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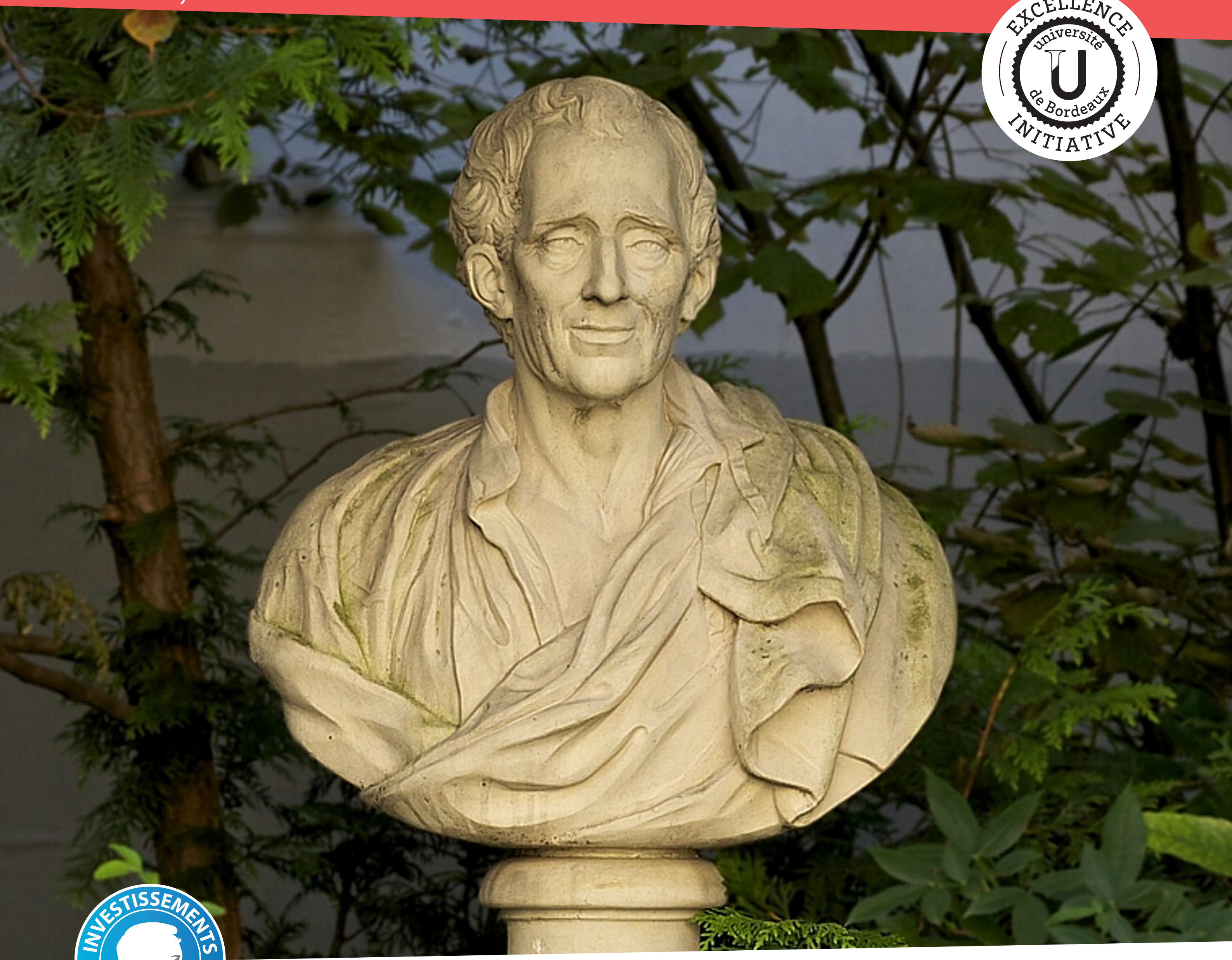

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Business law:

A step towards the harmonisation of EU law in matters of insolvency

Professor Jean-Luc Vallens

The Recommendation of the European Commission and France's Ordinance of 12 March 2014

It is quite natural to be surprised at the differences between national legislations when the respective economies of each European Member State are increasingly integrated and interdependent. The rules relating to the reorganisation and winding-up of credit institutions were the subject of a "forced-march" harmonisation as a result of the banking and financial crisis of recent years. Those relative to compulsory administration and liquidation of commercial and industrial enterprises remain, in contrast, singularly marked by the civil laws of each State. The European Union has doubtless already concerned itself with facilitating the effectiveness of judicial decisions in this field: such was the purpose of Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings, which is currently being reviewed (1). However, the approximation of such laws was not the purpose of the Regulation, which pushed first the European Parliament (2), then the European Commission (3), to embark on this work.

On the same day when French law was renewed with Ordinance n° 20014-326 of 12 March 2014, the European Commission adopted a Recommendation intended to give national legislatures guidelines for the adaptation and approximation of laws on insolvency.

A comment may be made here: in Europe, harmonisation is not, as one American scholar has observed, "a euphemism for forcing commercially less important countries to adopt the remedies and priorities of the commercially more important countries" (4). The perspectives evoked by the European Commission are not those of a uniform law of insolvency based on the American federal model, but a harmonisation, allowing the legal insecurity of economic and banking players to be reduced and facilitating foreign investment. This is the goal expressed at the beginning of Recommendation: *"[i]t is necessary to encourage greater coherence between the national* the *insolvency frameworks*" (5). By "coherence", we must understand "convergence" or "harmonisation", and not standardisation. The tools available for Community regulation allow such a nuanced, gradual approach. A Recommendation is first of all the result of a choice made by the Commission's departments, which may be followed by a subsequent Directive, destined to see those principles adopted therein transposed into national legislations, whilst being adapted to the local rules under domestic law. There is an indication in that sense in the final points of the Recommendation: the Member States are invited to implement the principles set out within 12 months and the Commission will assess national legislations within 18 months (6).

This "open method of co-ordination" is an expression of the concern for convergence, on the one hand, between national legislative systems and, on the other, between those systems and Community policy. We must recall, at this point, the objective pursued by the European Union, as expressed in the Recommendation: "to ensure that viable enterprises in financial difficulties, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole" (7): this is one way of expressing the general interest, even public economic policy, as highlighted by Professor Lucas (8).

This objective cannot be ignored when it is a matter of bringing successive amendments and adaptations to national law, as the French legislature does periodically.

The title of the Recommendation expresses the ambition pursued: it aims to provide "a new approach to business failure and insolvency". The stakes are considerable, given that national legislations are marked by the civil traditions of each legal system and find themselves at the confluence of multiple legal rules: securities law, property law, contract law, credit law and procedural rules.

The Commission has nonetheless adopted a particularly prudent approach, recommending a convergence of laws in fields where that convergence already exists: the early restructuring of companies in financial difficulty, which is intended to prevent insolvency and which is based on an analysis according to which insolvency is harmful both to the company and to its creditors, and a writing-off of an honest bankrupt entrepreneur's debts, which is considered as an independent method of recovery, to guarantee them a "fresh start".

The Commission thus avoids touching on the more sensitive subjects, i.e. more delicate issues: the adoption of standard criteria for opening insolvency proceedings, the establishment of common rules for verifying liabilities, the handling of debts subsequent to opening insolvency proceedings, the redefinition of those privileges and securities as may affect or be binding on the proceedings, or the establishment of standard rules for the voidability of legal acts detrimental to creditors. Some of these issues have already drawn the attention of the European Parliament, particularly the conditions for opening proceedings, the lodgement of claims, nullity actions, the treatment of corporate groups in insolvency and the powers held by receivers (9): the harmonisation of these rules would contribute even more fundamentally to legal certainty and investment. In opting for the two areas that it did select, the Commission has taken a partial approach which may be viewed as pragmatic. It is true that the Commission has undertaken to modernise (in the context of reviewing Regulation n° EC 1346/2000 of 29 May 2000) important topics such as the lodgement of claims, judicial co-operation and the treatment of groups in difficulty. However, these are essentially issues of judicial co-operation and the recognition of decisions more than substantive law.

The Commission's sector-based approach does, however, involve real co-ordination between the Commission, the European Parliament and the Member States in order to guarantee the coherence of the chosen approach. The expansion of the Parliament's prerogatives may even favour coherence in this instance.

The method employed also has the merit of giving the lie to a pessimistic interpretation, according to which harmonisation would always result in a "race to the bottom", where the convergence point between laws would be the least relevant and the least protective scheme for the interests concerned.

Conversely, while the Commission has limited its Recommendations to those areas where harmonisation appears, at the very least, to be useful and practicable, it does not confine itself to those general principles, but deliberately goes into the detail of the provisions that strike it as desirable. It is an interesting exercise to compare this with the guidelines chosen by the French legislature on the same day.

The simultaneity of these two legal documents allows, quite beyond differing objectives, a useful comparison to be made between the respective choices made by the Community legislature and the French legislature. We will use the Recommendation's titles to examine the relevance of French law in light of European law.

1. Preventive restructuring framework

The Commission provides a detailed "road map" for Member States:

- *debtors should be able to restructure at an early stage, as soon as it is apparent that there is a likelihood of insolvency;*
- *debtors should keep control over the day-to-day operation of its business;*
- *debtors should be able to request a temporary stay of individual enforcement actions;*
- *a restructuring plan adopted by the majority prescribed by national law should be binding on all creditors provided that the plan is confirmed by a court;,*
- *new financing which is necessary for the implementation of a restructuring plan should not be declared void, voidable or unenforceable as an act detrimental to the general body of creditors* (10)*.*

A few comments on these various points:

Negotiating an agreement:

French law, as reformed by Ordinance on 12 March 2014, broadly answers the concerns raised by the European Commission: the mediation procedure, like the accelerated safeguard procedure and the safeguard procedure (we will leave aside the accelerated financial safeguard, insofar as it does not constitute a true collective procedure) allow the debtor to keep control of the operation of its business, either in its entirety (under the mediation procedure and the accelerated safeguard procedure) or under the supervision of a professional (under the safeguard procedure). Under no circumstances is the debtor stripped of its powers but rather remains "in possession", as per the term used under Chapter XI of the American Bankruptcy Code.

Opening proceedings at an early stage:

The opening of these proceedings is also made possible as soon as difficulties emerge (mediation procedure) or in the event of insurmountable difficulties (safeguard procedure), whereas the accelerated safeguard procedure is available to a debtor previously subject to a mediation procedure and presenting the same risk of financial failure, with no consideration other than the existence of a plan likely to receive "sufficiently broad support from creditors" (11). A debtor involved in a mediation procedure may ask to be granted time limits, in the event of individual lawsuits (12); and, if it is successful in securing the opening of an accelerated safeguard procedure, individual lawsuits are stayed automatically for the duration of the same, which is the equivalent of the “moratorium” recommended by the Commission in its Recommendation. Nothing is said, however, on the recognition and enforcement of decisions given in proceedings, or on their public or confidential nature. The Commission and the European Parliament have taken this difficulty into account in the context of reviewing Regulation n° EC 1346/2000 of 29 May 2000 on insolvency proceedings.

Confirmation by a court:

A draft amicable agreement which has not been approved by all creditors may also be approved by a majority of them, followed by confirmation by a court, this making the agreement binding on all parties. Furthermore, where a debtor has obtained an amicable agreement that is confirmed by the court, the agreement will in future obstruct any potential deferral of the date for the suspension of payments, thus protecting the financing granted from any subsequent cancellation on the basis of acts during the suspect period.

Finally, it should be noted that the European Commission recommends limiting the timeframes for the various procedures, by setting the moratorium and negotiation period at four months, which is close to the duration of a mediation or an accelerated safeguard procedure (13).

Adoption of a restructuring plan:

The second aspect of the framework prescribed for the restructuring of companies in difficulty concerns the adoption of a plan, be it a restructuring or a recovery plan.

The Commission recommends a number of measures in that sense:

- *a classification of creditors,*
- *a majority vote in the amount of creditors' claims in each class,*
- *equality between creditors irrespective of where they are located,*
- *confirmation of the plan by a court protecting the legitimate interests of,*
- *the guarantee of treatment that is at least equivalent to what they would reasonably have received in the event of a compulsory liquidation, thus making the plan legally binding on all parties,*
- *safeguards, such as the rejection of an unrealistic plan, the protection of those creditors providing financing against the cancellation of measures and against any liability, and a general exception in the event of fraud on the part of the debtor* (14).

In terms of French national law, both the legislation in place prior to the Ordinance of 12 March 2014 and that resulting from the reforms broadly meet the Recommendation’s requirements, and France will have no difficulty in presenting an outline of her law at the assessment stage announced by the Commission.

The debtor presents a draft plan to its creditors, either individually or in the context of the creditor committees set up for the largest companies. An agreement voted by a majority of creditors on such committees results in the court approving the plan on condition that it respects the interests of all creditors. The approved plan then becomes legally binding on all parties. No distinction is made between creditors on the basis of their location, or indeed of their nationality: equal treatment is enshrined here, bearing in mind that this equality concerns unsecured or non-preferred creditors only, preferred creditors being guaranteed priority treatment provided by law.

Conversely, some of the European Commission's recommendations are hardly reflected in French law and present a challenge for France's national legislature.

The Recommendation of 12 March 2014 invites Member States to curb their legal formalities, particularly by avoiding the appointment of a mediator or a supervisor in order to "avoid unnecessary costs" (15). The Commission shows more naive optimism than pragmatism here, insofar as the intervention of an insolvency professional, whilst generating some costs, serves first of all to build up creditor confidence and ensure the equal treatment called for by the Commission. It is true that it concedes that the court may consider such an appointment necessary (16), which restricts the interest of this particular recommendation to a general call for cost containment. This approach could be more of a transfer to institutional creditors of the freedom to impose their own advisors on a debtor, with a view to developing the basis of a favourable agreement, thus confusing the specific interests of those creditors with the collective interests of all parties concerned, thereby also setting aside the expectations of heads of business. In the United States, for instance, where an insolvency professional is not appointed by the court, the head of the company will, at the request of the bank creditors, have an *ad hoc* administrator appointed, the Chief Restructuration Officer, who will negotiate the company's debts. On this point, it is not certain that the Commission's Recommendation truly meets the objective that it has set for itself. The French approach seems preferable here: this consists in establishing a framework for the remuneration of appointed professionals, which is the subject of many of the provisions contained in the Ordinance of 12 March 2014 (17).

The Commission also recommends the application of preventive procedures to all financial entities and providing for a creditor vote in all scenarios (18). The French legislature is more realistic in this respect; while the mediation procedure is open to all companies regardless of size, this is not the case for the other two aspects: the accelerated safeguard procedure and the creation of creditor committees.

Only the largest companies are eligible for the accelerated safeguard procedure created by the Ordinance of 12 March 2014 (19) and given creditor committees (20), in such a way that a vote by creditors on those committees concerns only credit institutions and the main suppliers to the debtor company. The following are excluding from these mechanisms: as regards debtors, companies that do not reach the requisite threshold (unless the bankruptcy judge rules otherwise); and, as regards creditors, those that are neither credit institutions nor the main suppliers to the debtor company.

For those creditors not called upon to vote, current French law restricts their involvement to an individual consultation, with no binding effect on the courts. From this perspective, national law is less favourable to creditor voting than is recommended by the Commission. French law differs on this point from several other national legislations, under which creditors gather in assemblies or committees and vote in the majority of procedures on the solutions presented by the head of the company. Whether the French legislature will resist taking the same course is not certain, despite the inconvenience presented by the creditors' meeting in terms of cost and time. French law's experiment with bankruptcy meetings in 1967 does not serve as an argument in favour of restoring these mechanisms.

The European Commission does appear to have guessed that there are difficulties, as it suggests that creditors be able to vote "by distance means of communication such as registered letter or secure electronic technologies" (21).

One final noteworthy difference between the respective directions of Community law and French law concerns the treatment of creditors in the context of a plan, for which the Commission recommends a specific safeguard: the rule on the best interests of creditors, i.e. a comparison between the treatment applied by the draft plan to a creditor and the creditor's fate in the event of compulsory liquidation (22). This mechanism draws inspiration from the "best interest test", itself inspired by American law, and incorporated in particular into the German insolvency code (23).

Again, this rule should in no way trouble the French legislature, which already recommends that courts confirm amicable agreements once they have ensured that those agreements safeguard the interests of those creditors who are not party to the agreement (24), and restricts voting to those creditors for whom the plan would change the payment methods (25).

2. Second chance for entrepreneurs

The European Commission deals with this issue in a more cursory manner. Under this heading, the Commission recommends the creation of a legal scheme for discharging entrepreneurs from their debts, prescribing a maximum period of 3 years as of the opening of bankruptcy proceedings or the confirmation of a recovery plan (26).

The rule recommended by the European Commission is also inspired from the common-law device known as *discharge*, and already featured as a major objective with the adoption of the Small Business Act in June 2008, redrafted in 2011. It can be found under a variety of names (e.g. *esdebitazzione*, *excusabilité* or *Restschuldsbefreiung*) in the national legislations of many European States, all reformed in this sense over the last twenty years: Belgium, Germany, Italy and Spain have thus opened the possibility of a complete discharge of their debts to those debtors in difficulty subject to bankruptcy proceedings, in order to allow them to resume an economic or commercial activity.

The concept of a compulsory remission of residual debts, which have not been paid in the context of compulsory liquidation proceedings, has – despite the initial criticisms from many civil law experts – found its place in the general economy of insolvency procedures in France and neighbouring countries.

It is expressed in national law by a prohibition on renewing individual lawsuits against a debtor at the end of compulsory liquidation proceedings closed on grounds of inadequacy of assets. The Commission's intention is to limit this possibility to honest debtors acting in good faith, which corresponds to the conditions set under French law, owing to the exceptions featured in Book IV of the *Code de commerce* (Commercial Code). Enshrined by the French legislature in 1985 (27), the right to a second chance for debtors has been extended to consumers who are heavily in debt by the *Code de la consommation* (Consumer Code) (28), for reasons more closely related in this instance to the need to maintain social harmony than the intention to encourage new individual businesses. The Ordinance of 12 March 2014 extends this option still further in favour of entrepreneurs with few assets by means of a new mechanism: the professional recovery procedure (29). The procedure is brief (lasting 4 months, in theory), stripped of any measures relating to liquidation and the audit of liabilities, and results in the writing-off of existing debts (30). On this point, the French legislature wished to facilitate the recovery of insolvent debtors with a good-faith condition whilst providing the possibility of ending it at any time, even cancelling the write-off of debts thereafter (31). The aim is to avoid onerous legal proceedings that generate additional costs and delays. The conditions recommended by the Commission, which mentions exceptions and restrictions, are linked to dishonest or good-faith behaviour on the part of the debtor. Other mechanisms are also connected to this aim, such as the simplified compulsory liquidation proceedings which end, in theory, within a year and now within six months following the reforms brought about by the Ordinance of 12 March 2014 (32), or the possibility of ending compulsory liquidation proceedings where the realisation of assets seems disproportionate with the interests of the proceedings (33), which covers the concept of a cost/benefit analysis: while they do not fully coincide with domestic law, these rules do express the common idea of a concession intended for debtors having been subject to insolvency procedures with no actions in bad faith or fraud on their part.

As mentioned above, the European Commission recommends a period of three years as of the opening of bankruptcy proceedings, to encourage Member States to set a reasonable timeframe for the duration of liquidation proceedings. Conventional law, which guarantees proceedings of a reasonable duration for litigants, appears to be an underlying principle behind the Recommendation. However, the Commission appears to deviate from this clear objective as it considers another option: it also recommends, as an alternative, a period of three years as of the implementation of a repayment plan. Does this mean that the duration of such a plan ought not to be longer? If so, the chances of success would be smaller, unless there were a significant drop in the number of creditors to repay. If not, it is scarcely conceivable that the Recommendation should appear to seek to discharge the debtor after three yearly instalments, in defiance of its own obligations.

Finally, the Commission recommends that debtors be allowed "means of survival", particularly through the possibility of "allowing the entrepreneur to keep certain assets" (34): again, the Ordinance of 12 March 2014 is consistent with the Recommendation, insofar as it allows the liquidator to release less valuable assets to the debtor's relatives, to allow timeframes to be set for a bankrupt debtor to vacate premises, and to exclude any property acquired by the debtor through inheritance from the scope of insolvency proceedings.

If, at the end of the assessment period scheduled by the Commission, French law has again to be changed, practitioners and courts will not be disorientated by the direction taken by the Community legislature.

Notes

(1) On 3 June 2014, the Commission and the European Parliament produced a joint version of a proposal for a revised Regulation, n° 10/284

(2) European Parliament, Resolution of 15 November 2011, P7 TA (2011) 0484.

(3) European Commission, Communication of 12 December 2012

(4) L. LoPucki, *Global and out of control?*, Amer. Bankr. Law Journal 2005, p 79
(5) European Commission, Recomm, guidance notes n° 11
(6) European Commission, Recomm, pt. 34 and s.
(7) European Commission., Recomm, guidance notes n° 1
(8) L'essentiel Dr. Entr. en diff., May 2014, n° 8, p 1
(9) EP, Resolution 2011(2006) of 15 November 2011
(10) European Commission. Recomm, pt. 6
(11) *Code de commerce,* Article L 628-1, para. 2
(12) *Code de commerce*, Article L 611-17 para. 5
(13) European Commission. Recomm, pt n° 13
(14) European Commission. Recomm, pt n° 15 and subs.
(15) European Commission. Recomm, guidance notes n° 17 and pts n°8 and 9
(16) European Commission. Recomm, pt. n°9
(17) *Code de commerce,* Article L 611-14, para 1, and L 611-16, para 2
(18) European Commission. Recomm., pt. n°16 and s.
(19) Being 20 employees, €3 million turnover and total assets of €1.5m (*Code de commerce*, Article D 628-3)
(20) Being 150 employees or €20m turnover (*Code de commerce*, Article R 626-52)
(21) European Commission. Recomm., pt. n°19
(22) European Commission. Recomm., pt. n°22, c)
(23) InsO, § 245 and 251
(24) *Code de commerce,* Article L 611-8 II, 3°
(25) *Code de commerce,* Article L 626-30-2, final para.
(26) European Commission. Recomm., pt. 30
(27) Now: *Code de commerce*, Article L 643-11
(28) *Code de la consommation*, Article L 332-6 para. 2 and L 332-9 para. 2
(29) *Code de commerce*, Article L 645-1 & subs., threshold set at €5000 (*C com* sec. R 645-1)
(30) *Code de commerce*, Article L 645-11
(31) *Code de commerce*, Articles L 645-9 and L 645-12
(32) *Code de commerce*, Article L 644-5
(33) *Code de commerce*, Article L 643-9
(34) European Commission. Recomm., pt n° 32 c)