****

**Inside Story – June 2019**

**Anticipating the Directive: Is France Prepared?**

*Jean-Luc Vallens, former Magistrate, CA Colmar <vallensjl@ymail.com>*

*Introduction: Editor’s Comment*

*The Preventive Restructuring Directive was adopted recently on 6 June 2019 and now enters its transposition phase, during which member states will endeavour to ensure that its terms are transposed into national law. In France, the Loi Pacte[[1]](#footnote-1) has authorised the Government to legislate by means of an Ordinance, which it must do within 24 months of this law coming into force. Once the Ordinance has been published, the Government must table before Parliament a draft law seeking to authorise the Ordinance within a further 4 months. In a recent piece published in Eurofenix, Jean-Luc Vallens, former Magistrate in France assesses the likely reception for the Directive in France and its impact on the law and practice there.*

**The Preventive Restructuring Directive: A French Perspective**

The Preventive Restructuring Directive (“PRD”), which is about to be adopted by the European legislator, deserves the close attention of French practitioners, as it will become, according to the French way of integrating such texts, part of Book VI of the Commercial Code. The French Government has been given the power to legislate by ordinance to effect these changes. The PRD will apply to the different procedures known to French law and will modify their structure and articulation.

**1. More Effective Prevention**

The PRD anticipates putting into place a framework for preventive restructuring that is both efficient and light: resort to a judge is no longer considered indispensable (Article 4), except for a few matters: evaluation of the business’ financial situation, stays of individual action to permit the parties to negotiate and the approval of an agreement. The initiative is left to the debtors or, with their consent, to one of the creditors (Article 4). The debtor may also be supported by a practitioner if the Member States see it as desirable (Article 5), which will be necessary to guarantee the professionalism of those involved in preventive restructuring. The PRD provides for a temporary stay of individual actions limited to 4 months, though with a possible extension to 12 months, subject to creditors being able to petition for its being lifted in case of unfair prejudice (Articles 6-7). A creditor providing financing for restructuring will enjoy a preference under this framework.

Except for the optional nature of the court intervention possible, the orientation of the procedure is largely inspired by the French *conciliation* procedure. Confidentiality is not, however, given priority by the European law-maker as a necessary procedural tool, though the PRD recommends a limited power for courts to intervene and provides that stays of individual actions should only affect those creditors who have been informed of the negotiations. The PRD also permits the Member States the possibility of introducing or maintaining procedures which do not adhere to the notice conditions, falling within the field of application of the Recast European Insolvency Regulation, to be included within the list in Annex A.

**2. A Reinforced Restructuring Procedure**

The PRD contains rules destined, it being the case, to apply to preventive procedures, but perhaps also, in an indirect way, to existing restructuring procedures, such as *sauvegarde* and *redressement judiciaire*. In effect, it prescribes the formation of creditor classes to vote on the restructuring agreement: creditors will be grouped together, by reference to the preferences they enjoy and to any existing agreements, into different classes reflecting comparable economic interests. Creditors thus grouped together will be required to vote on the restructuring proposals (Article 9). At least two classes will be created, one for creditors benefiting from preferences and security, the other for unsecured creditors. A class containing employees may also be put into place. Another class could bring shareholders together, which could increase the chances of a plan being approved via a cross-class cram-down.

With these changes, French law will move from a classification of creditors within the existing committee structure based on the status of creditors, to a classification in function of the type of debt. For smaller businesses, the Member States may set aside this mechanism as long as they determine what will be acceptable thresholds for approval. Voting majorities may be set freely, subject to an overall limit of 75% of the amount of debt in each class, so as to facilitate the approval of restructuring plans despite the opposition of some creditors.

The scope of application of these principles might raise a few difficulties: the *sauvegarde* and *redressement judiciaire* procedures currently in existence would be affected, not just the *conciliation* procedure. Sauvegarde is tied to the criterion of the probability of insolvency, while it may be inconceivable that different rules could apply within the *sauvegarde* and *redressement judiciaire* procedures for the adoption of plans which have the same outcomes. To this might also be added likely problems with the *sauvegarde accélérée* and the *sauvegarde financière accélérée*, both of use before cessation of payments happens.

The PRD empowers courts with a detailed, though formal, oversight of matters, which diverges from the French law position in which the appreciation of the merits of a plan is done according to legal criteria measured by the continuation of activity, the preservation of employment and the settlement of debts. Oversight is available in a number of matters, such as class formation, formalities in relation to the casting of votes, the provision of information to smaller creditors, the calculation of requisite majorities and other formal conditions required by national law. The equality of treatment of creditors belonging to the same class will also be a criterion for approval. Inspired by American law, another element will be introduced: the “best interests test”: this consists in comparing the position of opposing creditors under the restructuring plan to their situation, were a liquidation to take place (Article 10). This criterion goes much further than the current conditions for approval of plans in the *sauvegarde* and *redressement judiciaire* procedures imposed by the Commercial Courts.

Finally, a supplementary condition, close to one in the French law, provides for the possibility for a court to reject a proposed plan if it does not offer a reasonable prospect for the avoidance of insolvency or does not ensure the viability of the business. This is similar to the rule that requires that a rescue plan presents a “serious character” (Article 13).

The plan that is approved will be burdensome for all parties affected, that is to say especially those creditors whose rights have been modified, though, at the national level, a provision could be made: that the plan should not in any event affect the rights of workers. Appeals against approval by a court are also left to the Member States to regulate, though they are required to ensure that the procedural treatment of appeals is fast and that, should an appeal have the effect of suspending the application of an order, any affected creditors receive damages, for example interest for late payments (Article 15).

**3. Making Directors More Responsible**

The PRD provides that the Member States should transpose into their domestic laws and impose general duties on directors, such as the duty to protect the interests of creditors in cases where insolvency is probable, to take necessary steps to avoid insolvency, and to avoid gross negligence in carrying out activities that could compromise the viability of the business (Article 18). This draws on duties provided for and sanctioned by the French law in the presence of management misconduct, voluntarily neglecting to declare the insolvency of the business, defects in the keeping of accounts and the misappropriation of assets. Does this, however, require directors to petition for preventive measures? An interpretation in this direction might be risky, as it could push directors to ask for preventive measures solely in order to avoid the risk of sanctions.

The Member States are tasked with providing for sanctions in case of management misconduct. The French Commercial Code will not need substantial modification, except insofar as qualifying what ‘management misconduct’ might mean. The PRD also anticipates a framework for limiting shareholder rights, by excluding them from voting on restructuring plans and allowing the courts to dismiss their objections in respect of a plan voted against their will (Articles 9 and 12). As a consequence, French law will however need to be adjusted.

**4. A Rescue Eased by Debt Cancellation**

The French law has based itself on the Anglo-American model facilitating the restoration of individual debtors thanks to the cancellation of unpaid debt, which is expressed in the rule that unpaid creditors do not resume individual action, except in rare cases, following a *liquidation judiciaire* brought to an end due to a lack of assets.

To this, the PRD adds a few principles: the cancellation of unpaid debt should be automatic and not have to depend on the debtor making a request to this effect. In principle, this should occur at the end of a three-year period, calculated to begin once a plan is confirmed, or a procedure is opened, based on the debtor’s insolvency. Furthermore, the release from unpaid debt is uncoupled from the end of procedural activity, which might extend beyond this period. If disqualification from professional activity takes place based only on the fact of insolvency (such as that in the French law, preventing a director from exercising an independent activity during a *liquidation judiciaire*), then the prohibition should also end when the release happens. Exceptions may be made where the debtor acts in bad faith, where there is a substantial breach in the payment obligations or where the debtor fails to cooperate.

There is, however, a difficulty in the interpretation of the PRD, as between the prescribed three-year duration the Member States must enact and the duration of a rescue plan, which could be, as in the French law, greater. Undoubtedly, it is necessary to understand the PRD as a general rule from which a longer period for a rescue plan could derogate if a debtor does not comply with its obligation (in this sense, see Article 20-2(2)). A range of exceptions are provided for other debts, including criminal sanctions, damages, alimentary and family support, debts arising after the judgment opening proceedings and other privileged debts. Debtors subject to professional conduct rules or who are responsible for the management of property for the benefit of others are also subject to different rules (Articles 19-22). But the French law will not require substantial modification in this regard.

**5. Experienced Professionals**

The PRD’s model here is largely based on the status of French professionals insofar as the conditions for appointment and practice (transparency, fairness and professional training) are concerned. It also recognises the right of parties to remove practitioners in order to avoid any conflicts of interest (Articles 26-27). Qualification requirements are also introduced for judges in those courts in charge of insolvency procedures (Article 24). Access conditions and the oversight of insolvency professionals, as well as the initial and continued training for judges provided by the *Ecole Nationale de la Magistrature,* is very much in line with these requirements.

1. Article 196, Law no. 2019-486 of 22 May 2019. [↑](#footnote-ref-1)