Preservation and Pre-Packs à la française: The Evolution of French Insolvency Law After 2005

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Corporate insolvency; France; Pre-pack administrations

Introduction

The French law of insolvency has undergone a few transformations since the modern concept of rescue was institutionalised in legislation in 1967.1 Carried forward to the mid-1980s, albeit supplemented by developments dealing with the prevention of difficulties, pre-insolvency arrangements2 and the regulation of insolvency practitioners,3 the twin-track approach of having judicial rescue (redressement judiciaire) and judicial liquidation (liquidation judiciaire) proceedings as the primary procedures applicable to insolvent debtors seemed destined to endure.4 Minor modifications intervened in the mid-1990s to redress a perceived imbalance between debtors’ and creditors’ rights.5 Thereafter, the system appeared to undergo little change as it entered the post-millennium era, apart from commercial laws as a whole, including insolvency, being re-codified in a renewed and reinvigorated Commercial Code in 2000. This may be compared with the experience elsewhere in Europe, where the ebullience in reform matters in the 1990s, largely consequent on countries in Eastern Europe updating their legislation in the wake of the end of Soviet domination and the consequent reunification of Germany, continued into the following century, with revisions being undertaken in major economic jurisdictions such as Spain and the United Kingdom. Nonetheless, this is to underestimate the pressures for reform, to which France was not immune.

In fact, as early as 1999, the Ministry of Justice had issued a preparatory orientation document (document d’orientation préparatoire), containing quite detailed substantive changes to the insolvency law framework as set out in the Laws of 1984 and 1985. These included improving the efficiency of insolvency procedures through better upstream diagnosis and prevention of financial difficulties, changes to the informal procedures for treatment of business difficulties, the proper supervision of judicial rescue plans and the simplification of judicial liquidation procedures. It was during the early part of the first decade of the 21st century that these proposals underwent a radical metamorphosis between drafts issued in 2003 and 2004 that saw the proposed changes to the then existing framework being accompanied by proposals in the latter draft for the introduction of an entirely new procedure to be called preservation (sauvegarde). Despite a constitutional challenge to the legislation that effects these changes,6 the Law of 2005 was adopted and subsequently came into force on January 1, 2006.

The post-2005 framework

The insolvency law framework in the post-2005 model was quite sophisticated and complicated. This can be illustrated by the map of procedures shown in Figure 1.

Figure 1 Post-2005 insolvency law framework

<table>
<thead>
<tr>
<th>Financial difficulties</th>
<th>Cessation of payments</th>
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<tbody>
<tr>
<td></td>
<td>(0–45 days)</td>
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<tr>
<td>Conciliation</td>
<td></td>
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<td>Preservation</td>
<td></td>
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<td></td>
<td>Judicial rescue</td>
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The essential boundary in this map is between the state of financial difficulties and the fact of cessation of payments (cessation de paiements), which is based on the contingent liability test for insolvency.1 Upstream rescue, represented by preservation, is available up to the point this test is satisfied, while judicial rescue or judicial liquidation are initiated as a consequence of meeting this test. Only with pre-insolvency arrangements, intended to be accessible to debtors upstream of formal insolvency,

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2 Formerly called amicable settlement (règlement amiable), later renamed conciliation (conciliation).
4 Alongside these measures was the institution of the ad hoc mandate (mandat ad hoc), essentially a device to permit the court to appoint on an informal basis an individual to carry out a diagnosis of the business’s problems and to attempt a solution if one could be found.
7 For a discussion of this concept, see P. Omar, “Defining Insolvency: The Evolution of the Concept of ‘Cessation de Paiements’ in French Law” (2005) 2 E.B.L.R. 311.
is there a derogation with its being available to debtors for a limited period of 45 days after formal cessation of payments.  

Preservation was the core of the 2005 reforms. It was designed as an improvement of the existing judicial rescue model with features that were inspired by the American Chapter 11 model and, in part, the UK administration procedure. It was to be made available as a form of upstream rescue prior to the formal moment of cessation of payments and was designed to encourage debtors to seek the protection it would confer without the attendant risks of personal sanctions or losing control over their business or company such as tended to be imposed automatically as consequences of the opening of judicial rescue. In fact, judicial rescue too was reformed along the lines of preservation, with the provisions dealing with preservation being made applicable, mutatis mutandis, to judicial rescue. The two major differences between the procedures were thus based on the finding of cessation of payments as well as the application of voidable transaction rules, which would only occur in the context of judicial rescue. Preservation was conceived of as a debtor-in-possession procedure where small businesses would, under their directors or managers, steer themselves through the procedure with the benefit of an automatic moratorium and propose a plan with the assistance of creditors with a view to restructuring the business, the plan thereafter being submitted to a court for approval and for implementation. For businesses over a certain size, the secondment of an administrator to assist the debtor was at the discretion of the court, although invariably appointments were made, while plans had to be submitted to two creditors’ committees, constituted respectively of financial lenders and suppliers, with provision for voting by the creditors on the plan prior to implementation.

Much was expected of preservation, especially in the way it was hailed as an “anticipatory rescue procedure”. However, its implementation revealed problems, particularly the low take-up rate when compared to other procedures. A number of factors might have combined to make this happen. Pétel refers to the publicity the procedure gave to the difficulties experienced by the debtor and the uncertainty faced by the business managers who “mastered neither its operations nor its outcome”. In fact, when the statistics are viewed, it appears clear that about 500 procedures have been opened annually since the Law of 2005 came into force. Although the limited availability of statistics may not be entirely significant, comparisons could be made to conciliation and ad hoc mandates, which saw an increase in usage as a result of the same reforms to about 2,500 procedures annually, an increase from 1,500 procedures prior to the entry of the Law of 2005. Echoing Pétel, one explanation as to the relative importance of the more informal procedures despite the reforms promoting preservation is that the obligatory publicity for preservation was seen as an impediment by company directors keen to preserve the anonymity of what are essentially sensitive negotiations with creditors. Furthermore, the criterion on which access to preservation was based received the attention of the Supreme Court, which qualified the meaning of “insurmountable [difficulties]”, giving this a more restrictive interpretation. This was a factor that led to calls for a more liberal interpretation or, alternatively, the setting up of specialist “preservation” courts, in which the needs of businesses could be properly assessed. When set against the background of the overwhelming preponderance of judicial rescue and judicial liquidation procedures, the low use of preservation procedures seems disappointing, although Montéran described the procedure as having reached its “cruising speed”. Concern about the apparent under-utilisation of the procedure was apparently such that President Nicolas Sarkozy was motivated to refer to the need for further reforms as early as September 2007 in an address delivered to a gathering celebrating the bicentenary of the Commercial Code, in which he referred to preservation as a “partial innovation” that was only being “partially used”. Concerns over the apparent underutilisation of the procedure are also referred to in the President’s subsequent letter directing work on the reforms, in which preservation is referred to as a “partial innovation” requiring further amendments also to be inspired by the Chapter 11 model so as to encourage entrepreneurs to further “develop initiative and the taste for risk”.

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8 In practice, however, it may be difficult for this leeway to be used effectively, given that debtors may not appreciate the brevity of this period and the fact that courts have the power to backdate the moment of cessation of payments to establish, inter alia, liability for contributions.


10 The reforms provided, though, that removal of the directors could take place following a request being made by the Public Prosecutor: art.62, Law of 2005, amending art.L.626-4, Commercial Code.

11 Bondholders (obligataires) could also be required to vote on plans affecting them.


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The 2008 reforms: preservation (and other procedures) reviewed

As a result of the concerns expressed about the use of preservation, reforms were initiated in 2008 with art.74 of the Law of 200820 authorising the French Government to use the exceptional powers in art.38 of the Constitution to legislate by way of ordinance in order to reform the insolvency law framework.21 Although a period of six months from the date the law was published was provided for the reforms to occur, the Government acted speedily and produced the expected reforms by means of a text in December 2008.22 The Ordinance of 2008, at 174 articles, is based in part on a draft published on March 27, 2008,23 which makes major changes to the insolvency law framework affecting all of the insolvency procedures contained within Book 6 of the Commercial Code. The bulk of the provisions, however, address perceived deficiencies in the law relating to preservation. The Ordinance of 2008 was also accompanied by a report addressed to the President of the Republic and was later completed by regulations introduced by decree,24 which modified the regulatory sections of the Commercial Code and incidentally altered the conditions for the seizure and sale of properties.

According to the report, which was published in the Official Journal together with the Ordinance of 2008, the emphasis of the reforms is on increasing the options open to entrepreneurs faced with financial difficulties as well as enhancing the operation of the various insolvency procedures, especially those that favour negotiations with the creditors and support upstream rescue. A 2007 report presented by the National Assembly’s Commission for Laws concluded that the 2005 reforms, which introduced preservation and reshaped the other insolvency procedures, had been relatively successful, although some difficulties had been encountered by practitioners in its implementation. The need to correct these difficulties and reinforce the efficiency of the procedures overall has prompted the reforms currently being undertaken. As the report notes, the main aim of the Ordinance of 2008 is to deal with preservation so as to further encourage recourse to upstream rescue by clarifying the criterion for access to the procedure and the functioning of the creditors’ committees as well as their role in the procedure. Other procedures are also affected by the reforms, with important changes made to conciliation and judicial liquidation, while the directors’ liability regime is also the subject of some amendment.

Taking the procedures in the order they appear in the Commercial Code, the report highlights the changes that are made by the Ordinance of 2008.

Conciliation

The Ordinance of 2008 attempts to effect changes, while maintaining the essential characteristics of conciliation and the ad hoc mandate, notably their confidentiality and the amicable nature of negotiations under the supervision of a conciliator. The Ordinance of 2008 carefully adjusts jurisdictional competence between the High Court and Commercial Court in this and other procedures and will allow debtors to suggest the name of a conciliator to the court. Further changes will see stricter control over the time-limits applicable to conciliation and will exclude the time spent by the court in approving the rescue plan so that the current period of four months (with the possibility of one month’s further extension) may be used exclusively for negotiations. The reforms will also prevent a further procedure being opened within three months of the end of a first attempt at conciliation, with the Public Prosecutor’s office being given a right of appeal against any subsequent conciliation orders to safeguard the public interest. This is in order to ensure that resort to conciliation is not used as an alternative to the opening of more formal insolvency proceedings, where these would be more appropriate. The changes would also permit debtors to ask the court to agree to payment delays where, during negotiations, a creditor notifies the debtor of an outstanding account. New provisions will also deal with rescue plans notified to court that are not subject to a cram-down procedure and will align their operations on those formally adopted by order of the court. Notably, a wider definition will be introduced for those guarantors that will be able to rely on the concessions or waivers given by creditors that are included in any such plan. Finally, the court will be given the discretion, in the event of the failure of a rescue plan, to decide whether any payment delays accorded to the debtor will be removed.

Preservation

The Ordinance of 2008 simplifies the conditions for access to the procedure, now requiring the debtor to show that “[he] is in difficulties that [he] is not able to overcome”, although also retaining the requirement that the debtor not yet be in a state of “cessation of payments”, the usual criterion for the opening of formal insolvency proceedings. The intention is to reserve preservation for debtors in genuine need of upstream rescue and not, as the report puts it, to escape the usual rules of free competition on the open market. The criterion appears to be somewhat relaxed, given that the debtor is no longer required to prove that the difficulties are likely to lead to a cessation of payments in due course, proof of which being often difficult to bring with any certainty. The reforms also seek to improve the position of the managers of the business by allowing the debtor to suggest an
administrator to the courts when seeking the opening of proceedings and by permitting the debtor to carry out the inventory of assets subject to certification by an auditor.

Overlapping competences between the administrator and the debtor previously seen in the law have now been resolved, with the debtor now being given the power to ask the court for permission to carry out transactions outside the scope of management or to wind down part of the activity of the business as well as to approach the creditors with a view to substituting guarantees. The debtor is also now responsible for drafting the rescue plan, with the assistance of the administrator, and for submitting it to the creditors for approval. A further measure designed to comfort managers is the suppression of the threat of a forced removal from the business as the adoption of the rescue plan may no longer be subject to this precondition. Nonetheless, a power will be given to the court to order the conversion of preservation into judicial rescue proceedings if the adoption of a rescue plan becomes impossible and cessation of payments will occur if preservation proceedings come to an end.

As far as the creditors’ committees are concerned, the Ordinance of 2008 improves the conditions under which these institutions are designed to work within preservation. The definition of eligibility to participate in the formation of the committees has been widened to creditors beyond traditional financial institutions as well as assignees of debt, acknowledging the modern evolution of lending arrangements and the phenomenon of distressed debt trading. The threshold for participation in the committee composed of principal suppliers to the firm has also dropped from 5 per cent to 3 per cent of the total debt. The tight and cumbersome timetable for summoning the committees and requiring consideration of and voting on the plan has been removed, with the sole requirement now being that the committees meet and vote within six months of the procedure being opened. Voting on the committees has also altered with the requirement now being that the majority is now calculated according to the amount of debt held as a proportion of the total debt. The creditors will also be given a right to suggest terms for a rescue plan and plans will now be able to include a debt-equity swap element. Bondholders may also be offered the option of a debt-equity swap and their meetings will now be extended to holders of bonds issued on any market. In order to avoid excessive delays caused by the exercise of rights of appeal, the order adopting the rescue plan will now also decide on the issues raised by creditors, while creditors will be restricted to appeals against the decisions of only the committee of which they are a member. Other improvements to the preservation procedure include clarifying the priority of post-commencement finance and the expenses of the procedure.

**Judicial rescue**

Consequent on the clarification of the pre-condition for entry into preservation proceedings, the definition in judicial rescue of the cessation of payments criterion has also changed to take into account any payment delays and credit reserves the debtor may have. Calculation of the critical date when cessation of payments occurs is also improved, especially where judicial rescue has been preceded by preservation proceedings. In line with changes to preservation, the boundary of competence between the debtor and administrator has been readjusted, while the risk of the management being removed has also been lessened, although the prohibition on directors’ shares being transferred during proceedings has been widened to include shares indirectly held by them or associated persons. Finally, if a partial or complete sale of the business forms part of the rescue, the possibility of an administrator being appointed to carry out the sale has been introduced by the Ordinance of 2008.

**Judicial liquidation**

The reforms here have seen a power given to the Public Prosecutor’s office to suggest the nomination of a liquidator when proceedings are opened. Rules have been introduced to clarify the conditions under which the continuation of contracts in liquidation can occur, whether or not an order has been made authorising the continuation of business activity. A further clarification has been made, as in preservation, to the priority of post-commencement finance and the expenses of the procedure. Further changes have been made to the simplified liquidation procedure to allow for less formality and the sale by the liquidator of any of the debtor’s assets without the need for supervision by the court. The procedure for obtaining approval for a simplified procedure has also altered with the president of the court being delegated this power, previously only exercisable by the court.

The impression overall of the reforms is that they were timely, although the views of commentators tend towards accentuating the positive impact of the measures in the Ordinance of 2008. The reforms were described by Pétel as “completing” the programme of reforms undertaken by the Law of 2005 and that they served to make preservation “more attractive”. Roussel Galle suggested that, despite the pre-condition for preservation being made simpler, access to the procedure still remained “firmly hedged about”, although overall the reforms did improve preservation by increasing the powers of the directors and “guarantees as to their future”. In the wake of two major sets of reforms in 2005 and 2008, the landscape of insolvency in France seemed destined to require some time to settle down. Unfortunately, this was not to be the case, with a further modest, though momentous, reform in 2010.

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The 2010 reforms: pre-packs à la mode!

In 2010, a new insolvency tool was made available through the introduction of a new procedure called accelerated financial preservation (sauvegarde financière accélérée). Designed as a variation on the existing preservation procedure, the new procedure resulted from a package of reforms to the banking and financial sectors contained in proposals which were enacted in a 2010 text and which would be made available for use by business debtors from March 1, 2011. The new procedure is designed for the use of debtors who have been undergoing a conciliation procedure. Conciliation, which can be conducted in privacy and without adverse publicity, is normally available to debtors who are not yet in cessation of payments or who have only ceased making payments to creditors within the 45 days prior to the application being made. The main defect of conciliation is that it does not have a cram-down effect on dissenting creditors, whose claims are merely suspended for the duration of the implementation of the agreement and which revive when this comes to a close or fails for some reason. In fact, a conciliation agreement cannot be approved by the court unless it has no impact on the interests of dissenting creditors. As an alternative to conciliation, preservation was available to debtors who were not yet in a state of cessation of payments. This procedure would attract a moratorium absent in conciliation and achieve a cram-down effect through the adoption of the rescue plan by the creditors’ committees. The duration of preservation, which could last for up to 18 months, made it unattractive when compared to conciliation, which could only last for up to a maximum of five months.

The new procedure was designed to permit debtors in conciliation proceedings, but who could demonstrate the criterion for entry to preservation and who would, because of their size, be required to have creditors’ committees formed for the purposes of approving a rescue plan, to apply to court for the opening of an accelerated financial preservation procedure. This is subject to their having drafted a plan that will assure the continuation of the business and that they believe will command the support of a majority of financial creditors and, it being the case, bondholders. The court will take into account the views of the conciliator on the progress of conciliation and the likelihood of adoption of the draft plan by the relevant creditors. If the court agrees to open a procedure, it may appoint the conciliator as administrator or any other person it deems fit subject to reasons being given. Normally the same court before which conciliation proceedings are taking place will deal with the request for the opening of accelerated financial preservation proceedings. After proceedings have opened, the administrator will then summon committees of financial creditors and bondholders with the minimum notice for the meeting being eight days (reduced from the 15 days applicable to the standard preservation procedure). For the purposes of voting at the meetings, creditors will be required to prove their debts unless this has already taken place within prior conciliation proceedings. Once approval has been obtained, the court will adopt the plan, which it will normally do within a month of proceedings being opened, but may extend time up to a maximum of 60 days before giving judgment. If approval is not forthcoming, the procedure is terminated.

Given that preservation itself was designed as a hybrid of the Anglo-American approach and pre-existing judicial rescue, it is perhaps not surprising that the new accelerated financial preservation procedure also appears to draw on practice in the United States and United Kingdom with regard to pre-pack procedures, which are not without their criticisms. Experience in practice in France has revealed that, since at least 2009, debtors who wished to benefit from an arrangement similar in structure to a pre-pack often conducted restructurings, with or without the benefit of a conciliation, and would announce the (usually) favourable outcome at the same time as applying for the opening of a preservation procedure, in which the outcome would be adopted in the form of a rescue plan. Under the new accelerated financial preservation procedure, which stands between conciliation and preservation, a pre-pack would occur within a more concise time frame. This is of great advantage to debtors, who might experience difficulties in securing post-commencement financing if arrangements took too long to progress, as might be the case under the standard preservation procedure, and because it also has the benefit of the cram-down effect. It is also advantageous in that it need not involve creditors other than the financial institutions and bondholders, incidentally downgrading the status of suppliers and some say infringing the pari passu principle normally at the heart of collective insolvency proceedings. Nonetheless, the introduction of this procedure has been welcomed by practitioners and the business press, which would appear to augur reasonably well for its use.

32 Commercial Code art.L.628-3 (new). The conciliator can only be appointed if on the list of approved administrators under Commercial Code art.L.811-2.
33 Commercial Code art.L.628-7 (new).
34 Commercial Code art.L.628-4 (new).
36 Commercial Code art.L.628-6 (new).
Summary

It is noteworthy that the interval between reforms in France appears to be getting shorter with the major legislative events seeming to occur at shorter and shorter intervals in 1967, 1984-85, 1994 and 2005. The last of these reforms has now been joined by further changes in 2008 and 2010, the former major in their impact across all insolvency procedures, with the latter introducing a wholly new procedure in light of developments that have been occurring in practice post-2008. With the likelihood of the fallout from the global financial crisis extending over a number of years, it will be interesting to see whether the reforms in 2008 and 2010 will achieve their intended effect, that of further strengthening the insolvency law framework in France and its ability to meet the challenges of cyclical economic fluctuations and their impact of business and its ability to survive. In this light, the changes in France’s status in the Doing Business Report, issued by the World Bank, may be instructive. The intention behind the report series, issued annually, is to chart regulatory reforms in the jurisdictions under study with a view to ranking them according to established criteria, including one dealing with the rescue and closure of business. In the five years since rankings were individualised within categories, as opposed to the pre-2007 position when an overall ranking was supplied, France’s position appears to have deteriorated, as the following table suggests:

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<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
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<tr>
<td></td>
<td>32</td>
<td>32</td>
<td>40</td>
<td>42</td>
<td>44</td>
</tr>
</tbody>
</table>

This is despite the 2010 report signalling the reforms in 2008/2009, seemingly referring to the Ordinance of 2008. There are two ways of reading this information, either that France’s insolvency position has deteriorated as an absolute measure of its performance or that it has only deteriorated relatively when compared to other states where reforms may well have improved their performance in the insolvency stakes. Whatever the interpretation, it will be interesting to see whether the 2010 reforms register on the ranking of French insolvency procedures overall. This would perhaps serve to justify the fact of their introduction.

An assessment overall, though, of the French reforms may be that, in common with many other jurisdictions, the quest for reform is a perennial one. The speed at which reforms have taken place in France appears to be driven by the need to better deal with the consequences of global economic fallout. It is noteworthy, though, that in comparable jurisdictions, such as Germany, Spain and the United Kingdom, which have similarly been affected, the pace of reforms has nowhere been as rapid. What is clear though, from the latest in the reform series, those occurring in 2005, 2008 and 2010, that France is at least willing to emulate, by comparing her laws to those in other jurisdictions and adopting in part their structure, the perceived success of these systems. Whether these hybrids and partial legal transplants will achieve the desired effect remains to be seen in the long term. It is to be hoped, though, that the cumulative results of the changes introduced in the post-millennium period will now be given the opportunity to bed down so that practitioners, judges and debtors alike will have occasion to be able to familiarise themselves with the benefits of the plethora of procedures that France’s insolvency law framework now makes available.

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41 Reports are generally issued in the autumn of the year prior to the cover date and can be accessed via the Doing Business website at http://www.doingbusiness.org/reports [Accessed May 26, 2011].
42 See, for a comparison of the major reforms in these jurisdictions and France, P. Omar, “Four Models for Rescue: Convergence or Divergence in European Insolvency Laws?” Parts 1 and 2 [2007] I.C.C.L.R. 127 and 171.