French Insolvency Law: 
Remodelling the 
Reforms of 2005

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Introduction

The search for an insolvency law that is capable of dealing with the phenomenon of business failures is a perennial one. The fact that the number of such failures grows as economic times worsen prompts the need for an effective insolvency framework that can cope with the demand, in turn providing legislators with the motivation for action to reform insolvency texts seen as falling short of the ideal. In France, the cyclical effect of the economy on firms and the calls by business for action to reform insolvency texts seen as falling short of the ideal. In France, the cyclical effect of the economy on firms and the calls by business

focus on rescue was determined by the policy statement contained in its art.3, where the main purposes of rescue proceedings were set out as being the rescue of the firm, the continuation of business activity and employment and, finally, the settlement of debts. Although the reality of liquidation for many companies meant that the Law of 1985 also had to make provision for this type of proceeding (called liquidation judiciaire), the twin-track approach of focusing on distinguishing between rescuable businesses and those that had to be liquidated, with the priority being given to “judicial rescue” (redressement judiciaire), first instituted in the Law of 1967, appeared destined to remain supreme in French law. The Law of 2005, however, although it made many modifications to all insolvency procedures and some incidental rules, accentuated the importance of rescue further by introducing a further rescue procedure called “preservation” (sauvegarde). Constructed as a hybrid between the American Ch.11 model and the existing judicial rescue proceeding, preservation was hailed as a panacea for the ills of French business. The drafting technique chosen to introduce the procedure was curious. It grafted the provisions dealing with preservation onto the then existing section containing judicial rescue, with considerable amendments being made to the text, and created a new short section of some nine articles to deal with judicial rescue, with references being made back to preservation rules in the case of common stipulations. The net result of this is that two rescue-type procedures exist side by side in the Commercial Code (as amended by the Law of 2005).

The essential differences between the two procedures are twofold: the first being the qualification for entry to the procedures, dependent on whether the debtor is in a state of cessation of payments (cessation de paiements), the usual

10. For the importance of this concept, see, by this author, “Defining Insolvency: The Evolution of the Concept of ‘Cession de Paiements’ in French Law” [2005] 2 E.B.L.R. 311.
termed an “anticipatory rescue procedure”.¹² The abilities and, for that reason, preservation has been termed an “anticipatory rescue procedure”.

The court must convert this procedure to one of judicial rescue, which in substance will run along similar lines. The effect is to shift the emphasis from the management to the helm and steer the business through the financial difficulties being experienced with the end result being the conclusion of a rescue plan of the continuation type.¹³ Furthermore, in the Law of 2005, the conception of preservation as a debtor-in-possession procedure permitting the management to stay at the helm and steer the business through the financial difficulties being experienced with the end result being the conclusion of a rescue plan of the continuation type.¹³

Where cessation of payments has occurred, the court must convert this procedure to one of judicial rescue, which in substance will run along similar lines. The effect is to shift the emphasis from the management to the helm and steer the business through the financial difficulties being experienced with the end result being the conclusion of a rescue plan of the continuation type.¹³

The many perceived benefits of preservation made it seem as if the quest for a sound procedure capable of meeting the increasing demands of French business in the grip of a worsening financial situation that has lately manifested itself as a full-blown financial crisis. However, the statistics have not revealed a massive take-up of the institution, given that about 600 procedures have been opened annually since the Law of 2005 came into force on January 1, 2006.¹⁴ Although the statistics may not be entirely significant, comparisons can be made to conciliation and ad hoc mandates, where some 2,500 procedures are reported annually, an increase from 1,500 procedures before the entry of the law into force.¹⁵

One suggestion of the relative importance of the more informal procedures is that the obligatory publicity for preservation is seen as an impediment by company directors keen to preserve the anonymity of what are sensitive negotiations with creditors.¹⁶

Furthermore, the criterion by which preservation is adjudged has received the attention of the Supreme Court, which has qualified the meaning of “insurmountable” and given it a restrictive interpretation, a factor that has led to calls for a more liberal interpretation or, alternatively, the setting up of specialist “preservation” courts, in which the needs of businesses may be properly assessed.¹⁷ In addition, the statistics can be set against the general context, in which 2008 saw a massive increase of insolvency procedures being initiated (noted below). Against this background, the slow trickle of preservation procedures may seem disappointing, although Montéran describes the procedure as having reached its “cruising speed”.¹⁸ Concerns about the slow take up of preservation have reached the highest quarters, with President Sarkozy referring to the need to improve its functioning, attributing the problem with the procedure to it being a “partial innovation” that was only being “partially used”.¹⁹ As a result of this speech, less than three years after the law came into force on January 1, 2006, proposals have been issued that will see changes to insolvency law in early 2009.

The scope of the reforms

The proposals have taken the form of a draft law (noted below) as well as the Law of 2008,²⁰ whose art.74 takes the extraordinary step of authorising the French Government to legislate by way of ordinance, as the exceptional powers in art.38 of the Constitution permit, within six months of the date the law was published in the Official Gazette du Palais, January 24, 2008, no.24, p.3.

¹³. One of two options under the Law of 1985, the other being the sales plan, the idea now being that encouraging continuation plans (with limited possibilities for the sale of viable units) will push directors of potentially insolvent companies to seek early help without fearing the possibility of their companies being sold out of their hands.
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 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 Explanatory Memorandum accompanying the law illustrates the reasons why the law has been framed in this way. The note on art.19 (as the provision was numbered in the draft law submitted to the National Assembly on April 28, 2008) suggest that for the two years after the Law of 2005 came into force, practitioners reported difficulties with the procedure, perhaps along the lines of those noted by Monséry-Bon and Saint-Alary-Houin, leading to lacunae being revealed and the efficiency of the procedure being doubted. The purpose of the Law of 2008 is thus stated as being to reinforce the attractiveness of the procedure so as to encourage its use. This will be achieved through a more flexible approach to the pre-condition for entry to proceedings and ensuring the primacy of the managers of the business in the administration and reorganisation of the firm, thus incidentally reinforcing the debtor-in-possession concept at the root of the innovation introduced by preservation.

Other adjustments to preservation will include encouragement for the emergence of a distinct rescue plan framework specifically adapted to preservation proceedings and taking into account the role of the creditors’ committees, whose functioning thus far in the proceedings seen

24. One of the issues identified around the 2006 reforms to asset-security law was the lack of co-ordination with insolvency legislation, for which see P.-M. Le Corre, “Les incidences de la réforme du droit des sûretés sur les créanciers confrontés aux procédures collectives”, JCP La Semaine Juridique, Ed. É., 2007 no.1185, p.24.
before courts has been limited. The distinctiveness of preservation and conciliation will also be underlined so as not to remove the attractiveness of the latter institution, while changes to the liquidation procedure to further simplify its operations and permit the sales of assets and any viable units to occur relatively simply.

The effect of the proposals

To understand the scope of the reforms, however, one must enter into the detail and reference can be made to a draft ordinance that was published on March 27, 2008, in which some 150 or so articles cover the areas contained in art.74 and flesh out some of the elements 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 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 and trust law by the Law of 2007.

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 Chirac Government 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 October 21, 2008 reveals an average 17 per cent increase in the number of insolvencies in the third quarter of 2008 with property and estate agencies showing the highest progressions (55 per cent and 87 per cent 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 the address by President Sarkozy. Concerns over the apparent under-utilisation of the preservation procedure are also referred to in a letter by the President directing the scope of the reforms, which sees further reforms, to be inspired in part by Ch.11, as necessary to encourage entrepreneurs to “develop initiative and the taste for risk”.

Comments, nonetheless, 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. An interesting observation they make is in noting the contents of an OECD report detailing that the bankruptcy rates of firms in France in the first quarter of 2008 were the second highest in Western Europe (34 per cent), behind Ireland (44 per cent), 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.

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also appears in M.-H. Monsérité-Bon and C. Saint-Alary-Houin’s article, where it is attributed to J. Raibaut, President of the Conference of Consular Judges in France, the body representing commercial court judges.

The CCIP is of the view that reorientation towards small and medium enterprises is necessary, given that they constitute the reservoir of and opportunities for employment in most developed countries, including France. In the context of the call by the President to further emulate the apparent success of Ch.11, the CCIP notes that cultural and legal differences exist between it and preservation, the former being composed by the culture of secrecy in France, as compared to the transparency of the process in the United States, while the most important legal difference is constituted by the criterion for access to proceedings, the absence in Ch.11 for any formal entry requirement being a subject of note for the French.32

That said, for the CCIP, four main elements are necessary for the reforms to be successful. The first is a more relaxed criterion for opening proceedings, especially given the reported diversity in interpretations accorded by the courts studied in the OECD report. Two options present themselves, one being to extend to preservation the option open to businesses who may avail themselves of conciliation proceedings despite being in cessation of payments for up to 45 days, the problem with which is the tendency of many managers of firms to delay filing until the last possible moment, thus largely closing off this window of opportunity.33 The other is to retain cessation of payments as the fundamental difference between preservation and judicial rescue, while also clarifying its definition to make it more flexible in use.34

The second step for the CCIP is to introduce into preservation the procedure for exceptional redundancies available in judicial rescue, which, although canvassed as an option when the Law of 2005 was being debated before Parliament, was rejected by the then Minister for Justice (Garde des Sceaux)35 on grounds that preservation might be used as a shortcut to business reorganisation through downsizing rather than for other “more cogent” economic or financial reasons.36 The CCIP report practitioners’ views as tending to support this measure, given that the chances of rescue are enhanced, and that adequate control over the use of the exceptional redundancies procedure remains in the hands of the supervisory judge, thus avoiding any accusations that preservation could be used in a manipulative or ingenious way by entrepreneurs. Further worries that a drain on state resources is constituted by the availability of the procedure are palliated by the statistics, which reveal that the state body responsible for making redundancy payments37 has only thus far intervened in 1 preservation procedure out of every 12.37

The third of the elements is one also referred to in the Explanatory Memorandum, which looks to enhancing the role of the creditors’ committees in preservation, an institution inspired in part by similar models in use in the United Kingdom and the United States. The CCIP suggests a number of necessary changes, the first to recognise the fact of distressed debt trading and the role of hedge funds and other intermediaries in the composition of the lenders’ committee,38 the second to ensure the stability of the committee by referring membership to debts held at the moment proceedings are opened,39 and the third to recognise bondholders and their needs by constituting a separate forum for their participation in proceedings.40

The final element is to ensure that preservation proceedings are better managed in terms of their progress. One of the difficulties for the CCIP is the close resemblance of preservation to judicial rescue, given their legislative antecedents, and the tendency for courts to closely draw by analogy the rhythm of preservation on how judicial rescue progresses. Further time is necessary, in their view, for the constitution of the committees and further flexibility required for the debt-verification procedure, while the observation period, during which traditionally the health of the firm was observed and which led to a recommendation for the adoption of a rescue plan, could be shortened.41 The practice, seen especially in the United Kingdom, of “pre-packs” should also be recognised and court procedure should adjust to the reality of their use.42 In sum, representing the views of the business

34. Lit. Keeper of the Seals, the traditional title of this position.
39. Kling Report, p.9, available at http://www.ccip.fr [Accessed March 17, 2009], although the question does arise of transfers and assignments subsequent to the opening of proceedings when new and potentially undisclosed principals may have to be represented by the original debt-holders, a situation that is not ideal.
community, these recommendations appear to afford the preservation procedure a better chance of being accepted by the very companies the Government intends should use this procedure.

Summary

The Law of 2005 was seen as the product of a wide consultation exercise, given the evolution of its contents between the first draft in late 2003 and its enactment in July 2005. This is testimony to the fact that in 2002, the promise was made that insolvency law would be the subject of a new text in order to correct the negative effects in the Law of 1985, which sought at all costs to achieve rescue, with the price being paid by the creditors. Although partially resolved by the Law of 1994, the necessity of adapting procedures to economic reality meant that this process has to be pursued by re-legitimizing liquidation while streamlining it for efficiency considerations, by reaffirming rescue procedures to allow for the saving of businesses albeit in an advised manner, by underlining prevention and diagnosis to ensure that intervention occurs in good time as well as by simplifying the overall legislative framework to remove lacunae, reduce unnecessary complexities and thereby costs. The view was taken early on that the measures introduced by the Law of 2005 would have the desired effect of arresting the trend towards liquidation and of promoting an emphasis on rescue-type procedures.

The fact that new proposals have been forthcoming to further correct the perceived deficiencies of the law may seem to indicate that the vaunted purpose of the Law of 2005 has not been achieved. Nonetheless, the proposed reforms cannot be taken in isolation from the prevailing context, in which the spectre of recession, the inaptly named “credit crunch”, the appearance of large-scale insolvencies, including those of household names, have required insolvency law to be revisited and a reassessment made of its role in regulating the economy. These are all issues with which most Western European jurisdictions will have now begun to grapple. The curiosity in all this is the continued fascination with Ch.11 in France and elsewhere driven by perceptions of its efficacy, a point that even American commentators have started to doubt.

Nonetheless, the final word on these reform proposals may be left to President Sarkozy:

“The law should give to the manager of a firm the means to get going again; it should help him to recover confidence when he is faced with difficulties; it should convince him that failure is not irreversible. The vision in France of a failure that is final must come to an end.”

These are bold words, but the sentiment is palpable. Insolvency law is the means by which economic regulation is made possible in hard times. The right law that balances the circulation of assets in the economy with the need to boost and restore entrepreneurship is indispensable. France, no less than its neighbours and trading partners, is in dire need of such a law. Although difficult to predict with any certainty, it is to be hoped that the 2009 reforms, particularly if they take on board the views of the commercial judges, practitioners and the CCIP, will provide the right framework for enhancing the efficiency of French insolvency procedures.
