French reforms give teeth to creditor committees

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- **A French *Ordonnance* due to be passed this month will greatly improve the powers of creditor committees in local insolvency proceedings;**
- **The reform represents the most significant changes to the debtor-friendly jurisdiction's bankruptcy laws in a decade;**
- **Many lenders to distressed French debtors are delaying their restructuring decisions until the reforms take effect.**

In two weeks, France's Council of Ministers is expected to approve a package of reforms that will significantly improve creditor rights in the country's restructuring and insolvency proceedings.

Creditor committees would be empowered to take control of bankruptcy proceedings by proposing and voting on lender-led plans, and in certain circumstances, forcing debt-to-equity swaps onto shareholders.

The government-initiated *ordonnance* fundamentally changes the spirit of the debtor-friendly jurisdiction's bankruptcy laws, and is a boost for foreign lenders who have lacked confidence in the French system.

"This *ordonnance* shall penalise shareholders that are not able to contribute to the rescue of the company facing serious difficulties," said Delphine Caramalli, a partner at Paris-based restructuring boutique Bremond & Associés.

"The government wants to put in place mechanisms to ensure that when shareholders don't face their responsibilities, creditors have a way to take over the business," she added.

The *Ordonnance portant réforme de la prévention des difficultés des entreprises et des procédures collectives* (*Ordonnance*) consists of 29-pages of proposed amendments to the restructuring and insolvency provisions of the French Commercial Code.

The Council of Ministers will vote on the *Ordonnance* on February 26. A near final draft is now circulating, and the overriding principles of the reforms have been agreed by the ministries involved. As such, no major changes are expected before the *Ordonnance* takes effect.

The two most drastic reforms relate to the powers of creditor committees in safeguard proceedings *(procédure de sauvegarde)* and rehabilitation proceedings (*redressement judiciaire*).

First change: creditor committee plans

The draft *Ordonnance* permits each member of the creditor committee to present and vote on a restructuring plan, in competition with the debtor's plan.

While creditor committees in safeguard and rehabilitation proceedings have found ways to propose their own restructuring plans, the debtor has never been obliged to put these

counterproposals to a vote.

As such, creditors often had little choice but to agree to the debtor's plan. Otherwise they faced the threat of a court-imposed plan that could see their debt restructured over an even longer period.

"[Creditor committees] were designed in 2005 as a place to have discussions, but ultimately the last word was always with the debtor in safeguard proceedings or the administrator in *redressement judiciaire*," said Reinhard Dammann, a Clifford Chance partner who is part of the Commission advising the Minister of Justice on the *Ordonnance*.

"The possibility for creditors to oppose and vote on a plan is a fundamental change in the balance of power concerning the creditors committee," he added.

Second change: debt-to-equity swaps

The other major change permits creditor committees in rehabilitation proceedings to include a debt-to-equity swap as part of their restructuring plan, which can be approved by the court without debtor consent.

This would only apply, however, if the company's shares and quasi-equity instruments are, in effect, worthless and the shareholders are not willing to agree to the creditor's proposal.

"Of course this must be accepted by the court, but given the philosophy of French bankruptcy law, this is a pretty offensive new mechanism that French practitioners are not used to," said Caramalli.

Property rights

There has been some concern that forcing shareholders to sell their shares, even if they carry no value, could violate their property rights. And before the *Ordonnance* can take effect, the *Conseil d'Etat* – France's highest supreme court – must be satisfied that the changes are legal and constitutional.

Dammann, however, told IFLR that the Ministry of Justice is confident that a forced debt-to-equity swap in rehabilitation proceedings is not likely to be opposed on the grounds of property rights.

Caps on re-sale

The *Ordonnance* makes clear, however, that any debt-to-equity swap can be subject to a court-imposed ban on the re-sale of those shares until the company has fully repaid its debt.

This is intended to prevent excessive speculation over French distressed and insolvent companies.

Indeed, the reforms will emphasise the secondary market debt of French corporates. "If you give creditors new legal rights then it will incentivise hedge funds to acquire and trade that debt, given the new opportunities and the possibility to convert the debt and takeover businesses in France," said Caramalli.

Fellow Bremond & Associés partner Virginie Verfaillie, who is part of the ARE task force

consulting with the government on the reforms, queried the way the *Ordonnance* sought to limit this activity.

"The aim of the law is to develop the financing of our companies, so it is quite paradoxical that the court can order a debt-to-equity swap and then forbid the creditors to sell those shares for a period that can go up until the total reimbursement of the outstanding debt - which can be up to 10 years," she said.

As this prohibition is not automatic, the onus is on lawyers to steer courts' use of this power.

"Practically speaking, the lawyers of creditors will have to help shape how judges approach this new discretion," she said. This is especially important as forbidding creditors to sell their shares will limit the amount of new financing under the law.

Practical ramifications

Ironically, the *Ordonnance* could reduce the number of situations in which creditor committees have to use their enhanced powers.

As Caramalli explained, giving creditors additional rights obliges debtors to present a plan that take creditors' interests into serious consideration, to ensure they vote in favour of the debtor's proposal.

Dammann agreed: "There is a theoretical double-edged sword over the heads of the shareholders, as there is a technical mechanism in place to impose a debt-to-equity swap."

"Although this isn't automatic, I think it will make them more reasonable," he added.

But while the reforms make the country's restructuring and insolvency proceedings more creditor friendly, lenders will continue to be concerned by the outcome of hostile safeguard proceedings.

"They will therefore continue to seek structural protection in significant leveraged deals via the so-called double luxco structure, to allow them to take the control of the group by enforcing on the shares in Luxembourg notwithstanding the opening of a hostile safeguard," said Paris-based Clifford Chance counsel Daniel Zebib.

Lionel Spizzichino, a Paul Hastings partner in Paris said many creditors to distressed debtors are delaying their decisions and restructuring plans until the *Ordonnance* takes effect, to improve their options and power in a restructuring or insolvency scenario.

Other significant reforms under the *Ordonnance*

New money privilege

A number of years ago new money creditors were granted protections in conciliation proceedings – a type of pre-insolvency proceeding – to prevent their loans being considered old debt.

"In reality, that privilege had a significant weakness as if the proceedings moved to safeguard, there was a risk the money debt could be rescheduled," said Gilles Podeur, a Paris-based Clifford Chance counsel.

The *Ordonnance* will prevent that money from being rescheduled in court-imposed safeguard plan. "That will really strengthen the situation of new money providers in conciliation proceedings," Podeur added.

Pre-packs

At present, there is no formal framework in France for pre-packaged insolvencies. While some lawyers have managed to create pre-packs that have received court approval, the *Ordonnance* creates legal guidelines that will facilitate and accelerate such arrangements.

These will apply in amicable, or pre-insolvency, proceedings including conciliation. Importantly, if the pre-pack doesn't result in sale, the groundwork done during those initial proceedings can still assist in subsequent safeguard or rehabilitation proceedings.

"It means that if the conciliator has a mission to find a purchaser, then the court overseeing the subsequent safeguard or insolvency proceedings can use the work done by the conciliator to create a pre-pack sale plan involving that purchaser," explained Spizzichino.

Fees capped

The government is keen to limit the fees associated with all types of restructuring and bankruptcy proceedings. As such, the *Ordonnance* requires the court's public prosecutor to approve any receivers', conciliators' and administrators' budget of fees before the start of the relevant proceedings.

The *Ordonnance* also seeks to ban the payment of creditors' advisor fees by the debtor. While this is common practice in the UK and US, the French government does not want to grant lenders such rights in local proceedings.

Spizzichino, however, is sceptical of how useful this ban will be.

"If, for example, a creditors pool engages an investment bank to advise them on the proceedings, the investment bank may charge the fees directly to the company and not the creditors as the work done is for the restructuring of the company," he said.

It could also have the perverse consequence of making banks reluctant to provide new loans.

"I understand they are concerned about excessive fees, but I'm not sure they have found a way to resolve it and I am concerned about the reaction of the Anglo-Saxon financial institutions or investment funds," Spizzichino added.

Name of appointee

The *Ordonnance* makes it possible for creditors to suggest the name of the court appointee to oversee safeguard or rehabilitation proceedings. An earlier draft gave creditors the right to appeal the court's refusal of their nominee, but this has been removed from the latest version of the draft.

See also

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