French insolvency reforms aim to help businesses

Paul Omar assesses the forthcoming reforms to the insolvency law framework, introduced as part of plans to improve the general business infrastructure and to help businesses in the current economic climate

In France, a new insolvency law framework was brought in by Law no. 2005-845 of 26 July 2005. The effect was to introduce an anticipatory rescue procedure called preservation (*sauvegarde*), which was partly inspired by Chapter 11. Modifications were also made to the other pre-existing insolvency procedures of judicial rescue (*redressement judiciaire*), liquidation and conciliation. Now, less than three years after the law came into force on 1 January 2006, proposals have been issued that will see changes to insolvency law in early 2009. In fact, Article 74 of the Law of 2008 (Law no. 2008-676 of 4 August 2008 (titled "On the Modernisation of the Economy") takes the extraordinary step of authorising the French Government to legislate by way of ordinance, as the exceptional powers in Article 38 of the Constitution permit, within six months of the date the law was published (5 August). A further law will also be submitted in due course to Parliament for the purposes of approving the ordinance.

The scope of the reforms

As the Constitution requires, Article 74 sets out quite clearly the scope of the reforms the Government may undertake. These include clarifying and improving the framework for conciliation so as to encourage recourse to the procedure, improving preservation by relaxing the conditions for access to the procedure, enhancing debtor's rights as well as improving the conditions for business reorganisation so as to encourage early recourse to procedures for treating business difficulties. Further clauses will permit improvements to the rules for the composition and running of the creditors committees and bondholder assemblies within preservation and judicial rescue, the clarification and reordering of some of the rules of judicial rescue so as to improve their effectiveness and their co-ordination with the changes to the preservation procedure. In liquidation, the proposals will also complete and delineate the rules governing the procedure to improve its functioning as well as enhance the rights of secured creditors, while encouraging recourse to simplified liquidation proceedings by relaxing its use and requiring, in certain cases, compulsory recourse to this type of proceedings. Also, the sale of businesses as well as share transfers in liquidation will be encouraged and improved.

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Related reforms will adapt the legal framework for ongoing contracts to the needs of each procedure, simplify the framework for post-commencement debts and reduce the differences between the rules applicable to different proceedings. Furthermore, the changes will seek to enhance the efficiency of security, notably the use of the trust (*fiducie*) and charges over movables without dispossession (*gage sans dépossession*), within liquidation and to extend their effect to the preservation and judicial rescue procedures. The insolvency law framework will also be updated to take into account related legislative provisions in the areas of execution over real property (*saisie immobilière*) and security.

A number of the proposals are more general and seek to recalibrate the overall framework of insolvency law. For example, the coherence of financial, professional and criminal sanctions in the case of insolvency proceedings will be updated and reinforced, while the discounting of penalties and costs of prosecution currently available in cases of judicial rescue or liquidation will be extended to preservation. Further improvements will occur to the general procedural framework of insolvency law and the role of the Public Prosecutor (*ministère public*) will be reinforced with rights of appeal at various stages of the procedure being enhanced. There will also be improvements to the co-ordination between the provisions of insolvency law and the rules governing insolvency practice for the purposes of clarifying the law as well as to open up the possibility for the appointment of persons not currently enrolled on the lists of judicial administrators or nominees. Finally, the scope of insolvency law will be widened by permitting persons exercising a craft activity, who are normally exempted from enrolment on the register of professions, to benefit from preservation, judicial rescue or liquidation proceedings.

The effect of the proposals

To understand the scope of the reforms, reference can be made to a draft ordinance that was published on 27 March 2008, in which some 150 or so articles cover the areas contained in Article 74 and flesh out some of the detail of the proposals. The intention is apparently to ensure that each of the procedures currently existing in French law is rendered more efficient. In broad terms, conciliation will become subject to notification to the Public Prosecutor's office and will come to an end after a year if no demand for court recognition of the arrangement is made. In addition, further conciliation proceedings within 12 months of the first will not be permitted. In relation to preservation, the condition for access to the procedure will no longer require the debtor to demonstrate financial difficulties, while changes will reduce some procedural requirements and further enhance the debtor-in-possession concept enshrined in preservation, with the (optional) administrator taking less prominence in proceedings unless the Public Prosecutor makes a request to that effect.

In judicial rescue, a change to the definition of cessation of payments (*cessation de paiements*) will allow a debtor to contest a creditor's petition where reserves or agreed moratoria exist. The changes to the functioning of the creditors' committees in both preservation and judicial rescue will define the majorities required (two-thirds), how debts are defined for the purposes of eligibility and the reduction of the thresholds required for membership. As for liquidation, the emphasis will move to simplified proceedings and to allow, where necessary, for the continuation of ongoing contracts. The articulation between the various procedures will also be clarified with, for example, a further judicial rescue procedure following an unsuccessful preservation or judicial rescue hearing being permitted (unlike at present, when judicial liquidation must ensue). A review will also take place of the powers enjoyed by the Public Prosecutor, which may change to include the possibility of appealing against a conciliation agreement and suggesting to a court the appointment of a particular administrator or liquidator. Finally, the overall articulation of insolvency law with other laws will be reviewed, in particular its relationship to the reforms effected to asset-security law by the Ordinance of 2006 (no. 2006-346 of 23 March 2006) and trust law by the Law of 2007 (no. 2007-211 of 19 February 2007).

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Assessing the proposed changes

Given the relatively recent introduction of the Law of 2005, the breadth of the proposed amendments may strike the observer as quite a serious reform to undertake within such a short period. The Villepin Government under President Chirac clearly had a mission to improve the general business infrastructure, of which the reform of insolvency law in 2005 was clearly seen as a component. The ongoing reform initiative that President Sarkozy inherited upon his election in 2007 has now coincided with the present financial crisis and its further deleterious impact on business. In fact, a study reported in the Libération newspaper on 21 October 2008 reveals an average 17% increase in the number of insolvencies in the third quarter of 2008 with property and estate agencies showing the highest progressions (55% and 87% respectively). In this light, the further revisions to the legal framework that have started to occur are understandable, including those in the Law of 2008, which actually contains extensive reforms to tax, social security, employment and company laws in a bid to further encourage enterprise.

The proposed reforms to insolvency are also seen as a key element of this strategy and were referred to as such in an address on 6 September 2007 by President Sarkozy to a gathering at the Paris Commercial Court celebrating the bicentenary of the Commercial Code. Concerns over the apparent underutilisation of the preservation procedure are also referred to in a letter by the President directing the scope of the reforms, in which the preservation procedure is referred to as a "partial innovation" and which sees further reforms, to be inspired in part by Chapter 11, as necessary to encourage entrepreneurs to "develop initiative and the taste for risk". Nonetheless, comments on the draft ordinance indicate that business opinion is divided on the content of the reforms, with the Paris Chamber of Commerce and Industry in particular suggesting reconsideration of the proposals in some detail. Nonetheless, it will be interesting to see the final outcome of the reforms, which may well be imminent, and the shape they will ultimately take.

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