

The French pre-pack proceedings challenged by the Directive Proposal of the European Parliament and of the Council, harmonising certain aspects of insolvency law: the difficulty of finding the balance between transparency and confidentiality

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In France, pre-pack proceedings are considered as one of the key restructuring tools. The future transposition in French law of the Directive Proposal, as it now stands, should result in higher recovery rates in France within pre-pack proceedings, as they would require more transparency in the bidding process. However, that very transparency, as well as the increased obligations for the insolvency practitioner,¹ might render the pre-pack proceedings less attractive than they stand today.

After Directive 2019/1023 of the European Parliament and of the Council dated 20 June 2019 on preventive restructuring frameworks, the European Commission struck again and proposed a new directive aimed at harmonising the recovery of assets, the efficiency of insolvency proceedings, and the fair distribution of the recovered assets among creditors (the ‘Directive Proposal’).¹²

One of the provisions of the Directive Proposal, which will be discussed in this article, is the introduction of regulatory frameworks to govern pre-pack sales in European Union Member States.³ It is generally assumed that more value can be recovered by selling the business as a going concern rather than by piecemeal in liquidation. To promote going-concern sales in distressed situations, national insolvency regimes should include pre-pack proceedings, where the debtor in financial distress seeks, with the help

of an insolvency practitioner called a ‘monitor’, interested buyers, and prepares the sale of the business before the opening of formal insolvency proceedings during which the sale will be implemented by the court.⁴ As a principle, the sale of the business in a pre-pack scenario is completed debt – and liability free, which makes it so attractive.⁵

Pre-pack sales in France⁶ were introduced in 2014.⁷ Since then, they have been considered as one of the key restructuring tools, successfully implemented in famous cases such as *FRAM* (2015), *NextiraOne* (2015), *Tati* (2017) and *William Saurin* (2017). There is no doubt that, thanks to this efficient tool, many jobs have been saved. However, pre-pack sales⁸ also face critics in French practice, as they do not lead to satisfactory recovery for creditors, but, instead, focus on saving jobs.

Pre-pack proceedings under the Directive Proposal: general principles

The Directive Proposal aims at establishing, in Member States, pre-pack proceedings⁹ composed of a preparation phase, ‘which aims at finding an appropriate buyer for the debtor’s business or part thereof’, and a liquidation phase, ‘which aims at approving and executing the sale of the debtor’s business or part thereof and at distributing the proceeds to the creditors’.¹⁰

Preparation phase of the pre-pack sale

According to the Directive Proposal, during the preparation phase of the sale,¹¹ the debtor shall remain in control of its assets and the day-to-day operation of the business.¹² The court shall appoint a monitor, chosen among insolvency practitioners,¹³ who shall start the preparation phase and assist the debtor in the search for interested buyers.¹⁴ Member States should ensure that the monitor accomplishes a list of actions, to be recorded in writing and made available, in digital format and in a timely manner to all parties involved in the preparation phase, that is: (1) documenting and reporting on each step of the sale process; (2) justifying why he or she considers that the sale process is competitive, transparent, fair and meets market standards; (3) recommending the best bidder as the pre-pack acquirer;¹⁵ and (4) stating whether he or she considers that the best bid does not constitute a manifest breach of the best-interest-of-creditors test.

The Directive Proposal states as principles that the sale process carried out during the preparation phase shall be competitive, transparent, fair and meets market standards,¹⁶ and that in the presence of only one binding offer, it shall be deemed to reflect the business market price.¹⁷ Member States may only depart from these principles if the court runs a public auction in the later liquidation phase.¹⁸ From a French point of view, these principles are revolutionary.

During the preparation phase, the debtor would be able to benefit from a stay of individual enforcement measures if: (1) the debtor is insolvent *or in a situation of likelihood of insolvency*; and (2) it facilitates a successful outcome of the pre-pack proceedings, the monitor being heard prior to the decision of the court.¹⁹ This mechanism is already open to debtors under current French law²⁰ and largely used and appreciated in practice, but not limited to a situation of insolvency of the debtor.²¹

Liquidation phase: implementation of the pre-pack sale

Once the liquidation phase²² is opened, the Directive Proposal requires that Member States shall ensure that the court authorises the sale of the debtor’s business, or part of it, to the buyer proposed by the monitor, the latter having confirmed that the sale process during the preparation phase met the four requirements stated above. If not, the court must decline the sale and go on with a public auction that shall last no longer than four weeks and start within two weeks of the liquidation phase opening.²³ The court appoints the monitor as insolvency practitioner.²⁴

The offer first selected by the monitor in the preparation phase should be used as the initial bid in the auction, so that the following offers could only present improved conditions.²⁵ Member States shall ensure, if a different bidder prevails, that the initial bidder is compensated for the expenses incurred or shall receive a break-up fee in a ‘commensurate and proportionate’ amount, which ‘do not deter parties from bidding in the liquidation phase’.

Moreover, Member States would have to ensure that the buyer of the debtor’s business is assigned the necessary ‘executory’ (ie, ongoing) contracts for continuation of the business, without requiring the consent of the counterparty, except in the case in which the buyer is a competitor to the debtor’s counterparty. Under some conditions, the court may also decide to terminate an ongoing contract, for example, if the termination serves the interest of the debtor’s business²⁶ or if the buyer does not meet the technical and legal obligations of public service obligations in the contract.²⁷ The law applicable to the assignment or termination of ongoing contracts would be the law of the Member State where the liquidation phase was opened,²⁸ and is appropriate for the debtor and the court but alters the legal certainty for counterparties.

The Directive Proposal permits that parties closely related to the debtor are eligible to acquire the debtor’s business,²⁹ if: (1) they disclose their relation to the debtor in a timely manner to the monitor and the court; (2) other parties receive adequate information about the relation; and (3) other parties are given sufficient time to make an offer. Again, transparency is the key word. If the disclosure duty is breached, the court should revoke the ‘debt-free’ benefit of the contemplated pre-pack sale.

If the offer made by a party closely related to the debtor is the only existing offer, the monitor and insolvency practitioner must reject such an offer if it does not satisfy the best-interest-of-creditors test.³⁰ The Directive Proposal suggests Member States should

introduce additional ‘safeguards’ for the authorisation and execution of the sale to a unique offeror being closely related to the debtor, without specifying, however, what such ‘safeguards’ could be.

Secured creditors would be permitted to participate in the bidding process by proposing to offset their secured claims with the purchase price of assets over which they hold security, provided, however, that the value of the secured claims is significantly below the market value of the business.³¹ Indeed, a secured creditor should not benefit from an advantage in the bidding process.

From a French point of view, the protection of creditors’ interests proposed by the Directive Proposal is interesting. Creditors and equity holders, except if they are out of the money in a liquidation scenario, should have the right to be heard by the court prior to the authorisation or execution of the sale of the debtor’s business.³² It is true that ‘to be heard’ does not mean that the court must take creditors’ opinions into account. Nevertheless, the right to be heard would improve creditors’ rights in French proceedings.

Pre-pack proceedings in France

In France, the current legal framework for pre-pack proceedings is established by Articles L 611-7 and L 642-2 of the French Commercial Code pertaining to ‘conciliation’ and ‘*mandat ad hoc*’ proceedings. ‘Conciliation’ and ‘*mandat ad hoc*’ proceedings are pre-insolvency proceedings³³ led by an insolvency practitioner, appointed by the court, called the ‘conciliator’ or ‘*mandataire ad hoc*’, who negotiates with selected creditors a debt rescheduling or haircut to get the debtor on track again, avoiding insolvency. The mission assigned to the conciliator or ‘*mandataire ad hoc*’ may comprise the search for a buyer with whom the disposal of the business will be prepared for four months³⁴ and implemented in subsequent safeguard,³⁵ reorganisation or liquidation proceedings.

Once the preparation phase of the pre-pack proceedings is initiated, a limited bidding process may be launched for the acquisition of the business, which is not public – as it is conducted within confidential proceedings – but must nevertheless ensure ‘sufficient publicity’.³⁶ In practice, conciliators or ‘*mandataire ad hoc*’ consider in general that a buyer search via an investment bank or M&A boutique is sufficient to confer to the process adequate publicity.

The opening of subsequent insolvency proceedings is not mandatory under French law if the sale can be completed through a share or asset deal in which creditors can be fully paid. However, in practice, reorganisation or liquidation proceedings are generally opened to

benefit from an advantageous debt-free and liability-free purchase. In such a case, after the preparation phase, the debtor will enter a liquidation phase to sell its business (reorganisation or liquidation proceedings, as a total sale of the business cannot be implemented in the context of safeguard proceedings). The debtor must be in the status of insolvency,³⁷ in accordance with the conditions for opening such proceedings.

In most cases, the conciliator³⁸ who conducted the preparation phase of the sale will be appointed as the administrator in subsequent insolvency proceedings to ensure continuity between the preparation and implementation of the sale. The court will then review the conciliator’s actions and bids received to ensure sufficient publicity was provided during the preparation phase³⁹ and, if not, the French judge may decide to refuse the bid.⁴⁰

If deemed satisfactory, the court may decide not to open a public bidding process and set a date to review the bids.⁴¹ The court will then accept the offer that allows first, the rescue of the highest number of jobs and second, the payment of creditors under the best conditions.

If provisions of the French Commercial Code seem at first glance quite similar to the framework set by the Directive Proposal, some major differences are yet to be highlighted.

Confidentiality is a major aspect of French pre-pack proceedings, as it allows distressed companies to negotiate and execute a sale of assets in complete discretion under the umbrella of conciliation or ‘*mandat ad hoc*’ proceedings without fear that this will negatively affect their brand image or cause a loss of trust from their business partners. As it is for any French conciliation or ‘*mandat ad hoc*’ proceedings, regular or pre-packed, French law is very strict on the confidentiality requirement, Article L 611-15 of the French Commercial Code providing that ‘any person who is called upon to take part in the conciliation procedure or an ad hoc mandate or who, by virtue of his or her duties, has knowledge thereof is bound by confidentiality’. French case law has also proven to be very rigorous on the confidentiality of the pre-pack,⁴² accepting only few restrictions.

From the buyer’s point of view, a pre-pack sale is very attractive as it offers the possibility to purchase a fully functioning business for a low price, debt-free and with fewer competitors than on a free market; sometimes with none of them. Moreover, a pre-pack sale is quick⁴³ and therefore cost efficient.

The French closed shop practice would have to drastically evolve if the Directive Proposal, as it stands, is transposed, as their provisions require effective publicity of the sale to be organised by the monitor

and several new mechanisms towards this achievement, such as the ‘stalking horse’ process (revealing the first bid so that others may compete in a necessary ameliorative way) and the related payment of a break-up fee in a ‘commensurate and proportionate’ amount to the initial bidder or the creation of a register of pre-pack sales, that would enable the creditors and other stakeholders to have access to information about pre-pack proceedings.

As they prioritise confidentiality, French pre-pack proceedings do not ensure actual publicity or fair competition between bidders, as the Directive Proposal requires Member States to do. In most cases, today, during the preparation phase, the French conciliator approaches potential buyers through an investment bank. The potential buyers do not know of the existence or identity of the other candidates involved and are held apart from each other. As for the liquidation phase, the bidding process, which is indeed public, will often only last for one to three weeks and cannot be considered as a fair auction since this time frame is not sufficient for new bidders to be provided with the same level of information as the first bidder who prepared its offer during the preparation phase.

Moreover, the increased obligations for the monitor according to the Directive Proposal are not to be underestimated.⁴⁴ Indeed, they aim to ensure a certain level of transparency and put the sales process in a similar situation as it would be for a solvent business on the free market – ‘competitive, transparent, fair and meeting market standards’,⁴⁵ which is hardly compatible with the confidentiality obligations governing French conciliation proceedings in which the pre-pack sale is prepared. According to the Directive Proposal, the monitor would have to justify, in writing, his or her choice of offer by stating whether he or she considers that the best bid does not constitute a manifest breach of the best-interest-of-creditors test.⁴⁶ This is a harsh commitment in the light of the monitor’s (and insolvency practitioner’s) liability he or she would have to face according to the Directive Proposal: The monitor (and insolvency practitioner) can be held liable for the damage that his or her failure to comply with his or her obligations causes to creditors and third parties affected by the pre-pack proceedings.⁴⁷

The Directive Proposal also emphasises the protection of creditors, whereas French pre-pack proceedings have been criticised for lacking transparency towards creditors and not adequately protecting their interest. Article L 611-7 of the French Commercial Code does not require the debtor to provide detailed information to the creditors about the sale, making it difficult for them to evaluate

whether or not the sale is fair and reasonable. Under Article L 611-7, the creditors are only given the opportunity to express their opinion on the sale assignment to the conciliator, but this opinion remains non-binding to the court, and occurs prior to the expression of any identified offer. Creditors are not heard on the sale itself and can’t review its conditions (price, employees etc), as the Directive Proposal would require.

Moreover, as the rescuing of the business and related employment are prioritised, French pre-pack proceedings often lead to significant losses for creditors by allowing the sale at a significantly low price. The French practice would have to be rethought if the Directive Proposal were to be implemented as it is, since it requires that the pre-pack proceedings lead to a sale conducted on ‘market terms’, meaning that the price obtained for the assets would have to be comparable to the price that could be obtained on the market, which is definitely not the case in current French pre-pack proceedings.

The Directive Proposal also requires that the selected bid passes the creditors ‘best interest test’, meaning that creditors would have to be treated in a better way – or at least neutral way – than they would be in the event of a separate liquidation of assets, which is also not guaranteed in the French pre-pack proceedings, the creditors often being left with a very small or even no distribution at all.

The uncertain faith of the French pre-pack proceedings with regards to the Directive Proposal requirements

In the light of the changes that would be required if the Directive Proposal were to be transposed to French law, it is worth wondering what would become of the French pre-pack proceedings and whether it would still be of interest or not.

First, several of the Directive Proposal requirements (pre-pack sale register, hearing of the creditors on the sale, publicity of the first bid, sufficient publicity during the preparation phase etc) would definitely reduce the confidentiality of transactions conducted under pre-pack proceedings, as transparency is part of the framework set by the Directive Proposal.

But in distressed situations, too much transparency could discourage companies in financial distress from restructuring in a preventive manner as it could have a negative impact on the company’s reputation and could lead to a loss of trust and confidence in the company, which could make it difficult for the company to continue doing business with its partners. For this reason, precisely, French pre-insolvency proceedings provide for confidentiality.

Second, potential investors could be discouraged from participating in pre-pack proceedings, as the publication of the sale in a register could lead to them losing the competitive advantage they may have had over other investors, but also since the pre-pack proceedings would have to be conducted on market terms (ie, the price would have to be much higher than current French practice).

On top of that, pre-pack proceedings would become more time-consuming as they would require a lot more duties and accomplishments from the monitor/conciliator regarding the provisions of the Directive Proposal. Therefore, launching pre-pack proceedings would become more expensive as it is likely that it would also increase the monitor's/conciliator's fees.

The attraction of the current French pre-pack proceedings resides, so far, in its confidentiality, its effective timing and its reasonable cost for the debtor, so it is questionable whether the pre-pack proceedings under the provisions of the Directive Proposal would still be attractive in France, even more since the difference between pre-pack proceedings and a sale made under reorganisation proceedings seems to become even thinner from the perspective of the Directive Proposal.

The Directive Proposal aims to strike a balance between protecting the interests of distressed companies on the one hand, and the protection of creditors, the need for fair competition and preventing abuse on the other. It remains to be seen how it will be transposed in France and what will be the impact in practice on the faith of pre-pack proceedings. It is important to note that the Directive Proposal has not yet been adopted and may undergo changes before its final adoption.

Notes

- 1 Called 'monitor' in the preparation phase, Art 22 of the Directive Proposal.
- 2 Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law (COM (2022) 702) published 7 December 2022.
- 3 In line with the judgment rendered by the Court of Justice of the EU in the *Heiploeg* case, the Directive Proposal aims to clarify that the liquidation phase of pre-pack proceedings must be considered as insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of a competent public authority for the purpose of Art 5(1) of Directive 2001/23/EC.
- 4 See *in extenso*: Recital (22) of the Directive Proposal.
- 5 Art 28.
- 6 French law provides also for pre-pack plans, see Art L 628-1 of the French Commercial Code.
- 7 Introduced by the Ordinance no 2014-326, 12 March 2014.
- 8 Which we will call in the following, like the Directive Proposal, 'pre-pack proceedings'.
- 9 Title IV – Arts 19 to 35.
- 10 Art 19.
- 11 C 2, Arts 22–24.
- 12 Art 22(4).
- 13 Art 22(3).

- 14 Recital 22: 'with the help of a "monitor"'.
- 15 The criteria to select the best bid in pre-pack proceedings are the same as those used to select between competing offers in winding-up proceedings, Art 30.
- 16 Art 24(1).
- 17 Art 24(2).
- 18 Art 24(3).
- 19 Art 23.
- 20 Art L 611-7 s 5 of the French Commercial Code and 1345-5 of the French Civil Code.
- 21 This could be a potential issue in French law as this additional condition required by the Directive Proposal is restrictive.
- 22 C 3, Arts 25–29.
- 23 Art 26.
- 24 Art 25.
- 25 Art 26(2): 'stalking horse bid'.
- 26 Except for ongoing contracts related to intellectual and industrial property rights.
- 27 Art 27.
- 28 Art 27(3).
- 29 Art 32.
- 30 Art 32(2).
- 31 Art 33(3).
- 32 Art 34.
- 33 French insolvency law conducts only a 'cash-test'.
- 34 With the possibility of one month extension.
- 35 In case of a partial disposal only.
- 36 Art R 642-40 of the French Commercial Code.
- 37 Meaning 'cash insolvent' in French law.
- 38 Or '*mandataire ad hoc*'.
- 39 Art R 642-2 of the French Commercial Code. The opinion of the public prosecutor is required but not binding.
- 40 Eg, the *Doux* proceedings or the *Toys 'R' Us France* ones.
- 41 In practice, one can notice that in most cases, at the stage of the liquidation/implementation phase of the pre-pack sale, the judge has only one single offer to examine, as the others – if any – were eliminated in the preparation phase.
- 42 Confidentiality applies equally to third parties (Cass com, 15 December 2015, No 14-11.500) and to the debtor itself, (Cass com, 5 October 2022, No 21-13.108).
- 43 Four-to-six months all in all.
- 44 See above 1.1, Art 22.
- 45 Art 22(2).
- 46 The Directive Proposal does not give a definition of the 'best-interest-of-creditors test'. We assume that reference is made to Art 2 of the Directive 2019/1023 of the European Parliament and of the Council dated 20 June 2019, where 'best-interest-of-creditors test' means 'a test that is satisfied if no dissenting creditor would be worse off under a restructuring plan than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, either in the event of liquidation, whether piecemeal or by sale as a going concern, or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed'.
- 47 Art 31.

About the author

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