Transposition in France of the Restructuring and Insolvency Directive: Evolution or revolution for creditors and equity holders?



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By an Ordinance dated 15 September 2021, France finally transposed the European Directive 2019/1023/EU (the "**Directive**") into national law and took this opportunity to reform additional parts of its insolvency law (the "**Reform**").

Unlike other member states, France has been proposing pre-insolvency proceedings, i.e., *mandat ad hoc* and *conciliation* for many years, having proved their efficiency: 75% of these consensual, confidential, and fast proceedings available for debtors which are not yet insolvent end up in an agreement with their main creditors.

The negotiations in the frame of *mandat ad hoc* or *conciliation* are conducted under the supervision of an insolvency practitioner appointed by court upon the request of the debtor.

The creditor has no say in the choice of the person appointed whose aim remains the rescue of the debtor and the related jobs.

However, no statistic exists in France as for the viability of the so restructured debtor on the long run.

- Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.
- The Reform entered into force on 1st October 2021 for proceedings opened as from this date.
- Since 1985.
- "L'entreprise en difficulté en France en 2020, Des entreprises asymptomatiques face à la pandémie ?", May 2021, Altares Deloitte
- 'insolvent' meaning unable to pay debts when they fall due.
- Minor creditors, non-financial creditors or suppliers are very often not involved in pre-insolvency proceedings in order not to disturb the business.

These pre-insolvency proceedings remain in essence untouched by the Reform, although some provisions of the "Covid legislation" are maintained, such as the request of suspension of enforcement measures which a creditor may launch during the negotiations. Moreover, although *conciliation* proceedings are available for a debtor notwithstanding its size, in practice, these proceedings are mainly used by large caps.

The reason may be not only the lack of information suffered by SMEs, but also the important costs incurred by these restructuring proceedings, e.g., fees for the conciliator, lawyers, financial advisors which are freely defined. The Reform now imposes to the debtor the disclosure to the court of all costs incurred during pre-insolvency proceedings, including the fees invoiced by creditors' advisors, but borne by the debtor. The court has to acknowledge these costs before the approval or the homologation of the agreement executed as a result of the *conciliation* proceedings.

Since 1st October 2021, the new "accelerated safeguard" *("sauvegarde accelérée")*, a pre-insolvency procedure already included in Annex A of the European Regulation 2015/848, follows the requirements of the Directive: Fast (maximum 4 months), public and triggering a general stay for creditors. But above all, it requires the insolvency administrator to constitute classes of creditors which are affected by the restructuring plan. Such plan is drafted during the *conciliation* which is a compulsory pre-step of the accelerated safeguard.

Under the impetus of European law, France, which is known for its debtor-friendly system, had no choice than to readjust the influence of creditors in insolvency proceedings. But what will be the concrete consequences of the Reform for creditors and equity holders in the frame of a restructuring plan?

I. Creditors vote in classes of affected parties and can be 'crammed down'

- ***Replacement of the rarely implemented creditors' committees***

The classes of affected parties replace the former creditors' committees, an institution which did not take into consideration the

Ordinance n°2020-596 dated 20 May 2020, art.5; For more details, see our article "*French insolvency rules reformed in the light of pandemic COVID-19: Are they going too far?*", IBA Insolvency and Restructuring International - Vol 14, - September 2020

Involved or not involved in the conciliation proceedings.

As well as payment grace periods up to two years (Article L. 611-7 Code de commerce)

Article R 611-39-1 Code de commerce.

"*constat*"

But the court does not control the fees.

The new accelerated safeguard proceedings merge the former accelerated safeguard *("sauvegarde accelérée")* and the accelerated financial safeguard ("*sauvegarde financière accélérée*"). While these former proceedings were designed for large caps, the Reform removes all applicable thresholds so that all companies, regardless of their size, will now have access to the new accelerated safeguard.

France has therefore an advance compared to other EU member states whose new pre-insolvency proceedings don't benefit yet from the automatic recognition within the EU until their inclusion in Annexe A of the EIR 2015/848.

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economic reality of claims and was only marginally implemented in practice. Individual creditors' consultation therefore inevitably took precedence and prevented from realistic restructuring plans. Indeed, under French law, it is not possible to force an individual creditor to abandon its claim, whether entirely or in part.

As a result, in practice, restructuring plans in France came out to be economically unrealistic, without haircuts, so that in many cases the sale of the business was the only option. A business sale within insolvency proceedings is in general the worst recovery a creditor could get, if at all, since the price is sometimes so low that even secured creditors do not recover their claim or only in (a small) part. Indeed, courts generally prefer an offer rescuing a maximum of jobs to an attractive purchase price.

It must be noted that under French law, the creditors' opinion is only requested at the occasion of a restructuring plan, but not in the event of a business sale which is always decided by the court. This rule was not changed by the Reform.

- ***Set-up of creditors' classes***

If a restructuring plan is contemplated, from now on, the judicial administrator must set up classes of affected parties in the frame of:

- accelerated safeguard proceedings *("sauvegarde accelérée")*;
- safeguard and reorganisation proceedings ("*sauvegarde et redressement judiciaire")* only when the relevant thresholds are exceeded. It must be noted however, that the relevant thresholds are relatively high so that the creditors' vote in classes would only be current practice for large caps.
- or when the debtor requests it.

The formation of the creditors' classes follows the recommendations of the Directive. Creditors with similar economic interests will be grouped into classes, with a minimum of two classes, i.e., secured, and unsecured. But the selection of affected parties is very flexible and can be limited in the frame of accelerated safeguard proceedings to financial creditors. Employees' claims are always excluded.

Even though a creditor which is appointed as so-called 'controller' can give its opinion to the contemplated business sale. However, his/her opinion is not binding.

250 employees and 20MEUR turnover; or 40 MEUR turnover.

Even though in accelerated safeguard proceedings, the set-up of creditors' classes is compulsory notwithstanding the debtor's size, these proceedings are in practice often unknown to small/middle caps to whom pre-insolvency proceedings are not familiar or too costly.

With the previous approval of the insolvency judge ("*juge-commissaire*").

Each class of affected parties votes on the restructuring plan with a 2/3rd majority of the amount of the claim, no headcount.

- ***The cross-class cram-down mechanism***

Cross-class cram-down should facilitate the adoption of an economically realistic plan, provided that the debtor agrees to it and that at least one class which is "in the money", but which is not the equity holders' class, has voted in favour of the plan. Before acknowledging the restructuring plan, the court controls if the best interest test as well as the absolute priority rule have been applied by the plan, even though the court has power to allow some derogation. Such derogations must be necessary to achieve the objectives of the plan, and the plan must not unduly prejudice the rights or interests of affected parties.

In the frame of reorganisation proceedings ("*redressement judiciaire*"), any affected party may propose an alternative restructuring plan. This is not admitted in the pre-insolvency proceedings, accelerated safeguard or safeguard, where only the debtor can submit a plan.

However, in any case, even though the creditors may be now more efficiently involved in the design of restructuring plans, their power remains subject to the court which has the last word. Regretfully, the Reform did not extent the creditors' vote to business sales which remain under the sole power of the insolvency courts.

II. Equity holders "out of the money" can be squeezed out

The Directive sought to hinder equity holders of a debtor company which are "out of the money" from blocking the adoption of restructuring plans that would allow the company to return to viability.

A major innovation in France is that equity holders can now be put into a class as soon as their rights are affected by the draft plan, e.g., debt-to-equity-swap. During the preparation of the Reform, the set-up of one or several classes for equity holders was highly controversial, as it touches the absolute right of property. Moreover,

In *accelerated safeguard* and *safeguard* proceedings, but not in reorganisation proceedings ("*redressement judiciaire*") where the debtor's approval is not required.

i.e., which, after determining the value of the debtor as a going concern, could reasonably be expected not to be entitled to any payment or retain any interest while applying the distribution priority order in the context of a judicial liquidation or an asset sale.

Within the limits of article 11 (2) of the Directive.

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according to corporate law, a modification of the capital requires a vote in a general meeting.

From now on, equity holders can be deprived from their rights in the capital by suffering a cross-class cram-down under the following conditions: i) The debtor exceeds the thresholds, i.e., 250 employees and 20M€ turnover, or alternatively 40M€ turnover; ii) the equity holders are "out of the money" under a going concern valuation in a liquidation or business sale, both in insolvency proceedings; iii) the shareholders must benefit from a preferential subscription right in case the plan foresees a capital increase in cash; iv) the plan does not include a sale of entire or part of their equity rights.

The court's approval of the plan is deemed to validly modify the debtor's capital and the articles of association, without any additional vote in a general meeting. This is a rather elegant technical solution.

Under French law, the conversion of the creditor's claim into capital (debt-to-equity-swap) is operated as a capital increase in cash at face value (and not in kind like in some other jurisdictions), thus preventing from a valuation of the claim. Dissenting shareholders can only subscribe in cash, but they benefit from preferential subscription rights.

In practice, it must be noted that the squeezing out of dissenting equity holders may not be so easy in the frame of accelerated safeguard or safeguard proceedings, as the debtor (acting by its legal representatives) must consent to the plan and proposes it to court. This might be a problem as the shareholders may prevent him/her from giving such consent, e.g., by removing him/her from office. This difficulty does not exist in reorganisation proceedings ("*redressement judiciaire")*, since the debtor has no longer a say; a creditor can propose an alternative plan.

The new legal possibility of a debt-to-equity-swap by squeezing out equity holders which are "out of the money" is nevertheless a welcome tool, as it was previously only possible in the frame of long and sometimes dreadful negotiations.

All in all, with respect to restructuring plans, French insolvency law henceforth clearly meets international standards. However, the French system still fosters the balance in favour of the debtor's rescue and the related jobs, rather than the creditors' investments, so that the Reform is more an evolution than a revolution. Which is still a good step.

A legal exception existed nevertheless but which was never used – article L. 631-19-2 du Code de commerce

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