Restructuring in confidence and with confidentiality

Frédéric Cohen and Luc Marty ask why does it matter to deal with financial downturns ahead of insolvency from the director’s liability point of view?

For international investors, when restructuring time has come, French prevention proceedings offer various technical possibilities to keep this delicate phase confidential and remain one of the most suitable ways to reduce liability risks for directors.

What does French law provide for restructuring of operations on a confidentiality basis?

As in many European countries, the French economy has been hit by a significant slowdown, which puts great pressure on the financial situation of many companies. This situation sometimes creates a cash shortage which could put the company in a difficult position as regards settling its liabilities in the short term, although the fundamentals of its business remain healthy; a company may also find itself in a situation where, although in a position to settle its liabilities, its lower performance jeopardises its credit position and its relationships with its banks, for instance by being in breach of financial covenants set out in a financing agreement. As such agreements generally include cross default provisions, a single issue may create significant damages for a company.

In these circumstances, the company is exposed to legal actions from its creditors and may find itself in a weak negotiating position in the context of discussions with creditors in order to agree to the necessary rescheduling of its liabilities with them.

Preventing such situations from deteriorating into insolvency and providing efficient assistance to companies facing these issues have in recent years become a major concern in France. In order to address these needs, over the years French law has developed various schemes aimed at assisting companies to reach an agreement (or obtaining a court decision) which could restructure all or part of its debt and, as a result, avoiding a situation whereby the company in question files for bankruptcy.

When dealt with soon enough, the use of such schemes is decided by the company facing these difficulties (no agreement of a third party is required) on a voluntary basis, i.e. they are normally initiated by the company and are not compulsory; their implementation does not in principle involve the removal or limitations of powers of the management of the company concerned. In addition, none of these schemes may per se result in a forced change of control or change of directors of the company seeking to use them.

Companies experiencing economic hardship are increasingly using such schemes, in agreement with their shareholders, in order to facilitate the entry of new investors. This can be achieved through a recapitalisation and/or a change of control of a company; the entry of new investors being generally subject to a number of conditions, such as rescheduling of debt, settlement of disputes with creditors, redundancies, disposal of activities... all of which are facilitated by these schemes.

Main prevention schemes

The main prevention schemes are:

Appointment of a Mandataire ad hoc

This scheme is the most confidential and the “lightest” in terms of proceedings and applicable rules.

When experiencing specifically identified difficulties, and upon request to the President of the relevant commercial court, this expert will help the management board of the company to reach an agreement with the opposite party regarding a specific issue, most of the time, the rescheduling of the payment of one or several debts.

The mandataire ad hoc is generally an administrateur judiciaire (i.e. the French equivalent of a receiver) whose involvement should be considered as much nearer to a mediation attempt than to real insolvency proceedings, even though this phase may sometimes be very harsh and used as a preparation of a quickly solved insolvency (or sauvegarde) proceedings (prepack).

The appointment of the mandataire ad hoc, the scope and duration of his task are discussed and coordinated with the judge. This appointment is strictly confidential, i.e. it is neither published nor disclosed to the authorities; therefore, it does not damage the reputation or the financial credibility of the company concerned.

The mandataire ad hoc has no binding authority over the company (his appointment does not in any way limit the powers of the company’s directors). Furthermore, he has no authority over the opposing party, which
remains entitled to initiate legal proceedings against the company at any time during the discussion.

His role is purely advisory and consists of helping each party to understand the opposite party's positions and proposing alternative arrangements to resolve the matters at stake.

If the mission of the mandataire ad hoc is successful, the parties will prepare and execute a settlement agreement specifying the terms of their amicable arrangements.

Conciliation proceedings (procédure de conciliation)

These are also confidential and also apply when the company is experiencing one or several specifically identified difficulties which, however, allow at this stage for a financial recovery by the company.

As for the mandat ad hoc, the conciliation is initiated by the company on a voluntary basis and does not limit the powers of the management. The court will appoint a conciliateur, whose mission will consist of assisting the company.

The conciliation is only opened to companies which are not insolvent, but also to companies which have been in a state of insolvency for less than 45 days.

The main difference with the first one lies in the fact that the conciliateur’s mission cannot exceed five months in total.

The conciliation may therefore be used when entities have just become insolvent and is aimed at addressing a specific issue, the resolution of which would restore the financial situation.

The conciliateur is also entitled by law to negotiate rescheduling (or reduction) of debt with the tax and social security authorities.

The financial recovery plan may also provide for new equity or debt contributions to be made by existing shareholders or by new shareholders. This is achieved by subscribing for new shares or for complex securities (e.g. convertible bonds, bonds redeemable in shares). Once executed, the agreement with the creditors will enter into force once it has been ‘acknowledged’ by the president of the commercial court (in which case the agreement and the conciliation will remain confidential).

Why does it matter
to deal with financial downturn ahead of insolvency in order to reduce the directors’ liability risks?

For international investors, the French welfare organisation and the mindset concerning the employer’s responsibility could become, in some cases, a concern (when not an issue).

Prevention proceedings offer the investors:
- A legal possibility to start relations with its direct judicial and economic environment (commercial court, main creditors, main public authorities, etc…) and make them aware of the difficulties of their French operations before any insolvency is to be considered,
- A short but efficient period of time to demonstrate their good faith and willingness to solve the various issues at stake consensually (which does not mean peacefully).

Commercial courts are afraid of surprises. They are supposed to safeguard employment (i.e. decide quickly), which sometimes contradicts their need of time resulting from legal proceedings.

This time taken by the court to deal with prevention proceedings mainly aims to make sure that every option has been considered. As safeguarding employment remains since many years not only a global economic concern, but also one of the main goals that insolvency proceedings are supposed to achieve, commercial courts act carefully keeping that goal as one of their focus when being involved in prevention and/or insolvency proceedings.

Therefore, shareholders and directors, when conducting businesses in troubled times, should wisely take great care in using the aforementioned proceedings, whenever possible, in order to avoid insolvency proceedings, by dealing with their main creditors without damaging their own reputation, in a completely confidential manner and with the highest possible legal safety for their personal liability.

When insolvency proceedings cannot however be avoided, both shareholders and directors would have, through these proceedings, made the significant stakeholders aware of the situation at an early enough stage, so that they would have the chance to play their part in the restructuring process.

Restructuring is a team effort.

Being advised in good time on every aspect (commercial, legal, judicial, economic and financial, etc…), of these processes taking into account the specific situation of the business concerned is part of the risk control that any manager and director should consider.