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

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After the transposition of the Directive, French insolvency law, which was already on the right page with respect to pre-insolvency proceedings, now meets international standards. Following the Directive verbatim, French law introduced the creditors' vote in classes, whereby creditors can be crammed down, including cross-class cram-down. Moreover, equity holders can be allocated to a class and squeezed out, which was a highly controversial issue during the legislation process.

By an Ordinance dated 15 September 2021,[1] France transposed the European Directive 2019/1023/EU[2] (the 'Directive') into national law and took this opportunity to reform additional sections of its insolvency law[3] (the 'Reform').

Unlike other EU Member States, for many years France has been proposing pre-insolvency proceedings, that is, *mandat ad hoc* and *conciliation*,[4] having proved their efficiency: 75 per cent[5] of these consensual, confidential and fast proceedings available for debtors that are not yet insolvent[6] end with an agreement with their main creditors.[7] The negotiations in the frame of *mandat ad hoc* or *conciliation* are conducted under the supervision of an insolvency practitioner appointed by the court on the debtor's request. The creditor has no say in the choice of the person appointed whose purpose remains to rescue the debtor and related jobs. Nevertheless, there are no statistics in France to indicate the viability of the restructured debtor in the long run.

The pre-insolvency proceedings *mandat ad hoc* and *conciliation* remain in essence untouched by the Reform, although some provisions of the 'Covid legislation' are retained,[8] such as the request of suspension of enforcement measures, which a creditor[9] may launch during the negotiations.[10] Although *conciliation* proceedings are available for a debtor notwithstanding its size, in practice, these proceedings are mainly used by large businesses. The reason for this may not only be the lack of information available to small and medium-sized enterprises (SMEs), but also the important costs incurred by such restructuring proceedings, including fees for the conciliator, lawyers, financial advisors which are freely defined. The Reform imposes on 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.[11] The court must acknowledge these costs before the approval[12] or the homologation of the agreement executed as a result of the *conciliation* proceedings.[13]

The Reform modified parts of the existing 'accelerated safeguard'[14] (*sauvegarde accelérée*), a pre-insolvency procedure already included in Annex A of the EU Regulation 2015/848,[15] by following the requirements of the Directive: fast (maximum four months), public and triggering a general stay for creditors. But, above all, it now requires the insolvency administrator to constitute classes of creditors affected by the restructuring plan. Such a plan is drafted during the *conciliation* – a compulsory pre-step of the accelerated safeguard.

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

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 that did not take into consideration the economic reality of claims and was rarely implemented in practice. Individual creditors' consultation therefore inevitably took precedence and prevented realistic restructuring plans. Indeed, under French law, it is not possible to force an individual creditor to abandon its claim, either 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 may achieve, 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. Courts generally prefer an offer rescuing as many jobs as possible over 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.[16] This rule remained unchanged 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.[17] 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;[18] or when the debtor requests it.[19]

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: 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.

Each class of affected parties votes on the restructuring plan with a two-thirds 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,[20] and that at least one class that is 'in the money',[21] but 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.[22] Such derogations must be necessary to achieve the plan's objectives, 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 pre-insolvency proceedings, accelerated safeguard or safeguard, where only the debtor may submit a plan.

However, in any case, even though the creditors may now be more effectively involved in the design of restructuring plans, their power remains subject to the court, which still 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.

Equity holders 'out of the money' can be squeezed out

The Directive sought to hinder equity holders of a debtor company who 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, for example, debt-to-equity-swap. During 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, according to corporate law, a modification of the capital requires a vote at a general meeting.

Going forward, equity holders can be deprived of their rights in the capital by suffering a cross-class cram-down under the following conditions: (1) the debtor exceeds the thresholds, that is, 250 employees and €20m turnover, or alternatively €40m turnover; (2) the equity holders are 'out of the money' under a going concern valuation in a liquidation or business sale, both in insolvency proceedings; (3) the shareholders must benefit from a preferential subscription right in case the plan foresees a capital increase in cash; and (4) 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), therefore preventing 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 propose it to court. This might be a problem as the shareholders may prevent them from giving such consent, for example, by removing them from office. This difficulty does not exist in reorganisation proceedings (*redressement judiciaire*) since the debtor no longer has a say; a creditor may propose an alternative plan.

The new legal possibility of a debt-to-equity-swap by squeezing out equity holders who 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.[23]

Generally speaking, from now on with respect to restructuring plans, French insolvency law clearly meets international standards. However, the French system still fosters the balance in favour of the debtor's rescue and related jobs, rather than the creditors' investments, so this Reform is more an evolution than a revolution, which is still a good step.

Notes

1 Completed by Decree No 2021-1218 of 23 September 2021. At the time of editing this article, the Ordinance has been passing the ratification process in the French parliament.
2 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.
3 The Reform entered into force on 1 October 2021 for proceedings opened as from this date.
4 Since 1985.
5 '*L'entreprise en difficulté en France en 2020, Des entreprises asymptomatiques face à la pandémie?*', May 2021, Altares Deloitte.
6 'Insolvent' meaning unable to pay debts when they fall due.
7 Minor creditors, non-financial creditors or suppliers are often not involved in pre-insolvency proceedings in order not to interrupt the business.
8 Ordinance No 2020-596 dated 20 May 2020, art 5; For more details, see 'French insolvency rules reformed in the light of pandemic COVID-19: Are they going too far?', (2020) 14(2) IRI.
9 Involved or not involved in the conciliation proceedings.
10 As well as payment grace periods of up to two years (art L 611-7 *Code de commerce*).
11 Art R 611-39-1 *Code de commerce.*
12 '*Constat*'.
13 But the court does not control the fees.
14 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 companies, the Reform removes all applicable thresholds so that all companies, regardless of their size, now have access to the accelerated safeguard.
15 France, therefore, has an advantage compared to other EU Member States whose new pre-insolvency proceedings are yet to benefit from automatic recognition within the EU until their inclusion in Annex A of the EIR 2015/848.
16 Even though a creditor that is appointed as so-called 'controller' can give its opinion to the contemplated business sale, their opinion is not binding.
17 250 employees and €20m turnover; or €40m turnover.
18 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 SMEs who are unfamiliar with costly pre-insolvency proceedings.
19 With the previous approval of the insolvency judge (*juge-commissaire*).
20 In accelerated safeguard and safeguard proceedings, but not in reorganisation proceedings (*redressement judiciaire*) where the debtor's approval is not required.
21 Ie, 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.
22 Within the limits of art 11(2) of the Directive.
23 A legal exception existed nevertheless but was never used – art L 631-19-2 *Code de commerce.*

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