# New rules for bond restructurings in France

Mylène Boché-Robinet writes on the changes in France brought in by the adoption of the EU Directive on Preventive Restructuring and Insolvency

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**The Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, which was introduced in France in autumn 2021, has brought significant changes. The new regime of classes of affected parties is probably the most important shift, potentially a revolution.**

## An inconspicuous revolution

### *Existing preventive frameworks in France*

During its preparatory phase, the Directive did not arouse much interest among French restructuring and insolvency experts, except within restricted circles, contrasting sharply with the passionate debates taking place in other countries, for instance Germany. Indeed, one of the core purposes of the Directive was to ensure that each Member State could provide for at least one preventive restructuring framework, whose main features would be common to those of all other Member States. The French regime already included several preventive proceedings of different natures for decades.

The *mandat ad hoc* is the oldest process, stemming from the Civil Code and which practitioners began using decades ago in the context of restructuring processes. The *mandat ad hoc*, together with *conciliation* (a rather similar process introduced in 2005), are purely amicable and confidential proceedings. They consist in the appointment by the court of an independent mediator whose mission is to assist the debtor usually in defining and negotiating a restructuring agreement, but sometimes a sales process. The famous *sauvegarde* proceeding, to a certain extent comparable to US Chapter 11, is also a preventive framework, but public and collective. Moreover:

(i) it is only available to solvent debtors;
(ii) its sole outcome is a debt restructuring plan presented only by the debtor (and not by creditors); and
(iii) the court cannot impose any sale of assets, which makes this process quite attractive for debtors and shareholders.

Therefore, it appeared at first glance that the Directive would bring nothing new under the French sun. This was to a certain extent true, as its introduction did not lead to the creation of any new preventive proceeding. The already existing accelerated *sauvegarde*, a combination of *conciliation* and *sauvegarde*, was chosen as the proceeding answering the requirements of the EU legislator.

### *A new voting process*

Nevertheless, the Directive brought an inconspicuous revolution for French R&I law with its Chapter 3 on restructuring plans. According to Article 9.4:

> *"Member States shall ensure that affected parties are treated in separate classes which reflect sufficient commonality of interest based on verifiable criteria, in accordance with national law. As a minimum, creditors of secured and unsecured claims shall be treated in separate classes for the purposes of adopting a restructuring plan."*

Such a concept of classes of affected parties was totally unknown in France. In fact, until the introduction of the Directive, in proceedings concerning debtor entities above certain thresholds, creditors were divided for the voting process into two categories, dependent on the nature of their claims: on the one hand, a committee of main suppliers and, on the other hand, a committee of main financial establishments and assimilated entities (which could include creditors with very different interests, such as banks, equity holders and assignees of claims, regardless of the nature of the assigned claim).

Bondholders were consulted in a special assembly, considered as a sort of "third committee". Therefore, the related rights of creditors (resulting namely from privileges, guarantees, subordination agreements etc. and impacting their ranking in an insolvency distribution process) were not taken into account in the voting process or in the way creditors could impose the plan on others or alternatively be subject to a cram-down.

The former system was not necessarily negative for bondholders. Indeed, once approved by the two creditors' committees, the plan was submitted to the unique assembly of bondholders (*assemblée unique des obligataires*) which could reject the plan, thus having a sort of veto on its adoption, even though the bonds could be subordinated to other creditors' claims.

***Advantages of the new regime***

Nonetheless, bondholders are not necessarily disadvantaged by the new law. Indeed, from a general perspective, the new regime is deemed to enhance a more equitable treatment of creditors' relative positions, by adjusting the creditors' weight in the plan adoption process according to the rights attached to their claim (and no longer solely according to the nature and amount of the claims), which is a more coherent and fair mechanism.

One of the main legal innovations is also the possibility of imposing changes on the equity under a restructuring plan. Before the reform, modifications to the equity structure, by-laws or rights of equity holders had to be approved by equity holders in the general assemblies, as provided in the by-laws, following or simultaneously with court approval of the restructuring plan. Consequently, the implementation of a plan, although approved by a majority of creditors (including bondholders) and sanctioned by the insolvency court, could be completely jeopardized by equity holders having a majority vote in the assembly, despite the fact those holders might not even be "in the money" nor assist in financing the process. Now, the vote of equity holders is part of the plan adoption process, as equity holders are to be gathered and vote in specific classes (*classes de détenteurs de capital*) and therefore can be subject to a cram-down.

In addition, insofar as concerns bondholders especially, they now have the right to suggest their own plan, in addition to the one prepared by the debtor entity (via its judicial administrator). Before 2021, bondholders did not have any such right, which had been offered to all other creditors belonging to committees following a reform in 2014. The new law therefore constitutes quite a change, even though all creditors (including bondholders from now on) can only propose so-called "alternative plans" in the context of rehabilitation proceedings and no longer in *sauvegarde* proceedings, thus increasing to a certain extent the protective nature of *sauvegarde* over debtors' and shareholders' interests.

## Bondholders in classes of affected parties: lessons of the first cases

***Formation of classes***

How are bondholders divided into classes? A first question is related to holders of bonds giving access to equity (for instance, bonds convertible into new shares and bonds exchangeable for existing shares). It appears that, according to the new law, they should be in classes of equity holders (*classes de détenteurs de capital*). However, this interpretation has been notably challenged by some experts. They note that such a classification is not justified, as bondholders would then benefit from the protection offered to shareholders, such as the

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protection against expropriation in the context of the restructuring of small and mid-sized companies or preferential subscription rights in case of an increase in capital.

In the famous *Pierre & Vacances* case, the holders of bonds redeemable in cash and shares (ORNANE) were classified in a class of equity holders, but this was not challenged.[1]

The situation in the Orpea case was totally different. The holders of bonds convertible into new shares and/or exchangeable for existing shares (OCEANE) were considered creditors and placed in a class of ordinary affected parties, albeit this was contested.

The Versailles Court of Appeal recently approved the court of first instance's decision in *Orpea*, considering, *inter alia*, that such an interpretation is in line with the will of the European legislator.[2] Indeed, pursuant to Article 2.1(3) of the Directive:

> *"'equity holder' means a person that has an ownership interest in a debtor or a debtor's business, including a shareholder, in so far as that person is not a creditor."*

In this context, the French Supreme Court has already stated that holders of bonds redeemable with equity (ORA), i.e., for which the primary title is a bond (and not equity) are creditors and not equity holders.[3]

***"Masse"***

There is also the question whether holders of bonds who subscribed to the same issue of bonds (forming the so-called "*masse*" under French law) should be categorized in a separate class of affected parties. French law is silent in this respect. The criterion for dividing affected parties into separate classes is, as suggested under Article 9.4 of the Directive, the existence of a "*sufficient commonality of economic interest*" (with the French legislator adding the notion of "*economic*" interest).

The judicial administrator is therefore rather free to form the classes, under the only conditions that:

(i) creditors with security interests in the debtor's assets (*sûretés réelles*) are in separate classes;
(ii) the division into classes complies with subordination agreements entered into prior to the commencement of the proceedings; and
(iii) holders of equity form one or more distinct classes.

Therefore, it appears that holders of bonds can be grouped and vote in a class with other creditors. In one of the very first cases opened before the Versailles Commercial Court involving classes of affected parties, the judicial administrator indeed chose to gather bondholders belonging to different masses, taking into account that they were all unprivileged creditors sharing the same economic interest, namely as their investments were related to the same real estate projects in Germany.[4]

***Role of the representative***

There is also a question whether bondholders should vote individually or via their representative (*représentant de la masse*, trustee etc.). The law is unclear in this respect. However, it is notable, that, insofar as concerns the information process, notices and invitations to a vote are made either by publication in a special legal gazette or, alternatively, by letter to "each bondholder" (and not to the legal representative).

As far as the proof of claims process is concerned, it appears, however, that the legal representative still plays a key role, as was already the case before the reform. Indeed, the law clearly states that the representative shall file proofs of claims. If failing to do so, the law says that:

> *"a court decision must, at the request of the judicial representative, appoint an agent to represent the group in the sauvegarde, recovery or liquidation proceedings and to declare the claim."*[5]

But what if the parties decide not to be represented, which has been possible under French law since 2017? In the above-mentioned case before the Versailles court, it was decided that bondholders would be represented for the filing of claims process, for which the President of the Court appointed an independent insolvency office-holder as representative.

## Conclusion

The regime of classes of creditors is the result of the project of the European legislator to harmonize restructuring and insolvency laws. To a certain extent, it also reflects an Americanization of the law, as many legal concepts have been "imported" from the US, such as, for instance, the key notions of "best interest", "cross-class cram-down" and the "absolute priority rule". Undoubtedly, the US regime and case law will influence the way restructuring will be carried out in the future in France. At least, French experts will be able to learn from legal practice on the other side of the Atlantic, with this resulting in a certain "sophistication" of restructuring deals. To date, the regime of classes of affected parties is applicable only to the largest companies, exceeding certain thresholds, but it is likely that all financial restructurings involving bonds will be affected. It should also be remembered that this regime can be freely applied by the debtor or the insolvency administrator, with an authorization of the insolvency judge which is not subject to appeal by the creditors. ■

**Footnotes:**

1 TC Paris, 31 July 2022, no. 2022028115.
2 CA Versailles, 13e ch. 22 June 2023, no. 23/03276 and 23/0333.8.
3 Cass.com., 13 June 1995, no. 94-21003, *Metrologie International*.
4 CA Versailles, 13e ch., 14 March 2023, no. 23/00519.
5 Article L. 228-85 of the French Commercial Code