



# French insolvency law

REFORM OF SAFEGUARD PROCEEDINGS COMES INTO EFFECT ON  
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On 15 February 2009 a reform of French insolvency law is due to come into force. Its main aim is to promote the use of the safeguard procedure (*la procédure de sauvegarde*), which was introduced on 1 January 2006. This briefing provides an overview of the key changes to be introduced by the reform and considers how it will affect the various players in French restructurings.

Although safeguard proceedings have been used successfully as a negotiation tool in a number of high-profile cases (such as the Eurotunnel case), they have represented just 1 per cent of all insolvency proceedings in France since the Business Safeguard Act 2005 introduced the safeguard procedure in January 2006. The main reason for this lack of success is the continuing stigma that is attached to insolvency proceedings in France. This stigma usually leads the debtor's management to delay filing a petition for the commencement of safeguard proceedings for so long that they reach a point at which the company is already insolvent, by which time it is too late to enter into the safeguard procedure.

## Safeguard proceedings – background

The Business Safeguard Act 2005 introduced a new type of insolvency proceedings called safeguard proceedings. They were inspired by the US chapter 11. The safeguard procedure is available to any debtor company that is not insolvent but faces difficulties that it cannot overcome and that may cause it to become insolvent under the French test (a cash flow test).

Safeguard proceedings open a six-month 'observation period' (renewable for up to 18 months) during which the company can negotiate a restructuring or waiver of its debts with its creditors. The court can appoint an administrator to supervise or assist the company's management in the negotiations if certain thresholds are met or the court so decides. During the observation period the company enjoys a stay of:

- payments relating to debts that arose before the opening of the safeguard proceedings and debts that are not necessary for the carrying on of the debtor's business or for the purpose of the proceedings; and
- legal actions aimed at either the payment of debts that arose before the opening of the safeguard proceedings or the termination of a contract by reason of a default in payment.

The safeguard plan that results from the negotiations may provide for waivers of debt, a rescheduling of debt, a change of control or a sale of certain business assets.

## Safeguard proceedings – the problems to date

The Eurotunnel Group's safeguard proceedings revealed some flaws in the safeguard process and prompted the new reform. For instance, in safeguard proceedings affecting large companies, the law provides for the setting up of only two creditors' committees, one composed of the 'credit institutions' and the other of the 'main suppliers', for the purposes both of voting on the safeguard plan and of negotiating the safeguard plan. Although investment funds held large chunks of debt in Eurotunnel, it was unclear whether they had to sit on the 'credit institutions' committee or whether they were to be consulted individually on a restructuring or waiver of debt. The law also did not set out rules regulating the voting of bondholders whose bond issue was not governed by French law.

## Safeguard proceedings – the reform

The reform's main purpose is to amend the provisions of the French Commercial Code to promote the use of the safeguard proceedings, by reinforcing the powers of the company's management, and to remedy the flaws and fill in the gaps in the Business Safeguard Act.

The reform makes the following provisions.

- The test for entry into safeguard proceedings is amended so that the debtor company need only show that, while not yet cash flow insolvent, it faces difficulties that it cannot overcome. The debtor is therefore no longer required to show that its difficulties are likely to cause the company to become insolvent. This will assist distressed businesses by facilitating entry into safeguard proceedings, but it will also create additional uncertainty for creditors over when a debtor company can ask for court protection.
- The debtor company's management can suggest to the court the name of an insolvency practitioner to be appointed as the safeguard administrator (*l'administrateur judiciaire*) for the company.
- The voting rules for the creditors' committees are amended. Each creditors' committee must approve the plan for it to be binding. Currently, approval of a plan requires a vote in favour by a simple majority by number of members of the relevant committee, representing at least two-thirds of the claims by value of that committee. Following the reform, approval of a plan will require only a vote in favour by committee members representing at least two-thirds of the claims by value of that committee. This is intended to end the practice, seen in the Eurotunnel case, of creditors splitting the debt among various entities of the same group to try to obtain a majority in number.
- Any party that holds debt that was originally bank debt (such as investment funds that purchased debt on the secondary market) will now sit on the credit institutions committee. In addition, a creditor that sells its debt will stop having a seat on the creditors' committee.
- If creditors' committees have to be set up to negotiate the safeguard plan, and if the debtor company has issued notes (whether in France or abroad), a two-thirds majority by value of all noteholders must vote as a single body in favour of the plan approved by the two creditors' committees for the plan to take effect. This rule replaces the law and terms currently applicable to bond issues.

- Creditors and noteholders may be consulted on a rescheduling or waiver of debt, as well as on debt for equity swaps or conversions of debts into instruments giving rights to equity.
- The restructuring plan may allow creditors to be treated differently if such differentiated treatment is justified by their differing situations.
- Finally, the reform improves the situation of a company's management in safeguard proceedings, in that the court may no longer make its approval of the restructuring plan conditional upon a change in management or forbid the managing directors from selling the shares they hold in the debtor company.

## A useful reform?

There are aspects of the reform that are positive but it is by no means all good news for those involved in French restructurings. The amendment of the criteria for entry into safeguard proceedings is not a desirable change for creditors. It creates more uncertainty over when a company will seek court protection and increases the risk of an abusive use of safeguard proceedings. In seeking to make safeguard proceedings more attractive to debtor companies, the reform has in fact turned the safeguard proceedings into a powerful restructuring tool for debtors, who can seek court protection any time their creditors threaten to accelerate the debt and enforce their security.

The reform is also something of a missed opportunity. Arguably, the French legislature could have used the reform of the safeguard procedure to introduce more significant changes to the regime, such as super priority for creditors willing to finance debtor companies, thus encouraging the financing of debtor companies in safeguard proceedings.

The reform is nonetheless generally welcome: it clarifies the rules applicable to the approval of a safeguard plan and provides more certainty in implementing a plan.

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