France's New Fast-Track Safeguard Law

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Editor's Note: *France has once again reformed its safeguard procedure, which allows debtors facing difficulties but who are not yet insolvent to pursue a restructuring under the umbrella of a payment and enforcement moratorium. Safeguard has sometimes been billed as France's chapter 11. The two procedures bear superficial resemblance in that they both allow debtors to negotiate and implement restructurings under cover of a moratorium. Both also allow for debtor-in-possession financing and provide a cramdown mechanism, but there are several fundamental differences. In this article, Antonin Besse and Nicolas Morelli provide the background to the safeguard procedure and examine the recent changes to the safeguard procedure that took effect on March 1, 2011.*

Safeguard is rooted in the philosophy of French insolvency law, which is to preserve the continuity of business and employment rather than creditor's rights. It is often criticized (usually by financiers) for tipping the balance of interests between the stakeholders in business too far away from the providers of capital, and for allowing the management and sponsors of a failing debtor to avoid their debt obligations too easily.


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In fact, safeguard provides a very useful means for debtors who have negotiated a financial restructuring with their principal creditors to implement the agreed deal under court protection, with the help of an effective cramdown mechanism, all before they become irretrievably insolvent and while there is still a business to save. Therefore, it is not the weapon of mass destruction that some make it out to be, even though it has at times been abused by debtors.

Safeguard was introduced in 2005[1] and was given its first successful large-scale international road test in the *Eurotunnel*[2] case, which gave rise to reforms of the safeguard regime at the end of 2008.[3] The latest 2010 reform described in this article makes the implementation of pre-agreed restructurings, or "pre-packs," easier by introducing an accelerated safeguard timetable with a modified regime for the consultation of creditors.[4] It clearly owes its existence to—and some of its provisions are inspired by—the recent landmark *Technicolor*[5] restructuring.

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How Does Safeguard Work?

Some readers may be familiar with the safeguard regime. However, for those who are not, or who want a brief reminder of its main features in order to better understand the reform described in the second part of this article, the following section attempts to summarize what you need to know.

Who Can Petition?

Safeguard protection is available to debtors who are not yet insolvent but face insurmountable difficulties that threaten to put them out of business. The French test of insolvency is a cash-flow test, not a balance-sheet test, and only the debtor is entitled to petition for safeguard. The petition will often be preceded by a period of negotiation with creditors under the aegis of a *mandataire ad hoc* or a *conciliateur*, who are court-appointed officials. *Mandat ad hoc* and *conciliation* are confidential procedures aimed at helping a debtor work out its financial difficulties under the court's supervision. However, those procedures do not confer any universal legal protection from enforcement or creditor actions, nor do they enable dissenting creditors to be crammed down.

Effect and Territorial Application


Antonin Besse

Safeguard, on the other hand, is a public procedure that confers immediate protection from acceleration, enforcement and other creditor actions, and prevents executory contracts from being terminated. The debtor's payment obligations are frozen during the safeguard, other than in respect of services rendered or goods delivered to the debtor for the purpose of the continuation of the business during the safeguard period.

By virtue of the European Insolvency Regulation of 2000[6] (the Insolvency Regulation), the effects of safeguard are extended automatically throughout the European Union, except for Denmark, thereby preventing a creditor from taking action in, *e.g.*, the English High Court to circumvent the safeguard moratorium. Creditors are entitled to enforce their security interests and other rights *in rem* outside of France. By virtue of the Insolvency Regulation, a debtor seeking the protection of safeguard must demonstrate that its center of main interest (COMI) is in France. Each member of a group of companies seeking protection must make a separate application and, in principle, demonstrate that it has a COMI in France. However, the members of a group that is centrally managed from France should in practice all be able to satisfy the French COMI test.

Role of Court Officials

Once the safeguard order is granted, the court will appoint one or more *administrateurs judiciaires*, who are officials charged with steering the debtor through the process and reporting to the court, and *mandataires judiciaires*, who deal with the administration of the debt claims. It is an important feature of safeguard that the management of the debtor

1 Business Safeguard Law, No 2005-845 of July 26, 2005.

2 Paris Commercial Court, Jan. 15, 2007: No 2007079780, *et seq.* Freshfields Bruckhaus Deringer LLP played the leading legal role in advising Eurotunnel.

3 Ordinance No 2008-1345 of Dec. 18, 2008.

4 Banking and Financial Regulation Law, No 2010-1249 of Oct. 22, 2010. Freshfields Bruckhaus Deringer LLP also played the role of lead counsel, acting for the bank creditors.

5 Nanterre Commercial Court, Feb. 17, 2010, No 2010L00346.

6 Council regulation (EC), No 1346/2000 of May 29, 2000, as amended by the Council regulation (EC) No 694/2006 of April 27, 2006.

retains its powers and is not displaced by the *administrateurs judiciaires*.

Filing of Debt Claims

Nicolas Morelli

Creditors must file their debt claims within two months of the publication of the judgment opening the safeguard, although creditors outside France have four months to declare their debts. Trading of debt claims is permitted following the opening judgment, although this may give rise to complications concerning who is required to file the debt claim. Failure to claim in time will deprive the creditor of its right to participate in the safeguard settlement.

Challenges

A creditor may challenge the safeguard judgment and any other court order made during the safeguard period, although such challenge will not suspend the safeguard proceedings or the effect of any disputed decision.

Treatment of Creditors

A debtor must present its debt-restructuring plan to its creditors. If the debtor meets certain size thresholds (*i.e.*, EUR 20 million annual turnover or 150 employees calculated on a stand-alone, as opposed to a consolidated, basis), creditors will vote in three committees on the debtor's proposals. The committees are made up of the suppliers, holders of bank debt and bondholders. The decision of a majority of 66.66 percent by value of creditors who attend and vote in each committee will bind the minority. Each creditor has a vote irrespective of its debt ranking, and the value of subordinated debt claims are not weighted or subject to any haircut. If each committee has approved the plan by the required majority, it must then be approved by the court. A complicating factor arises if the debtor's proposals involve a debt-for-equity swap or the issue of any hybrid instruments repayable in, or convertible into, shares. In those cases, the debtor's shareholders must also approve the proposal on a 66.66 percent majority. This requirement of French corporate law is not overridden by the safeguard procedure.

Accordingly, subordinated and out-of-the-money creditors as well as shareholders have the potential to block restructurings in France, which often leads to their recovering more in restructuring negotiations than that to which they are economically entitled. This mismatch between voting and economic rights is made worse by the fact that bondholders have their own committee, even though they are often subordinated creditors (particularly in French leveraged buyouts where mezzanine as well as junior debt is commonly in note form). This separate committee gives subordinated bondholders an effective veto right.

These distortions could be eliminated if France were to adopt reforms tying to say that creditors have in insolvency proceedings to the economic value of their debt, in the same way as chapter 11 in the United States and schemes of arrangement in England. Unfortunately, the French insolvency law system, including the mentality of the courts and insolvency practitioners, is not geared toward this economic approach, so such a reform may be some time in coming. However, there are features of the latest safeguard reform that are helpful in this regard: The law provides that safeguard plans must now take account of subordination (although precisely what this means is unclear), and creditors whose debts are not affected by a safeguard plan no longer have the right to be consulted or vote, which means that certain classes of subordinated debt can be left out of restructuring plans in order to deprive their holders of a vote. There is nevertheless room for more, as mentioned at the end of this article.

Term-Out

If the creditors reject the plan, the court can extend the maturity of debt to 10 years. The operation of this rule is explained under the heading "Other Reforms." This rule is the "hammer" that debtors often use to coerce creditors into accepting its proposals, on the basis that a 10-year term-out would be worse than what is on the table. It is considered by some to be a particularly invidious feature of the safeguard regime.

Main Features of the New "Fast-Track" Procedure

Pre-Existing Agreement

A debtor who wishes to invoke the new regime must meet certain size thresholds and have negotiated a restructuring with a majority of its creditors under a conciliation procedure. Conciliation proceedings offer a formal framework enabling debtors to negotiate arrangements with their creditors. The confidential discussions take place under the guidance of a court-appointed insolvency practitioner. An agreement reached in conciliation benefits certain legal advantages if blessed by a court, but this requires creditor unanimity. The new fast-track safeguard enables such an agreement to be implemented, even if a minority opposes it, by using safeguard's 66.66 percent creditor-majority regime to cram down the dissenters.

Size Thresholds

The size thresholds are a consolidated turnover of EUR 20 million annual turnover or 150 employees. For a traditional, unaccelerated safeguard, the thresholds are calculated on a stand-alone, as opposed to a consolidated, basis.

Creditor Support

The restructuring agreement must have the support of a sufficiently large group of creditors to make it likely that it will be adopted by both the holders of bank debt and bonds (if any) by a 66.66 percent majority within one month of the opening of the safeguard proceedings. In practice, this means that the court will look at the proposed plan and history of the restructuring negotiations before deciding to open the proceedings. Creditors may be able to draw a measure of comfort from this.

Only Financial Creditors Affected

The opening of the safeguard affects only financial creditors whose debts are modified by the proposed restructuring. Only those particular creditors suffer a moratorium on enforcement and payment. Similarly, only those particular creditors are consulted and allowed to vote. Suppliers and other creditors are not affected, nor are they allowed to vote.

Filing of Debt Claims

Although the cumbersome requirement that creditors declare their claims within a certain period has been maintained, for those creditors who participated in the conciliation proceedings before the opening of the safeguard, a list of claims prepared by the debtor and certified by an auditor or an accountant is deemed sufficient.

Effective Date

The fast-track regime is available to debtors who start conciliation proceedings on or after March 1, 2011.

Other Reforms

The new law also reforms certain other aspects of safeguard. Those

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reforms are of universal application (*i.e.*, they do not just apply to fast-track safeguards), and apply to all safeguard proceedings starting on or after March 1, 2011. In particular:

Term-out: Where a court imposes a "term-out" (where a safeguard plan is rejected by creditors, the court can require that principal be repaid by annuities over a maximum of 10 years), the first annuity is payable one year after the court order at the latest, although it now cannot be earlier than the original contractual maturity. This prevents the unintended effect of the previous law that the maturity of certain debts was accelerated, because annuities had to be paid from the first year of the term-out irrespective of the original contractual maturity.

Unaffected creditors no longer vote: Creditors whose debts are not affected by a safeguard plan no longer have the right to be consulted or vote.

Subordination: Safeguard plans must now take account of subordination. It remains to be seen of what this means in practice.

Future Improvements

The new procedure is a positive step forward, but does not go as far as it should, possibly because it was introduced and passed too quickly. For example, one of the difficulties of safeguard is that all creditors have an equal vote irrespective of their degree of subordination. A related difficulty is that bondholders, who are often subordinated, vote in a separate committee from bank creditors, thereby giving them a veto right. Another issue that could have been addressed is that intra-group debt is able to vote alongside the bank creditors, which leaves open the possibility of the debtor manipulating the bank creditors' vote to some degree.

None of these issues were addressed in the new law, even they could have been by means of relatively simple amendments. We propose that a step in the right direction for future reform could be to merge bank debt and bondholders' committees, and to strip intra-group debt of voting rights. ■