

**Isabelle Didier**

**The use of *ad hoc* mandate as a risk-control tool**

**Facts:**

X, a joint-venture company created by two companies of different nationalities, and the industrial operation of which was bleeding red ink, called on us to contemplate a restructuring. That company's operation was making large losses and it was difficult to determine whether in-depth restructuring would have allowed it to be profitable. It was even uncertain whether maintaining its production in a country with high labour costs was viable. In addition, a history of relations between shareholders impeded decision-making. We were accordingly asked to support the management in selecting an appropriate restructuring procedure.

After discussions with the company's management and their advisers, an application to the Nanterre Commercial Court for the opening of an *ad hoc* mandate was decided upon. This procedure allowed the company concerned to make room for discussion under the Court's benevolent gaze, while providing time to consider the prospects for the redeployment of operations.

In connection with the *ad hoc* mandate, we supported the management of the company concerned in order to restore dialogue between the two main shareholders. In addition, a strategic consultancy intervened to perform an audit of production costs and of the economic viability of that operation in Europe.

The latent liabilities, amounting to some EUR 180 M, broke down as follows: 60% of intercompany current account, 20% of debt to one of the indirect shareholders, 20% to third-party suppliers.

At the time, the various scenarios for an exit from the *ad hoc* mandate were:

- refinancing of the company to proceed with operation after restructuring;
- filing for bankruptcy and reorganisation in order to obtain a moratorium from certain creditors and assistance from the salary-guarantee funds in connection with a lay-off plan;
- amicable liquidation;
- judicial liquidation.

The issues to be resolved then were the following:

- negotiation of liabilities with the various creditors;
- financing of the restructuring plan, including in particular the various lay-off plans in all the countries where the company was established;
- negotiation between founding shareholders regarding their respective contributions to the restructuring effort;

- maintenance of operation to preserve the value of assets and remain on the market at a seasonal peak time in order also to facilitate a restoration of business;
- maintenance of the trademark licence for the purpose of continued operation, on the basis of an offshore business model.

*Ad hoc* mandate proceedings were accordingly opened with a concern to demonstrate the management's sense of responsibility and in order to initiate a period of discussion with the creditors.

### **1) Minimum requirement: the absence of cessation of payments**

The company had not ceased payments when it was decided to make it enter an *ad hoc* mandate. This was an essential pre-requisite as the purpose of an *ad hoc* mandate is precisely to preempt and settle certain events which could in fact cause difficulties that could subsequently compel "subjection" to judicial insolvency proceedings: otherwise, the company would have been compelled to file for bankruptcy and insolvency proceedings.

This absence of cessation of payments was owing mainly to the fact that a major part of intercompany debt was not due.

### **2) Specific structure of liabilities: marginal third-party debt**

Less than 20% of the total liabilities related to supplier debt. Accordingly, the margin for negotiation relied on a lesser effort from suppliers compared with the shareholders' and intercompany suppliers', which was a major element in support of the *ad hoc* mandate's success and the development of a salutary protocol.

The managers' liability accordingly lay in a marginal amount and the management decisions made during the *ad hoc* mandate proceedings. In addition, a majority of the supplier creditors to be dealt with were strategic partners for the entire group, leading almost to an obligation to satisfy a large portion of those claims.

### **3) *Ad hoc* mandate, the background for amicable negotiation**

Article 611-3 lays down the general rules for the *ad hoc* mandate procedure.

The *ad hoc* mandate is suited to the spirit of the Company Rescue Act: control of the restructuring process and the related negotiations is left to the debtor and its advisers, subject to regular disclosure to the Court and compliance with essential principles of law.

This accordingly appears to be a highly effective tool, appreciated by both creditors and debtors. An *ad hoc* mandate allows freedom of negotiation without intrusive involvement of the judiciary, and

with the attraction of confidentiality in relation to third parties. In addition, this procedure has the advantage of not alarming the company's creditors, owing to the forward-looking nature of the system which allows negotiation without the pressure of time, thereby securing a measure of calm in the process. The creditor is freed of the unpleasant feeling of having to give up part of his rights owing to destitution of the contracting-party debtor, through being cornered as is often the case in insolvency proceedings.

Owing to its flexibility, this procedure usually works upstream of all others. The legislature retained the very extensive freedom allowed to the parties (debtor, creditors, contracting parties, auxiliary officer) in order to allow them, in complete discretion, to achieve an agreement putting an end to the company's difficulties.

The responsibility of each party, intervening freely and spontaneously in the proceedings, is the key to negotiations. The debtor is only required to report on a regular basis to the judge in charge of preventive proceedings regarding the progress of discussions before applying for conversion of the *ad hoc* mandate into another form of proceedings.

#### **4) Observance of certain mandatory principles**

An *ad hoc* mandate does not remove all risks of liability. They are connected mainly with observance of the general principles of insolvency proceedings, including in particular the equal treatment of creditors and the lawfulness of certain action taken during the so-called "suspicious period" in the event of a subsequent cessation of payments.

- **The concept of a suspicious period.** As an *ad hoc* mandate may be extended as long as necessary, its duration is theoretically unlimited. If cessation of payments occurs during the *ad hoc* mandate, the debtor is required to file for bankruptcy immediately. The concept of a suspicious period then comes into play, allowing certain creditors to call into question transactions which are essential to the restructuring (redefinition of operational limits, realisation of assets, establishment of security interests, etc.). This principle accordingly allows the Court to invalidate any major decision made during a period starting 18 months before the cessation of payments. This option for the Court thereby creates a period of uncertainty regarding many transactions carried out as long as no rescue agreement or plan has been signed, which is always the case during the term of an *ad hoc* mandate, since no approval procedure is provided for with respect to the *ad hoc* mandate in the strict sense: major decisions for sales of assets or payments are subject to censure. In the case in point, one subsidiary of the distressed company was sold to the parent company in consideration of the latter's forgiveness of a current-account claim. This subsidiary was valued by an independent auditor. The amount of the debt waived in consideration of the stock was slightly in excess of the subsidiary's average estimated value. This transaction accordingly involves a dual risk: Is the amount sufficient? Since the transaction has been completed, in the event of avoidance, the parent company could be required to pay for the subsidiary's stock in cash, involving a cash-management risk for the parent and therefore for the entire group. In addition, the other creditors might assert a preferential payment since the amount of the claim waived by the parent company corresponds

roughly to the subsidiary's value. If the other creditors subsequently see their claims satisfied only to the extent of 70%, this may cause difficulties and therefore locks the management into less leeway in relation to third parties. Thus, despite the management's good faith and the independent valuation, a measure of uncertainty remains with respect to the validation of certain acts of management.

- **Negotiation with non-group creditors.** One of the great advantages of an *ad hoc* mandate is the flexibility allowed to the debtor in negotiating with the creditors. If cessation of payments does not occur, the debtor can take as much time as it likes to achieve a plan for settlement of its liabilities. On the other hand, it is required to comply with the principle of equal treatment among the creditors. For this purpose, the debtor must create categories of creditors. Observance of the principle of equal treatment is evaluated within each of these categories.

- **Temporary continuation of operations.** Pursuant to *ad hoc* mandate proceedings, the debtor may naturally continue to engage in normal operations. On the other hand, it must take care not to worsen the shortfall in addition to the expected difficulties on which the application for the *ad hoc* mandate was based. In return, the debtor may not apply for a stay of proceedings by creditors.

### **Conclusion**

Starting from the premise that nothing effective can be done without the creditors' consent, an *ad hoc* mandate is a highly effective tool as it creates a feeling of relative trust by proving that the debtor is assuming its management liabilities in advance. This creates a positive atmosphere preventing any worsening in the situation. This procedure's flexibility accordingly makes it a preamble to all other pre-insolvency proceedings and to insolvency proceedings as a whole, provided that cessation of payment does not occur within the estimated duration of the procedure.