France's new legislation attempts to narrow shareholders' powers in a restructuring scenario: a first step in rebalancing creditors' and shareholders' rights?

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French insolvency law has been significantly reformed by Ordinance No 2014-326, dated 12 March 2014, which came into force on 1 July 2014 and amended the sixth book of the commercial code. An implementing decree (No 2014-736) dated 30 June 2014 clarified the rules for its application. The reform mainly aims at simplifying the insolvency regime and rebalancing shareholders' and creditors' rights in the context of insolvency proceedings.

To this effect, a new accelerated safeguard procedure (*'procédure de sauvegarde accélérée'*)[1] has been introduced in addition to the already existing safeguard (*'procédure de sauvegarde'*) and accelerated financial safeguard procedures (*'procédure de sauvegarde financière accélérée'*). This novelty enables debtors to elaborate a pre-packaged plan with their main creditors during the conciliation procedure which is an out-of-court pre-insolvency[2] phase. The plan must then be adopted within a three-month timeframe starting from the commencement of the accelerated safeguard procedure.[3] The accelerated safeguard procedure may lead to a cram-down of minority creditors who were dissenting during the conciliation procedure.[4]

Moreover, the reform implements a rebalancing of creditors' and shareholders' rights in the context of insolvency proceedings. French insolvency law traditionally favours the rescue of the debtor's business and preserves shareholders' rights, whereas creditors play only a second role. The reform's amendments strengthen creditors' rights and enhance their level of participation in the proceedings. Several new measures also limit shareholders' ability to block the adoption of a plan that does not meet their goals.

Strengthening creditors' rights

Creditors' competing plans[5]

In the event of a reorganisation (*'procédure de redressement'*) or safeguard procedure, any creditor who is also member of a committee can now propose a safeguard or reorganisation plan, as the case may be, which will compete with the debtor's plan, meaning that the creditors' committees will be asked to vote on it. Since bondholders are not members of a creditors' committee, they should not be able to submit their own restructuring plan. Where a plan is adopted by each creditors' committee[6] as well as the bondholders' assembly, if any, the court will examine both plans, ensure that the interests of all creditors are not harmed and will then render its judgment. This new rule in French law[7] aims to avoid a well-known situation where creditors are confronted by two equally unsatisfying solutions: (i) accepting a plan the debtor has voluntarily made unattractive or (ii) accepting a debt rescheduling over many years (even ten years).[8] However, the content of the competing plan cannot overrule shareholders' regular voting rights which remain untouched, for example, taking over the control of the company against their vote.[9]

Extension of the 'New Money Privilege'

French insolvency law provides for what is referred to as 'New Money Privilege'. This gives creditors priority to recover their claim when they agree to inject fresh money into the company at the time of the conciliation agreement.[10] The 2014 reform extends this privilege to those creditors who inject fresh money at an earlier stage of the conciliation proceedings, encouraging financing of the business even before an agreement is reached.[11] It has to be noted that the New Money Privilege does not apply to shareholders injecting fresh money in the context of a capital increase.[12]

The New Money Privilege confers a priority ranking in case of a subsequent insolvency of the debtor and since the 2014 reform, the reorganisation or safeguard plan cannot impose a rescheduling of repayment on a new money creditor who does not consent,[13] whereas a plan can impose such a rescheduling on other creditors.[14]

The (limited) neutralisation of shareholders' ability to block resolutions or plans

A new possibility to override shareholders' refusal to adopt a reorganisation plan

During a reorganisation procedure – and only in that case – the reformed legislation states that the shareholders' refusal to adopt a resolution implementing a reorganisation plan can be overridden in case: (i) the company is legally obliged to reconstitute its equity; and (ii) the plan provides a change in the capital in favour of third parties who agree to commit to it. If the legal obligation to reconstitute the company's equity up to half the capital[15] is not complied with, the administrator can request the court to appoint a '*mandataire ad hoc*' whose task will be to convene the shareholders' assembly and to vote the equity's reconstitution in place of the opposing shareholders.[16]

This measure, which has been criticised as amounting to an eviction of shareholders, is actually more limited than it seems at first glance. The preferential right of subscription[17] ('*droit préférentiel de souscription*') still gives shareholders priority to participate in the capital increase and therefore offers them an option to avoid dilution caused by the entry of third parties. In order to launch this procedure, the reform requires that the company be in a situation where it is obliged to reconstitute its equity and thereby limits the measures' application to this specific case only. The equity reconstitution is only compulsory to a certain level established by legislation, namely half of the capital. The potential dilution of shareholders' participation is therefore somewhat limited whereas the new money injection may only be of interest for an investor or creditor if they can obtain control over the debtor.

The possible change of voting rights aimed at neutralising blocking minorities

In the context of a safeguard or reorganisation procedure, the court can now alter shareholders' voting rights to some extent in order to override blocking minorities during the implementation of the plan.[18] Statutory changes generally require a qualified majority or unanimity, which enables minority shareholders to block decisions. The new amendments provide that if an administrator has been authorised to convene the shareholders' assembly[19] and has done so, the court can decide that a majority of the present or represented shareholders' votes will suffice to take decisions, if they hold at least half of the shares to which voting rights are attached.

Shareholders' obligation to pay remaining outstanding capital contribution

The occurrence of the insolvency proceedings' opening judgment suffices in itself to oblige shareholders to pay the capital they still owe the company.[20] The '*mandataire ad hoc*' can also summon them to pay those remaining sums, that is to say the price of shares to which they have subscribed but have not yet paid. Shareholders are thereby obliged to contribute to the company's losses, which they originally committed themselves to do. This restores a sort of (small) equilibrium between shareholders and creditors in sharing the financial burden in case of insolvency proceedings.

However, the neutralisation of shareholders' powers to block resolutions and therefore reorganisation plans is not totally satisfactory since the 2014 reform does not alter their voting rights in the event of a capital increase further to a plan providing for a debt-to-equity swap. In France, for example, the creditors' committees can approve the conversion of claims to equity by a two-thirds majority,[21] whereas in Germany, a creditor cannot be forced to become a shareholder without their consent. On the other hand, in France the debt-to-equity swap approved by the creditors' committees can only succeed if the shareholders vote in favour of it at the end of the process in the context of an extraordinary shareholders' assembly.[22] It has to be noted that insolvency law does not restrict the shareholders' voting rights deriving from the regular rules with respect to statutory changes like a capital decrease and increase,[23] that is, a two-thirds majority in the common form of a limited liability company as

société anonyme (SA) / *société par actions simplifiée* (SAS). As a result, debt-to-equity swaps in France may in fact be blocked by the existing shareholders, despite the fact that they are out of money in an insolvency scenario,[24] whereas in Germany the existing shareholders of the debtor have very limited means to prevent the adoption of the plan providing for a debt-to-equity swap.[25] The situation is different in safeguard proceedings where the debtor is not yet insolvent: a limitation of voting rights of the existing shareholders or, worse, a possibility to evict shareholders, would prevent a debtor from filing for safeguard proceedings which are one of the preferred tools for an early restructuring. In addition, German insolvency law[26] goes into more detail in order to confer debt-to-equity swap higher efficiency as a restructuring tool, for example, by blocking any change-of-control clauses contained in the debtor's material agreements.

Conclusion

The consequences of the 2014 reform on the situation of shareholders turn out to be less severe than originally planned. While a first draft of the ordinance suggested allowing the eviction of shareholders from the company through a forced disposal of their shares, the final version of the 2014 reform only enables a limited dilution of their participation. Unlike directors, shareholders cannot be forced to transfer their shares in the context of an insolvency procedure.[27] Their voting right is not compromised either, except in the event of L 631-19-1 of the Commercial Code, when the company is obliged to reconstitute its equity. Shareholders, although totally out of money in an insolvency scenario, may continue to exercise leverage.

An additional ordinance was announced for the near future, presumably aimed at taking more drastic measures towards shareholders although this remains uncertain. Some commentators criticise the possibility to evict shareholders as a violation of the constitutionally protected property right, which might discourage the Chancellery from going much further.

Notes

1 Article L 628-1 Code de Commerce ('Ccom').
2 Conciliation proceedings can be commenced by a debtor which is not yet insolvent or has been insolvent for less than 45 days, Article L 611-4 Ccom.
3 Carole Champalaune, *L'ordonnance du 12 mars 2014 améliore la sauvegarde et crée une procédure de sauvegarde accélérée*, 12 March 2014, Article L 628-8 Ccom: www.textes.justice.gouv.fr.
4 Adoption of the plan by a two-thirds majority in the creditors' committees: the majority being calculated on the claim amount of the voting creditors (L 626-30-2 Ccom). The adoption of a restructuring plan during the conciliation procedure requires unanimity.
5 L 626-30-2; L 626-30-3; L 626-31 Ccom.
6 See n4 above.
7 Already existing in German law and in US law.
8 Philippe Pétel, *Entreprises en difficulté : encore une réforme,* La Semaine Juridique Edition Générale *No 23,* 9 June 2014.
9 See the section entitled 'The (limited) neutralisation of shareholders' ability to block resolutions or plans'.
10 See n2; L 611-11 Ccom.
11 L 611-11 Ccom.
12 L 611-11, 2 Ccom.
13 L 626-20 Ccom.
14 Before the 2014 reform, and in case of a plan, new money creditors could have been submitted to the same payment deadlines as other creditors, making the New Money Privilege rather unattractive.
15 L 626-3 Ccom.
16 L 631-9-1 Ccom.
17 L 225-132 Ccom.
18 L 626-16-1 Ccom.
19 L 626-16 Ccom.
20 L 624-20 Ccom.
21 Only in limited liability companies, for example, SAS, SA, SARL.
22 Unlike in Germany, where shareholders vote in an independent group alongside with the other creditors' groups voting on the plan even though the existing shareholders' voting rights are depending solely on their shareholding in the debtor.
23 In practice, the capital increase by way of a debt-to-equity swap, meaning technically a set-off of the creditor's claim with the company's claim out of the capital increase, will follow a capital decrease compensating losses. It has to be noted however that the new rules do not state that a capital decrease can be imposed to the existing shareholders.
24 As opposed to in safeguard proceedings.
25 See Jan Wildberger and Katharina Reuther 'Debt-to-equity swaps under German insolvency law' (June 2012) *Financier Worldwide*.
26 'Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen', ESUG 1 March 2012, s 225a (4).
27 The forced disposal of shares held by a director of an insolvent company is, however, highly unlikely in practice.