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French Insolvency Law: The 2004 Project and Reform Perspectives

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Introduction[1]

The quest for the perfect insolvency law in many jurisdictions is a history of incremental progress and reversals of fortune. In France, as elsewhere, the search for the ideal procedure to palliate the economic effects of insolvency has seen a number of different methods used to deal with the phenomenon. The increasing numbers of insolvencies and the apparent inability of legal regimes to stem the tide, as much a product of macro-economic influences as the occasional micro-economic reasons deriving from the conduct of directors, have prompted periodic calls for reforms, perhaps in the belief that change would bring more certainty. In France, these calls have succeeded in introducing substantial changes to domestic insolvency law in 1967, 1984–1985 and again in 1994. Now, similar appeals to the need to deal with what has become an unstoppable phenomenon have prompted the production of a new draft law that is likely to undergo enactment in 2005. This draft has not been immune to changes during the currency of its existence, undergoing a reorientation between 2003 and 2004. The result is the creation of a highly complex set of procedures, which has left commentators in no doubt that the reforms are projected on a scale previously unforeseen and may represent a profound shift in the philosophy of French insolvency law. It is the purpose of this article to chart the proposed reforms and outline some views on where the reforms will leave the quest for the model insolvency regime.

French insolvency law: an historical précis

Insolvency law in France has a long and ancient history.[2] Modern insolvency law in France dates, however, from the introduction of legislation in 1967 providing for rescue and liquidation as alternative outcomes dependent on an initial examination of the financial situation of the afflicted debtor.[3] The Law of 1967 represented a comparative novelty in that it shifted the emphasis from the bankruptcy of individuals and, through their status as company directors, their companies to the treatment of the problems of the enterprise as a whole. Despite these changes, reform proposals were current during the 1970s and early 1980s, chiefly prompted by the worsening economic climate and the inexorable rise in the number of business failures. Developments in other jurisdictions influenced the outcome of the reform proposals that eventually secured passage into legislation in 1984–1985. Although France was one of the earliest countries to boast of a rescue regime, the refinements and developments in many other jurisdictions of institutions that promoted the ideal of 'corporate rescue' had some influence in the shape of the new rules that would be enshrined in these laws.[4] The result was to focus attention on legal structures whose purpose was to promote corporate rescue as an alternative to liquidation and improve the early prevention and treatment of businesses facing financial difficulties by using pre-insolvency diagnostic tools as well as informal arrangements allowing for compacts between the debtor and creditors, thus involving creditors in the rescue process.

In light of these philosophies, the programme of reform began with a text introduced in 1984,[5] which

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1 Thanks are due to Maître Anker Sorensen for casting a critical eye over this article and providing some observations on the analysis undertaken here.

2 See B. Soinne, *Traité des Procédures Collectives* (LITEC, Paris, 1999) at 3-5.

3 Law no. 67-563 of 13 July 1967 ('Law of 1967').

4 See M.-J. Campana, 'A Critical Evaluation of the Development and Reform of the Corporate Rescue Procedures in France' in K. Broc and R. Parry (eds.), *Corporate Rescue in Europe: Recent Developments* (Kluwer Law International, The Hague, 2004) Chapter 2, pp. 21–49.

5 Law no. 84-148 of 1 March 1984 ('Law of 1984').

promoted pre-insolvency arrangements. Two further laws passed in 1985 dealt with the most ambitious part of the reform project resulting in the reshaping of the law and institutions of insolvency and the introduction of a new regime governing insolvency practice.[6] The purpose of the new legislation was firmly set as being threefold: the rescue of the firm, the continuation of business activity and employment and, finally, the settlement of debts.[7] A rescue procedure was instituted, characterized by a three-step approach. An opening phase would be followed by an observation period, during which the activity and health of the business would be monitored and throughout which the collection of assets and the preservation of the company's activity would be carried out. The process would end with the adoption of a rescue plan, providing for either the continuation of the business or its sale as a going concern. Two variants of rescue were made available, the first called the simplified procedure, dealing with small enterprises and the second, a more lengthy and involved procedure, dealing with large-scale enterprises where the problems were likely to be more complex and require closer court supervision. The outcome in the event of the failure of rescue would be liquidation. Liquidation could also be ordered from the outset for businesses presenting a profile that indicated prospects for recovery were bleak. Meanwhile, the law on insolvency practice installed a new regime to deal with the status, duties and responsibilities of insolvency practitioners, of which there were to be two types: administrators and liquidators.[8]

The Laws of 1984 and 1985 were not immune to criticism, notably from creditors and in general the financial institutions who felt that the law was becoming too pro-debtor and that their rights in the process were being eroded. There was also the view that came in later that these laws needed to be enhanced and upgraded to deal with the greater tide of insolvency cases. Accordingly, the insolvency regime was the subject of a further reform in 1994.[9] The purpose of this reform was stated as being fourfold: to reinforce measures at the pre-insolvency stage dealing with voluntary arrangements, to redress some of the rights of creditors during insolvency proceedings, to ensure better dividend payments and realizations of assets for the benefit of creditors as well as to ensure greater equity in rescue plans resulting in the sale or transfer of all or part of the business. The Explanatory Memorandum accompanying the Law of 1994 recognized that the Law of 1985 represented a movement towards a greater priority for rescue and was more pro-debtor in nature. This ran counter to the philosophy behind previous legislation, the purpose of which was to maximize debt recovery for the benefit of creditors. As this shift could produce some undesirable results, the Law of 1994 was dedicated at redressing the balance between the interests of the debtor and its creditors. Opinion was divided about its impact, many commentators feeling that it merely tinkered with the procedural framework and had no real effect on the fundamental philosophy underlying the institutions of insolvency.[10] Furthermore, the Law of 1994 did not address the situation of insolvency practitioners as the practice environment had not till then met with any adverse commentary. For a long time afterwards therefore, it seemed as if overall reform of insolvency law was not to be a high priority on the Government's agenda. This was despite views to the contrary being emitted by very eminent members of the insolvency profession.[11]

Reforms, however, were to be precipitated by the occurrence of financial scandals affecting insolvency practitioners and the Commercial Courts, whose jurisdiction, although broadly commercial, is chiefly composed of insolvency cases.[12] Elisabeth Guigou, then Garde des Sceaux,[13] put forward proposals in a speech on 24 October 1997 addressing concerns about the impact of the scandals on public confidence in the commercial justice system. A parliamentary enquiry began, followed by a Government inspection into areas of concern outlined in the proposals. The scope of both enquiries, which ranged widely, included an examination of the entire legal framework for the administration of commercial justice in France and, in particular, its application to insolvency matters.

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6 Law no. 85-98 of 25 January 1985 ('Law of 1985') and Law no. 85-99 of 25 January 1985.

7 Article 3, Law of 1985 (now Article L.620-1, Commercial Code).

8 Both these groups have a role to play in rescue, the administrator in many cases seconding or replacing the debtor in management, while the liquidator is appointed as creditors' representative, in charge of the verification process for creditors' debts.

9 Law no. 94-475 of 10 June 1994 ('Law of 1994'). For an overview of the structure of French insolvency law following the Law of 1994, see A. Sorensen and P. Omar, *Corporate Rescue Procedures in France* (Kluwer Law International, The Hague, 1996).

10 See J.-L. Vallens, 'A propos de la réforme de la loi sur les entreprises en difficulté: Le rapport du groupe de travail du ministère de la justice' (in three parts), *Petites Affiches* 1994.21.11, 1994.22.4 and 1994.23.15.

11 See B. Soinne, 'Le bateau ivre (A propos de l'évolution récente du droit des procédures collectives)' (in two parts), *Petites Affiches* 1997.58.12 and 1997.59.4.

12 See P. Omar, 'Renovation of the Façade of Commercial Justice in France' [2003] 2 Insolv L 61.

13 Lit. 'Keeper of the Seals', the official title of the Minister of Justice.

Through the work of both enquiries, revelations about the systemic abuses that were identified led to considerable public disquiet being expressed about the functioning of a major part of the commercial justice framework, in turn prompting the government to consider some radical measures. In light of this, the Ministry of Economy and Finances issued a press statement on 14 October 1998 containing a number of proposals covering the reform of the commercial justice system, the reform of professions linked to commercial justice (insolvency practitioners and '*greffiers*' (court registrars)) as well as the reform of the framework for insolvency law. In particular, insolvency law was to be the focus of targeted reforms dealing with major concerns about the length of proceedings and their integrity and transparency. An ambitious timetable was appended to the statement, which would have seen the reform process completed in stages by the end of 2001.

With this in mind, the Ministry of Justice issued a paper in early 1999 titled a '*document d'orientation préparatoire*' (preparatory orientation document).[14] This text contained quite detailed substantive changes to insolvency law as well as a number of technical amendments seeking to streamline the rules of insolvency generally. The overall scope of the reforms was aimed at improving the efficiency of insolvency law procedures, these being the diagnosis and prevention of financial difficulties at a stage before the formal onset of insolvency, the informal treatment of business difficulties through compositions and agreements with creditors, the proper supervision of rescue plans and the simplification of liquidation procedures. In addition, the formal definitions of and preconditions for insolvency would be refined to make the choices between procedures and options clearer to directors of companies faced with the prospect of insolvency. These plans represented important changes to the administration of insolvency matters and a shift in emphasis towards more transparency and safeguards in the process. They were the subject of extensive comment by the professional bodies representing the commercial sector, which was largely supportive.[15] Insolvency law reforms became subsumed, however, by the general raft of reforms to the commercial justice sector, of which insolvency law was seen as a part.[16] In fact, the Government had become engaged in an extensive reform process as part of its strategy to modernize the general legal framework, which also saw the codification of commercial law, including company law and insolvency law, in the body of a renewed Commercial Code in late 2000.[17] In 2001, a number of draft texts were produced dealing with the Commercial Courts and with insolvency practice. Early comment on these proposals questioned the wisdom of pushing ahead with reforms to practice conditions without waiting for developments in relation to insolvency law, despite the fact that changes to insolvency law were considered the most urgent of all the reforms.[18]

It is not an exaggeration to say that the overall reform process ran into some difficulty, given widespread hostility from the business sector and from the judges in the courts concerned. There was delay in the introduction of the texts into Parliament and concerted opposition was mounted in the Senate to derail the Commercial Court texts. The insolvency practice text was the subject of considerable amendments and eventually fell by the wayside while no attempt was made to proceed with the reforms to insolvency law. It took the General and Presidential Elections in 2002, with the return of a Government of a different composition, to see a change in imperative. The new Garde des Sceaux, Dominique Perben, made an announcement to this effect in a speech given to the Annual Conference of the National Congress of Commercial Courts on 22 November 2002. He made public the Government's intention to abandon the reforms to the Commercial Court, giving as reasons the apparent lack of consensus and the failure of the proposals to take into account the special nature of the Commercial Court system.[19] However, a promise was made that the French Government would be embarking on the long-awaited reforms to insolvency law and that proposals would be placed before Parliament for consideration during the course of 2003. Similarly, reforms to insolvency practice, which had been considerably amended by the Senate in February 2002,

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14 See P. Omar, 'Insolvency Law Reform in France: A Herculean Task' [2003] 6 ICCLR 205.

15 See J. Courtière, 'Réforme du droit des entreprises en difficulté – Réaction au document d'orientation de la Chancellerie', Chambre de Commerce et d'Industrie de Paris ('CCIP') Report (February 1999). This and other CCIP reports are available on the CCIP website at <www.ccip.fr>.

16 For an account of the history of the overall reform initiative from 1996 to 2003, see P. Omar, 'The Progress of Reforms to Insolvency Law and Practice in France' in K. Broc and R. Parry (eds.), op. cit., Chapter 3, pp. 51–78.

17 Ordinance no. 2000-912 of 18 September 2000, to which the Commercial Code is annexed. Insolvency law and practice are in Books VI and VIII respectively.

18 See J. Courtière, 'Réforme des professions d'administrateur judiciaire et de mandataire judiciaire à la liquidation des entreprises' CCIP Report (May 2000).

19 The full speech may be viewed through the Ministry of Justice website at: <www.justice.gouv.fr/discours/d221102b.htm>.

were to be brought again before Parliament. In fact, the practice proposals successfully progressed to enactment in early 2003, making a number of important changes to the practice conditions for insolvency practitioners, the conditions for access to the profession, control, inspection and discipline, the constitution of guarantee funds and professional liability as well as professional ethics.[20]

The final phase in the reform initiative in insolvency law thus saw the production of an advance text in late 2003, which was the subject of some commentary.[21] Some updating of the proposals was necessary to take into account the codification process and developments at the European level.[22] The content of these proposals was also influenced by a report on the state of insolvency law in France following the adoption of the Laws of 1984 and 1985 that had been issued by the Parliamentary Office for the Evaluation of Legislation.[23] The 2003 text, however, was rapidly replaced by a later version submitted to the Conseil d'Etat in early 2004, which contained a number of new proposals, including the introduction of a new procedure called '*sauvegarde*' (preservation). This in turn was superseded by a final draft produced on 12 May 2004, which forms the basis of the working text being introduced into Parliament.[24] The overall initiative seeks to introduce a framework that takes into account many of the views expressed by the Garde des Sceaux in his 2002 speech and the contents of the Parliamentary study noted above. The reforms that the texts seek to introduce are seemingly quite profound and will, if enacted, substantially change the nature of insolvency procedures in France.[25] In fact, the text has now been presented to Parliament and it is intended that the text be examined in the National Assembly in January 2005, although it is uncertain at present whether the text will complete Parliamentary scrutiny during the course of the current session.

The 2004 proposals

The proposals in the 2004 text, divided among nearly 200 articles, can be separated into five distinct areas:

(i) Pre-insolvency measures;
(ii) The new procedure of '*sauvegarde*';
(iii) Rescue;
(iv) Liquidation;
(v) Sanctions.

In addition, as far as '*sauvegarde*' and rescue are concerned, there will be common rules covering the operation of both of these procedures. Furthermore, new definitions are to be introduced defining the onset of insolvency so as to distinguish clearly for debtors the options between the new and updated procedures to be instituted. There will also be procedural amendments to the rules on hearings and appeals as well as consequential amendments to other texts. Furthermore, a preliminary point may be made in that insolvency procedures will now be extended to cover the position of independent professionals,[26] who previously, unless practising under the umbrella of a civil professional firm, fell between the Law of 1985 and the provisions dealing with personal (or consumer) debt. The extension of the coverage to independent professionals is viewed as being one of the major contributions of these reforms.[27]

Pre-insolvency measures

There are two limbs to the changes affecting pre-insolvency measures. The first, dealing with the detection or diagnosis of difficulties, will see the reinforcement of provisions allowing the auditors to alert the company and its shareholders of financial difficulties on the horizon. This role is considered vital because periodic audits are the best formula for diagnosing the financial state of health of the business. A role will also be given to the '*comité d'entreprise*'

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20 Law no. 2003-7 of 3 January 2003 ('Law of 2003').

21 See J.-L. Vallens, 'Réforme des procédures collectives: premier commentaire de l'avant-projet' Bull. Lamy, droit commercial, 2003G.160.1; B. Soinne, 'La croisée des chemins: l'avant-projet de réforme' Act. Proc. Coll. 2003/19. See also J. Courtière, 'Réforme des textes sur la prevention et le traitement des difficultés des entreprises' CCIP Report (November 2003).

22 In particular, the enactment of a cross-border insolvency regime in Council Regulation (EC) No. 1346/2000 of 29 May 2000 (OJ 2000 L160/1).

23 This report may be viewed on the Senate website at: <www.senat.fr/rap/r01-120/r01-120.mono.html>.

24 The texts differ mostly by reason of terminology and numbering, the introduction of the new procedure of '*sauvegarde*' in the 2004 versions necessitating new definitions and references. The final 2004 text, an accompanying '*Exposé des Motifs*' (Explanatory Memorandum), a Press dossier and a marked-up version of how the changes will affect Book VI of the Commercial Code are available from the Ministry of Justice website at <www.justice.gouv.fr>.

25 See P.-M. Le Corre, 'Présentation générale du projet de réforme des entreprises en difficulté: de l'avant-projet au projet de loi de sauvegarde des entreprises' *Gazette du Palais* 2004.56-57.4.

26 This category principally includes persons falling within regulated professions, such as lawyers, accountants, architects etc.

27 See P.-M. Le Corre, op. cit. at 4. However, in the case of independent professionals, the opening of procedures will be tied in to information being supplied to the professional regulatory body.

(works council), representing the employees, which will see this body being given the right to transmit information to the auditors with view to activating an alert. The way the system works will be speeded up and made more efficient, allowing for timely intervention by the courts. The courts will also be permitted to intervene, as they do now, by using the failure to file accounting documents as a trigger for action. Company directors, who are normally under an obligation to file these documents in the Commercial Court registries, will be the subject of injunctions requiring filing to take place within a limited period, where default has occurred. They will also be made to attend court so that an investigation may be made as to whether proceedings need to be opened in the event the company is experiencing difficulties.[28] The second limb, covering the procedures available, will see a number of particular developments. The first is a change in nomenclature, which will see the current term '*règlement amiable*' (amicable settlement) disappear in favour of '*conciliation*' (conciliation).[29] A second development will see an extension of the time limits for the conclusion of an agreement from three to four months. The aim of the substantive changes are to preserve the contractual nature of the process by promoting the conclusion of an agreement with the creditors and by preventing the agreement from being overturned by rogue creditors through ensuring that the interests of all creditors are respected. The confidential nature of the process is also to be retained, to allow the debtor company the ability to negotiate with creditors without raising undue public attention.

As for the substantive changes, in the first instance, the outcomes of the process will be made more secure, with transactions occurring as a result of the negotiations or the eventual agreement being immune from attack in any subsequent insolvency proceedings by reason of the debtor being in cessation of payments, the formal pre-requisite for triggering insolvency proceedings. The conclusion of an agreement and its subsequent validation by the court will raise a conclusive presumption that cessation of payments has not occurred and that any contracts and security may not subsequently be rendered void by deeming them to have occurred within a relation-back period. This development also ties in with the new definition of eligibility for the opening of proceedings, which will allow debtors to have recourse to conciliation within forty-five days of cessation of payments occurring. In this event, the conclusion of any agreement will raise a similar presumption by deeming the state of cessation of payments to have come to an end. However, the existence of any agreement does not mean that the court is bound to automatically uphold the plan. This possibility is subordinated to three pre-conditions being satisfied, that the debtor is not in a state of cessation of payments or that this state will come to an end because of the agreement, the nature of the agreement contains sufficient assurances for the continuity of the business and that the agreement is not prejudicial to the interests of the creditors who have not participated in its conclusion. Of course, exactly what may constitute prejudice for creditors who may be required to make significant concessions will no doubt be fleshed out by case law in due course.

With view to ensuring the success of any agreement, new payment priorities are to be instituted so that parties who provide new funding will be paid in priority to creditors relying on debts acquired prior to the opening of proceedings or even those arising post-commencement. The text also addresses one of the concerns that banks and financial institutions have raised about '*soutien abusif*' (improper support), a doctrine that deems a credit-provider liable to other creditors for providing funds that lead to the continuation of business activity later deemed unlawful. The reasoning employed by the Explanatory Memorandum for changes here is that the information provided to all parties for the purposes of negotiating an agreement puts all parties in the best negotiating position possible. It would thus be iniquitous and unreasonable to allow the creditors to invoke a right to pursue a fellow creditor on the basis that previous financing arrangements seemed to give a misleading impression of the debtor's financial status. However, the right would remain where fraud and manifestly improper behaviour were features of the case. Finally, addressing some of the concerns expressed in previous analyses of the workings of pre-insolvency measures, the text will ensure that the person in charge of conciliation can be considered independent. No appointments may be made of any person who has been remunerated by the company within the previous 24 months, no person may be appointed who is or has been a judge of the Commercial Court within the previous five years and insurance providing for liability cover will be made mandatory. Furthermore, in the absence of express provision in the context of any agreement reached within the framework of the conciliation procedure, the President of the Commercial Court will fix the remuneration of the person appointed.[30] The extension to independent profes-

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28 *Exposé des Motifs* at 4.

29 The 2003 text opted for the term '*redressement amiable*' (amicable rescue). This was changed because of the probable confusion with '*redressement judiciaire*' (judicial rescue), which remains as one of the available procedures.

30 *Exposé des Motifs* at 5–6.

sionals noted above may be particularly useful in enhancing the attractiveness of these pre-insolvency measures, which under the regime of the Law of 1985 were too infrequently used.

The new procedure of 'sauvegarde' (preservation)

The core of the reform project is the new procedure of '*sauvegarde*'. However, to understand where its place lies in the overall scheme of things, it is necessary to appreciate that the 2004 text grafts the provisions dealing with '*sauvegarde*' onto the existing section containing current provisions dealing with rescue. A new and smaller rescue procedure will be the subject of a new section to be inserted following these provisions and referring back to these in the case of common stipulations. However, that said, the most profound change to this set of provisions is that, in order to qualify for '*sauvegarde*', the debtor must not be in a state of cessation of payments.[31] The effect is to shift the emphasis on rescue in its broadest sense to a time before the debtor becomes unable to meet its contingent liabilities. For that reason, '*sauvegarde*' has been called an 'anticipatory rescue procedure'.[32] '*Sauvegarde*' is conceived as a type of debtor-in-possession procedure which permits the management to stay in charge and help resolve the problems facing the business. Where the business meets a threshold requirement, an administrator may be appointed, but his role will be limited to advising the debtor-in-possession. The procedure will carry with it an automatic moratorium and will allow the debtor to propose a plan with the assistance of its creditors with view to a reorganization of the business, the plan subsequently being validated by the courts. The voluntary (and thus non-coercive) nature of the procedure is underlined by two elements, the first being that the plans will generally be of a continuation-type (one of the two options under the Law of 1985) and will not usually allow for the sale of assets or of the business itself. Nevertheless, parts of the business may still be sold if they constitute autonomous and separately viable units with new provisions ensuring that any such sales will be free of the opportunity for fraud.[33] This limitation to a continuation-type plan is designed to ensure that directors of potentially insolvent companies are given the incentive to seek help early and will so act if they do not face the possibility of their companies being sold underneath them.[34] The second element is that the courts will lose the right ex officio to remove directors from office on grounds that this may be essential to the survival of the business. This provision was often used under the Law of 1985 as a quasi-sanction. Courts will now only be able to do so if the Public Prosecutor makes a request to this end.

The '*sauvegarde*' procedure may lead, as part of the reorganization process, to a reorganization of the share capital of the business as part of debt-management proposals. Debts may be converted into capital or options for capital and new money may be brought in through participation by third parties. The overall impact of the use of these techniques, which have become current in practice, although thus far not placed on a statutory footing, will be to leave the incorporated form undisturbed, while providing a forum for negotiations for the overall settlement of debts. In fact, the '*sauvegarde*' procedure is expressly designed to serve as part of an overall negotiation strategy between the debtor and creditors leading to the conclusion of a plan with common objectives, thus underlining its essentially co-operative nature. Approval by creditors is to be signified through the constitution of two committees, representing financial institutions and principal suppliers respectively. The interests of unrepresented creditors will be considered when any agreed plan is presented to the court for validation. The objective is that the debtor-in-possession, assisted, it being the case, by an administrator, will present a draft to these committees for their views, the subsequent exchanges of opinion and observations contributing to the final draft submitted to court. Voting on the committees will be by majority, calculated according to the amount of debt certified by the company auditors. A positive vote by both committees (amounting to at least two-thirds of the value of the total debt) is required for the plan to make it into court for validation. However, once this occurs, the role of the court being to ensure that all interests are duly taken into account, dissenting and non-participating creditors will become bound. Validation will be normally accompanied by the appointment of a supervisor to oversee the implementation of the plan. Where the plan is not approved or validated or subsequently

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31 However, the debtor must be able 'to justify [being in] difficulties capable of leading to a cessation of payments'. If cessation of payments has in fact happened, the court must note this and convert the procedure to one of rescue.

32 See P.-M. Le Corre, op. cit. at 6.

33 Despite Article L.621-57, Commercial Code prohibiting directors, their agents and families from making bids for assets to be divested, many such sales took place, often of the entire business, thus allowing for phoenix-company type scenarios.

34 A further incentive lies in the fact that, contrary to current law, guarantors providing independent guarantees or seconding the company's debt will be able to take advantage of any provisions within the plan that provide for waiver, concessions or extinction of the principal debt. This will largely benefit individual guarantors (which will include many company directors and members of their close family).

its implementation becomes impossible, the outcome will usually be a liquidation order. The Explanatory Memorandum makes it clear that these proposals are designed to encourage durable restructurings and reorganizations and to allow for credible negotiations to take place involving creditors in the rehabilitation of their debtor.[35] However, underlining the importance of the public interest in the process, two proposals are included in the text. The first will see public bodies being allowed, on the same basis as other creditors, to consent to waivers and other concessions in relation to the debts owed them.[36] This does not, however, go as far as the suggestion made by the MEDEF[37] that the preference granted these debts be removed.[38] The second is that the Public Prosecutor will have access to any proposals and the court will be required to solicit his views on the matter.[39]

Rescue and common provisions

As noted above, the '*sauvegarde*' provisions have been grafted onto the existing ones for rescue, leaving rescue to be inserted by means of a new section with references back to earlier provisions. In fact, the 2004 text contains just nine, albeit lengthy, articles dealing with rescue in its new form, which apply, mutatis mutandis, the rules on '*sauvegarde*' to rescue. Three areas in which the procedures will differ, however, are the pre-condition for opening proceedings, where the qualification for rescue will be that the debtor has entered the state of cessation of payments within the previous forty-five days,[40] the rules relating to voidable transactions,[41] which will only apply to rescue procedures, and the types of rescue plan available, which in this procedure may involve either continuation-type or sales-type plans.[42] The logic in retaining rescue, albeit in a smaller form,[43] is two-fold. The Explanatory Memorandum states that the diagnosis and prevention measures that are highlighted in the 2004 text will not be able to deal with the problems of all firms. In fact, it is probable that many SMEs will not, for good reasons, be able to accurately forecast their difficulties and may miss the opportunity for conciliation or '*sauvegarde*'. The availability of a rescue option is thus a sensible alternative to having to liquidate these firms.[44] That said, rescue may also be conceived of as an ante-chamber to liquidation of the company through the use of the sales-type plan, where the entirety of the business may be made the subject of takeover bids. The court will consider any such option at the end of the observation period as an alternative to proposals from the management for continuation. The aim will be to ensure a better realization of the assets and repartition of the consequent sales price among the creditors, the existence of the rescue procedure allowing the opportunity for the plan to be elaborated that a straightforward liquidation would not offer.[45] One further change that will enhance the position of creditors in rescue will be a new provision requiring, in the case of continuation-type plans, the entry into a commitment to providing a regular (usually annual) dividend of a specified minimum amount.

Turning to the common provisions, the existing provisions on family law (rights of a partner), recovery of goods (retention of title and other rights over unpaid goods) and the duties of the debtor in the absence of the appointment of an administrator are

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35 *Exposé des Motifs* at 7.

36 Including taxes, social security contributions as well as interest and penalties on amounts owing. An important question here will be the extent to which courts will be able to impose provisions of the eventual plan on this type of creditor.

37 *Mouvement d'Entreprises de France*, the equivalent of the CBI in the United Kingdom.

38 'Quel traitement pour les entreprises en difficulté? Propositions pour améliorer la prevention' (September 2003) at 9. This report and others mentioned below are available through the MEDEF website at <www.medef.fr>.

39 In fact, where the business exceeds a certain threshold, the presence of the Public Prosecutor at hearings will be mandatory.

40 This is an improvement on the current allowance of 15 days. However, in the event of the failure of an earlier conciliation procedure, a debtor in cessation of payments will only have eight days to apply for rescue.

41 Currently in Articles L.621-107 and 621-108, Commercial Code.

42 There is also the possibility for hybrid plans (as under the Law of 1985), combining elements of continuation with sales of assets or viable units.

43 The current distinction between the general regime and simplified regime in rescue will disappear, although the courts will retain a discretion in the choice of appointing an administrator to second or replace the debtor.

44 *Exposé des Motifs* at 7.

45 This may be compared to the position in administration in the United Kingdom, where a better realization is one of the options for which administration may be ordered.

retained, albeit with slight modifications. The substantive amendments come with the introduction of a new right to the creditor nominated as a monitor in proceedings.[46] This will allow that individual to exercise the right to initiate litigation in the absence of action by the insolvency practitioner against the directors and third parties with view to recovering damages for the insolvent estate.[47] There are also a number of provisions dealing with the status of debts. One important qualification will be in respect of post-commencement debts, where the Law of 1985 automatically gave these priority over other debts, regardless of how they were incurred. The courts will now be able to distinguish clearly between debts relating to new financing needs or to services or supplies provided and those in fact arising from obligations prior to insolvency or that have no relationship to post-commencement commitments. The position of creditors with real rights and in rem rights will be improved by easing the procedural rules relating to declarations and proofs of debt.[48] The draft will also repeal the provision stipulating that debts submitted to proof declared out of time and not otherwise subject to relief by the court are extinct. This is said to be in line with similar rules in other European Union countries.[49] Relief in the specific case of fraud or concealment by the debtor will be placed on a statutory footing.[50] Finally, new rules will be introduced dealing with the consequences of the debtor failing to adhere to the terms of a plan (whether in '*sauvegarde*' or in rescue). The court will be entitled to determine that the plan has failed and to open new proceedings (generally liquidation) with respect to the debtor. Otherwise, the successful conclusion of a plan will be the subject of a specific order by the court recognizing the end of proceedings.

Liquidation

An important part of the 2004 draft is devoted to the position of liquidation. This is recognition of the prevailing economic reality, in which approximately 90% of all procedures begin or end as liquidation proceedings. The aim of the draft law is to enhance the attractiveness of rescue while streamlining the liquidation procedure so as to maximize creditor benefit. One of the first things the text does is to give liquidation autonomy on a par with other procedures.[51] Liquidation will be defined as a procedure open to any debtor in a state of cessation of payments who is clearly in an impossible situation with regard to forming a rescue plan for the business and which will bring an end to business activity through the realization of assets.[52] As will also be the case for rescue, the opening of proceedings must be requested within 45 days of the debtor entering the state of cessation of payments or within eight days of the ending of conciliation proceedings. Some important changes are nonetheless introduced by the draft text. In the first instance, business activity will be permitted to continue in liquidation where either a sale of the business or a collection of assets is envisaged or where the public interest or the interests of the creditors require it. In this event, business is conducted by the liquidator unless the company exceeds a certain size threshold, when an administrator may be appointed, or where the court deems it necessary to make an appointment. The status of the debtor in proceedings will also be clarified, so that there is no automatic prohibition for the debtor being involved in the management of business activity or for directors of a company being involved in decision-making and any legal steps normally incumbent upon them outside insolvency. It will remain the case that, where the directors refuse or are unable to act, a judicial nominee may be appointed to represent their interests in the liquidation process. Furthermore, the speed of

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46 The role of the monitor (appointed from the ranks of the creditors) under Article L.621-13 is to assist the supervising judge and creditors' representative in the organization of the procedure and generally to ensure that creditors' interests are taken into account, the euphemistically named creditors' representative being in fact the insolvency practitioner appointed to ascertain and verify proofs of debt (see footnote 8 above).

47 *Exposé des Motifs* at 8. The current position under Article L.621-39 is that only the creditors' representative may undertake litigation. Case law has interpreted this facility as excluding creditors from pursuing a case, even in the absence of action by the creditors' representative, for which see *Cassation commerciale*, 15 May 2001, RJDA 2001.10 no. 990.

48 This will include creditors holding security, a hire-purchase or leasing contract, a retention of title clause and those benefiting from a debt arising from criminal proceedings (award of damages, penalties and interest etc).

49 *Exposé des Motifs* at 8.

50 See P.-M. Le Corre, op. cit. at 10, who states that the ambiguity in the case law with respect to pleadings by creditors alleging fraud by the debtor make this reform necessary.

51 Under the Law of 1985, liquidation could only follow a prior attempt at rescue, leading the courts to evolve an ingenious, but meaningless, procedure in which a rescue order was made immediately followed by one for liquidation. The Law of 1994 corrected this by allowing for liquidations ab initio.

52 *Exposé des Motifs* at 9. Realization may take place by means of a sale of all assets or of separate collections of assets.

procedures will be accelerated and courts will be invited, when opening proceedings, to fix a recall date to determine whether proceedings may be brought to a close or will require further time. In addition, the expiry of a two-year period from the making of a liquidation order will entitle any party to approach the court for an order that proceedings be terminated. Finally, an important provision relating to the rights of creditors to resume proceedings against the debtor for particular defaults will be altered to exclude disqualification from management as one of the pre-condition for proceedings, but will be extended to cover any debt arising in the context of criminal proceedings. [53]

Further changes to the liquidation environment will have an impact on situations where the liquidation is to be carried out through a sale of the business or of one or more collections of assets. The idea is to enhance the potential for rescue for viable units capable of independent activity.[54] The model used will be that of the sales plan in rescue proceedings. For this purpose, the liquidation proper may be preceded by a period of rescue during which a plan is drafted for validation by the court. In common with the regime governing sales plans, a '*cession-liquidation*' (liquidation-transfer) will be subject to enhanced security to avoid instances of fraud occurring. This addresses one of the major criticisms of liquidation as an opportunity for sharp behaviour by directors or for the acquisition of assets at substantial undervalue by unscrupulous parties. Under the new regime, bids for the business or viable units must be made containing precise indications of a number of important elements: the length of time the bidder will remain bound for performance purposes, whether any party may be substituted later for the performance of any contract as well as how the purchase price will be paid or how any loans incurred for takeover purposes will be settled together with any attendant guarantees. The court will be bound to evaluate the seriousness of the offer by looking to how much of the overall debt will be settled if the bid is accepted and may impose further conditions and obligations on the bidder. In any event, the bidder will remain a guarantor for the performance of the plan despite any later substitution of parties. Furthermore, new proposals will see the introduction of a facility for the court to maintain supervision over the transferred business or assets and indeed to bring any transfer contract to an end upon failure in performance. This will, according to the Explanatory Memorandum, serve as a check on speculative bids which are made solely with view to asset-stripping.[55] In fact, a default in performance followed by the termination of the contract will result in the bidder being liable for damages and being prevented from reclaiming any purchase price. Furthermore, any transactions carried out during the performance of the contract may be investigated by the court with view to their being impugned and any property being recovered for the benefit of the company.

Finally, one of the perennial problems of liquidation, the position of asset-poor businesses, will be addressed through the introduction of a simplified liquidation regime.[56] This recognizes the reality that, in many instances, the sums garnered from the sale of assets barely cover the costs of organizing the procedure. The initiative here seeks to promote a short-form liquidation for small businesses, falling under a threshold to be defined, following which the entrepreneur will be free to resume activity unless the subject of sanctions. The differences between this and the ordinary regime will be chiefly in the speed of proceedings and the consideration of the position of creditors being limited to a defined number of categories. The process will be initiated following a rapid examination of the situation by the liquidator and a report to the court normally made within a month. The report will indicate whether business activity is taking place, the number of employees in the firm and whether there are any obstacles to the use of the simplified regime, which will include the situation where the debtor's asset base includes 'difficult' assets (real property and intangibles of a complex nature) and where litigation may be ongoing or contemplated. The court then decides whether the simplified regime is appropriate in the circumstances and, even where it opts for this regime, may convert the procedure at a later date to a normal liquidation. This may, for example, occur where proceedings are contemplated against the directors for misfeasance or insolvent trading. In the event the simplified system is used, the liquidator proceeds to a sale of the assets at will or at public auction without the need to obtain the approval of the supervising judge for every transaction. At the end of this period, any remaining assets have to be disposed of by public auction. While this process occurs, the liquidator verifies proofs of debt, only being required to do so in the case of claims by employees and those creditors that may derive a benefit from the sums

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53 Article L.622-32-III, Commercial Code, contains a list including fraud against creditors, personal bankruptcy, disqualification from management, criminal bankruptcy and, where the person is a director of an insolvent company, the liquidation of that company has been brought to an early close because of a lack of assets to distribute.

54 *Exposé des Motifs* at 10.

55 Ibid., at 11.

56 Ibid., at 11–12.

raised by way of disposal of assets. The logic of these provisions is that payment of other debts will be impossible, unless further assets are discovered, and hence it would be inefficient to use the liquidator's time in this way. Following the final sale and the list of debts being established, the liquidator will propose a formula for distribution of dividends that will be deposited in the court registry for public access. Subject to any objections, which will be heard by the supervising judge, dividends will be distributed a month after publication of the formula. A final report will be presented by the liquidator at the end of a year following the opening of proceedings, in light of which the court will either bring proceedings to an end or, as an exception, allocate a further three months at most for matters to be dealt with. These proposals will undoubtedly represent a vast improvement on present measures.

Sanctions

The amendments to the sanctions provisions are not minor in nature, but in substance do not change the overall impact of the liability regime.[57] This is despite the view taken by the business sector, which firmly believes that the liability regime and sanctions in insolvency are too penal in orientation. The MEDEF produced a 2003 report which made a number of recommendations with a view to reducing the impact of what they term the 'extremely severe law' that applies as a result of the Law of 1985.[58] In the Explanatory Memorandum, some of the concerns expressed by the MEDEF are incorporated. Under the rubric of civil claims, the memorandum echoes the feelings articulated by the MEDEF, which wished to see the abolition of the procedure allowing for the extension of proceedings.[59] The proposed amendments are aimed at completing the process of dissociation between the firm and the individual commenced by the regime introduced by the Law of 1967. Insofar as insolvency affects a corporate body, where individuals are liable for payment of its debts, no longer will the courts have the option to extend proceedings automatically to these individuals. Only if the individuals fall within the scope of the law (by being commercial persons, craftsmen etc.) will they have proceedings opened, subject to their being in cessation of payments themselves, a situation which would normally apply where their assets have been exhausted following a call on their liability for the business' debts. Where individuals do not fall within the ambit of the law, claims will be made the subject of ordinary civil enforcement rules.[60] Similarly, the extension of proceedings as a sanction will be replaced by a finding of liability for the totality of business debts. The draft text will also make it easier to organize preservation measures over assets so that debtors cannot turn the new provisions to their profit by 'organizing their own insolvency'. Furthermore, as far as company directors are concerned, extension of proceedings as a sanction or by reason of a failure to settle any liability for the company's debts pursuant to a judgment of the court or for the acts of mismanagement in Article 624-5 will no longer be permitted.[61] The presence of grave fault will be sanctioned by making the directors liable for the totality of the losses and the pursuit of claims will be furthered by the ordinary civil enforcement rules.[62] Only where the exhaustion of assets would render directors subject to insolvency law measures may proceedings be opened. In fact, the emphasis will largely shift to the claim for a contribution, which will be limited to instances of liquidation, it being deemed incompatible with rescue and the new '*sauvegarde*' procedures. This is because the adoption of a rescue plan, which provides normally for the settlement of all claims, is deemed to see creditors satisfied. Only if the rescue plan comes to an end prematurely by default will claims be possible.[63]

In dealing with civil sanctions, the memorandum does not, however, take on board many of the views expressed by the MEDEF, which wished to replace the option for personal bankruptcy by amendments to the disqualification option.[64] As far as the disqualification regime is concerned, the only amendment involves

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57 The liability regime includes two types of civil claims (claim for a contribution and extension of proceedings), two types of civil sanctions (personal bankruptcy and disqualification from management) and criminal sanctions (criminal bankruptcy and other offences).

58 'Encourager l'initiative économique grace à une politique raisonnée de la sanction en cas d'échec: la réforme des sanctions dans les procédures collectives' (March 2003) at 2.

59 For a similar view by the CCIP, see J. Courtière, op. cit. (in footnote 21 above) at 30.

60 *Exposé des Motifs* at 13.

61 These acts of mismanagement include using company assets as one's own, conducting business in an abusive manner for personal gain, failing to keep proper accounts, misappropriating company assets or fraudulently increasing company debt.

62 See P.-M. Le Corre, op. cit. at 16 for concerns about whether courts will have the discretion to opt between liability for part or all of the company debt where one of the constitutive elements for the greater sanction is present.

63 *Exposé des Motifs* at 13.

64 This advocated the introduction of two types of disqualification: 'simple' disqualification, which would consist of disqualification from management, and 'aggravated' disqualification, which would carry with it other disqualifications from the enjoyment of civil rights (voting in and standing for election, wearing civil/military decorations), loss of professional qualifications and the right to deal in shares.

removing disqualification from the list of preconditions entitling creditors to resume claims against delinquent directors.[65] Conversely, the personal bankruptcy regime is the subject of quite a number of changes. Courts will no longer enjoy the right to take action ex officio, but must await a decision by the insolvency practitioner to bring an action, precisely because of concerns about the impartiality of courts sitting as prosecutor and judge. Creditors are, nevertheless, to recover some rights of action if the insolvency practitioner fails to act. However, the draft will require that insolvent members of a regulated profession may only be the subject of proceedings where action is taken by the relevant regulatory authorities. Article L.625-5 (fact situations constitutive of personal bankruptcy) will be redrafted in light of the procedural changes to be instituted, which will extend the period following cessation of payments within which insolvency proceedings must be opened to 45 days. The redrafted article will also include three further fact situations: omitting to make a declaration of cessation of payments within eight days in the event of the failure of a preceding attempt at a conciliation, voluntarily abstaining from co-operating with those responsible for insolvency proceedings by 'forming a manifest obstacle to its good 'progress' and making accounting documents belonging to the company disappear or failing to keep accounts or having kept fictitious accounts, including those 'manifestly incomplete or irregular in the eyes of the applicable law'. The provisions aimed at prohibiting individuals from holding public office, previously in the Law of 1985 but omitted from the Commercial Code 2000 because of a successful challenge before the Constitutional Court, will also be reintroduced,[66] with the safeguard that any court hearing a personal bankruptcy matter must expressly make a decision imposing the prohibition. Furthermore, the maximum duration of sanctions under this chapter will be fixed at fifteen years,[67] any subsidiary disqualifications and prohibitions coming to an end automatically upon expiry of this period. Finally, the changes to the criminal provisions are purely definition-orientated, save for the present rule that does not forbid criminal and civil (including commercial) courts from making concurrent pronouncements on the same facts, although in practice only the sanction imposed by the criminal courts is enforced. To avoid double jeopardy, the criminal courts may only hear matters where the civil courts have not already done so. Where the converse occurs, the criminal courts will have sole jurisdiction.[68]

Summary

The reform of insolvency law is a project of considerable magnitude in any jurisdiction. It demands not inconsiderable reflection and its progress is often slow and deliberate as the interests of the many participants in the process are taken on board and finely balanced. In France, the reform project began inauspiciously in an atmosphere of scandal surrounding the operations of the Commercial Court and insolvency practice. It became linked to these other reforms, being seen by the Government as part and parcel of a necessary and timely renovation of the commercial legal environment. For that reason, it suffered from the close association, which tied together the success or failure of structural and substantive changes. The rush to produce a cure for malpractices in the Commercial Courts prompted hasty consideration of the problems of insolvency law and the production of an early and quick text in 1999. This text, although containing the embryo of many of the ideas to be found in later reforms, did not in itself inspire much hope of a radical revision of insolvency law. Fortunately for the reform initiative, when the Senate sounded the death-knell of the texts relating to the Commercial Court, it permitted a period of contemplation, during which plans could be further refined and reconsidered. The elections held in 2002, although returning a Government of a different political complexion, provided further breathing space, during which many of the ideas now to be seen in the 2004 text were developed. It is the case that the same postponement allowed for developments in insolvency practice leading to the Law of 2003, which some would describe as a far better text for being the result of greater thought about the problems endemic to the system. If this is so, it is likely that the changes to insolvency law will be regarded in much the same light for having had the extra time for maturing. It is in this light that, undoubtedly, commentators will be approaching this text. Indications are that the greater emphasis on prevention and cure at an early stage find

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65 See footnote 53 above.

66 The challenge was motivated by the fact that the 'automatic' nature of this sanction offended against Article 6 of the European Convention on Human Rights.

67 The MEDEF advocated ten years as a ceiling.

68 *Exposé des Motifs* at 14–15.

favour with the business sector, from which group at present the approximately 45 000 insolvencies each year are drawn.[69] The final enactment will no doubt take on board many of the views that will be expressed by business, practitioners and the Commercial Court judges during its progress through Parliament.

It is necessary, however, to recall that the previous Government set itself the task of updating the commercial law environment for a specific purpose: to permit French law and institutions to compete on a global basis with other jurisdictions, where only efficient delivery of legal services will prompt users to continue to select particular rules for their legal transactions. It was in this light that the 2000 General Conference of the Commercial Courts chose as its theme: 'Anglo-Saxon (common) law and Romano-Germanic (civil) law: war or peace?' Speaking at this congress, Marylise Lebranchu, Dominique Perben's predecessor as Garde des Sceaux, put the reforms firmly into context. She stated that:

> The reform of commercial justice requires its participants to adapt to new rules. The decisions of the legislators must be put into operation and the new laws must be made to live. The [Commercial Court] judges have known – and they have shown this – how to evolve in the past. I am convinced that the [Commercial Court] judges will also do this for the present reforms.[70]

Although the particular reforms spoken of have now been put into suspension and may not be revived, the sentiments uttered are still an important indicator of why the present Government has continued to pay attention to the problems in the insolvency legal environment and has engaged in a process leading to a profound reappraisal of French insolvency procedures. When in 2002 Dominique Perben promised that insolvency law would be the subject of a new text, he did so by appealing to the need to correct the negative effects in the Law of 1985, which sought at all costs to achieve rescue, with the price being paid by the creditors, albeit partially resolved by the Law of 1994. However, the necessity of adapting procedures to economic reality meant that this process has to be pursued by re-legitimating liquidation whilst streamlining it for efficiency considerations, by reaffirming rescue procedures to allow for the saving of businesses albeit in an advised manner, by underlining prevention and diagnosis to ensure that intervention occurs in good time as well as by simplifying the overall legislative framework to remove lacunae, reduce unnecessary complexities and thereby costs.

These are all issues with which most Western European jurisdictions will have grappled. The quest towards a realistic insolvency regime is one that has preoccupied many of these jurisdictions in recent years. Examples may be given of Germany,[71] the United Kingdom[72] and Spain.[73] Reforms are also said to be progressing in Italy and many of the accession candidates to the European Union are also in the process of updating their laws. Some authors speak of a 'second wave' of collective reforms, which may lead to a convergence in European insolvency laws.[74] Some draw their inspiration for the processes occurring in Europe and elsewhere from the example of Chapter 11 of the United States Bankruptcy Code, which is well-known as a debtor-friendly regime, and point to the similarities between this system and the positions to which European domestic laws are gravitating.[75] In this respect, the French reforms, in particular the new procedure of '*sauvegarde*', are regarded as closely approaching the American model.[76] In the European Union generally, although initiatives have occurred at European level in insolvency, these have been mostly geared towards resolution of jurisdiction and choice of law issues in cross-border instances.[77] Thus far, there has not been a repetition of early calls for harmonization of substantive law within the European Union.[78] Nevertheless, the existence of global trends that have encouraged the introduction of progressive insolvency measures, such as corporate rescue, pre-insolvency diagnostic

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69 See Y. Gallois, 'Près de 45000 défaillances en France', *Le Mond*e (1 October 2002) reporting 42 000 insolvencies in 2001 and a progression of some 6.4%, leading to an assumption of 45 000 insolvencies occurring in the 2002 period. Sectors worst affected included construction, industry, transport and textiles.

70 Speech of 19 October 2000. A copy is available at: <www.justice.gouv.fr/discours/d191000.htm>.

71 *Insolvenzordnung* of 18 October 1994 (in force 1 January 1999).

72 Insolvency Act 2000 and Enterprise Act 2002 (relevant provisions in force 7 November 2003).

73 Insolvency Law of 10 July 2003 (in force 1 September 2004).

74 See R. Parry, 'Introduction' in K. Broc and R. Parry (eds.), op. cit. at 2–5. The 'first wave' is regarded as having occurred in the 1980s, of which the Laws of 1984 and 1985 (France) and the Insolvency Act 1986 (United Kingdom) are examples.

75 See M. Frison-Roche, 'L'inéluctable convergence des droits de la faillite' *Les Echos* (30 September 2002).

76 See P.-M. Le Corre, op. cit. at 7.

77 See footnote 22 above.

78 See P. Omar, *European Insolvency Law* (Ashgate, Aldershot, 2004) at 177 and 188–190.

and intervention procedures as well as more internationally focused co-operation in many jurisdictions around the world may indicate that there is sufficient weight to the argument that a convergence in philosophy and substance is occurring that could see closer harmonization become a more realistic ambition and prospect. It is this trend that perhaps is being witnessed in the progressive enactments of this century happening in Western Europe. Whether inspired by the American model or by other comparative analyses, it remains the case that this work is ongoing and the quest for the ideal insolvency system remains a perennial one.