NEW FRENCH BANKRUPTCY LAW FOSTERS PRE-INSOLVENCY RESTRUCTURING

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To Our Clients and Friends:

On February 15, 2009, a new French bankruptcy law (*Ordonnance* 2008-1345 of December 18, 2008, and implementing regulation *décret* 2009-160 of February 12, 2009) came into force. Its main thrust is to facilitate pre-insolvency restructurings.

In addition to existing pre-insolvency contractual arrangements, the French legislature introduced, effective on January 1, 2006, a form of organized pre-insolvency restructuring ("*procédure de sauvegarde*"), an approach previously unknown in France. The current financial and economic crisis and certain drafting deficiencies highlighted in the first court decisions on that statute prompted a legislative overhaul of the text, with a view to reinforcing the effectiveness of the restructuring process.

The purpose of these pre-insolvency proceedings is to ensure, to the extent possible, the survival of the debtor's business. This goal is achieved through the debtor remaining in possession, and largely to the disadvantage of its financial creditors.

LIMITED RIGHTS OF FINANCIAL CREDITORS

All holders of bank credit (including banks, funds and holders of assigned debts) against the debtor shall now be clearly included in the safeguard plan process. However, at the same time, their ranking, priorities and security may be substantially disregarded.

Banks and holders of financial debt are, by law, members of a "credit institutions" creditors' committee. It had been strongly debated, in particular with respect to the funds which held bank debt of Eurotunnel, whether they could qualify as "credit institutions," a defined term covering licensed financial institutions operating in France. The legislature has now acknowledged that debtors may be financed by different sources, which are not limited to banks. Funds will now be members of the credit institutions committee as shall the assignees of a debt initially held by a bank, and, therefore, bound by committee approval. The law refers to "assignments" of existing bank debts, and it is unclear as to whether this word would also cover novation, which creates a new debt, to a holder which may not be a "credit institution."

There is only one such "credit institutions" committee which includes all secured and unsecured financial creditors, regardless of rank or class. The draft safeguard plan must be submitted to this committee, which must approve it by a two-thirds majority of the debt held by the members of the committee present or represented at the meeting. If the plan is approved by this committee and the similar supplier's committee, as well as the noteholders, and is then approved by the court, it is binding on all members of the committees. While the plan may permit preferential treatment among the creditors if their differences in situation so justify, this provision does not expressly require that ranking and priorities be respected to their fullest extent. Thus senior creditors may be "crammed-down" by a plan approved by more junior creditors. At the end of the day, creditors will be relying on the French court (and the "*mandataire judiciaries*") to supervise the process in a fair way, though what this means in practice is uncertain.

The creditors allowed to take part in meetings are the holders of the debt existing on the date of the court decision opening the safeguard procedure.

Disputes on the composition or operation of a committee can now only marginally affect the procedure: they shall be finally disposed of no later than upon approval of the plan by the various committees. This reinforces the ability of the debtor to push through the restructuring on its own terms.

NOTEHOLDERS IN A QUASI-COMMITTEE

Up to now, noteholders were not officially involved in the preparation of the plan, and holders of notes in each issue could decide whether to amend its terms and conditions.

Noteholders shall now be treated in a manner similar to that of financial creditors. They must be called to one meeting, consisting of all noteholders, irrespective of their issues, or their rank or security interests. They shall vote on the amendment to notes proposed by the draft plan. The quorum (20% of notes held as of the first meeting; if not satisfied, second meeting with no quorum) and the majority (two-thirds of the notes held by the holders present or represented) shall be those applicable to a noteholders' meeting. If the draft restructuring plan is approved by the noteholders and finally approved by the court, the note issue documentation must be amended accordingly.

REINFORCING THE EFFECTIVENESS OF FORCEFUL PRE-INSOLVENCY RESTRUCTURING

The "*procédure de sauvegarde*" can be initiated solely by the debtor which is only obliged to justify "difficulties which it may not overcome." There is no longer a need to demonstrate that these difficulties should lead to insolvency (on a cash basis). In the absence of

legislative history, it is difficult to anticipate the type of difficulties which can qualify and much may be left to the perception of the situation by the head of the commercial court, a non-professional judge.

The debtor may now suggest to the court the name of the administrator to assist with or supervise the preparation of the restructuring plan. This individual must be from a list of licensed professionals, but this possibility of choice may facilitate pre-arranged or pre-packaged restructurings.

The "safeguard plan" is developed by the debtor and the new law affords more flexibility as to its content. Procedurally, in addition to the debtor, any member of a creditors' committee may come forward to propose measures for a plan. It remains to be seen how this permission will actually play out, as the debtor has discretion to submit those proposals to the vote of the committees. Substantively, the debt can now be converted into equity of the debtor, which has only been discussed up to now; in addition, the tax and social security authorities may now agree to some reduction or rescheduling of their claims, irrespective of the terms and conditions regarding other creditors. Also, certain security interests (in particular, retention rights of a creditor over collateral retained by the debtor, *e.g.* a pledge of inventory) are not enforceable if the property is necessary for the carrying out of the business activity of the debtor. However, the content of the plan is not freely set. For instance, it cannot provide either for the disposal of the debtor's entire business or the dismissal of the existing management or the forced sale of the debtor's shares held by management. Also, the rules granting procedural, financial and other benefits to employees are not relaxed for lay-offs under a safeguard plan (as is the case for a continuation plan following an insolvency), resulting in substantial delays and costs in carrying out job reductions, and thus limiting the scope of the type of restructuring a safeguard plan may practically include.

PRE-INSOLVENCY CONTRACTUAL RESTRUCTURING

The new statute confirms the right of the debtor to request the head of the commercial court to appoint an individual to either carry out a defined goal ("*mandataire ad hoc*") or facilitate the negotiation of an arrangement with creditors ("*conciliateur*").

These two approaches may appeal in certain situations as they are confidential, and approval by the court of an eventual arrangement with debtors allows the benefit of a new money priority for additional funding. However, the potential arrangement is merely contractual and remains limited to the parties only, without any cram-down of other creditors. In addition, the term of the office of the *conciliateur* (five months), may be too short to achieve

useful discussions where there are numerous creditors, for example, due to syndication or the participation of hedge funds.

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Please feel free to contact us with any questions.

Antoine F. Kirry
+33 1 40 73 12 35
akirry@debevoise.com

Antoine d'Ornano
+33 1 40 73 12 45
adornano@debevoise.com

Colin Bogie
+44 207 786 9060
cwbogie@debevoise.com

Peter Hockless
+44 207 786 9180
phockless@debevoise.com

My Chi To
+1 212 909 7425
mcto@debevoise.com