Seeking amicable proceedings in France: From out of court to pre-pack sale

Jean Baron writes on the rise of the pre-pack in France

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When trying to take into account the diverse interests of stakeholders we have to imagine a trapeze artist during a balancing act.

The main illustration of these diverse interests resides in the will of the creditors to reduce their exposure and maximise their return faced with a management and a number of shareholders who wish to conserve their potential future.

This quest for balance is in the DNA of out of court proceedings, the primary goal being to find agreements between all vested interests. Indeed, intercreditor subordination agreements remain in place unless otherwise negotiated.

The rise of this process is for the most part due to its flexibility and confidentiality, compared to formal proceedings where the solution is imposed on at least a category of stakeholders.

In parallel to the development of amicable proceedings, judicial proceedings have also evolved to become an extension of these anticipated solutions, either imposing the plan decided by the majority, or implementing a pre-pack sale.

Involving stakeholders throughout the process gives a more balanced approach whether the solution is found out of court or through a pre-pack.

> **PREVENTION HAS THE EXTRAORDINARY VIRTUE OF NOT IMPACTING BUSINESS DUE TO ITS CONFIDENTIALITY**

Out of court workouts

"*Prevention is better than cure*". Professional practitioners have created original anticipated solutions to solve the difficulties of companies which European legislators are consecrating.

Prevention has the extraordinary virtue of not impacting business due to its confidentiality. It allows the implementation of negotiations with the main creditors whilst sorting the wheat from the chaff and then reshuffling the financial structure of a company or a group.

In the United States one can see a reduction in arduous long-haul chapter 11 cases, replaced by negotiated solutions which are sometimes ending in pre-packs. For instance, the General Motors plan had been implemented within a month after the filing due to its preparation out of court.

In France, out of court proceedings have been developing since the '90, with great success, but this has not been represented through statistics due to the confidentiality of the process.

Official numbers on the return to creditors through a French procedure would be counterbalanced by the quality of these restructurings, probably less marketed than the English schemes, but just as efficient.

The main goal of these procedures, *mandat ad hoc* and *conciliation*, is to find an agreement with the principal stakeholders under the guidance of an independent professional, the "*mandataire ad hoc*" or "*conciliateur*". Usually, it is a licensed judicial administrator whose know-how is to coordinate the stakeholders and a team efficient in operational planning and negotiation with various players.

A specialised judge controls the balance of obtained agreements and verifies that these agreements do not impair other creditors' interests.

For the most part, the important restructurings of the past decade have been driven under the guidance of *mandataires ad hoc* through these lightly supervised and confidential proceedings.

These procedures are equally efficient paths to the adequate judicial process, which can be a negotiated financial restructuring imposed on the minority creditors, or a pre-pack sale.

This process frees up time for the judge, under the conduit of an independent professional and allows information of the principal stakeholders in order to avoid the feeling of being held up when a prepack is put in place.

The rise of the pre-pack

In search of the necessary unanimity of the creditors in the prevention proceedings, legislators have invented judicial tools able to impose the solution that has reached a majority during the negotiations onto the minority creditors.

The imposition of this solution on the minorities is called "*cramdown*".

Cramdown is generally implemented during a judicial proceeding know as a pre-pack, prepared after the majority of creditors have voted in favour of a plan. The principle is to benefit from the automatic stay and the ability of imposing the cramdown acrosss a judicial procedure of a very short duration.

These judicial restructuring tools are developing in Europe and have been born out of necessity, being complementary to some out of court proceedings

when minority creditors are blocking the implementation of a fair workout.

Furthermore, due to the reality of the way the current credit market operates, with the growing circulation of debts, certain conflicting interests have arisen, particularly when the debt is dealt with through a CDS.

Cramdown power is variable depending on the country's legislation. In the United States, the jurisdiction can even impose the writing off of both debts and shares on the condition that the initial degree of existing subordination is respected.

Even if not utilised on a daily basis, cramdown acts as an instrument of persuasion in out of court negotiations.

In France, prior to the Law No. 2005-84 of 26 July 2005, the legislation was clearly pro-debtor and pro-employees.

Since then, the creditors have been more involved in the plan through a creditors' committee and a cramdown process was added to the corpus which requires an agreement of 75% of the creditors.

The implication of creditors is currently being reinforced as a result of the new legislation of March 1st 2014, allowing them to present an alternative plan to that of the management. Nevertheless, the current reform of the French law has for the moment pushed aside the possibility of forcing the sale or writing off of shares in these continuity plans.

Despite this, when the court is satisfied that no continuity plan of the initial company is enforceable, shareholders can be wiped out to the benefit of new ownership through a plan of sale, ongoing business or assets-based.

Preparation of a pre-pack sale

When restructuring of the debt is impossible, even with the cramdown of creditors, the sale of an ongoing business with its employees is an alternative to the liquidation. This sale is imposed by the jurisdiction, but in this hypothesis it is important to respect the larger scope of the stakeholders in order to avoid the feeling of lack of transparency of the process.

The preparation of the anticipated sale, out of the camera's lens, allows for a negotiation in the best possible course of business and then the launching of the implementation, with the benefits of the judicial proceedings including its automatic stay and the possibility to sell the business clear of liens and pre-existing liabilities.

The main challenge with these pre-pack sales is to make the process as transparent as possible for the stakeholders. The fact that they are prepared under the supervision of an IP and a judge rather than by the management only is clearly a supplementary guaranty.

In Europe, professional practice and legislations are recognising the need for this supervision. For instance, pre-pack sales have been implemented many times by IPs in England through schemes, and The Netherlands has adopted a new act allowing for the preparation of a pre-pack sale by a trustee.

In France as well, the recent ordinance of 1 March 2014 gives the concilliator the ability to prepare the sale ahead of judicial proceedings during the conciliation period.

Implementation of the pre-pack sale: should we import the stalking-horse process?

The stalking-horse used in hunting to hide the hunter is also a sale process used in insolvency workouts: the stalking-horse offer is the floor bid against which all other must compete.

It has proved to be an efficient method in the United States by maximising the value of ongoing businesses or assets. Launched in s.363 sales, it is encouraged by the lender willing to liquidate its lien but also at the request of the debtor to sell an ongoing activity with its employees. Unlike the hidden hunter, the purchaser's identity and terms of offer are publicly exposed through the Court process and become known to all bidders and stakeholders, which gives more visibility on the process.

If higher quality bids are received by the deadline, the court may authorise the company to enter into an agreement with the highest bidder and approve the transaction. In this case the stalking-horse bidder is compensated with a predetermined break-fee and usually expense reimbursement.

In case no better qualifying bids are received, the stalking-horse will acquire the assets pursuant to the terms of the initial agreement.

When dealing with corporate cross-border groups, it is relatively common to sell a global business in its entirety through this process. For instance, in Nortel Networks, operating as a global enterprise in over 70 countries, the sales through stalking-horse auctions yielded unprecedented recoveries. The final amount of recovery of $4.5 billions for Nortel's intellectual property sold to Rockstar consortium represented five times the initial bid submitted by Google.

Another main advantage of the stalking-horse process is the certainty that an outcome will emerge, which gives comfort to the employees and to all stakeholders as to the continuity of business.

Canada has imported with success this type of stalking-horse auction in its restructuring corpus: BIA and CCAA.

This process could also be adapted in many European countries even in stand-alone national cases, in order to complete out of court proceedings ending in a pre-pack sale.

The fact that pre-packs within Europe are more and more often prepared out of court and coordinated by an independent IP instead of the company itself is a supplementary guaranty for all stakeholders. ■

> **EVEN IF NOT UTILISED ON A DAILY BASIS, CRAMDOWN ACTS AS AN INSTRUMENT OF PERSUASION IN OUT OF COURT NEGOTIATIONS**

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