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The New French Bankruptcy Statute

I. Introduction

Adopted on 25 January 1985 and not yet in force at this writing, the new French statute concerning the reorganization and liquidation of enterprises abrogates existing bankruptcy statutes and introduces a number of important changes in the treatment of insolvent business under French law.[1] It also provides the occasion for a short commentary on French bankruptcy law and on its new dress.

The consequences of bankruptcy have been worked out over the years in France with hesitant progress from the draconian measures aimed at punishing the defaulting debtor exemplified by the bankruptcy provisions of the Napoleonic Code of Commerce adopted in 1807 toward a process which is primarily concerned with saving the enterprise and, especially, the jobs it provides. Through all of this there has been increasing recognition, in words if not always in practice, that insolvency may be the result of external conditions and is not always attributable to bad management or, indeed, to bad faith or dishonesty on the part of the debtor.[2]

This article is mainly concerned with the fate of limited liability companies, the *société anonyme* and the *société à responsabilité limitée*. The focus, however, is not meant to suggest that the problems of the sole

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1. Law 85–98 of Jan. 25, 1985 [hereinafter cited as the "new law"], (J. O.) 1097 (Lois et Decrets, ed.). The new law enters into force at the earlier of a date fixed by decree or January 1, 1986.

2. Even the terminology of the new statute is suggestive of change. Where previously the law spoke of "*règlement judiciaire*" (payment to creditors—usually *pro rata* but, in any event *payment*—under judicial supervision), the new law calls the initial period *redressement judiciaire* (putting the enterprise back on its feet under judicial supervision). The change in title suggests the change in spirit: make an attempt, before paying, or even worrying about, creditors to save the enterprise and as many as possible of the jobs of its employees. The change in fact amounts to little more than textual recognition of what has become the dominant preoccupation of the officials concerned under the old law.

proprietorship or collective entity without limited liability are less important. French law provides no mechanism for the protection of individuals other than merchants from creditors or from their own insolvency.[3]

II. Old and New Laws Contrasted

A. Replacement of the Syndic

Until the entry into force of the 1985 law, the principal personage in French bankruptcy proceedings is the *syndic*, analog of the American trustee. When a company is declared bankrupt a *syndic* is appointed by the court and thereafter plays the central role in the proceedings.[4] Under the old law the debtor company was placed in *règlement judiciaire* (where a work-out arrangement with creditors was sought) if there was any realistic chance that it might be salvaged, or went, either directly or from a failed attempt at *règlement judiciaire*, into liquidation.[5] In both cases the *syndic* was, for all practical purposes, in charge. Under the new law, the *syndic* is to be replaced during the first stage (to be called "*redressement judiciaire*"—the righting of the debtor under judicial supervision—which is to occur in every case) by a judicial administrator,[6] and by a different person, called a *mandataire liquidateur* during liquidation.[7] Both the old and the new statutes place these officials under the supervision of a member of the commercial court (the *juge-commissaire*).[8]

The old law provided that existing management remains in place during *règlement judiciaire* and was only (although obligatorily) "assisted" by the *syndic* while, if the matter became one for liquidation, management had no further role to play and the assets were placed entirely in the hands of the *syndic* for liquidation.[9] The notion of "assistance" to management by the *syndic* was, to say the least, strained for at least two reasons. First, management had no legal choice but to follow the advice of the *syndic*. Second, the *syndic* generally had too much to do and was responsible for far too many bankrupt debtors, to engage in serious debate about the management or future of anyone. He therefore frequently took the decision quickly and alone.

When the new statute comes into effect, the situation is meant to be different. The judgment of the commercial court putting the company into

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3. *See, e.g.*, 2 Ripert and Roblot, Traité Elementaire de Droit Commercial (9th ed., 1981) 638–49, [hereinafter cited as Ripert].
4. Law 67–563 of July 13, 1967 [the "old law"], Annex to the Code de Commerce in the Petit Code de Commerce, 1984–85 Dalloz Sirey Legislation (D.S.L.), art. 9, at 341.
5. Old law, *id.*, at art. 7.
6. New law, *supra* note 1, at art. 10.
7. *Id.* at art. 148.
8. Old law, *supra* note 4, at art. B; New law, *supra* note 1, at arts. 10 and 14.
9. Old law, *supra* note 4, at arts. 14 and 15.

redressement judiciaire opens a brief period of "observation" during which a report, dealing both with the economics of the situation and with the debtor's position as an employer, is drawn up.[10] A rescue plan is to be prepared by the judicial administrator with the assistance of management, of appointed experts and of two other figures whose posts are created by the new law: the representative of the creditors (this was formerly the official role of the *syndic*)[11] and the representative of the employees (there was no such person in the past).[12]

B. Other New Bankruptcy Officials

The relationship between the judicial administrator and existing management of the bankrupt debtor during the period of observation is defined in terms which more explicitly subordinate the latter to the judicial administrator than has been the case in the past with respect to the *syndic*, but which will probably entail little real change for reasons which are suggested above.[13] The full extent of the judicial administrator's authority in fact depends on the decisions taken by the commercial court[14] and may, it would seem, be very broad indeed. The appointment of a creditors' representative is likewise within the province of the court[15] and it must choose, not among the creditors, but from the approved list of *mandataires-liquidateurs*.[16] The same person may, if the court so decides, later be charged with the liquidation of the debtor if no basis for salvaging it can be found. One supposes that identity of the creditors' representative during the period of *redressement judiciaire* and of the person who may later be responsible for the liquidation of the debtor reflects the principal concern of both functions which is the protection of creditors subject to certain priorities (discussed below) and the conclusion, reached by the court, that the enterprise and the jobs it represents cannot be saved. The representative of the employees appears in a consultative role which, during the period of *redressement*, is at least as weighty as that of the creditors' representative.[17]

C. Continuation of the Business

During the initial period, before any measures have been taken for the implementation of the plan, the business is continued under circumstances

10. New law, *supra* note 1, at art. 1B.
11. Old law, *supra* note 4, at art. 13.
12. New law, *supra* note 1, at arts. 18–24.
13. *Id.* at art. 13 and text following note 8 above.
14. New law, *supra* note 1, at art. 31.
15. *Id.* at art. 10.
16. *Id.* at art. 148.
17. *Id.* at arts. 44–46. The list is established pursuant to another statute adopted at the same time: Law No. 85–99 of Jan. 25, 1985, J.O., at 1117.

which are difficult to define in the abstract. Two points, however, are worth making: first, under both the old and the new laws, any clause in any contract of the debtor which provides for termination in the event of insolvency proceedings is void.[18] The administrator (or the *syndic* under the old law) decides which executory contracts he wishes to maintain in force provided only that he causes the debtor to perform its own promises. The new law will permit the solvent party to accelerate the decision by asking for a determination within thirty days of the receipt of the request by the administrator.[19] Second, contrary to previous law,[20] the new statute does not cause the as yet executory promises of the debtor to become due although they are suspended at least initially.[21] Outstanding obligations of the debtor do not automatically become due until the debtor is put into liquidation.[22]

D. Cessation of Payments

The procedures prescribed by the new law (as was the case under the old) can be initiated by a number of persons including the court acting on its own motion, the creditors, the employees, or the debtor itself.[23] The management of the debtor company is subject to a penally sanctioned duty to do so within fifteen days after "*cessation de paiements.*"[24] This term, very much a term of art in French bankruptcy, had no statutory definition under the old law.[25] It does under the new: ". . . the impossibility of meeting liabilities which are due with available assets . . ."[26] The old interpretation—essentially a product of the case-law—of "cessation of payments" focused originally on the debtor's actual failure to pay his debts as they fell due and only slowly came to an insolvency test framed by the question of whether the debtor's situation was "irremediably compromised." The new statutory definition seems to be oriented toward the debtor's overall financial condition. It would appear that actual failure to pay has been replaced definitively by what amounts to a balance sheet comparison of current assets and current liabilities.

E. Preferences

One of the most important uses of the notion of "cessation of payments," after that of determining the occasion for bankruptcy, is that of fixing the

18. Old law, *supra* note 4, at art. 38; New law, *supra* note 1, at art. 37.
19. *Id.*
20. Old law, *supra* note 4, at art. 37.
21. New law, *supra* note 1, at art. 56.
22. *Id.* at art. 160.
23. *Id.* at arts. 3 and 4.
24. *Id.* at art. 3.
25. Ripert *supra* note 3, at 653–57.
26. New law, *supra* note 1, at art. 3.

preference period. Normally only payments made after the date of cessation of payments can be treated as preferences although purely gratuitous payments made up to six months earlier can be attacked as preferences and avoided.[27] The date of cessation of payments is fixed by the court and can be set up to eighteen months prior to the date of judgment.[28] In the absence of a determination by the court the date is deemed to be the date of judgment.[29]

With respect to preferences, the new law makes what appears to be a significant change although only time and new judicial decisions are likely to reveal its real importance. Where all such payments (the list is close enough to that which applies in American law to need no repetition here) were invalid as against declared creditors (who constituted a "*masse*" represented by the *syndic* which has disappeared under the terms of the new law), they now appear to be void *ab initio* as against any third party.[30] Thus one supposes that, for example, an agreement constituting such a payment could be avoided by either party to the agreement, including the debtor itself.

F. Lease-Management

One of the solutions for the continuation of the business and which has formed the core of many a plan in the past, is the so-called *location-gérance* (literally: "lease-management") of the bankrupt concern's business. Lease-management is a fairly standard type of agreement which has been adapted to the bankruptcy situation and which permits the *syndic* to get the problems of management into the hands of a firm which may ultimately acquire the business. In bankruptcy, the agreement often includes an option permitting the lessee-manager to purchase the business for a nominal price if he elects to do so. A recent decision of the Court of Cassation (France's highest court in matters of this kind) confirms that this is merely an option and that, in the absence of express language to the contrary, the lease-manager is free to hand the business of the bankrupt debtor back to the *syndic* at the end of the lease-management agreement if he decides not to purchase.[31] The ability to do so is particularly important where there are large numbers of employees because the high cost of their termination if that is the step then taken, is borne by the bankrupt estate (in fact, by the public insurance entity which will, in most cases, have paid the employees and whose rights of subrogation against the bankrupt estate are often worth very little). Under the new law, lease-management remains possible but it must now incude an undertaking

27. *Id.* at art. 107.
28. *Id.* at art. 9.
29. *Id.*
30. *Id.* at art. 107.
31. Ferrari et qualites v. SIEV, Cass. civ. (Dec. 10, 1984) (unpublished) and the decision of the Court of Appeal of Paris there affirmed.

on the part of the lessee-manager to acquire at the end of the term.[32] Moreover, the contract may not exceed two years' duration where three to six years was common under prior law.[33]

The obligation to acquire, which turns the lease-management agreement into little more than a deferred purchase contract, may be avoided if the following curious requirement is satisfied:

> However, when the lessee-manager establishes that he cannot acquire as initially provided for a reason which is not attributable to him, he may apply to the court, before expiration of the lease contract, for the modification of the acquisition terms. . . .[34]

Not only is it difficult to say what this language will mean in practice, but it appears to import into French civil law the *clausula rebus sic stantibus* which has always been rejected by the civil, but not by the administrative (actions against the government) courts.[35] This may be only another indication that the judicial administrator, who acts on behalf of the bankrupt debtor in making the contract of lease-management, is a representative of the interests of the state (employment) rather than of those of the creditors. However that may be, it appears unlikely that there will be, under the new law, any interest on the part of potential purchasers who wish to use the lease-management arrangement as a way of taking an initial, though hardly risk-free, look at the business before deciding whether to acquire. One senses that this modification in the law is going to make it that much harder to find sound and serious candidates to take over enterprises in difficulty; in a word, that this change, at least, is likely to be highly counter-productive.

G. Liability of Management

The change brought about by the new law which has attracted the most attention, and which certainly marks progress toward statutory recognition that the cause of bankruptcy may as well be the external economic conditions of the times as the quality (or lack thereof) of management, is the elimination of the presumption contained in article 99 of the old statute. The new provisions, set out in article 180 of the 1985 law, provide (as did article 99) that if defective management has contributed to the debtor's situation, all or part of its debts may be put at the charge of one of more members of management. Under the new statute, as under the old, management is broadly defined to include managers-in-fact (e.g., controlling shareholders) as well as those who are responsible in law for the management of the

32. New law, *supra* note 1, at arts. 94–98.
33. *Id.* at art. 97.
34. *Id.* at art. 98.
35. *See, e.g.*, 2 Ghestin, Traité de Droit Civil 106 (1980); 1 de Laubadere, Venezia and Gaudemet, Traité de Droit Administratif 422–27 (9th ed., 1984).

bankrupt. The difference is that it will no longer be presumed that this is the case on a mere *prima facie* showing by the *syndic*. When the court accepted the *syndic*'s suggestion, the management was subject to the burden of proving that it had brought to the task of managing the debtor all of the diligence which was appropriate under the circumstances. Few have been successful in bearing that burden. The existence of article 99 and its presumption have become, needless, perhaps, to say, a staple of the lawyer's advice to his client whose company or subsidiary was in trouble. The presumption will be gone when the new law enters into force.

H. Position of Secured Creditors

The position of secured creditors does not appear to have greatly changed except to the extent that the reinforcement of the employees' right to intervene in the proceedings both as employees and as creditors may result in a strengthening of their position. Under both the old and the new law, salary claims (including vacation pay, social charges, and various indemnities), for a period of sixty days prior to the date of cessation of payments, enjoy a "super-privilege" which attaches to such claims a priority senior even to the claims of secured creditors.[36] This said, the position of the secured creditor remains relatively strong and the holder of what is known in American law as a "purchase money" security interest may, under certain circumstances, even override the super-privilege attached to salary claims. The new law preserves the unpaid seller's right to retain the goods sold or even to recover them if they remain identifiable among the assets of the bankrupt buyer.[37] It also maintains the right of the seller to hold back title until paid, a right which had disappeared in the case-law but which was reintroduced by legislation in 1980.[38]

Most interesting, although of lesser value until the Court of Cessation decided last October that here, too, the super-privilege had to give way, is the possibility open to the holder (seller or financing party) of a security interest in machine tools or other industrial equipment.[39] Despite the explicit language of the old bankruptcy statute as well as the Labor Code, it was held that the secured party could demand application of article 2078 of the Civil Code which permits the holder of such a security interest to obtain

36. New law, art. 40; Code de Travail (Labor Code), arts. L.143–10 and 143–11, both as amended by the new law (Dalloz Petits Codes, 1984).

37. New law, *supra* note 1, at arts. 115–17.

38. *Id.* at art. 118; Old law *supra* note 4, at art. 65.

39. "*Nantissement de l'outillage et du materiel*", perfected under the Law of 18 January 1951. The decision of the Court of Cessation is the judgment rendered in S.A. Union Francaise des Banques v. A.S.S.E.D.I.C. Doubs–Jura, (Cass. civ., Ass. Plen. (Oct. 26, 1984), 1985 D.S. Jur. 33.)

delivery to him of the security and the settlement *pro tanto* of his claim.[40] The solution appears to have been preserved in the new law which adds only that the request for application of article 2078 must be made within the period after the liquidator gives notice of his intention to sell the security and before the sale (at least fifteen days).[41] No time was set under the prior law. In the area of purchase money security, the new law seems to reflect recognition of the need to protect sellers and financing parties if they are to sell at term and that their willingness to do so may be an essential condition of the buyer's ability to carry on his business.

III. Conclusion

This essay has offered a bird's-eye view of the new French bankruptcy statute and has expounded briefly on some general notions of that law and of French bankruptcy practice. There is necessarily a great deal more to be said, but it is perhaps best said after some experience has been gained under the new law. This is especially important in the light of the new statute's attempt to take account of at least certain imperatives of a market economy while, at the same time, seeking to give greater weight to state concerns.

40. The value of the security thus surrendered and the extent to which the secured party's claim is thereby extinguished is determined by appraisal.

41. New law, *supra* note 1, at art. 159.