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France Publishes Restructuring and Insolvency Law Reform Ordinance

Ordinance 2021-1193, which effects into law the European Directive on preventive restructuring frameworks, applies to proceedings opened from 1 October 2021.

Key Points:

- Certain preventive mechanisms are strengthened and certain measures, which are part of the COVID legislative framework are confirmed.
- New accelerated safeguard proceedings ("*sauvegarde accélérée*") are introduced to serve as the key proceeding for effecting into law the European directive.
- The Ordinance introduces classes of affected parties and the application of cross-class cram-downs.
- The "post-money" privilege is confirmed.
- The Ordinance reinforces the differentiation between safeguard and reorganisation proceedings and limits the application of a "term-out".
- The Ordinance clarifies the applicable regime to securities in insolvency proceedings.

The Ordinance 2021-1193 (the Ordinance) which comes into force on 1 October 2021, was published in the Official Journal (*Journal Officiel*) on 16 September 2021, setting the stage for the expected comprehensive reform of the country's restructuring and insolvency laws. With a slight delay due to the pandemic and numerous debates, in particular with regards to creditors' classification and, very recently, on the so-called "post-money" privilege, it will apply to proceedings opened as from 1 October 2021 and aims at increasing French law's attractiveness while restoring the balance of powers between stakeholders. It substantially modifies and enhances French restructuring tools and processes while harmonising French insolvency law with security law, also amended by a separate order published on the same day.

However, the Ordinance remains to be clarified in many aspects (in particular on legal recourses) since the related decrees have not yet been published.

Strengthening of certain detection and preventive mechanisms and confirmation of measures introduced as part of the COVID legislative framework

Acceleration of the mechanisms for the detection of difficulties and the warning proceedings

The Ordinance strengthens existing mechanisms to detect and prevent French companies' difficulties in two ways, thus entrenching temporary measures enacted during the COVID health crisis. Firstly, the President of the competent Court can request any useful document to clarify the economic and financial situation of a company as soon as a company director is called to a preliminary meeting, and without waiting for the meeting to be held. Secondly, warning procedures (*procédures d'alerte*) may be accelerated if a company's auditor finds the company needing to adopt emergency measures, but the company's director either refuses to act, or the auditor considered the proposed measures insufficient. In such a case, the auditor can immediately inform the Court (in parallel with bringing information about the competent corporate body or the director and without waiting for the expiration of a 15-day response period).

A marginal strengthening of *conciliation* proceedings through a modification of the procedure allowing the debtor to obtain grace periods

French insolvency law, through *mandat ad hoc* and *conciliation*, has been a forerunner with respect to restructuring preventive frameworks, which have proven to be efficient tools over recent decades. Such *conciliation* proceedings have thus only been slightly altered by the Ordinance.

The derogated regime introduced during the COVID-19 pandemic, which was intended to bring *conciliation* proceedings more in line with insolvency proceedings by imposing a stay of claims on certain creditors, was not reinstated. However, the Ordinance retained the reinforcement and acceleration of the "grace period" regime. Indeed, the debtor will no longer have to wait for a formal notice from creditors but will be able, upon the expiration of a time limit set by the conciliator in the absence of a favourable response from the creditor, to request the President of the Court, by subpoena, to benefit from "classic" grace periods, allowing the judge to postpone or reschedule payment of due amounts up to a maximum of two years, but also the postponing or the rescheduling of undue claims for the duration of the *conciliation* proceedings.

The introduction of new "accelerated safeguard" proceedings

The French government introduced a new version of "accelerated safeguard" proceedings, which allow the imposition of a plan on dissenting stakeholders by merging the existing safeguard and accelerated financial safeguard proceedings (also known as SFA proceedings). With a maximum duration of four months, such proceedings will be available to all companies, regardless of their size. The debtor can still limit the scope of the opening of accelerated safeguard proceedings to some of its creditors, e.g., only to its financial creditors.

As with previous versions, such proceedings can only be opened at the end of *conciliation* proceedings, which will create an opportunity to discuss the plan at an early stage and therefore to obtain greater support. Claims taken into account for the plan must be listed and certified by the auditors or, failing that, endorsed by a certificate from the certified public accountant.

If the plan is not adopted within the required time limit, the proceedings will automatically terminate and the Court will not be able to impose a term-out.

This new accelerated framework is the underlying proceeding for the transposition of the European Directive, and the constitution of creditors' classes is automatic and mandatory, notwithstanding applicable thresholds in cases of "classic" insolvency proceedings. This framework contributes to reinforcing French law's attractiveness and improving the clarity and efficiency of fast-track restructurings.

New classes of affected parties

The creditors' classes mechanism is intended to replace creditor committees and will now be coupled with the ability to implement a cross-class cram-down.

Scope and thresholds: regular proceedings vs. accelerated safeguard proceedings

Classes of affected parties will be:

- Mandatory and automatic under the new merged accelerated safeguard proceedings
- Subject to certain thresholds under regular safeguard proceedings and reorganisation proceedings, appreciated at the level of the debtor company and its subsidiaries, which will be specified by decree, but which should be identical to those retained for the jurisdiction of specialised commercial courts dedicated to significant insolvency cases (*Tribunaux de commerce spécialisés*)

Below such thresholds, creditors' classes remain optional at the debtor's request (for safeguard proceedings) and at the debtor's and the court-appointed receiver's request (*administrateur judiciaire*) (for reorganisation proceedings) and subject to the supervisory judge's (*juge-commissaire*) approval.

Nature of creditors' classes

Only affected parties (*parties affectées*) are entitled to vote on the draft restructuring plan, i.e.:

- Creditors whose rights are directly impaired by the proposed draft restructuring plan
- Equity holders, if their equity interest in the debtor, the articles of association, or their rights are modified by the proposed restructuring plan

The constitution of classes is made under the responsibility of the court-appointed receiver, who must, on the basis of verifiable criteria, gather creditors sharing a sufficient community of interests (*communauté d'intérêts suffisante*) within the same class, in which they must benefit from equal treatment.

Claims taken into account are those indicated by the debtor and certified by its auditor(s) or, failing that, endorsed by a certificate from its certified public accountant. The decision of each class is taken by a two-thirds majority of the votes held by the members of such class casting a vote.

Composition of classes

The Ordinance also provides:

- A separation into two distinct classes of secured creditors benefiting from “*rights in rem*” security interests (*sûretés réelles*) and other creditors and the constitution of one or more classes of equity holders (where applicable if they are affected by the draft restructuring plan)
- The distribution into classes will take into account subordination agreements entered into before the opening of the proceedings and brought to the attention of the court-appointed receiver
- Claims arising from employment contracts (including AGS (the French wage guarantee scheme) claims), pension rights, and maintenance claims cannot be affected by a restructuring plan, nor can the amount of claims secured by a *fiducie*

The court-appointed receiver can also create “ad hoc” classes, for example for public creditors or strategic suppliers.

The composition of classes, the presence of equity holder classes and the (supervised) flexibility left to the court-appointed receiver in their composition should allow for the emergence of greater options and solutions while better protecting secured creditors’ rights. The introduction of classes (coupled with the cross-class cram-down mechanism described below) thus contributes to reinforcing France’s attractiveness, particularly for foreign investors.

Cross-class cram-down mechanism

General principles

The key principles applicable to the cross-class cram-down mechanism are the following:

- The debtor’s consent is compulsory in safeguard and accelerated safeguard proceedings unlike in reorganisation proceedings ([see below](#))
- The absolute priority rule, i.e., creditors of a class that voted against the plan must be fully repaid (by identical or equivalent means) when a lower-ranking class is entitled to be paid or retains an interest. The court may, however, make exceptions to this requirement (e.g., in the case of strategic suppliers, tort claims, or even equity holders) if such exceptions are deemed necessary to achieve the plan’s objectives and if the plan does not excessively affect the rights or interests of impaired parties;
- In order to adopt a restructuring plan despite the negative vote of one or several creditors classes, and therefore implement a cross-class cram-down, the court must verify that one of the following two criteria are met:
 - a majority of the classes of impaired parties voted in favour of the plan, provided that at least one of those classes is a secured creditors’ class or is senior to the ordinary unsecured creditors’ class (*créanciers chirographaires*); or
 - at least one of the classes of affected parties has voted favorably, i.e. a class other than an equity holders’ class or any other class which is “in the money”, i.e. which, after determining the value of the debtor as a going concern, could reasonably be expected not to be entitled to any payment or retain any interest while applying the distribution priority order in the context of a judicial liquidation or an asset sale plan (*plan de cession*).

- Finally, the Court shall verify, in accordance with the best interests of creditors test, that any impaired party which has voted against the plan is not in a less favourable situation than it would have been in the event of a judicial liquidation, an asset sale plan or a better alternative solution.

Cross-class cram-down against equity holders

When one or more classes of equity holders have been constituted and have not approved the plan, a cross-class cram-down may only be implemented if:

- the company exceeds certain thresholds, appreciated at the level of the debtor company and its subsidiaries, which shall be later defined by decree and which cannot be less than 150 employees and €20 million of turnover;
- the equity holders of one or several dissenting classes are not “in the money”, i.e. after determining the value of the debtor as a going concern, could reasonably be expected not to be entitled to any payment or retain any interest while applying the distribution priority order in the context of a judicial liquidation or an asset sale plan (*plan de cession*);
- if the plan provides for a capital increase subscribed by cash contribution or by way of set-off against receivables, the shares issued are offered in priority to the shareholders, *pro rata* their existing shareholding. It being noted that this condition, which is logical in the case of unlisted companies where the willingness of pre-existing shareholders to continue to support the company or not can be easily identified, shall *a priori* prevent forcing the vote of capital increases reserved for creditors converting their debt or for providers of new money in the case of listed companies; and
- the plan does not provide for the transfer of all or part of the rights of dissenting class or classes of equity holders.

The specific terms and conditions for appeals against decisions in connection with the adoption or the cross-class cram-down of a plan, as well as the modalities for determining the value of the debtor's business in a litigation context shall be determined later by decree.

The “post-money” privilege is made durable

The orders implemented in response to the COVID-19 pandemic, inspired by the European Directive n° 2019/1023 on preventive restructuring frameworks, introduced a post-money privilege which did not exist until then and which has been entrenched in the Order. This privilege benefits to claims arising from a cash contribution to the debtor:

- during the observation period, authorised by the supervisory judge's; and/or
- for the implementation of the safeguard or reorganisation plan adopted by the court; or
- for a modification of the plan, adopted by the court.

Just as claims benefiting from the *conciliation* privilege, claims guaranteed by this privilege shall not be subject to write-off or postponements, which are not agreed to by their holders in the event of subsequent restructuring proceedings.

In restructuring proceedings, these claims shall only be overridden by certain specific claims (super-priority of salaries, legal fees, *conciliation* privilege and post-petition claims of the AGS (the wage

guarantee scheme)) without benefitting from a first ranking privilege on the debtor's asset as this is the case with debtor-in possession financing in the context of Chapter 11 proceedings in the United States.

Finally, by way of exception, the post-money privilege may be granted in the event of a plan modification adopted in the context of restructuring proceedings opened prior to 22 May 2020, it being specified that the post-money privilege as it results from the COVID orders shall continue to apply to proceedings opened between 22 May 2020 and 1 October 2021.

Additional distinctions between regular safeguard and reorganisation proceedings and limitation of an imposed plan with term-out

The regimes applicable to these two proceedings are historically very similar. However, safeguard proceedings are available to solvent debtors and reorganisation proceedings to insolvent ones. As a result, this distinction *de facto* leads to apply comparable regimes to companies in very different situations.

The Order only slightly modified these proceedings as the government preferred to use the new accelerated safeguard proceedings as the main vessel for the transposition.

However, safeguard proceedings are in practice often used defensively to protect a company facing financial difficulties, or as a threat in negotiations. Therefore and given the inherent differences between these two judicial proceedings, the French government has chosen to introduce additional distinctions:

- the maximum duration of regular safeguard proceedings has been lowered to 12 months (as opposed to reorganisation proceedings, which can last up to 18 months);
- in the case creditors' classes are constituted, an impaired party may propose a competitive draft restructuring plan only in reorganisation proceedings;
- cross-class cram-down is more widely available in reorganisation proceedings, as in safeguard proceedings this can only be made at the debtor's or the court-appointed receiver's (with the agreement of the debtor) request, whereas reorganisation proceedings seems to allow cross-class cram-down enforcement at the request of an impaired party;
- finally, in the presence of creditors' classes and in the event a restructuring plan (including failure of a cross-class cram-down) is not adopted, the French courts' ability to impose a term-out (i.e., a rescheduling of the indebtedness over a maximum period of 10 years, imposed to dissenting creditors) is maintained in reorganisation, but removed in safeguard (although the articulation between the relevant paragraphs in the Ordinance on this subject is not easy to follow). The term-out will therefore only be possible in two cases (i) in the absence of creditors' classes and (ii) in case of failure of the vote of the classes in reorganisation proceedings, it being specified that new conditions are applicable as the rescheduling of a minimum amount representing 5% of the claims as from the third annual instalment of the restructuring plan is now coupled with a minimum amount of 10% as from the sixth annual instalment.

In the event of safeguard proceedings being converted into a reorganisation proceedings, the benefit of the classes of impaired parties already constituted will be remained.

Clarification of the regime applicable to securities in collective proceedings

The Order entrenches a large number of changes to the security regime in restructuring proceedings, either to simplify and clarify the applicable regime, or to improve the creditors' rights, in line with the reform on security law. Among these modifications, the following are noteworthy:

- the modernisation of the rule of automatic void transactions during the hardening period (in particular with regard to substitutions of securities of equivalent nature and basis and Dailly assignments);
- the extension of the stay of enforcement proceedings against the beneficiary of a "*rights in rem*" security interest granted by the debtor to secure a third party's debt;
- the prohibition of any increase in the basis of a contractual "*rights in rem*" security interest or a contractual right of retention, regardless of the terms and conditions, once restructuring proceedings have been initiated (in particular top up clauses in securities account pledges); and
- the improvement of the protection of natural persons guarantors, whose regime in reorganisation proceedings is now the same as in safeguard proceedings.

In conclusion, the Order makes significant changes to French restructuring and insolvency law, making France more attractive to financial investors. The use of preventive measures by managers, and in particular *conciliation* proceedings (including the improvement of the grace period mechanism) and accelerated safeguard proceedings (with the automatic constitution of classes) is once again encouraged in order to deal with difficulties at the earliest stage. At the same time, the risk of using classic safeguard proceedings in the most important cases is limited with the end of the "term-out", increased protection is now offered to secured creditors, whilst the company's preservation remains at the heart of French law.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

[Alexandra Bigot](#)

alexandra.bigot@lw.com
+33.1.40.62.29.30
Paris

[Thomas Doyen](#)

thomas.doyen@lw.com
+33.1.40.62.23.70
Paris

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