France is catching up

Reinhard Dammann writes on the anticipated transposition of the Directive on preventive restructuring frameworks

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The Draft Bill "PACTE" (the "Draft Bill"), which will be under discussion in the French Parliament in September 2018, contains several reforms intended to allow the Government to transpose by anticipation the future Directive on preventive restructuring frameworks (the "Directive"), itself largely inspired by the French pre-insolvency proceedings.

At the same time, the Draft Bill allows the Government to reform some aspects of the legal regime applicable to securities during insolvency proceedings. The clear intention behind these reforms is to increase the attractiveness and economic efficiency of continental insolvency laws through an accelerated Franco-German harmonisation, called for by the French President, Emmanuel Macron.

Classes of creditors

The Draft Bill intends to introduce in the French law the mechanism of classes of creditors (Article 64-I-1°). The Directive, which is to be transposed on this point follows the German (§ 222, para. 2, InsO) and the American (Chapter 11, US Bankruptcy Code) models in proposing the formation of classes so as to reflect the rights and seniority of the affected claims and interests under the restructuring plan. It also allows for the formation of sub-classes of creditors if their rights are sufficiently similar to consider them to be a homogenous group with a commonality of interest.

While it is still uncertain what the exact class formation criteria will be under the French law, the reform will certainly give rise to a more efficient system. Indeed, the French law currently differentiates between creditors on the basis of their status (financial creditors, suppliers, bond holders). This results in creditors with diverging interests and rights being part of the same comity. Surely, the insolvency practitioner can modulate the creditors' voting rights based on their securities and inter-creditor agreements. However, the modulation criteria are not predictable enough to reassure the creditors in complex financial restructurings.

On this point, the intended reform should result, as in German law, in a more efficient grouping of creditors, solely based on the objective similarity of the qualities of their receivables. In our opinion, it should also provide for a clear hierarchy between different classes, in order to facilitate the transposition of the absolute priority rule inspired by the German law.

Cross-class cram-down

While the French law currently provides for a cram-down of dissenting creditors within comities of creditors, for comities approve restructuring plans with a 2/3 majority, the Draft Bill intends to also implement a mechanism of cross-class cram down (Article 64-I-2°). Indeed, the Directive provides that a restructuring plan which is not approved by all the classes of creditors can be confirmed by a judicial or administrative authority with the debtor's agreement if it has been approved by at least one class other than the equity holders and the classes which would not receive any payment in the case of the debtor's liquidation (Article 11). The intended reform will therefore align French Insolvency law with its German counterpart, which already allows for a cross-class cram-down insofar as the plan is approved by a majority of classes.

While the Draft Bill does not explicitly anticipate such a reform, its wording should allow for the transposition in the French insolvency law of a mechanism imposing reasonable restructuring plans to equity holders where their approval is necessary, for instance in cases of debt equity swaps. Indeed, following the German example, Article 12 of the Directive provides for the application of the cross-class cram-down mechanism to such equity holders. By comparison, the French law only allows for a forced dilution or equity sale in very restrictive circumstances, where the debtor's liquidation would have a severe negative impact on the national or regional economy.

'Best interest of creditors' test

The Draft Bill empowers the Government to adapt the French law so as to ensure that the interests of creditors are respected where a restructuring plan is imposed through cram-down mechanisms, allowing therefore for the transposition of the 'best interest of creditors' test, provided for by both the Directive (Article 10) and the German law. Thus,

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where the plan is approved by the judicial authority, it has to make sure that the dissenting creditors are better off if the plan is approved than in case of the debtor being liquidated.

The reform of securities law

The Draft Bill empowers the Government to simplify and improve the general legibility of the French securities law. The clear intention is to make the French law more attractive for international investors and to increase its over-all effectiveness, thus facilitating the financing of the French companies. In particular, a reflection is under way concerning the reform of the law governing securities in case of insolvency proceedings.

For the sake of creating a coherent overall system, the reform could extend the effective regime of the French *fiducie-sûreté* to traditional securities, in order to render the situation of creditors in case of liquidation predictable and thus allow for a meaningful implementation of the above-mentioned 'best interest of creditors' test. Indeed, such a test is only possible where the comparison between the two situations for each creditor is feasible. Unfortunately, this is not yet the case in France, where securities are treated differently in case of a disposal plan and the sale of isolated assets. Moreover, the outcome of liquidation proceedings depends on the situation of the privileged creditors (notably, the employees).

Simplified proceedings

The Directive encourages Member States to allow struggling small entrepreneurs and companies to quickly restart their activities. Consequently, the Draft Bill empowers the French Government to render the simplified liquidation proceedings mandatory for the small and medium-size companies, which have less than five employees and a 750,000-euros turnover. These proceedings are simple, cheap and fast, as they should be closed within 6 months (1 year in exceptional circumstances) from their opening. They shorten, therefore, the period during which the debtor is forbidden to engage in any economic activities.

Furthermore, the Draft Bill provides for an obligation for judges to systematically suggest opening simplified non-liquidation proceedings (*rétablissement professionnel*) in favour of qualifying professionals and entrepreneurs. Such proceedings, which already exist but should become more popular, result in a general discharge of debt and allow for a quick recovery of the debtor.

Conclusion

The anticipated implementation of the Directive and the resulting Franco-German harmonisation will allow the French insolvency law, with its decades-long experience of pre-insolvency proceedings, to become a model for other countries. In the wake of Brexit, the intended reforms could give continental legal systems an edge over their competitors across the Channel. ■