PERVERSE EFFECTS OF THE ABSOLUTE RULE OF CONFIDENTIALITY APPLICABLE TO FRENCH AMICABLE SETTLEMENT PROCEDURES SERVING AS PREVENTIVE RESTRUCTURING FRAMEWORKS

Advocacy to legislators and Courts for more transparency

Sophie Vermeille

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Executive Summary

"*Any person who is called upon to participate in a conciliation procedure or an ad hoc mandate or who, by virtue of his duties, becomes aware of it shall be bound by confidentiality*". It is in these terms that Article L. 611-15 of the French Commercial Code enshrines the confidential nature of the two French amicable settlement procedures, serving as preventive restructuring frameworks and, which are referred to in Part VI of the French Commercial Code: the *ad hoc* mandate and the conciliation procedure[3].

This rule of confidentiality, which covers both the opening of these two amicable settlement procedures and their content, pursues the noble objective of enabling the debtor to negotiate more calmly the restructuring of his liabilities with his main creditors, without jeopardising his relations with other economic partners and his reputation on his market. With the exception of the (limited) publicity provided for the approval of a conciliation agreement when parties desire it, the confidentiality attached to amicable settlement procedures (serving as preventive restructuring frameworks) is not affected in any way. In this respect, we call it an "absolute confidentiality rule."

[1] The author would like to thank Nicolas Crocq and Thibault Jauffret in particular for their many comments on an earlier version of this article. The author also thanks Youcef Dridi. The views expressed in this article are those of the author alone. The latter certifies that there is no relationship that could influence, in any way, the content of the views expressed herein. However, the author would like to inform the reader that, as a lawyer, she represents the interests of investors who have taken short positions in Casino and Rallye at the date of publication of this article. Some of the ideas developed in this article, prior to the beginning of the author's mandate, may have been used for the purposes of the execution of her current mandate as lawyer.

[2] Droit & Croissance (D&C) is an independent and non-partisan think tank, founded in 2012 and open to everybody sharing its ambition to carry out and popularize studies in the fields of law, economics and finance. Since 2016, D&C is affiliated with the Institut Louis Bachelier, a non-profit association under the supervision of the French Ministry of Economy and Finance, which brings together 350 researchers. D&C's mission is to engage public and private actors, as well as to stimulate civil society debates, in order to highlight the importance of research in Law & Economics and Behavioral Economics. D&C is thus committed to bridging the gaps in French academic research at the crossroads of the various social science disciplines, which, according to D&C, is responsible for the inadequacy of French law to the evolution of economics and finance.

[3] The terms "*mandats amiables*" and " *procédures amiables préventives des difficultés* " are also used in French to designate the "*mandat ad hoc"* (translated into English as "*ad hoc mandates*") and the "*procédure de conciliation*" (translated as "*conciliation procedure*").

Legal doctrine, practitioners, and now case law[4] strongly defend the absolute rule of confidentiality. We strongly disagree with this majority position.

This article highlights various **perverse effects of the absolute confidentiality rule on the** debtor companies themselves, on their creditors and shareholders and more generally on the French economy and financial markets as a whole. The absolute rule of confidentiality of amicable settlement procedures serving as preventive restructuring frameworks reduces the company's chances of recovery because it leads to:

- reinforcing the climate of mistrust between the company and its own investors, and is likely to unduly protect companies hiding the reality of their financial difficulties in their financial statements;
- encouraging transfers of undue wealth between the different classes of creditors of the debtor company (and its subsidiaries), depending on whether the creditors are parties or third parties to the *ad hoc* mandate or conciliation procedure;
- making it more difficult to seek financing, given the impact of the confidentiality rule on the secondary debt market;
- encouraging the debtor company to sell its assets under poor conditions, as it fails to organize open and transparent auction procedures; and
- hindering the implementation of an in-depth corporate restructuring plan or a change in governance, which may be essential to the company's survival.

We will see to what extent the absolute confidentiality rule sometimes unduly protects the interests of the controlling shareholder of a distressed company - often also a corporate officer - who, having virtually lost his investment, has nothing more to lose and prevents the change of control of the company and therefore a change of corporate governance.

The article also highlights the **benefits of transparency** for the debtor and the various involved parties, especially in view of obtaining a restructuring agreement that is (i) realistic in terms of the company's cash flow prospects and (ii) in line with the order of loss absorption, the so-called "absolute priority rule", according to the terminology used by the European Commission in its draft directive of 22 November 2016.[5]

Through this article, we hope to **encourage public authorities and Courts to put an end to the absolute rule of confidentiality in *ad hoc* mandates and conciliation procedures and to create the conditions for greater transparency in insolvency proceedings**. The expected developments in European corporate insolvency laws raise hopes of such a shift in approach, even if the European Commission is not beyond reproach. It is indeed unfortunate that the Commission made no mention in the draft directive of the need to ensure transparency in restructuring frameworks.

[4] See the decisions in Mergermarket (CA Versailles, 14 September 2017, Nb. 15/08941, Cass., Com, 15 December 2015, Nb. 14-11.500, Cass., Com, 4 October 2018, Nb. 18-10.688, the latter decision refusing to refer a priority preliminary ruling on constitutionality to the Constitutional Council) and Conforama (T. Com. Paris, 22 January 2018, Nb. 2018001979).

[5] Proposal for a directive of 22 November 2016 on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

INTRODUCTION

(1) "*Any person who is called upon to participate in the conciliation procedure or an ad hoc mandate or who, by virtue of his duties, becomes aware of it shall be bound by confidentiality*". It is in these terms that Article L. 611-15 of the French Commercial Code enshrines the confidential nature of the two preventive restructuring frameworks taking the form of amicable settlement procedures and which are referred to in Part VI of the French Commercial Code: the *ad hoc* mandate and the conciliation procedure.

2. The *ad hoc* mandate allows the President of the competent commercial court to appoint an agent in charge of assisting the debtor in resolving his difficulties. The conciliation procedure allows a debtor who is experiencing an existing or foreseeable legal, economic or financial difficulty, and who has not been in a situation of cessation of payments (i.e., in a situation where the debtor can no longer pay its due and payable liabilities with available assets) for more than forty-five days, to benefit from a favorable negotiating framework under the aegis of an impartial third party whose mission is to "*promote, between the debtor and his main creditors and, where appropriate, his usual co-contractors, the entering into an amicable settlement procedure intended to put an end to the company's difficulties.*"[6]

3. The debtor, assisted by the *ad hoc* agent ("*mandataire ad hoc*") or a conciliator, has the right to choose at his discretion the creditors he wishes to include in the negotiations taking place during an amicable settlement procedure. These creditors will have to keep confidential, not only the content of the negotiations taking place, but also the very existence of the opening of an amicable settlement procedure. Only the debtor may disclose the information relating to the conciliation procedure and the *ad hoc* mandate since he is the only party initiating their opening and may therefore waive confidentiality.

4. In the Mergermarket case[7] (being noted that Mergermarket is now "Acuris"), the *Cour of Cassation* (i.e. the French Supreme Court) and the lower Courts ruled on the scope of the confidentiality obligation. Mergermarket Limited is the publisher of the online financial information website Debtwire, which specializes in monitoring *leveraged buyouts* (LBOs) of distressed companies and companies indebted to non-bank institutional investors in the so-called "direct lending market."

5. On July 12, 2012, Mergermarket published an article commenting on the opening of an *ad hoc* mandate procedure for the companies of the Consolis group, the European leader in precast concrete products, which has been facing significant financial distress since the 2008 financial crisis. Subsequently, Mergermarket published various articles reporting on the progress of the ongoing ad hoc mandate, which subsequently led to the opening of a conciliation procedure.

6. Mergermarket was summoned by several companies of the Consolis group and by the *ad hoc* agent before the Commercial Court to obtain the withdrawal of all the articles mentioning the opening of the two amicable settlement procedures supposedly confidential under French law, as well as information surrounding the negotiations.

[6] French Com. code, art. L. 611-7.
[7] See footnote 4 above.

7. On 16 November 2012, the Court ruled that Mergermarket had committed a manifestly unlawful disturbance by knowingly publishing information that it knew was confidential, (justifying a measure of cessation ordered in interim relief,) and therefore ordered the removal from the Debtwire website of all articles containing confidential information about the Consolis group's amicable settlement procedures.

8. Mergermarket lodged an appeal against the decision and, on 27 November 2013, the Versailles Court of Appeal overturned the order of the Commercial Court on the grounds that Mergermarket, as a third party to the amicable settlement procedure, could not be directly bound by the confidentiality obligation of Article L. 611-15 of the French Commercial Code.[8]

9. The companies of the Consolis group filed an appeal to the *Cour de Cassation*. The *Cour de Cassation* had to determine whether journalists, despite their status as third parties to conciliation procedures or *ad hoc* mandates, were required to respect the confidentiality of the amicable settlement procedures. The *Cour de Cassation* had to decide whether forcing parties, who had not taken part in negotiations, to respect the confidentiality rule, did not excessively infringe freedom of expression within the meaning of Article 10§2 of the European Convention for the Protection of Human Rights and Fundamental Freedoms.[9]

10. The *Cour de Cassation* declared the decision of the Versailles Court of Appeal unlawful and considered that "*the dissemination of information relating to an amicable settlement procedure [serving as a preventive restructuring framework] covered by confidentiality, without it being established that it contributes to the legitimate information of the public on a debate of general interest, constitutes in itself a manifestly unlawful disturbance*."[10] As a result, the principle of confidentiality of amicable settlement procedures, serving as preventive restructuring frameworks, prevails over the principle of freedom of expression of journalists, even though the journalists are third parties to amicable settlement procedures. Therefore, the disclosure of confidential information relating to such procedures by journalists can only take place on an exceptional basis when such information contributes to the legitimate information of the public on a debate of general interest.

11. Later on, the Paris Court of Appeal were also to hand on its ruling on this case after that the *Cour de Cassation* declared the decision of the Versailles Court of Appeal unlawful. Not surprisingly, the Paris Court of Appeal gave a particularly restrictive interpretation to this exception to the obligation of confidentiality which now applies to journalists.[11] The Paris Court of Appeal held that the articles published by Debtwire did not constitute legitimate information relating to a debate of general interest, despite the size of the Consolis group and the possible repercussions of the group's difficulties on employment and the economy. Moreover, the Paris Court of Appeal held that "*the purpose of the confidentiality rule of the amicable settlement procedure is precisely employment protection and the preservation of the economy to the benefit of companies*." Ruling on the question of the liability of the financial information website in tort, the Versailles Court of Appeal recently ordered Mergermarket to pay an amount of approximately 350,000 euros for the damage suffered by the companies which are

[8] CA Versailles, 27 November 2013, n°13/00670.
[9] In this study, we will not discuss the arguments in favor of freedom of expression that would justify abandoning the absolute rule of confidentiality per se. See M.-H. Monsérie-Bon, Revue Lamy droit des affaires, n°114, April 1, 2016. We will only evoke arguments of an economic nature.
[10] Cass, com, 15 December 2015, n°14-11.500.
[11] CA Paris, 20 April 2017, n°16/02849.

part to the Consolis group as a result of the dissemination of confidential information.[12]

12. Despite the request of Mergermarket, the *Cour de Cassation* recently refused to bring the matter to the Conseil Constitutionnel (i.e. the French Constitutional Court), to rule as to the constitutionality of Article L. 611-15 of the French Commercial Code. The *Cour de Cassation* considered the issue to be not serious enough, in particular because the possibility of seeking the liability of the media company is justified "*by the necessary protection due to companies engaged in a negotiation process with their creditors*," and taking into account the fact that "*disclosure [is] likely to compromise the success of the current process, or even the company's sustainability*."[13]

13. The Mergermarket case reveals the central place of the rule of confidentiality in French amicable settlement procedures serving as preventive restructuring frameworks[14] and the poor understanding of Courts and legislators regarding the importance of better transparency of information, which is in the interest of failing companies and, more broadly, in the interest of our economy.

14. **The confidentiality rule applicable to amicable settlement procedures serving as preventive restructuring frameworks have several virtues**. The rule aims to enable the debtor to continue its operational activity under normal conditions, while at the same time negotiating with its financial creditors the restructuring of its debt. The confidentiality rule is perceived as a means of protecting the debtor's operational activity, avoiding a sudden stop in the financing of its activities and the triggering of a negative spiral when the first difficulties are announced. The confidentiality rule then allows truth about the seriousness of the situation to be concealed from suppliers, customers and credit insurers of the companies concerned:

1) Advantage of the confidentiality rule towards suppliers: the aim is to prevent that suppliers, who very frequently finance the working capital of their SME customers (by granting significant payment deadlines), from interrupting or reducing their support by requiring to be paid in cash when the opening of a ad hoc mandate is made public. In this respect, it should be noted that the amount of supplier credit is particularly high in France, due to the fact that a large number of companies do not have sufficient access to bank credit.[15] The loss of supplier support may force the failing company to urgently find new sources of financing, otherwise the company may find itself in a situation where it cannot fulfil its own obligations to its customers.

2) Advantage of the confidentiality rule towards the suppliers' credit insurer: the aim is to

[12] CA Versailles, 14 September 2017, n°15/08941.

[13] Cass, Com, 4 October 2018, n°18-10.688. The priority preliminary constitutionality issue was: "*The provisions of Article L. 611-15 of the [French] Commercial Code are they in accordance with the Constitution, specifically with Article 11 of the Declaration of Rights of 1789 and Article 34 of the Constitution, which establish the principle that it is the legislator's responsibility to provide for the cases in which a citizen must be held liable for abuses of the freedom of expression and communication and to reconcile that freedom with the rights and freedoms that prevent it by taking necessary, appropriate and proportionate measures to the objective pursued, in that, as interpreted by established case law of the Court of Cassation (Com., 15 December 2015, appeal n°14-11500, published in the Bulletin), they make it possible to engage the non-contractual civil liability of a press body for having disseminated information relating to the execution of an ad hoc mandate or to a conciliation procedure, whereas the terms they use do not provide that third parties in such conciliation may be held liable if they disseminate such information and do not prescribe, and therefore do not limit the sanctions that may be imposed, and whereas such civil liability could be engaged, according to this established case law, on the sole condition that the dissemination of information contributes to a debate on a question of general interest, whatever the content of this information, the confidentiality of which is otherwise prescribed without any time limit?* ».

[14] F.-X. Lucas, "*Responsabilité pour violation de la confidentialité*", CA Versailles, 14 Septembre 2017, L'essentiel du droit des entreprises en difficulté, p 1.

[15] The importance of supplier credit for financing the company's working capital needs is a consequence of the systematic violation of the rights of bank lenders in insolvency proceedings; see below.

prevent the suppliers' credit insurer from modifying the cost of the protection it offers to its customers in the event of their own customer's default. Indeed, the credit insurer always has the possibility to modify, without delay, the terms of the insurance coverage it offers to suppliers in the event of default by their counterparty, depending on the seriousness of the latter's financial situation. In the event of an upward revision of the cost of the insurance policy, the debtor's suppliers may be forced to require from their customers to be paid in cash from now on.

3) Advantage of the confidentiality rule towards clients and/or commercial partners: the aim is to prevent clients of the distressed company from reacting excessively given the seriousness of the situation when the first difficulties are announced, and from renouncing to enter into a contract with the failing company for fear that the performance of the planned contract may not be completed. The temptation is great for customers to turn to the supplier's competitors, which is why we speak of negative spiral. In such a scenario, the supplier company may be in great difficulty even though it has not yet committed any contractual breach and is fully meeting its obligations within the agreed time limits. The risk of a negative spiral being triggered is all the greater when the firm in difficulty concerned belongs to a sector of activity requiring the contracting parties to make long-term commitments. This is the case in sectors that produce tailor-made products for a small number of customers, such as the steel mill, whose customers are concentrated on a few car manufacturers. The announcement of a company's difficulties in this sector can lead to the sudden loss of contracts, as car manufacturers cannot take the risk of ordering custom-made parts if there is the slightest risk that the production line will disappear after two years. In addition, the risk of loss of revenue due to the announcement of the first difficulties is all the greater for a company operating in a highly competitive sector. This is still the case for the steel industry in Europe, which is facing fierce competition from Chinese companies. In this respect, it should be noted that, in an increasingly globalized world, each sector of the economy is likely to be subject to increased competition. Under these circumstances, as more and more companies are likely to suffer from the effects of a negative spiral, it becomes crucial for legislators to adopt effective corporate insolvency laws.

15. Despite the obvious benefits of the confidentiality rule, there are a large number of perverse effects for the company, ignored in France and elsewhere in Europe (**Part I**). Some perverse effects in particular result from the confusion between the interests of companies and the interests of the shareholder (often also the executive officer) who, unlike the company, always has an interest in playing the opacity card (**Part II**). Finally, we will examine the extent to which it is necessary to reform corporate insolvency law and then introduce a principle of transparency with limited scope, in amicable settlement procedures serving as preventive restructuring frameworks (**Part III**).

PART I: THE COST TO COMPANIES OF THE CONFIDENTIALITY RULE

16. The absolute rule of confidentiality of amicable settlement procedures serving as preventive restructuring frameworks:

1) reinforces the climate of mistrust between the company and its own investors and is likely to unduly protect companies that hide the reality of their financial difficulties in their financial statements;

2) makes it more difficult to seek financing, given the impact of the confidentiality rule on secondary debt markets;
3) encourages transfers of undue wealth between the different classes of creditors of the debtor company (and its subsidiaries), depending on whether the creditors are parties or third parties to the *ad hoc mandate* or conciliation procedure; and
4) encourages the debtor company to sell its assets under poor conditions, as it fails to organize open and transparent auction procedures.

1) The confidentiality rule reinforces the climate of mistrust between the company and its own investors and is likely to unduly protect companies that mask the reality of their difficulties

17. In general, the more the company is in difficulty, the more it is encouraged to distort the reality of its situation, in the hope of not losing the support of its main suppliers, customers and financial creditors.[16] The managers are tempted to present the company in the most favorable light possible despite commercial difficulties, because the debtor company's ability to convince its creditors to trust it depends on the image it gives to the public. It is well known that the more a company's financial situation deteriorates, the greater the temptation to adopt so-called "earnings management" which is the use of accounting techniques to produce financial reports that present an overly positive view of a company's business activities and financial position. As some empirical studies have shown, there is a correlation between poor financial communication and earnings management.[17] Executives may make adjustments to net income, or restate amounts that should have been included in the net income as exceptional expenses, in order to present a better picture of that net income. The quality of the accounts sometimes deteriorates to the point where the integrity of the financial statements can be questioned. Just as the use of a combination of tax optimization techniques (which taken individually are perfectly legal) can tip a company into tax evasion, the use of too many accounting adjustments can constitute the offence of insincere accounting. Executives may also refuse to make provisions for the impairment of assets despite their obligations. For this reason, when a change of manager occurs in a distressed company, the new manager often carries out an audit upon arrival to ensure that all provisions have been recorded at the time of arrival, so as not to bear responsibility in the future for losses incurred prior to arrival.

18. For these reasons, the managers of the distressed company are likely to use the absolute rule of confidentiality of amicable settlement procedures, serving as preventive restructuring frameworks, to maintain a certain opacity about the reality of the company's financial situation towards its creditors (most often bondholders)[18] and its minority shareholders who are not parties to the negotiations. This situation is likely to occur in both listed and private companies of significant size. The absolute rule of confidentiality hinders the dissemination of essential information to analysts and investors. This information's confidentiality is extremely difficult to maintain in the case of companies with listed instruments (bonds and/or shares). It is thus likely to perpetuate situations of significant information

[16] The boundary between earnings managements and fraud can then ultimately become porous in fine. In general, fraud is revealed during periods of recession when the company is struggling. "*Only when the tide goes out, do you discover who's been swimming naked*" (Warren Buffet).
[17] G. Lobo, et J. Zhou, « *Disclosure quality and earnings management* », 2001, Asia-Pacific Journal of Accounting and Economics, 2001, V8 (1): 1-20.
[18] Bondholders are more difficult to coordinate than credit institutions because of their large number. In addition, some may not have sufficient resources to participate in the negotiations.

asymmetries between the various market players, and some investors remain misled by the debtor's financial communication masking the reality of the facts.[19]

19. It is true that creditors with non-public information about the company are not allowed to sell their debt instruments on the market under penalty of insider trading. However, this prohibition alone does not guarantee that investors excluded from the negotiations are not financially harmed. For instance, such harm may occur as soon as investors agree, on the basis of their truncated financial information, to participate in a so-called "distressed equity offering", which is supposed to allow the company to rebound (i.e. an equity offering during which the company asks its shareholders to reinject equity, while prior to such operation, the company has not obtained from its creditors material concessions in the form of a write off of their claims or the conversion of their claims into equity). Relying on their financial statements giving a truncated image of their situation, companies may hide to their shareholders that they are balance-sheet insolvent (in the sense that their debts are greater than the market value of their assets), and this despite the fact that in such situation, a distressed equity offering (without a priori restructuring of the company debt) leads to undue transfers of wealth from shareholders for the benefit of certain existing creditors. This may explain why, following a distressed equity offering, a large proportion of companies fail to rebound in the long term. Indeed, we can see that following a distressed equity offering, eventually a large number of companies carry out a major restructuring of their balance sheet, thereby crystallizing the loss of their shareholders (in such case, not only shareholders lose their initial investment, but also they lose the money that they have reinjected in the company).[20]

20. Subsequent to the opening of a conciliation procedure, we see large companies filing for an accelerated safeguard procedure or an accelerated financial safeguard procedure before a Commercial Court, with the view to force certain dissenting minority creditors in each classes of creditors to respect the agreement agreed by certain creditors during the amicable settlement procedure". Unfortunately, the filing of formal insolvency proceedings does not encourage companies to act with transparency. It is only if the company is listed and carries out a transaction which leads to an equity offering that it is required to produce a prospectus that is supposed to inform the market very shortly before the transaction is carried out. In practice, we have seen that transparency is not guaranteed before Commercial Courts as many companies have announced to the market that they face difficulties shortly after carrying-out a distressed equity offerings due to overly optimistic business plans (synonymous of insufficient depreciations of assets)[21].

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[19] For these reasons, it must be recognised that the absolute rule of confidentiality may perpetuate bubbles at the level of listed companies, i.e. situations where the price of shares and debt instruments issued by the distressed company does not reflect the true value of the company's assets, as analyzed by the majority of qualified investors, able to carry out their own fundamental analysis. The company's financial instruments are then held only by individual shareholders, index funds and any other funds that do not have the capacity to analyze the financial statements of the distressed company on their own. It is therefore understandable that the absolute rule of confidentiality may conflict with the obligation on companies whose securities are listed on regulated markets not to delay the disclosure of information that has a significant impact on the price.

[20] S. Vermeille, " *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*", Revue Trimestrielle de Droit Financier, 01/06/17, n°2, p.3-67. On the basis of the analysis of capital increase operations carried out by listed distressed companies, the study concluded that these recapitalizations frequently carried out a massive transfer of wealth from subscribers to the capital increase to creditors. The study mainly pointed out the shortcomings of French corporate insolvency law and corporate law to explain this situation. A third explanation clearly lies in the fact that these transactions are often carried out after the completion of amicable settlement procedures serving as preventive restructuring frameworks, followed by the opening of safeguard proceedings, in order to force creditors and minority shareholders who refused to approved the plan which was negotiated during a amicable settlement procedure.

[21] S. Vermeille, " *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*", op. cit.

2) The confidentiality rule makes it more difficult to seek financing, given the impact of the confidentiality rule on the secondary debt market

21. The rule of confidentiality during amicable settlement procedures, serving as preventive restructuring frameworks, is also a significant obstacle to the financing of distressed companies. In particular, the confidentiality rule of amicable settlement procedures increases the cost of credit by limiting the efficiency of the secondary debt market (*i*) hinders competition between new money providers and leads to the misuse of the legal privilege applicable to such new money, in violation of the rights of third parties (*ii*).

i. The absolute rule of confidentiality increases the cost of credit

22. For several years, the secondary debt market has played an increasing role when borrowers of a certain size encounter financial difficulties, including when debt instruments take the form of a loan or a bond issued as part of a private placement. Such a market has advantages for both creditors and the company. From the creditors' point of view, the secondary market offers credit institutions an efficient and flexible way to dispose of their claims and to manage their balance sheet, enabling them to quickly sell underperforming assets at the best possible price. This allows credit institutions to limit their exposure to risk and strengthen their equity.[22]

23. The importance of this secondary market function is expected to increase in the near future in the European Union, since the European authorities are encouraging the decrease in banking institutions' risk exposure. This is evidenced by 1) the European Central Bank's guidelines of March 2017,[23] supplemented by an addendum in October 2017, 2) the action plan of the European Commission and the Council of the European Union approved in July 2017, and 3) the 14 March 2018 Proposal for a directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral. These texts call for European banks to implement strategies to reduce the level of non-performing loans on their balance sheets.

24. This fundamental role of the secondary market can only work if financial markets are efficient, that is, if prices at which securities are traded reflect the fair prices of assets. However, the condition relating to the efficiency of the markets presupposes that all market participants have at their disposal high-quality information provided by the issuer on the reality of the operational and financial situation of the company, so that there is no asymmetry in the ability to analyze the information provided by the issuer that could prevent agreement on a sale price[24] between various players that can be more or less sophisticated. This market efficiency requirement is essential to ensure the liquidity of the securities (so that each transaction, taken in isolation, does not have a significant impact on prices). The debtor

[22] This function of the secondary market has become essential in view of the development of prudential rules and, in particular, the publication, on 16 December 2010, of Basel III agreements designed to improve the level and quality of banks' capital in order to strengthen their financial strength. In particular, Basel III agreements provide for compliance with a Liquidity Coverage Ratio (LCR) to ensure that banks have sufficient unencumbered High Quality Liquid Assets that can be easily and immediately converted into liquidity in private markets in the event of a liquidity crisis that would last 30 calendar days. Without going into detail about the new prudential regulations, they impose a risk weighting system on banks that requires them to increase their capital when they hold risky assets. The existence of a liquid secondary market for non-performing loans allows banks to clean up their balance sheets since they can sell their doubtful loans to risk investors (reversal funds) and thus comply with prudential ratios by quickly and easily converting receivables whose recovery was uncertain into cash.

[23] European Central Bank, « *Guidance to banks on non-performing loans* », March 2017.

[24] K. Bardos, « *Quality of financial information and liquidity* », Review of financial Economics, 22 December 2010.

company must therefore take great care to ensure a good quality of its financial communication and fight against its natural tendency to hide its difficulties for the reasons explained above. If an investor in the secondary market is not able to have a good understanding of the company's financial situation, he will be less inclined, as a result, to acquire the company's debt because he cannot understand the extent of its risk.

25. By providing credit institutions with an effective mechanism for managing their balance sheets and making their investments, the secondary market promotes access to credit and reduces the cost of capital. Indeed, if creditors know that they can easily sell their claims against the borrower on the secondary debt market if the borrower faces difficulties, they will naturally be more inclined to lend on favorable terms for the company.[25] It has been observed in the United States that the liquidity of a secondary debt market reduces the cost of credit for businesses.[26]

26. The inefficiency of the secondary debt market has consequences for the primary market. On this market, creditors lend on less advantageous terms since when negotiating those terms, they take into consideration their chances of leaving the secondary market, which are reduced because of the lack of liquidity of the securities traded on it. While this principle has yet to be empirically demonstrated for loans from credit institutions - with the cost of credit varying for a variety of reasons that are difficult to isolate - it is established that the existence of an efficient secondary debt market provides companies of a certain size with access to financing from hedge funds which are specialized in so-called "distressed" situations.[27]

27. In the Mergermarket case, it is precisely this very function of the secondary market that the *Cour de Cassation* and the Paris Court of Appeal ruling after that the *Cour de Cassation* declared unlawful the decision of the Versailles Court of Appeal, have chosen to ignore. Indeed, Debtwire's articles are notably destined to inform investors, which pursue a strategy of buying debt at a discounted price on the secondary market, of the situation of a distressed company so that markets can been efficient. By denying journalists the right to communicate to the market facts surrounding the amicable settlement procedure, the Courts' rulings contribute to reducing the liquidity of the secondary debt market in general in France and therefore the cost of credit.

ii. Confidentiality hinders the competitive bidding of new money providers in conciliation

28. When a company faces distress, the sustainability of its activity is often dependent on the granting of new financing, especially to enable it to meet its working capital requirements. However, investors are naturally reluctant to finance a company that offers limited repayment guarantees and is likely to be involved in insolvency proceedings subjecting creditors to collective discipline that bars individual action.

[25] A. Gande et A. Saunders, « *Are Banks Still Specials when there is a secondary market for loans* », August 2011, Journal of Finance, p.2.
[26] R. Gilson et C. Whitehead, « *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets* », Columbia Law Review, 2008, Vol. 108, p. 231.
[27] The acquisition of debt securities at a discounted price on the secondary market when the debtor is in financial difficulty is a particularly risky business. There are two main reasons for this: (1) companies in difficulty tend to want to hide the reality of their difficulties; investing in this particular market for the debt of companies in difficulty requires a strong ability to analyze the information provided by the debtor, (2) there is always uncertainty about the chances of recovery of the company in difficulty (macroeconomic conditions, conditions relating to its governance, conditions for its financial restructuring, etc.).

29. In order to remedy this problem and to encourage the use of amicable settlement procedures as a preventive restructuring framework, the legislator granted a legal privilege to any person making a new cash contribution to ensure the continuation of the company's activity when the agreement providing for such cash contribution is negotiated during a conciliation procedure and vetted by the Court.[28] This so-called "new money legal privilege" is extremely favorable to the new money provider. It gives the cash contribution a seniority ranking over all other claims in the payment hierarchy in the event of the opening of insolvency proceedings after the conciliation procedure. Such legal privilege is only junior to the super legal privilege benefiting employees and to the legal privilege benefiting to legal costs arising regularly after the judgment opening the insolvency proceedings.[29]

30. Nevertheless, the interest of this legal privilege from the point of view of the company seeking fresh money is substantially diminished by the absolute rule of confidentiality. This rule leads to an increase in the cost of new money since it essentially limits the number of investors likely to be able to provide new money to the sole creditors invited to negotiations. Despite very low interest rates, there is a high proportion of new money loans granted to companies in conciliation procedures with a double-digit interest rate.[30] In this respect, creditors not only have the opportunity to lend money to the company at a very high rate, but also, in some cases, may benefit from new guarantees whose value is higher than the concessions made, for example, in the event of the roll-over of the initial loan.

31. The new money legal privilege may even encourage lenders to lend the company more money than is necessary to meet the company's needs. This was the case during the restructuring of CGG. A large part of the new money was repaid only after three months.[31] This situation has the effect of transferring wealth from initial lenders, such as banks (which increasingly rarely participate in the second round of financing because of the cost for their capital structure pursuant to the banking prudential rules), to the benefit of other new lenders wishing to provide new money under such conditions.[32] This situation is detrimental to the initial lenders and is also unsatisfactory for the company. Indeed, in many cases, significantly raising the gearing of the company at a high rate is a fallback solution, compared to a preferable solution consisting in the in-depth restructuring of the company's balance sheet via a conversion of debt into shares. The confidentiality rule of amicable settlement procedure therefore increases the risk of discrimination between creditors and places third party creditors in a situation of uncertainty and distrust towards the debtor.

32. The law itself encourages this mistrust between creditors and the debtor by encouraging the debtor to favor "hidden credit", which has many perverse effects.[33] Indeed, in the case of an agreement

[28] C. com., art. L. 611-11.
[29] C. com., art. L. 622-17 and L. 641-13.
[30] In addition to the lack of competition between the various potential contributors of new money, high rates are explained by the fact that contribution of new money can be used for needs that go beyond improving the cash situation in the near term before a more in-depth restructuring of the company. Besides, providers of new money do not have the last word to decide over the future of the company after the conciliation procedure, should the debtor then enters a formal insolvency proceeding. Finally, it has been shown that companies emerging from insolvency proceedings often had excessive levels of debt due to difficulties in significantly reducing their debt. The company's debt reduction may be complicated during the conciliation phase, particularly in view of (i) the impossibility of forcing the consent of a creditor as in insolvency proceedings and (ii) the fact that some creditors, especially banks, cannot consider insolvency proceedings as a credible alternative in the event of failure to negotiate, which may then encourage the conclusion of unrealistic agreements for the company.
[31] V. S. Vermeille, "*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*," ibid.
[32] Unlike banks, these new creditors are more able to lend under risky conditions because they are not subject to prudential banking rules. Since they will have bought part of the original debt at a price below its nominal value (this repurchase, often in violation of the confidentiality rule, allowing them to participate in the negotiations), they will be all the less affected by the transfer of wealth resulting from the creation of a new expensive debt tranche for the company now senior to the old debt.
[33] M. Simkovic, « *Secret liens and the financial crisis of 2008*, » American Bankruptcy Law Journal, Vol. 83, p. 253.

reached between parties during a conciliation procedure and vetted by a Court, the existence of a "new money legal privilege" is not mentioned on the K-bis of the company (i.e. the certificate of incorporation publicly available). It must merely be mentioned in the ruling of the Court vetting the agreement providing for the new money. As a result, a creditor may grant a credit to the company, without knowing that his claim will be junior to the claim benefiting of the new money legal privilege. While it is unlikely in practice that a bank would not be informed of the existence of this legal privilege, it is quite possible that a supplier would only later learn that their claims are junior to the claim benefiting of the new money legal privilege.[34] This restriction of competition on the market for financing distressed companies is detrimental not only to large companies, but also to smaller ones. The penalty is all the more severe in France, which in recent years has seen a development of the so-called "direct lending"[35] market, following the changes in the rules applicable to the provision of loans (which granted, until recently, a monopoly to banks[36]). It is therefore regrettable for all these reasons that the confidentiality rule contributes to significantly reducing competition on the market for financing companies in difficulty.

3) The confidentiality rule encourages undue transfers of wealth between the different classes of creditors of the debtor company (and its subsidiaries), depending on whether the creditors are parties or third parties to a *ad hoc mandate* or a conciliation procedure

33. The confidentiality rule leads to a distinction between, on the one hand, creditors participating in the amicable settlement procedure and therefore participating in negotiations with the debtor - most often the debtor's banks - and, on the other hand, creditors who are third parties to the negotiations – whether such creditors are bondholders of the debtor or significant creditors of the subsidiaries of such debtor.[37]

34. Being invited to the negotiating table often means having to make concessions, something for which other creditors have no incentive. However, in certain cases described below, creditors participating to discussions as part of an amicable settlement procedure may take advantage of the confidential nature of the negotiations to obtain, in exchange for their concessions, compensation in excess of the concessions made. The confidentiality rule prevents these transfers from being made public and thus facilitates unjustified differences in treatment among creditors.

35. For example, banks may extend the maturity date of their claims in exchange for a small

[34] P.-M. Le Corre, "*Du privilège occulte de la conciliation*," Gazette du Palais, 13 October 2012, n°287, p. 3.

[35] Direct lending is a form of lending to companies, offered by lenders who are not credit institutions. These entities lend to non-intermediary companies for the benefit of small and medium-sized companies, but also to companies in significant difficulty, as current banking prudential rules penalize banks that offer credit to fragile companies (by asking them for additional capital charges in their balance sheets, thereby reducing their profitability). Hedge funds known as "opportunistic funds" focus on a market of companies of a size large enough so that there is a real prospect of a secondary market for their financial instruments to develop. This second market gives them the assurance that they can withdraw from the company without necessarily waiting for the maturity date of their claims. In addition to investment funds, crowdfunding platforms have developed in recent years as a result of changes in the regulations. Some have already disappeared due to the flaws of their business plans and a lack of a credible risk model. Others have developed credit analysis models and claim to surpass certain banking models, particularly through the use of *big data*. The future will tell if these new players will succeed in settling permanently in France. In the meantime, they offer the possibility for relatively large companies to finance their working capital needs, provided they accept a cost of debt that is higher than that required by banking institutions in a favorable monetary policy context.

[36] See the report of the High Legal Committee of the Paris Financial Centre on the banking monopoly via the following website: http://www.eifr.eu/uploads/eventdocs/573325f34a4c6.pdf. Despite the changes made to the rules applicable to the providers of loans which, until recently, had created a monopoly in favor of banks only, some players have no choice but to lend through the bond markets.

[37] The non-participation of suppliers in negotiations under amicable settlement procedures is sometimes justified. This is the case whenever the company's difficulties results from an excess of financial debts in relation to the company's cash flow generation prospects. This often concerns companies under LBO. Imposing concessions on suppliers is likely to have a greater negative impact on the company and its financial creditors than the benefit of the concessions granted by the same suppliers.

consideration of the debtor and at the same time obtain a generously remunerated investment banking mandate, with the task of organizing the sale of substantial assets of the company in difficulty. These arrangements may take place with the greatest discretion, without informing creditors who are not parties to the amicable settlement procedure. Similarly, creditors of a parent holding may apparently make concessions but, at the same time, obtain compensation by becoming counterparties to the holding's operating subsidiaries in sale & lease back transactions. In this type of transaction, the operating subsidiaries sell their real estate assets and immediately lease them back. Sale & lease back transactions enable the selling subsidiary to generate cash from the proceeds of the sale; this cash is likely to be transferred to the parent company (the proceeds constitute distributable income in the financial statements) for the purpose of repaying the holding company's creditors, who are also purchasers of the property; at the same time, these same counterparties obtain an extremely advantageous status in the event of the subsidiary's insolvency proceedings. Compared to the lender, the lessor is in a privileged position in the event of the opening of insolvency proceedings by the debtor because the debtor cannot interrupt the payment of rents or risk losing the use of the asset and the lessor enjoys a high ranking in the hierarchy of payments under Article 2232 of the French Civil Code.

36. The scope of the legal mechanism allowing the Court to annul certain acts committed by the debtor during the period of suspicion ("*période suspecte*" preceding the ruling of the Court that pronounced the initiation of an insolvency proceeding (in the context of receivership proceedings (*redressement judiciaire*) or liquidation proceedings) is too restrictive for these unjustified transfers of value between creditors to be called into question by virtue of the absolute priority rule (i.e. the order of payments resulting from the ranking of creditors).[38]

37. The questioning of an undue transaction on the ground that such transaction was performed during the so-called "period of suspicion" by an injured party presupposes that the competent Court considers that the date of the cessation of payment (la "*date de cessation des paiements*") of the debtor (i.e. the date at which the debtor can no longer pays its due and payable debts with its available assets) was prior to the completion of the disputed transaction.[39] However, disputed transactions often occur well before the date of the cessation of payment of the debtor, at a stage where the company can still pay its due and payable debts with its available assets, for example because such debtor still has undrawn credit lines available. This situation does not rule out the possibility that the debtor is insolvent in the sense that the total amount of its debts may well exceed the market value of its assets. In other words, a so-called insolvent company can carry out a whole series of acts (such as the rapid sale of "crown jewel" assets under conditions that do not make it possible to maximize their price to the detriment of creditors), for the sole purpose of generating cash before that certain debts mature. Under these conditions, the company only wants to save time. 38. Moreover, the nature of the operations which may fall within the scope of the legal regime applicable to operations carried out during the period of suspicion is too limited for the protection offered under the legal regime to be fully effective. Indeed, the legislator has favored a form over the substance criteria with respect to the transactions which may be clawed back. Indeed, Courts are empowered to annul the transactions which are exhaustively listed in Articles L. 632-1 and L. 632-2 of the French Commercial Code, during the period of suspicion preceding the opening of the insolvency proceedings. Thus, an agreement reached between the debtor and one of its creditors in fraud

[38] See also for a critique, S. Vermeille and S. Bardasi, "*L'intérêt de l'analyse économique du droit dans le traitement du surendettement des sociétés sous LBO"*, RTDF, n°3, 2014, p. 96.

[39] The period of suspicion is the period running from the date of the cessation of payments and the opening of a receivership (*redressement judiciaire*) or liquidation procedure. This period may not exceed 18 months. The purpose of the action for annulment of transactions committed during the period of suspicion is to reintegrate into the debtor's balance sheets the assets that have been removed as a result of transactions carried out when the company was in cessation of payments, in violation of the company's rights and its creditors'ones in general or contrary to the interests of certain creditors in particular.

of the rights of other creditors does not run the risk of being cancelled if it is not listed in one of the two articles mentioned above.[40]

4) The absolute rule of confidentiality is likely to encourage the debtor company to sell its assets under poor conditions, as it fails to organize open and transparent auction procedures

39. The sale of assets, usually quality assets in comparison to the rest of the company's assets, is a widespread technique among distressed companies to rapidly reduce their level of indebtedness. In this respect, the confidentiality rule may be useful, insofar as it prevents the buyer from becoming aware of the seller's difficulties and taking advantage of them in a timely manner by offering a low price. However, a sale of assets for the sole purpose of using its proceeds to reduce debt can also lead to unnecessary destruction of value. The confidentiality rule can then serve the sole interests of executive shareholders seeking to save time by masking the conditions of asset disposal. On a large scale, the confidential sale of these assets, with no competitive process, is more akin to a liquidation procedure with a sale of the company's activity than a genuine restructuring measure. It is understandable that not informing all creditors and shareholders of disorderly asset transfers can be extremely detrimental to them.[41]

PART II: THE CONFIDENTIALITY RULE CAN PLAY INTO THE HANDS OF THE CONTROLLING SHAREHOLDER AND THE MANAGER TO THE DETRIMENT OF THE DISTRESSED COMPANY, ITS CREDITORS AND MINORITY SHAREHOLDERS

41. The confidentiality rule can be used to serve the interests of the managers/controlling shareholders who are at the source of companies' distress, given for instance their errors in strategic choices. We will see that the confidentiality rule is then likely to prevent the emergence of alternatives to those proposed by the existing managers/controlling shareholder with the help of their advisors. If this is the case, the confidentiality rule then becomes a source of value destruction for employees, creditors and minority shareholders, whenever the future of the company requires a change in

[40] In addition, the law itself reduces the possibility for aggrieved creditors to challenge the legality of the arrangements made during the conciliation procedure, once they have been approved. The law instituting the safeguard procedure has indeed introduced a time limit that contributes to the safety of parties who reach an agreement during a conciliation procedure which has been vetted by a Court. Except in cases of fraud, the period of suspicion cannot be postponed to a date prior to the final Court decision vetting the agreement reached during the conciliation procedure (C. com., art. L. 631-8). However, the definition of fraud is far too restrictive to cover all potential arrangements between creditors involved in the negotiation and debtors with the conciliator's blessing. While the competent Court for the homologation of the agreement must ensure that the agreement does not prejudice the interests of non-signatory creditors, in practice, Courts' resistance to the confirmation of this type of agreement is rare. The Court will prefer to give a chance to the agreement concluded by the parties, under the control of the conciliator. In addition, appeals against Court decisions vetting an agreement reached during a conciliation procedure by third party to the conciliation procedure are also rare (French Com. Code, Art. L. 611-8), as the terms and conditions of the agreement are not reproduced *in extenso* the Court's homologation judgment, third parties cannot have access to them (pursuant to Article R. 661-2, paragraph 2 of the French Commercial Code, non-signatory creditors may file third-party proceedings against the Court decision vetting the agreement within 10 days after its publication in the BODACC). When the conciliation procedure is ended by such Court decision, it therefore offers a very effective tool for securing any agreements that may have been concluded between the debtor and a creditor to the detriment of other creditors.

[41] The temptation of managers to sell the company's assets at low prices to save time and, in particular, to keep control of the company has been highlighted in economic studies. In France, this situation was observed to the extreme in the Belvédère case. The managers pushed for the dismantling of the company, even in safeguard proceedings and in the subsequent receivership proceedings, before being stopped by the receiver once the company had returned to receivership. V. S. Vermeille, R. Bourgueil, A. Bézert, "*L'affaire Belvédère ou les effets contreproductifs du droit français des entreprises en difficulté - Plaidoyer pour une réforme ambitieuse*", 2013, RTDF n°3, pp. 17-41.

governance. It is therefore essential that the legislator recognize that the absolute rule of confidentiality:

1) can play into the hands of the controlling shareholder and/or manager seeking to postpone as much as possible the date on which he has no other alternative than to crystallize his loss and resign;

2. may lead to a transfer of the company at a discount by the manager, in violation of investors' rights.

1) The absolute rule of confidentiality plays into the hands of the controlling shareholder seeking to postpone as much as possible the date on which he must crystallize his loss

42. As mentioned above, the preservation of the interests of a distressed company sometimes requires a reduced disclosure of its financial situation. For example, when it is about to enter into major new commercial contracts, which may radically change its prospects for recovery, the company finds it beneficial to maintain a certain degree of opacity. Maintaining opacity in this way means focusing on the short term, while waiting for concrete positive results for the company in the future. However, in certain circumstances, the absolute rule of confidentiality may be contrary to the interests of the corporation and may serve the interests of the controlling shareholder and the manager. The confidentiality rule, in this case, might cast opacity over the company's financial situation and could lead to postponing the date on which shareholders are forced to crystallize their losses (and therefore potentially lose control of the company), so it is important to understand when it is in the interest of the distressed company to switch from opacity to transparency.

43. Switching from opacity to transparency means accepting a change towards a long-term solution. If the company's situation worsens, it should find it more advantageous to be fully transparent, as the benefits of transparency becomes greater than its cost. The cost of opacity (and therefore transparency's benefits) is observed within a company when the company's financial statements and its communication are so mistrusted by the market that several negative consequences are observed. Thus, market mistrust can result in the withdrawal of long-term qualified investors, which can explain the high volatility of share and debt prices of distressed companies. Market distrust can also result in a significant proportion of investment funds being short sellers. the Closing of access to the primary debt market may also be a consequence of market distrust, given the uncertainty surrounding the company's prospects. The advantage that the company derives from transparency is then, under these conditions, greater than the benefit it derives from concealing its difficulties (it is indeed difficult to hide its difficulties from its suppliers or partners under these conditions). When financial communication becomes more transparent, uncertainty as to the value of the company's financial instruments is reduced, investors are therefore more able to assess risk. Henceforth, long-term solutions such as in-depth debt restructuring become possible, provided that prices of the company's debt instruments are consistent with the common view of opportunistic funds (investing in distressed companies) on the value of the underlying assets (otherwise, the debt instruments are not purchased by this type of funds and therefore they cannot take control of negotiations on behalf of creditors, which is important to promote restructuring agreements when the company's debt is held by many hands). In the long term, for all these reasons, the company has an interest in responding to market mistrust by improving the content of its financial communication.

44. This is not the case for the interest of the director/controlling shareholder of the company.

The controlling shareholder of an insolvent company has a vested interest in ensuring that the company maintains opacity as long as possible, even if the company suffers from it, for the following reasons. To start with, it must be understood that the more a company is in distress, the more the interest of such company is misaligned with the personal interest of its shareholders. A shareholder who has lost all or substantially all of his investment is a shareholder who is likely to cause the company to take undue risks, such as delaying debt restructuring up until near the date of the cessation of payments (since he has nothing to lose in the event of a liquidity crisis). The shareholder is then said to be in a situation of moral hazard, in the sense that he does not suffer the consequences of his actions. A shareholder who has virtually lost his investment is an investor whose security has the value of an option (whose value changes with time, the cyclical nature of the activity, etc.)[42]. For this reason, the controlling shareholder may personally have an interest in maintaining opacity over the financial situation in the hope of a turnaround of the company. The more the date on which he is forced to crystallize his loss is postponed, the more the option value of his shares increases. The controlling shareholder may then force the company to postpone as far as possible the prospect of a major restructuring of its debt, even if this means at the same time causing the sale of a large number of assets in order to delay the date of the liquidity crisis. The shareholder wants at all costs to avoid a restructuring that would reflect a crystallization of his loss.

45. When a company of significant size encounters financial distress and offers a real chance of recovery, it is likely to interest a specific category of investors pursuing a strategy of repurchasing debt at a discounted price on the secondary debt market. This repurchase of debt on the secondary market is sometimes part of a so-called "loan to own strategy," i.e. the forward conversion of the debt acquired into equity securities, a phenomenon that is firmly established on the other side of the Atlantic[43] and which has recently seen a boom in France. The concerned investors may want to actively participate in the company's recovery if they believe that the company offers significant growth potential, which will allow them to enjoy a substantial profit once they become shareholders, that is, after debt has been converted into shares, followed by the company's recovery and sale. The secondary market therefore offers the possibility of a rebound for the distressed company through the intervention of investors by allowing a change in corporate governance. A US study has shown that the operational results of companies emerging from Chapter 11 procedures are better if an investor specializing in turnarounds was able to take control of the company.[44] This situation is notably explained by the fact that the investor generally does away with the previous managers and appoints a new team, which is likely to reassure various players of the company's real ability to rebound.

46. However, for a *"*loan to own" transaction to occur, prices of debt instruments must necessarily reflect the value of their underlying as assessed by funds specialized in the repurchase of debt at a discounted price. If markets are not efficient and the price of a company's debt instruments remains too high relative to the "fair" value of the assets, no opportunistic investment fund will have an interest in acquiring the securities. In this type of scenario, investment funds are then in a short position (they are called "short"), and not holders of debt instruments (they are not "long"). Investment funds then avoid taking a long position because there is doubt as to the sincerity of an issuer's accounts, which is a source

[42] V. S. Vermeille, "*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*," op. cit.
[43] S. Vermeille, "*Can one lend to own (" prêt à posséder ") in French law? "*, JCP E n° 28, July 9, 2009.
[44] E. S. Hotchkiss et R. Mooradian, « *Vulture Investors and the Market for Control of Distressed Firms* », Journal of Financial Economics, 1997, 43: 401.

of uncertainty for the investment fund. While creditors may agree to take large bets, depending on their risk assessment, they are nevertheless risk adverse regarding uncertainties that make it difficult to quantify risk measurement. In such a scenario, even if the manager who has no conflicts of interest with shareholders and other investors wants a thorough restructuring of the company, negotiations with creditors are very difficult because there is no investor they can talk to who specializes in restructuring operations, as shown by negotiations on Technicolor's restructuring in the past.[45]

2) The absolute rule of confidentiality may lead to a fire sale of the company by the manager in violation of investors' rights

47. The confidentiality rule can also lead to destruction of value when the transfer procedure is organized by managers who consider themselves unaccountable, both to their shareholders and to their creditors. It is worth recalling in this respect that under French law, executives do not owe fiduciary duties towards their investors, unlike fiduciary duties owed by American and English executives towards the own investors.[46] These rights are important to compel executives, in the event of too great a misalignment of interests with their investors, to ensure in Court that the rights of the investors prevail over those of the executives (unsurprisingly, the latter often pretend that their interests are aligned with those of the company). In other words, the existence of fiduciary duties can force executives to maximize the company's selling price in the interest of their investors, something that executives are not required to do in France if no controlling shareholder puts pressure on them. To measure the danger of such a misalignment of interests between the manager and investors, it is necessary to look back at the context in which the pre-pack sale was created.

48. For many years, the legislator has promoted the recovery of the company at all costs as a solution to preserving employment. However, rules applicable to receivership proceedings (*redressement judiciaire*) and the mistrust of economic actors towards these proceedings made it difficult to resume the company's activity under good conditions. Recently, the legislator has become aware that a sale of assets to a buyer may be a more desirable solution under certain circumstances[47] and corporate insolvency law has evolved to encourage the initiation of the disposal of the company through an amicable settlement procedure serving as a preventive restructuring framework (the sale itself requiring the filing for formal insolvency proceedings).

49. Thus, under the terms of Article L. 611-7 of the French Commercial Code, after consulting the participating creditors, the conciliator may be instructed by the debtor to carry out a mission for the partial or total transfer of the company.[48] Since the Ordinance n°2014-326 of 12 March 2014, this assignment (organized during an amicable settlement procedure serving as a preventive restructuring framework by the conciliator or the *mandataire ad hoc*)[49] may be implemented in the context of subsequent safeguard, receivership or liquidation proceedings. This is the legislative recognition of the prepack sale, a practice inspired by Anglo-Saxon law and in particular by the English prepack administration. The prepack sale has the advantage of allowing the parties involved to negotiate and organize the sale of the company quickly in the context of an amicable settlement procedure before the

[45] S. Vermeille and T. François, "*Le "feuilleton Technicolor" : et si rien n'était vraiment réglé ?* ", JCP E 2012. 1582.
[46] J. Velasco, « *The Development of Fiduciary Duties in Corporate Law* » (March 27, 2009). Disponile sur SSRN: https://ssrn.com/abstract=1389662 or http://dx.doi.org/10.2139/ssrn.1389662
[47] The company may be subject to a plan of total or partial sale as part of receivership or liquidation. However, the transfer of the company under the safeguard procedure is not provided for in the texts.
[48] French Com. Code, Art L. 611-7.
[49] French. Com. Code, Art L. 642-2.

insolvency proceedings, which is open for the sole purpose of finalizing the transaction that will have been agreed during the amicable settlement procedure. The period during which the debtor is under a formal insolvency proceeding is therefore significantly reduced since the Court may set aside the fixing of a deadline for the submission of tenders if it considers that steps taken by the conciliator or *mandataire ad hoc* "*have ensured sufficient publicity for the preparation of the sale*."[50] This means that the Court may rule out the introduction of a tendering process as part of the insolvency proceedings if it considers that sufficient publicity has been given during the amicable settlement procedure.

50. It is true that the consensual asset sale, which is merely ratified during an insolvency proceeding, offers considerable time gains to the parties involved and therefore limits the destruction of value inherent in the opening of insolvency proceedings. However, it also allows the buyer to avoid the transparency and competitive requirements attached to the transfer of assets under court supervision, while benefiting from the advantages of court supervision and in particular from the discharge of any assumption of liabilities by the buyer. Thus, when the state of the company's difficulties requires a change in governance and/or shareholder, or the organization of the sale of the company, the confidentiality rule may hinder the implementation of a competitive process to maximize the sale price of the assets. Some potential buyers are necessarily excluded from the sale process if they are not listed in the address book of the investment bank mandated for the purposes of the sale.

51. Aware that the accelerated sale of the company under court supervision following an amicable settlement procedure may distort competition, the legislator has put in place several safeguards to ensure that the competitive process has not been totally ignored in the amicable settlement procedure. Thus, the Court must (i) verify that sufficient publicity has been given by the conciliator or *mandataire ad hoc* and (ii) guarantee that third parties who show an interest in the acquisition of the company had the opportunity to make an offer no later than eight days before the Court hearing that review the bid.[51] In addition, (iii) the Public Prosecutor has the opportunity to give an opinion on the transfer process.[52]

53. However, these safeguards may appear to be largely insufficient and the criterion of "*sufficient publicity*" in particular should give rise to significant interpretation issues. The criterion does not offer any grid of interpretation as to the degree of competition that will have to be ensured and leaves a significant margin of appreciation to the Court. However, without a sufficient competitive process, the proposed price for the partial or total sale of the business may not be maximized, to the detriment of creditors.[53] This reduction in the sale price of complex assets, which may result from the prepack sale, may also have negative consequences for companies in the same sector, since the similar assets they hold may in turn be devalued.[54]

54. This situation is all the more serious as case law has admitted that the manager was not at fault for not informing his shareholders of the existence of a conciliation procedure, despite provisions in the shareholders' agreement to this effect[55]. This is critical as shareholders are sometimes able to propose solutions that would avoid a fire sale of the company. Applied in a general way, this principle

[50] French Com. Code, Art. R. 642-40, para. 4.
[51] French Com. Code, Art R. 642-1, para. 3.
[52] French Com. Code, Art. L. 642-2, para. 2.
[53] P. Guyomar'h, "*Les risques du prepack cession*", Bull. Joly 2015, n°6, p. 389.
[54] M. Simkovic, « *Secret liens and the financial crisis of 2008* », American Bankruptcy Law Journal, Vol. 83, p. 253, 2009.
[55] Paris Court of Appeal, 15 May 2014, No. 13/07123: In this case, the aim was to prevent the shareholder from requesting early repayment of his convertible bonds solely because of the opening of the conciliation procedure. Since Article L. 611-16 of the French Commercial Code, resulting from the Ordinance n°2014-326 of 12 March 2014, French law provides that any clause that modifies the conditions for the continuation of a current contract by reducing the debtor's rights or increasing his obligations solely by appointing a *mandataire ad hoc* or opening a conciliation procedure is deemed unwritten.

allows the manager to completely free himself from the supervision of his shareholders, even though the difficulties that the company face very often result from the manager's mistakes, who is in particular need of advice in this type of situation. The manager is thus free to choose solutions that may lead to an increase in the cost of difficulties for shareholders. This situation is likely to arise in unlisted companies with a great number of sparse shareholders.[56]

55. This being said, it should be noted that prepack sale rules seem to protect creditors from the risk of total eviction in the event of a sale at an outrageously low price,[57] unlike what was seen in the United Kingdom at one time. In France, the approval of the plan by the Court and the supervision of the process by the conciliator seem to be effective safeguards against the risk of eviction.

PART III: IMPROVING THE INSOLVENCY PROCEEDINGS WOULD FACILITATE THE IMPLEMENTATION OF A PRINCIPLE OF TRANSPARENCY

56. The absolute rule of confidentiality of *mandats ad hoc* and conciliation procedures has as such many perverse effects that are underestimated by professionals of distressed situations. Establishing a general principle of transparency in the context of amicable settlement procedures serving as preventive restructuring frameworks would be easier if insolvency proceedings were simply more attractive from the point of view of the company and its investors. A revaluation of the interest of such insolnvecy proceedings is therefore necessary. This revaluation essentially presupposes that insolvency proceedings become more efficient in the economic sense of the term (1). We will see that the proposed European directive goes in the right direction by establishing effective restructuring frameworks. However, it fails to stress on the importance of transparent restructuring frameworks, thus taking the dangerous path pursued by French law in amicable settlement procedure (2).

1) More effective insolvency proceedings: a necessary precondition for the establishment of a principle of transparency in amicable settlement procedures serving as preventive restructuring frameworks

57. The difficulties we have outlined argue in favor of the abolition of the absolute rule of confidentiality of amicable settlement procedures serving as preventive restructuring frameworks. To avoid disparities in treatment between creditors and to encourage competition between investors, it

[56] The prepack cession must be compared to the English practice of prepack administration, which allows the negotiation and preparation of the sale of a distressed company before the insolvency practitioner is notified, and then the very quick conclusion of the sale after the appointment of the administrator, without any involvement of the Court. The prepack administration has been the subject of strong criticism across the Channel, in particular because of (i) the lack of transparency of the sale process, (ii) the absence of a competitive process and (iii) the risk of abuses since the sale is generally carried out without the consent of unsecured creditors and the assignees are often the former partners or managers of the distressed company who sometimes participated in the latter's insolvency. Even if, unlike the French prepack, the transfer is not subject to any control by the Court, practice has taken into account the issues caused by the occult nature of the prepack administration and soft law measures have been adopted. In January 2009, the *Statement of Insolvency Practice - SIP 16* (revised in 2013) was published, containing a guide to good practices for directors, encouraging them to explain to creditors, before the sale is completed, the reasons why a prepack administration was chosen and to detail the publicity measures that were carried out and the valuation of the company that was made. The recent Graham Review also published several guidelines aimed at significantly enhancing the transparency and competitiveness of the prepack administration process. The French legislator would have been well advised to draw lessons from the numerous criticisms levelled at the prepack administration and to regulate more strictly the prepack transfer in the French style in order to avoid a deviation from the principle of transparency which must nevertheless prevail in the case of transfer under court supervision. Graham Review into Pre-pack administration, June 16, 2014.

[57] J.-P. Tribe, « *Corporate Insolvency in England and Wales - Phoenix Companies: Do Directors Learn Form Failure*? » Final Report (January 16, 2009). Available at SSRN: https://ssrn.com/abstract=1329120

seems desirable to remove the possibility for the debtor to choose at his or her discretion the inclusion of a particular creditor in the negotiations. It should be possible, for example, to systematically allow credit providers holding a license in France to have access, via a platform, to information on all *ad hoc* mandates and conciliation procedures, in exchange for the signature of confidentiality agreements. This measure would necessarily increase competition in the market for credit to distressed companies.

58. The abandonment of the absolute rule of confidentiality in amicable settlement procedures serving as preventive restructuring frameworks must not lead to the introduction of an absolute rule of transparency imposed in all circumstances. There is no point in alerting the company's suppliers and customers until the company can clearly communicate how it intends to bounce back. When communicating the extent of its difficulties, the company must also be able to send a positive signal to its creditors and the market to show that it has grasped the extent of the difficulties and is implementing appropriate measures to resolve them.

59. However, as French insolvency law currently stands, no positive signal can be sent to compensate for the announcement of the opening of negotiations with financial creditors. The parties do not have confidence in their own ability to reach an agreement with lasting effects that will allow the company to emerge. The existence of financial difficulties and therefore of possible insolvency proceedings, marked by a high rate of relapse for the reasons mentioned below,[58] act like a scarecrow and very often lead suppliers to cease their contractual relations with the debtor. The consequences are significant for the parties well in advance of the insolvency proceedings. Thus, knowing that their debtor's banks are working to find a solution before the company defaults on its debt is not likely to reassure suppliers about the long-term viability of their debtor. Indeed, the debtor's banks in conciliation procedures often have no other choice when the claims are significant than to negotiate, because they always see an agreement reached during an amicable settlement procedure (serving as a preventive restructuring framework) as a more positive measure than a plan approved during an insolvency proceeding in France: the reorganization plan (approved during a receivership) or a safeguard plan (approved during a safeguard procedure) can be imposed on all creditors, including secured creditors. Consequently, the announcement of the company's difficulties is always experienced as a negative event, the effect of which cannot be mitigated by the concomitant announcement of the opening of an amicable settlement procedure with the financial creditors. The announcement of the existence of negotiations cannot be an indication that banks believe in the sustainability of the failing company.

60. The prospect of possible insolvency proceedings creates among the commercial partners of the debtor, the temptation for a debtor to maintain an absolute rule of confidentiality is high. Rather than encouraging confidentiality, we believe it is preferable to argue in favor of a significant reform of the various insolvency proceedings to restore the confidence of the various economic actors. This implies strengthening the effectiveness of insolvency proceedings.

61. Enshrining a principle of transparency in French law is, in our opinion, subject to the effectiveness of insolvency proceedings, which requires (i) a better diagnosis of the economic viability of a company and (ii) greater efficiency in restructuring the balance sheet of insolvent companies (*we do not develop this point in this article but simply highlight the statistics*).

62. French law must appropriate legal tools that would allow it to sort through two types of distressed debtors. On the one hand, economically viable debtors with real potential for reversal but who face too much debt. These debtors need to be restructured. On the other hand, economically non-viable

[58] See the statistics of credit insurer Euler Hermès below.

debtors whose difficulties are structural and do not offer any prospect of recovery. These debtors must be liquidated.

63. With such a clear line between these two types of debtors, the absolute rule of confidentiality of amicable settlement procedures would lose part of its justification: there would be less reason to hide the debtor's difficulties. Debtors' suppliers would be more willing to rely on decisions of others, starting with financial creditors and Courts, before discontinuing their support to the debtor. Negotiations with banks for debt restructuring should be an encouraging signal for the debtor's suppliers.

64. Thus, if it is established that the debtor is probably not a viable business, the announcement of the first difficulties sufficiently in advance has the advantage of avoiding the creation of supplier liabilities that we know in advance cannot be settled. If, on the other hand, the debtor is a viable but is financially distressed, the announcement of difficulties has the merit of allowing creditors to find a solution, rather than allowing the debtor to enter into opaque arrangements with certain creditors that may endanger its long-term sustainability and favor one class of creditors over another, in violation of original agreements.

65. To date, statistics show that insolvency proceedings are not effective and do not ensure the long-term sustainability of companies. In France:

- 28% of safeguard proceedings (*procédures de sauvegarde*) were converted into judicial liquidation in 2014;[59]
- nearly 60% of receiverships (*procédure de redressement judiciaire*) were converted into liquidation proceedings in 2016;[60] and
- 65% of companies emerging from receivership and 50% of companies emerging from safeguard proceedings file for liquidation proceedings within 5 years, according to Euler Hermes' figures.[61] At the national level, these rates are necessarily higher, since companies that insure themselves against their own customers' default with Euler Hermès do so because their customers are relatively large and therefore more likely to bounce back than smaller companies.

66. The ineffectiveness of insolvency proceedings cannot be the only cause of these relapses and other exogenous elements should be highlighted. Nevertheless, these figures must be put in perspective with the much lower relapse rate of Chapter 11.[62] If the conversion rate from Chapter 11 to Chapter 7 (liquidation procedure) is 21% for a sample of listed companies,[63] it is higher than 50% for SMEs.[64]

67. The ineffectiveness of safeguard and receivership proceedings therefore explains this attraction to amicable settlement procedures serving as preventive restructuring frameworks (especially since the confidentiality rule applies), which makes it possible to avoid the loss of the necessary support to sustain the debtor's business . From this perspective, the rule of confidentiality is not a guarantee of successful prevention, but a second best measure justified by the ineffectiveness of our insolvency

[59] Deloitte - Altares, "*L'entreprise en difficulté en France. In the antechamber of recovery*," March 2015.
[60] Deloitte, "*L'entreprise en difficulté en France en 2016, un équilibre fragile*," March 2017.
[61] Credit-insurer statistics, Euler Hermès, available on request.
[62] Between 1983 and 2013, about 18.5% of companies emerging from Chapter 11 proceedings filed again for bankruptcy proceedings in the following years, See E. Altman, "*Revisiting the Recidivism-Chapter 22 Phenomenon in the U.S. Bankruptcy System*," 8 Brook. J. Corp. End. & Com. L. (2014).
[63] E. Hotchkiss, K. John, K. Thorburn, and R. Mooradian, "*Bankruptcy and the Resolution of Financial Distress*" (January 2008). Available at SSRN: https://ssrn.com/abstract=1086942.
[64] E. Morrison, « *Bankruptcy Decision making: An Empirical Study of Continuation Bias in Small Business Bankruptcies* » (January 25, 2006), Columbia Law and Economics Working Paper No. 239. Available at SSRN: https://ssrn.com/abstract=880101.

proceedings and therefore recognized under French law. In other words, the ineffectiveness of the law on insolvency proceedings has made it necessary to adopt the principle of absolute confidentiality of amicable settlement procedures serving as preventive restructuring frameworks, to the detriment of the principle of transparency. As a result, if the effectiveness of insolvency law were strengthened, the abandonment of an absolute rule of confidentiality during amicable settlement procedures serving as preventive restructuring frameworks would no longer be an issue.

2) The European Proposal for a Directive: an opportunity for the French legislator to strengthen the effectiveness of insolvency proceedings, but a missed opportunity to highlight the need for transparency of restructuring frameworks binding on dissenting creditors

68. The 22 November 2016 European Commission's proposal for a directive offers us the opportunity to significantly strengthen the effectiveness of our insolvency law. After more than two years of negotiations, and numerous amendments by the European Parliament and the Council of the European Union[65] leaving Member States considerable leeway in transposing the preventive restructuring frameworks, the proposal has now returned to the European Commission. We hope that this directive will be adopted before the renewal of the European Parliament in May 2019.

6966. Among the main advances of the proposal of directive aimed at improving the predictability and effectiveness of our corporate insolvency law are:

- The adoption of the "absolute priority rule" according to which a dissenting class of creditors must be fully repayed before a lower class in the payment hierarchy can benefit from the distributions or retain a share in the restructuring plan;
- The creation of classes of creditors for the adoption of restructuring plans based on the similarity of their rights and the ranking of their claims in the payment hierarchy (unlike current French law, which classifies creditors according to the category to which they belong - credit institutions and similar entities, main suppliers, and bondholders);
- Exclusion of unaffected creditors from voting for the adoption of a restructuring plan - when approving the plan, only the parties affected by the plan should be able to vote;
- Adoption of the "best interest test" preventing a dissenting creditor within the same class of creditors from being in a less favorable situation as a result of the restructuring plan than he would be in the event of a liquidation;
- Introduction of a "cross-class cram-down" - when the consent of each class participating in the vote on the plan is not obtained, possibility, based on the value of the company in continuation, of excluding entire classes of creditors and shareholders under certain conditions.

70. A major change is expected in the coming months as the bill on the growth and transformation of companies ("*Le plan d'action pour la croissance et la transformation des enterprises*" – *loi* "PACTE") providing for the reform of corporate insolvency law in accordance with the provisions of the 22 November 2016 European proposal for a directive[67], was already adopted at first reading by the National Assembly on 9 October 2018.

71. This change could thus considerably increase the weight of secured creditors. From now on,

[65] Latest version proposed by the Council of the European Union on 1 October 2018, available at http://data.consilium.europa.eu/doc/document/ST-12536-2018-INIT/en/pdf.
[66] S. Vermeille and T. Jauffret, « *Enfin un droit de la restructuration efficace*, » *LPA*, 28/08/2017, n° 171, p. 5.
[67] Draft Covenant Act of 19 June 2018, Article 64.

a continuation plan could no longer be opposed to them without their agreement if they are affected by the plan. Under these conditions, access to bank financing could be improved and, in turn, companies would then be less dependent on supplier credit. In this respect, it should be noted that academic work has shown that the importance of supplier credit in financing the economy is inversely correlated with the quality of financial creditors' rights protection. In other words, the more a system protects the rights of financial creditors, the less the company will need to finance itself through supplier credit[68].

72. Moreover, the adoption of the principles dictated by the European Commission would have the effect of promoting the use of insolvency proceedings as a means of promoting the operational restructuring of companies. Indeed, promoting operational restructuring requires not only the possibility of being able to terminate contracts considered too onerous for the company, but also to be able to cram down the claims of suppliers and other commercial partners resulting from the early termination of the contract (when such contract provides for an indemnity in the event of an early termination of the contract). This claim can only be extinguished if the valuation of the company carried out under insolvency proceedings justifies the cram down of unsecured creditors, to the benefit of senior creditors. The opacity of the conciliation procedure and *mandats ad hoc* validly giving way to a much welcome principle of transparency is therefore subject to the incorporation of these principles into French law.

73. However, one can regret that the directive did not insist on the need to ensure transparency. Indeed, the proposal for a Directive does not include any provision to promote transparency, despite the proposed recommendations of international doctrine.[69] If France, along with other Member States, fails to fully embrace a culture of transparency similar to the culture prevailing in the United States, there will still be a long way to go before financial markets can fully develop in continental Europe. However, the expected turnaround in the cycle would require Europe to accelerate its pace. It is becoming increasingly urgent to reduce the proportion of bank financing in our economy.

[68] P. Santella, "*The Legal Cost of Trade Credit, European Securities and Markets Authority*," available at www.ssrn.com. See also A. Demirgiiu-Kunt and V. Maksimovic, "*Firms as financial intermediaries, evidence from trade credit data*," Policy Research Paper 2696, available at www-wds.worldbank.org. World Bank economists have also concluded that the importance of inter-company credit in financing the economy can be linked to the inability of the legal environment to sufficiently protect the rights of banking institutions.

[69] European Law Institute, "*Rescue of Business in insolvency Law*," 2017; Recommendation 7.04 recommending for a transfer of the company to establish standards and practical rules relating to the transparency of the negotiation process before the opening of formal insolvency proceedings.