Legal high Committee for
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# *REPORT OF THE "BUSINESS FAILURES" WORKING GROUP*

*of the Haut Comité Juridique de la Place Financière de Paris (Legal High Advisory Committee for Financial Markets of Paris) on "guidelines for the approximation of national corporate insolvency laws in the European Union"*

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*9 rue de Valois 75001 Paris - Tél.: 33 (0)1 42 92 20 00 - hautcomite@hcjp.fr - www.hcjp.fr*

**REPORT OF THE "BUSINESS FAILURES" WORKING GROUP OF THE HAUT COMITÉ JURIDIQUE DE LA PLACE FINANCIÈRE DE PARIS (LEGAL HIGH ADVISORY COMMITTEE FOR FINANCIAL MARKETS OF PARIS) ON "GUIDELINES FOR THE APPROXIMATION OF NATIONAL CORPORATE INSOLVENCY LAWS IN THE EUROPEAN UNION"**

## Summary of the report


In February 2015, the European Commission launched a consultation on the harmonisation of corporate insolvency law and invited all interested persons to submit proposals.

The "Failure of Non-banking Enterprises" working group chaired by Claire Favre, under the aegis of the *Haut Comité Juridique de la Place Financière de Paris*, focused on seeking recommendations that could be passed on to the European Commission.

It appears that French **preventive proceedings**, which have increased significantly since 2011, have a high success rate and that going through Conciliation proceedings substantially improves the likelihood of achieving a sustainable continuation plan in Judicial Restructuring proceedings. The European Commission may be interested in examining French Conciliation proceedings and retaining three important features: (i) the negotiation process, (ii) a de facto procedure combining Conciliation/Fast-Track Financial Safeguarding *(sauvegarde financière accélérée* – SFA) and (iii) the implementation of a pre-negotiated asset sale plan ("prepack sale").

In terms of **collective proceedings**, it would be useful for the European Commission to lay down some minimum rules that apply to all proceedings for the judicial handling of difficulties faced by non-bank enterprises in the European Union.

There should be nine of these rules:

- Implementation of a dual test for triggering insolvency procedures;
- Priority to be given to negotiated continuation plans as opposed to court "imposed" plans;
- Securing independent expert opinion, beyond certain thresholds, as to the sustainability of a continuation plan;
- Reduction and unification of timeframes for Collective proceedings;
- Submission of creditor's claims under a simplified format;
- Harmonisation of certain limitations to shareholders' rights;
- Opening of asset disposals to competitive processes;
- Consolidation of Collective proceedings for groups of companies;
- Outcomes of proceedings and sanctions and penalties for directors and executives.

# Introduction

In its Green Paper on Capital Markets Union dated 18 February 2015, the European Commission invited the Member States to make recommendations on the approximation of the different national insolvency laws.

Until now, the various European regulatory and legislative initiatives have been aimed at coordinating insolvency proceedings for non-bank enterprises, by instituting, among other things, a system of rules on conflicts of jurisdictions and laws rather than harmonising the substantive rules of European law in this area.

Yet, since 2010 in particular, a number of consultations have all reached the conclusion that the approximation of substantive corporate insolvency laws would contribute to growth in Europe. This is the result that emerges from the following studies, resolutions and communications in particular:

- 2010 European Parliament study (EP 419 633) entitled "Harmonisation of Insolvency law at EU level";
- European Parliament resolution of 15 November 2011 with recommendations to the European Commission on insolvency proceedings in the context of EU company law (2011/2006(INI));
- Communication from the European Commission entitled: "A new European approach to business failure and insolvency" dated 12 December 2012 (COM(2012) 742 final);
- European Commission public consultation on a new European approach to business failure and insolvency (5 July-11 October 2013);
- Commission Recommendation no 2014/135/EU of 12 March 2014 on a new approach to business failure and insolvency (OJEU no. L 74 of 14 March 2014, pp. 65 to 70).

Current non-bank corporate insolvency law in Europe includes major discrepancies in approaches and varying levels of efficiency.

The fact that a great many euro area banks are weighed down by the high percentage of non-performing loans on their balance sheets makes the approximation of the different national insolvency laws all the more important. Overall, such loans are estimated to total more than EUR 900 billion. To allow banks to regain the liquidity needed to finance the economy, not only should they be able to reduce their non-performing loans, but their borrowers should have better access to credit and benefit from harmonised rules that make it easier to resolve any difficulties they may face.

In February 2015, the European Commission launched a consultation of the harmonisation of corporate insolvency law. It commissioned Leeds University in the United Kingdom to assess the impact of the EU regulation of 20 May 2015 and assembled a group of experts to work on different areas where harmonisation may be possible.

The priorities for approximation were previously summarised in the European Commission's communication of 12 December 2012 and further elaborated in Recommendation 2014/135/EU of 12 March 2014. According to the Commission, the approximation of national laws should incorporate in particular:

- Restructuring "at an early stage" before insolvency;
- Arrangements to give honest entrepreneurs a second chance:
    - By fast-tracking liquidation proceedings,
    - By granting debtors full discharge of their debts within a short period following the closure of the proceedings;
- The criteria for commencing national insolvency proceedings, including the debtor insolvency test;
- The right for creditors and public authorities to request the commencement of collective proceedings;
- The rules on submitting and verifying claims (particularly time limits, sanctions and consequences of failure to submit claims);
- Rules promoting restructuring plans:
    - By allowing creditors to suggest a plan,
    - By standardising the rules for the approval of plans by creditors' committees and the courts.

In March 2015, the *Haut Comité Juridique de la Place Financière de Paris*[1] set up a Working Group on "Non-bank Enterprise Failures" to make recommendations in connection with the European Commission's initiative. The composition of the Working Group is set out in Appendix 1 of this report.

In order to draw up its report and make recommendations, the Working Group talked to a number of specialists to get their viewpoints and hear their assessment of the state of the French corporate insolvency system and a possible proposal for a common resolution system to deal with difficulties at the EU level.

The list of people interviewed is set out in Appendix 2 of this report.

This report will address preventive proceedings and collective proceedings for handling difficulties and will not cover debt problems among private individuals.

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[1] *Created in 2015 at the behest of the Autorité des marchés financiers (AMF - Financial Markets Authority) and the Banque de France, the Haut Comité Juridique de la Place Financière de Paris (HCJP) conducts and publishes fully independent legal analyses. The HCJP is made up of lawyers, judges, academics, business leaders and other qualified individuals. It is tasked with the following:*

- *proposing draft reforms to promote the legal competitiveness of the Paris financial centre,*
- *helping and supporting public authorities in connection with the negotiation of European and international texts in this area,*
- *increasing legal certainty by providing answers to legal questions concerning all financial stakeholders, both public and private.*

*The public authorities and Regulators in charge of regulating and supervising the Paris financial centre are involved in all meetings of the HCJP.*
*The HCJP is chaired by one of its members, currently Michel Prada, Honorary General Finance Inspector and former Chairman of the AMF.*

The working group decided that its recommendations should be primarily based on a **statistical analysis of the outcomes** of French collective proceedings (1); on this basis, it felt that the European Commission should adopt some minimum common rules, firstly in terms of **measures to prevent** companies getting into difficulty (2), and secondly in relation to **collective proceedings (3)**.

# I. Brief statistical analysis of the economic outcomes of collective proceedings under French insolvency law

A number of relevant statistics were identified for the working group's purposes. The bulk of these are derived from the Deloitte/Altares[2] report published in March 2016. They include procedures brought before both the judge of commercial cases and the district and regional courts[3].

As was noted during the hearings, it is unfortunate that as yet there are no national statistics available (including anonymised statistics in some cases). These would be particularly helpful in better identifying the types of difficulties faced most often under the different proceedings. It would be useful, for example, to know, among other things, the reasons why requests to appoint a special commissioner (*mandataire ad hoc*) or commence conciliation proceedings are refused, what are the percentage of conciliation procedures commenced when the company suspends its payments, the types of recurring weaknesses of court-imposed safeguarding or restructuring plans, as well as the sanctions imposed on company directors or executives.

## 1. Composition of the business landscape in France

First, it should be noted that commercial enterprises are categorised as follows across all EU countries:

(a) Large companies.

(b) Mid-size companies that employ between 250 and 5,000 people and whose annual turnover or total balance sheet assets do not exceed €1.5 billion or €2 billion respectively.

(c) Small and medium-sized enterprises (SMEs)[4], classified as follows:

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[2] *Some statistics are also included in certain Comité Interministériel de Restructuration (CIRI - Interministerial Restructuring Committee) or OECD reports and some figures are reported during the various hearings held by the working group.*

[3] *Note that the figures for jobs at risk mainly relate to commercial companies (proceedings handled by judges in charge of commercial cases) and, secondly, the proportion of cases dealt with by the civil courts is only about 3% to 5% of the total amount of voluntary and legal proceedings).*

[4] *SMEs are very small in size if we focus on turnover or total balance sheet assets.*

- Intermediate-sized enterprises (ISEs) that employ between 50 and 250 people and whose annual turnover or total balance sheet assets do not exceed €50 million or €43 million respectively;

- Small enterprises (SE) that employ between 10 and 50 people and whose annual turnover or total balance sheet assets do not exceed €10 million;

- Very small enterprises (VSE) or microenterprises that employ between 0 and 10 people and whose annual turnover or total balance sheet assets do not exceed €2 million;

SMEs account for between 95% and 99% of European businesses. In France, SMEs (92% of which are VSEs) make up around 99% of France's 3.7 million French enterprises[5].

In 2015, VSEs accounted for over 90% of business failures and involved nearly 50% of jobs at risk[6], it being noted that businesses with over 20 employees accounted for only 3% of failures but alone involved 40% of jobs at risk[7].

## 2. What is as stake

(a) The number of jobs at risk in 2015 was around 560,000 employees under preventive proceedings and 235,000 under collective proceedings[8].

(b) At the same time, 525,000 new businesses were set up, but since half of them were microenterprises, they did not create in any significant number of new jobs[9].

(c) In addition, the success rate of mutual agreement procedures was 70%, which means that close to 400,000 jobs were able to be saved. Since safeguarding and restructuring proceedings have only a 30% success rate, we can estimate, based on the report, that out of some 125,000 jobs affected by both procedures, only 50,000 jobs could be saved out of a total of 235,000 (all procedures combined including direct court-ordered liquidations[10]).

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[5] *Note that nearly two-thirds of these, i.e. more than 2.5 million businesses, are microenterprises that have virtually no paid employees.*
[6] *See pages 7 and 8 of the report.*
[7] *See page 8 of the report.*
[8] *See pages 10 and 18 of the report*
[9] *See page 7 of the report.*
[10] *The Association pour la gestion du régime de Garantie des créances des Salariés (AGS - French Wage Guarantee Insurance Association) estimates that based on the 119,000 redundancies it financed last year, it is possible to conclude that almost half of the jobs would be saved (page 10 of the report).*

## 3. Preventive procedures

(a) The number of cases handled under mutual agreement procedures in 2015 totalled 1,500 for special commissions (*mandats ad hoc*) and 1,000 for conciliations.

According to the report, the number of new special commissions and conciliation proceedings rose by 37% and 72%[11] respectively between 2011 and 2015, which attests to their considerable appeal and effectiveness. It is noted in this respect that the market has very much welcomed the introduction, since early 2014, of the combined "conciliation/prepack sale" solution.

(b) Note that intermediate-sized companies experiencing difficulties can use the services of the *Comité Interministériel de Restructuration* (CIRI - Interministerial Restructuring Committee) if they have more than 400 employees. The CIRI helps distressed businesses develop a recovery plan and negotiate a solution with the firm's financial and industrial partners, generally in the framework of prevention proceedings.

Each year, the CIRI receives around 30 referrals, representing 30,000 to 50,000 jobs at risk.

(c) Overall, preventive proceedings handled have a successful outcome in nearly 70%[12] of cases.

Finally, it is worth noting that safeguarding and judicial restructuring preceded by conciliation proceedings have a 50% greater chance of leading to a sustainable restructuring plan[13].

(d) A special commissioner is appointed in around 80% of the cases where a failure procedure of any type is opened, and in 70% of the cases where a conciliation proceeding is opened.

Preventive measures are indisputably effective in heading off problems. However, it has emerged from various hearings that these proceedings are mostly used by larger type-sized enterprises.

Moreover, there is a regrettable lack of defined warning indicators which could be used by VSE and SE enterprises. These would enable business owners to set basic accounting tools and monitor their business situation and allow them to take corrective measures needed to remedy a situation potentially leading to difficulties and/or a suspension of payments (état de cessation des paiements). However, it would be necessary to check if the financial cost of such preventive framework is affordable for small businesses.

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[11] *See page 17 of the report.*
[12] *Cases referred to the CIRI have a success rate of nearly 85%. The average time it takes the CIRI to process cases is eight to ten months (CIRI 2014 Business Report).*
[13] *See page 10 of the report.*

## 4. Collectives proceedings

(a) Of the 63,000 Collective proceedings initiated in 2015, nearly 69% (43,178) were subject to direct court-ordered liquidations and 29% (18,370) were Restructuring proceedings[14].

Safeguarding proceedings accounted for a mere 2% of total Collective proceedings, i.e. just over 1,500 in 2015, with 200 of them (i.e. 12%) involving businesses with more than 20 employees.

(b) Businesses with more than 20 employees also accounted for nearly 70,000 out of the some 125,000 jobs under threat under Safeguarding and Restructuring proceedings[15].

Half of all safeguarding and restructuring plans fail and end in court-ordered liquidation within less than three years and two-thirds of businesses that have been subject to said proceedings go out of business within eight years.

In light of the above, it appears that preventive proceedings, which have increased significantly since 2011, have a high success rate and that going through conciliation proceedings substantially improves the likelihood of achieving a sustainable continuation plan in restructuring proceedings.

Note that the legislature has effectively implemented a number of effective adjustments and tools in relation to these preventive procedures over the past two years.

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Regarding Restructuring proceedings, apart from not enabling the great majority of businesses to recover, they present a certain number of drawbacks, particularly regarding the organisation and role of creditors, the valuation of the failing business, the submission process of creditor's claims, and the implementation of the job protection objective, which is usually interpreted too rigidly and is difficult to appreciate in the absence of any reliable assessment of the viability of the proposed continuation plan.

[14] *See page 25 of the report.*
[15] *See pages 21 and 25 of the report.*

## II. The existing preventive measures in France have demonstrated their effectiveness

While the various preventive proceedings have proven effective (1), improvements are possible to increase harmonisation under EU law (2).

### 1. Summary description of the different types of preventive proceedings in France

Book VI of the *Code de commerce* provides for two distinct procedures available to enterprises that anticipate or are experiencing difficulties: the Special Commission procedure on one hand and the Conciliation proceedings on the other. Successive reforms (*loi n°2010-1249 du 22 octobre 2010* and *ordonnance n°2014-326 du 12 mars 2014*) have improved the outcomes of these preventive proceedings by introducing a fast-track financial Safeguarding proceeding (*sauvegarde financière accélérée* – "**SFA**") and a "**Prepack Sale**" alternative.

Ces deux procédures présentent des caractéristiques communes (1) mais également des particularités (2).

#### A. Common features

***i. The appointment of an independent professional***

The special commission procedure and the conciliation proceedings both lead the debtor of a distressed company to seek the appointment of an independent professional acting either as a special commissioner or as a mediator. Although the criteria for the appointment of this professional are fairly flexible, the judge will usually select a court registered administrator or receiver. In some cases, these professionals may also be appointed by the judge in subsequent Collective proceedings.

Court-appointed administrators and receivers carry out a regulated profession that is governed by Articles L. 811-1 *et seq*. of the *Code de commerce*. The conditions of access to the profession are set out in these articles.

The remuneration of these professionals is subject to a tariff set by government decree, which applies when they are appointed in Collective proceedings. In Preventive proceedings, the fees received by the special commissioner or the mediator must be approved by the judge.

It is worth noting that any debtor may put forward names of professionals for consideration by the judge.

The duties assigned to the special commissioner or mediator are also determined by a court order.

Often, the professional will act as an independent mediator between the debtor and its main creditors. Its objective is to meet the corporate interests of the enterprise as well as to safeguard the interests of employees, while ensuring that the negotiated agreement makes it possible to settle the liabilities of the company.

***ii. The debtor's freedom to choose and confidentiality***

Special Commission procedure and Conciliation proceedings are triggered at the discretion of the debtor, who has sole authority to apply for the commencement of such procedure or proceedings.

Furthermore, both processes are kept confidential, except for the external auditors of the company who must be informed thereof. Creditors will not face any freeze on their claims nor any legal action against the debtor will be suspended. Consequently, no submission of claims needs to be made by creditors. Creditors taking part in negotiations commonly agree, however, not to bring legal action against the debtor. Finally, any contractual clause that renders a debt due as the result of the commencement of a special commission procedure or Conciliation proceedings is null and void.

***iii. Involvement of the judge***

The role of the judge has increased following recent successive reforms.

The judge may be actively involved, even prior to any Preventive proceedings, through his ability to summon management of a company for meetings if alerted of potential risks, such, for example, as the absence of filings of annual financial statements of the company with the clerk of the court's office. These confidential meetings are an opportunity for the judge and the management to discern, at an early stage, possible implementation of certain corrective measures.

Throughout both processes the (Special Commission or Conciliation), the special commissioner or mediator must report regularly to the judge on the progress of his assignment. The judge alone will rule on the termination of the special commissioner's or mediator's assignment, its possible extension (within the time limits set by law) or on the adoption of the agreement reached (between the parties).

Finally, but only in the context of Conciliation proceedings, the judge has access to any information that would be useful to him or her in assessing the economic, financial, and employment situation and the assets of the company. He may to that effect appoint an expert (Article L. 611-6(5) of the *Code de commerce*).

## B. The two processes and their outcomes

### *a) The special commission*

When a debtor anticipates difficulties of a financial nature but also in the running of his business, he may ask a judge to appoint a Special Commissioner.

The special commission is a fairly flexible procedure, with no time restrictions or any access conditions, except that the debtor must not be in a state of suspension of payments (*état de cessation des paiements*).

At the end of the special commission process, either an agreement is reached with the creditors or the procedure is terminated due to the failure by the parties to reach an agreement. Often, Conciliation proceedings are commenced when a special commission procedure is closed. This, in practice, facilitates a positive outcome of the negotiations.

### *b) Conciliation*

An application to commence the more formal Conciliation proceedings must meet the following criteria:

- the debtor must not have suspended payments for more than 45 days prior to the application for commencement;
- the debtor must not have been subject to conciliation proceedings within the three months preceding the application;
- the debtor must provide evidence of an actual or foreseeable legal, economic or financial difficulty.

The proceedings are also time-limited: they commence for a period not exceeding four months, which period may be extended at the debtor's request provided however that the total duration of the proceedings does not exceed five months.

Three outcomes may result from Conciliation proceedings:

- An agreement is reached and is certified (constaté) or formally approved (homologué) by the court

This agreement, which must be unanimously approved by those creditors who have taken part in the Conciliation proceedings, may be either certified or formally approved by the judge. In this latter case, the court gives an order, that is partly published making the terms and conditions of the agreement enforceable against third parties.

Thus, if creditors investing "new money" want to secure priority ranking rights in the case subsequent Collective proceedings were to occur, the agreement must necessarily have been formally approved by the judge.

Formal approval by the court of the agreement will also protect creditors if subsequently, in the course of a Collective proceeding, the actual date of suspension of payments (*état de cessation des paiements)* is retroactively fixed by the judge at a date prior to the date on which the agreement will have been formally approved under the Conciliation proceedings.

- Commencement of fast-track financial safeguarding proceedings (SFA)

The *loi du 22 octobre 2010* introduced new proceedings[16] in the form of fast-track financial safeguarding proceedings, a variant of safeguarding proceedings.

These proceedings allow for a continuation of the negotiations begun during conciliation proceedings, but only with the "financial" creditors and, when applicable, with the bondholders of the distressed company.

With respect to these financial creditors, the commencement order will cause:

- a freeze on financial claims and a ban on earlier repayments of financial debts by debtor;
- a suspension of any legal action.

Unlike other safeguarding proceedings, the SFA may be commenced even if the debtor has suspended its payments within forty-five days prior to the request for commencement of the conciliation proceedings[17].

The outcome of such SFA proceedings is to allow the finalisation of a continuation plan, developed and negotiated beforehand in Conciliation proceedings. The financial creditors alone meet in a single committee or in two committees if bondholders are involved (this second committee will take the form of a general meeting of bondholders). Each committee will decide on the adoption of the plan, at a majority representing two-thirds of the total amount of the debts or bonds as the case may be of (Articles L. 626-30-2 and L. 626-32 of the *Code de commerce*).

This specific SFA proceeding must be completed within a maximum of two months (one month renewable once)[18].

The *ordonnance du 12 mars 2014* introduced another variant extending this fast-track safeguarding to all creditors, except employees. The new proceeding must be completed within a maximum of three months.[19]

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[16] *PM LE CORRE : GPC 16 oct. 2010, p.3 ; LUCAS : LEDEN 2010-11, p.1.*
[17] *Article L. 628-1 of the Code de commerce applicable to the SFA.*
[18] *Article L. 628-10 of the Code de commerce.*
[19] *Articles L. 628-1 to L. 628-8 of the Code de commerce.*

From a practical standpoint, it should be noted that if these fast-track safeguarding proceedings are still rarely applied, they are generally viewed as a threat by recalcitrant creditors in Conciliation proceedings as a threat, which is sufficient to entice them to finally give their approval to the negotiated Continuation plan.

- Negotiation of a "prepack sale" of assets

The *ordonnance du 12 mars 2014* introduced a new mechanism[20] giving the mediator the possibility of pre-arranging a partial or total sale of the business, which could be implemented, if appropriate, under subsequent Safeguarding, Restructuring or Liquidation proceedings. This «prepack sale» option must be requested by debtor, after notification to the participating creditors.

The main objective of this mechanism is to **limit the loss of value** of the business when it is disposed of outside the Conciliation proceedings:

- This pre-negotiated asset sale takes advantage of the confidentiality attached to the Conciliation proceedings during which the mediator will organise the search for as many potential purchasers as possible and assess the bids received;

- Shortening the duration of the subsequent Collective proceedings, since the court is able to proceed with a hearing to examine the various bids, in the early weeks of the Observation period.

Two recent takeovers, completed in the framework of prepack sales illustrate this:

- In June 2015, NextiraOne was taken over by Butler Industries, saving 1,400 jobs (100% of the jobs were taken over),

- In November 2015, a prepack sale resulted in the disposal of FRAM, a tour operator company, at a selling price five times the initially proposed price, while saving 87% of jobs.

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[19] *Articles L. 628-1 to L. 628-8 of the Code de commerce.*
[20] *This mechanism is codified in Article L. 611-7 of the Code de commerce.*

Overall, preventive measures have several advantages:

- their confidential nature helps to preserve the value of the business, especially its relations established by the Company with its suppliers;

- the involvement of the judge brings a high degree of security to the management of the company and its creditors;

- the negotiation process ensures that all stakeholders feel that they have some "ownership» in the solutions;

- the involvement of independent professionals helps to avoid conflicts of interest and facilitates decision-making by bank credit committees, which can rely on the conclusions of these experts with confidence;

- the speed of these proceedings helps to prevent the company's business from deteriorating.

## 2. Possible improvements in French preventive proceedings under the harmonisation EU law

The majority of persons interviewed expressed the difficulty there is of causing small and very small enterprises to be made aware of Preventive proceedings. This, it seems that work is needed to provide such awareness to said enterprises more aware of these proceedings. Encouraging executives of such small enterprises to use chartered accountants would be particularly beneficial. Enterprises should also be encouraged to consult with the special Units organized within commercial courts to discuss on an informal basis potential difficulties. Taking action on distressed businesses is also part of the remit of the *Chambres de Commerce et d'Industrie* (CCI - Chambers of Commerce and Industry). These tasks are defined by each CCI at the local level. For example, the Paris CCI prepares three types of actions: (1) training company management or Unions' representatives on insolvency law; (2) publishing information materials; (3) offering confidential individual meetings, free of charge, between company's management, and a lawyer/an accountant/honorary magistrate on legal issues law.

These types of external actions have the advantage of dispensing entrepreneurs from meeting with court officials, which they often consider to be *per se* a punitive measure.

The legal framework of preventive proceedings is generally satisfactory. Thus, there is no reason to suggest or recommend major changes to be made to the existing rules.

Some improvement could however be made in combining further Conciliation and SFA proceedings and in "Prepack sale" arrangements.

*i. Creation of creditors' committees*

Classes of creditors should be created in Conciliation proceedings. This would facilitate convergence with the current UK scheme of arrangement in which the creation of classes of creditors appears to be essential for judicial supervision.

The introduction of classes of creditors would also require an adjustment of majority rules and of voting rights. At present, a majority representing two-thirds of the value of claims in each committee (creditors and/or of bondholders) is required. Accordingly, bondholders possessing bonds that are significantly depreciated, have a serious "nuisance" impact.

The introduction of classes of creditors (which is also provided for in the Commission Recommendation of 14 March 2014) would make it possible to class creditors according to the "quality" of their claims (subordinated, unsecured, proposed or specially secured claims, etc.). In each of the classes, the proposed continuation plan would be adopted by a majority (currently of two-third) of the claims. This would help avoid any disputes on the allocation of voting rights by the court-appointed administrator, who, under the current rules, has the power to allocate such rights in taking into consideration subordination agreements and guarantees. In addition, a consultation could also be undertaken as to whether shareholders should, in certain situations, be grouped in a special class with appropriate safeguards, as is the practice under German law. Such a system would be in line with international practice, particularly in the United Kingdom under the scheme of arrangement, and in Germany.

*ii. Use of the pre-negotiated asset disposal plan ("prepack sale")*

This procedure shortens Collective proceedings. It allows for rapid and confidential negotiations on the survival of the company and with all the necessary procedural safeguards. Whereas under the UK prepack, the senior creditor or the person designated by it will be the person taking over the assets, the French prepack opens up bidding to persons outside the proceedings, while offering the procedural safeguards resulting from the commencement of Collective proceedings.

The French prepack sale arrangement has the advantage of combining confidentiality, free consent from the entrusted parties and an earlier closure of the insolvency proceedings (which combination is in line with regulation (EC) no. 1346/2000).

French preventive type proceedings could be used within Europe, especially since the French system benefits from a significant experience having proven its worth for more than 25 years.

## III/ Collective proceedings could be subject to a few common rules at the European level

The Working Group believes it would be helpful for the European Commission also to define some minimum common rules, applicable to all insolvency procedures for non-bank enterprises in the European Union. The Working Group felt, however, it was not its role to address employment law issues, which are nevertheless of key importance, while noting that the general objective of collective proceedings is the safeguard the business and therefore must be relevant to employment as much as possible.

There could be nine of these rules:

### 1. Implementation of a dual test for triggering collective procedures aimed at restructuring the enterprise

Collective proceedings aimed at redressing a company facing difficulties should be initiated either when the company comes up against insurmountable difficulties or it is faced with a suspension of payments (*état de cessation des paiements*).

In France, the *Code de commerce* provides for three separate types of collective proceedings for distressed enterprises – safeguard, restructuring and liquidation proceedings – of which only the first two, will be covered here.

***i. Safeguarding***

According to Article L. 620-1 of the French Code de commerce, Safeguarding proceedings are commenced at the request of a debtor who can prove that although it is not in a state of suspension of payments (*état de cessation des paiements*) has difficulties that it is unable to overcome.

The law does not give any clarifications on the nature of such difficulties; they may be of economic, financial, corporate, technical or human nature. The «insurmountable» qualification is to be appreciated with regard to the debtor's borrowing capacity.

The main differences with Restructuring proceedings, which will be analysed briefly below, lie in the voluntary nature of the safeguarding procedure and its preventive nature: it may only be commenced at the sole initiative of a debtor who is not in a state of suspension of payments.

The Observation period under safeguarding proceedings lasts six months. This period may be renewed once, if justified, at the debtor's request and, in exceptional circumstances, a second time at the request of the Office of the Public Prosecutor.

The Safeguarding proceedings cause a stay of individual prosecutions (Article L. 622-21 of the *Code de commerce*); a stops of interest accruals and surcharges, with the exception of interest on loans exceeding one year, and a suspension any legal action against the debtor's guarantors (Article L. 622-28 of the *Code de commerce*). In addition, the debtor may not pay any claims arising prior to the commencement order (L. 622-7 of the *Code de commerce*) as well as any claim arising after the commencement order, except, in this case:

- the claim arose in the conduct of the proceedings or of the observation period, or
- it relates to a service provided to the debtor during that period, or
- it is a maintenance claim. (Article L. 622-17 of the *Code de commerce*).

***ii. Judicial restructuring***

According to Article L. 631-1 of the *Code de commerce*, the commencement of Restructuring proceedings should be sought if the debtor has suspended payments. Under Article L. 631-1 of the *Code de commerce*, a debtor is in a state of suspension of payments (*état de cessation des paiements*) if it is unable to meet its current liabilities with its available assets.

Responsibility for commencing restructuring proceedings lies with the debtor, who must act within forty-five days of the suspension of payments at the latest, or with any creditor or with the Office of the Public Prosecutor (Articles L. 631-5, R. 631-2 and R. 631-4 of the *Code de commerce*).

Restructuring proceedings begin with an observation period of up to six months. This period may be renewed but may not exceed 18 months in total.

During the first two months, the court may, in the absence of sufficient information on the progress of the company's business, or if the debtor fails to meet its current liabilities or if no restructuring solution is possible, decide to convert the restructuring proceedings into judicial liquidation proceedings.

The court-appointed administrator assists the debtor in all or certain management operations. The court may also decide that the court-appointed administrator directly issue the entire administration of the company (Article L. 631-12 of the Code de commerce). The commencement of Restructuring proceedings results in the suspension of legal actions against debtor creditors, can no longer institute court proceedings or seize property to enforce earlier court decisions. As a matter of fact the protective measures benefitting debtor are similar to those under the Safeguard proceedings.

### *iii. The suspension of payments and the insurmountable difficulties test*

a. Suspension of payments is the reference point

The suspension of payments (*état de cessation des paiements*) should be the reference criteria for setting the date from which the debtor must, within a maximum period of time, request the commencement of Restructuring Proceedings. This date, as finally determined by the court, is also the starting point of the so-called suspect period during which certain contracts entered by debtor may be held void.

The suspension of payments is a reliable indicator of a proven liquidity crisis. Several European countries use a similar concept, which is sometimes combined with a balance sheet based insolvency test, as in Germany.

Although the suspension of payments test is no longer the *summa divisio* between amicable/ preventive proceedings, and Collective proceedings (judicial Restructuring and Liquidation), this test remains essential for treating creditors equally while best preserving the debtor's assets.

b. Insurmountable difficulties – the alternative test

Any debtor must be able to commence safeguard proceedings, even if it is not yet in a situation where it has suspended payments.

Indeed, handling problems at an earlier stage makes it easier to deal with the difficulties encountered by any company.

## 2. Negotiation over Court "Imposed" recovery plans

Priority must indeed be given, in France and the other European Member States, to negotiated plans as opposed to Court "Imposed" recovery plans.

Imposed plans have indeed several drawbacks, given in particular that under French law, equal treatment must be offered to creditors. For example, an "imposed plan" can only provide under the current French rules for the rescheduling of debts over a 10-year period and therefore do not take account the different rankings of creditors' claims.

Furthermore, the progressive nature of repayments stipulated in such plans, is likely to harm creditors' interests. Indeed, imposed plans often require only a token repayment of debts during the first two years. As a result, the plan creates an artificially favourable plan during this early period. Since under French law, at least 5% of the restructured debt is to be paid off in the third year of the plan, debtors often are unable to manage and few plans resist to such steep increase after three years.

Incidentally, the legal constraints applicable to imposed plans seems to be a French particularity, unknown in German and UK law.

Negotiating a plan with creditors has the advantage of leading to more realistic plans.

Where creditors are able to suggest alternative plans, the negotiation process should apply and creditors should be able to determine, for example, the duration of the plan. Ultimately, if the plan does not receive the majority approval of the creditors, then only the Continuation plan may be drawn up by the debtor with the assistance of the administrator and then approved by the court.

The legislature's goal is to encourage majority-approved and mutually agreed debt restructuring plans. A court-imposed plan should therefore remain exceptional.

## 3. Requirement of an expert opinion

Companies above certain revenue and employee thresholds should be required to call upon a financial expert to establish a report analysing the sources of the problems, and the seriousness of the management's proposed business plan and of the proposed financial restructuring plan. Such expert advice given to the court would be the same as that already required for preventive proceedings. For companies below the revenue and employee thresholds, the use of an expert could be optional.

An expert (generally a chartered accountant), once appointed, will be an asset in managing the company's difficulties since his unbiased expertise will help to better understand past difficulties and set up more lasting recovery solutions. He would also be able to help the court-appointed administrator best prepare its economic and corporate assessment. He may also assist the court in the observation period during which it must decide on the company's capacity to finance itself during that period, as well as at the time of adoption of the safeguarding or restructuring plan or the asset disposal plan.

The use of such experts could be made compulsory by law. The experts' fees could also be set by law (in a similar way to the fees of court-appointed administrators and receivers). This is because such expert advice will inevitably involve a cost, which will have to be weighed in light of the company's financial difficulties and its cash flow.

## 4. Harmonisation and reduction of collective proceedings timeframes

As experience clearly shows, earlier the risks of business failures are addressed, greater the chances of recovery are.

There are three stages of timeframes in insolvency collective proceedings related to the commencement, the proceedings themselves and the closure thereof.

These three stages should probably be unified within Europe and should be set with the aim to deal promptly with difficulties met by companies.

The timeframe for the commencement of collective proceedings should be as short as possible; in France, the period between referral to the court and the commencement order is approximately one week on average.

In some European countries, insolvency proceedings are sometimes preceded by pre-insolvency proceedings which generally last up to three months. This is the case in Germany, for example. However, one should not be misled as to the true nature of those "pre-insolvency proceedings"; in fact, they are very much the same as the French Observation periods. Indeed, these pre-insolvency proceedings allow an interim administrator to draw up an assessment of the situation of the company and to inform creditors about whether it is appropriate to commence formal insolvency proceedings. During this period, salaries are pre-funded by a government agency (the German counterpart of the AGS). It may be noted that proceedings are only commenced if there are sufficient assets to pay the legal costs. At the end of these interim proceedings, the creditors must decide whether the business should continue as a going concern under a continuation plan (*Insolvenzplan*) or authorise the court to proceed with disposal plan.

The observation period in Restructuring proceedings is currently up to six months, with the possibility of extension up to a maximum of eighteen months. This period is too long. Thus, it is proposed that the observation period be reduced to three months, which period could be extended once or twice in exceptional cases on the advice of an expert and the court-appointed administrator.

This reduction should be accompanied by the alignment of other time periods that are required for certain formalities to be accompanied in relation to the commencement of collective proceedings, including:

- the period for submitting claims, which is currently two months (and a further two months for foreign creditors) as from the date of publication of the commencement order in the *Bulletin officiel des annonces civiles et commerciales* (BODACC - French official bulletin of civil and commercial announcements);
- the time limit set for claiming recovery of goods, which is currently three months;
- the time limit for requesting the cancellation of a lease, which at present can only be done within three months into the proceedings.

Finally, the duration of the Continuation plan should be:

- freely determined when the creditors have voted for the plan[21]; or

[21] *This scenario is already provided for in Article L. 626-30-2 of the Code de commerce which specifically excludes the application of Article L. 626-12 of the Code de commerce when creditor committees are involved.*

- in the case of a court "imposed" plan, limited to five years[22], except in exceptional cases to enable large companies to benefit from more suitable plans.

Limiting each of these three procedural stages would also place time constraints on certain participants in to the proceedings, namely the court-appointed administrator and receiver, the supervisory judge, the Office of the Public Prosecutor, the management of the company and the employee representatives. They indeed would have to be mobilised all at once in order for them to contribute in a timely manner to the implementation of a Continuation plan. These time limitations will also help to contain the stigma impact of collective proceedings on the enterprise as well as their demoralizing impact on the management and employees of the enterprise.

It is worth noting that limiting the duration of Collective proceedings is already a priority for the French legislature, which has recently reduced the length of Conciliation proceedings to a maximum of five months and introduced Fast-Track safeguard proceedings (financial or otherwise), as well as the "prepack sale" mechanism.

## 5. Simplified submission of claims

The obligation for creditors to submit claims is enshrined in EC Regulation no. 1346/2000; this solution is repeated in new EU Regulation no. 2015/848 that replaces it.

The submission of claims may take various forms. It has recently been simplified in France where it is no longer considered a legal action. On this point, France has aligned with UK and German law, which provide for even less stringent formalities.

French law prescribes strict deadlines. German and UK law seem more flexible on this issue.

In French law, all claims existing prior to the commencement order of the proceedings are subject to this filing obligation, except for salary and maintenance claims.

For claims arising after the commencement order, a distinction must be made concerning claims properly incurred after the commencement order in the conduct of the proceedings or of the Observation period (so-called «useful claims»), which must only be brought to the attention of the court in charge of the proceedings. All other claims arising after the commencement order follow the submission rules as for prior claims.

[22] *This period is currently up to 10 years. It is proposed that it be reduced to five years.*

## 6. Positioning of shareholders

The French legislature recently amended the rules applicable to shareholders. In particular, the *ordonnance du 12 mars 2014* introduced into French law the possibility of diluting shareholders, including by way of forcing the sale of shares, as part of a capital increase. The *loi du 6 août 2015 n° 2015-990* introduced a new Article L. 631-19-2 to the *Code de commerce*, which no longer subjects such dilution to the failure on the part of the shareholders to restore equity.

The measures taken make it possible to dilute shareholders' interests or force them to sell their shares even though there would be no misconduct on their part, provided that:

- there is serious disruption to the national or regional economy, or to the local employment area ("*bassin d'emploi*");
- the company concerned has at least 150 employees or controls one or more companies with an aggregate workforce of at least 150 employees;
- other options involving a full or partial disposal of assets have been considered.

Article L. 631-19-2 of the *Code de commerce* stipulates that shareholders' rights may be amended in two ways:

- the forced dilution of shareholders' interests through a capital increase by means of a cash infusion or a debt-for-equity swap approved at a shareholders' meeting by a judicial representative appointed by the cour to vote in place of the shareholders to absorb the company's losses; or
- a forced sale of shares held by shareholders who are likely to block the approval of a capital increase. In this case, the sale price of the shares is determined by expert valuation if the interested parties are unable to agree on the price.

It should be underlined that the eviction of shareholders resulting from both types of processes can only occur in Restructuring Proceedings since Article L. 631-19-2 of the *Code de commerce* does not apply to Safeguard proceedings.

While this new measure is perceived as a highly anticipated and innovative arrangement, it is worth noting that a takeover by senior creditors could already be imposed in the past in the absence of specific provisions in the law under Conciliation proceedings followed by Safeguard proceedings. Indeed, this was the case in the Saur, Eurotunnel, Belvédère and more recently Latécoère restructuring operations relevant to the so-called "lender led" process. It should be noted that the conditions for implementing Article L. 631-19-2 of the *Code de commerce* are very strict they are also somewhat imprecise; for example, terms such, as "serious disruption" or, "local employment area" are not defined).

In Germany, the only condition needed to overcome the resistance of shareholders is that the restructuring plan as adopted by the majority of creditors must offer shareholders a better outcome than they would have had in a judicial liquidation.

Even if it remains difficult to implement, this mechanism will have the merit, as had the SFA when it was first introduced, of increasing bargaining power with recalcitrant shareholders, (since conversion into Restructuring proceedings is facilitated in the event an obstacle exists pursuant to Article L. 622-10 (3) of the *Code de commerce*).

The general question of the shareholder's positioning still remains to be answered and defined in a uniform way. Should the safeguard proceedings, for example protect shareholders who would reject a debt-for-equity swap while shareholders' equity is negative?

The German solution involves classifying shareholders, like creditors, in a separate class, in order to facilitate a forced sale of shares or a debt-for-equity swap.

It is indeed important to provide for an appropriate treatment of shareholders in order to avoid unjustified blockages on their part, while implementing safeguards against unjustified expropriation. For example, a shareholder should not be able to unreasonably oppose a capital increase subscribed by a third party.

## 7. Opening up to competitive processes

It appears essential to improve **competitive bidding process for sales of assets carried out under restructuring proceedings, for example in:**

- listing of assets online,
- opening up access to Markets,
- having tender processes.

Assets which are necessary to the activity of the company should not be bought in priority by parties who do not intend to acquire the complete business.

In this respect, US proceedings provide an interesting example with the establishment of a reference sale, which is subject to a transparent auction process. If this reference sale is finally not carried out because bids of the investor are not accepted, bidders in question are reimbursed of certain of their costs.

It seems useful therefore to have flexible rules that allow the court to choose the best method of sale depending on the assets and circumstances of each case in order to achieve the best possible price while respecting the equality of treatment and the transparency of bids.

## 8. Joint proceedings for groups of companies

Restructuring a group of companies may require a consolidation of proceedings within the same court and the appointment of the same officers in charge of proceedings for all companies in the group.

Insolvency practitioners' interpretation of the jurisdiction rules of EC regulation 1346/2000 has proved valuable on this point (see Eurotunnel case).

The *loi Macron* recently loosened up jurisdiction rules, for the purpose of allowing the concentration of proceedings in a specialised court, paving the way for forum shopping *à la française* for groups of companies.

These new types of provisions could be uniformly set up within Europe.

## 9. Sanctions and Penalties

An array of possible sanctions exists against directors and executives of bankrupt companies.

These sanctions may be of different nature: professional, financial or criminal.

They are specific and add to the common liability rules to which directors or executives are subject in the conduct of any business.

In terms of financial penalties, any director or executive who has committed errors that have contributed to a shortfall of assets may be required to compensate, in full or partially, for the shortfall in assets (*procédure de comblement de passif*)[23].

In terms of professional sanctions, directors and executives may be subject to "personal disqualifications"[24]. These sanctions are intended to prohibit, under certain limits, a director or executive from managing, directing, administering or even controlling (directly or indirectly) companies they may also be limited to barring during a certain period of time a director or executive from managing a business.

Finally, criminal sanctions may be imposed, to a director or executive who has, for example, attempted to avoid or delay the commencement of a Restructuring proceeding, or who has fraudulently increased liabilities of a company, or concealed or embezzled part of the assets, or kept fictitious or incomplete accounts.

The Management of any enterprise is therefore encouraged to commence collective proceedings as early as possible to avoid possible sanctions, and, at the same time to benefit from, certain protective measures set forth in the law.

On a more general consideration, sanctions against management should be based on a «bonus-malus» principle. Diligent directors and executives should not be sanctioned so as to be able to resume new business activities.

[23] *Articles L. 651-1 et seq. of the Code de commerce.*
[24] *Articles L. 653-2 et seq. of the Code de commerce.*

For example, is it necessary to resort to criminal sanctions for a failure to declare a state of suspension of payments (état de cessation des paiements), as is currently the case in Germany?

At the same time, appropriate sanctions must exist for directors or executives who have personally caused a company to become bankrupt. A general consultation should certainly take place on this overall subject matter.

# *ANNEX 1*

*Members of the Working Group*

## MEMBERS OF THE WORKING GROUP

The "Non-bank Enterprise Failures" Working Group has the following members:

- **Claire Favre**, Honorary President of the *Chambre Commerciale de la Cour de Cassation* and Vice-President of the *Autorité de la Concurrence* (Chair of the Working Group);
- **Reinhard Dammann**, Partner at the law firm Clifford Chance specialising in restructuring;
- **Lionel Spizzichino**, Partner at the law firm Willkie Farr & Gallagher specialising in restructuring;
- **Dominique Borde**, Partner at the law firm Paul Hastings;
- **Gérard Gardella**, Secretary General of the *Haut Comité Juridique de la Place Financière de Paris* and formerly a judge and Head of Legal Affairs at Société Générale Group;
- **Jean-François Biard**, former investment banker and consultant;
- **Matthieu Luneau**, Associate of the law firm Bredin Prat;

With the participation of:

- representatives of the **French Treasury Department**;
- and representatives of the **Central Administration of the French Ministry of Justice**.

# *ANNEX 2*

*List of persons interviewed by the Working Group*

# LIST OF PERSONS INTERVIEWED BY THE WORKING GROUP

In order to draw up its report and make recommendations, the Working Group talked to a number specialists to get their viewpoints and hear their assessment of the state of the French corporate insolvency system and a possible proposal for a common resolution system to deal with difficulties at the EU level.

The Working Group interviewed:

- **Franck Gentin**, Presiding Judge of the *Tribunal de Commerce de Paris*;
- **Marc Sénéchal**, Official Receiver and Professor at the Panthéon-Sorbonne University;
- **Marie-Hélène Huertas**, President of the *Association Française en Faveur de l'Institution Consulaire* (AFFIC - French Association for the Promotion of the Consular Institution);
- **Alain Magnan**, Head of Special Affairs at HSBC France;
- **Hélène Bourbouloux**, Official Administrator and partner of the firm FBH;
- **Jean Baron**, Official Administrator and partner of the firm CBF Associés;
- **François Xavier Lucas**, professor at the Panthéon-Sorbonne University;
- **Yves Lelièvre**, former Presiding Judge of the Commercial Court of Nanterre;
- **François Legrand**, Official Receiver and former Chairman of the *Institut Français des Praticiens des Procédures Collectives* (French Institute of Insolvency Practitioners);
- **Stéphanie Chatelon**, partner of the law firm TAJ, Deloitte Group;
- **Jean-Pascal Beauchamp**, chartered accountant, Head of Deloitte's Financial Restructuring Department;
- **Thierry Météyé**, Head of the *Union nationale interprofessionnelle pour l'emploi dans l'industrie et le commerce* (UNEDIC - French National Professional Union for Employment in Industry and Trade) delegation of the *Association pour la gestion du régime de Garantie des Créances des Salariés* (AGS - French Wage Guarantee Insurance Association);
- **Sophie Vermeille**, Associate of the law firm DLA Piper and founder of the *Institut Droit & Croissance* (Rules for Growth Institute).