Legal high Committee for
Financial markets of Paris

OPINION

of the Legal High Advisory Committee of the Financial Market of Paris (HCJP) on the proposal of 22 November 2016 for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU

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INTRODUCTION

The scope of application of the proposed Directive of 22 November 2016 (hereinafter «the Directive») is defined in its first article. It concerns preventive restructuring procedures[1] and procedures leading to a discharge of debts incurred by over-indebted entrepreneurs and natural persons, and allowing them to take up a new activity (second chance)[2]. The Directive also includes a Title IV setting out measures to increase the efficiency of these two categories of procedure, as well as that of insolvency proceedings.

The transposition into French law of the measures on second chance relates to the procedures in place for the judicial rehabilitation and judicial liquidation of a company (*redressement judiciaire* and *liquidation judiciaire*). The measures for increasing the efficiency of the procedures defined in Title IV of the Directive concern all procedures set out in Book VI of the French Commercial Code. The rules on «preventive restructuring procedures enabling debtors in financial difficulty to restructure [....] so as to avoid insolvency» are more complicated, however, and questions are being raised by practitioners and in the standard doctrine as to their scope of application. One notable uncertainty is whether the transposition will affect the safeguard procedure (*procédure de sauvegarde*), introduced into ordinary French law by Law No. 2005-845 of 26 July 2005 and governed by Articles L. 626-1 et seq. of the Commercial Code, and which allows a court to decide on a restructuring plan if there is a genuine possibility that a company can be saved, and whether it will affect the conciliation procedure created by Law No. 2005-845 of 26 July 2005, and governed by Articles L. 611-4 to L. 611-15 of the Commercial Code, a preventive solution also aimed at saving a company.

The working group notes that the Directive makes a distinction between preventive restructuring procedures and insolvency procedures, as defined in Regulation (EC) No 1346/2000. Article 2, paragraph 1, point (a) of the Directive defines an insolvency procedure as «a collective insolvency procedure which entails a partial or total divestment of the debtor and the appointment of a liquidator».

The group also notes that the Directive is not designed to replace or modify existing ordinary law on insolvency procedures, but rather to create a common legal framework across the European Union (EU) for the prevention of liquidation. Each Member State is required to put in place a preventive restructuring procedure that meets the conditions set out in the Directive. If a Member State does not already have such a procedure, then the national legislator must create one in accordance with the framework defined in the Directive. If a Member State already has one or more preventive tools in place, it must ensure that at least one of these tools meets the conditions set out in the Directive.

[1] *Article 1, paragraph 1, point (a) of the Directive.*

[2] *Article 1, paragraph 1, point (b) of the Directive.*

The Directive thus aims to harmonise preventive restructuring procedures across EU Member States. The Commission's objective is not to «interfere with what works well».[3]

After already emphasising in its previous report that it finds the preventive measures both constructive and effective, the working group welcomes the EU legislator's desire to increase prevention. It would also like to add that these measures, as highlighted by the Commission in its explanatory memorandum, «support trade and investment, [and] help create and preserve jobs», which is in line with the objective of the French national legislator.

Article 1, paragraph 1, point (a) of the Directive concerns «procedures available for debtors in financial difficulty». The French *mandat ad hoc* procedure specified in Article L. 611-3 of the Commercial Code does not appear to fall within the scope of the Directive, as it only involves the appointment of a special commissioner whose duties are defined by the presiding judge. As such it is not a procedure in the sense defined in the Directive, but rather a form of support provided to the debtor who in turn remains free from any constraints.

Under Article 1, paragraph 1, point (a) of the Directive, a debtor in financial difficulty must be able to request the implementation of a preventive restructuring procedure «when there is a likelihood of insolvency». However, the Directive does not define the concept of «likelihood of insolvency». Recital 2 in the preamble merely states that preventive frameworks should enable debtors to restructure «at an early stage» in order to avoid insolvency. Moreover, recital 18 proposes the opening of an «informal» restructuring process, provided this does not affect the rights of third parties.

Under French law, therefore, it is the conciliation procedure that appears to fall within the scope of the Directive, as it can be opened as soon as a debtor is faced with actual or foreseeable legal, economic or financial difficulties, provided said debtor has not been in a state of cessation of payments for more than 45 days.

However, it needs to be possible to «combine» the conciliation procedure with the accelerated financial safeguard procedure (SFA – *procédure de sauvegarde accélérée*) introduced by Law 2010-1249 of 22 October 2010 on banking and financial regulation and designed to impose a conciliation agreement even if it has not been approved by all the financial creditors. It also needs to be possible to combine it with the accelerated safeguard procedure (SA – *procédure de sauvegarde accélérée*), created by Ordinance No. 2014-326 of 12 March 2014, which reforms the prevention of difficulties faced by businesses and collective procedures, and can be opened when a company has broad support for its conciliation agreement, but still faces opposition from one or more of its creditors.[4]

[3] *V. Explanatory Memorandum of the Directive, Objective of the proposal, p. 7.*

[4] *These two procedures are governed by Book VI, Title 2, Chapter VIII of the Commercial Code, which comprises Articles L. 628-1 to L 628-10.*

Unlike the ordinary safeguard procedure, the SFA and SA are not stand-alone proceedings. In other words, they can only be opened through the conversion of an existing conciliation procedure, and are used to enact agreements previously negotiated as part of the conciliation process. It is interesting to note that Article 4, paragraph 2 of the Directive specifically allows Member States to combine more than one procedure in their preventive restructuring framework for companies in difficulty.[5]

The next question is whether the ordinary safeguard procedure falls within the scope of the Directive. In this case, the answer is definitely no, since the preventive procedure as defined in the Directive can be opened prior to a safeguard procedure.

This interpretation is in line with the objective of the EU legislator. Debtors in each Member State should have access to at least one «harmonised» preventive procedure, but this does not mean a State cannot have other ordinary law procedures in place which are also accessible prior to insolvency.

The working group therefore believes that national law already includes rules that comply with the common framework defined by the Directive – that is the rules found in the two-stage «conciliation-SFA» or «conciliation-SA» procedures. The conciliation procedure meets the criteria set out in the Directive in that it can be opened when a debtor is faced with actual or foreseeable legal, economic or financial difficulties and has not been in a state of cessation of payments for more than 45 days, and can be converted into an SFA or SA if the debtor evidences that is has prepared a draft aimed at ensuring the sustainability of the company and which is liable to receive sufficiently broad support from the creditors to make its adoption in the required time limit probable.

As a result, this report shall focus on determining whether the provisions of the Directive are appropriate and, if yes, whether they imply an amendment of existing national laws.

The first section of this report (**Part 1**) will focus on Title II of the Proposed Directive which concerns preventive restructuring frameworks. The second section (**Part 2**) will look at Titles III and VI which cover second chance for entrepreneurs, and the other provisions of the Proposed Directive.

[5] *Article 4, paragraph 2 of the Directive.*

Part 1 – Preventive restructuring frameworks

Title II

Title II of the Proposed Directive sets out common, core elements for preventive restructuring frameworks to give debtors in financial difficulty, be they legal or natural persons, effective access to procedures facilitating restructuring plans' early negotiation, adoption by creditors and possible confirmation by a judicial or administrative authority.

1- Appointment of a practitioner in the field of restructuring

Under Article 5, paragraph 2 of the Directive, the appointment of a «practitioner in the field of restructuring» is, in principle, optional. However, Article 5, paragraph 3 states that Member States can make the appointment of a practitioner in the field of restructuring mandatory if the debtor has been granted a general stay of individual enforcement actions, or if a restructuring needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down.[6]

French law takes a slightly different approach on this point, in that a conciliator is systematically appointed by the judicial authority. This person is an experienced negotiator, and as such plays a key role in the conciliation process, and hence in the success of the proceedings. Similarly, in the case of an SFA or SA, a judicial administrator is always appointed.

Given the efficiency of the French model, it might be desirable to make the Directive more flexible, so that, when a procedure is carried out under the aegis of a judicial or administrative authority, Member States can make it mandatory to appoint a practitioner in the field of preventive restructuring, in line with current practice in France.

2- Stay of individual enforcement actions

According to Article 6, paragraph 1 of the Directive, Member States shall ensure that debtors who are negotiating a restructuring plan with their creditors may benefit from a (general or partial) stay of individual enforcement actions if and to the extent that such a stay is necessary to support the

[6] *Article 2, paragraphs 7 and 8 of the Directive: forced application of a restructuring plan over the dissent of one or several affected classes of creditors.*

of a restructuring plan.[7] This stay can also apply to secured and preferential creditors.[8] Nonetheless, an individual creditor or single class of creditors can challenge a stay of enforcement if its implementation would mean they suffered unfair prejudice.

As a stay constitutes a major restriction of creditors' rights, Article 6, paragraph 4 of the Directive limits its duration to a maximum of four months. The Directive also allows judicial or administrative authorities to lift the stay in three specific cases.[9]

Article 7 of the Directive completes this mechanism by stipulating that a general stay of individual enforcement actions shall prevent the opening of insolvency procedures at the request of one or more creditors.[10]

Through these measures, the Directive aims to make it easier to reach an agreement on a restructuring plan, while at the same time ensuring that creditors do not suffer excessive detriment: the stay of enforcement must preserve the overall value of the estate and prevent dissenting minority creditors from blocking the process for their own financial gain.

The French system for the stay of individual enforcement actions is less complex and, in practice, has proven to be satisfactory. It also appears to be in line with the objectives of the Directive.

During the conciliation procedure, individual creditors cannot request the opening of judicial rehabilitation or liquidation proceedings, which is consistent with the Directive. Where a creditor has begun proceedings against a debtor or issued a formal notice to pay, the debtor may ask the judge to order a grace period of up to 24 months.[11]

Moreover, the opening of an SFA or SA procedure immediately brings to a halt any individual proceedings brought by creditors against the debtor.

The working group therefore considers that existing national laws are compatible with the letter and spirit of the Directive. It opposes any form of transposition that would result in a general or partial suspension of individual proceedings being imposed from the start of the conciliation procedure, as this would undermine the principle of confidentiality, which is essential in ensuring the preventive procedure goes smoothly and in preserving the value of the business.

[7] *Under Article 6, paragraph 3 of the Directive allows workers' outstanding claims to be exempted from the stay.*

[8] *Article 6, paragraph 2 of the Directive.*

[9] *Articles 8 and 9 of the Directive.*

[10] *Article 7, paragraph 2 of the Directive.*

[11] *Article L. 611-7 of the Commercial Code.*

3- Restructuring plans

a) – Contents of restructuring plans

Article 8 of the Directive lists the minimum information that needs to be included in restructuring plans. Member States can require additional mandatory information, provided this does not put a disproportionate burden on debtors. Member States should develop online restructuring plan models and provide practical information on how a plan proposer can use such models.

The valuation obligation stipulated in point (b) of paragraph 1 of Article 8 would imply an amendment to French law if it were to require an expert appraisal of the company. Under French law, the debtor merely submits a request to the judge stating its economic, employment and financial situation, financing needs and, if necessary, the means to tackle them.[12] Moreover, in the event of an SFA or SA procedure, only a few figures are provided in the form filled out by the company. This valuation obligation would be costly and could lead to delays in proceedings. It would therefore be advisable to relax this rule, as it is only really useful in the event of a disagreement, where minority creditors are liable to initiate individual proceedings.

b) – Creditor classes

Article 9 of the Directive relates to the adoption of restructuring plans by the affected creditors or classes of creditors. Member States must ensure that affected creditors with different claims or interests are treated as separate classes of creditors. The text stipulates that, as a minimum, a distinction must be made between secured and unsecured claims, and adds that Member States may provide that workers are treated in a separate class of their own.

Only affected creditors have a right to vote on the adoption of the restructuring plan. In this respect, Article 9, paragraph 1, of the Directive corresponds to the principle set forth in Article L. 626-30-2, paragraph 5 of the Commercial Code, under which creditors for whom the plan does not provide for changes in the terms of payment or provides for full payment in cash right after the plan or after the admission of their claims do not participate in voting. Article 9, paragraph 2 of the Directive lays down the rules for the formation of creditor classes. In line with German law, the Directive distinguishes between a first mandatory separation of creditors into classes, and then the optional creation of additional sub-categories.

[12] *Article L. 611-6 of the Commercial Code.*

The definition of «class formation» is provided in Article 2, point (6) of the Directive: it refers to the grouping of affected creditors and equity holders in a restructuring plan in such a way as to reflect the rights and seniority of the affected claims and interests, taking into account possible pre-existing entitlements, liens or inter-creditor agreements.

The Directive also allows the possibility of creating sub-categories within each class of creditors, provided that the claims or interests with rights included in each sub-category are sufficiently similar to justify considering the members as a homogeneous group with commonality of interest. This optional creation of new «sub-classes» is based on the German model (section 222, paragraph 2 of the InsO) and on the US Chapter 11 (section 1222 (a) of the US Bankruptcy Code – BC).

In France, the safeguarding law of 26 July 2005 introduced the notion of «committees of creditors» and opted for a relatively simplistic approach to their formation. The categories are defined on the basis of the nature of the creditors and not according to the nature of their claims. Thus, in the Commercial Code, creditors are divided into three categories: financial creditors, suppliers and bondholders.

However, this classification has drawn criticism,[13] with some arguing that it is not in line with the best international standards, at a time when corporate financing methods are becoming increasingly sophisticated. Ordinance 2014-326 of 12 March 2014 attempted to improve the system by allowing judicial administrators to adjust voting rights according to the existence of guarantees and subordination agreements.[14] However, this model does not exist in other European countries.

In consequence, the working group supports the introduction of a mechanism such as that set out in the Directive.

However, it notes that it would be more appropriate to use the term «categories» rather than «classes», to avoid the idea that creditors are being classified.

In addition, given the criteria that need to be met, it would appear that the rules of the Directive cannot be applied to all companies, but only to those requiring financial restructuring.[15] Indeed, the

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[13] V. R. Dammann and G. Podeur, D. 2014, Chron. 752 «Le rééquilibrage des pouvoirs au profit des créanciers résultant de l'ordonnance du 12 mars 2014».

[14] Article L. 626-30-2, paragraph 4 of the Commercial Code.

[15] R. Dammann and M. Boché-Robinet, «Transposition du projet de directive du 22 novembre 2016 sur l'harmonisation des procédures de restructuration préventive en Europe : une chance à saisir pour la France», June 2017, p. 1264.

cost of the proceedings and the difficulty of dividing creditors into classes mean that the system is not accessible to all companies facing difficulties.

As a result, it should be possible to only group creditors into classes where the negotiations will necessarily lead to an SFA procedure, and then only where different interests exist. This latter point is made clear in the explanatory memorandum to the Directive, but not in Article 9.

The working group therefore feels that clear thresholds need to be set for determining when class formation is mandatory. These thresholds could be those already set out under French law for the creation of committees of creditors.[16]

Exceptions would nonetheless need to be made: companies meeting the thresholds but facing other, non-financial problems could be granted an exemption from the class formation requirement, to avoid having to create classes that do not correspond to their particular situation. Conversely, debtors that do not meet the thresholds could be allowed the option of voluntarily dividing their creditors into classes.

With regard to the rules on class formation laid out in the Directive, these are sufficiently flexible to apply to all cases.[17] The preamble to the Directive[18] specifies that affected parties should be treated in separate classes which reflect the class formation criteria under national law.

These criteria must be objective and non-discriminatory. It should be possible to adapt them to each specific case, so that each class «comprises claims or interests with rights that are sufficiently similar to justify considering the members of the class as a homogeneous group with commonality of interest».[19]

Integrating the rules of the Directive should not pose any particular problems for the conciliation procedure combined with the opening of an SFA or SA. It would be useful to specify that the class formation should be prepared during the conciliation phase if there is a likelihood that an SFA or SA will be necessary to ensure that the plan is approved by a qualified majority of creditors. The actual separation of creditors into classes should then be carried out when the SFA or SA is

[16] *Articles D. 626-29 and R. 626-52 of the Commercial Code.*

[17] *Under French law, the treatment of creditors in the proposed restructuring plan must take into account existing subordination agreements. However, given that in practice this rule is not always applied stricto sensu, the new criteria set out by the Directive should be flexible.*

[18] *Recital 25 of the preamble to the Directive.*

[19] *Article 9, paragraph 2 of the Directive.*

opened, and should be validated by the judge called to examine the restructuring plan, in accordance with Article 9, paragraph 3 of the Directive.

However, some feel that an appeal should be organised immediately after the class formation, in order to deal rapidly with any disputes that might arise over the issue. The appeal could be brought before the bankruptcy judge appointed in the decision to open accelerated proceedings, and should be held as quickly as possible, since the main concern with holding an appeal at this stage is, of course, that it could increase the time taken to handle the case.

The maximum majority required for the adoption of a restructuring plan within each class (75% of the total amount of the claims)[20] appears to be logical and consistent with existing practices in other EU countries. It is greater than the majority required for committees of creditors under French law (two-thirds of the total amount of claims held by the members who cast a vote). As a result, there is no need to amend French law on this subject.

c) Principles guiding the confirmation of the restructuring plan

Deadline for the confirmation of the restructuring plan

Article 10, paragraph 4 of the Directive stipulates that a decision should be taken without undue delay after the request for confirmation has been filed, and in any case no later than 30 days after the request is filed. It seems appropriate to introduce this confirmation deadline into French law, as it is important to handle a case quickly to have a better chance of saving the company.

Respect of the interests of creditors and suppliers

Article 10 of the Directive states that a plan should only be confirmed if it complies with the best interest of creditors, as this ensures that no dissenting creditor is worse off under the restructuring plan than they would be in the case of liquidation.[21]

This definition does not exist in French law. However, under current substantive law, a court must ensure that «the interests of all creditors are sufficiently protected», which appears to implicitly

[20] *Article 9, paragraph 4 of the Directive.*

[21] *Recital 27 of the preamble to the Directive*

cover the same principle, but without requiring that the outcome for each creditor be compared to what it would have been under a liquidation.

This principle, which guides the application of the subsequent rules, is relevant and should be transposed into national law, although again with the proviso that Member States be allowed some degree of flexibility in its interpretation. However, it will mean carrying out a simulation to establish the liquidation value of the company, taking into account the best possible price that could be obtained in the event of a piecemeal liquidation or sale of the business as a going concern, and then simulating the distribution of the proceeds to verify that no dissident minority creditor would have received more under a liquidation than under the restructuring plan.

Cross-class cram-down

Article 11 of the Directive sets out the conditions to be fulfilled to ensure that a restructuring plan not supported by all classes of creditors is nevertheless confirmed by a judicial or administrative authority. While a restructuring plan should always be deemed adopted if it is supported by the required majority in each affected creditor class, a restructuring plan which is not supported by this required majority may still be confirmed by a judicial or administrative authority, provided that it is supported by at least one class of affected creditors and that dissenting creditors are not unfairly prejudiced under the proposed plan. This is known as the «cross-class cram-down» mechanism. The plan should also abide by the «absolute priority rule» which ensures that a dissenting class of creditors is paid in full before a more junior class can receive any distribution or keep any interest under the restructuring plan.[22]

These provisions seem familiar on the surface, but in fact constitute a change of paradigm. In line with US and German law, the Directive introduces a cram-down mechanism to overcome opposition from minority creditors.

The introduction of a cross-class cram-down mechanism appears legitimate, and is in keeping with the forced exclusion of shareholders introduced by the French legislator in recent years (and also suggested in the proposed Directive),[23] in that it aims to prevent individual parties from unreasonably obstructing insolvency procedures.

[22] *Point 28 of the preamble to the Directive*

[23] *Article 12, paragraph 1 of the Directive.*

However, the voting system to be used in the event of a cross-class cram-down should be chosen by the national legislator.

The rule currently proposed by the Directive is based on the US system. It is particularly complex and requires that the company be valued by an expert in order to determine which creditor classes need to give their approval. Other, simpler voting systems exist, such as that used in Germany, where a simple majority of creditor classes is required to approve the plan (two if there are three classes in total; three if there are five in total).

The absolute priority rule

The Directive requires that restructuring plans abide by the absolute priority rule, which is an interesting concept and aims to provide some degree of predictability. The rule means that is not possible to give a particular class of creditors priority over a more senior class. Once the classes have been defined, the court merely has to check that the claims of junior creditors are to be repaid after those of more senior classes.

The working group sees no reason to oppose this principle, which is designed to prevent plans from being blocked. It also appears to safeguard the interests of claimants, which is in line with the shift in French law towards providing greater protection for creditors.

It is worth stressing, nonetheless, that this rule only applies to creditors affected by the restructuring plan; in the majority of cases, suppliers are not concerned by the proceedings as they play a vital role in enabling the company to continue its activity.

It should also be noted that another measure in the Directive (Article 10, paragraph 3) aims to prevent the adoption of plans deemed unviable, which the working group feels is a good initiative.

d) Valuation of the company by the judicial or administrative authority

One area where the Directive aims to make improvements is in the valuation of enterprises.

However, while the main objective of the Directive is to make preventive restructuring procedures more effective within the EU, the introduction of reference values (going-concern value and liquidation value) could potentially have the opposite effect as it raises various difficulties (method used to determine the value, cost and time taken to determine the value), and hence makes existing procedures unusable.

Moreover, several valuations are mentioned.

It appears that the «liquidation value»[24] applies in the case of an intra-class cram-down (when a restructuring plan adopted by the majority of creditors is imposed on minority creditors within the same class), whereas «the value of the enterprise as a going concern»[25] applies in the case of a cross-class cram-down (when a restructuring plan approved by several classes of creditors is imposed on dissenting classes).

In addition, Article 8, paragraph 1, point (b) of the Directive, which the working group notes is imprecise, also refers to «a valuation of the present value of the debtor or the debtor's business» which must be contained in the restructuring plan submitted for confirmation by a judicial authority. As previously mentioned, the working group feels that the figures provided in the request for the opening of an SFA or SA procedure (form specifying the value of the company's assets, including all available assets, and its liabilities, including liabilities fallen due or about to fall due) are sufficient for the judicial authority to establish whether or not the company is viable.

Whatever the outcome, it would be useful to clarify the provisions of the Directive.

The working group, for its part, considers that the valuation as a going concern should be used in the case of a cross-class cram-down and the liquidation value in the case of an intra-class cram-down. In the group's view, in both cases, it is up to the minority creditor who feels prejudiced by the majority vote and is thus contesting the plan to provide proof that it would have been better off in the case of a liquidation (at going-concern value in the case of a cross-class cram-down and at liquidation value in the case of an intra-class cram-down).

e) Appeals against a decision confirming a restructuring plan

Article 15 lays down the minimum rules applicable to appeals, which provide a safeguard for protecting the parties' legitimate interests, while also ensuring that such safeguards do not delay confirmation or implementation of restructuring plans.

An appeal against a decision confirming a plan shall have no suspensive effects on the execution of a plan.[26] French national law contains similar provisions (absence of suspensive effects) for

[24] Article 13, paragraph 1 of the Directive.
[25] Article 13, paragraph 2 of the Directive.
[26] Article 15, paragraph 3 of the Directive.

applications to set aside court decisions confirming safeguarding plans.[27] As a result, the working group naturally approves the provision, as it appears to be inspired by the French system.

Article 15, paragraph 4, point (b) allows the judicial authority the possibility of confirming the plan and granting monetary compensation to the dissenting creditors, payable by the debtor or by the creditors who voted in favour of the plan.

The working group supports the transposition of this provision, as it makes the restructuring procedure more flexible and pragmatic.

4- Equity holders and duties of directors

a) Context of the article

Article 12 falls under Chapter 3 of Title II of the Directive which relates to restructuring plans, and forms part of the preventive restructuring framework. This reminder is necessary to put Article 12 into context. It is designed to prevent shareholders and other equity holders with an interest in what happens to a debtor facing insolvency from obstructing the adoption and implementation of a restructuring plan.[28] In French law, this approach has only been introduced to a very limited extent, under the safeguard procedure (Article L. 626-3 of the Commercial Code) at the preventive stage, and under the judicial rehabilitation procedure (Article 631-19-2 of the Commercial Code), which applies when a debtor is already in a state of cessation of payments, or, to use EU terminology, already insolvent. Therefore, in light of the conditions for voting on plans set out in the safeguard procedure and its various forms, Article 12, although new, would be entirely compatible with French law.

It is also easy to understand the advantages of this provision in view of the outcome for creditors: the measure implicitly favours the secondary debt market. Above all, the text ensures that creditors benefit from a genuine restructuring plan that guarantees at least partial repayment, and is above all predictable. It is therefore useful to be able to oblige shareholders and other equity holders to behave «reasonably». Moreover, as creditors have a guarantee that equity holders will not behave

[27] *Article L. 661-1 of the Commercial Code.*

[28] *For the economic reasoning behind this provision and the requirements of French constitutional law as expressed by the Constitutional Council in its decision adopting the Law of 6 August 2015 (Decision No. 2015-715 DC of 5 August 2015) introducing the possibility of a forced sale of shareholdings, see article by R. Dammann and M. Boché-Robinet, December 2017 (forthcoming), p. 14.*

«unreasonably», they are more likely to agree to the conversion of their claims into capital. The importance of the measure is therefore clear.[29]

b) Analysis of the text

An analysis of the text itself is particularly instructive. The structure of the article is as follows: the first paragraph is directive, beginning «Member States shall ensure that…». The second paragraph is a means of achieving the objective of the first paragraph and is optional, i.e. «Member States may provide that...». This second paragraph reflects a desire to align the treatment of equity holders with that of creditors, as the former can be given a right to form one or more distinct classes by themselves and vote on the adoption of restructuring plans that are likely to be crammed down.

The first paragraph includes a number of key elements. It reiterates that the debtor is faced with a likelihood of insolvency, and that the restructuring plan clearly forms part of a preventive framework. It concerns equity holders in the broadest sense: shareholders, but also holders of convertible bonds. The aim of the restructuring plan is clearly specified: to restore the viability of the business. On the whole, these requirements can be considered compatible with French law as the latter already has preventive procedures in place, agreed through a process of conciliation and sanctioned via an SA or SFA or via a safeguard procedure, and which include provisions allowing for equity holders to be crammed down. The working group wonders whether the provisions of the article might potentially correspond to the existing prudential measures included in the Commercial Code under Articles L. 626-3 and L. 631-19-2, for safeguard and judicial rehabilitation procedures.

One difficulty that arises is with the notion of «unreasonable». According to the text, shareholders and other equity holders may not «unreasonably prevent the adoption or implementation a restructuring plan». This notion is bound to lead to disputes and does not exist in French law. It should also be stressed that the requirement conflicts not only with French law on enterprises in difficulty, but also with French company law.

The second paragraph gives Member States greater freedom in the transposition of the Directive while also allowing them to introduce binding measures for shareholders and other equity holders. States can, for example, oblige them to form one or more distinct classes by themselves and give them the right to vote on the adoption of restructuring plans. The counterpart to this is that they have to accept the cross-class cram-down mechanism specified in Article 11 for creditor classes.

[29] *Idem.*

However, the Directive only provides for a cram-down of shareholders if the debtor is in agreement. This condition is welcome as it ensures that preventive procedures remain attractive. Creditors can only force a conversion of claims into capital or the sale of securities with the prior agreement of the directors of the debtor company.

It is important to ensure that Article 12 of the Directive is compatible with French judicial preventive proceedings. However, the measures proposed imply taking a stricter approach in French law towards shareholders and equity holders, and imposing restrictions on them to prevent them from blocking the adoption and implementation of restructuring plans, and this will necessarily have an impact on French company law and on the existing laws for companies in difficulty. There remains a problem with the transposition of the notion of «unreasonable». The fundamental issue is whether it is possible and appropriate to impose measures on equity holders, notably the conversion of claims into capital against the will of existing shareholders, as part of preventive procedures, without undermining said procedures. If the directors decided to cram down shareholders, this could lead to tensions with shareholders that could potentially hamper the preventive procedure. The majority of the working group therefore considers that it is not appropriate to introduce the possibility of creating a specific class for shareholders at this early stage in the proceedings, except where the company has negative capital.

A shareholder who has lost everything and whose equity is negative should not be allowed to oppose a forced dilution, in line with the absolute priority rule, provided there are adequate protective rules in place to ensure that the capital is genuinely negative. This protective rule, combined with the obligation to obtain the agreement of the debtor for cross-class cram-downs, appears to ensure a fair balance between the interests of the debtor, the shareholders and the creditors, including those of the employees.

It should also be remembered that equity holders vote at annual general meetings of shareholders, and that such meetings are always required to validate restructuring plans involving a change in capital or in the company by-laws.

c) Duties of directors

First, it is important to specify the context for Article 18. It is the only article in Chapter 5 of Title II of the Directive. Chapter 5 concerns «Duties of directors in connection with negotiations on a preventive restructuring plan». It is necessarily linked to Article 12 and to directors' obligation to participate in efforts to restructure the company prior to an insolvency.[30]

[30] *See R. Dammann and M. Boché-Robinet, December 2017 (forthcoming), p. 15.*

The article raises one question: the title implies that the Directive primarily concerns debtors that are «legal entities» whereas Articles 1 and 2 do not appear to be this specific. However, the provisions of Article 18 can be understood as applying only to a portion of the debtors falling within the scope of the Directive. The notion of «director» should be made more precise – does it refer to an ipso jure or ipso facto director? Is the concept specific to EU law, or is it defined in national law?

In general, Article 18 aims to make directors more accountable, to encourage them (and implicitly oblige them?) to use preventive proceedings when there is a «likelihood of insolvency». The approach is understandable in that it aims to avoid companies getting into difficulty because their directors have failed to take action at a sufficiently early stage. But the fact remains that the text forms part of the framework for preventing a likely insolvency, and imposing extended duties on directors at this stage is a significant step and clear boundaries need to be set. These obligations could, for example, be used by creditors to pressure directors into negotiating a restructuring plan even when a debtor is not insolvent and in a state of cessation of payments, according to the criteria defined under French law. French law is based on the philosophy that the debtor is master of his/her own company and is thus free to decide on matters of prevention. Transposing these provisions on extended duties would modify this approach and risks changing the perception of prevention under French law. As a result, the working group laments the wording of the article and the lack of objective criteria.

An analysis of the text shows there is a lack of precision and no reference is made to objective criteria that can be used to determine the duties of the directors. The provisions say that Member States should «lay down» the rules for imposing the four specified obligations on directors. The transposition of the provisions will therefore fall to Member States. But the obligations listed do not make reference to any objective criteria. The first question this raises is what criteria should be used to determine the notion of «likelihood of insolvency»?

Point (a) refers to immediate steps that must be taken to minimise the loss for creditors, workers, shareholders and other stakeholders. What should be understood by «the loss for creditors»? Does «minimise» simply refer to the decision to use preventive proceedings? In the event of legal action by creditors, who should pay for the losses incurred and under what conditions? The same question can be asked in relation to workers, shareholders and other stakeholders, in other words all the «victims» of the directors' lack of due diligence but who are not legally defined. How can provisions as general and vague as these be adequately transposed into national law?

Point (b) obliges directors to have due regard to the interests of creditors and other stakeholders… The meaning of the paragraph remains elusive. Concerning the «due regard to the interests of creditors»: What creditors? What interests? Interests may differ widely...

The worst section in terms of vagueness is point (c). How should one interpret «reasonable steps to avoid insolvency»?
Only point (d) on deliberate behaviour or grossly negligent conduct that threatens the viability of the company has a potential equivalent in the sanctions provided for in national law: liability for excess of liabilities over assets and prohibition from running a company. While the extension of this to preventive procedures might seem excessive, it would nonetheless meet the objectives of the Directive.

Transposing this point would make French law stricter, as it would mean directors who did not take preventive measures would be found at fault and could subsequently be held liable in collective insolvency proceedings (judicial rehabilitation or liquidation). In short, it introduces the notion that directors can be held liable for not taking preventive measures.

However, national law already makes a link between cessation of payments, deliberate failure to disclose this situation within the time limit of 45 days and failure to file for the commencement of conciliation proceedings.[31]

As a result, the working group considers that, while the principle is commendable in that it provides a means of preventing inaction, bad faith and negligence on the part of directors, it cannot fully support the article due to the vagueness of the wording. The lack of objective and predictable criteria raises the risk of a major legal dispute that would generate jurisprudence, and it would be difficult to make this jurisprudence coherent due to the large number of unpredictable and widely varied demands. Does the national system, under which company mismanagement is punishable by law, not provide sufficient incentive for directors to act in accordance with the obligations defined in points (a), (b), (c) and (d) of Article 18?

5- Protection for new and interim financing

Articles 16 and 17 of the Directive provide minimum protection for new financing necessary to implement the restructuring plan, for interim financing incurred to ensure a business's continuity during restructuring negotiations, and for other transactions concluded in close connection with a restructuring plan. It states that this financing and these transactions shall not be declared void, voidable or unenforceable as an act detrimental to the creditors in the context of subsequent insolvency procedures, unless such transactions have been carried out fraudulently or in bad faith.

Article 16 thus aims to encourage new financing and is based to a great extent on the French «new money» system applicable in the case of an approved conciliation agreement. However, French law

[31] *Article L. 653-8, paragraph 3 of the Commercial Code.*

would need to be modified to ensure that «interim financing» is not classified as «suspect financing» if (i) the amount of said financing is reasonable, (ii) it has been authorised by the judge, and (iii) it is not given the same priority treatment as that given to financing under an approved plan.

The working group is not in favour of extending the privilege granted under conciliation proceedings to interim financing as it could lead to discrimination between creditors in any subsequent collective proceedings.

Moreover, the working group finds it hard to understand the reference to the criminal liability of creditors providing new or interim financing, as mentioned in paragraph 3 of Article 16.

Article 17 of the Directive extends this so-called «safe harbour» protection to a range of transactions carried out to further the negotiation of a restructuring plan confirmed by a judicial or administrative authority. On this point, the working group considers that the approved conciliation appears to offer an equivalent degree of protection, but feels that further discussions could be held on whether or not the authorisation of a conciliator should be required for the protection of certain transactions cited in Article 17, paragraph 2.

Part 2 – Second chance for entrepreneurs, and other provisions

Titles III et IV

Title III of the Proposed Directive puts in place minimum provisions on discharge of debt for over-indebted entrepreneurs as the basic conditions for ensuring entrepreneurs have a second chance. Articles 19 to 23 set out rules designed to reduce the negative effects of over-indebtedness and bankruptcy on entrepreneurs, notably access to full discharge of debts after a certain time limit and the limitation of disqualification orders in the case of over-indebtedness, except where the debtor is dishonest or has acted in bad faith. The Directive also lays down rules designed to avoid excessively long insolvency proceedings,[32] which create legal uncertainty for creditors and investors and lead to low recovery rates.

Title IV sets out measures to increase the efficiency of restructuring, insolvency and second chance procedures. They apply not only to preventive restructuring and discharge procedures, but also to insolvency procedures, that is to judicial rehabilitation and liquidation procedures.

1- Rules on second chance

a) Scope of application

According to the Directive, «over-indebted entrepreneur» means a natural person exercising a trade, business, craft or profession, who is otherwise than temporarily unable to pay debts as they fall due.[33]

This definition is exactly the same as in French law. Therefore it does not cover corporate directors (*mandataire social*). It would perhaps be useful to specify this in the actual text, and to indicate that it only concerns entrepreneurs operating on an individual basis.

The European text also proposes that Member States extend the principles of discharge to natural persons who are not entrepreneurs, in other words to consumers.[34]

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[32] *Recitals 37, 38 and 39 of the preamble to the Directive.*

[33] *Article 2, point (13) of the Directive.*

[34] *Explanatory memorandum to the Directive, page 16.*

French law already contains specific rules suited to consumers,[35] which apply to cases of over-indebtedness resulting exclusively from non-professional debts, and notably lay down rules for the discharge of personal debts (*rétablissement personnel*) with or without judicial liquidation. Special commissions called «household over-indebtedness commissions» examine the individual cases and propose solutions, and proceedings take place under the jurisdiction of the court of first instance (*tribunal d'instance*). Where the debtor has declared himself/herself to have assets specifically dedicated to a professional activity, proceedings are coordinated with the competent jurisdictions. As a result, the working group deems there is no need to modify existing law and make the system for individual entrepreneurs applicable to consumers.

b) Rules on second chance

Article 19 sets out the principle whereby an over-indebted entrepreneur may be discharged of his/her debts after partial repayment or even with no repayment at all. The period after which debts can be discharged is set out in Article 20.

French law, which some judges regard as extremely sophisticated, already includes mechanisms that are suited to entrepreneurs who are natural persons operating on an individual basis.

Among these is the simplified judicial liquidation procedure, introduced by the law of 26 July 2005, a fast-track mechanism under which liquidation operations must be completed no later than one year after the commencement of proceedings, regardless of whether they are mandatory[36] or optional[37]. That said, it only applies to cases where the debtor's assets include no immovable property and if the number of employees and amount of turnover are below certain thresholds.

Another mechanism is personal debt discharge proceedings which were introduced under Ordinance No. 2014-326 of 12 March 2014[38] and are designed to allow entrepreneurs who are natural persons and have very few assets to be discharged of their debts, and thus allow them to start a new business activity.

Nonetheless, given the thresholds that apply to these proceedings, they cannot be used in all cases of over-indebtedness.

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[35] Articles L. 711-1 and L. 762-2 of the Consumer Code.

[36] Article L. 641-2 of the Commercial Code.

[37] Article L. 641-2-1 of the Commercial Code.

[38] Article L. 645-1 of the Commercial Code.

Article 20 of the Directive states that entrepreneurs should be able to benefit from a full discharge of their debts after a maximum period of three years without the need to reapply to a judicial or administrative authority. The starting point for this three-year period shall vary depending on whether the debtor makes payments to creditors under a repayment plan or the procedure consists solely of the realisation of assets. Limitations to this short discharge period are set out in Article 22.

At present, no such discharge deadline is specified under French law. While the working group is naturally in favour of the idea of shortening the deadline in the case of a liquidation of assets, it has some reservations about reducing the discharge period to three years, without exception, in cases where a repayment plan has been implemented. In its view, this provision could prove counterproductive as it would only be possible to make very small repayments and there is a risk the judge might give preference to a straightforward liquidation.

Article 22 of the Directive grants Member States a large margin when setting limitations to the provisions on access to discharge and on discharge periods, provided that such limitations are clearly specified and are necessary to protect a general interest.

The working group has no particular observations on these provisions, as French law already includes precise rules on the duties of entrepreneurs. Nonetheless, paragraph 1 point (b) of this text appears to state that, if the debtor refuses any form of plan, his or her debts cannot be discharged. This would imply an amendment to French law.

Lastly, Article 23 of the Directive states that, as personal debts of a professional and non-professional nature are often intertwined, Member States should try to consolidate, where applicable, the separate procedures to achieve effective access to second chance for entrepreneurs.

As indicated previously, in France, professional and non-professional debts are treated separately and fall under different jurisdictions. However, the respective proceedings are coordinated and debtors must indicate to the over-indebtedness commission whether they are the subject of one of the procedures provided for under Book VI, Titles II to IV of the Commercial Code, and if so under which jurisdiction.[39]

[39] *Article L. 7-11-8 of the Consumer Code.*

2- Measures to increase the efficiency of procedures

a) Judges

Article 24 requires Member States to ensure that members of the judiciary and of other competent authorities are properly trained and specialised in restructuring, insolvency and second chance matters.

Title VII of Law No. 2016-1547 of 18 November 2016 on the modernisation of French law for the 21st century, known as «Justice 21», is designed to update existing legislation and adapt it to the economic and employment challenges of the new millennium. It provides increased guarantees of the independence of commercial court judges by preventing them from holding certain other mandates,[40] and introduces new training and ethical obligations.

For example, judges in a commercial court are now required to receive initial training as well as ongoing specialist training, and failure to comply with this means they are automatically deemed to have resigned.[41]

The law also introduces requirements in terms of ethics and the prevention of conflicts of interest. While a disciplinary procedure already existed under French law, in practice it was rarely used. The new law therefore reforms this disciplinary procedure, notably by granting the president of the court of appeals the power to issue a warning before disciplinary action is taken.

b) Practitioners

Article 25 requires Member States to encourage the initial and further training of as well as the establishment of codes of conduct for practitioners dealing with restructuring, insolvency and second chance matters. Moreover, Article 26 contains minimum standards for appointing, supervising and remunerating said practitioners.

In France, administrators and members of the judiciary practise as licensed professionals and as such are subject to strict regulations. Conditions of access to these positions, in terms of qualifications, training and internships, are very demanding. Practitioners are remunerated by way of a tariff, set by decree, which takes into account the costs incurred for the service together with a reasonable amount of compensation defined on the basis of objective criteria.[42] They are appointed to the case

[40] *Article L. 722-6-1 of the Commercial Code.*

[41] *Article L. 722-17 of the Commercial Code.*

[42] *Article L. 444-2 of the Commercial Code, created by Law No. 2015-990 of 6 August 2015, known as the Macron Law.*

by the commercial court. Practitioners are subject to regular controls, covering the exercise of their activity, the declaration of earnings, and the calculation and payment of their fees; any violations are liable to punishment by a disciplinary committee.

The aforementioned provisions of the Directive, on judicial or administrative authorities and practitioners, therefore seem to be inspired directly by French law. The working group welcomes this and reiterates that requirements in terms of training, specialisation and speed are vital in rescuing ailing companies, and that the earlier a judge or practitioner can intervene, the more likely it is that a company can be saved. The working group therefore believes that training for individual entrepreneurs needs to be improved, as do information and early warning tools, as those currently in place are insufficient. A number of interesting initiatives have been launched, notably *Santé Entreprise* insurance policies which cover the duty of managers to anticipate and mitigate risks.

CONCLUSION

France already has very detailed rules in place on the treatment of companies in difficulty. These include preventive mechanisms, which allow steps to be taken before a company defaults on its loans.

The provisions of the Directive should tie in with these mechanisms without completely modifying existing legislation.

The modifications required relate essentially to two points:

- The formation of classes of creditors, which corresponds to a desire expressed by a majority of practitioners. This modification should only affect a very limited number of procedures, that is those requiring the restructuring of complex debts, and should not therefore lead to the modification or complexification of the existing ordinary law *mandat ad hoc* and conciliation procedures. One question that remains, however, is whether the rules on safeguarding or debt discharge plans should be modified.

- The treatment of partners. This is the most difficult point and one on which the working group remains divided. What is certain is that any modifications should take into account the requirements of French constitutional law specified by the Constitutional Council when it adopted the Law of 6 August 2015.[43] Finally, it is important to remember that the adopted mechanism would at least offer some degree of leverage over dissenting shareholders.

[43] *See Note 28.*

ANNEX 1

Working group members

WORKING GROUP MEMBERS

- **Claire Favre**, Honorary President of the Commercial, Economic and Financial Law Chamber of the French Supreme Court; Vice-president of the French Competition Authority and chairman of the working group;

- **Reinhard Dammann**, partner at Clifford Chance, practising Restructuring;

- **Lionel Spizzichino**, partner at Wilkie Farr & Gallagher, practising Restructuring;

- **Dominique Borde**, partner at Paul Hasting;

- **Gérard Gardella**, Secretary General of the High Advisory Committee of the Financial Market of Paris, former magistrate and former head of legal affairs at Société Générale;

- **Jean-François Biard**, former investment banker and consultant;

- **Caroline Henry**, General Counsel at the French Supreme Court;

- **Thierry Montéran**, partner at UGGC, member of the Bar Council;

- **Fabienne Beuzit**, partner at Weil, Gotshal & Manges;

- **Perrine Macorigh**, associate at Cleary Gottlieb Steen & Hamilton.

With the participation of:

- representatives of the French Treasury;

- representatives of the Ministry of Justice.