

MENU DU JOUR – RESTRUCTURING AND INSOLVENCY OPTIONS IN FRANCE: SOMETHING FOR EVERYONE?

New restructuring rules have been available to debtors since the start of October last year. The most significant reform is the availability of the new accelerated safeguard procedure, which is designed to offer a streamlined rescue mechanism, allowing debtors to restructure within 4 months and without the unanimous consent of all creditors. In this briefing we look beyond this reform to consider the full menu of options now available in France. In particular, we consider how the options impact on different stakeholders, including lenders, bondholders, and shareholders. We consider whether the range of options now calls for a different approach to restructurings and insolvencies and a change in strategy to maximise returns.

"France has become a very attractive jurisdiction for major domestic and cross border restructurings. French law emphasises management's role and anticipation by encouraging preventive mechanisms and ensuring debtor in possession. French law also promotes creditors' existing rights and priorities and restricts shareholders ability to jeopardise restructuring processes."

Delphine Caramalli – Head of Restructuring and Insolvency, France

"France has a great collection of restructuring tools. This gives better visibility and business opportunities for investors as well as giving more flexibility for debtors."

Philip Hertz – Global Head of Restructuring and Insolvency

OVERVIEW OF FRENCH LAW CONSENSUAL AND BANKRUPTCY PROCEEDINGS

Consensual Proceedings (*procédures amiables*)

It goes without saying that when looking at strategies that preserve value and maximise returns, pursuing a consensual solution is often preferred by stakeholders. This preference has been borne out in practice with French market trends over the past 18 months, providing for fewer 'in-Court proceedings' but an increase in the number of consensual processes in 2021 (+45% compared to 2020). Certain sectors have been more affected than others including real estate, retail and aeronautical activities.

Key issues

- 'Out of Court' consensual proceedings require stakeholders' consent
- 'In court' restructurings have the benefit of an automatic stay
- Debtor remains in possession during the course of 'In Court' proceedings
- Classes are constituted by the judicial administrator according to existing priority and security rights
- DIP financing is possible under French law
- Forced transfer of equity holdings is restricted to very limited cases
- Term out is limited to rehabilitation proceedings and regular safeguard only
- Cross-class cram-down is possible
- Cram-down of shareholders is possible, with Court approval
- Forced sale of assets is possible in rehabilitation proceedings where no plan is viable (*plan de cession*)

In France, the two consensual options available are *mandat ad hoc* and conciliation. Each has the advantage of being entirely confidential.

Mandat ad hoc proceedings

In practice, *mandat ad hoc* proceedings are used by debtors at an early stage, debtors must not be in 'a state of cessation of payments'. French judges apply a cash flow test to assess the state of cessation of payments. *Mandat ad hoc* proceedings are not limited in time, and when a consensual agreement is reached, it is reported to the President of the Court, but it is not formally approved by the Court.

Conciliation proceedings

Likewise, conciliation proceedings may only be initiated if the Debtor is not in a state of cessation of payments or has not been so for more than 45 days. They may last up to 5 months.

During conciliation proceedings, the Debtor may file a petition before the President of the Court to request (i) the rescheduling of accrued debt over a maximum period of 24 months ("grace period") and/or (ii) the freezing or rescheduling of the debt to be accrued (i.e., undue debt at the date of the petition) during the period of the conciliation proceedings.

When an agreement is found during the course of the conciliation, such conciliation agreement may be acknowledged (*constaté*) by the President of the Court, in which case the proceedings remain fully confidential. Alternatively, the conciliation agreement may be approved (*homologué*) by the Court. Such approval will be made public, but the agreement itself remains confidential. New money providers may benefit from a priority of payment and may not be compromised in a restructuring plan in the event of subsequent Bankruptcy Proceedings. In addition, in the event of subsequent Bankruptcy Proceedings, claw back risk is mitigated where a conciliation agreement has been homologated by the Court.

A guarantor of the Debtor may also benefit from the provisions of the conciliation agreement, including any grace period granted by the judge to the Debtor.

When no unanimous deal is found during the conciliation, the Debtor can decide to file for accelerated safeguard proceedings to present a plan. Consensual Proceedings may also be used to organise a pre-pack sale plan that may be implemented in the context of subsequent Bankruptcy Proceedings.

Overview of Bankruptcy Proceedings (*procédures collectives*)

In terms of in-Court formal restructurings, the options have been greatly enhanced by the recent reforms. The different types are accelerated safeguard (*sauvegarde accélérée*), regular safeguard (*sauvegarde*), rehabilitation (*redressement judiciaire*) and judicial liquidation (*liquidation Judiciaire*) (together the "**Bankruptcy Proceedings**").

Each have some common aspects:

- a judicial administrator ("**JA**") (*administrateur judiciaire*) to assist the Debtor's management in the elaboration of solutions;

- a bankruptcy judge (*juge-commissaire*) whose approval will be required for management decisions that fall outside the scope of the ordinary course of business;
- a creditors' representative (*mandataire judiciaire*) which may also act as judicial liquidator.

The bankruptcy judge may also appoint up to 5 controllers from the creditors to supervise the proceedings.

Bankruptcy Proceedings trigger a stay of claims and actions relating to debts which arose prior to the proceedings. Subject to limited exceptions, the Debtor may not pay such debts and creditors may not initiate or pursue legal actions against the Debtor which would rely on such debts (i.e., seeking a payment, the termination of a contract or the seizure of the Debtor's assets). Creditors must instead file a claim with the creditor representative.

Contractual provisions that are detrimental to the Debtor simply by reason of the commencement of Bankruptcy Proceedings may not be enforceable against the Debtor (for example, termination triggers related to ongoing agreements).

Accelerated safeguard proceedings

Accelerated safeguard proceedings are aimed at restructuring and reorganising capital structures of distressed companies when no unanimous agreement was possible during previous conciliation proceedings. Accelerated safeguard proceedings are available to companies regardless of their size, and the Debtor remains in possession.

The restructuring plan is presented by the management to financial creditors only or all affected parties in classes. No term out/rescheduling can be imposed by the Court in case of an unfavourable vote. Accelerated safeguard proceedings have a maximum duration of 2 months that can be extended up to a maximum of 4 months.

Safeguard proceedings

A Debtor that experiences difficulties that it is not able to overcome may, at its sole discretion, file for safeguard proceedings, provided it is not in cessation of payments. Following the opening judgement, they begin a 6-month period ("**observation period**"), renewable for up to a total of 12 months, during which the Debtor remains in possession.

The purpose of a safeguard proceedings is for the company to prepare a safeguard plan contemplating the restructuring terms of the company. Such plan can provide for assets disposal. The plan is presented to creditors (individually or within classes if classes are constituted) for their consent. In the sole instance of the non-constitution of classes, the Court can impose a debt rescheduling upon creditors (within a maximum period of 10 years) in absence of their consent on the plan; but no debt write off or debt to equity swap can be imposed by the Court.

Rehabilitation proceedings

Rehabilitation proceedings apply to Debtors in cessation of payments (that are not subject to a conciliation proceedings). They are initiated at the request of the management or by a creditor or prosecutor. In rehabilitation proceedings, the maximum 12-month observation period can be exceptionally

extended up to 18 months if requested by the prosecutor, during which the Debtor remains in possession (unless decided otherwise by the Court).

The purpose of rehabilitation proceedings for the company is to be restructured according to the terms of a restructuring plan (most of the rules applicable to safeguard apply in rehabilitation proceedings), provided however that if no solution can be found to preserve the company as a legal entity, the JA can decide to organise a sale of the business to a third party to preserve assets and jobs. If no restructuring plan nor business sale can be contemplated, the Court can then as an alternative decide to convert rehabilitation proceedings into a judicial liquidation proceeding.

Judicial liquidation proceedings

Judicial liquidation proceedings may be initiated against or by the Debtor only if it is in cessation of payments and if the Debtor's recovery appears not to be possible. The purpose of a liquidation is to organise the disposal of assets by a Court-appointed liquidator. Amounts collected by the liquidator shall be used to reimburse creditors according to their ranking as set forth into the law.

DIRECTORS' OBLIGATION TO FILE FOR PROCEEDINGS

French law does not provide for a general obligation on the management to file for Consensual Proceedings or Bankruptcy Proceedings.

French law only provides for the obligation to file for rehabilitation proceedings where the company faces a situation of cessation of payments within the definition of French law. This applies unless the management has already commenced a conciliation proceeding. Thus, should the Debtor be in a state of cessation of payments, their legal representative would be subject to the obligation to file for rehabilitation proceedings (or conciliation) within 45 days from the occurrence of such cessation of payments. Failing to comply could expose the director of the insolvent company to personal liability risk (although recent case law in the context of COVID-19 has lightened directors' liability exposure) French judges have held that this obligation applies notwithstanding any by-laws seeking to limit such effects by providing prior authorisation by the shareholders or the board of directors.

WHAT ARE THE IMPACTS ON STAKEHOLDERS' RIGHTS?

From the start of the court proceedings for accelerated safeguard, regular safeguard or rehabilitation proceedings, stakeholders' rights are impacted according to specific rules.

Creditor claims

The Debtor is prohibited from making any payment in relation to debts accrued prior to the opening judgment. Creditors must file their claim with creditors' representative within 2 months following the date of the publication of the opening judgment in the official gazette (so called *déclaration de créances*). This 2-month deadline can be extended for up to 4 months for creditors registered outside of France. Failing to file a claim in due time results in the absence of recognition of such debt and consequently precludes repayment.

Third party property claims

Third party assets in the Debtor's possession at the date of the opening judgment may be the subject of a formal action. Third parties can apply to have their property right duly recognised by the bankruptcy judge (so called *action en revendication*). That is the case for instance in relation to aircraft lessors in case of an airline bankruptcy where the airline is the lessee. Such filing must take place within three months following the publication of the opening judgment.

Shareholders

The commencement of Bankruptcy Proceedings also impacts on shareholders' rights, such as:

- Capital release (*libération du capital social*): unpaid capital increases decided prior to the opening of the Bankruptcy Proceedings must be immediately paid by shareholders. The creditor's representative has the authority to put a shareholder on notice to pay the sums remaining due (within the limit of the amount of the shares subscribed).
- Transfer of shares: in case a *de jure* or *de facto* manager owns shares into the company in rehabilitation proceedings only, the Court may order the non-transferability of such shares. For other shareholders, disposal of shares of a company in rehabilitation proceedings is subject to prior approval from the bankruptcy judge.
- Shareholder's current account (*compte courant d'associés*): from the day of the opening judgment, repayment of current account/shareholders' debt is prohibited. Shareholders must file a claim with the creditors' representative appointed by the Court for such debt to be recognised (*déclaration de créance*). Set off is also strictly restricted. Reimbursement of shareholder's current account during the hardening period may be subject to claw back.

WHAT ARE THE EXIT OPTIONS FROM BANKRUPTCY?

The main differences between accelerated safeguard and regular safeguard on the one hand and rehabilitation proceedings on the other hand regard the exit options.

Safeguard proceedings are aimed at organising the Debtor's restructuring throughout a plan, whereas, in rehabilitation proceedings, JA may decide to organise a different exit depending on the overall situation and the different factors. In rehabilitation proceedings, JA may decide to:

- prepare and present a continuation plan to restructure the debt;
- organise a sale of the assets as a going concern (*plan de cession*) to be decided by the Court following a JA-monitored auction process; and
- orientate for a judicial liquidation should no solution be found to preserve the company and/or the business.

Safeguard Plan - Continuation plan

This briefing does not consider all the detail applicable to the preparation, presentation and voting requirements relating to a safeguard plan or continuation plan, but rather how stakeholders may be impacted in a context where the Debtor's management and JA decide to exit the Bankruptcy Proceedings by means of a plan.

The new regime, which has been in force since 1 October 2021, has significantly impacted stakeholders. Generally, plans contemplate the restructuring terms applicable to a company in safeguard or rehabilitation proceedings. A plan can impact creditors (where extending maturity or writing-off debt, for instance) and/or shareholders (where obligations to proceed with a capital increase to reinforce the capital structure or debt to equity swap, for instance). Although French law provides for the possibility for the Court to squeeze shareholders out by forcing a transfer of the equity to a third party, this regime is applicable to very limited cases and is subject to very strict conditions. For companies (including subsidiaries) in regular safeguard or rehabilitation proceedings with more than (i) 250 employees and €20m of turnover or (ii) €40m of turnover, the JA must constitute classes of affected parties to vote on the plan in an accelerated safeguard, constitution of classes is mandatory regardless of thresholds. The JA is responsible for constituting classes based on existing priority arrangements and existing security rights. Creditors benefiting from a *fiducie sûreté* are not deemed to be members of any classes.

If the draft plan impacts shareholders' equity interest, status or rights, shareholders are considered affected parties and become members of the classes. As such, shareholders can vote on the plan with required majorities and, subject to approval by the Court, the plan becomes enforceable towards affected parties (including voting shareholders). Shareholders could be members of different classes if they have different exposures. For example, a shareholder in its capacity as an equity holder and in its other capacity as a creditor benefiting from new money privilege. As a result, shareholders may be impacted by the plan provided that in rehabilitation proceedings only, creditors can also present a competitive plan if they disagree with the plan presented by the management.

To be adopted, the plan must be approved by a two-third majority vote within each class (*majorité des deux tiers des voix détenues par les membres ayant exprimé un vote*). After the plan has been adopted with a two-third majority vote, the plan must be approved by the Court. Before reaching its decision, the Court verifies that the overall process has been conducted in accordance with the applicable rules. The Court also verifies *inter alia* that individual dissenting creditors are no worse off than in a liquidation scenario.

Nevertheless, the restructuring plan can be imposed by the Court on dissenting creditors (even though the two-third majorities have not been met) if it has been approved by (i) a majority of classes of affected parties, provided that at least one of those classes is secured or senior to ordinary unsecured creditor or (ii) at least one of the classes of affected parties is "in the money" (this cannot be a shareholders' class) upon a valuation of the company by an independent expert.

In the event a cross-class cram-down is used against shareholders, the Court can rule on the plan after conducting a series of tests, such as verifying that, under the plan, dissenting senior creditors are fully repaid before a junior ranking class, as well as ensuring that the following additional conditions are met (provided that the decision of the Court is deemed to replace the shareholders' meeting and to modify by-laws and share capital):

- the Debtor has a minimum of (i) 250 employees and a turnover of €20m or (ii) a turnover of €40m;

- it could reasonably be expected that the dissenting shareholders' class would not likely be reimbursed in a liquidation scenario (upon a valuation of the company by an independent expert);
- if the plan provides for a capital increase by cash contribution, the shareholders should benefit from a preferential subscription right that would be proportionate to the amount of their shares; and
- the plan does not provide for the transfer of the shares of the dissenting shareholders' class without their consent.

In case of classes' unfavourable votes, the Court can also decide to impose a ten-year term out where the Debtor is in rehabilitation proceedings or where the Debtor is in regular safeguard and no classes have been constituted. Term out is not possible for Debtors in accelerated safeguard in case of classes' unfavourable votes.

Sale Plan

In rehabilitation proceedings only, the JA may decide to organise a sale of the assets as a going concern if the company is not able to operate properly despite a reduction in its annual debt. Although shareholders are not prohibited to bid *per se*, shareholders acting as de facto or de jure directors of the company in rehabilitation proceedings are not eligible to present a sale plan and are restricted from offering to acquire the business in rehabilitation proceedings. Following the auction process, the Court renders its decision and elects the winning bidder based on business projections, number of jobs preserved, and acquisition price.

Following the Court decision, shareholders are deprived of their equity rights, including the right to object to the sale (*clauses d'agrément*). Creditors' debt (if properly filed within applicable deadline with the creditors' representative) shall be repaid subject to the proceeds available and in accordance with legal ranking. In practice, the global sale price of the assets may be totally disconnected from the value of each asset comprised in the sale plan. As a consequence, the sale proceeds to be shared among the creditors may be particularly low.

Judicial Liquidation

A judicial liquidation procedure must be opened if the Debtor is insolvent and restructuring through a continuation plan or a sale plan is not possible.

Following a petition, the Court appoints a liquidator who exercises all the powers of management and represents the general interest of the community of creditors, as well as being responsible for asset disposal. Shareholders' debt (if properly filed within applicable deadline) shall be repaid subject to the available proceeds and in accordance with legal ranking.

Conclusion

The range of restructuring and bankruptcy procedures available in France are designed to offer greater flexibility for dealing with distressed businesses. The emphasis on restructuring rather than formal liquidation is very much in keeping with international trends. It is also aligned with the previous French pursuit of debtor led solutions. The recent reforms go further however, in seeking to balance debtor rights with enhanced creditor involvement, so that lenders and bondholders have a more fundamental role to play in delivering a restructuring. In providing a broad legislative framework and understanding

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the need to take into account all stakeholders' interests, France is firmly on its way to being considered a forum for both domestic and cross border restructurings of the future.

Comparison of Accelerated Safeguard and other In-Court Proceedings

	Accelerated safeguard	Safeguard	Judicial rehabilitation
Maximum duration	4 months	12 months	18 months
Stay	Yes (applicable to affected parties only)	Yes (General)	Yes (General)
Confidential or Public	Public, following a confidential conciliation	Public	Public
Petitioner	Debtor's management	Debtor's management	Debtor's management or litigating creditor(s) or Prosecutor
Debtor in Possession	Yes	Yes	Yes (unless decided otherwise by the Court)
Constitution of classes	Mandatory	Mandatory only if certain thresholds are met	Mandatory only if certain thresholds are met
Presentation of a plan	Only the Debtor	Only the Debtor	The Debtor or any affected party
Cross-class cram-down	Possible (with the agreement of the Debtor or the receiver)	Possible (with the agreement of the Debtor or the receiver)	Possible
Court imposed term-out	Not possible	Possible (max. 10-year period) only if classes have not been constituted	Possible (max. 10-year period)
Forced sale of assets as going concern	Not possible	Not possible	Possible

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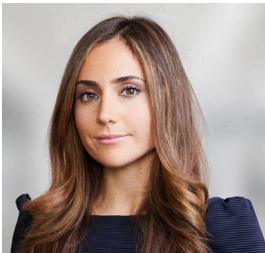
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