Restructuring a French company's liabilities: How can the law help?

As in many European countries, the French economy has been hit by a significant slowdown, which puts great pressure on the financial situation of many companies. This situation sometimes creates a cash shortage which could put the company in a difficult position as regards settling its liabilities in the short term, although the fundamentals of its business remain healthy; a company may also find itself in a situation where, although in a position to settle its liabilities, its lower performance jeopardises its credit position and its relationships with its banks, for instance by being in breach of financial covenants set out in a financing agreement. As such agreements generally include cross default provisions, a single issue may create significant damages for a company.

In these circumstances, the company is exposed to legal action from its creditors and may find itself in a weak negotiating position in the context of discussions with creditors in order to agree to the necessary rescheduling of its liabilities with them.

Preventing such situations from deteriorating into insolvency and providing efficient assistance to companies facing these issues have in recent years become a major concern in France. In order to address these needs, over the years French law has developed various schemes aimed at assisting companies to reach an agreement (or obtaining a court decision) which could restructure all or part of its debt and, as a result, avoiding a situation whereby the company in question files for bankruptcy.

The use of such schemes is decided by the company facing these difficulties (no agreement of a third party is required) on a voluntary basis, i.e. they are normally initiated by the company and are not compulsory; their implementation does not in principle involve the removal or limitations of powers of the management of the company concerned. In addition, none of these schemes may *per se* result in a forced change of control or change of directors of the company seeking to use them.

Companies experiencing economic hardship are increasingly using such schemes, in agreement with their shareholders, in order to facilitate the entry of new investors. This can be achieved through a recapitalisation and/or a change of control of a company, the entry of new investors being generally subject to a number of conditions, such as rescheduling of debt, settlement of disputes with creditors, redundancies, disposal of activities…all of which are facilitated by these schemes.

- **Appointment of a *Mandataire ad hoc***

This scheme is the most confidential and the "lightest" in terms of proceedings and applicable rules.

When a company is experiencing one or several specifically identified difficulties, its legal representative may request the President of the relevant commercial court (*Tribunal de commerce*) or civil court (*Tribunal de Grande Instance*) to appoint an expert (*mandataire ad hoc*) who will help the management board of the company to reach an agreement with the opposite party (ies) regarding a specific issue, most of the time, the rescheduling of the payment of one or several debts. The *mandataire ad hoc* is generally an *administrateur judiciaire* (i.e. the French equivalent of a receiver).

When applying for the appointment of a *mandataire ad hoc*, the company must not be in a state of insolvency[1].

[1] Under French law, insolvency (*cessation des paiements)* occurs when a company is unable to settle its payable liabilities with its available cash resources.

The appointment of the *mandataire ad hoc*, the scope and duration of his task are determined by the judge. The management of the company may suggest the name of a *mandataire ad hoc* to the court, although the court is not bound by such a recommendation. The *mandataire ad hoc* is generally appointed for a period of 3 months, which may be renewed without limitations.

This appointment is strictly confidential, i.e. it is neither published nor disclosed to the authorities (or even to the public prosecutor); therefore, it does not affect the reputation or the financial credibility of the company concerned.

The *mandataire ad hoc* has no binding authority over the company (his appointment does not in any way limit the powers of the company's directors), which may at any time request the court to terminate his mission. Furthermore, he has no authority over the opposing party, which remains entitled to initiate legal proceedings against the company at any time during the discussion. His role is purely advisory and consists of helping each party to understand the opposite party's positions and proposing alternative arrangements to resolve the matters at stake.

The involvement of the court in this process is therefore minimal and the success of such a procedure will rely mostly on the willingness of both parties to find an amicable solution to the matter at stake and on the negotiating skills of the *mandataire ad hoc*.

If the mission of the *mandataire ad hoc* is successful, the parties will prepare and execute a settlement agreement specifying the terms of their amicable arrangements.

- ***Procédure de conciliation***

This procedure, governed by Article L. 611-4 et seq. of the French commercial code is confidential (although the public prosecutor is informed of its opening) and also applies when the company is experiencing one or several specifically identified difficulties which, however, allows at this stage for a financial recovery by the company.

As for the *mandat ad hoc*, the *conciliation* is initiated by the company on a voluntary basis (the consent of the other party(ies) is not necessary) and does not limit the powers of the management; the court will appoint a *conciliateur*, whose mission will consist of assisting the company.

However, this specific procedure is less "contractual" in its operation than the *mandat ad hoc* and has several important differences:

- The *procedure de conciliation* is open to companies which are *in bonis*, but also to companies which have been in a state of insolvency for less than 45 days. The *conciliation* may therefore be used when the company has just become insolvent and is aimed at addressing a specific issue, the resolution of which would restore its financial situation.

- The role of the *conciliateur* may go beyond that of a mere middleman : in addition to assisting the company in negotiating with its creditors, the *conciliateur* may also make proposals regarding the preservation of the company, the continuation of its business and the preservation of employment within the company.

- As for a *mandat ad hoc,* the company's creditors remain free to initiate proceedings against the company to recover their debts. However, (i) the judge may impose deferred terms of payment on them (as authorised by articles 1,244-1 et seq. of the Code civil) and (ii) the creditors cannot request a court to initiate insolvency proceedings *(redressement judiciaire*) against a company which is subject to a *conciliation*.

- The *conciliateur* is also entitled by law to negotiate rescheduling (or reduction) of debt with the tax and social security authorities.

- The duration of the *conciliateur*'s mission cannot exceed 5 months in total. For this reason, companies tend to apply first for the

appointment of a *mandataire ad hoc* before initiating a *conciliation*.

The financial recovery plan may also provide for new equity or debt contributions, to be made by existing shareholders or by new shareholders. This is achieved by subscribing for new shares or for complex securities (e.g. convertible bonds, bonds redeemable in shares).

Once executed, the agreement with the creditors will enter into force once it has been "acknowledged" by the court (in which case the agreement and the *conciliation* will remain confidential).

Alternatively, the agreement may be formally approved ("*homologué*") by the court ; in such a case, the agreement will not remain confidential but (i) the creditors who have signed it will be prevented from initiating any proceedings against the company for the payment of the debts covered by the agreement, and (ii), in the event of *sauvegarde* or insolvency proceedings being initiated against the company at a later date, the repayment of any cash contribution (debt) made to the company in accordance with the agreement will benefit from a priority against any debt existing prior to the opening of the *procedure de conciliation (*except salaries and court expenses). This rule – known as *Privilège de new money* – also applies to debts owed by the company to its suppliers in relation to the supply of goods or services made under the agreement signed with the creditors.

- ***Procedure de sauvegarde***

This procedure was introduced into French law in 2005 and directly takes its inspiration from the US Chapter 11. It is regulated by Articles L. 620-1 to L. 625-9 of the French commercial code. Its purpose is to prevent the company from becoming insolvent by providing it with strong protection and giving it the necessary time to draw up a recovery plan.

While the *mandat ad* hoc and the *conciliation* may be seen as amicable processes designed to solve specific issues, the *procedure de sauvegarde* is far closer in its operation, as well as in the solutions implemented, to the "regular" insolvency proceedings (*redressement judiciaire*) and has been designed for companies facing complex difficulties. This scheme is implemented under close supervision by various bodies appointed by the court, which will liaise with the company and its creditors to elaborate the recovery measures that are necessary to prevent the company in question from becoming insolvent.

This procedure is aimed at companies (i) which are not insolvent, i.e. which are not compelled to file for insolvency and (ii) which have significant liabilities which they are unable to deal with without assistance. The purpose of this procedure is to elaborate a reorganisation with the creditors of the company plan of the company either for its continuance or for its continuance coupled with a partial sale of the business.

The opening of such a procedure is a strong message showing the company's creditors the need to agree on a restructuring of the company's liabilities and that there is a significant risk of the company becoming insolvent in the near future.

By prohibiting the payment of all debts generated prior to the opening of the *sauvegarde*, as well as any legal action in relation to such debts, it also immediately gives the company some leeway. Furthermore, it may enable the company to raise debt to finance its operations as the repayment of loans made to the company after the opening of the *sauvegarde* as well as of debts relating to agreed deferred payment of sums due in relation to contracts continued will benefit from a priority against other debts created before the opening of the *sauvegarde* or after such opening *(*except salaries and court expenses).

The judgement opening the procedures appoints, inter alia, an *administrateur judiciaire* (i.e. a receiver) whose mission is to draft a report regarding the current situation of the company and to assist the company's management with the reorganisation. The company may suggest the name of an *administrateur judiciaire* to be appointed, but the court is not bound to follow this proposal.

Although the principle is that the legal representative of the company retains the entirety of the management powers of the

company, the judge may extend the scope of the mission of the *administrateur judiciaire* from one of "monitoring" to one of "assistance" for all or part of the transactions carried out on behalf of the company.

The filing for *sauvegarde* leads to a 6 month observation period (renewable once) during which :

- No debt existing prior to the date of opening of the proceedings may in principle be paid;
- No claim for payment of a debt existing prior to the date of opening of the proceedings may be initiated or continued;
- All interest due with regard to debt existing prior to the date of opening of the proceedings are stopped. This is effective from the date of opening of the procedure.

During the observation period, the company continues to operate its business. Provided that the company complies with its undertakings and notwithstanding any provision to the contrary, no contract in progress may be terminated by a third party without the prior consent of the *administrateur judiciaire*. However, all payment obligations by the company must be settled on a cash basis (unless otherwise agreed by the third party concerned).

The observation period allows shareholders (together with, as the case may be, new investors) to agree on the terms and conditions under which they will contribute new equity (and/or debt) to the company.

If, during the observation period, it appears that the company has in fact become insolvent, the *sauvegarde* may be converted into an insolvency procedure (*redressement judiciaire*) or liquidation.

Also, in the event that, prior to the opening of a *sauvegarde*, an agreement was signed with the company's creditors in the context of *conciliation*, such agreement is deemed to have been terminated as a result of the opening of the *sauvegarde*.

The creditors will have to declare their debts against the company in order to clearly establish the amount and nature of the liabilities. They will be represented by two committees (banks, other creditors) in order to discuss the possible terms of the restructuring of their debts, which may include a rescheduling of the debt, a reduction of its amount or a conversion of all or part of the debt into equity or convertible securities.

Each committee will deliberate over the proposals made by the *administrateur judiciaire* (with a majority rule equal to two-thirds of the amount of the debts represented at the relevant committee).

If the committees approve the proposals, the court will ratify them after having checked that the interests of the creditors are appropriately protected and such proposals will become enforceable against all the members of such committees. If the proposals are not approved, the court remains entitled (i) to consult with each creditor individually and (ii) to impose on all creditors a rescheduling of their debts (with a first payment no later than one year after the judgement and no annual payment equal to less than 5 % of the debt) as well as offering each of them an accelerated payment in return for a reduction of the amount of their debt.

If it appears that there are solutions to enable the company to solve its current difficulties, the *administrateur judiciaire* will draw up a recovery plan that will be submitted to the court for approval. The duration of the plan may not exceed ten years.

The repayment of loans made to the company after the opening of the *sauvegarde* as well as of debts relating to agreed deferred payment of sums due in relation to contracts continued will benefit from a priority against other debts created before the opening of the sauvegarde or after such opening *(*except salaries and court expenses).

In conclusion, French law now offers the appropriate tools to allow France-based companies to reorganise their financial situation and improve their overall position. Used appropriately, these schemes bring an interesting leverage to negotiations with creditors and may also be an efficient tool

to facilitate the transfer and/or recapitalisation of distressed companies. However, preparation and appropriate timing are key to the success of these schemes. Now that the rules are in place, it is up to managers and finance executives to use them proactively, at a stage when their companies still have room for manoeuvre.

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