal value of one million euros.

151 - In 2015, 27 billion dollars was raised in the United States in order to invest in this sole segment. Numerous opportunistic funds raised significant sums in Europe, on the promise of high rates, benefitting, in fact, from the race for returns in which numerous institutional investors or rich individuals launched themselves, in a contet of low rates, considering the accomodative monetary policy of the central banks. As of this date, the major investment fund in the world in the sector of companies in difficulty is Oaktree Capital Management which alone manages seven billion in assets. Preqin Global Data Coverage «*Mezzanine and Distressed Debt: On the Sidelines? Septembre 2016*» available on https://www.preqin.com/docs/newsletters/pd/Preqin-PDSL-September-16-Mezzanine-and-Distressed-Debt.pdf

157 - This strategy consists in investors taking control of companies in difficulty by converting their debts into equity securities of the debtor company. Their investments may be in the form of a loan, hoping to convert it at a future time into equity securities of the company or the purchase of debt held by its creditors on the secondary market. V.S. Vermeille, "*Peut-on prêter pour posséder (loan to own) en droit français?*» [Can one lend in order to own (loan to own) under French law?], 2009, JCP E 2009, no. 5.

153 - Forbes, «*How Chrysler put the bite on Cerberus*», January 5, 2009.

80. – **The presence of investors specialized in the companies in difficulty segment must be encouraged in the restructuring of large companies.** A debate is going on in the United States concerning the advantage of the presence of opportunistic funds for the economy and the companies involved. Studies have been carried out concerning the extent and performances realized on the market for control of companies in difficulty[154]. Studies have shown that under certain circumstances certain opportunistic funds deploy short-term strategies that are not necessarily in the interest of the company. For example, whenever what is involved is rather to encourage higher interest rates or pushing it to make asset disposals under conditions that do not allow for maximizing their value. Other studies have highlighted the advantage for a company in difficulty to have in its capital, following the restructuring phase, an opportunistic fund desirous of taking the reorganization of the company in hand.[155]. Several reasons militate in favor of the presence of large opportunistic funds liable to play an active role in negotiations:

1°) Investors, holders of debt instruments purchased on the secondary market, interchangeably agree to hold debt instruments or shares; now, in general, the more a restructuring plan provides for the conversion of debt into shares, the greater the chances that such plan shall allow for a lasting recovery of the company. Conversely, the more a restructuring plan provides for a mere refinancing of existing debt, the lesser the chances of recovery for the company are real. In connection with a restructuring plan, credit institutions always prefer either to be repaid or receive debt instruments rather than receive shares. Credit institutions are obliged to hold healthy assets in order to observe the prudential ratios imposed on them. In fact, they may more easily observe prudential ratios if they receive debt instruments, benefitting from effective security interests. Furthermore, considering the commitments they undertook vis-à-vis their depositors, they cannot allow themselves to lose money by agreeing to become mere residual shareholders. Conversely, opportunistic funds may be indifferent and more easily agree to receiving shares whenever the financial situation of the company so justifies.

2°) The intervention of opportunistic investors may contribute to facilitating reaching a lasting restructuring agreement for the company with the managers: the arrival of this type of player facilitates consolidating the debt in the hands of a few number of creditors. By definition, the opportunistic funds that imagine taking control of the debtor add greater value to the debt instruments issued by the debtor than investors who limit themselves to a passive short-term strategy. However, envisaging taking control of the debtor necessitates a considerable number of purchases of on the secondary debt market. For this reason, it is sometimes noted that as the company's difficulties increase, the debt is consolidated in the hands of a small number of creditors. Such consolidation may be welcomed by the company's managers in that it greatly facilitates negotiations. The company's managers can then count on the support of several large creditors in order to bring about the adoption of a restructuring plan. Agreements in support of the plan may accordingly be entered into between the parties pursuant to which the investors agree to approve the plan according to the terms and conditions reached by mutual agreement. In the case of sale of their debts to a third party, the investors also guarantee that such third parties shall comply with the commitments undertaken pursuant to the agreement. In the absence of opportunistic funds, the volumes of exchanges of debt remains very significant on the secondary debt market, thereby rendering agreement extremely difficult. For this reason the restructuring of Technicolor in 2009 was particularly difficult. Without consolidation of the debt, lenders are admittedly new investors, experts in «special» situations. However, they differ from investors liable to seek to become shareholders of the company. Their goal is to be reapid by the company as quickly as possible, if needed with the proceeds from a distressed equity offering; it is of little import if the transaction merely delays the difficult decisions. Ultimately, the launching of such an increase, as in the case of the Solocal Group in 2014, is a sign that the managers let themselves be convinced by creditors favoring a short-term strategy, in the absence of being able to envisage creating value by becoming a shareholder. This type of transaction may even be a sign of defiance on the part of creditors with respect to the viability of the company.

3°) Lastly, the intervention of opportunistic investors allows for effecting a change in control within the company, which may be beneficial for the often numerous problems of governance in companies in difficulty and may even be at the origin of their difficulties. From the moment that creditors consider that they are able to recuperate the control of the company, they are desirous of being able to be repaid via the capital

154 - E. Altman, «*Are Historically Based Default and recovery models in the high-yield and distressed debt markets still relevant in today's credit environment*», 2006, NYU Stern Sch. of Bus., Salomon Ctr., available on http://people.stern.nyu.edu/ealtman/Are-Historical-Models-Still-Relevant1.pdf.

155 - See, for a presentation of this discussion: M. Harner, J. Marincic, Griffin, J. Ivey-Crickenberger «*Activist Investors, Distressed Companies, and Value Uncertainty*», 2013, Tennessee Journal of Business Law 15. «*Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*». American Bankruptcy Institute Law Review, Vol. 16, No. 69, 2008, available on SSRN: https://ssrn.com/abstract=1147643; W. Jiang, K. Li, W. Wang, «*Hedge Funds and Chapter 11*». Journal of Finance, Volume 67, Issue 2, April 2012, Pages 513–560.

gain they expect to realize with the shares. This strategy guarantees that the new shareholders will do everything to pay down the debts of the company in adequate proportions.

81. – **The vested interest of long-term opportunistic funds provided that the activity of the company is viable.** The presence of opportunistic funds deploying «loan to own» strategies allows for reducing the risk that managers of companies in difficulty make short-term decisions, provided however that the activity of the company is indeed viable. Their presence is likely to reduce the risk of shareholders making a bad investment, by taking part in a distressed equity offering without any significant concession by creditors. Whenever, however, a significant doubt exists concerning the viability of the company's activity, opportunistic funds will necessarily adopt more short-term strategies that may raise criteria on the part of the other stakeholders. The company may thus not generate enough value in the opinion of the funds in order to justify its long-term support. This being said, two conditions are necessary in order to enable opportunistic funds, purchasing the debt of viable companies in difficulty, to emerge in the negotiation process in order to find long-term solutions for the company: (i) bankruptcy law that facilitates a change of control by the company's residual creditors, and (ii) rules of company governance facilitating this changeover. French law does not allow any of the conditions to be fulfilled.

82. – **Concerning the first condition, the insolvency proceeding must allow for a foreseeable, equitable and transparent allocation of risk.** Failing this, the insolvency proceeding prevents consolidation of the debt in the hands of a few creditors liable to wish to take control of the company. It is, therefore, highly unlikely that investment funds purchase large quantities of debt of large companies on financial markets. In fact, implementation of a loan to own strategy necessitates:

(i) that the rules of the insolvency proceeding confer the power to approve the reorganization plan of the company in insolvency in a limited number of classes of creditors; this condition is even more important whenever the debtor has a complex balance sheet containing several tranches of debt conferring different rights; based on this condition the fund can identify the tranches of debt to be purchased on the secondary market, in order to implement its strategy of taking control, failing which the fund must envisage purchasing all the tranches of the company's debt, which is illusory,

(ii) that this or these classes of decision-making creditors may be foreseeably identified upstream from the insolvency proceeding; this condition presupposes that if the class or classes of decision-making creditors are designated depending on the order of priority of payments and the financial situation of the company, failing which the opportunistic funds will hesitate in purchasing,

(iii) that the other classes of creditors and shareholders cannot oppose the reorganization plan approved by the decision-making creditors once a certain number of safeguards, of which the creditors are aware, have been observed.

83. – By conferring the right to approve the plan on all of a company's creditors and shareholders, insolvency law *de facto* creates an insurmountable poison pill, preventing the taking of control of large companies in difficulty, having complex balance sheets, by opportunistic funds investing in the medium term. For these reasons, the debt of the latter companies will not be consolidated within the hands of a limited number of creditors and will continue to be subject to a high volume of exchanges, as the Technicolor matter has demonstrated[156]. As the law stands, investment funds may only acquire companies having a simple balance sheet, with a single tranche of debt. The recent taking of control of the aeronautic supplier, Latécoère, by the Apollo Management fund[157] which had the specificity of not having issued bond debt, is a good illustration.

Parallel with the sovereign debt crisis

The parallel with the sovereign debt crisis provides a wealth of information concerning the consequences of the absence of insolvency proceedings in bond debt restructurings. In the absence of insolvency proceedings, the restructuring of sovereign debt is characterized by the absence of an alternative solution in case of failure of out-of-court negotiations. The recent sovereign debt crisis, whether in Greece or Argentina, demonstrated

156 - S. Vermeille, T. François, «*Le « feuilleton Technicolor » : et si rien n'était vraiment réglé ?*», *op. cit.*

157 - L'Agefi, «*Les actionnaires de Latécoère valident la restructuration du groupe*» [The shareholders of Latécoère validate restructuring of the group}, July 16, 2015.

the limits of a purely consensual approach in settling difficulties. Inextricable blocking situations sometimes prevented the settlement of difficulties during a long period of time.

The restructuring of the Greek debt re-launched the debate concerning the benefit of creating a competent international tribunal[158]. The absence of a forum in the case of an impasse in negotiations concerning sovereign debt complicates consensual negotiations between sovereign States in difficulty and their creditors, regardless of the applicable law. It should be noted that even if powerful States are able to impose their national law on investors, developing States are often forced to issue their bonds pursuant to the law of the State of New York. In any event, the increased complexity of sovereign debt instruments has led to an increase in hold out situations.

The stakeholders, the IMF in the lead, wished to reduce hold out situations in the future and proposed a modification of collective clauses in bond debt issuance contracts. The declared objective was to be able to compel not only minority creditors within the same series of bonds, but also entire series of bonds if the creditors in value and the sovereign State involved agreed on a solution, to accept an agreement[159].

Going against the flow of this movement, the economists, Joseph Stiglitz and Martin Guzman correctly pointed out that the multiplication of collective clauses in debt contracts is not a solution to all problems [160]. Market failures are too numerous, the contracts may always be improved and the consequences for the national economies involved shall always be burdensome.

A court (or *a minima* an arbitration proceeding) seems indispensible as an alternative to consensual negotiations and observance of the order of priority as well as the equitable treatment of the various categories of creditors.

Parallel with the LBO debt crisis

In principle, companies subject to an LBO are companies having a high growth potential at the time of being acquired by a private equity fund. The latter has recourse to financial leverage to pay for its acquisition. For this reason, companies subject to an LBO are presumed being able to support a high level of indebtedness.

Of course there are sometimes errors in the choice of the target, or the private equity fund does not anticipate profound structural changes in the sector of activity involved, or simply the bursting of a financial crisis, as that of 2008, reducing the prospects of refinancing these heavily indebted companies to zero. For this reason, companies subject to an LBO, although supposedly selected for their good health, are subject to a relatively high number of restructuring transactions in France.

Contrary to negotiations involving the debt of a listed company with a complex balance sheet, those involving the debt of a company subject to an LBO is characterized by 1) the presence of a majority shareholder, the private equity fund, having a wide experience in negotiations and, in principle, concerned about maintaining its reputation[161], and by 2) a weaker dispersion of the debt, even if such difference tends to diminish due to greater and greater recourse these last years to the bond holder market of issuers classified high yield for financing acquisitions. Until recently, the debt of companies subject to an LBO were characterized by recourse to a banking pool and a debt known as «mezzanine», that is, financing obtained in connection with a private investment.

Coordination between the creditors at the level of companies subject to an LBO is therefore, in principle, easier than in the case of a listed company with a complex balance sheet. Consequently, the progress of the offers and counter-offers phase upstream from a restructuring agreement is also easier. This situation facilitates reaching an agreement in spite of deficiencies in insolvency law. However, just as listed companies,

158 - M. Guzman, J. Stiglitz, «*Creating a Framework for Sovereign Debt that Works*» *op. cit.*; Ch. Mooney «*A Framework for a Formal Sovereign Debt Restructuring Mechanism: The KISS Principle (Keep It Simple, Stupid) and Other Guiding Principles*», 2015, available on: http://scholarship.law.upenn.edu/faculty_scholarship/1547; A. Haldane, A. Penalver, V. Saporta,S. Hyun Song, «*Analytics of Sovereign Debt Restructuring*», 2003, Bank of England Working Paper No. 203, available on SSRN: http://ssrn.com/abstract=597403.

159 - See, notably, Ch. DeLong, N. Aggarwal, «*Strengthening the Contractual Framework for Sovereign Debt Restructuring - The 'IMF's' Perspective*», 2016, available on SSRN: http://ssrn.com/abstract=2727309.

160 - M. Guzman, J. Stiglitz «*Creating a Framework for Sovereign Debt that Works*», *op. cit.*

161 - *Cf. supra* § 26.

unlisted companies with complex balance sheets suffer from the difficulty of reaching a long-lasting agreement during the phase of friendly negotiations which are organized in the shadow of an insolvency proceeding. It is therefore necessary to live with the lacuna of insolvency law.

Except in the financial situation of the target is extremely deteriorated, the private equity fund derives benefit from insolvency law in order to remain in the capital of the company, with the consent of banking institutions which, unfortunately, are often inclined to put off making difficult decisions. The creditors, therefore, often agree on an inadequate debt pay down of the company[162].

This situation is reflected by a high rate of renegotiation of agreements entered into in connection with an *ad hoc* mandate and a conciliation proceeding. The wave of restructuring of companies subject to an LBO, which began in 2009, thus demonstrated the limits of proceedings known as «friendly» (*ad hoc* mandate and conciliation proceeding) [163].

Currently, the most emblematic illustration of the difficulty of friendly proceedings in reaching a long-lasting agreement is that of the on-going restructuring of the Vivarte group. The company is subject to strong competition in the textile market sector. In less than three years, Vivarte has been subject to two successive restructuring agreements concluded during a friendly phase in the presence of a trustee, following an initial renegotiation of the debt without the intervention of a mediatory appointed by the court[164] and even though the private equity fund, Charterhouse, at the origin of the LBO, had very rapidly agreed to «hand over the keys» to an investment fund specialized in the purchase of companies in difficulty, Oaktree Capital Management, and not require being kept in the company's capital. Vivarte furthermore illustrates the fact that friendly proceedings are not adapted to handling the difficulties of companies suffering from serious operational problems, rapidly necessitating a separation of «good assets» from «bad assets» on the model of the bad bank and the good bank[165] in effect in banking failures in order to avoid a contagious effect within the whole group.

84. – **Concerning the second condition, the absence in French law of the duty of loyalty of the manager vis-à-vis creditors, increases the risk of making decisions that are not long-lasting for the company**. In the United States, the rules of corporate governance compel managers, confronted with the seriousness of the difficulties[166], often placed in a situation of denial, to make decisions upstream from the difficulties, which are necessary in order to ensure the recovery of the company. Historically, the law in the United States imposed on managers, as an extension of their obligations with regard to the company, to act in the interest of their shareholders[167]. More recently, in a decision «Credit Lyonnais Bank Nederland v. Pathe Communications», case law of the State of Delaware acknowledged the existence of a duty of loyalty of managers vis a vis creditors. This duty of loyalty takes shape whenever the company finds itself in a «zone of insolvency». Under these circumstances, the law of certain American States acknowledge that certain decisions of a manager may not be in the interest of the creditors, and, as such, are sanctioned. The essential argument relates to the fact that whenever a company is insolvent, the shareholders have, by definition, lost everything, and it is the creditors that thus have the most to lose. In this situation, the manager is liable to cause the company to incur thoughtless risks. Accordingly, he may be sanctioned for having launched investment projects that he knew were inadequately profitable in order to ensure the company's long-lasting recovery. Managers' duty of loyalty vis a vis creditors may also reduce managers' temptation to organize a distressed equity offering which would not be in the company's long-term interest.

85. – **Contours of the duty of loyalty in American law.** This case law is the subject matter of controversy in academia[168]. The demarcation of the «zone of insolvency» is not easy to define. Case law considered that it

162 - S. Vermeille, S. Bardasi, «*L'intérêt de l'analyse économique du droit dans le traitement du surendettement des sociétés sous LBO*», *op. cit.*

163 - *Ibid*, see also the importance of the being able to use an insolvency proceeding and not a preventive or friendly proceeding for handling serious operational problems of companies that necessitate, for example, the calling into question of suppliers' agreements and the termination of leasings, W. Adam, A. Levitin, «*The New Bond Workouts*», *op. cit.*

164 - Le Figaro, «*Vivarte a bouclé la restructuration de la dette*» [Vivarte completed its debt restructuring], October 29, 2014; Le Figaro «*Vivarte une restructuration massive attendue*» [Vivarte, an expected massive restructuring], January 17, 2017

165 - *Cf. infra* § 131.

166 - *Cf. infra* § 84.

167 - *Cf. infra*, point no. 115. We shall come back to this point in detail further on. *Cf. infra* footnote 168.

168 - See., for e.g., D. Baird, H. Todd, «*Other People's Money*», 2008, Stanford Law Review, Vol. 60, Symposium issue, U of Chicago Law & Economics, Olin Working Paper No. 359, available on SSRN: http:// ssrn.com /abstract=1017615; A. Hargovan, T. Todd, «*Financial Twilight Re-Appraisal: Ending the*

implies that the value of the assets of the company is less than the value of the liabilities or that the company is not able to meet its obligations in the normal course of business. In spite of the low number of sanctions against managers, this case law had a substantial impact on the conduct of managers, who are fearful of being held liable whenever they do not contend with difficulties early enough[169]. This rule of corporate governance plays a particularly beneficial role whenever, in the absence of breach of covenant, creditors are not able to threaten managers with requiring early repayment of their debts, if they do not take necessary measures. The rules of corporate governance may accordingly take over when the discipline of the market cannot fully play its role.

86.– **Interim conclusion*:*** The lacuna in insolvency law principally explains the absence of public offers of exchanges of bond instruments for shares, even if the financial situation of the company may justify a rapid and significant paying down of the debt. The arbitrary and uncertain allocation of risk in France, as well as the absence of loyalty of managers vis a vis creditors, severely complicates reaching a restructuring agreement upstream from an insolvency proceeding. This is especially the case with respect to debtors having optimized their financial structure and having confronted numerous creditors dispersed over the financial markets. The lack of ambition of managers in the friendly restructuring of their debts and the impossibility for opportunistic funds liable to take control of companies in difficulty, via the purchase of their debt, to exercise discipline over managers, has numerous adverse consequences for the company. Delaying the in-depth restructuring of its balance sheet risks increasing a company's difficulties and injure its recovery. As previously mentioned, in order to stabilize their financial situation, company managers shall probably be incited to find alternative solutions, the consequences of which are not very satisfactory. Accordingly, *a priori*, we should observe a greater propensity of companies in difficulty in France, as compared to the United States:

1°) in launching distressed recapitalization transactions, in spite of the risks of such transactions. This analysis is confirmed, as discussed earlier on, by empirical studies highlighting a greater number of «distressed equity offerings» in Europe than in the United States[170], these effects being examined in detail in the second sub-part of this part;

2°) in disposing of their assets whenever they incur difficulties, whether before or during an insolvency proceeding, in order to reduce their indebtedness. This analysis remains to be empirically confirmed;

3°) in having to lean on third party companies, after having had to take several years to handle their operational and financial problems. Admittedly, such debtors finally settle their difficulties by disposing of their assets and implementing one or several distressed recapitalizations which will have turned out to be necessary; from this point of view, these companies will have succeeded in recovering. However, such companies will have lost precious years. This analysis remains to be empirically confirmed; at this stage, it may be remarked that companies such as Rhodia (purchased by Solvay in 2010), Bull (purchased by Atos in 2014) and, of course, Alcatel-Lucent (absorbed by Nokia in 2015)[171], having been in difficulty for a long time, all ended by leaning on a third party. Even if a consolidation could have been necessary in their sector, in any event, such takeovers could perhaps have been made reversely if the managers and creditors had had the means of settling the difficulties more quickly and in greater depth;

4°) in having to open more insolvency proceedings in the future in order to deal with their bond liabilities once French companies shall get in the habit of optimizing their financial structure and having recourse to bond markets as much as American companies.

B) DISTRESSED EQUITY OFFERINGS FAVORED BY THE ABSENCE OF EFFICIENT CORPORATE LAW AND STOCK EXCHANGE LAW

***5th observation*: Failing incitement or means of significantly reducing the level of his debt, a French manager is more easily inclined to have recourse to distressed recapitalizations. The economic theory known**

Judicially Created Quagmire of Fiduciary Duties to Creditors», 2016, University of Pittsburgh Law Review, Vol. 78, No. 2, 2016 (DOI 10.5195/lawreview.2016.450), available on SSRN: https://ssrn.com/ abstract=2943069.

169 - M. Huebner, H. McCullough, «*The fiduciary duties of directors of troubled U.S. companies: emerging clarity*», 2009, Davis Polk & Wardwell.

170 - J. Franks, and S. Sanzhar, 2006, «*Evidence on debt overhang from distressed equity issues*» *op. cit.*; J. Park, «*Equity Issuance of Distressed Firms*», *op. cit.*

171 - L'Usine Digitale, «*Alcatel-Lucent, de la CGE en 1898 à la fusion en 2015 en 14 dates*» [Alcatel-Laurent, from the CGE in 1898 to the merger in 2015 in 14 dates], April 14, 2015; Le Nouvel Obs, «*Des « grands » patrons qui ont désindustrialisé la France !*» [The «major» bosses who deindustrialized France!], May 14, 2013.

as «debt overhang», postulates that rational shareholders normally refrain from taking part in transactions presenting such an important financial risk. However, empirical studies carried out in Europe, as well as our analysis of French cases, shows that there is a discrepency between theory and practice.

87. – **Attempt at definition of the debt overhang theory**. In theory, it is not so obvious that a «distressed» recapitalization can be used as an alternative to a pay down of debt transaction by the conversion of debt into shares. As previously discussed, shareholders are supposed to be sensitive to the risk of transfer of wealth between shareholders and creditors. For a long time economists have highlighted from both a theoretical as well empirical point of view the phenomena known as «debt overhang». This phenomena reflects shareholders' reticence to let managers reduce the level of a company's indebtedness although it may be very indebted. At first blush, it is not in the interest of shareholders to be reticent. The risk of default is kept away and the company thereby finds a means, for example, of re-launching it investment policy. A reduction in debt does not negatively affect the total value of the company. On the contrary, it may contribute to increasing it[172]. Even if there is every reason to believe that shareholders should be favorable to a reduction of debt, they have good reasons to be reticent thereof to the extent that creditors are the first beneficiaries thereof. A decrease in the level of indebtedness of the company by definition increases the chances of creditors having their debts paid; except if the shareholders obtain a concession of adequate compensation from the creditors, it is therefore not in the interest of the shareholders to authorize a debt reduction if the company is insolvent or close to becoming so.

88. – **The source of the debt overhang phenomena is the existence of a conflict of interest between shareholders and creditors**, considering the order of priority and the absorption of losses. A decrease in the level of a company's indebtedness is mechanically reflected by a transfer of value from the shareholders for the benefit of the creditors. Financial markets regularly note this transfer of wealth each time that a company announces it is going to increase its capital. Such announcement mechanically entails a fall in share prices of the companies involved[173].

89. – **A steady increase of decisions that defy the theory**. Shareholders' reaction to the measures aiming at reducing the level of indebtedness should depend on the type of transaction envisaged for reducing the level of indebtedness. Amongst all the options that may be envisaged, in principle shareholders should be most hostile to a «pure» recapitalization. Such a transaction leads to using the proceeds of a cash increase for the sole purpose of repaying existing liabilities. In the alternative, a company may reduce its level of indebtedness by means of asset disposals. The proceeds of the disposal is then used to repay its debt. A company may also reinforce its equity not for the repayment of its debt but to carry out new investments, as EDF shall do shortly[174]. In such case, the transaction leads to a correlative modification of the company's assets (due to the entry of new assets) and its liabilities (due to the reduction of the debt); it is not necessarily in the interest of the shareholders to contribute the necessary equity. Such reticence may exist even if the proceeds of the capital increase are to be used to finance projects that are considered profitable for the company[175].

90. – **The risk of abstention of the shareholders**. It is only in the interest of shareholders to take part in a capital increase if the expected return is adequate as compared to the risks incurred. It does not suffice, therefore, that the projects of the company to be financed are profitable; they must be sufficiently profitable from the shareholders' point of view. As previously mentioned, in principle shareholders are sensitive to the transfer of wealth between existing shareholders who do not take part in a capital increase for the benefit of shareholders who intend to subscribe to the transaction. However, if the company is insolvent there is no transfer of wealth. The company must accordingly justify the well-founded nature of the capital increase by demonstrating that a sufficiently important portion of the net value created by such projects can be captured by the shareholders. If the company fails in making such demonstration the shareholders shall consider that the only effects of the

172 - See, for a complete explanation, A. Admati, P. DeMarzo, M. Peter, M. Hellwig, C. Pfleiderer, «*Debt Overhang and Capital Regulation*», 2012, Rock Center for Corporate Governance at Stanford University Working Paper No. 114, available on SSRN: http://ssrn.com/abstract=2031204 or http://dx.doi.org/10.2139/ssrn.2031204

173 - This phenomena of debt overhang may even lead to a phenomena of addiction to debt by shareholders. Instead of reducing the level of a company's indebtedness, on the contrary they may be encouraged, assuming the financial covenants permit, to push the manager to increase the level of indebtedness of the company whenever the latter incurs difficulties. This situation is seen in France in respect of companies subject to an LBO. Sometimes companies that are over indebted do not hesitate in taking on more debt and pay a high price for this. The companies can thus use, from this perspective, the new money privilege of Article L. 611-11 of the French Commercial Code afforded contributors of fresh money in conciliation proceedings, following negotiations with their creditors on restructuring of the debt. In spite of the seniority ranking conferred on this new tranche of debt, the remuneration of this type of investment has often been two figures these last few years. Such significant remunerations in a context of low interest rates, is often equivalent to a shareholder's remuneration and shows that the company is still over indebted.

174 - Le Monde, «*Augmentation de capital d'EDF qui atteint 4 milliards d'euros*» [EDF's capital increase is reaching 4 billion euros], March 28, 2017.

175 - S. Myers, «*Determinants of Corporate Borrowing*», Journal of Financial Economics, 5, 147-175, 1977.

investment projects is to enrich the creditors whose chances of being repaid are improved. Under such circumstances, it would be totally logical for shareholders to abstain from taking part in a capital increase. For such reason, the consequences for the company are obviously dramatic if the theory of debt overhang factually materializes. The problem of debt overhang has been highlighted by numerous economists in order to explain the weak recovery of the economy subsequently to the 2007-2008 financial crisis due to the very high level of company debt[176].

91. – **Equity financing of projects more difficult in the absence of significant concessions**. In contradiction it appears with this theory, studies highlight the positive relation between the level of financial difficulty of a company and the occurrence of a capital increase[177]. These results do not, however, contradict the theory of debt overhang provided that the projects financed with the proceeds of a capital increase are suffficiently profitable for the shareholders and/or the latter have previously obtained adequate compensation from the creditors. This compensation must enable the shareholders to capture a share of the value created owing to the proceeds of the capital increase that is considered adequate. Depending on the company's financial situation, the mere rescheduling of debts cannot be adequate compensation. Considering the theory of debt overhang, one can guess that French companies that do not obtain adequate compensation from their bond creditors must incur difficulties in financing their investment projects. The reasoning is the following: if it is more difficult in France than in the United States to obtain from their bond holder creditors an early repayment of their debt in compensation for the issuance of new shares, the operational situation being equivalent, it should be harder for French companies to finance their investment projects in equity.

92. – **The practice in contradiction with the theory**. Fortunately for French companies, the theory of debt overhang is a poor preacher for distressed recapitalizations[178]. An analysis of a certain number of these transactions implemented by listed French companies highlight results that are in contradiction with theory. The table in Annex 1 shows the repetition of capital increases by certain very indebted issuers. Certain transactions serve only to repay past liabilities. The capital increases of Solocal in 2014 or Sequana in 2012 are the most outstanding examples of the last eight years. A little bit earlier the successive capital increases of Rhodia[179] equally left their mark on the news. After having carried out several asset disposals, Rhodia organized a recapitalization in December 2008 (the second in two years) to which its principal shareholder, Sanofi-Aventis, did not take part. The aim of the transaction was to refloat its negative equity of nearly 690 million euros. The funds raised were allocated in the amount of 420 million euros to repay the debt, while 150 million euros were appropriated to «financing development projects». Rhodia ended up being sold to the Solvay group in 2011. Other recapitalizations, such as those of Bull[180] and France Telecom in 2003[181] are revealing of the discrepancy between the theory of debt overhang and practice.

93. – Other recapitalization transactions less openly defy the theory of debt overhang than Solocal to the extent that the proceeds of the capital increases serve to finance restructurings transactions and even investment projects of the companies in question. For example, EDF envisages organizing in the near future a capital increase in the amount of 4 billion euros «which aims at making EDF the powerful electrician and champion of low

176 - C. Reinhart and K. Rogoff, «*The Aftermath of Financial Crises*», 2009, American Economic Review, American Economic Association, vol. 99(2), pages 466-72, available on SSRN: https://papers.ssrn.com/sol3/ papers.cfm?abstract_id=1329274; F. Occhino and A. Pescatori, «*Debt overhang and credit risk in a business cycle model*», 2010, Working Paper 1003, Federal Reserve Bank of Cleveland, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1595077

177 - Ph. Jostarndt, «*Equity Offerings in Financial Distress - Evidence from German Restructurings*», 2009, Schmalenbach Business Review, Vol. 61, pp. 84-111, 2009, available on: SSRN: http://ssrn.com/abstract= 1334110. J. Park, «*Equity Issuance of Distressed Firms*» *op. cit.*; J. Franks, and S. Sanzhar «*Evidence on debt overhang from distressed equity issues*» *op. cit.* There exists, however, exceptional circumstances during which it may be in the interest of shareholders to take part in a recapitalization in order to settle short-term liquidity problems. Following the 2008 financial crisis, the credit market was closed for all companies, regardless of their fundamentals (in particular, the solvency of such companies). Under these circumstances, it may be in the interest of companies to rush into the share market in order to raise money, before it also closed. We are not, by hypothesis, in such scenario within the framework of our study.

178 - J. Park, «*Equity Issuance of Distressed Firms*», *op. cit.*

179 - La Tribune, «*Rhodia lance une augmentation de capital de 604 millions d'euros*» [Rhodia is launching a 604 million euro capital increase], October 19, 2008.

180 - *Cf. supra* p. 23 for a detailed description of the Bull matter.

181 - As a consequence of a hazardous development strategy, France Telecom entered abysmal losses between 2001 (-8.8 billion euros) and 2003 (-20.7 billion euros). Its indebtedness, equal to 68 billion in 2002, made the company the most indebted in the world. As of 2003, France Télécom implemented a reorganization plan aiming, in particular, at reinforcing its equity. The company implemented a capital increase of more than 15 billion euros, as well as a public exchange offer concerning Orange, enabling it to gain 5.6 billion euros. Several years later, in 2006, France Telecom sold its nugget, Pages Jaunes. This level of indebtedness is even more disconcerting in a sector that requires annual major investments. In 2013, France Telecom became Orange. In 2014, Orange innovated and launched a perpetual debt platform, in euros and pounds sterling for 2 billion euros (L'Agefi, «*Orange se convertit à la dette hybride pour défendre sa notation*» [Orange converts to hybrid debt in order to defend its rating], January 24, 2014).

carbon growth»[182]. Three billion is subscribed by the State, in a context, as underscored by the *Cour des comptes* (court of auditors) «*where the financial equation of EDF remains strained and where the risks connected to its major projects appear non-negligible*»[183]. One may be sceptical with respect to the benefit for individual shareholders to subscribe to such a capital increase, even if the investment projects are presumed to be profitable. The conditions of the 2016 recapitalization of CGG also illustrates the discrepancy between theory and practice.

The successive restructurings of Eurotunnel[184]

Although for a long time Eurotunnel's debt was exclusively bank debt, the analysis of the conditions of its restructuring is very instructive. On September 14, 1995, Eurotunnel announced that it was suspending repayment of its junior banking debt in the amount of 8.56 billion pounds sterling. This default was one of the greatest ones ever seen in Europe. As of such date, 220 banking institutions were members of a banking syndicate constituted on an ad hoc basis. This number was decreased to 174 at the time of the financial restructuring.

In 1994, Eurotunnel was confronted with an uncontrollable debt in the amount of 10 billion pounds sterling whereas the original debt projections were only apporximately 5 billion pounds sterling. Eurotunnel's difficulties were essentially connected to errors committed at the time of the structuring of this extraordinary project. The latter was inadequately capitalized and did not include any sponsor, that is, a majority shareholder. Eurotunnel's capital was in fact comprised exclusively of minority shareholders, many of whom were individuals. Thus, the same errors were committed with Eurotunnel as at the time of the privatization of a certain number of companies in the 1990s, such as Compagnie Général des Eaux.

This was a major error: whenever the level of indebtedness is extremely high, as in the case of Eurotunnel, conflicts of interests amongst the various categories of investors are exacerbated. This situation advocates for a concentration of capital in the hands of a few in order to ensure that management of the company in fact takes the interests of the shareholders into account in conducting the company's business and not only those of the creditors. The latter can lead it to making investment decisions that are not in the interest of the shareholders and, by extension, in the interest of the company, as long as it is solvent. For this reason, in the financing of projects in general, and the financing of the tunnel under the Channel is not an exception, it is indispensable that the company have a majority shareholder.

In the Eurotunnel case, this situation gave much too much latitude to Eurotunnel's management which was thereafter criticized for having entered into contracts with suppliers and other Eurotunnel partners under conditions that were too costly for the company, thereby preventing any value in the project from being able to be captured by the shareholders.

The group was constrained to carry out two capital increases, only three years then seven years after its initial public offering. The effect of these capital transactions was to cause significant transfers of wealth from individual shareholders for the benefit of credit institutions. While in 1994, Eurotunnel carried out a second capital increase, the following year Eurotunnel suspended payment of its debt, thereby leaving it be presumed that Eurotunnel was indeed insolvent at the time of the capital increase.

During this entire period, the banking institutions captured all the operating cash flows generated by the project. It, therefore, did see any disadvantage in maintaining the group in a state of financial distress. The banks holding pattern was logical to the extent that the creditors did not have to fear that Eurotunnel's assets would evaporate under the weight of the debts. Eurotunnel's value lie in the concession agreements entered into with the French State and British State, which were not threatened with disappearing. Furthermore, the senior creditors had a right of substitution in the case of Eurotunnel defaulting on its debt.

The Eurotunnel case is a case study in the spoliation of individual shareholders for the benefit of banking institutions. No representative of the shareholders was invited to negotiate with Eurotunnel's co-contractors at the time the project was structured. Recourses were launched at the time by associations of the minority shareholders – two means were advocated:

- against the banks at the time of the capital increase. Under the pressure of the *association de défense des actionnaires d'Eurotunnel* (association for the defense of Eurotunnel shareholders (ADACTE)); in 1994 the

182 - Le Monde, «*EDF lance l'augmentation de capital de 4 milliards*» [EDF launches a 4 billion capital increase], March 7, 2017.

183 - Cour des comptes «*L'État actionnaire*» [The State shareholder], 2017, p. 52.

184 - L. Vilanova, «*Financial distress, Lender passivity and project finance: the case of Eurotunnel*», 2006, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=675304

Commission des opérations de bourses (stock exchange commission) initiated a sanctions proceeding against the banks for price manipulation (by means of massive purchases and sales in which the banks notably took part, guaranteeing the capital increase) and insider trading,

- against the managers – the offense of presenting intentionally erroneous accounts and projections that were clearly too optimistic. Following 10 years of proceedings, a judgment was handed down on July 4, 2007 by the 11th criminal chamber of the *Tribunal de Grande Instance* (District Court] of Paris and acquitted the sole manager that the ordinance of the investigating judge had sent before the criminal court[185].

In April 2007 an initial in-depth restructuring plan was finally approved. Considering the impossibility under French law in removing shareholders and creditors without their consent whenever the financial situation so justifies it, the restructuring could not emerge except from an agreement, that was the fruit of concessions by all of the parties. As is current practice in the restructurings of large French companies, this situation led to the issuance of very complex financial instruments that were totally incomprehensible for the individual shareholders (issuance of common shares, bonds reimbursable in shares, signature of a participating loan, of a resettable facility, new junior debt, etc., in exchange for the purchase of one and the same junior loan in an amount equal to approximately 8 billion pounds sterling). The proposal also provided for the distribution of equity warrants to the existing shareholders. The purpose of such warrants, if exercised in 2001 and 2003, was to avoid a subsequent dilution by the effect of the reimbursement in shares of the bonds redeemable in shares by the company. In other words, each time the small holders were asked to gamble on the future of the company by repaying prior liabilities a little more!

Desirous of protecting the fate of individual shareholders who were not responsible for the situation, the parties considered it a good idea to encourage them to make illusory financial gambles. Eurotunnel's misfortunes did not stop there, since it was not until 2006 that the company finally achieved the restructuring of its financial debt within the framework of a safeguarding proceeding. The plan provided this time for an overall reorganization of Eurotunnel. The objective was, in particular, to restructure the debt by significantly reducing the overall amount of debt.

Accordingly, a long-term loan was provided for and the issuance of bonds reimbursable in shares (BRS). These new financings were to enable refinancing the whole of the group's debt and decrease it from 9.073 billion euros to 4.164 billion euros. A new company was incorporated and listed in Paris and London, with a British mirror company to issue the BRS. This new entity was to then launch a public exchange offer for the holders of units of Eurotunnel PLC and Eurotunnel SA, enabling those holders who contributed their units to the public exchange offer to become shareholders of the new umbrella entity. In sum, by means of a public exchange offer, and in spite of the deficiencies of bankruptcy law, it was possible to organize the removal of shareholders in significant proportions and a part of the creditors. Accretion rights for the benefit of existing shareholders were, however, issued in order to reduce the dilutive effect of the plan, depending on the company's return to better fortune.

If we were to draw up a text book case and imagine Eurotunnel's bankruptcy today, no investment fund would be able to take control by purchasing its debt, considering the rules of insolvency proceedings. As in Technicolor, it is probable that the company would emerge from a possible insolvency proceeding with still too much debt, which is the fruit of a compromise amongst all of the parties.

The restructuring of Alcatel before its absorption by Nokia[186]

The analysis of the restructuring conditions of Alcatel allows for demonstrating the long-term consequences of the impossibility of a company to be able to rapidly restructure itself on the operational and financial level.

Alcatel arose from the Compagnie Générale des Eaux, the «CGE», which was nationalized in 1982 and privatized in 1987. However, the CGE was inadequately capitalized. Alcatel was a technological leader in the 1980s in the landline and cell phone field with the GSM. Alcatel, however, poorly negotiated the Internet turning point, the liberalization of telecommunications and market globalization. The company accordingly was the victim of repetitive strategic errors in the course of the last ten years. Its difficulties were aggravated

185 - Webmanagercenter.com, «*Relaxe de l'ex-coprésident d'Eurotunnel poursuivi pour informations trompeuses*» [Acquittal of the ex co-president of Eurotunnel prosecuted for misleading information], July 4, 2007.

186 - Telos.eu, «*Alcatel : la débâcle en chantant*» [Alcatel: the debacle while singing], May 5, 2015; Usine nouvelle, «*Le prochain Alstom, c'est Alcatel*» [Alcatel is the next Alstom], June 19, 2014.

following its merger with Lucent Technolgies, an American company that was already in great difficulty. The hope of opening the American telecommunication market in the future by means of this merger, however, very rapidly collapsed.

On the financial level, Alcatel was never able to recover from its under-capitalization problem, linked to the history of the CGE. Upon his arrival in 1995, Pierre Tchuruk found himself caught between the financial needs necessary for the development of the telecom-information activity and the immensity of an empire resulting from the time of conglomerates, to inadequate equity. In the beginning, Pierre Tchururk resolved the problem by indebtedness, but he was stopped by the bursting of the Internet bubble, which forced him to enter massive losses. At no time was Alcatel able to significantly reduce its debt.

At the end of 2012, Alcatel-Lucent was forced to pledge its patents with Goldman Sachs in order to finance itself. Alcatel thereafter issued OCEANES (bonds convertible or exchangeable into new or existing shares). In 2014, Alcatel-Lucent succeeded a distressed equity recapitalization in an amount of 995 million euros and in the same wake, a high yield bond program of 750 million euros and a syndicated loan of 500 million euros! This plan aimed at controlling the group's debt and financing the recovery of the company. At the time of the announcement of the plan, the stock market very obviously took it very badly with a 8% drop in the share.

Overall, Alcatel underwent five consecutive restructurings. On the verge of bankruptcy, Alcatel ended by succeeding its restructuring and was absorbed by Nokia in 2015. The shareholders who had invested in 2013 at the time of the distressed equity offering were able to realize a significant capital gain, after having incurred numerous losses in the past.

94. – The discrepancy between the theory of debt overhang and the reality necessitates explanations. We shall see that in order for the theory to concretize in the facts, a certain number of conditions must be fulfilled. Certain of these conditions are legal, in particular as concerns rules in respect to corporate governance. We shall see in what measure the large number of recapitalizations, known as «distressed» is revealing of the deficiencies of company law and stock exchange law.

6th observation: **The discrepancy between theory and practice is explained, firstly, by the difficulty of minority shareholders, placed in an information asymmetry situation, to correctly assess their proprietary interest in such transactions. This discrepancy is also explained by the propensity of a minority shareholder to let himself be trapped by his own cognitive bias which sometimes prevents him from adopting rational behavior.**

95. – The theory postulates that the shareholder is able to decide on the relevance of the capital increase in light of his proprietary interests. The theory is based on the hypothesis that the shareholder has adequate information (first condition) and that he is acting in a rational manner (second condition). In practice, these two hypotheses are rarely verified.

96. – **Concerning the first condition relating to a quasi perfect system of information**, reality shows that the shareholder rarely disposes of an adequate level of information or, at the least, he does not make himself adequately aware of the information available to him. In order to be able to decide on the relevance of a capital increase, the shareholder must be aware of the company's financial situation as well as its mid- and long-term prospects. Knowing the amount of the current income generated by the company does not suffice; the shareholder must be convinced of the profitable nature of the company's activity in the long term. In the same way, knowing the products or services currently furnished by the company is inadequate; the shareholder must be convinced that the products or services furnished tomorrow shall be adapted to demand and the market. Collecting information indispensable for making a decision has a cost for the shareholder.

97. – The manager intrinsically detains more information specific to the activity of the company than a minority shareholder. Assuming that the manager is fully willing to transmit all relevant information to the market (which, in practice, he never does in order to protect the company vis-à-vis its competitors and incur liability), correctly communicating such information to the market is not always easy. In fact, this amounts to delivering as complete information as possible, concerning the goods and services produced, the prospects for growth, sector-specific conditions, etc., which allow for forming an idea in respect to the company's future results.

98. – **The necessity imposed on company managers to publish their forecasts**. Furthermore, the information necessary for a shareholder to make a decision is often not fully available, even for the manager who is supposed to be the best placed. For example, the continuation of the reorganization plan put in place by the manager may be conditioned on a contribution of fresh money, thereby justifying a recapitalization of the company. Thus, the reorganization has then not borne its fruits at the time that the shareholder must decide to reinvest in the

company's capital. A certain number of conditions relating to the proper execution of the restructuring plan are not yet fulfilled. Furthermore, the recovery of the company may be linked to external factors that the manager does not have control of. Nevertheless, these conditions may be crucial for fully assessing the company's future prospects. In such hypothesis, even the manager does not have adequate information in order to guarantee the proper execution of the restructuring plan. He rarely makes forecasts due to such reasons. Stock exchange law does not oblige him to do so. The analysis of the 82 capital transactions with maintenance of preferential subscription rights, regardless of size, reveals that issuers rarely make forecasts. If they venture therein, they only make forecasts concerning the then-current year. However, *a minima*, he must understand the objectives that the company must fulfill in order that the capital increase create value for him.

99. – **The interest of guaranteeing the transaction in the assessment of the proprietary benefit of the transaction for the shareholders.** The fact that the recapitalization transaction is guaranteed by a banking institution enables the shareholder to avoid preoccupying himself with knowing whether the capital increase shall be subscribed to in the proportions that are adequate in order that all of the transactions envisaged by the company, justifying the carrying out of a capital increase, are realized. The shareholder then only has to preoccupy himself with the benefit of the transaction for him and not knowing how the other shareholders are going to react. Whenever he assesses the benefit that the transaction bears, a minority shareholder should ignore the past and focus solely on the benefit for him of the transaction, on a proprietary level, in light of the risk incurred. The decision of a shareholder to take part in the recapitalization transaction depends on several factors, in particular, the price of subscribing to new shares reserved to the company's shareholders, the company's future cash flow prospects and therefore the value of the company once operational adjustments are made, the cost of the money without risk and, of course, the amount of the concessions obtained from the creditors. For this reason, to forge an opinion in the absence of adequate communication by the company, and in particular in the absence of forecasts, appears quite illusory.

100. – **Value of subscribed shares**. The academic world agrees that the valuations carried out in respect of companies in difficulty are extremely difficult[187]. In general, determining the value of a company is a difficult art. Such exercise is even more difficult whenever the company is in difficulty. The new shares subscribed to in a company in difficulty accordingly take the form of an option whose value depends on clearly identified factors:

1°) the volatility of the value of the debtor's company (very important in certain sectors considered as very cyclical, such as the automobile and oil sectors). The lesser the volatility the more the value of the option is reduced; for this reason, taking part in the recapitalization of PSA, CGG or Vallourec makes more sense *a priori* than taking part in the recapitalization of Bull or Technicolor,

2°) the history of the value of the debtor company and its expectations for growth: the more the activity of the debtor decreases over time, the greater the probability that the company is unable to pay its debt when due and, therefore, the value of the option is reduced; for this reason taking part in the recapitalization of the Solocal Group, Sequana and Gascogne is very risky;

3°) the discrepancy between the amount of the financial debt and the value of the company: the greater the discrepancy the greater the probability that the company is unable to pay its debt when due; and, finally,

4°) the duration of the period preceding the expiry date of the option, that is, the payability date of the financial debt: the shorter this period, the more the option value is reduced.

101. – **The indispensable communication of forecasts**. Considering the results of empirical studies showing a level of the average return of a share of a company in difficulty, less than that of a company in good health [188], the law should require that shareholders have a right to require a greater level of information concerning companies in difficulty than companies in good health. For this reason, it appears necessary to reinforce the obligations incumbent upon companies in difficulty, whenever they envisage carrying out distressed capital transactions. For this reason we propose compelling companies to disclose, every three years, projections of business plans, in support of their decision to carry out a distressed recapitalization offering. In particular, the companies shall clearly communicate objective factors in support of which they effect their forecasts which will enable justifying the benefit of the recapitalization for an informed minority shareholder. The relevance of these objective factors, as the projections of the company, should be validated by an independent expert, who may be the statutory auditors.

187 - A. Eisdorfer, A. Goyal, A. Zhdanov «*Misvaluation and Return Anomalies in Distressed Stocks*», 2011, Swiss Finance Institute Research Paper No. 12-12.

188 - *Cf. supra* § 7.

102. – **Concerning the second condition, relating to the rational nature of the shareholder's investment decision**, this condition is also difficult to fulfill. Shareholders often suffer from cognitive bias. These biases are exacerbated by other factors that prevent a shareholder from making a rational investment decision:

1°) A minority shareholder risks making his investment decision, with regard to the difference between, on the one hand, the stock market price of the share at the time of the announcement and, on the other, the subscription price offered in connection with the recapitalization. In fact, the terms and condition of the capital increase are set in such manner as to convince, to the greatest extent possible, the shareholder to take part in the transaction. The subscription price of new shares is always significantly less than the stock market price of the company, just before the announcement of the transaction. Accordingly, the shareholder may have the impression of getting a «good deal», since he presumes that this stock market price is a price that reflects the true value of the company with respect to its difficulties. However, the stock price for the shareholder is a poor referential as the assessment of the extent of the company's difficulties is difficult to carry out. In fact, under such circumstances managers often hesitate in transmitting relevant information. The risk that the shareholder mistakenly uses the stock market price before the announcement of the transaction as referential, is aggravated by the fact that the company insists on the benefit for the shareholder in taking part in the recapitalization in order to avoid a massive dilution of his rights. If he does not subscribe to the capital increase, the shareholder is warned of the fact that the price of the preferential subscription right could not constitute a fair compensation for the dilution of his rights. Regardless of the benefit for the shareholder of a recapitalization, preferential subscription rights are almost never exchanged on the markets at a price that reflects the supposed fair value of the right to subscribe new shares of the company with a discount. This situation is connected to the fact that often recapitalization leads to the issuance of a large number of new shares on the markets, compared to the company's capitalization. The market then is not able to absorb this considerable offer of new shares.

2°) Furthermore, a minority shareholder risks making his investment decision based on the difference between, on the one hand, the historical price of the share at the time that he acquired his shares, or, at the least, the average price in the course of the six preceding months and, on the other, the subscription price. However, it is frequent that the recapitalization transaction takes place after a long decent into hell of the company's stock market price. For this reason, the decision of the shareholder may be motivated by the desire to «recuperate». In this hypothesis, he then suffers confirmation bias. This bias explains the tendency of the shareholder to look for and take into consideration only that information that confirms his starting beliefs concerning the company's prospects. Accordingly, his opinion takes root at the time he purchases his shares, the shareholder ignoring or even discrediting any information contradicting it. The risk that the shareholder mistakenly uses the historic price of the share, at the time of acquisition, is aggravated by the fact that the company insists on the benefit for the shareholder in taking part in the recapitalization, in order to take advantage of the turn of events, often presented by the company as taken for granted through its communication.

104. – For all of these reasons, the shareholder inadequately measures the extent of the alignment between his interest, that of the managers and that of the company. He may thus not realize that in the case where the creditors did not make veritable concessions, his proprietary interest in taking part in the recapitalization is weak. The interest in protecting minority shareholders against their own cognitive bias is open to debate. After all, most shareholders today are informed investors and no longer individuals as in the past. Furthermore, investing in financial markets naturally comprises risks that shareholders are presumed to accept.

105. – **An alternative solution: PIPEs**. At this stage, one must ask whether it is not perferable to encourage companies in difficulty to seek an investor, specialized in the type of financing considered and which therefore has a better level of information than the historic shareholders having a wider investment policy. The capital increase may thus take the form of a capital increase reserved for a named person (private investment in public offering) or «PIPE». Considering the existence of a «distressed puzzle[189]» this presupposes being able to offer to this type of investor a return prospect greater than the return prospect that the company in difficulty would have been able to offer to its shareholders if it had opened the subscription to the transaction to all of its shareholders. In other words, the company would have to offer to a sole investor the benefit of subscribing to the new shares with a very sizeable discount, so that said investor would hold a significant share of the capital subsequently to the transaction.

189 - *Cf supra* § 7. The «distressed puzzle» expresses the fact that the average level of return of a share of a company is abnormally low.

106. – **The obstacles to recourse to PIPEs in France**. The extensive assessment of the AMF in respect of equal treatment of shareholders oftn prevents the carrying out of PIPEs in France whenever the company is in financial difficulty. In fact, the AMF requires, under these circumstances, that all of the shareholders may take part, if they so desire, in the recapitalization of the company once the subscription price is significantly lower than the stock market price, which by hypothesis is the case[190]. A modification of the AMF's doctrine in such matters is desireable. As previously raised, it is frequent in the United States that companies carry out PIPEs whenever they are in difficulty and they want to rapidly benefit from an equity contribution[191]. It is a fact that PIPEs are sometimes the subject matter of controversies whenever the subscription price offered the investor was indexed on the evolution of the stock market price, subsequently to the carrying out of the transaction. Accordingly, the more the price of the share dropped, the more the share of the investment fund in the capital increased. Clearly, this type of clause would be illegal in France to the extent that it would lead the shareholder to exonerate itself from losses. The last PIPEs in the United States were carried out at a set price[192]. PIPEs remain a means of rapidly enabling a company to improve its cash flow situation in the context of a difficult market and strong defiance of the market, at a stage that is very upstream from difficulties.

107. – In any event, the best means for the lawmaker to handle both, on the one hand, the problem connected to the information asymmetry situation in which minority shareholders find themselves and, on the other, the risk that their investment decision is not rational, is to require companies to not propose to their shareholders to take part in recapitalization transactions whenever the transaction is clearly not in the interest of the shareholders considering the evolution of the company's activity. This objective can only be achieved on the condition that the managers of these defaulting companies undertake to act in the interest of the shareholders. We shall see that the rules of corporate governance applicable in France are far from enabling such objective to be attained.

7th observation: **The discrepancy between theory and practice is also explained by the conflict of interest in which the manager finds himself; he frequently finds a personal interest in organizing a distressed recapitalization in order to maintain his advantages, in particular his employment and/or to avoid marring his resume with an insolvency proceeding with respect to a company for which he was responsible. More generally, the discrepancy is explained by the inadequacy of French corporate governance rules which do not offer minority shareholders any efficient tool for protecing themselves from the natural tendency of managers to cause a company in difficulty to run an excessive risk under these circumstances.**

108. – **The manager is best placed to assess the investment risk**. The difficulties encountered by shareholders in order to assess the seriousness of the situation of a company in difficulty justify that they leave it up to the decision of the manager, who in principle is best placed. Consequently, the manager should refrain from proposing a recapitalization of the company whenever such a transaction is probably contrary to the proprietary interest of his minority shareholders. In other words, the manager should refrain from proposing an issuance of new shares whenever he knows that he is causing shareholders to take an inordinately risky financial gamble. Even if the appetite for risk varies from one shareholder to another, the manager should refrain whenever the risk of failure is very high. Moreover, this position is in the interest of the company since, whenever the risk is too high, the company is probably insolvent. It is therefore unlikely that the capital increase is adequate in the long term.

109. – **The discrepancy between the theory of debt overhang and practice shows that a manager may not act in the interest of the shareholders**: either because he is pursuing a personal interest, distinct from that of the shareholders, or because he is acting in the immediate interest of the company to the detriment of the shareholders' interest, or also because he is acting irrationally, falling into the trap of cognitive and heuristic biases as discussed earlier.

110. – **Concerning the risk that the manager fall into the trap of cognitive biases:** works in behaviorial economics highlight that company managers are no different than the rest of the population on a psycholoical

190 - Such doctrine of the AMF, however, is not public.

191 - S. Chaplinsky, «*Pipes: Private Equity Investments in Distressed Firms*», 2008, available on SSRN: https://papers.ssrn.com/sol3/pap ers.cfm?abstract_id=909741.

192 - S. Champlinsky, D. Haushalter, «*Financing Under Extreme Risk: Contract Terms and Returns to Private Investments in Public Equity*», 2006, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm? abstract_id=907676.

level. Just as most human beings, managers sin, in general, by excess confidence and, consequently, have a tendency to cause the company to run excessive risks[193].

111.– Managers are less concerned by this bias at the beginning of their careers. In the course of their experience they are trapped by the effect of a second cognitive bias, called attribution bias[194]. This bias is reflected by a natural tendency of an individual to under-evaluate the weight of external factors (situations, outside events, others) and over-evaluate the weight of personal factors (natural personal dispositions, personality traits, intentions, efforts) in analyzing the factors of his professional success. Managers thereafter have a tendency to excessively attribute the success of the company to themselves. Their accumulation leads to a manager, who has not sinned by excessive confidence at the beginning of his professional career, to cause his company to run excessive risks[195].

112. – Research has highlighted that a manager's excessive confidence is reflected by excessive optimism whenever the company is prey to financial difficulties. The manager then adopts a too conservative attitude[196]. The manager has problems in facing reality and has a tendency to think that past successes will make tomorrow's successes. This difficulty in assessing the seriousness of the company's difficulties may naturally lead a manager to prefer to gaining time and put difficult decisions off for a later date. Such attitude may lead a manager, in good faith, to request his shareholders to recapitalize the company in order to enable the company to surmount difficulties he considers temporary. For this reason, it is very important that there exists effective counter-powers vis-à-vis managers, within the company, in particular within boards of directors[197].

113. - **Concerning the risk that the manager is in a conflict of interests situation:** a manager's pursuing of his personal interest may also lead him to make decisions that are contrary to the interest of the company, and more particularly, that of the shareholders. In fact, a conflict of interest may oppose the shareholders and the manager in the case where the control and ownership are dissociated, as is frequently the case in large listed companies. Whenever a company undergoes financial difficulties, the risk of a conflict of interests between the shareholders and the manager is exacerbated to the extent that the effects of a default are significant for a manager. An insolvency proceeding entails severe consequences for managers, in particular a very great decrease in their remuneration in the two/three years following the loss of his employment[198]. A study highlights that in the United States 70% of managers lose their job once the company has emerged from an insolvency proceeding[199]. In a general manner, the manager is likely to lose all his benefits acquired in the company. He may also lose the specific human capital that he has developed for the benefit of this company and which would probably be difficult to use in another company.

114. – **Under these circumstances a manager may easily commit, for example, acts unknown by the shareholders that are contrary to their interest**. For example, a manager may have a personal interest in investing in projects in spite of the fact that they create little value for the sole purpose of avoiding losing his employment[200]. He may also find himself in a situation of moral hazard, by not disclosing essential information to his

193 - The referential for assessing the rational behavior of an agent is the *homo œconomicus*. It is a theoretical representation of the behavior of a human being. It is the basis of the neo-classic model in economy. Rationality is characterized as the internal and logical coherency of behavior in a system of preference and given belief. Rational behavior implies that the person making a decision must have a well-established preference set to the point of being able to attribute to each of the options a well-defined utilitarian value and thereby be able to establish a hierarchy of preferences. Behavior is said to be rational if, as previously discussed, the human being disposes of all information necessary for making a decision and he thus can fully measure the consequences of this or that option. Lastly, he must have adequate cognitive dispositions for assessing each of the possible scenarios. See, B.A. Mellers, A. Schwartz, A.D. Cooke, «*Judgment and decision making*», 1999, Annu. Rev. Psychol., 49:447-77.

194 - *Ibid.*

195 - See, for e.g., A. Goel, A. Thakor, «*Overconfidence, CEO Selection, and Corporate Governance*», 2008, 63 J. FIN. 2737, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=890274; D. Langevoort, «*The Organizational Psychology of Hyper-competition: Corporate Irresponsibility and the Lessons of Enron*», 2002, 70 GEO. WASH. L. REV. 968.

196 - A. Goel, A. Thakor, «*Overconfidence, CEO Selection, and Corporate Governance*», *ibid.*

197 -The corporate governance code drafted by the AFEP (*Association française des entreprises privés* (French association of private companies))/MEDEF (*Mouvement des entreprises de France* (national confederation of French employers)) obviously encourages companies to constitute their boards of directors in such manner as to counter-balance managers' powers. It could be of interest to insist on the very important role that the independent members of the board of directors must be led to play whenever a company makes decisions likely to create a conflict of interests between the company and its shareholders. In practice this is not the case to the extent that there is no duty of loyalty incumbent upon them, if not to respect the interest of the company, which is not an adequate indicator whenever the company is in great difficulty and all the interests present are exacerbated.

198 - See, in particular E. Eckbo, K. Thorburn, W. Wang, «*How costly is corporate bankruptcy for the CEO?*», 2016, Journal of Financial Economics, Elsevier, vol. 121(1), pages 210-229, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2138778.

199 - K. Ayotte, and E. Morrison, «*Creditor Control and Conflict in Chapter 11*», 2009, The Journal of Legal Analysis, Vol. 1, No. 2, pp. 511-551, available on SSRN: http://ssrn.com/abstract=1463413; L. LoPucki and W. Whitford, «*Patterns in the Bankruptcy Reorganization of Large Publicly Held Companies*», 1993, 78 Cornell L. Rev. 597.

200 - J. Park, «*Equity Issuance of Distressed Firms*», *op. cit.* It has furthermore been highlighted that the loss of remuneration, the evaporation of the human capital developed for the specific needs of the company and the effect on reputation encourage managers to continue to finance projects that do not create value.

shareholders concerning the company's future. Whenever the latter are not adequately informed they are not able to be aware of all the parameters that led the manager to make his decision. The shareholders can then not judge the relevance of the manager's decision, such as that of organizing a recapitalization transaction[201].

115. – **For all of these reasons, counter-powers, both external to and internal in the company, are absolutely essential in a company in order to improve its governance**. Such counter-powers are even more essential whenever the company undergoes financial difficulties. In fact, such situation exacerbates the risk of conflicts of interests amongst the various parties, not only between the manager and the shareholder, but also between the company and its shareholders and creditors. The counter-powers must function in such manner that decisions committing the future of the company are made with knowledge of these conflicts of interests and in conformity with law.

116. – **The distressed recapitalization of a company is a good example of a decision opposing the interest of the company, that of its manager and that of its shareholders and creditors**. Contrary to conventional wisdom, it is never in the interest of a company to carry out a distressed recapitalization in order to reinforce its equity if such transaction allows for financing unprofitable investment projects. As previously mentioned, the interest of the shareholders is much less certain. With respect to creditors, depending on the circumstances, they have a greater or lesser interest in the carrying out of such transaction. A study has highlighted that the weaker the governance of a company with respect to a certain number of specific criteria[202], the greater the propensity of managers to carry out a distressed recapitalization. The less the interests of the shareholders are taken into account in the governance of the company, unsurprisingly increases the risk of a distressed recapitalization. Accordingly, certain distressed recapitalizations are carried out considering the governance of companies that it considered deficient with respect to certain international criteria.

117. – **It is symptomatic that French company law does not really interest itself in the issue of conflicts of interests within a company**. Few dispositions exist such as to discourage a manager from carrying out a distressed recapitalization that is too risky for his shareholders. At this stage we shall point out:

1°) **The weakness of counter-powers inside the company (independent members of the board of directors, general meetings)** considering the absence of specific duties of French managers vis-à-vis his shareholders and creditors; indeed:

a) according to case law, the manager has an obligation to act in the interest of the company[203] and not in the interest of the shareholders in spite of the provisions of the French Civil Code[204]; contrary to other foreign laws, the pursuit of the interest of the company by the managers is not accompanied by an obligation of loyalty vis a vis the shareholders;

b) under French law, no duty of general loyalty exists incumbent upon a manager vis a vis the shareholders and creditors (as previously discussed)[205]. The flagrant lack of loyalty of the manager vis a vis the company – only – and not vis a vis the shareholders is only sanctioned under French law owing to criminal law, in particular the offense of embezzlement of company assets;

See, in particular, S. Grossman, O. Hart, J. McCall. «*Corporate Financial Structure and Managerial Incentives*», 1982, *The Economics of Information and Uncertainty* (University of Chicago Press), pp. 107–140. ISBN 0-226-55559-3; Ph. Aghion, P. Bolton, «*An incomplete contracts approach to financial contracting*», 1992, Review of Economic Studies, 77: 338-401; M. Dewatripont, J. Tirole, «*A theory of debt and equity: Diversity of securities and manager-shareholder congruence*», 1994, Quarterly Journal of Economics 109: 1027-1054.

201 - F. Drescher «*Insolvency Timing and Managerial Decision-Making*», 2013, Edition Springer Gabler, pp. 87 *et seq.*.

202 - J. Park, «*Equity Issuance of Distressed Firms*», *op. cit.*

203 - See, for example, Cass. Com, December 13, 2005 no. 03-18.002.

204 - French Civil Code, Art. 1833.

205 - Case law acknowledges a manager's duty of loyalty in a limited number of cases. Admittedly, a manager must, however, manage in conformity with the interest of the company and show himself loyal with regard to a shareholder whose stake reclassification, in particular, he assures. Cass. com., February 27, 1996, no. 94-11.241; Cass. com. May 12, 2004, no. 00-15.618; Cass. com. February 22, 2005, no. 01-13.642 and July 11, 2006, no. 05-12.024; Cass. com., March 12, 2013, no. 12-11.970; Cass. com., April 12, 2016, no. 14-19.200. For the manager, the obligation of loyalty consists in informing the selling shareholder of the existence of on-going negotiations with a view to the resale of his shares and in not hiding information of such nature as to influence his consent and *a fortiori* the manager only may be aware of. The scope of application of the duty of loyalty is tending, however, to expand: obligation to reveal any conflict of interests, to observe an obligation of information and transparency or to refrain from any act liable to compete with the company that he is conducting. For example, it has been held that the general manager of a stock corporation committed a serious fault by breaching vis-à-vis the principal shareholder the duty of loyalty appearing in his officer's agreement, by disseminating a negative message concerning the financial situation of the company to the company's financial partners (although the majority shareholder had requested that he be neutral) and putting into place strategies contrary to the interest of the majority shareholder unbeknownst to the board of directors by consulting specialized banks, by getting ready to begin negotiations with an investment fund that was a competitor of this shareholder, whereas certain directors were in the middle of negotiations in order to recapitalize the group. CA Versailles, July 1, 2014, no. 12/07800, see, B. Dondero, «*Société anonyme – La loyauté du dirigeant envers l'actionnaire*» [Stock corporation – Loyalty of the manager towards the shareholder], La Semaine Juridique Entreprise et Affaire no. 38, September 2014. See, more generally in respect of a manager's

c) these inadequacies in the definition of the duties of a manager necessarily present an obstacle in the prospect of uncovering the conflicts of interest amongst the various parties involved in a decision. French law does not adequately concern itself with these issues, which considerably weakens the governance of companies in difficulty;

d) these provisions of French law are unique in relation to the law of countries in which deep financial markets exist. By comparison, in American law (with several variations according to the States), a manager has fiduciary duties, as previously discussed. Whenever a company is solvent, its managers and directors have an obligation of prudence and loyalty vis-à-vis the company and its shareholders[206].

2°) **Amongst the counter-powers that are external to the company, the relative weakness of sanction mechanisms to public policy rules**, thus:

a) sanctions in case of violation of market rules intended to protect third party investments, in particular in the case of dissemination of misleading information, are inadequate;

b) the lawmaker in France struggles to envisage criminal business law as a means of improving the efficiency of financial markets via the establishment of extremely severe criminal penalties (and not only for the purpose of re-establishing moral order) contrary to the custom in Anglo-Saxon countries[207]; the Law of June 21, 2016, which led to an increase in penalties, notably in the case of the offense of dissemination of misleading information[208], must be favorably received from this point of view. The impact of this change must be assessed in practice. At present, it will be difficult to gather the proof that would allow for sanctioning a company manager for having organized a recapitalization transaction for the purpose of saving his company (even if the transaction was guided above all by his personal interest) and thereby having abused the credulity of his shareholders.

3°) **Amongst the other external counter-power mechanisms, the extreme weakness of private litigation**, thus:

a) The contours of an *ut singuli* action for a manager's mismanagement[209] are difficult to implement and do not allow for disciplining the behavior of managers upstream; the absence of a duty of loyalty furthermore also poses difficulties to the extent that it is difficult to find a cause for his action;

b) French law does not recognize class actions in favor of shareholders, which renders very problematic the financing of an action for liability[210]; it is always beneficial for shareholders that it is a third party, rather than each of them, who pays procedural costs;

c) The scope of application of an action for a shortfall in assets initiated by a liquidator against a manager is too limited in order to truly contribute to the proper governance of companies in difficulty; such action is intended to sanction a manager in the case of an asset shortfall whenever the manager has committed faults having led to the increase in liabilities; this action presupposes that the company is already in court-

duty of loyalty: B. Daille-Duclos, «*Le devoir de loyauté du dirigeant*» [The manager's duty of loyalty], September 1998, La Semaine Juridique Entreprise et Affaire no. 38.

206 - This difference between French company law and American company law, in particular that of the State of Delaware, can be explained by the fact that American financial markets are characterized by a capital structure in a greater number of hands. Conversely, the capital structure of large companies in France and elsewhere in continental Europe remains very concentrated. There are very few companies that do not have a shareholder of reference. The majority shareholder is thus supposed to ensure, by his action, the protection of the minority shareholders. In the absence of a majority shareholder in the capital of American companies, the law of Delaware is more concerned than French law in ensuring an alignment, at all times, of interests between the manager and his shareholders. See, for an analysis of the implications of insolvency law on the allocation of capital: J. Armour, B. Cheffins and D. Skeels «*Corporate ownership structure and the evolution of bankruptcy law in the US and the UK*», 2002, ESRC Centre for Business Research, available on http://econpapers.repec.org /paper/cbrcbrwps/wp226.htm.

207 - See, notably T. Brown, «*Nobody Goes to Jail: The Economics of Criminal Law, Securities Fraud, and the 2008 Recession*», 2015, New England Journal on Criminal & Civil Confinement, Vol. 41 Issue 2, pp. 343-365; See, also Th. Moellers, «*Efficiency as a Standard in Capital Market Law - The Application of Empirical and Economic Arguments for the Justification of Civil Law, Criminal Law and Administrative Law Sanctions*», 2009, European Business Law Review, Vol. 20, pp. 243-271, available on SSRN: http://ssrn.com/abs tract=1709855; H. Jackson, M. Roe, «*Public and Private Enforcement of Securities Laws: Resource-Based Evidence*», 2009, *Journal of Financial Economics* (JFE), Vol. 93, 2009, Harvard Public Law Working Paper No. 0-28, Harvard Law and Economics Discussion Paper No. 638, available on SSRN: http://ssrn.com/abstract=1000086 or http://dx.doi.org/10.2139/ssrn.1000086.

208 - Law no. 2005-842 of July 26, 2005 introduced the offense of dissemination of false or misleading informationa (French Monetary and Financial Code, former Art. L. 465-2, henceforth Art. L. 465-3-2). Law no. 2016-819 of June 21, 2016, reforming the system of repression of market abuse, increased the penalties incurred. Henceforth, if it is demonstrated that a manager knowingly disseminated false information, and was aware of its erroneous nature, he incurs a maximal prison sentence of 5 years and up to 100 millions euros.

209 - French Commercial Code, Art. L.225-252.

210 - French Consumer Code, Art., L. 623-1 *et seq.*, resulting fro Law no. 2014-344 of March 17, 2014.

ordered liquidation. It produces no effect on the behavior of the manager upstream from the insolvency, at the time that he must decide on the principle of a distressed equity offering[211].

4°) **Lastly, the inadequacy of market discipline due to the deficiencies in insolvency law** :

a) The rules of insolvency proceedings do not enable creditors to take control of a company without the consent of the manager appointed by the shareholders so long as the company is not insolvent; this situation prevents insolvency law from contributing to the improvement in the governance of companies in difficulty, by enabling creditors to exercise power over the company's management well upstream from the opening of an insolvency proceeding[212] ;

b) On the contrary, case law in respect of the liability for *de facto* management, discourages creditors from interfering in a company's management; accordingly, this case law has a counter-productive effect whenever creditors have an interest in the rapid settlement of difficulties, they should be encouraged by law to become whistleblowers vis a vis the company's board of directors[213].

118. – **Recourse to incentive mechanisms**. Assuming that French law is able reform itself in order to more easily uncover conflicts of interest within and outside the company, it may be extremely difficult to provide in a definitive and absolute manner, via a law, the conditions under which managers may act, enabling courts to judge the facts *a posteriori*. The proponents of a liberal approach to the issue, whether in the United States or Germany, consider that this condition cannot be fully dealt with by means of contractual mechanisms for the remuneration of managers[214]. Many American companies in difficulty have put into place profit-sharing plans for the benefit of their key employees (key employee retention plans) to incite them to remain in the company and take part in the restructuring process, even if the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has restricted their use. These profit-sharing plans are particularly widespread in companies with a large number of creditors playing an active role in restructuring. The advantages granted to employees, in particular managers, evolve depending on the rapidity of the handling of the difficulties, the amount of the decrease of the level of indebtedness or also certain financial performances. It has been proved that in the United States, this method of employee profit-sharing favors the emergence of solutions for handling difficulties, a decrease in the duration of bankruptcies and allows for a greater observance of the order of priority of creditors.

C) THE INTERVENTION OF THE STATE AS SHAREHOLDER OF LAST RESORT: A PALLIATIVE TO THE DEFICIENCIES OF THE LAW

8th observation: **The discrepancy between theory and practice is lastly explained by the frequent participation of the French State in distressed recapitalizations and the absence of a transparent and competitive market for the acquisition of the control of large companies in difficulty. Up to the present, the State often took on the role of shareholder of last resort without adequately seeking to reduce the cost for public finances of its intervention. The intervention of the State is thus of such nature as to misleadingly encourage less well-informed minority shareholders to take mindless risks in order to reinforce a company's equity.**

119. – **The State is present in a large number of large companies in difficulty**. The State is present in 13 out of the 30 recapitalization transactions in our sample. The State takes part in the recapitalization of defaulting companies in which it is sometimes the majority shareholder (by way of illustration, Areva and EDF). The State also takes part in the recapitalization of companies in which it has no holding (by way of illustration, the recapitalizations of Alstom in 2004, PSA Peugeot Citroën in 2014 and, to a lesser extent, Sequana in 2012, Soitec in 2011 and Gascogne in 2014). If the first recapitalization is inadequate for ensuring the company's recovery, the State often renews its support (by way of illustration, the recapitalizations of Sequana in 2014,

211 - French Commercial Code, Art. L. 651-2, resulting from Law no. 2005-845 of July 26, 2005, as amended by Ordinance no. 2008-1345 of Dcember 18, 2008 and Ordinance no. 2010-1512 of December 9, 2010.

212 - For an analysis of the importance of insolvency law in the service of better corporate governance see, J. Armour, B. Cheffins, D. Skeels, «*Corporate ownership structure and the evolution of bankruptcy law in the US and the UK*», *op. cit.*

213 - Classic case law holds that a *de facto* manager is «one who exercises a positive and independent activity in the general administration of a company» (Cass. com, May 9, 978) or also, «any person, assuming the same duties and powers of a *de jure* manager, in a completely sovereign manner and completely independently, a positive management and administration activity» (CA Paris, March 17, 1978). In other decisions case law has insisted on the importance of the interference of the *de facto* manager in the running of the company (Cass. 3rd civ, Feb. 25, 2004, *SA Marks Spencer v. SA Plein Ciel*). The liability of creditors interfering in the running of a company may be the basis of an action for an asset shortfall (French Commercial Code, Art. L. 650-2).

214 - K. Goyal, W. Wang, «*Provision of management incentives in bankrupt firms*», 2015, available on SSRN: http://ssrn.com/abstract=2109527.

Soitec in 2013, 2014 and 2016). The State also acts as minority shareholder through BPI France (by way of illustration, CGG and Vallourec in 2016). In this regard, it plays what it considers its role as shareholder. Public money is thus often invested under conditions where the State takes very important risks, as shown by the analysis of the performance of shares issued in connection with recapitalization transactions appearing in Annex 1. For a long time the finances of the State appeared unlimited. The support contributed during years to Bull is an illustration[215]. Considering the situation of the public finances, it is necessary to launch a debate concerning the role of the State in safeguarding transactions of non-financial companies.

120. – **The consequences of the inefficiency of insolvency law on the State**. It is essential that public officials fully measure the consequences of the inefficiency of the law on:

1°) **the very attitude of the State**, the latter is sometimes compelled to lend assistance to large companies in which they, however (no longer) have any holding, in the absence of a market for the control of large companies in difficulty by the buy back of their debts, considering the absence of «loan to own» transactions at the level of large companies with complex balanced sheets, as discussed earlier[216];

2°) **the time of the intervention of the State:** by definition, the State does not lend its assistance except when requested by the manager of the defaulting company (by way of illustration, Soitec, Sequana, Gascogne); this presupposes that the latter had surmounted their cognitive biases and ended the denial of reality that often affects company managers whenever the company is confronted with a problem of solvency; however, except in an exceptional case, as in the restructuring of PSA Peugeot Citroën in 2014 due to the crisis at the level of PSA Finance[217], the State often intervenes at a too advanced stage of the difficulties of the company. Taking control of the company by the debt is often a solution enabling for an intervention more upstream from the difficulties of the company[218];

3°) **the very terms and conditions of its intervention:** under certain circumstances the State may not limit the cost for the taxpayer of its interventions and often intervenes as shareholder of last resort, in otherwords, carry out a bail-out. It may, nevertheless, draw inspiration in this regard from the system applicable to banking institutions in such matters.

121. – **Concerning the attitude of the State, prompt to assist companies in which they do not yet have a stake**, as recently stressed by the *Cour des comptes*, a Colbertist tradition is perpetuated in France leading the State to adopt a voluntarist policy in relation to that of other countries of the OECD[219]. The public doctrine concerning the conditions for intervention of the State rescuing a defaulting company is succinct to say the least.[220]. Moreover, it is hardly observed whenever what is involved is intervening in companies in difficulty, to the extent that the State only sets out, in its public doctrine, the necessity of lending assistance to companies in difficulty whose disappearance would be liable to entail a systemic risk. In this area, the State furthermore intervenes in an arbitrary and not very transparent manner (sometimes, through other entities such as the SNCF[221]).

122. – **A public investment doctrine to be clarified whenever the State intervenes to save non-financial companies.** The State must indicate that it intends to reserve the possibility of intervening whenever an industrial failure is imputable not due to the incapacity of the concerned company to cope with the competition, as such intervention would harm the Common Market, but extraordinary circumstances explaining an insolvencey situation and/or a liquidity crisis. To refuse its support under such circumstances may be synonymous to useless destruction of value. By way of illustration, in the Alstom matter in 2004, it appears that major errors were committed, in particular at the time of the company being admitted to the stock exchange and the acquisition of ABB. These errors being able to generate a problem of insolvency, combined with a cash flow crisis, could justify, as discussed hereinafter, the rescuing of the company by the State in the absence of private investors.

215 - *Cf. infra* p. 23 for the detailed description of the restructuring of Bull.

216 - S. Vermeille, «*Peut-on prêter pour posséder (*« *loan to own* ») *en droit français* ?», *op. cit.*

217 - *Cf. infra* p. 70, for a detailed description of the PSA Peugeot Citroën matter.

218 - *Cf supra*, § 79.

219 - In its report published in January 2017, the *Cour des comptes* notes that «even if most countries maintain public stakes in companies, their weight in the economy varies greatly. In absolute value, with nearly 800,000 employees in public companies (that is, held for more than 50% by the State), France is at the head of the countries of the OECD», *Cour des Comptes*, report on «*l'État actionnaire*», *op. cit.* p 23.

220 - See, the public doctrine mentioned on the Internet site of the Ministry of the Economy and Finance. https://www.economie.gouv.fr/files/files/dir ections_services/agence-participationsÉtat/Documents/Textes_de_refe rence/ Lignes_directrices_de_l'État_actionnaire__17_03_2014.pdf.

221 - Cour des comptes, report on «*l'État actionnaire*», *op. cit.*

Concerning the bank of the PSA group in 2012, the risk of a tipping of PSA Finance's rating into the speculative category following the deterioration of the rating of the automobile manufacturer, in the middle of the 2012 automobile crisis, risked creating a liquidity crisis at any time at the level of PSA Finance, liable to entail a systemic crisis. In fact, the specific feature of financial institutions is having to refinance themselves every day on the financial markets, which considerably weakens their situation. This situation legitimates the guarantee granted to the State failing an alternative *a priori*[222].

123. – **The State compelled to intervene due to the market failures that it itself created.** The policy of the State in respect to safeguarding of companies is not, however, guided only by considerations of industrial policy or the concern to avoid a systemic risk in case of bank failure. The action of the State is also the backlash of the absence of a market in France for the control of large companies in France. As previously discussed, but also more in detail in the following chapter, insolvency law prevents the development of a private market animated by investment funds specialized in the purchase of companies in difficulty. The rules of insolvency proceedings do not allow investment funds specialized in the purchase of companies in difficulty to determine, amongst all the tranches of debt issued by the listed issuer, which is liable to confer on its holder the power to control the insolvency proceeding and its outcome. For this reason, beyond a certain size, no investment fund can deploy in France a loan to own strategy or the purchase of debt instruments on the markets, with a view to ensuring the control of the target. In CGG, the rules of insolvency proceedings prevent a consolidation of the debt in the hands of one or several funds, truly desirous of reducing the company's debt[223].

124. – **Give priority to loan to own transactions in order to avoid authorizations subject to conditions of the European Commission in matters of State aid**. In the absence of an alternative solution, the concern of the State to avoid, by its intervention, unnecessary destructions of wealth provoked by the dismantling of a group of companies, is legitimate. However, the intervention of the State rather than a private investor entails negative effects. Often the European Commission authorizes the aid of a State comply with a certain number of commitments in the name of protection of the Common Market. Favoring the development of a market for the control of companies in difficulty would thereby have real gains on an industrial level. The blossoming of this market would avoid the forced disposal of assets that are sometimes key for the company in difficulty, as in the Alstom matter, thereafter hampering its chances of recovery. In the same way, more efficient insolvency law as well as company law would favor the blossoming of preferred shares that are not very present in the balance sheets of listed French companies. These preferred shares could benefit from senior ranking in relation to common shareholders and, in certain situations, confer on its holder a voting right that is not disposed of by the holders of hybrid debt, an alternative solution used up until now in France. Under these conditions, a private investor perhaps would have found a benefit in substituting himself for the State and offering his guarantee to PSA Finance, as Warren Buffet did for Goldman Sachs, at the worse moment of the crisis[224]. The automobile manufacturer would be spared a certain number of forced disposals required by the European Commission[225].

The rescuing of Alstom by the French State before being dismantled

Alstom was born from the spin-off of Alcatel-Alstom (ex Compagnie Générale des Eaux) in the name of the specialisation in the telecommunication sector. At the time it was admitted to the stock exchange in 1989, the company was under-capitalized for the benefit of Alcatel which, at the time, should have had the means of financing its costly acquisitions program. Five years later, this under-capitalization was one of the causes of Alstom's decline in 2004. In the meantime, Alstom's development was characterized by a growth realized by means of major acquistions (of a value of 4.5 billion euros as compared to 2.5 billion euros in disposals) essentially financed by debt. Furthermore, Alstom's problems had origins other than its under-capitalization problem: the group suffered from the general sluggishness of the economy following the events of September 11, 2001 and the liberalization of certain markets (electricty and tranportation). Technical problems occurred

222 -The State could also justify its intervention whenever it is directly responsible for the under-capitalization of a company and commits significant errors in the conception of the initial project. The conditions of the creation of the Eurotunnel company, at the time of launching of the construction of the tunnel under the Channel, is a blatant example. In this case specifically, the State nevertheless refused to intervene in order to reduce the disastrous financial consequences for the small holders, of a project that from the beginning was inadequately capitalized and which should have had a controlling shareholder. In the present case, it appears that the refusal of the British government to intervene was undoubtedly the principal reason for the non-intervention of the French State.

223 - *Cf. supra* p 29, for a description of the CGG matter.

224 - Seeking Alpha «*Warren Buffet Stocks in Focus: Goldman Sachs*» March 31, 2017.

225 - It should be noted that following the granting of the guarantee to PSA Finace by the State, within the limit of 7 billion euros, the State entered PSA's capital alongside the Chinese, Dongfeng. The latter invested 800 million euros in PSA in order to acquire 14% of the group, thereby entailing the loss of control by the Peugeot family.

in gas turbines from the Swiss-Swedish industrial group, ABB, difficulties connected to trains sold to the United Kingdom and the absence of orders for cruise ships also had harmful repercussions on the financial situation[226].

An initial restructuring plan was decided in March 2002, which was only partially implemented. A second, more ambitious plan, was decreed in March 2003 and was to extend up until the 2005/2006 financial year. It provided for four sets of measures: a) a re-centering around the basic activities (energy and transportation), b) reorganization of sectors, c) reducing global costs, and d) financial measures.

In March 2003, Alstom had losses in the amount of 1.4 billion euros and its level of indebtedness was equal to 5.3 billion euros. The structure of its indebtedness was simple since Alstom was not financed on the bond markets at the time.

The lending banking institutions refused to convert their debts into shares. Moreover, at the time opportunistic funds specialized in the investment in companies in difficulty were not so present in Europe as they are today. The secondary bank debt market was underdeveloped. Therefore, there did not exist funds liable to purchase the banks' debts with a discount and in an adequate (including 300 million contributed by the State) quantity to affect the negotiations. Furthermore, also absent an industrial buyer, Alstom's only alternative was to turn to the State so as to avoid being dismantled.

In order to finance the restructuring and endow the company with adequate capital, the French State, Alstom and their major French banks, adopted a financial plan on August 2, 2003. This included measures that were to be taken by Alstom, the State and numerous banks: (i) a capital increase of 600 million euros (including 300 million contributed by the State); (ii) short-term liquidity of 600 million euros (including 300 million contributed by the State); (iii) securities of 3.5 billion euros (including 65% in counter-guarantees by the State) for performance of contracts, and (iv) a subordinated loan of 1.2 billion euros (including 200 million contributed by the State). This measure also contains an issuance of one billion euros in bonds redeemable for shares («BRS»), without participation of the State. The total amount of the plan was 6.9 billion euros. The French State became Alstom's main shareholder (31.50%).

In sum, instead of converting their debts into shares, the banking institutions chose to subscribe to the capital of the company, maintaining their existing debts, while ensuring themselves of the State's support. Owing to the State's participation in the plan, they avoided entering a loss in their accounts. The State agreed to subscribe to the company's capital under extremely risky conditions considering the maintenance of the company's level of indebtedness at a high level (since in parallel to the reinforcement of the equity, Alstom was forced to incur more debt).

The State tried to challenge the classification of its commitment to subscribe to the capital in the amount of 300 million euros as State aid, on the ground that the banks had undertaken to subscribe to the other half of this capital (300 million additional euros).The State thereby alleged that the share of this capital injection subscribed by the State was concomitant with that of private investors. The participation of the State therefore was that of a market economy operator! Moreover, the State also asserted that the purchase price of a share had been set at 1.25 euros, i.e., below its actual price at the time. The State alleged that any any investor of the same size would therefore wish to invest at such price (less than that of the market).

The European Commission correctly remarked that the State was not in a position comparable to the banks which subscribed to the rest of the capital contribution. To the extent that they intended to secure their past investments, it was in their interest to support Alstom. In the end, it was rather to the banks than Alstom that the State contributed its aid.

All the same the State succeeded in obtaining the authorization of the European Commission for the rescue of Alstom under such conditions, in spite of the constraints laid down by legislation in respect of State aid[227].

In order to obtain the authorization of the European Commission, Alstom had to give up a certain number of assets for the benefit of its competitors, representing 10% of its turnover. The State was also compelled to undertake to dispose of its stake in Alstom within four years. Two years later the State succeeded in selling it to Bouygues for an amount of 2 billion euros, thereby realizing a good capital gain. To the extent that Bouygues hoped, owing to such acquisition, obtaining from the State that it also sell it Areva, one may

226 - E. Cohen, *De la CGE à Alstom : une histoire bien française*» [From CGE to Alstom:, a real French story] Sociétal, 1st quarter 2004 – No. 43. The majority of Alstom had been acquired in 1969. L'Express, «*Chronique d'un sauvetage d'État*» [Chronic of a State rescue], September 1, 2003.

227 - The AGEFI, «*La recapitalisation de Vallourec diluera à 69% l'actionnariat*» [The recapitalization of Vallourec shall dilute 69% of the shareholding], April 11, 2016.

question whether this price was really a market price, especially in light of the seriousness of Alstom's situation as of 2012.

The State's intervention in Alstom could be justified: Alstom's default brought about unnecessary destructions of wealth and did not principally result from the company's inability to contend with the competition, due to an obsolete industrial park. Above all the group suffered from a problem of solvency.

The existence of a market at this time for the control of large companies in difficulty would have allowed for finding another alternative than the State. Investment funds could have purchased a significant part of the debts of the banking institutions in order to convert them into shares so as to take control of the group (it should be stated, however, that one may ask whether, politically, the State would not have done everything in order to prevent such taking of control). If they had succeeded in taking control the funds would have obtained much more than the 30% of the capital obtained by the State. Alstom would not have been obliged to sell assets to its competitors in order to comply with the requirements of the European Commission. The opportunistic funds would admittedly probably compel the group to vastly restructure itself on an operational level. However, the restructurings would not have been linked to considerations relating to maintaining competition on the Common Market.

It should be emphasized that Alstom's financial structure was relatively simple in 2004. It was comprised exclusively of bank debts. In spite of the obstacles created by insolvency law, investment funds could have reached an agreement with an adequate number of banking institutions with a view to securing their taking control of the company. However, at the time it was not yet possible to force the conversion of debts into shares within the committee of banking institutions. This measure entered into force in 2009.

Today, considering the evolution of the banking market following the 2008 crisis, a company the size of Alstom would most probably at least partially finance itself on the bond markets. Its more complex balance sheet structure would have rendered its taking of control by debt extremely difficult for the reasons previously mentioned. In the end, if the Alstom of 2004 were to fall again in 2017, it is not obvious that the company has more alternatives than the French State in spite of the development of the distressed market in Europe in the meantime, the multiplication of opportunistic funds allowing for the multiplication of transactions known as loan to own.

Since then Alstom has incurred other difficulties, following the arrival, in particular, of Asian competition, entailing the disposal of the energy department to General Electric[228]. Today it remains the transportation department in poor health which is still a subject for discussion. We may ask ourselves regarding the fate of Alstom today if the group had truly succeeded in reducing its debt in 2004.

The rescue of PSA Peugeot Citroën by the French State

The PSA group is a company listed on Euronext Paris. In 2011, the group sold more than 3.5 million vehicles and spare parts throughout the world (42% outside of Europe). Commercially present in 160 countries, the PSA group operates 11 factories, known as «terminals» (including 9 in the European Union), in which the group's vehicles are assembled, as well as 12 factories known as «mechanics» which are specialized in the production of certain mechanical parts. The group's activities also extend to automobile financing (BPF) and automobile equipment (Faurecia).

The PSA group was seriously impacted by the economic crisis following the financial crisis. Its operating result collapsed between 2010 and 2011, going from 1.2 billion euros to 366 million euros.

In February 2012, the PSA group entered into a partnership with General Motors («GM») which was reflected by the taking of a stake by GM in PSA's capital in the amount of 7%, in connection with a capital increase with maintenance of preferential subscription rights. PSA's historic shareholders sold GM a part of their preferential subscription rights and GM purchased from PSA a part of the treasury shares. Following this transaction GM became the second shareholder after the Peugeot family. The marriage, however, was short lived. As of October PSA scaled down its ambitions with GM, that it limited to the European market in crisis. In the wake, numerous cooperation projects, such as a common platform for small vehicles, were abandoned one after the other. General Motors resold its stake in PSA's capital in December 2013.

228 - E. Cohen «*Alstom, l'histoire d'une longue descente aux enfers*» [Alstom, the history of a long descent into hell], Slate, September 14, 2016.

This same year the group was confronted with difficulties in financing the debt of its captive bank, Banque PSA Finance, following the deterioration of the rating of the PSA group, entailing by way of ricochet the deterioration of the rating of the captive bank. The latter proposed financing solutions to purchasers of Peugeot and Citroën vehicles and intended for Peugeot and Citroën dealers.

The State was thus called in to guarantee a bond issuance in an amount of 1.2 billion euros. The Commission temporarily authorized such State aid in May 2013 for reasons of financial stability. In this context, the French authorities undertook to notify a group restructuring plan and a viability plan of the Banque PSA Finance.

In a decision of July 29, 2013, the European Commission declared as being compatible with the internal market the State aid that France envisaged putting into effect in favor of the PSA Peugeot Citroën SA group, in the form of a State guarantee covering the Banque PSA Finances' bond issuances carried out up until December 31, 2016 within the limit of 7 billion euros (for a gross subsidy equivalent of 486 million euros),on the one hand, and in the form of repayable advances of 85.90 million euros for the carrying out of the «50CO2Cars» R&D project, on the other, i.e., a total amount in aid of 571.9 million euros.

The group contributed to the costs of its restructuring due to the putting into place of a major asset disposal plan.

PSA Peugeot Citroën thereafter pursued several operations whose objective was to improve its competitiveness, accelerate its strategy of globalization and conquest of emerging markets, as well as reinforcing its financial solidity.

Aware of the necessity of going further in the restructuring of the group, PSA reinforced its existing industrial and commercial partnership with Dongfeng Motor Group, the second largest Chinese automobile manufacturer, with the objective of capitalizing on the current success of the group on the largest automobile market world-wide, today the main potential customer growth base for the sector. With that in mind PSA carried out new capital increases for the benefit of Dongfeng, but also the State which had just contributed substantial financial support. The intervention of the State was not classified as State aid to the extent that, due to the simultaneous investment by Dongfeng, it is presumed to have intervened as an informed private investor.

The total amount of the capital increases reserved to the State and Dongfeng amounted to 1.048 billion euros. The total amount of the capital increase with maintenance of preferential subscription rights to which the State, Dongfeng but also historical family shareholders, amounts to 1.953 billion euros, i.e., a total amount of 3 billion euros. The dilution for the historic shareholders of PSA who could not take part in the capital increase was significant (0.45 % for a shareholder who held 1%), whereas the discount in relation to the stock market price preceding the announcement was more significant (50.3) than that of Faurecia, organized in 2009 (but the latter was more dilutive).

In 2017, encouraged by a successful restructuring, PSA purchased Opel and Vauxhall for an amount of 1.3 billion. At the same time, the State sold its stake in Bpifrance and thereby made a capital gain of 1.12 billion euros.

Undeniably this was a happy outcome for the State's finances. This outcome was probably rendered possible considering the intervention of the State at a stage adequately upstream from the group's difficulties, well before the group's means of production were no longer competitive, absent an adequate level of investment.

The fact that the State and PSA's management had to work together at the time of seeking a solution for facilitating the refinancing of PSA Finance undoubtedly was an important factor in management's decision to solicit the State a second time. PSA's management thus rapidly saw the benefit of a partnership with Dongfeng but also a major recapitalization of the group with a third party, in order to not be placed under the domination of a foreign partner. The State's investment was thus made at the best time of the crisis that the group went through, at a price significantly lower than the stock market price before the announcement of the transaction. Management finally succeeded in convincing the Peugeot family of the benefit of an investor like the State in the capital. Finally, PSA Finance's crisis will have happy consequences.

It may, however, be regretted that a financial partner was not found in order to avoid the State assuming the role of guarantor and shareholder. Benefitting from State support is not without consequence thereafter. PSA today finds itself beholden vis-à-vis the State which knows how to remind it whenever politics regains the upper hand, as recently shown by the GM&S matter.

125. – **Concerning the terms and conditions of the intervention of the State, the latter bearing the consequences of this market failure in case of the implementation of a distressed equity offering.** It is difficult

for the State, especially whenever it intervenes as a minority shareholder, to require that company creditors, to which it lent assistance, previously absorb the losses if the complexity of their balance sheet does not permit them. The year 2016 was marked by the distressed recapitalization of CGG by Bpifrance and the *Institut Français du Pétrole* (French Petroleum Institute), both minority shareholders as well as Vallourec by Bpifrance. In both cases, bond holders did not have to make significant concessions in compensation for the recapitalization; certain could even exchange their bonds for the delivery of loans accompanied by security interests. Concerning CGG, BpiFrance and the IFP will probably lose all of the funds reinvested in the beginning of 2016. A massive dilution of the rights of CGG's shareholders is henceforth anticipated[229]. Accordingly, even if the principle of State intervention in large companies may be understandable, such intervention must be orchestrated so as to limit the cost for public finances. It is true that Vallourec enjoyed a completely different fate as shown in the table in Annex 1, but how many failures for one success.

126. – **The importance of the support of the shareholder of reference for the success of a recapitalization transaction**. The participation of one or several shareholders of reference is important for improving the chances of a distressed recapitalization. Considering the fact that they are often represented on the board of directors, by definition they have better access to company information, and even if at the time of the capital increase the company has an obligation to re-establish equality of treatment of shareholders in respect of access to information. The announcement of the participation of the shareholder of reference may consequently be perceived as a positive signal vis-à-vis the minority shareholders. The structure of the capital of large French companies, which for the most part are concentrated, contrary to the United States, may be furthermore partially explained by the fact that it is easier in France, than in the United States, to envisage the launching of very risky distressed equity offerings. In our sample the increase of Faurecia's capital in 2009 is particularly revealing[230].

127. - **Save exception, the role of the State shareholder must be assessed in light of the principles applicable in private law.** Subject to the application of mandatory rules, in particular in public law, the attitude of the State in the course of rescuing defaulting companies may absolutely be analyzed by the principles recalled in respect to company law. The State must also be able to benefit from the principle of limited liability and not grant its support whenever it is blatantly ruinous for it. It could furthermore give itself the possibility of facilitating the transfer of the control of the company to other entities, in order to take responsibility for the end of activity, which is politically unthinkable.

128. – **The disputable existence of an implicit guarantee under all circumstances**. In practice, whenever the State is already a minority shareholder of the company in difficulty at the time it is solicited, it is politically extremely difficult for the State to abstain from lending assistance, as illustrated by the restructuring of CGG and Vallourec. Whenever the State is a majority shareholder of the company in difficulty, this is even less imaginable. Public companies, such as Areva, accordingly implement for their benefit the implicit guarantee that the State affords them. In general, financial institutions are also the major beneficiaries in order to avoid the risk of contagion. Nevertheless, the State is not bound by a law (in the case of Areva, the law, however, specifies that the State must hold at least 50% of the company's capital) or a contract; it does so for political or strategic reasons or in order to avoid any systemic risk (this was the case of the banks at the time of the subprime crisis, failing an alternative solution, such as the bail-in at the time)[231]. This being said, the French State intervened less than elsewhere, in the rescue of financial institutions, its intervention being limited in the end essentially to Dexia.

129. – **The direct interference of the State in the business of companies may justify protecting creditors' rights**. Furthermore, regardless of the case of private law companies or industrial and commercial public establishments, the State is not to interfere in the conducting of business. Accordingly, if it violates this principle by committing proven involvement, as is the case it appears in the SNCF, according to the *Cour des comptes*[232], it is not illegitimate, vis a vis creditors, that it be obligated to absorb losses before creditors. In the other hypotheses, the State should be able to be treated as any other passive shareholder of a limited liability company.

130. – **Save exception, the necessary reconciliation of the system for the rescue of non-financial companies with the rules applicable in respect of banking resolution.** Whenever the State intends becoming a majority shareholder of the entity to which it lends assistance, it may have recourse to a structure known as defeasance (or *de facto* deleverage) in order to force the shareholders and creditors to absorb losses, in spite of the lacuna

229 - *Cf. supra*, p.29.

230 - *Cf. footnote 147*.

231 - Le Monde, J.-M. Bezat, «*5 milliards pour sauver Areva*» [5 billion to save Areva], January 28, 2016.

232 - *Cour des Comptes*, report on «*l'État actionnaire*» *op. cit.*, p. 99.

of insolvency law. This type of structure is often put into place in order to organize the ordered resolution of defaulting financial institutions, such as Dexia. Recourse to a defeasance structure thereby leads to a splitting in two of the assets and liabilities of the defaulting company. There is thus created a bad bank as opposed to a good bank. However, this structure may be a means of forcing the shareholders and creditors of the defaulting entity to absorb the losses under certain conditions. This implies transferring to the new entity created to serve as a receptacle for the healthy assets only a part of the existing liabilities. The amount of the liabilities must thus depend on the valuation of the retained assets, preferentially following the intervention of an independent third party. The contribution of equity by the State to the new entity is thus carried out in a solvent entity, since it is released from a part of its liabilities. The doubtful assets remain at the level of the original entity, just as the share of the liabilities that was not transferred. The original entity is thereafter to be liquidated at a future time.

131. – Obviously, creditors whose debt securities have not been jointly transferred with the healthy assets, do not veritably absorb the losses at the time of liquidation of the original entity except on the condition, by hypothesis, that the State refrains from recapitalizing the original entity in order to indemnify the shareholders and the creditors! Unfortunately, in practice, this is rarely the case as demonstrated by the Dexia matter. It is true that in the case of a banking institution, it is necessary to organize the orderly resolution of the banking institution, which cannot be brutally liquidated considering the portfolio assets it holds[233]. However, it is one thing that the State contributes its assistance to the entity in the process of liquidation in order to maximize the value of the assets to be liquidated. It is another to recapitalize an insolvent structure, so as to place the shareholders and creditors in a situation of moral hazard. The introduction of the new directive in respect to banking resolution should profoundly modify the manner in which credit institutions may receive the support of sovereign States[234].

132. – **The questionable use of the system of partial asset contributions in French law for the organization of a defeasance structure**. Whenever the entity involved is not a banking institution, the transformation of an insolvent entity into a defeasance structure takes place, in French law, by using the partial asset contributions system[235]. Healthy assets are supposed to together form an autonomous branch of activity and are transferred as such to a new entity. However, the partial asset contributions system was not designed for transferring assets and liabilities of companies in difficulty. The law provides that the transferred liabilities must be those attached to the autonomous branch of activity that is disposed of in parallel. The law thus only permits establishing discrimination between the various liabilities of the defaulting entity, depending on their origin. For this reason, in theory it is not possible to separate liabilities, by taking into account the order of priorities in order to force the most junior creditors and the shareholders to absorb losses. Admittedly, the use by a private law company of the partial asset contribution system for such purpose would surely lead to multiples disputes. Regarding the State and the protection of the general interest, it must, however, be possible to adapt to strict compliance with the rules of law, provided, however, in order to avoid any arbitrariness, to submit to the control of a third party the valuation of the assets transferred to the new entity (based on which a distinction would thus be made between creditors, depending on the order of priority, allowing only certain assets to be transferred). Creditors should also be authorized to challenge such valuation.

133. – **The State frequently places the creditors and shareholders of defaulting entities in a situation of moral hazard**. History shows, however, that even when it has recourse to a defeasance structure, the State rarely requests creditors to absorb losses, even if the entity involved is not a financial institution! Accordingly, for the needs of restructuring of Areva, all of the bond liabilities were transmitted to «NewCo», receptacle of the healthy assets of the group and it was provided that in the future, as we shall see hereinafter, that the State also recapitalize the original structure! In this case, even before its recapitalization by the State Areva was

233 - *Cour des comptes*, «*DEXIA : un sinistre coûteux, des risques persistants*» [DEXIA: a costly loss, persistant risks], July 2013.

234 -Directive 2014/59/EU of May 15, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, not. Art. 34; the bail-in (or internal refloating mechanism to grant the power to resolution authorities (in France, the ACPR [*Autorité de contrôle prudentiel et de résolution* (French Prudential Supervisory Authority)], the power to compel shareholders and creditors to sustain losses by depreciating their securities or convering them into equity, thereby making them participate in the refinancing of the defaulting institution. This solution is opposed to the bail-out, that is, to refloating by funds external to the institution such as public funds. The directive has been transposed into French Law by Ordinance no. 2015-1024 of August 20, 2015, Decree no. 2015-1160 of September 17, 2015 relating to various provisions for adapting French law to European Union law in respect of financial matters and five orders of September 11, 2015.

235 - See, the declaration of Areva: https://www.journal-officiel.gouv.fr/balo/ pdf/117_monte_final.PDF. In respect of banking resolution, the defeasance structure is an option provided by Directive 2014/59/EU of May 15, 2014 (known as BBRD). The latter empowers national resolution authorities to draw up the most appropriate solutions for handling the insolvency of credit institions. For this purpose, the authorities dispose of a certain flexibilility and may, in particular, decide to separate the assets between an entity continuing the essential activities and an entity subject to liquidation («good bank/bad bank»). The transaction consequently obeys this specific system whenever a bank is involved.

admittedly a public company. The State could have considered that it was to draw the consequences of its failure of supervision as the main shareholder of the company. The State's announcement of the purchase of Areva's shares, in violation it appears of European rules which impose absorption of losses by the shareholders, is very questionable[236].

134. – **The State frequently places the creditors and shareholders of defaulting entities in a situation of moral hazard**. However, even if the State always supports all companies, whether or not public, then there is not more risk for the creditors. As stressed by Nobel Prize winners Joseph Stiglitz and Martin Guzman, a bad loan is equally the result of the action of a bad debtor as a bad lender[237]. The attitude of the State causes the consequences of excess indebtedness to rest on the taxpayer and unduly protects bond creditors. It places the latter in a situation of moral hazard and incites bad lenders to encourage borrowers to take on excessive debt. The creditors then no longer exercise any control, both at the time of the issuance of debt instruments and in the course of the life of the loan[238]. The financial markets then no longer exercise their role and refrain from being a control on large companies in France, considered as «too big to fail», whether in the banking or industrial sector.

The questionable rescue of Areva by the French State

The Areva group is a French group in the energy sector that furnishes products and services over the whole of the nuclear cycle, from the uranium mine up until the the recycling of used fuels, passing through the design of nuclear reactors and services for their operation.

The Areva group is listed, and directly or indirectly controlled, by the French State for 86.52%. Areva SA, its parent company, in in fact directly held by the State for 28.83%, and indirectly through the *Commissariat à l'Energie Atomique* (French atomic energy commission) and by Bpifrance Participations, which respectively hold 54.37% and 3.32% of Areva SA.

These last years the Areva group encountered significant difficulties. These are due, firstly, to the consequences of the brutal reversal of the nuclear market and the deteriorated economic and financial conjuncture since 2008. The Areva group thereafter sustained significant losses in a limited number of industrial projects. Lastly, its profitability was weakened following certain acquisitions and the development of certain activities.

Accordingly, in the course of financial years 2011 to 2015 the Areva group entered considerable losses whose combined amount exceeds 9 billion euros. The State shareholder, which is very much a majority shareholder, did not know how to prevent the deterioration of the company's financial situation and the appearance of major difficulties within the nuclear sector[239]. In its report, the *Cour des comptes* did not point out any proven interference of the State in the management of Areva, as opposed to that of the SNCF.

In order to finance such losses and the investments necessary to modernize its industrial tool, the Areva group indebted itself with financial institutions and had recourse to the bond markets. Following the draw down of new banking lines, in the beginning of 2016, at January 5, 2016 its debt reached 9.4 billion euros including 6.0 billion in bond debt.

On April 29, 2016, the French authorities notified a restructuring plan to the Commission. Pursuant to the terms of this plan, it was planned that Areva separate itself from its construction of reactors activity (Areva

236 - *Cf.* Guidlines on State aid for rescuing and restructuring non-financial undertakings in difficulty (2014/C 249/01). Accordingly, Article 3.5.2.2. provides: «*Where State support is given in a form that enhances the beneficiary's equity position, for example where the State provides grants, injects capital or writes off debt, this can have the effect of protecting shareholders and subordinated creditors from the consequences of their choice to invest in the beneficiary. That can create moral hazard and undermine market discipline. Consequently, aid to cover losses should only be granted on terms which involve adequate burden sharing by existing investors. Adequate burden sharing will normally mean that incumbent shareholders and, where necessary, subordinated creditors must absorb losses in full. Subordinated creditors should contribute to the absorption of losses either via conversion into equity or write-down of the principal of the relevant instruments. Therefore, State intervention should only take place after losses have been fully accounted for and attributed to the existing shareholders and subordinated debt holders. In any case, cash outflows from the beneficiary to holders of equity or subordinated debt should be prevented during the restructuring period to the extent legally possible, unless that would disproportionately affect those that have injected fresh equity.*»

237 - M. Guzman, J. Stiglitz «*Creating a Framework for Sovereign Debt that Works*», *op. cit.*

238 - Furthermore, by analysing more than 5,000 debt instruments in 43 countries over the 1991-2010 period, American researchers238 showed that the cost of financing companies where the State is present in the capital would be greater than the cost of financing private companies. Over long statistical series, State intervention would, therefore, not allow for reducing the cost of the debt. This could be explained by the fact that investors *de facto* consider that State-held companies are less well managed than private companies. The advantage procured by the benefit of the implied guarantee would be neutralized considering the suspicion of bad management. Finally, the implicit guarantee of the State appears to be an overly costly solution that distorts the market and whose efficiency is very controversial. G. Borisova, V. Fotak, K. Holland, W. Megginson, «*Government Ownership and the Cost of Debt: Evidence from Government Investments in Publicly Traded Firms*», 2013, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2046911.

239 - *Cour des comptes* «*L'État actionnaire*», *op. cit.*, p. 64.

NP) in favor of EDF. The rest of its activity was split in two. Areva SA became the defeasance structure which bears the liabilities of the group corresponding to the debt linked to the end of the Finnish site of the EPR and the anomalies identified on the defective parts. A new company was created (NewCo) where the activities of the re-centered group are henceforth lodged downstream and upstream from the fuel cycle. NewCo shall be held for 40% by Areva SA, for 50% directly by the State and for 10% by a Japanese consortium (Mitsubishi Heavy Industries and Japan Nuclear Fuel Limited).

The restructuring plan includes, in particular, two capital injections by the French State, respectively in Areva SA, the parent company and in NewCo, for a combined amount of 4.5 billion euros. These capital injections constitute aid to the restructuring in favor of the Areva group.

The Commission concluded that the capital injections envisaged by the French State constituted State aid compatible with the internal market under certain conditions[240]. The European Commission conditioned its authorization on the opinion of the *Autorité de sûreté nucléaire* (French nuclear safety authority (ASN)) on the condition of the EPR reactor of Flammanville, which decision was to be rendered in the summer of 2017, as well as the authorization by the European Commission on the merger between EDF and Areva NP (the latter was obtained at the end of May 2017).

In its decision, the European Commission did not consider it necessary that Areva's bond debt be previously restructured since it authorized its transfer to the new Areva, in connection with a partial asset contribution agreement. Conversely, Areva's bank debt remained lodged in the defeasance structure without the discriminatory treatment between the bond debt and the bank debt being justified with regard to the law.

The State furthermore announced it was launching a public withdrawal offer, followed by a squeeze-out in order to buy out the minority holdings at the price of 4.5 euros. Now, however, the absorption of losses by the shareholders is a condition appearing in the guidelines laid down by the European Commission and negotiated, however, with the Member States[241].

Even if the European Commission is obliged to remain neutral with respect to the benefit for a Member State to directly hold a company in a given sector, it may be regretted that it does not further compel the Member States to scrupulously comply with the rules in respect of State aid. The Commission could thus compel the Member States to reduce the cost of rescues for their public finances, even when it is a matter of assisting public companies. Areva's operational activity, of which the interest of maintaining it alive is not under debate in Europe, would not be affected.

Accordingly, it would have been totally possible in the Areva case to use the partial asset contribution system in order to get around the lacuna of insolvency law and thereby reduce rescue costs for public finances. For this purpose, it would have been necessary to accept that the bonds and loans be purchased by the State with a discount in relation to the nominal value, bringing out the difference between the valuation of the assets, on the one hand, and Areva's liabilities, on the other. The State would thereafter have converted the purchased debts into shares of NewCo. In such manner, the State would have remained the majority shareholder of the new entity, as obliged by law, by purchasing the transferred debts.

Even in the United States, in the worst moments of the financial crisis, the courts agreed that the strict application of the law, deemed inadequate, be ruled out whenever the measures taken to save the financial system had been contested, in order to reduce the cost thereof for the American taxpayer[242]. In the case of Areva, it turns out in addition that the State had already freed itself from strict compliance with the laws.

As previously mentioned, there was discrimination between the creditors, not based on the order of priority, but based on the nature of the debts, which criteria is more debatable with regard to the law, than that of the order of priority. The State thus had authority to decide that the banking institutions shall remain at the level of the existing entity, contrary to the bond holders, without at this stage being able to fully understand how the first shall be treated, whereas they are supposed to be *pari passu* with the bond holders.

The decision to protect the bond markets was undoubtedly dictated, at least partially, by the desire of the State to not trigger consequences in a domino effect for the other very indebted public companies, such as the SNCF or EDF, protected for the moment by the discipline of the markets. These seem to not have any

240 - Le Monde, «*Bruxelles accepte la recapitalisation d'Areva par l'État français*» [Brussels accepts the recapitalization of Areva by the French State], January 10, 2017.

241 - European Commission «*Guidlines on State aid for rescuing and restructuring non-financial undertakings in difficulty*» (2014/C 249/01).

242 - R. Rasmussen, D. Skeel, «*Governmental Intervention in an Economic Crisis*», *op. cit.*

more influence on their shareholder, the French State, which the *Cour des comptes* regularly criticizes for imposing a too importantant policy of distribution of dividends considering the weakness of the companies[243].

The State may not continue in this manner to come to the rescue of large companies. The situation is currently intended to evolve in the years to come, considering the greater and greater significant deterioration of public finances. The cost of the inefficiency of insolvency law would appear to be much greater to our economy in the future.

Parallels with the banking crisis

The contingent convertibles or Co-cos, a solution to the problem?

Confronted with the necessity of being able under very rapid conditions to force the restructuring of the balance sheet of defaulting banking institutions, which by nature are extremely complex, the banking sector encountered the appearance of contingent convertibles or «Cocos». These instruments have become beneficial in order to avoid the collapse of banking institutions which have the particularity of being able to refinance themselves every morning on the financial markets under pain of defaulting. The occupation of banking institutions is above all long-term lending and short-term borrowing.

Private investors are logically reticent to reinforce the equity of banks whenever they are weakened. Often, *in extremis*, public powers intervene as «shareholders of last resort», in order to avoid bankruptcy in a disordered manner. Such an injection is costly for public finances and creates a situation of moral hazard at the level of banks.

A manner of settling the problem consists for banking institutions in issuing hybrid securities that absorb the losses, by provoking a conversion of debt into shares, under the conditions set out in the issuance agreement. The triggering factor is often the violation of a ratio of equity imposed by prudential regulations.

Apart from the financial sector, encouraging companies to issue Cocos in order to get around the problem of the inefficiency of insolvency law and shareholders' vetoes is not easy. If such companies are not subject to prudential rules, it is difficult to find, in advance, criteria allowing for the forced conversion of bonds.

In any event, nothing in French law appears to be opposed to the contractualization of the conversion of bonds if the parameters are sufficiently objective. The appointment of an independent expert could suffice.

135. – **Acting as an informed investor, the surest means of avoiding the European Commission**. In order to avoid calling the transaction into question by the European Commission pursuant to the laws on State aid, the latter conditions its intervention on the intervention of private partners[244]. The State thereby hopes to demonstrate that it is acting as an informed private investor, in spite of the fact that it is assuming the role of shareholder of last resort, by hypothesis insolvent or close to being so. Under these circumstances, it should *a priori* be difficult for the State to find private investors, desirous of taking such financial gambles at the very least whenever the situation of the company is particularly indebted. In reality, if the State achieves this, it is because its partners have a distinct interest, from that of a classic financial investor, in taking part in rescuing the company in question. The most obvious partner under these circumstances is a competitive industrialist of the company in difficulty with which synergies are eventually possible. Thus, recently at the time of the recapitalization of Vallourec, the French State could count on the participation of Nippon Steel & Sumitomo Metal Corporation – NSSMC[245]. In the case of the arrival of the Chinese Dongfeng in PSA's capital, it appears that the interest was more financial than industrial to the extent that the two manufacturers already had a partnership enabling PSA to have access to the Chinese market. By investing in PSA, the Chinese shareholder enabled PSA to have access to the Chinese banking market which fully supports automobile manufacturers, which are not

243 - Cour des comptes «*L'État actionnaire*», *op. cit.*, p. 50.

244 - TFUE, Art. 107.

245 - L'Opinion, «*L'État et Nippon steel, pompiers volontaires chez Vallourec*» [The State and Nippon Steel, voluntary firefirefighters at Vallourec], February 1, 2016; The AGEFI (economique and financial press group), «*La recapitalisation de Vallourec diluera à 69% l'actionnariat*» [The recapitalization of Vallourec shall dilute the shareholding by 69%], April 11, 2016.

subject to the same prudential constraints as European banks. This being said, Dongfeng indeed intends, owing to this alliance, to benefit from transfers of the group's technologies[246].

136. – **The risk of «tunneling» of an industrial shareholder**. Under these circumstances, the industrial partner may agree to sustain a financial loss in connection with the recapitalization, knowing that it may off-set such loss with the profits it may derive on an industrial level from such link. The risk of «tunneling», in other words, the extraction of value by the industrial partner to the detriment of other minority shareholders must therefore not be neglected[247]. The risk in France is even greater, as the contours of the abuse of the majority under French law, as drawn by case law, are much too narrow[248]. For this reason, at the time of the recapitalization of PSA, the *Association de défense des actionnaires minoritaires* (association for the defense of minority shareholders) (ADAM)) proposed an alternative to the arrival of Dongfeng and the French State, in the form of a conversion of the bank debt. This solution, even if justified in principle, was however unrealistic, considering the new prudential constraints of banking institutions[249]; unless the latter can sell their debts to an investment fund desirous of taking control of PSA, there is little chance that such outcome is realized. This initiative had even less chance of being realized as it necessitated the consent of the Peugeot family as PSA's main shareholder which, one images, would have preferred the State as a shareholder alongside it, rather than an investment fund. Fortunately for the minority shareholders in the PSA and Vallourec matters, both groups enjoyed a spectacular recovery.

137. – **A potential misalignment of interest between minority shareholders and the State**. Under these circumstances, the interest of other minority shareholders is not whatsoever aligned either with that of the industrial partners nor with that of the State, at the time of recapitalization. For these reasons, minority shareholders should not let themselves be influenced at the time of assessing the benefit of distressed recapitalization for itself. As stressed on several occasions by the *Cour des comptes*, the State plays the role of an atypical shareholder by the multitude of interests it must take into account, which are often contradictory.[250] By jointly taking part in company recapitalizations, alongside the State and industrial investors, minority shareholders probably take more risks than they realize. This is particularly the case in that, considering the state of public finances, we can no longer presume that tomorrow the State shall be able to contribute its support in the case of a relapse.

9th observation: **The American insolvency proceeding known as Chapter 11 affords the manager of a company in difficulty powerful levers in order to both compel and convince his bond creditors to agree to significant concessions. Chapter 11 thereby avoids having the American Treasury compelled to contribute its aid to companies by assuming the maximal risk borne by a shareholder of last resort.**

138. –. The analysis of the conditions under which large American companies restructure themselves allows for shedding a little more light on the lacuna of French law. Rules of insolvency proceeding are governed in the United States by the Bankruptcy Reform Act of 1978 marginally amended by the Bankruptcy Reform Act of 2005. In substance, company managers have the choice between Chapter 11 and Chapter 7. The American Chapter 11 proceeding is one that is available to companies of a certain size, whose prospects for recovery are real. Management remains in control of the company. Chapter 7 is the equivalent of a liquidation proceeding leading to the realization of all of the company's assets. Transactions are carried out by a trustee. It is used for small, non-viable companies.

139. – **The objective of maximizing the value-in-use of the assets.** American bankruptcy law is oriented towards seeking maximizing the value-in-use of the company's property for the benefit of it creditors. In other words, the objective of the law is to limit the destructions of value at the level of the company linked to the financial and operation difficulties of the company in the interest of the creditors. Contrary to French law, Chapter 11 is justified only on condition that it is shown that this solution generates additional value with regard to the consequences attached to termination of the company's activity. The managers benefit from an exclusive

246 - France 24, «*PSA officiellement renfloué par la Chine et l'État français*» [PSA officially bailed-out by China and the French State], February 19, 2014.

247 - A. Atanasov, B. S. Black, «*Unbundling and Measuring Tunneling*», 2008, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030529.

248 - M. Harner, «*The corporate governance and public policy implications of activist distressed debt investing*», 2008, Fordham Law Review, Vol. 77, available on SSRN: https://papers.ssrn.com /sol3/papers.cfm?abs tract_id=1125082. The question posed is to know whether the tunneling proceeding is liable to be sanctioned on the ground of majority abuse. This is highly unlikely as long as its admission by law and case law is restrictive. At most, tunneling is contrary to the company's interest and intentionally breaks up equality amongst shareholders. Nevertheless, tunneling is often carried out surreptitiously without a particular decision of the meeting, which places it outside the scope of majority abuse.

249 - Le Monde, «*Recapitalisation de PSA : les actionnaires minoritaires s'inquiètent*», [Recapitalization of PSA: the minority shareholder are worried], February 4, 2014.

period for submitting a restructuring plan for the vote by the creditors and the approval by the court. Furthermore, it is especially important in a Chapter 11 proceeding to comply with the departure arrangements including the order of priority of payments and the absorption of losses of debts prior to the opening of the insolvency proceeding.

140. – **The fate of companies in the hand of holders of a fulcrum security**. Two types of transactions may be proposed: (i) an asset disposal on condition of demonstrating that the potential purchaser will pay the highest possible price, or (ii) a restructuring of the company in support of a valorization of the value of the company in reorganization, often carried out by an investment bank. The Chapter 11 proceeding is, more particularly, a set of rules concerning the terms and conditions of approval of the restructuring plan, based on the idea that the control of the company must revert to the class or classes of investors having the greatest interest in the reorganization of the company by weighing the risks incurred. Whenever the proceeding leads to voting on a restructuring plan, such plan must thus be approved by one or several specific classes of investors and not, as in French law, by all of the creditors/shareholders of the company, brought together in committees or a meeting. This class or these classes bring together investors whose incentives are most aligned with the fate of the company, with regard to the on-going concern value and the absolute priority rule. Whenever the company is insolvent, Chapter 11 leads to the transfer of control of the company, initially held by the shareholders, to the class or classes located at the level where the value breaks with regard to the order of priority. This class or these classes are thus holders of the fulcrum security. Amongst all the classes of creditors, these are the creditors who have lost any hope of being fully repaid in case of realization of all of the assets of the company with regard to the latter's corporate value. Their rights and interests are therefore necessarily affected by the restructuring plan, contrary to other more senior creditors in the order of priority. Contrary to other more junior creditors who have lost all rights in the proceeding, holders of fulcrum securities have not lost everything and are beneficiaries of the plan[251]. Creditors whose rights are not affected by the reorganization plan thus do not take part in the voting of said plan. The shareholders and creditors, who receive nothing by virtue of the plan, are presumed to be opposed to it, but their opposition is not an obstacle to the adoption of the plan[252].

141. – By having vote only those creditors who are holders of fulcrum securities or «pivot» creditors, the expression given by the *Conceal d'analyse économique* (French official economic analysis council) [253], American law enables avoiding two pitfalls:

1°) an unnecessary destruction of value at the level of the company in case of the realization of all of the assets of the company in favor of a third party, at a price that is less than the corporate value of the company in reorganization; this risk exists since the power is systematically conferred on the senior creditors holding securities, as in English law; in fact, these creditors have an interest in requesting the realization of all of the company's assets, if they are assured, considering their ranking, of being fully repaid owing to the proceeds of the disposal; by definition, the value breaks below them; a creditor of a company in difficulty always prefers being repaid today rather than betting on the recovery of the company, even if the economic value of their claims is not affected by the restructuring plan which protects them

2°) an unnecessary destruction of value at the level of the company in case of reorganization of the company under unrealistic conditions, considering the conserved level of indebtedness of the company, in fact, if the shareholders remain decision-makers in the insolvency proceeding and are thus able to oppose a total dilution of their rights, the creditors cannot convert their debt into shares, as far as necessary, so that the company continues to suffer from a situation of financial distress that burdens its prospect of recovery; this risk of over indebtedness, very present in France, exists since the power must be shared with the classes of creditors and shareholders of which the value of the claims is already reduced to zero at the time of the approval of the plan. These classes of investors no longer sustain the consequences of the aggravation of the company's financial situation and only envisage the continuation of the activity of the company, although still indebted,

251 - D. Baird, A. Bris, N. Zhu, «*The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study*». 2007, Yale ICF Working Paper No. 05-29, available on SSRN: https://papers.ssrn.com/sol3/papers.cfm? abstract_id=866865; D. Baird, B. Rasmussen, «*Anti-Bankruptcy*», 2009, Yale Law Journal, Vol. 119, p. 648, 2010, available on SSRN: http://ssrn.com/abstract=1396827; D. Baird, and D. Bernstein, «*Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*», 2006, available on SSRN: http://ssrn.com/abstract=813085 or http://dx.doi.org/10.2139/ssrn.813085; D. Baird, B. Rasmussen, «*Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*», 2001 Virginia Law Review, Vol. 87, pp. 921-959, available on SSRN: http://ssrn.com/abstract=278841

252 - S. Vermeille, «*Peut-on prêter pour posséder (loan to own) en droit français ?*», *op. cit.*; S. Vermeille, «*Un Chapter 11 bancaire ?*» [Chapter 11 bank banktupcy?], January 2013, Revue Banque, nos. 755-756.

253 - G. Plantin, D. Thesmar and J. Tirole, «*Les enjeux économiques du droit des faillites*» [The economic stakes of bankruptcy law], June 2013, Notes of the *Conseil d'Analyse Economique.*

as a positive prospect for themselves (but not necessarily for the others who have more to lose than those who have already lost everything), even if the company was rapidly to relapse, as is the case in France.

142. – **Under American law, the judge does not decide the fate of the company; his mission is to assess the equitable nature of the treatment of all of the investors**, by reference either to the net asset value whenever it is a question of forcing the consent of a minority of creditors within a class of creditors, or the corporate value of the company in reorganization whenever it is a question of forcing the consent of an entire class of creditors. Chapter 11 is thus distinguished from French law by the clarity of its rules, the rigorous compliance with vested contractual rights and, by extension, the order of priority of payment and absorption of losses, as well as the role of the judge as guarantor of compliance with the rights of the various parties. For this reason, it is therefore not surprising that in its proposed European Directive of November 22, 2016 the European Commission chose to follow the American approach[254].

143. – **The clarity of Chapter 11 rules favors the consolidation of the debt in the hands of an investment fund which adds the most value to a company in the reorganization phase**: these are the investors desirous of acquiring control of the company in order to modify the governance thereof and impose a new business plan. In spite of the complexity of the structure of the balance sheet of very large American companies, the clarity of Chapter 11 rules and strict compliance with the order or priorities of payment enable investment funds to identity the fulcrum security enabling the taking of control of the company. These funds thus proceed with acquisitions of this specific class of debt, which often entails an increase in price just before the opening of a Chapter 11 proceeding. The consolidation of the company's debt in favor of active investment funds *ex ante* modifies the dynamic of negotiations outside of an insolvency proceeding, between management and creditors. The presence of active investment funds in the negotiation process allows for reducing coordination costs between creditors, facilitates work on the restructuring of the debt and improves the company's governance.

144. – **As discussed, contrary to banking institutions, investment funds are sometimes desirous of obtaining shares in exchange for the purchase of bonds**. If they are confident in the recovery capacity of the company, they envisage realizing a capital gain on the transaction, not as a creditor but as shareholders. They therefore have more incentive in pushing in favor of an in-depth restructuring of the company's balance sheet than banking institutions. In fact, these latter never envisage finding themselves in the situation of a shareholder. Regardless of the company's financial situation, they never consider themselves as a shareholder receiving a right, admittedly residual, but however unlimited, in the fruits of the company. The difference in attitude between an investment fund and a banking institution has deepened since the toughening of prudential rules. These latter henceforth severely penalize banks that convert their debts into shares. Moreover, contrary to a banking institution, investment funds are not likely to find themselves in a conflict of interests' situation considering their position both as a creditor and a potential guarantor of the distressed equity offering that may be a source of considerable remuneration. To the extent that these two positions are held by two different departments within the same banking institution, the risk of a conflict of interests is proven. The department likely to win, from an issuer, a mandate with a view to guarantee its distressed recapitalization, has no interest in the balance sheet of the company being restructured in such a way that there is a change in control of the company. In this hypothesis, the new controlling shareholder would take in charge the care of guaranteeing the issuance of new shares, such as the Apollo Management fund, in the course of the restructuring of Latécoère[255].

145. – **Chapter 11 is naturally the subject matter of numerous criticisms** that, recently, were concentrated on three subjects[256]:

1°) the weightiness and, therefore, the cost of the observation period to the extent that a great number of acts of the debtor's manager must receive the consent of the judge, a U.S. trustee not having a role equivalent to a court-appointed administrator in France which may be invaluable; it should be noted that any and all creditors may be heard at the hearing and assert their views, even if it preferable to go through the creditors' committee constituted for such purpose;

254 - See, The vocabulary and mechanisms provided by the Directive of November 22, 2016 testify to a reconciliation with American law. For example, the «viability» of the company becomes the decisive criteria for the eligibility of a reorganization rather than a liquidation; the proceeding sets the «on going concern value» and its «liquidation value» which allows for determining the rights of the various creditors; the latter being divided into «classes» and may restructure the financial obligations of the company on a non-consensual basis, this is the «cramdown».

255 - Actunews, «*Restructuration financière du groupe Latécoère – Lancement des augmentations de capital*» [Financial restructuring of the Latécoère group – Launching of capital increases], August 20, 2015.

256 - American Bankruptcy Institute, «*Commission to study the reform of chapter 11 – final report and recommendations*», 2014, available on https://abiworld.app.box.com/s/vvircv5xv83aavl4dp4h.

2°) more and more litigation between the parties involving the corporate value of the company in reorganization; in this manner investment funds contest the control of the company, both alleging to be the holder of the fulcrum security;

3°) the disposals of all of the company's assets for the benefit of creditors holding security interests, even before the crystallization of the corporate value and therefore the approval of the plan by the holders of the fulcrum security. The generalization of the use of the exception provided in the U.S. Bankruptcy Code authorizing disposals of the debtor's assets arose from the growing need to shorten proceeding times. The switching over in an economy that is more and more intangible rendered necessary decreasing the observation period in the United States. This being said, these rapid disposals gave rise to numerous criticisms on the ground that they allowed investment funds to capture a share of the value that in principle belonged to unsecured creditors[257]. A reform of Chapter 11 is being envisaged in order to correct this practice[258].

146. – **In spite of these criticisms, on the level of the principles, Chapter 11 appears intrinsically superior to French insolvency law, in particular whenever it is a question of facilitating the restructurings of bond debt as efficiently as possible**. Due to the threat of the opening of a Chapter 11 proceeding, an American company manager thus has a greater power of negotiation than a French company manager. He is in a better position for both convincing and compelling creditors dispersed over the financial markets to agree to make significant concessions. Whenever the financial situation of the company so justifies, the managers may obtain from bond holders the partial cancellation of the debt in consideration for the delivery of shares within the framework of public exchange offers, each bond holder, in light of the law, having to give his consent to such an exchange.

147. – **Obviously, sometimes public offers fail in the United States in spite of the advantage of Chapter 11**. Empirical studies, however, have shown an improvement these last years in the capacity of companies in restructuring their bond debt outside of an insolvency proceeding. An initial study dating from 1994 thus showed that out of 161 companies rated CCC according to the Standards & Poor scale, 76 companies succeeded in restructuring themselves in connection with a public offer, 78 did not succeed and thereafter opening a Chapter 11 proceeding[259]. A second study dating from 2006 this time demonstrated that the proportion of companies that succeeded in restructuring themselves outside of an insolvency proceeding declined in the beginning of the 2000s. During this period, 60% of the bond issues that were subject to default would have given rise to the opening of an insolvency proceeding[260]. This tendency was thereafter inversed. Thus, the recent evolution of the equilibrium of the parties in the course of an insolvency proceeding, for the benefit of secured creditors, would tend to favor the success of public offers with unsecured bond holders, the latter thereby compelled to accept the offer. Bond holders thus fear that senior creditors unduly capture the value in the course of the insolvency proceeding[261].

148. – **Improving the chances of success of the public exchange offer by the practice of exit consents**. Concerned about the success of his public offer and aware of the risk of inertia of bond holders, a company manager must construct his offer so as to render it as attractive as possible. The debtor may seek to encourage bond holders to take part in the offer, by promising, for example, to pay them remuneration in case of success in the form of a consent fee. The debtor may also seek to compel bond holders to take part in the offer. In this area, contractual freedom should be encouraged, subject to compliance with applicable law. The effect of the proposals of the initiator must not, in fact, violate their consent. The holders must remain free to agree to take part in the offer or not[262]. In order to compel bond holders to recapitalize the company, just as in Théolia and Bull in France[263], certain American issuers sought, in parallel to the organization of a public exchange offer, to cause the bond holders to approve modifications to the terms and conditions of the loan. The bond holders are thus requested to approve a decrease in their rights (essentially by provoking a delay in the maturity date, a

257 - D. Baird, B. Rasmussen, «*The End of Bankruptcy*», Stanford Law Review, Vol. 55, 2002, available on SSRN: https://ssrn.com/abstract= 359241 or http://dx.doi.org/10.2139/ssrn.359241.

258 - American Bankruptcy Institute, «*Commission to study the reform of chapter 11 – final report and recommendations*», *op. cit.*

259 - J. Franks, W. Torous «*A comparison of financial recontracting in distressed exchanges and chapter 11 reorganizations*», 1994, Journal of Financial Economics, vol. 35, issue 3, pages 349-370.

260 - See,. E. Altman, and W. Stonberg, «*The Market in Defaulted Bonds and Bank Loans*», 2006, Journal of Portfolio Management 32, 93-106; Douglas G. Baird, Robert K. Rasmussen, 2003, «*Chapter 11 at Twilight*», Stanford Law Review 56, 673-699.

261 - W. Adam, A. Levitin, «*The New Bond Workouts*», *op. cit.*

262 - If the offer is set in a particular proceeding, it cannot alter the profound nature thereof so that the law of contracts remains applicable.

263 - *Cf. supra* § 38.

decrease in the interest rate, elimination of the covenants and securities)[264]. Those bond holders, choosing to not take part in the offer, thus find themselves holders of a bond, which by definition is less liquid and devoid of elementary protection mechanisms. Mechanically the value of the original bonds shall thereby collapse on the financial markets. This practice is this baptized as the practice of exit consents. Confronted with the derivatives of such practice[265], the courts of the United States, contrary to those of France, have been referred to in order to specify the conditions of the right of bond holders to modify, by a qualified majority, the terms and conditions of the loan. Such case law has been subject to numerous controversies. Confronted with the risk of failure of public offers, a discussion has thus begun in the United States in order to envisage reforming the Trust Indenture Act (TIA) imposing the rule of unanimity in case of a significant modification of the terms and conditions of the loan. However, the increase these last few years in the rate of success of public offers due to an evolution of the Chapter 11 negotiating dynamic, unfavorable to bond holders, and rendering the opening of an insolvency proceeding more costly for them, appears to have stopped, in the short-term, any vague desire for reform, as the rate of success of public offers has increased[266]. In France, we have opted for a commendable reform, even if it may be regretted that there was no discussion with investors before adopting such a measure.

149. – **Repercussions on recapitalization transactions:** even if the number of empirical studies is still inadequate in such matters[267], for all of these reasons it must be possible to attribute the lowest number of distressed recapitalization transactions to the United States, in relation to Europe, to the efficiency of Chapter 11. These last few years American companies have rather implemented capital increases in cash, subsequently to the in-depth restructuring of their balance sheet, during the Chapter 11 phase. A capital increase is beneficial at this stage for all of the parties. The debtor benefits from a contribution of fresh money without recourse to indebtedness. The creditors, as well as the holders of shares prior to the insolvency proceeding, may protect their capital investment of the debtor by subscribing to the capital increase. They may also improve their chances of a return on investment by subscribing to the shares at a price presumed to be lower than the real value of the shares, by definition insolvent. The success of the capital increase indicates to the market that the parties are optimistic with respect to the prospects of the turn-around of the company[268]. This type of financing appears preferable to the issuance of new high yield bonds at high interest rates, which solution was recently proposed by CGG, in order to benefit from a contribution of fresh money[269]. For all these reasons, certain learned writers have considered that Chapter 11 had been a key factor in the rapid recovery of the United States, in relation to the rest of Europe[270].

150. – **Repercussion on the terms and condition of intervention of the American Treasury with companies in difficulty:** the difference between Chapter 11 and French company law has repercussions on the manner in which the American Treasury lends assistance to private American companies. The American State had to intervene to lend assistance to American companies at the worst moment of the financial crisis. Aside from the time of the complete collapse of the financial markets in 2008, a veritable private market for financing of companies in difficulty exists in the United States. As of 2009, large American companies subject to Chapter 11 were capable of having their short term financial needs, although in the billions, be financed by private investors[271]. It was therefore only exceptionally that the American Treasury intervened at the very beginning of the financial crisis. In fact, the rescue operations were justified by the Obama administration and the members of Congress in light of the seriousness of the financial crisis and the consequences on the economy of the disappearance of certain financial institutions, as well as large automobile manufacturers. The conditions of the

264 -W. Adam, A. Levitin, «*The New Bond Workouts*», 2017, U of Penn, Inst for Law & Econ Research Paper No. 17-9, available on onSSRN:https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2909186.

265 - Trust Indenture Act, Section 316 (b); See, the decisions *Marblegate Asset Management, LLC v. Education Management Corp.* and *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp*; Latham & Watkins, «*A new tool for holdout bondholders: the Trust Idenure Act*», 2015; Weil, Gotshal & Manges, Bankrupcy Blog, «*What Marblegate Can Teach Us About the Protections Available to Minority Noteholders in an Out-of-Court Restructuring*», 2012.

266 - M. Roe, «*The Trust Indenture Act of 1939 in Congress and the Courts in 2016: Bringing the Sec to the Table*», 2016, available on the Harvard Law School site,: http://blogs.harvard.edu /bankruptcyroundtable/ files/2016/02/Roe-Bringing-the-SEC-to-the-Table.pdf.

267 - J. Park, «*Equity Issuance of Distressed Firms*», *op. cit.*

268 - See, in particular, Th. Carlson, «*Rights Offerings Provide 'New' Solution to Classic Leverage Problem*», 2007, The Journal of corporate renewal; D. Winikka, P. Green «*Rights Oerings [sic] in Bankruptcy: more than New capital*», 2001, Association of insolvency and restructuring advisor, Journal Volume 24 Number 5. In France, it is not very frequent for companies emerging from insolvency proceedings to oranize capital increases. This, however, was the case in the Latécoère matter: Press communiqué, Restructuration financière du groupe Latécoère – réalisation de l'augmentation de capital réservée aux prêteurs du 21 aout 2015 [Financial restructuring of the Latécoère group – carrying out the capital increase reserved to lenders, of August 21, 2015].

269 - *Cf. supra* p. 29 for a detailed description of the CGG matter

270 - S. Gilson, «*Coming Through in a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping to Revive the U.S*», 2012, Economy. Journal of Applied Corporate Finance, 24: 23–35.

271 - Ibis. See, also, G. Plantin, D. Thesmar and J. Tirole, «*Les enjeux économiques du droit des entreprises en difficulté*», *op. cit.*, p. 4.

rescue by the American State of the automobile manufacturers, Chrysler and General Motors, were the subject of lively discussions, including in the academic world[272] In any event, the manner in which the Treasury intervened is of such a nature as to furthermore reduce the cost of the transaction for public finances. In any event, at the time of the intervention, the four founding principles of the rescue fund were (1) the protection of the investment of the tax payer and the maximization of the investment within the limits of what is possible, (ii) promoting stability and preventing the shut down of the financial markets and the economy, (iii) reinforcing confidence in the market in order to encourage private investment, and (iv) realizing the investment as rapidly as possible in the most appropriate manner in order to reduce the financial and economic impact of the intervention [273]. It shall be noted that these principles are very removed from those of the French State.

The rescue of General Motors by the American Treasury

The intervention of the American Treasury to lend assistance to GM was motivated by the closing of the credit market to the automobile manufacturer in the midst of the financial crisis.

The rescuing of automobile manufacturers was carried out in a manner such as to minimize the cost for public finances. At first, the American Treasury afforded loans to GM in the amount of 20 billion euros together with guarantees. The Treasury thereafter afforded 30 billion subsequent to the opening of a Chapter 11 proceeding, in debt and with the privileged status afforded debtor in possession financing or DIP financing (the equivalent to a procedural privilege).

Contrary to Areva, GM's bond debt was not transferred with the healthy assets. Essentially, only the debt of the American Treasury and the Canadian government, benefitting from a more favorable ranking than the historical creditors, could be transferred, considering the value of the assets. GM's shareholders and bond holders remained in the company which was thereafter subject to liquidation within the framework of a Chapter 7 proceeding.

The American Treasury thereafter, together with the American State and GM's creditors, took control of the «New GM», a new entity that was the receptacle of GM assets that were considered viable, leaving the others to be liquidated within the framework of a Chapter 7 proceeding.

The American Treasury never had as its objective the taking of control of the group (at the most, its participation was equal to 60% of the capital) and was always concerned about minimizing the cost of the intervention for the American tax payer. It thus relieved itself of its stake, taking advantage of the admission of the New GM on the stock market in 2010, then successive opportunities. The Treasury acknowledged having realized a capital loss of 9 billion dollars in the transaction in spite of the manufacturers' return to profitability, the stock market price not having yet found its prior level.

[272] M. Roe, D. Skeel, «*Assessing the Chrysler Bankruptcy*», 2010, Michigan Law Review, Vol. 108, pp. 727-772, available on SSRN: http://ssrn.com/abstract=1426530; S. Lubben, «*No Big Deal: The GM and Chysler Cases in Context*», 2009, American Bankruptcy Law Journal, Vol. 83, available on SSRN: http://ssrn.com/abstract=1467862; J. Warburton, «*Understanding the Bankruptcies of Chrysler and General Motors: A Primer*», 2010, Syracuse Law Review », Vol. 60, No. 3, available on SSRN: http://ssrn.com/abstract=1532562; E. Morrison, «*Chrysler, GM and the Future of Chapter 11*», 2009, Columbia Law and Economics Research Paper No. 365, available on SSRN: http://ssrn.com/abstract=1529734.

273 - B. Canis, B. Webel, «*The role of TARP Assistance in the restructuring of General Motors*», 2014, CRS Report for Congress.

Part III: Recommendations and general conclusion

151. – **Consequences on a micro-economic level, of unknown legal lacuna**. The Member States of the European Union, in particular France, as well as European institutions, today find themselves confronted with the challenge of carrying out an ambitious reform of insolvency law. The first, often under-estimated obstacle, is to agree on the cost of the effects induced by ill-adapted insolvency law. In France, we have difficulty in establishing a common diagnosis with respect to the *ex ante* and *ex post* effects of insolvency law. For this reason, we have chosen in this study to especially stress one of the negative effects of insolvency law, that is: the impossible in-depth restructuring of the balance sheet of listed companies, tapping the bond markets and, the negative consequences that are induced, both for their minority shareholders as well as the State, called upon to take on the role of shareholder of last resort, in the absence of rules applicable to corporate governance and stock exchange law for adequately protecting investors in France.

152. – We have also briefly mentioned other detrimental consequences of insolvency law[274]:

1°) for large listed companies, that is, the great propensity of such companies to be compelled either 1) to be dismantled for the sole purpose of dealing with their financial problems, or 2) being able to seek a backing solution with an industrial third party, often foreign, with the consequences that are induced for France, in terms of employment,

2°) for unlisted companies, like companies subject to a LBO, very great difficulty equally in restructuring their debt.

153. – **Consequences on a macro-economic level, of the lacuna of the law, not yet adequately analyzed:** an indicator of the inefficiency of insolvency law could be found at the level of the rate of the five-year relapse of companies emerging from an insolvency proceeding in a situation of being recovered. According to the Euler Hermès company, the latter is equal to 85% in France with respect to companies emerging from a judicial reorganization in connection with a recovery plan. It is equal to 50% with respect to companies emerging from a safeguarding proceeding[275]. These very high rates can reflect two things: on the one hand, courts have a tendency to force the reorganization of non-viable companies to the detriment of competing companies, for the purpose of protecting employment at any price. On the other, the courts allow to emerge from insolvency proceedings companies that are perhaps viable, but still too heavily indebted, for the reasons previously from insolvency proceedings companies that are perhaps viable, but still too heavily indebted, for the reasons previously mentioned. These results are coherent with regard to the analyses made at the macro-economic level. They explain the very depressive effect of an insolvency proceeding on the activity of companies. Companies that really merit being rescued are penalized due to the attempt to preserve non-viable companies at any price. Professionals having the greatest experience in insolvency law do not necessarily grasp these macro-economic considerations. Legal professionals are more focused on the consequences on the micro-economic level of the decisions that are made. How many times does one hear in the courtrooms that there is nothing to lose in artificially prolonging the life of a company if this enables protecting a hundred employees from six additional months of unemployment? The consequences on the competition of young outsiders are not taken into consideration.

154. –**Major obstacles to an ambitious reform of insolvency law.** The awareness of all of the effects induced by insolvency law must lead us to conclude that the French lawmaker has no other choice than to again reform

274 - It must be recalled that contrary to the widespread view, the efficiency of insolvency law is not measured in terms of the noted number of company bankruptcies or the *ad hoc* mandates and conciliation proceedings opened every year. A country is not necessarily in poor health due to the high number of company bankruptcies. A country that has known both a high number of company failures and a number – which is even greater – of growth companies, is a country that is in better health than a country that has a low number of company failures but even less growth companies. In this regard, France is often criticized for having too many mid-size or large companies known as «static», which create little employment. See, in this regard, the statistics in Th. Aubrey, R. Thillaye, A. Reed «*Supporting Investors and Growth Firms*», 2015, Policy Network, available on www.policy-network.net. Furthermore, a high number of openings of insolvency proceedings is not necessarily a relevant indicator. This is the case if the great majority of the companies concerned are companies with a sole shareholder or very small companies, having only one or two employees. Rather than being amicably liquidated, these companies choose to have recourse to insolvency proceedings. However, they often have a small number of creditors rendering easy, in principle, the wiping off of liabilities. France typically finds itself in this situation since it has undergone a very large number of minor failures that uselessly encumber the courts. The existence of specific labor law rules applicable on condition that the company be placed in an involvency proceeding explains this situation. The prospect of being able to guarantee the payment of salaries and certain indemnities, owing to the AGS [*Association pour la Garantie des Salaires* (Association for the management of employee claims)] thereby encourages employers of small companies (corresponding to the very large contingent of companies in France) having recourse to insolvency proceedings rather than the amicable liquidation of their company. Conversely, the small number of bankruptcies in Spain is not a good indicator of the good health of the economy. Studies have shown that, in reality, Spanish companies avoid insolvency proceedings that they consider ineffective. Ready to do everything to avoid courts, companies try to find alternative solutions which are not always optimal. See, A. Gurrea-Martínez, «*The Low Use of Bankruptcy Procedures in Spain: Reasons and Implications for the Spanish Economy*», 2016, Ibero-American Institute for Law and Finance, Working Paper Series 5/2016, available on SSRN: http://ssrn.com/abstract=2783666.

275 - Statistics of the credit insurer, Euler-Hermès, available upon request.

such law. Admittedly, insolvency law is strongly impregnated with the culture and history of the country in which it applies. For a long time it was influenced by public policy considerations, just like the Law of 1985[276], conferring a very proactive objective on insolvency proceedings. This being recalled, the search for efficiency, leading to the return to consensualism, henceforth prevails to a large extent. The support of creditors for recovery plans has become a priority for court-appointed administrators and the Commercial Courts in major restructuring matters. It is therefore not surprising that, lately, a Socialist government launched two reforms of insolvency law considered as favorable to the rights of creditors, in 2014[277] and 2015[278].

155. – History is admittedly marked by failed attempts in transposing the laws of one country to another. For example, at the time of the fall of the Berlin wall, Eastern European countries attempted to introduce the U.S. Chapter 11 proceeding[279] without any great success. The academic world, at the international level, considers for this reason that States suffer from path dependency[280]. However, these failures are related above all to the great difficulty in importing a law that requires, we too often forget, particularly adapted judicial institutions as well as specialized legal and financial professionals, in order to to be able to adequately assist debtors and creditors in countries having a very different institutional and economic level of development. By refusing an ambitious reform of insolvency law, perhaps France is allowing itself, in this post-Brexit period, to acknowledge that it does not have judicial institutions and an adequate professional environment?

156. – Aside from the weight of tradition, the place that insolvency law takes in the legal system would be an obstacle to any ambitious reform. Insolvency law is, in fact, a junction of numerous other laws. For example, it must be fit in with company law, securities law and stock exchange law. For this reason, any significant modification of insolvency law is likely to entail uncontrolled repercussions in other branches of law if the lawmaker does not pay attention. To this argument, there may be raised that considering the pro-active approach of insolvency law in favor of employees and, by extension, in favor of shareholders, the coordination of French insolvency law with, on the one hand, company law and, on the other, the law of securities, already functions poorly for the reasons mentioned earlier. This situation very much injures the clarity and efficiency of our legal system.

157. – **The strategy of the lawmaker to reform in small steps, having undergone acceleration since 2005 which partially failed**, in spite of significant improvements made to the Law of 1985. This strategy was initiated as of 1994[281], the date on which there was voted the first law responsible for dealing with the undue effects provoked by the radical approach of the Law of 1985 on the handling of difficulties. Due to the supposedly impossible reform of insolvency proceedings in France, more particularly judicial reorganization, the lawmaker triggered a headlong rush that successively lead to:

1°) thinking that an out-of-court settlement of difficulties was always preferable, under all circumstances, to the opening of an insolvency proceeding; now, a company having a large number of uncoordinated creditors, whether suppliers or creditors following a very significant tortious damage, probably has little interest in launching itself into out-of-court negotiations;

2°) introducing more and more exemptions to the rule of the termination of proceedings, for example, by recently encouraging securities conferring ownership like the trust, entailing a transfer of ownership outside of the debtor's assets, in order to avoid the rule of the termination of proceedings;

3°) introducing more and more exemptions to the rule of the collective nature of an insolvency proceeding, which supposedly draws all of the company's creditors, via the introduction of the accelerated safeguarding

276 - With respect to Law no. 85-98 of January 25, 1985 the declared objective of the lawmaker was clear: the recovery of the company. This objective was declared as of Article 1 of the law, aiming at «*the safeguarding of the company, the maintenance of activity, employment and wiping off the liabilities*» in order to attain which the lawmaker did not hesitate in infringing creditors' rights (*in particular, decline of security rights*), almost deemed guilty for companies in difficulty.

277 - Ordinance no. 2014-326 of March 12, 2014 and it implementing Decree no. 2014-736 of June 30, 2014; Ordinance no. 2014-1088 of September 26, 2014.

278 - Law no. 2015-990 of August 6 2015 for growth, activity and equality of economic chances (known as the «Macron Law»).

279 - K. Pistor, M. Raiser, S. Gelfer, «*Law and Finance in Transition Economies*», 2000, available on SSRN:https://papers.ssrn.com/sol3/papers.cfm?abstract_id=214648.

280 - See, for e.g., K. Pistor «*Patterns of legal change : shareholders and creditors rights in transition economies*», 2000, European Business Organization Law Review, 1: 59-108.

281 - As the Law of 1985 did not produce the hoped for fruits and the infringements of creditors' rights turning out to be unjustified with respect to the results obtained, Law no. 94-475 of June 10, 1994 undertook to correct the excesses of the reform by restoring creditors' rights to a certain extent. Since then reforms have succeeded each other in order to multiply readjustments and ensure finding adapted mechanisms for reorganizing a company without, however, too seriously infringing the rights of creditors: Safeguarding Law no. 2005-843 of July 26, 2005, Ordinance no. 2008-1345 of December 18, 2008, Law no. 2010-1249 of October 22, 2010, Ordinance no. 2014-326 of March 12 2014, Law no. 2014-990 of August 6, 2015.

proceeding and the accelerated financial safeguarding proceeding, leading to violating the consent of the creditors without adequate safeguards having been established;

4°) introducing safeguards enabling an alignment to be re-established between the body of creditors, on the one hand, and the debtor company, on the other, considering the power to harm unjustly conferred on certain dissident creditors due to the effect of rules in respect of the approval of recovery plans, for example, recently the questioning of the principle: «one euro, one vote» in creditors' committees;

5°) introducing a mechanism to allegedly reduce shareholders' power to harm, under all circumstances holders of the right to approve recapitalization transactions, in violation of the order of priority; this, for example, is the possibility afforded by the Law of 2015 to squeeze out shareholders in the name of the protection of employment; unfortunately this measure was inefficient as the law is not based on an objective of maximizing the fair value of the assets; pursuing this objective would have led the lawmaker to acknowledge that the squeezing out of the shareholder must be allowed from the moment that the company is insolvent, upstream from the cessation of payments;

6°) taking measures leading to re-establishing, unfortunately only partially, the objective of maximizing the fair value of the assets, by authorizing disposal plans, in connection with a «pre-pack sale» even when the company is not in a situation of cessation of payments, without, however, obliging the parties to sell the debtor to the highest bidder (but still imposing a competitive process).

158. – It is probable that in the course of the upcoming months, even years, serious negative effects shall appear, provoked by the institution of these patchy measures, in particular following the introduction of the security trust in respect of shares, thereby enabling creditors to avoid insolvency proceedings to a greater and greater extent. Disputes would accordingly multiply each time that the law does not allow for a foreseeable and fair allocation of risks for investors. **This headlong rush of the lawmaker since 1994 must be the signal of alert of French law that is much too impermeable to the teachings of law and economics and behavioral economics.** It is important the French lawmaker take note at present of the failure of this headlong rush strategy, considering the challenges to come.

159. – **A major difficulty in assessing the extent of the benefits of a significant reform considering the challenges to come**. If the difficulty in establishing a common diagnosis of the costs of insolvency law for our economy is not to be underestimated, the difficulty in agreeing on all of the benefits of a significant reform of the law is equally important. In this regard, the European Commission has recently asserted the necessity of significantly reforming insolvency law, essentially for two reasons:

1°) the handling of doubtful debts in the balance sheets of banks (non–performing loans); this problem is especially salient, in particular, in Italy, Greece, Portugal and Spain. Banking institutions must be able to more rapidly rid themselves of their doubtful debts, with the prospect of financing new investment projects, promoters of growth. A detailed analysis of this stake here exceeds the context of our analysis;

2°) the development of bond markets in Europe. In its February 2015 green paper, the European Commission recalled the importance of a Union of capital markets intended to render such markets both more accessible, in particular for SMEs/mid-cap companies and more efficient, so that they may satisfy the requirement of diversification of the financing sources of companies[282]. The banking intermediation and the bond market are, in fact, two complementary tools. Economists agree in saying that neither of the two is a panacea and one should not wait for the mechanical effect of the substitution of bond markets for banking intermediation. However, together, and in competition, they allow for diversifying an offer of credit and render it more competitive. The existence of a robust bond market, functioning in parallel to the banking system is, furthermore, an indicator of a well-developed financial system[283]. More specifically, a well-developed high yield bond market furnishes a financial offer for the benefit of issuers classified as speculative for which the banking market is closed[284].

160. – **We have also identified other stakes, considering the challenges that are forthcoming, in particular:**

1°) **the next bond crisis provoked by the excesses, during the period of restriction of access to the banking market, of the debt market opened to issuers classified as speculative (high yield market);** the bond

282 - Available on its site: http://eur-lex.europa.eu/legal-content/FR/ TXT/?uri=CELEX:52015DC0063

283 - R. Herring, N. Chatusripitak: «*The case of the missing market: the bond market and why it matters for financial development*», 2000, Asian Development Bank Institute working paper, no 11; W. De Bondt, «*Portrait Psychologique de l'Investisseur Individuel en Europe*», 2002, Revue d'Économie Financière.

284 - F. Allen, D. Gale, «*Financial Contagion*», 2000, The Journal of Political Economy, Volume 109, Issue 1, 1-33; M. Davis, «*Infectious defaults*», 2001, Quantitative Finance, Vol: 1, Pages: 382-387, ISSN: 1469-7688

market has developed in Europe in an unprecedented manner since the bursting of the last financial bubble, following the closing of the banking market; the resumption of the latter has not prevented bond markets from durably developing, even more so since the increase in prudential constraints on banking institutions pushed them to abandon certain sectors of the market for financing of the economy, in particular that of the financing of weak companies; lastly, these excesses of the bond market have been facilitated by the particularly accommodating monetary policy of the European Central Bank which *a priori* shall soon end; it should be noted that within such context, financial documentation contains little or no financial covenants, which shall render even more complicated the anticipation of difficulties upstream from a default,

2°) **the change of the environment which more large companies with complex balance sheets will from now on face due to the ongoing digital revolution** (for e.g., the Solocal Group but also Gascogne and Sequana in the paper industry) as well as the energetic transition (for e.g., Areva, CGG, Vallourec); large-sized companies are accordingly no longer protected by their size, regardless of their sector of activity; up until now, the restructurings of large companies in France mainly concerned companies: 1) too under capitalized at the time of the independence vis a vis the State (for e.g., Alstom, Alcatel, with the particular case of Eurotunnel), or 2) which had difficulties in adapting themselves following the progressive liberalization of their sector of activity (for e.g., France Telecom, and soon the SNCF, EDF and again Air France), or 3) whose activity was subject to strong Asiatic competition (for e.g.,Thomson/Technicolor or also Alcatel): henceforth, all large companies must feel concerned by the inefficiency of insolvency law, considering the on-going digital revolution,

3°) **the acceleration of the rhythm of the destructions of value provoked by failing companies, considering the dematerialization of the economy;** this situation is such as to reconcile the methods for handling defaults of large companies with those applied to the handling of bank defaults; in this regard, it shall be noted that the evolution of finance at the beginning of the XXIst century provoked an increase in the complexity of the balance sheets of all companies combined (and not only financial institutions), turning more and more to the financial markets, and by having recourse to complex debt instruments; henceforth, the evolution of the economy definitively moved larger and larger non-financial companies closer to financial institutions, such evolutions were of such nature as to incite the public powers to reconcile the system for handling the difficulties of non-financial companies with the system applicable to financial institutions; in this regard, the introduction of a bail-in proceeding in our bank bankruptcy law, enabling the *Autorité de contrôle prudentielle et de résolution* to force, authoritatively, the massive conversion of a bank's claims into shares, in the space of a week-end, depending on the order of priority and valuation of the assets of the banking institutions, must be understood as a precursory sign of the evolutions to be expected in the handling of the default of non-financial companies,

4°) **the deterioration of public finances** which shall lead the State in the future to have to agree less often to take on the role of shareholder of last resort, at least with private companies and, one hopes in the future with public companies.

161. – **Take the reform route opened by the European Commission**. For all these reasons, the French lawmaker has no other choice than to adapt our legal framework and, in this regard, take advantage of the initiatives launched by the European Commission. In its proposal of the Directive of November 22, 2016, the European Commission clearly showed the route for improving the handling of debts of large companies. Admittedly, such proposal is not devoid of criticisms[285]; we shall consider, however, that **France would be the first country to take advantage of the introduction into its law of the proposals of the European Commission for the following reasons:**

1°) **the total absence of the allocation of foreseeable, transparent and fair risks is unique under French law,**

2°) **the size of its economy and the depth of its financial markets,** to the extent that we shall consider that the proposal of the European Commission is aimed firstly at the countries in Western Europe endowed with solid judicial institutions and in which the courts, attorneys, banking and financial intermediaries possess adequate expertise to be able to handle complex questions, such as the valuation of companies,

3°) **the number of significant companies in France considering our history and, in particular, the construction of our State which is based on a Colbertist culture,** the significant companies should be the

285 - H. Eindemüeller, «*Contracting for a European Insolvency Regime*», *op. cit.*

first beneficiaries of the introduction of the proposals of the European Commission, even if this was probably not the objective sought.

162. – **For all these reasons, we advocate the following recommendations:**

Recommendation no. 1

Render the allocation of risks foreseeable, transparent and fair whenever the company goes into an insolvency proceeding, relying for this on the proposals of the Directive of the European Commission of November 22, 2016, in particular:

- compliance with the order of priority of payments (absolute priority rule);
- the principle of consensualism, leading to prohibiting the adoption of a recovery plan for the company in an insolvency proceeding without the consent of at least one class of creditors;
- the principle of the no worse off principle or best interest creditor test, guaranteeing creditors in case of recovery of the company in an insolvency proceeding that they cannot be treated worse than in the case of liquidation and realization of all of its assets separately (liquidation value);
- the principle of a fair and equitable treatment of the investors, guaranteeing that in a similar situation, the investors are treated in an identical manner and, if in a different situation, they are treated differently;
- the possibility of squeezing out shareholders and classes of junior creditors if they have the right to nothing in case of disposal of the company at a price equal to its on going concern value.

163. – In order to favor restructurings outside of an insolvency proceeding, the possibility must be left to the bond holders to waive the rule of unanimity whenever the loan is open to institutional investors only, in order to encourage purchases of debt in exchange for the issuance of shares.

Recommendation no. 2:

Authorize contractual adjustments to the rules of the group of the bond holders in loans reserved to institutional investors, in order to authorize, outside of an insolvency proceeding, conversion of the bond debt into shares by decision of the majority of the 2/3 of the bond holders of one and the same series of bonds. This authorization shall concern simple bonds, just as bonds giving access to the capital. The Ordinance of May 10, 2017 must therefor be amended. However, safeguards must be instituted to handle the risk of conflicts of interest.

164 We have thus wished to concentrate our remarks on the importance of insolvency law and in-depth reform. However, we must not minimize the importance of other branches of law allowing for favoring the settlement of bond debt crises. Corporate governance of companies in difficulty must, in particular, be reinforced. This reinforcement occurs by the introduction of a certain number of measures in company law and stock exchange law.

Recommendation no. 3:

Encourage courts to acknowledge that in the prolongation of the interest of the company, managers owe a general duty of loyalty vis-à-vis shareholders as well as, whenever the company is close to the threshold of insolvency, vis-à-vis the creditors.

165. – In stock exchange law, three measures should nevertheless be able to be proposed in the short term in order to improve the efficiency of our financial markets, in particular, the rules of transparency. These simple measures should compel companies to communicate better on the extent of their difficulties and the contours of business plans in support of which they launch distressed recapitalizations.

Recommendation no. 4:

Reinforce the information obligations incumbent upon the issuers of new shares classified as speculative, in particular, oblige them to disclose projected information enabling the markets to understand the assumptions made by the managers in order to justify the company’s future recovery.

Recommendation no. 5:

Require the issuers classified as speculative, who issue new shares intended for their minority shareholders, to obtain the confirmation of an independent expert of the solvency of the issuer. This opinion must lead to

a veritable exercise of financial valuation going beyond the recommendations of the AMF in respect of independent expertise.

166. – A more technical measure can be taken in order to encourage the realization of PIPES, allowing for reducing the risk of seeing minority shareholders take risks the extent of which they do not measure.

Recommendation no. 6:

Encourage a modification of the AMF doctrine in respect of the equality of treatment of shareholders, in order to encourage private investments in listed companies or private investments in public equity (PIPEs) at the level of companies in difficulty.

167. – **French research in these areas remains too embryonic.** Answers must be rapidly made in order to improve, in particular:

1°) the other rules of corporate governance, inadequate from the perspective of raising the level of protection afforded minority shareholders,

2°) the rules in respect of State aid, in order to better regulate the conditions under which the Member States could henceforth contribute their assistance to defaulting companies, in such a way as to force them to further reduce the cost of their interventions for public finances. It shall be useful to state that, from now on, the States must, to the extent necessary, with regard to company difficulties, force investors to absorb the company's losses, prior to any public financial assistance (and not only compel the shareholders and subordinated creditors).

168. – **We strongly hope for an evolution of the conditions of research in France in the upcoming years in order to enable such objectives to be attained.**

June 2, 2017

S. V.

ANNEX 1 – TABLE OF THE 30 MOST IMPORTANT CAPITAL INCREASES WITH MAINTENANCE OF PREFERENTIAL SUBSCRIPTION RIGHTS

Company	Sector / Reasons for the difficulties	Price	Discount	Dilution (1%)	Settlement-delivery	State participation	Concessions grandted by creditors / Use of the proceeds / Comments
"Last chance" capital increase							
Faurécia	automotive / crisis	7,00 €	34,00%	0,27%	26 May 2009		no (bond debt and bank debt) /compliance with financial ratios / support from PSA Citroën Peugeot
Imerys	ore / crisis	20,00 €	33,00%	0,83%	2nd Junr 2009		no (bond debt and bank debt)
Club Méditerrannée	leisure / crisis	7,90 €	39,10%	0,61%	8 june 2009		no (bond debt and bank debt) / Financing WCR / compliance with covenants
Mersen (former Carbonne Lorraine)	electrical components / crisis	17,00 €	34,20%	0,80%	26 May 2010	X (existing shareholder)	no (debt repayment with the proceeds of issue)
Futuren (1) (former Théolia)	New energy / deregulation	2,00 €	55,80%	0,47%	20 July 2010		yes (bond debt)
Groupe Partouche (1)	casino / digital	40,00 €	11,00%	0,46%	13 August 2010		yes (conversion of the parent company's debt)
Michelin	automotive / crisis	45,00 €	31,00%	0,85%	25 October 2010		no (bond debt and bank debt) / imrprovement of financial rating
Groupe Partouche (2)	casino / digital	40,00 €	21,20%	0,85%	9 May 2011		yes (conversion of debt owed to the parent company)
Soitec (1)	microelectronics / crisis	90,00 €	41,00%	0,60%	25 July 2011	X (shareholder of last resort)	no (entry of an investment fund specialized in turnaround situations)
PSA Peugeot Citroën (1)	automotiv / crisis	8,27 €	42,09%	0,66%	29 March 2012	X (PSA Finance's guarantor)	no (General Motors enters into the share capital)
Sequana (1)	paper / digital	1,50 €	50,30%	0,33%	09 July 2012	X (shareholder of last resort)	no (bank debt) / debt repayment with the proceeds of issue
Technicolor (2)	electronics / structural	1,56 €	19,30%	0,67%	16 July 2012		no (new investor enters into the share capital)
Soitec (2)	new energy / regulation	29,00 €	37,50%	0,71%	23 July 2013	X (existing shareholder)	no (debt repayment with the proceeds of issue)
Alcatel-Lucent	telecom / deregulation	2,10 €	29,30%	0,84%	09 December 2013		no (bond debt and bank debt)
PSA Peugeot Citroën (2)	automotive / crisis	6,77 €	42,90%	0,45%	23 May 2014	X (shareholder of last resort)	no (bond debt and bank debt) / State's entry into the share capital
Solocal (1)	directory / digital	16,00 €	69,70%	0,24%	6 June 2014		no (debt repayment with the proceeds of issue)
Soitec (3)	microelectronics / crisis	32,00 €	46,10%	0,77%	22 July 2014	X (existing shareholder)	no (debt repayment with the proceeds of issue)
Sequana (2)	paper / digital	2,55 €	50,00%	0,50%	29 July 2014	X (existing shareholder)	yes (bank debt converted into ORAN, waiver of debt)
Futuren (2) (former Théolia)	energy / deregulation	0,50 €	21,00%	0,35%	9 Décember 2014		yes (conversion of redeemable bonds OCEANE)
Monte-Carlo SA des bains	leisure / crisis	34,50 €	17,62%	0,74%	24 March 2015		no (support from the Principality of Monaco)
OL Groupe	leisure / structural	1,60 €	66,24%	0,29%	29 June 2015		no (bond debt and bank debt) / New investor enters into the share capital
CGG	energy / crisis	21,12 €	71,55%	0,25%	5 February 2016	X (existing shareholder)	no (bond debt and bank debt)
Valllourec	steel / crisis	2,21 €	62,60%	0,31%	3 May 2016	X (existing shareholder)	no (bond debt and bank debt)
Soitec (4)	microelectronics	6,40 €	52,90%	0,61%	8 June 2016	X (existing shareholder)	yes (debt repayment with the proceeds of issue)
EDF	energy / structural / crisis	6,35 €	34,50%	0,77%	30 June 2017	X (existing shareholder)	no (bond debt and bank debt)
In-depth balance sheet restructuring leading to significant dilution of shareholders' rights							
Technicolor (1)	electronics / structural	6,60 €	26,77%	0,16%	18 October 2009		yes (conversion of bond debt and bank debt) without any controlling shareholder
Gascogne	paper / digital	2,50 €	43,30%	0,10%	16 July 2014	X (shareholder of last resort)	yes (bank debt converted into shares and ORAN) - Investment fund specialized in turnaround situations
Eurodisney SCA	leisure / structural + crisis	1,00 €	71,00%	0,05%	20 February 2015		yes (conversion of debt owed to the parent company) / no new controlling shareholder
Latécoère	aviation / structural	3,00 €	11,90%	0,13%	17 September 2015		yes (bank debt) - new controlling shareholder
Solocal (2)	directory / digital	1,00 €	61,00%	0,15%	13 May 2017		yes (conversion of bank debt (historic + interco-loans) without any controlling shareholder

Price : Price of subscription, adjusted to take into account share consolidations if any

Discount : Discount at a face value with respect to the share price at a face value

Dilution : Impact on existing shareholders on the basis of 1% of share capital before the issue

Concessions : Concessions in the form of waiver of debt or conversion of debt

Company	Status	Share price	Variation	CAC 40	Comments
Augmentations de la dernière chance					
Faurécia	Normal	45,405	548,64%	62,82%	company controlled by PSA Peugeot Citroën
Imerys	Normal	77,17	285,85%	57,62%	
Club Méditerrannée	Normal	25,58	223,80%	61,85%	
Mersen (former Carbonne Lorraine)	Normal	25,95	52,65%	36,79%	
Futuren (1) (former Théolia)	Buyout on 3rd-august-2016	1,15	-42,50%	53,53%	
Groupe Partouche (1)	Normal	37,01	-7,48%	47,45%	
Michelin	Normal	118,8	164,00%	42,19%	
Groupe Partouche (2)	Normal	37,01	-7,48%	32,87%	Impact when taking into account reserves
Soitec (1)	Normal	46,1	-48,78%	39,64%	
PSA Peugeot Citroën (1)	Normal	18,55	124,30%	57,47%	
Sequana (1)	Normal	1,55	3,33%	68,66%	
Technicolor (2)	Normal	4,6	194,87%	67,44%	Impact when taking into account reserves
Soitec (2)	Normal	46,1	58,97%	35,72%	
Alcatel-Lucent	Buyout on 2nd-november-2016	3,5	66,67%	28,79%	
PSA Peugeot Citroën (2)	Normal	18,55	174,00%	18,50%	In parallel to the reserved capital increases at a price of 7,5 euros
Solocal (1)	Normal	1,155	-92,78%	16,22%	
Soitec (3)	Normal	46,1	44,06%	21,85%	
Sequana (2)	Normal	1,55	-39,22%	21,96%	
Futuren (2) (former Théolia)	Buyout on 3rd-august-2016	1,15	130,00%	24,87%	
Monte-Carlo SA des bains	Normal	32,49	-5,83%	4,64%	company majority-owned by the Principality of Monaco
OL Groupe	Normal	2,78	73,75%	9,33%	White knight posteriorly entered into the share capital; not representative
CGG	Normal	5	-76,33%	26,75%	Impact when taking into account reserves
Valllourec	Normal	5,937	168,64%	21,78%	
Soitec (4)	Normal	46,1	620,31%	19,68%	significant turnaround after under-performance
EDF	Normal		-100,00%		
In-depth balance sheet restructuring = change of control					
Technicolor (1)	Normal	4,6	-30,30%	56,21%	Change in control without change in governance
Gascogne	Normal	4,08	63,20%	21,87%	Change in control and change in governance
Eurodisney SCA	Buyout in progress	2	100,00%	10,22%	Without change in governance but buyout conducted by parent company
Latécoère	Normal	3,82	27,33%	14,38%	Change in control and change in governance
Solocal (2)	Normal	1,155	15,50%	-1,72%	Change in control without change in governance

Concessions : Concessions granted by creditors, in the form of waiver of debt or conversion of debt

Share price : Market price : closing price on 19 may 2017 if status is normal or before if buyout occured in the meantime

Variation : fluctuation of shares' price of shares issued since settlement-delivery

CAC 40 : Fluctuation of CAC 40 since the day of settlement-delivery