INSOLVENCY À LA FRANÇAISE

France Gets Fast Track Restructuring Law

By
Reinhard Dammann
Clifford Chance Europe LLP
Paris

June 21-22, 2012
France gets ‘fast track’ restructuring law

Since the creation of the safeguard procedure (sauvegarde) in 2005, French insolvency law has occasionally been amended in order to draw the lessons resulting from landmark cases. The French government is determined to make sure that practitioners have efficient legal tools to deal with complex restructurings, so that they will not be tempted to "relocate" such matters to other European member states such as the UK.

By Reinhard Dammann, a partner, and Gilles Podeur, a lawyer, in the Paris office of Clifford Chance.

The latest reform to the safeguard procedure was enacted on October 22, 2010. It is intended to address some of the key issues that were faced by insolvency practitioners in the recent restructuring of Technicolor SA (formerly Thomson), a French listed company.

Some features of the existing safeguard procedure have been amended, in particular by inserting a provision whereby restructuring plans must "take into account" subordination agreements.

However, the key point of this reform is the creation of an "accelerated financial safeguard procedure" which will become available to debtors from 1st March, 2011.

This procedure derives from the ordinary safeguard procedure, but it is more adapted to situations where (i) a large majority of the financial creditors would accept the debtor’s proposal, but (ii) on the other hand, a minority of creditors block the negotiations, for any reasons (e.g. the debtor simply cannot identify them; or they try to improve their position through their nuisance value; or they are covered by CDS and therefore have no interest in accepting a restructuring).

For example, in the case of Technicolor SA, a large majority of the banks and bondholders had accepted the debtor’s proposals, but reaching unanimous consent was impossible. The company had no choice but to impose its restructuring on the minority of the creditors that either could not be identified or rejected the proposals.

The main drawback of the ordinary safeguard procedure is that it always has an impact on all creditors, including suppliers: in the case of Technicolor, their receivables remained "frozen" from the opening of the procedure until the adoption of the plan (i.e. approximately 2 months) although their position was supposed to remain unaffected under the draft safeguard plan.

Thanks to the new "accelerated financial safeguard procedure", it will now be possible for the debtor to initiate a safeguard procedure whose effects will be circumscribed to "financial creditors", i.e. banks, "assimilated entities", and bondholders. Only their claims will be frozen during the procedure and restructured in the court-approved "safeguard plan".

The law provides that the procedure cannot take more than a month from the opening of the procedure (with a possible extension of a further month), which is much shorter than that of most "ordinary" safeguard procedures, which generally take between 6 and 12 months.

The law also provides that this procedure cannot be initiated unless the debtor has first started a confidential "conciliation procedure", under the aegis of a court-appointed mediator, and is capable to prove that the draft restructuring plan has a good chance of being approved by a majority of two thirds of the claims in each of the creditors’ committees (i.e. (i) the committee of financial institutions and assimilated entities and (ii) the committee of bondholders, if any).

Comment

Pre-packs introduced to stop the abuse of sauvegarde

International financial investors should be delighted that France’s new fast-track procedure, ‘sauvegarde financier accélérée’ (AFS) described above, will enable pre-packs and bring further predictability to large restructurings in that country.

Christine Lagarde, France’s Minister of Economic Affairs, introduced the AFS as a quick fix after a couple of high profile sauvegarde cases threatened to bring the insolvency law into disrepute; Alcoholic drinks group Belvedere, and Coeur Défense, a CMBS structure based on the biggest office block in Paris.

The AFS will enable ‘pre-pack’ insolvencies in France, and is especially aimed at LBOs where financial creditors want to engineer a swift restructuring. Under the existing sauvegarde procedure, it only takes a vote of two thirds of creditors to force the plan through and cram down any recalcitrant parties. To this, the AFS adds the bonus of only applying to financial creditors, leaving payments to suppliers untouched. Under the AFS, therefore, suppliers don’t have to be consulted.

It also only affects those financial creditors whose debts are modified by the procedure. This is important. If, for instance, a group of bondholders have formed a ‘hold-out’ position, they can be ignored simply by not including their class of bonds in the pre-pack proposal.

Antonin Besse, from Freshfields Bruckhaus Deringer in Paris, welcomes the AFS: "It’s a good idea. But it would have been very helpful to reform the voting system (for sauvegarde) as well."

The existing sauvegarde law calls for three separate committees to vote on the plan; one

Continued on page 7
The inter-creditor battle rages on; Restructuring in Europe in 2011

The London office of Latham & Watkins held its annual restructuring conference before Christmas, where an audience of hedge fund managers, investment bankers and financial advisers debated the year ahead. Attendees were then polled on their conclusions for 2011, and these are the results.

1. Which market factor has been most different - and has had the most impact - in this restructuring cycle as compared to previous cycles?

   Too much leverage
   45%

   More opportunist investors looking for “loan to own” opportunities or similar
   5%

   Creditors/shareholders challenges to the restructuring process
   3%

   Capital structures significantly more complex than in the past
   47%

The most surprising result perhaps to the first question was number 2 – only five per cent of attendees thought that the biggest impact this time around was from ‘loan to own’ investors.

As John Houghton, head of restructuring at Latham & Watkins’s London office, commented afterwards:

“Debt is not trading in the quantities that the distressed investors require to take control.”

And even fewer, three per cent, opted for creditor or shareholder challenges to the restructuring process; IMO Carwash and European Directories are two recent examples.

“You’ve only had one substantial challenge a year so far which has ended up in court,” says Houghton, “so it hasn’t shaken the world.”

The big winners are too much leverage and more complex capital structures. A good example of both these factors at work would be Wind Hellas.

2. Do you foresee the number of restructurings to be;

   Around the same number as 2010
   30%

   Significantly increasing, starting in the first half of 2011
   6%

   Significantly increasing, but starting in the second half of 2011
   41%

   A decrease on 2010 numbers
   23%

Houghton reckons the most significant result here is that nearly a quarter of attendees thought that there would be a decrease in restructurings. “I agree with that,” says Houghton. One of the financial adviser panelists told the conference: “Go on holidays in the first half of 2011.”

As for current activity, some hedge funds are chasing sovereign debt situations such as Iceland, Houghton adds, while the aftermath of the Icelandic financial meltdown continues with various bank meetings. There is a relatively low level of trading in LBO debt and loan-to-own activity generally, he concludes.

3. Do you foresee more European situations being restructured through US Chapter 11, where possible?

   Yes
   51%

   No
   49%

Two recent Chapter 11 filings in the US by big European companies, Almatis and Truvo, might suggest that this is a wave of the future; the meeting was split roughly half and half on this question. The filing by Almatis did not necessarily deliver the result planned by the company’s senior creditors, and what people want above all from a restructuring process is predictability, says Houghton. For this reason, European Chapter 11s may not take off.

4. What market factor will most account for an increase in restructurings in 2011?

   Wall of maturing debt
   17%

   Capital structures have been patched up and operational turnarounds have been ignored
   17%

   General economic conditions will continue to worsen hitting particular sectors
   13%

   All of the above and more
   53%

Given the level of economic uncertainty in the world, such as sovereign debt problems in the Eurozone and inflationary pressures in the UK to name but two, it is not surprising that around half the participants answered “all the above and more”.

The ‘wall of maturing debt’ story has been pointed to by restructuring people for some time as likely to drive more activity, but when? Houghton suspects it may only come into play in 2012-14. The recovering high yield market has also filled some of the hole so far.

The second point will interest operational turnaround managers, who have complained since the credit crunch first broke in 2008 that nobody seems to want to pay to improve businesses, preferring to apply financial ‘quick fixes’ which merely put off the day of reckoning and produce ‘zombie’ businesses.

One recent example of this is German aluminium company Honsel, which filed for insolvency in October, only 15 months after a restructuring which saw private equity firm RHJ International take a 51 per cent stake in the company for 50 million euro. In retrospect it looks like an operational turnaround was not delivered in tandem with the financial restructuring at Honsel, which continued to make “significant operating losses”. These losses eventually forced the company to file.

One emerging consensus, if a cautious one, is that the UK has escaped a ‘double dip’ so far, and the Coalition Government’s plans to rein in the deficit remain roughly on track. This continued on page 7
may explain the low score for factor number three, which might have got a very different response in Ireland or Spain, for instance.

5. In terms of market liquidity, will we see more bank debt available for re-financing to assist the high yield markets?  
Bank debt is available now in sufficient quantum  
8%  
Liquidity will return and quickly in 2011  
7%  
Liquidity will return but only gradually through 2011  
36%  
Don't expect the bank market to return any time soon  
49%  
Houghton declares: “High yield is now central for corporate refinancing and will continue to be robust for at least the first half of 2011.”

This is just as well, considering the pessimism surrounding the banks’ ability to turn the liquidity tap back on; although Houghton also commented that “there were more bank and bond deals getting done now and that also seems set to continue in 2011.”

This begs one question; if bank lending doesn’t return any time soon, as the attendees agreed, then how will recent high yield deals be restructured in the coming years?

6. What is the future for the mezzanine financing market?  
It’s not coming back for a while - the inter-creditor debate will not be resolved any time soon  
21%  
It will come back, but not to a significant degree  
36%  
We will see it return in 2011 as sponsors and senior lenders need subordinated debt and the inter-creditor debate is already being advanced  
43%  

This point is linked to the last one; the feeling of the meeting was one of guarded optimism that sponsors, senior and mezzanine creditors will be able to resolve their differences in future restructurings, not least because of progress in new inter-creditor agreements recently introduced by the Loan Market Association (LMA).

The new LMA inter-creditor agreement  
The model inter-creditor agreement launched recently by the Loan Markets Association (LMA) has been at the centre of restructuring advisers’ attention.

It was drafted by Clifford Chance and negotiated by leveraged finance lawyers. The restructuring processes of IOM Carwash and European Directories saw junior creditors trying to build in defences. The European Directories challenge was defeated (see page 4) but Houghton warns that the subject of release clauses is not gone and forgotten. “There are many different permutations of release clause out there and European Directories only dealt with one facet of one particular style of release clause.

“I would not assume that there will be no debates over the effectiveness of release clauses in 2011,” says Houghton.

The original sauvegarde law worked very well for Eurotunnel and a more recent case, Technicolor (previously Thomson). But it did not work so well for two restructurings which are still stumbling on, Belvedere and Coeur Défense.

Belvedere not a pretty sight  
The long-drawn-out restructuring of the world’s seventh-biggest maker of vodka, Belvedere, which has 550 million euro of debt, has focused criticism by insolvency practitioners and international creditors on the perceived inadequacies of France’s original sauvegarde procedure.

The latest round came on 10 January this year when a group of Floating Rate Note (FRN) holders representing debt of 375 million euro launched legal proceedings against Belvedere via their representative, The Bank of New York Mellon, alleging a “flagrant breach of a conservation plan” negotiated under a sauvegarde procedure filed in July 2008.

Last September the company said that a ruling by a court in Dijon meant it no longer had to pay interest on an FRN maturing in 2013, and that therefore it was revising an asset-sale calendar previously negotiated with creditors under its sauvegarde plan.

Creditors have been at loggerheads with the company ever since it filed for sauvegarde. They voted down its original proposals, so the court by default rescheduled Belvedere’s debts over ten years – a key failing of the law, according to many creditors.

“The company was able to put a gun to the creditors’ heads,” says one practitioner. “It’s a completely crazy situation.”

Creditors have tried to put the group’s Polish subsidiary into insolvency, without success.

Coeur Défense loses its sauvegarde  
The skyscraper complex in central Paris was symbolic of the French capital’s success as a financial centre when Lehman Brothers bought a majority stake for 2.1 billion euro in 2007. The deal was financed by a CMBS structure worth 1.5 billion euro.

When Lehman collapsed soon after, the CMBS had to find an alternative counterparty, which it found impossible due to the freezing of the credit markets. Sensibly, the CMBS was put into sauvegarde, which came as a shock to many investors, who had assumed the French insolvency law did not apply to special purpose vehicles (SPVs).

Crucially, the CMBS did not put forward an adequate restructuring plan, leaving the court to spread repayments out over ten years. In February 2009 the Paris Court of Appeal ruled that the sauvegarde filing was not appropriate and terminated it, to the surprise of many of those involved.

The Court said that sauvegarde should only be available to companies in real financial difficulties, not just those seeking to renegotiate their covenants and the like.

While the decision reassured international creditors, it raised another big question mark over the sauvegarde procedure. The French Government hopes the AFS will answer many of these questions.