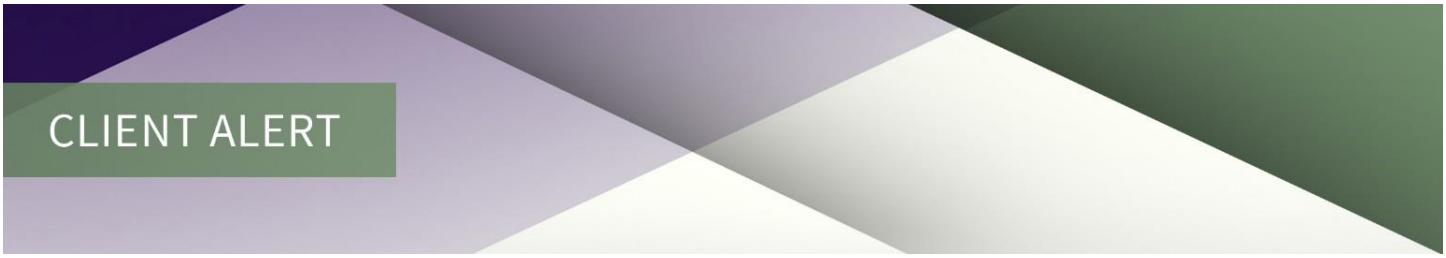
WILLKIE FARR & GALLAGHER LLP



French Insolvency Law Reform – Rebalancing of Power Among Stakeholders

October 11, 2021

AUTHORS

Lionel Spizzichino | Edward Downer | Graham Lane | Batiste Saint-Guily
Gérald Giaoui

After the "Dutch scheme"[1] and the "German scheme"[2] entered into force at the beginning of 2021, France has now published its much-anticipated transposition of the European directive of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (the "**Restructuring Directive**").

The new French law contained in ordinance 2021-1193 published in the Official Journal (*Journal Officiel*) on 16 September 2021 (the "**Ordinance**") applies to proceedings from 1 October 2021.

Its main features are:

- the introduction of a new and unique version of the accelerated safeguard proceedings (*sauvegarde accélérée*) to serve as the key proceeding implementing the Restructuring Directive;

- the replacement of the existing "creditor-committees" system by a class-based system for adopting restructuring plans, and the possibility to cram down dissenting classes including equity holders (cross-class cram-down);

---

1 Pursuant to *Wet homologatie onderhands akkoord ter voorkoming van faillissement* (WHOA), in force since 1 January 2021.

2 *Unternehmensstabilisierungs- und restrukturierungsgesetz – StaRUG*, in force from 1 January 2021.

- the strengthening of the demarcation of regular safeguard proceedings (*sauvegarde*) and rehabilitation proceedings (*redressement judiciaire*);

- the permanent establishment of "super priority ranking" new money financing (also referred to as "post money" privilege) originally introduced as a temporary measure during the COVID-19 pandemic to protect new funding provided to a debtor in connection with safeguard or rehabilitation proceedings;

- a series of other, more minor reforms such as:

  (i) the strengthening of early warning systems and the confidential *conciliation* procedure; and

  (ii) the clarification of the interaction between certain types of security[3] and insolvency proceedings.

Whilst the new voting classes and cross-class cram-down mechanism in safeguard and rehabilitation proceedings are expected to change stakeholder dynamics in French restructurings, the French pre-insolvency and preventive restructuring toolbox still remains primarily debtor-driven. As the reforms modify existing restructuring proceedings rather than add new proceedings, it is not expected that they will significantly affect cross-border recognition in the UK or the US.

New accelerated safeguard proceedings – mandatory classes to approve a plan

The new accelerated safeguard proceedings merge the two existing accelerated proceedings (i.e. the current accelerated safeguard and the accelerated financial safeguard). They offer a short, tailored process for implementing a pre-negotiated restructuring plan, if necessary over the objection of other classes.

As with the existing accelerated proceedings, the new accelerated safeguard proceedings can only be opened at the end of voluntary conciliation proceedings (*conciliation*) if there is likely to be sufficient support for the pre-negotiated safeguard plan to be approved despite dissenting creditors.

The scope of creditors or shareholders to be affected by the new accelerated proceedings can also be tailored by the debtor as necessary under the contemplated safeguard plan in order to limit the impact of the proceedings on the debtor's business operations.

Unlike ordinary safeguard proceedings, once commenced, accelerated safeguard proceedings are set to last two months, with the ability to extend the proceedings by another two months before they terminate automatically.

[3] In addition to the reforms in the Ordinance, the French government has published a separate ordinance, coming into effect on 1 January 2022, to simplify and modernise the French law on security interests.

Approval of a plan through new stakeholder classes

The constitution of creditor classes will be mandatory (i) in accelerated safeguard proceedings regardless of the debtor's size, and (ii) in ordinary safeguard and rehabilitation proceedings for debtor companies exceeding specified minimum thresholds[4]. The classes will replace the previous system of creditor committees under which creditors were gathered into three committees based on the identity of the creditor (credit institutions, main suppliers and bondholders) rather than based on legal rights.

The court-appointed administrator who assists the debtor with the restructuring plan has the power to constitute the classes of stakeholders based on certain criteria, such as a sufficient common economic interest test, compliance with intercreditor and subordination agreements and the requirement for secured creditors, unsecured creditors and equity holders (if affected by the plan) to vote in separate classes.

Only creditors whose rights are directly impaired by the plan and equity holders facing a modification of their rights or equity interest by the proposed plan will be included within the classes[5].

Each class approves a plan by a two-thirds majority of the votes held by its members having cast a vote.

To the extent that there is any dissenting member within a class, confirmation of the plan requires the satisfaction of a "best interest of creditors" test, according to which dissenting members must not be any worse off under the plan than they would otherwise be under a piecemeal liquidation, a court-ordered sale of the business as a going concern (*plan de cession*) or any other relevant better alternative.

The cross-class cram-down

The new cross-class cram-down feature also permits approval of the plan over the dissent of one or more classes if certain conditions are satisfied:

Firstly, one or more dissenting classes can be crammed down if the plan has been approved by (a) a majority of classes (of which one must be a class senior to ordinary unsecured creditors), or (b) at least one class which is "in the money".

---

4 If a company has (i) a turnover of at least EUR 20m and 150 employees, or (ii) at least EUR 40m of turnover (NB: in case of a holding company, these thresholds are assessed on a consolidated basis with controlled entities), classes are mandatory in ordinary safeguard and rehabilitation proceedings. The court can order the constitution of classes for companies below these thresholds if requested by the debtor.

5 The proposed plan can exclude any creditor from the compromise, which is then excluded from voting in the relevant classes. This is similar to the debtor's ability to exclude creditors in an English restructuring plan. In addition, claims arising from employment contracts (including the French wage guarantee scheme), pension rights, and maintenance claims cannot be subject to a plan, nor can the amount of claims secured by a *fiducie*.

Secondly, the plan must comply with an "absolute priority rule"[6], pursuant to which a more senior creditor class that voted against the plan must be "*satisfied in full by the same or equivalent means*" if a class junior to it is to receive any payment or keep any interest under the plan. The Ordinance provides that the court may however decide to deviate from the absolute priority rule in favour of strategic suppliers, tort claims, or equity holders (without limitation) if deemed necessary to achieve the plan's objectives and if the plan does not excessively affect the rights or interests of impaired parties.

The new cross-class cram-down mechanism now permits the cram-down of dissenting equity holders if deemed "out of the money", whereas previously, debt-for-equity swaps needed to obtain the approval of the general meeting of shareholders. The ability to cram down dissenting equity holders remains restricted, however. In particular:

- it remains limited to larger companies (exceeding (a) 250 employees and EUR 20m turnover or (b) EUR 40m turnover) or groups (the above thresholds being assessed for a holding entity on a consolidated basis with controlled companies);

- whilst their equity can be diluted, preferential subscription rights of existing equity holders must be preserved under the plan; and

- a plan cannot provide for the transfer of all or part of the rights of a dissenting shareholder class.

Clearer demarcation of ordinary safeguard from rehabilitation proceedings

Historically, both types of proceedings have been similar in design despite applying in different circumstances: Safeguard proceedings have only been available to cash-flow solvent entities facing difficulties, and have become an important pre-insolvency restructuring tool for distressed corporate groups in France. In contrast, rehabilitation proceedings are only available to insolvent companies which are still operating and capable of being rescued.

As a way to encourage debtors to tackle financial difficulties at an earlier stage, the Ordinance provides for a number of changes which make safeguard a more debtor-driven pre-insolvency procedure in comparison to rehabilitation proceedings. These changes include:

- Creditor participation – Where classes are constituted in rehabilitation proceedings[7], an impaired party (such as a secured creditor) can propose an alternative plan to be voted on in competition with the debtor's plan. A creditor

[6] Inspired by the absolute priority rule applicable in U.S. chapter 11 proceedings.

[7] I.e. subject to the debtor exceeding the abovementioned thresholds or if voluntarily applying the class system where the debtor does not exceed the thresholds.

can also petition the court to exercise its power to order cross-class cram-down. The modified ordinary safeguard proceedings only permit the debtor to propose a plan and/or cross-class cram-down.

- Court's ability to order "term-out" – In circumstances where the plan is not approved by the requisite classes, including through a cross-class cram-down, the judge's power to reschedule the debtor's liabilities by up to ten years (known as "term-out") is no longer available in safeguard proceedings[8] but remains available in rehabilitation proceedings (subject to a minimum instalment of 10% after the fifth year) thereby providing debtors with stronger leverage in restructuring discussions.

- Length of proceedings – The maximum duration of safeguard proceedings has been shortened to 12 months (six months renewable once), from the previous limit of 18 months in both types of proceedings.

Protection of funding provided during restructuring

Introduced as part of France's temporary measures to support the economy during the COVID-19 pandemic, the Ordinance now permanently entrenches "super priority ranking" new money financing (also referred to as "post-money" privilege) into French law.

As a result, similar to *conciliation* privilege, new money financing provided (i) during the proceedings (*période d'observation*)[9], (ii) as part of the plan and for its implementation[10], or (iii) as part of a subsequent modification of the plan, is protected in the event of subsequent restructuring proceedings from being forcibly compromised and benefits from a statutory super-priority ranking.

Implications for creditors in respect of debt governed by English or New York law

Regardless of the form of proceedings (accelerated safeguard, ordinary safeguard or rehabilitation), the introduction of classes, the absolute priority rule and a cross-class cram-down mechanism into the French restructuring toolbox will be welcomed by holders of New York or English law-governed debt who are familiar with similar concepts in the US chapter 11 and English restructuring plan regimes.

Overall, it is expected that the class voting system will shift the dynamics between different groups of stakeholders. The ability to cram down shareholders in certain circumstances also shifts the balance in favour of creditors, allowing them to take control of a distressed group by diluting out-of-the-money shareholders in a debt-for-equity swap imposed via cross-class cram-down.

8 Except in safeguard proceedings in which no classes are constituted.

9 For the purpose of funding operations during the observation period and subject to the supervisory judge's approval.

10 Subject to court approval – if necessary to the implementation of the plan and not adverse to the interests of affected stakeholders.

Implications for cross-border restructurings

Although wide-ranging, the reforms set out in the Ordinance revamp certain existing proceedings rather than add new restructuring proceedings, and all of them remain enumerated in Annex A of the recast EU regulation on insolvency proceedings[11] (the "**Recast Insolvency Regulation**"). Cross-border recognition within the EU should therefore not be affected by the reforms.

However, the principles governing the recognition of proceedings commenced following Brexit, whilst not affected by the reforms, may nevertheless impact the operation of the new safeguard proceedings where they purport to compromise English law-governed debt. As the Recast Insolvency Regulation no longer applies in the UK from 1 January 2021, recognition in the UK of the new French safeguard proceedings could be sought under the Cross-Border Insolvency Regulations 2006 (which enact the UNCITRAL Model Law on cross-border insolvency). If the safeguard proceedings purport to compromise English law-governed debt, the enforcement of the plan approved by a French court against any "hold out" English creditors may be denied as a result of the rule in *Gibbs*[12], which limits the extent to which English law recognises the modification or compromise of English law-governed debt by a foreign court proceeding, and the institution of a parallel English scheme of arrangement or restructuring plan may be required to achieve such purpose.

[11] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

[12] *Antony Gibbs and sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399: Obligations governed by English law cannot be discharged in foreign law proceedings unless the creditor agrees to the foreign law discharge; otherwise they can only be discharged by English law proceedings. The Recast Insolvency Regulations modified this principle for insolvency proceedings within its scope.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

Lionel Spizzichino
+33 1 53 43 46 11
lspizzichino@willkie.com

Edward Downer
+44 203 580 4725
edowner@willkie.com

Graham Lane
+44 20 3580 4706
glane@willkie.com

Batiste Saint-Guily
+33 1 53 43 46 21
bsaintguily@willkie.com

Gérald Giaoui
+33 1 53 43 46 64
ggiaoui@willkie.com