INTERNATIONAL INSOLVENCY INSTITUTE

Twelfth Annual International Insolvency Conference

Supreme Court of France

Paris, France

RIGHTS AND ROLES OF UNSECURED CREDITORS

RIGHTS OF UNSECURED CREDITORS IN FRENCH INSOVENCY LAW

By

Justice Brigitte Petiet
Commercial Court of Nanterre
Nanterre

June 21-22, 2012

©International Insolvency Institute 2012. All rights reserved.

RIGHTS OF UNSECURED CREDITORS IN FRENCH INSOVENCY LAW

Justice Brigitte Petiet
juge au tribunal de commerce de Nanterre - France
Mai 2012

The latest reforms on insolvency law have strengthened the role played by creditors within insolvency proceedings. The doctrine pointed out the "*vanishment of creditors*" whose rights had considerably been diminished in 1985, since they lost the power to decide on the fate of the debtor.
In the past, under the regime of the 1967 law, unprivileged creditors used to vote on a arrangement agreement ("*concordat*"), approved by the Court, and privileged creditors had to be paid the day after Court's approval.
Thus, creditors have been deprived of their power to "*rule on the debtor's life* " as professor Derrrida puts it.
Like the law as of June 10th 1994, the 2005 reform introducing safeguard proceedings and the order as of December 18th 2008 as well restored creditors rights.
However, it would be inaccurate to explain the growing role of creditors by the sole influence of a legal policy: the major cause of such an increase is to be found in the development of mechanisms aiming at preventing the difficulties of the debtor and in their effectiveness.
When introducing safeguard proceedings in 2005, the legislator has increased the role played by creditors within insolvency proceedings. This active participation does not only come from the creation of creditors' committees and of the bondholders assembly: it is inherent to the anticipated treatment of the debtor's struggles: the more difficulties are treated early, the more it is necessary to take into account the interest of creditors.
As a matter of fact, at the prevention stage, the treatment of difficulties is more financial than social. This explains why creditors are due to play a prominent role.
It is first necessary to detail the setting-up of creditor's committee (1) before studying the way they work (II)

I. The setting-up of creditors committees

Although it remains perfectible, the setting-up of committee does not raise peculiar issues (A) contrarily to the determination of holders of the voting rights within these committees, which is a more thorny issue (B).

A. Conditions and composition of creditor's committee

(i) Conditions for setting-up

In the view of the adoption of a safeguard plan, article L. 625-5 of the French commercial code sets forth a procedure for consulting creditors on potential postponement of terms of payment and/or debt write-off. The 2005 law imagined a new type of consultation procedure, different form the classical one. In this type of consultation procedure, the creditor's representative submit a proposal on the payment of debts which arose prior to the opening of insolvency proceedings to the creditors, who then must approve or reject the proposed option within 30 days.

The creditor's committee meeting can be defined, according to M. Deharveng, as a "*new way of adopting plan which favors a much greater involvement of creditors in the reorganization process*".
Thus, committees are possible driving forces of the adoption of a safeguard or a reorganization plan: indeed, if they vote in favor of the plan, this last one has to be approved by Court subject the test the Court has to do.

We must bear in mind that creditors who are not part of committees must be consulted pursuant to ordinary-law procedure. Furthermore, we must note that the ordinary-law consultation procedure becomes applicable to members of committees in case the plan is not adopted by them.
The setting-up of committees is compulsory if two conditions pertaining to the debtor are met:

- An accountancy requirement: financial statements of the debtor must be certified by an auditor or established by a chartered accountant

- A threshold requirement, which can be departed from: the number of employees or the turnover must at least respectively be of 150 employees or 20 millions euros.

However, the judge in charge of the proceedings can authorize the setting-up of committees in case these thresholds are not met if the debtor or the official administrator asks for it and if the accountancy condition is satisfied.

(ii) Constitution

Only the most important creditors whose rights arose prior to the opening of insolvency proceedings are meant to be part of a committee: as Professor Françoise Pérochon sets it, this is a kind of reverse elitism. This is not a favor, but a constraint and, unless the case a creditor holds the majority within a committee, it is not advantageous for a creditor to be part of a committee because he can be imposed upon measures he refuses (especially debt write-off) by other creditors. That's why there is no public creditors' committee, nor employees'.
The credit institutions' committee: Initially, the law as of 2005 was only aimed at "*credit institutions*" but the drafting of the law revealed itself to be too narrow. Now, article R.626-55 specifies that "*any entity with which the debtor has entered into a credit operation*" shall be part of the credit institutions' committee, which makes the inclusion of hedge funds in the committee possible. The amended version or article L.626-30 additionally includes "*all the holders of a rights acquired from a credit institution or the like or from a goods or services provider.*"
The major goods or services providers' committee compulsorily includes, as a matter of law, all providers whose claims represent 3% of the amount of all the providers' claims (inclusive of all taxes) which exists at the opening of insolvency proceedings.
The general rule that we have previously seen, pursuant to which any creditor who acquires a claim from a goods or services provider becomes a member of the credit institutions' committee necessarily means that the major goods or services providers' committee is exclusively made of original creditors whose claims have never been assigned.

Bondholders creditors, who are governed by a special provision, are not part of any of these two committees but are called upon separately to vote on the plan proposal within a unique general assembly. This assembly deliberates pursuant to the same rules as committee's and its vote has the same scope. However, this assembly will only be consulted if the two other committees have adopted the plan proposal.
Remember that membership of a committee does not depend on the filing of a proof of claims by creditors.
While insolvency proceedings imposes per nature a collectivization of creditor's interest, the law introducing safeguard proceedings has established, paradoxically, a committee for goods and services providers and a committee for credit institutions.
Thus, the legislator explicitly acknowledged the existence of several groups of creditors within a same insolvency proceedings. In 2005, he opted for the setting up of committees based upon the quality of creditors. Such a classification is open to criticism:

- A bank's claim can be included among those gathered in the credit institution's committee while it arose within a financial advisory business.

- A financial lessor will be part of the credit institutions' committee and an operational lessor will be part of the goods and services providers' while they both make operational means available to the company.

Thus, the creation of creditor's committee based on the nature of the claims rather than on the quality of creditors, as it is in American insolvency law, would allow us to avoid such snags. The interest of creditors who are part of a same committee would hence gain a certain homogeneity. The legislator could then entrust the official administrator with the mission to set up each creditors' committees, under the judge supervision, within each insolvency proceedings, based upon the interests of the various creditors.

B. Issues relating to voting rights within committees

Two issues are to be tackled here: the assignment of claims and (i) the determination of the holder of the voting rights (ii).

(i) Issues arising from the assignment of claims

When passing the last reform, the legislator has had to specify the composition of committees in case claims have been assigned. Article L.626-30-1 provides that "*The obligation or, as the case may be, the possibility to be part of a committee is attached to the claims which arose prior to the judgment opening proceedings and is transferred by the sole operation of law to its successive holders notwithstanding any clause to the contrary. The membership to the credit institutions' committee or to the major goods and services providers' committee is determined pursuant to the second and third subparagraphs of article L.623-30*".

Thus, it is not possible to grasp the incidence of claims assignment upon voting right in the current state of positive law. Article R. 626-58 of the French commercial code provides that "*Eight days prior to the date on which the vote is due to take place, the official administrator fixes the amount, inclusive of all taxes, of the claims held by the committee who has to deliberate.*" Furthermore, article R.626-57 sets forth : "*the assignment of a claim which arose before the judgment opening insolvency proceedings must be notified to the official administrator by registered letter with acknowledgement of receipt.*"

First, we must precise that the provision does not require that the assignment occur before the judgment opening proceedings to be applicable: only the assigned claims must have arisen before this date for the provision to be applicable. However, to be enforceable against the insolvency proceedings, the assignment of the claims and the ensuing quality of creditors must be notified to the official administrator by registered letter with acknowledgement of receipt.

The provision does not require that the notification be made by the new holder (who prefers staying out of the committee). The former holder should inform the official administrator so as to ensure the enforceability of the assignment against the insolvency proceedings.

The absence of coordination between these two provisions raises an issue in case an assignment of claims occurs within the eight days period before the date committees will vote, since the official administrator will not be aware of it when fixing the voting rights held by each creditor. The same goes if the assignment is not notified to him before the eightieth day before the vote.

It must be specified that the two provisions we have previously seen only refer to article L.626-30-2 of the French commercial code: hence, they should not be applicable to the vote held within the general assembly of bondholders. As a consequence, the official administrator should, in theory, fix the voting rights before the vote of this assembly takes place. In case bonds are listed on a financial market, this appears to be incompatible with the organization of the exercise of the bondholder creditors' voting rights.

In the current state of positive law and in view of the flaws of legal provisions dealing with this matter, the official administrator, based upon article R.626-62 providing that " *the official administrator is sole competent to fix the way the vote shall take place within committees and the general assembly of bondholders*", has to fix, in the creditor's committees' rules of procedure and in the general assembly of bondholders', the terms and conditions pursuant to which the vote shall take place.

(ii) Issues relating to the determination of the holder of the voting rights

Does each creditor who is part of a committee hold a voting right?

Article L.626-30-3, subparagraph 1 of the French commercial code provides that "*the composition of committees is determined based upon the claims which arose prior to the judgment opening insolvency proceedings*". If the perimeter of the claims which are to be considered to determine the composition of committees is sufficiently clear, the perimeter of the creditors who hold a voting right within these committees is much less clearer. For instance, in a decision dated February 17th 2012 approving the safeguard plan of Thomson S.A, the Commercial court of Nanterre created a general rule pursuant to which only claims which are impacted on by the plan proposal can confer voting rights upon creditors. In the case at hand, the aim was to deprive the holders of perpetual and deeply subordinated notes of their voting rights attached to the face value of their notes, because this claims could only be recovered in case of winding up or judicial liquidation of the company. On the contrary, the Court decided that the claims relating to interests was impacted on by the plan.

The legal regime governing committees can be improved. In the meantime, the officials in charge of the proceedings and case law have to specify and, in case of need, fulfill this regime.

II. The way creditors' committees work

After having studied the legal regime which is applicable to the adoption of a plan by committees (A), we will see that this regime can raise some issues regarding the notion of collective and individual interest of creditors (B).

A. The legal regime governing the consultation and adoption of a plan by creditors

Pursuant to article L.626-30, subparagraph 2, the debtor, with the assistance of the official administrator, must submit "*proposals in view of the elaboration of a* [safeguard] *plan*" to committees. No limitation of time is provided for but since there is a global period of 6 months to create committees and have them to vote, sooner is better.

The submitted draft must set forth proposals for the repayment of claims held by the members of committees, but also the terms and conditions of payment of claims held by creditors which are not part of them.

Furthermore, the consultation can either discuss proposals from a creditor who is part of a committee, with the understanding that the debtor and the official administrator will be able to filter in proposals which they deem unnecessary to be presented in committee.

Contrarily to the way it is in case of classical consultation, some provisions are not applicable such as the one which cap the maximal duration of the plan to 10 years and imposes the first payment within the year of adoption and then minimal annual installments. In addition, it will be possible to impose debt-write off within a committee upon its members.

Moreover, the order as of December 18th 2008 makes the debt-equity swap possible.

Finally, this order specifies that the plan proposal "*can establish a differentiated treatment between creditors if their difference in situation justifies such treatment*".

Both committees vote separately on the plan proposal pursuant to the terms and conditions fixed by the official administrator determining how the vote shall take place.

Majority requirements have been alleviated in 2008: from then on, a two-third majority in amount of the claims held by the members having voted is required to get the plan passed instead of a two-third majority in amount of all claims held by the members of the committee. Indeed, if creditors cannot be forced to vote, it is logical that their abstention be of no effect on the adoption of the plan.

The presentation of a plan proposal raises an issue regarding the notion of collective and individual interest of creditors.

B. The collective interest and the interest of a creditor within a committee

The possibility, within a committee, to impose to minority creditors a safeguard plan proposal which could be disadvantageous to them raises issues upon the legitimacy of decision taken by the committee. The legislator has considered this issue and provided that the Court shall not be bound by the decision of committees: the Court shall indeed make sure that the interests of all creditors are sufficiently protected. In other words, it shall ensure that the plan proposal is equitable before it approves it. This is actually a thorny mission because there are no legal criterion which would be likely to guide the Court in its appreciation of the plan adopted by committees. The court cannot refuses to approve the plan on the sole consideration that the protection of some creditors is insufficient. The creditors whose interest must be considered are the minority creditors, who must be protected from a potential undue use of majority power, but also other creditors, whose vote of committees indirectly impact on their interest.

The composition of committees based on the nature of the claims could make the test of the legitimacy of the adopted plan easier.

The legitimacy of the plan should be scrutinized in light of the goal the legislator wants to reach: the safeguard of the company's value.

We must precise, in the end, that the Court decision makes the proposals which have been adopted by the committee applicable to all the members of such committee only.

Conclusion:

The legislator's endeavors to increase the role played by creditors is undeniable: creation of creditor's committees, creation of the accelerated financial safeguard proceedings …

There can be no doubt that these new prerogatives are directly taken from practice: indeed, the insolvency proceedings and the safeguard plan of Thomson SA approved by the Commercial Court of Nanterre are at the source of accelerated financial safeguard proceedings. Previously, the provisions of the order as of December 18th 2008 had been the outcome of the issues that were raised within the frame of the safeguard proceedings of *Eurotunnel*. The order essentially implemented the solutions that were found by the Eurotunnel group , its directors and its various creditors under the supervision of the Commercial Court of Paris.

Therefore, the importance of these contributions must be shaded, whatever it is within the frame of creditors' committees or of the accelerated financial safeguard proceedings: the implementation of these mechanisms and of the rights attached to them are far from being the majority of cases Courts have to deal with on a daily basis. As we have just seen, these new tools which have been made available to insolvency law practitioners have been taken out of exceptional insolvency proceedings and their application is deemed to remain exceptional too.