France: quo vadis? France is keen to reform its security and insolvency law

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After the release of the broad outlines in December 2017, the French *plan d'action pour la croissance et la transformation des entreprises* (PACTE) is currently under discussion and is expected to come into force at the beginning of 2019. One of the key measures introduced by the PACTE draft law is the implementation of the future directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures.

Since the election of President Emmanuel Macron on 7 May 2017, the French government has been focusing on transforming and strengthening the domestic economy, which had been struggling for years. Throughout 2017, major steps have been taken in order to tackle unemployment, the trade deficit and low investment in business savings, which have boosted the French economy continuously. However, the fact remains that it is difficult for French enterprises to grow at the same level as their European neighbours. It is in light of this deficit that the so-called *plan d'action pour la croissance et la transformation des entreprises* (PACTE) draft law has been proposed by the government.

The PACTE draft law aims to give French enterprises the means to innovate, transform, grow and create jobs. These goals are meant to be achieved by the removal of all obstacles to the growth of a business from the time of its creation to its expansion, including its potential transfer and financing.

After the release of the broad outlines of the project in December 2017, as well as an online public consultation last January, the PACTE draft law was debated for the first time in the French Parliament on 19 June 2018, and will be examined by the Parliamentary Finance Committee next September. The PACTE law is expected to come into force at the beginning of 2019.[1]

An important issue addressed by the PACTE draft law is the necessity to reform the French securities law. One of the points the Government has proposed in its draft is to enable the easier financing of companies through the simplification and improvement of the efficiency of securities law. The reform is meant to modernise certain securities, clarify the hierarchy among the securities and simplify the access to necessary information. In order to speed up the process, the PACTE draft law authorised the Government to reform the French securities law by ordinance,[2] thus avoiding the lengthy parliamentary process.

Another key measure introduced by the PACTE draft law is the implementation of the future directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, and amending Directive 2012/30/EU (the 'Directive').[3]

What's new in securities law?

When it comes to the need to modernise its securities law, France cannot be accused of procrastination.[4] It was only in October 2017 that France fundamentally changed the regime of the security agent by introducing a flexible and efficient security trustee for syndicated loans.[5] Up until then, 'French style' security agents, which were hastily established by French law in 2007,[6] had their powers limited to simple security administration mandates on behalf of banking pools. Therefore, this disappointed practitioners, who quickly abandoned this mechanism. It is thanks to this expansion of the role and powers of security agents in 2017 that France is now able to compete with existing systems in Anglo-Saxon jurisdictions, as well as provide banking pools with modern and effective solutions.

Even though France has undoubtedly taken an important measure in modernising security law, the need for fundamental reform remains. With its very broad scope, it is almost all security law that is targeted to be reformed by the PACTE draft law. The envisaged

law includes: guarantees (*cautionnement*), liens (*privileges*), pledge over tangible movable property/assets (*gage de meubles corporels*), special security rights over movable property (*sûretés mobilières spéciales*) and its publicity, pledge on claims (*nantissement de créance*), retention of title, assignment of claims as guarantee,[7] fiduciary security rights and property security rights.

More specifically, the provisions of Article 16 of the PACTE draft law faithfully reproduce the proposals formulated by the Henri Capitant Association ('Capitant'), which issued a reform proposal of security law in October 2017 at the request of the Minister of Justice (the so-called *avant-projet de réforme des sûretés*).[8] The commission Capitant suggested, inter alia, to reform the guarantee (*cautionnement*) by unifying its scope in the civil code and removing annoying duplicates.[9]

As far as restructuring and insolvency proceedings are concerned, it is remarkable that the PACTE draft law aims to implement by anticipation the future directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, and amending the Directive.[10]

The PACTE draft law authorises the Government to implement the Directive into domestic law by ordinance. Article 64 of the PACTE draft law defines the 'guidelines' that the Government should follow in drafting the ordinance. These 'guidelines' appear to be vague and will be giving the Government a large amount of flexibility for the content of the ordinance.[11]

What's new in French restructurings?

The introduction of 'true' creditor classes into French law

After the implementation of the Directive, French insolvency law would give the opportunity to the debtor to form 'true' creditor classes that will be entitled to vote on the restructuring plan.[12]

Indeed, one of the important elements entailed in the Directive proposal is inspired by United States and German law: the formation of separate creditor classes 'in such a way that each class comprises claims and interests with rights that are sufficiently similar to justify considering the members of the class as a homogenous group with commonality of interest. As a minimum, secured and unsecured claims shall be treated in separate classes for the purposes of adopting a restructuring plan. Member States may also provide that workers are treated in a separate class of their own';[13] and 'equity holders are to form one or more distinct classes by themselves'.[14]

The implementation of this provision[15] into French law will be an interesting step forward. French practitioners agree that the current creditors' classification does not correspond to international standards in complex financing schemes involving different 'layers' (eg senior, second lien and mezzanine).

Indeed, in 2005,[16] French law opted for a dual rather simple system of creditor committees, formed in view of the *person* of the creditor, that is, financial institutions, suppliers or bondholders. The nature of the claim itself is disregarded. The reform in 2014[17] giving the insolvency administrator the power to equilibrate sophisticated creditors' rights while taking into consideration subordination agreements gave rise to important critics in practice because it lacks objective criteria.

The PACTE draft law that will be implementing the Directive does not define the creditor classes the Government is supposed to introduce in domestic law,[18] giving the latter wide latitude to define the provisions.

What can be expected beyond the minimum classification into 'secured' and 'unsecured claims'?

In this new system, it seems clear that the creditor (the person) is disregarded in favour of the characteristics of the claim itself (eg, secured and unsecured).

As in Chapter 11 restructurings and German law, each category of class could now comprise subcategories that form a separate class in order to include members 'with commonality of interest' in a 'homogenous group'. For example, the secured creditors' class may have the following subcategories: claims secured by a mortgage; claims secured by pledges on movable assets; claims secured by pledges on intangible assets; and claims of a trustee.[19]

As for the unsecured claims, classes could be created according to different economic interests; for example, one class could comprise financial institutions and another class solely suppliers. Moreover, equity claims should be in a separate class, as well as claims out of bonds.

Who should be in charge of the class formation?

The draft PACTE draft law is silent in this respect, and the Directive suggests that 'Class formation shall be examined by the judicial or administrative authority when a request is filed for confirmation of the restructuring plan'.[20]

In practice, however, the control at the moment of confirmation by a court of a restructuring plan adopted by the creditor classes seems too late.

Indeed, the restructuring plan should mention in detail the composition of each class, followed by the number of votes per class, and the formation of the classes as such should nevertheless be controlled in an earlier stage (ie, just after the opening of the preventive restructuring procedure) in order to be fixed prior to the vote and not to delay the voting process. In

France, the insolvency practitioner appointed in the preventive restructuring procedure[21] could be in charge of controlling the class formation as operated by the debtor. The court approving the restructuring plan could then proceed to the ultimate control, verifying that the legal criteria are duly complied with. The judgment should be subject to appeal to the benefit of creditors and the public prosecutor in a limited time frame, for example, ten days.[22]

It should be noted that in France, only restructuring plans can be submitted to the vote of creditors' committees;[23] should assets be divested,[24] the vote of creditors (either in committees or individually) is not required. Only the court has the power to decide on the disposal of assets and the best offer with regard to the number of jobs safeguarded and purchase price offered.[25] Indeed, under French insolvency law, the main objective is the continuation of business and rescue of jobs; the creditors' interest does not play a major role.

Adoption of a restructuring plan: should the court still have the power to force it?

The adoption of a restructuring plan in French law requires a majority of two-thirds of the number of claims by each of the committees.[26] In this respect, the Directive proposal enjoins Member States to lay down the required majorities that shall not be higher than 75 per cent in the amount of claims or interests in each class.[27] Therefore, one does not expect a change in the current majority rule set by French law. Moreover, as this is already the case in French law, according to the Directive, only 'affected creditors have a right to vote on the adoption of a restructuring plan'.[28]

After the vote in each creditors' class, the binding adoption of a restructuring plan requires, according to the Directive, the confirmation by a judicial or administrative authority if the plan: (1) affects the interests of dissenting affected parties; or (2) provides for new financing.[29]

In France, it is likely that such power will remain in the hands of the commercial courts, which should take into consideration, among other criteria,[30] the best interest of creditors test, that is, the court must verify that the dissenting creditors have the same treatment that they would have had in a liquidation scenario,[31] whether as a going concern or in isolated asset disposals. The best interest of creditors test criteria should be more challenging for French courts, which currently have to verify that the interest of all creditors is sufficiently protected.[32] Indeed, such criteria suppose a concrete simulation and calculation of the business: (1) in an ongoing concern scenario; and (2) in an isolated asset disposal, whatever is more favourable, while taking into consideration the complex ranking rights of each dissenting creditor. Such an exercise means, in practice, that the debtor should provide the court with a report established by an accounting expert, and will add a challenge in terms of costs and timing.

The draft PACTE law[33] provides that a restructuring plan can be adopted via the mechanism of 'cross-class cram down',[34] which will be a new concept in French law. Indeed, currently, a cram down is only possible within one class. Following a strict economic view, the cross-class cram down can also affect shareholders that currently are protected by French law, although, in practice, they are most of the time 'out of the money'.[35] It is true that, according to the Directive, shareholders maintain certain protection because the debtor (ie, management) has proposed or agreed to the restructuring plan adopted via a cross-class cram down.[36]

The confirmation by court of a plan adopted by the creditors' classes should suppose, according to the Directive,[37] compliance with the absolute priority rule. As defined by the Directive, the absolute priority rule shall ensure that a dissenting class of creditors is paid in full before a more junior class can receive any distribution or keep any interest under the restructuring plan. Such a rule is stricter than the above described (rough) verification by French courts under the current rules.

The absolute priority rule, if introduced as such into French law,[38] should lead to the result that a court could not approve a restructuring plan proposed by a debtor if it was rejected by all creditors' classes.[39]

Moreover, the court's power with respect to the confirmation of a restructuring plan is clearly defined by the Directive[40] and may lead to a limitation of power of French courts once implemented in domestic law.

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Notes

1 It is likely that the French Parliament will provide for some changes to the draft law. However, the proposed PACTE draft law is more advanced than other draft laws because of the preliminary phase of public consultation to which it has been subject.
2 Within 24 months of the publication of the PACTE law. Art 16 of the PACTE draft law.
3 Proposal dated 22 November 2016.
4 The necessity of a reform in the field of French securities law has been growing ever since the deficits of its last reform in 2006 have become more and more evident.
5 Law No 2016-1691 of 9 December 2016 on transparency, the fight against corruption and the modernisation of the economy. The new law only applies to security agents appointed after its entry into force, ie, 1 October 2017. For more details, see Anja Droege Gagnier and Amélie Dorst, 'France has introduced a flexible and efficient security trustee for syndicated loans', Less is More BMH Newsletter, February 2018 http://bmhavocats.com/en/france-introduced-flexible-efficient-security-trustee-syndicated-loans accessed 9 July 2018.
6 Law No 2007-211 of 19 February 2007.
7 The so-called 'Dailly' assignment of claims should remain unchanged.
8 For more details, see http://henricapitant.org/storage/app/media/pdfs/travaux/avant-projet-de-reforme-du-droit-des-suretes.pdf accessed 9 July 2018.
9 A reform is essential because this security had been left aside by the last reform of 23 March 2006. The guarantee (*cautionnement*) suffers from the scattering of legal articles and numerous litigations.
10 Proposal dated 22 November 2016.
11 At this stage, the Directive has not yet been adopted, whereas the PACTE law has just been adopted by the Council of Ministers and will have to be adopted by the French Parliament (this autumn), therefore probably before the vote of the Directive by the European Parliament.
12 The Directive concerns admittedly preventive insolvency proceedings (in France: *sauvegarde*, *sauvegarde accélérée* (SA) and *sauvegarde financière accélérée* (SFA)), the new creditors' classes should nevertheless also be formed when coming to a restructuring plan within the rehabilitation procedure (*procedure de redressement judiciaire*), which is an insolvency procedure falling under Annexe A of the EIR (as recast).
13 Art 9 para 2 of the Directive.
14 Art 9 para 1 and Article 12 para 2 of the Directive.
15 Which seems to be an element on which the Member States already reached an agreement at the time of drafting the present article.
16 'Safeguard Law' No 2005-848 dated 26 July 2005.
17 Ordinance 12 March 2014.
18 Art 64 of the PACTE draft law.
19 *Fiduciaire*.
20 Art 9 para 3 of the Directive.
21 *Conciliateur*, if the French conciliation procedure should be comprised in the scope of the Directive, which seems unclear at this stage. In the case of safeguard proceedings (*sauvegarde, sauvegarde financière accélérée* and *sauvegarde accélérée*), the insolvency practitioner is the administrator or the so-called 'creditors' representative' (*administrateur judiciaire/mandataire judiciaire*).
22 In French insolvency proceedings, the public prosecutor is in general involved. The appeal period of judgments in insolvency proceedings is often limited to ten days.
23 After the implementation of the Directive, one should read 'classes'.
24 So-called *plans de cession*, which can, however, only be a partial disposal in a safeguard procedure: Art L 626-1 para 2 of the French Commercial Code.
25 Art L 626-9 / L 631-19 of the French Commercial Code.
26 Art L 626-30-2 para 4 of the French Commercial Code.
27 Art 9 para 4 of the Directive.
28 Art 9 para 1 of the Directive; Art L 626-30-2 para 5 of the French Commercial Code.
29 Art 10 para 1 of the Directive.
30 Art 10 of the Directive.
31 Art 10 para 2 (b) of the Directive.
32 Art L 626-31 of the French Commercial Code.
33 P 44 of the preamble with respect to Art 64.
34 According to the guidelines of the Directive set in Art 11. Art 64 para 2 of the draft PACTE law.
35 Art L 631-19-2 of the French Commercial Code, which provides for a forced sale of shares under very restrictive conditions (only in a rehabilitation procedure).
36 Art 11 of the Directive.
37 Art 2 para 10 of the Directive.
38 Art 64 of the PACTE draft law provides only in para 4 that the ordinance must take into account subordination agreements which seems to be vaguer than the absolute priority rule.
39 Currently, French courts can impose a restructuring plan against the vote of creditors (either organised in classes or consulted individually). Indeed, secured creditors may be forced by court into a restructuring plan providing for instalments over ten years.
40 Art 11 of the Directive.