French pre-insolvency proceedings: A before and after the COVID period?

Georges-Louis Harang and Gaël Couturier write on how the new measures have been used

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Pre-insolvency proceedings have existed in the French legal system since 1985. The COVID period, even before the transposition of the EU Directive[1], has given a new role to these pre-insolvency proceedings, especially to Conciliation, by aiming to protect the insolvent company at the early stages of its financial difficulties.

To deal with all of the economic difficulties linked to quarantines, curfews or all sorts of restrictive measures, the French government has used the pre-insolvency proceedings as a weapon of… massive negotiations.

As a continuation of the objectives of the Directive, pre-insolvency proceedings are more than ever the useful tools which help prevent companies from having to file for insolvency and open formal insolvency proceedings, by finding negotiated solutions on a mid- / long-terms basis, while maintaining the CEO in charge of the management; all this in order to solidify the financial health of the company and to perpetuate the confidence of suppliers and creditors.

French pre-insolvency proceedings: Focus on conciliation

With the aim of preventing insolvency, the law provides for two types of consensual and confidential pre-insolvency proceedings for companies experiencing financial difficulties or anticipating foreseeable financial difficulties: "*Mandat Ad Hoc*" (Ad Hoc mandate) and *Conciliation*. The "mandat ad hoc" is not subject to any fixed time frame and will apply if the debtor is not insolvent yet.

Conciliation is also flexible and confidential and is available to companies experiencing financial, economic and/or legal difficulties, or likely to experience such difficulties in the future and which have been in cessation of payments for fewer than 45 days. Only legal representatives may file for this procedure.

The conciliator (a French insolvency practitioner or "IP") is appointed by the president of the commercial court for 4 months, with a possible 1-month extension.

After this period, it is not possible to open another conciliation procedure, until three months have passed. In conciliation, there is no automatic stay, but only an individual stay. If a creditor who is not included in the conciliation sues the debtor, the latter may ask the president of the court who ordered the conciliation to grant more time for repayments, of up to a maximum of two years.

The mission of such a conciliator will be fixed by the president of the commercial court in his decision, and this will normally be: to assist the debtor company in its negotiations, seeking to put an end to its difficulties, by promoting and encouraging it to enter into an amicable agreement with its main creditors and, if possible, its usual commercial partners.

This agreement mainly sets out any loans extended by

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creditors or shareholders and any consents by creditors to grant waivers, to reschedule and/or cancel existing debts, propose debt write-offs, accept new financings and/or restructuring of the company. It interrupts and prohibits any judicial actions. Finally, the conciliator has to report back to the president of the commercial court.

Pursuant to article L 611-11 of the Commercial code, lenders that extended credit to a company as part of an amicable agreement during Conciliation will benefit from protection for this new financing, by being ranked ahead of all pre-petition and post-petition claims, in case of insolvency proceedings at a later stage. In a way, this is what Article 17 of the Directive promotes.

It is important to note that, during the consensual and confidential "mandate ad hoc" and conciliation proceedings (which are not insolvency proceedings), creditors may open individual judicial proceedings against the debtor, enforcement proceedings included.

Conciliation used as a weapon of mass negotiations during the pandemic

During the pandemic, the French government has adopted legal measures to reinforce the use of pre-insolvency proceedings, especially Conciliation, and has decided to adopt coercive measures in order to constrain reluctant creditors to accept negotiated solutions and thus prevent foreseeable financial difficulties for the companies. Due to its flexibility, the "*mandat ad hoc*" has not been amended since the COVID pandemic.

First, the duration of Conciliation may be extended, once or several times, at the request of the Conciliator, by a reasoned decision of the president of the commercial court, but it cannot exceed ten months, which is twice as long as the ordinary period.

By several Decrees and an Act[2], Conciliation tools have been reinforced to the benefit of the insolvent companies in order to paralyse reluctant creditors' rights (by constraining creditors to stay in a prolonged waiting situation without the possibility to undertake judicial actions), notably by ordering:

- the interruption or the prohibition of judicial actions brought with a view to having the insolvent company ordered to pay further sums and/or to terminate the contracts, because of the interruption of payments;
- the interruption or the prohibition of any enforcement proceedings implemented by creditors towards both movable and immovable property; and
- the possibility, before any formal notice or judicial actions, to ask the president of the commercial court to postpone or spread-out payments due to creditors for a period of up to two years. Basically, this measure will apply if creditors refuse to grant a standstill, regardless of whether they have attempted to enforce their rights.

These measures are:

- not automatically implemented, meaning that the claims must be brought before the president of the commercial court;
- individual, because they will only take effect against one creditor, not the community of creditors; and
- applicable only until 31 December 2021.

These measures will only take effect at the end of the conciliation proceedings for those opened before 31 December 2021. Nevertheless, the recent transposition of the Directive (Decree n° 2021-1193 of 15 September 2021) into the French legal system maintains part of these measures as article L 611-7 of the Commercial code (in its new drafting entering into force on 1st October 2021), which enables the debtor to ask the Judge for postponing or spreading-out payments due to creditors for a period of up to two years.

Practical examples and statistics

At first sight, insolvency proceedings are mostly used in France to deal with distressed companies. For instance, in 2020, 9980 safeguard (*sauvegarde*) or judicial reorganization (*redressement judiciaire*) proceedings were opened, compared to 3460 *ad hoc* and conciliation proceedings.

However, insolvency proceedings mostly concern small companies, rarely medium-sized ones (in 2020, 39 companies with a turnover of over €50m or more than 300 employees), and very exceptionally, large companies (in 2020, 6 companies with more than 1,000 employees).

Although they can also be used by small and medium-sized companies, large companies and their creditors prefer the *mandat ad hoc* and conciliation proceedings to deal with their difficulties because of the flexibility and the confidentiality of these proceedings. This trend was strongly reinforced following the 2008 financial crisis, because these proceedings were increasingly used to restructure LBO financing, which had become unsustainable due to the real post-crisis profitability of operating companies. They are currently being used intensively in the current context of the covid crisis.

For example, in the airline sector, which is particularly impacted by the crisis, a foreign airline used conciliation proceedings to seek a settlement with an Irish aircraft leasing company. The contracts had been concluded with several French SPVs (turnover of €400m) which were subleasing aircraft to various companies in the group. Unlike other leasers, this leaser had taken a very hard line.

As the latter refused the standstill proposed by the conciliator, the president of the court:

(i) ordered a standstill for the duration of the conciliation proceedings (up to 10 months),

(ii) forbade the leaser from taking any enforcement action on the arline's assets during the conciliation proceedings, and

(iii) granted a grace period for the payment of the debts that the guarantors were able to avail themselves of.

This order has not only been effective in France but also in the United Kingdom, thanks to the recognition by the High Court of Justice of the conciliation proceedings on the basis of the cross-border insolvency regulations (CBIR). This decision helped to readjust the balance of power between the parties and led the leaser to negotiate.

In a very different field of activity, conciliation proceedings were used by a holding company of a large group with a turnover of almost €4 billion, listed in France and the United States, with more than 13,000 employees. While it had initiated a capital increase, its completion was jeopardized by the closure of the film studios in the United States, on which one of the group's major business segments depended. As part of the conciliation proceedings, the group managed to achieve a very complex restructuring of its debt (€1.7bn) involving a new money injection of more than €400m, a conversion of part of its debt into capital and the rearrangement of the terms and conditions of the remaining debt. Under the aegis of the conciliators, an agreement was reached with more than 300 lenders, mainly British and American, in just one month. Supported by a very large majority of creditors, it was implemented under an accelerated financial safeguard procedure. The whole transaction took two months.

Conclusion

The *mandat ad hoc* and the conciliation proceedings are highly effective and meet the needs of companies and their creditors. They already meet the objectives and purposes of the Directive. Therefore, these preventive proceedings are not modified by the transposition of the Directive.

A report from French Deputies, filed on 21 July 2021[3], had promoted a reform of the pre-insolvency proceedings / Conciliation by maintaining some of the coercive and derogative measures adopted during the pandemic period, notably a Conciliation period permanently extended up to ten months and the interruption/prohibition of judicial actions under the supervision of the Judge (to avoid any windfall effects).

To date, the French lawmaker has only maintained the temporary suspension of the right for creditors to obtain payment of their claims; conciliation stays a weapon of negotiation with creditors after the COVID period. ■

Footnotes:

1 EU Directive 2019/1023 of 20 June 2019 on Restructuring and Insolvency.

2 Decree n° 2020-341 of 27 March 2020 / Decree n° 2020-596 of 20 May 2020 / Decree n° 2020-1443 of 25 November 2020 and Article 124 of the Act n° 2020-1525 dated 7 December 2020

3 Report n° 4390 related to companies in financial difficulties due to the health crisis filed on 21 July 2021 before the National Assembly (see pages 72 and 151).

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