

**Out of Court Settlement in France**  
**“The Conciliation”**

Article L 611-4 to L 611-15 of the French Commerce Code.

Act n° 2005-845 of 26 July 2005, as completed and amended, has created a new out of court settlement process known under French law as “Conciliation” and replacing the former amicable settlement or “*règlement amiable*”.

Both the Conciliation and the *mandat ad hoc* are viewed as preventive schemes, that is, schemes aimed at preventing debtors’ actual insolvency or bankruptcy. The aim is to induce debtors to face as early on as possible their financial difficulties by encouraging them to start negotiating with creditors an appropriate rescue package.

**In a nutshell:**

This is a (1) purely national scheme, applicable to natural (self-employed or traders) or legal persons. The purpose of the Conciliation is to allow, (2) on a confidential basis, (3) at an early stage in the debtor’s financial difficulties (4) during a limited time period (5) negotiations with key creditors (6) towards reaching a compromise agreement. To that end, (7) a professional third party, a Conciliator, is appointed by the Court. French law provides for various tools aimed at encouraging key participating creditors to compromise (8) and support the fresh start (9). The opening of negotiations does not trigger any automatic stay and the debtor stays in possession (10). Once a compromise is reached, the agreement is either validated or endorsed by the Court (11). A failure of negotiations or breach of the agreement can lead to insolvency (12). Certain statistics and practical considerations (13) are helpful in order to assess the merits of the Conciliation in the real world.

**(1) A National Scheme**

The Conciliation scheme does not appear in either Annex A or Annex B of EC Regulation n° 1346/2000 of 29 May 2000 on insolvency proceedings (“the Regulation”). In particular, the Conciliation does not entail partial or total divestment of a debtor nor the appointment of a liquidator as required by Article 1 (scope) of the Regulation. The amicable and confidential nature of the Conciliation would also be incompatible with the automatic recognition and publication requirements under the Regulation. Consequently, the starting of Conciliation will in principle have no official effect outside of France.

**(2) A Confidential Scheme**

The Conciliation is designed to remain confidential except when contracting parties want to have their compromise agreement endorsed by the Court (see section 11 below).

2.1 Only the debtor’s management is empowered to file for the opening of a Conciliation scheme with the President of the Commercial Court (conversely, the debtor’s management may terminate it at any time). Public prosecutors, creditors or employees do not have such a right. The executive officer has in principle that power without any need to obtain the prior approval from his Board of directors or shareholders. There is no obligation either to inform the works council (at least until the compromise agreement is finalized) or external auditors.

2.2 Information on the opening of the Conciliation is given to certain third parties such as the public prosecutor, external auditors (when applicable), applicable professional bodies or supervising authorities for self-employed persons.

2.3 All participants to the Conciliation scheme are bound by a strict confidentiality obligation. This being said, risks of leaks are a reality.

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2.4 Since there is no obligation to conduct negotiations with all creditors, the choice made by the debtors among those called into the negotiations can also be made, at least partially, in light of confidentiality considerations.

2.5 The publication of the endorsement judgment will put an end to the confidentiality in respect of any contractual guarantees granted and the amount of the “new money privilege” (the other terms and conditions of the compromise agreement will not be published, see item 10.2 below).

### **(3) Early Stage**

Eligible debtors must experience legal, economic or financial difficulties, whether established or foreseeable. However, debtors are no longer eligible to benefit from Conciliation if they have already reached a “state of insolvency” (“*cessation de paiements*”) for more than 45 days.

State of insolvency is defined by French case law as the stage where the debtor can no longer pay its debt payable and effectively asked for payment by creditors with cash and cash equivalent assets.

Until that state is reached, debtors have a certain margin to also file for the opening of a safeguard proceedings (“*procédure sauvegarde*”) <sup>1</sup>. Once that stage is reached, debtors have no other choice but to file for Conciliation, receivership (“*redressement judiciaire*”) or judicial liquidation.

The opening of the Conciliation requires that detailed information on the debtor be filed with the President of the Court who should benefit as a result from a good knowledge of each particular case (e.g., list of main creditors, summary of all indebtedness, cash and cash equivalent assets). To the extent necessary, the President may collect additional information through an expert appointed for this purpose. Bank secrecy cannot be opposed. The same level of information is made available by the President to the Conciliator.

### **(4) Limited time period**

4.1 The Conciliation may not last more than 4 months, renewable by 1 month maximum upon request from the Conciliator (i.e., thus 5 months maximum). If the compromise agreement is endorsed by the Court, the time taken by Court to issue its endorsement is not counted in the period (which means that to be eligible, the request asking for the judicial endorsement must be filed no later than the last day of the 4 to 5 month period).

4.2 In order to avoid an abusive use of successive conciliation proceedings in circumstances where other insolvency proceedings would be more appropriate to the situation, no new Conciliation may be opened before the expiry of a 3-month period as of the closure of the preceding Conciliation.

4.3 In practice, if it appears that amicable negotiations with creditors will last more than 4 to 5 months, nothing precludes the debtor from having the conciliation preceded by a *mandat ad hoc* scheme, which is not regulated (in particular, no specific time limit applies) and extremely flexible. In certain situations, the Conciliation may consist in an necessary preparation step to discuss pre-packaged plan before agreeing on such a plan during a safeguard scheme. In other situations, creditors will be better advised to file immediately for the opening of a safeguard scheme (e.g., to benefit from the automatic stay) in order to avoid being in a situation where conciliation negotiations have failed when they have reached the “state of insolvency” in which case the receivership or judicial liquidation will remain the sole option left.

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<sup>1</sup> By contrast, the threshold to open a safeguard procedure is for debtors to justify “difficulties (i) that they are not capable of overcoming and (ii) the nature of which will lead them to reach a state of insolvency “ ;

**(5) Negotiations with key creditors**

5.1 The Conciliator's mission is to favourize a compromise agreement between the debtors and key creditors and as the case may be, regular business partners (not necessarily creditors) aimed at putting an end to the debtor's financial difficulties. The Conciliator is thus not in charge of assisting in the management or otherwise representing the debtor. He may formulate any proposal favoring the debtor's rescue, the continuity of business operations and preservation of jobs. Conversely, the compromise agreement does not require consent of all creditors. The process is contractual, confidential, optional and very simple.

5.2 In practice, once a recovery plan is drafted by the debtor's management and the Conciliator, a selection can be made by category of creditors (i.e., tax and social security, banks, trade suppliers) while considering at the same time the global and collective indebtedness. All will depend on criteria such as the debtor's business sector. Limiting the number of creditors can enhance confidentiality by reducing the risk of leaks. The draft recovery plan submitted to support negotiations must be serious and viable.

5.3 All creditors are not necessarily party to the negotiations. In addition, there is no requirement to provide for an equal treatment among the participating creditors. The compromise agreement will only be binding among its signatories with no effect on third parties. Third parties will keep all their rights for individual enforcement actions (within the limit of the Grace period commented upon in section 9.2 below): among, these actions are the right to initiate the opening of a receivership or judicial liquidation procedure.

**(6) Reaching a contractual compromise**

6.1 As indicated above, the objective is to negotiate amicably, outside of any judicial constraint, a reduction of the debtor's total outstanding debt and secure certain postponement of maturity dates as the debtor's financial capacity will permit. Other measures may be included in the agreement such as capital increase, restructuring, issuance of new securities etc. Behind the negotiation scene, the threat of a possible conversion of the Conciliation into receivership or liquidation proceeding will remain present. Indeed, if the negotiations fail or if the measures proposed in the compromise agreement are not sufficient to ensure the continuity of business operations, the opening of a receivership or judicial liquidation will be unavoidable in which case the perspectives of the creditors will be much less favourable. In addition, the debtor may use the threat of filing for safeguard or receivership at any time during the negotiations in order to obtain more from creditors.

6.2 The compromise must meet the condition of putting an end to the debtor's financial difficulties.

6.3 The contractual nature of the compromise can be best illustrated by the fact that certain creditors may participate in the compromise agreement for a portion only of their claims against the debtor, the other portion remaining outside the scope of the agreement.

**(7) Professional third party**

In order to have any chance of success, there must be a good trust relationship between the debtor and the conciliator. Conciliators are usually appointed from among the receivers (*"administrateurs judiciaires"*) but can also be chosen among turnaround professionals and even accountants, experts, attorneys who are deemed competent or well-known. Certain strict incompatibility rules will also govern the President's choice. The debtor is free to propose the name of his choice or to oppose the proposal made by the President. Conciliators enjoy certain investigating powers with public administrations.

### **(8) Incentives for key participating creditors**

#### 8.1 “New money privilege” (upon endorsement only)

Provided that the compromise agreement is endorsed by the Court, Qualified Creditors benefit from a “new money privilege” in case of subsequent safeguard proceeding, receivership or judicial liquidation,

##### a. Qualified Creditors are those providing either:

- new cash contribution to current account (but not contribution to capital), and/or
- new supplies of goods or services;
- ensuring the continuity of business operations
- as set forth in the compromise agreement.

Conversely, neither cash contributions granted before the opening of the Conciliation nor simple postponement of maturity, will qualify under the privilege.

##### b. The new money privilege consists in a senior rank, coming immediately after judicial costs and wages applicable when the Conciliation is converted into a safeguard, receivership or judicial liquidation.

#### 8.2 Other incentives

##### a. No earlier date for the possible “suspected period”

Under French law, transactions carried out before (up to 18 months maximum) the opening of an insolvency proceedings (receivership and judicial liquidation) can become null and void retroactively if (i) they are deemed to have defrauded creditors’ rights and (ii) at the time they were entered into, the concerned debtor was deemed to have already reached the stage of insolvency (“suspected period”).

In order to secure creditors participating in the negotiations of the compromise agreement, the suspected period may not be constructed retroactively as starting before the Court’s decision to endorse a compromise agreement if the Conciliation is subsequently converted into a receivership or judicial liquidation, which means in practice that all transactions completed by participating creditors during or as a result of these negotiations will not be exposed to such a possible retroactive cancellation.

Note that this incentive will benefit all creditors even those who are not signatory to the compromise agreement.

##### b. Limited grounds for personal liability of creditors

Providers of new money during the Conciliation (to which the new money privilege attaches if the compromise agreement is subsequently judicially endorsed) will be shielded from possible liability for abusive lending (should the Conciliation be converted subsequently into receivership or judicial liquidation), except in the following limited circumstances:

- (i) fraud;
- (ii) participation in the debtor’s management;
- (iii) unbalanced guarantees secured in consideration of the new cash contributions.

##### c. Time limitation applicable to claims are suspended during the term of the compromise agreement to the extent such claims are within the scope of the agreement;

**(9) Supporting tools**

9.1 Cancellation of indebtedness by certain public creditors

As it is also the case when a safeguard or receivership proceedings are opened, Public creditors (tax and social security authorities), represented within an ad hoc commission, may as part of the conditions to reaching a compromise agreement under the Conciliation, consent to certain cancellation of indebtedness upon receipt of detailed information from the debtor or the Conciliator.

The following cumulative conditions apply:

- simultaneous cancellations made by private creditors;
- proportionality test applied to concessions made by private creditors (maximum quantitative ratio private/public of 1 to 3; cancellation rate must be equal to the weighted average rate of cancellation by private creditors);
- limits of fair market conditions, had the public creditors been private ones;
- cancellation applied by priority against judicial enforcement costs, surcharges, penalties, fines and lastly, on the principal amount.

Several types of tax and social security indebtedness are eligible to this scheme, except that in respect of indirect tax (such as VAT), cancellation is limited to late penalties, other penalties, surcharges and fines (at the exclusion of the principal).

9.2 “Grace period”

In case of individual proceedings initiated by existing creditors against the debtors while the Conciliation is in progress, including those initiated before the opening of the Conciliation, the Court, at the debtor’s request, in summary proceedings may impose upon creditors certain moratorium in their claim pursuant to articles 1244-1 to 1244-3 of the French Civil Code. These articles, which are Civil Code principles of general use, can be of strategic use during the Conciliation : indeed, pursuant to them, the Court, after consultation with the Conciliator, can impose on individual creditors - account being taken of the financial difficulties of the debtor and actual needs of the creditors - mainly new payment instalments or the postponement of the debt maturity, by up to 2 years. Such a decision amounts to an automatic stay against the individual enforcement action during the time period decided by the Court and freezes any late penalty or interest increases. The Court can subordinate the decision to certain acts of management by the debtor in order to facilitate or guarantee the payment of its debt payable.

The debtor can seek the benefit of the grace period from the Court as from receipt of a creditor’s letter of summons.

9.3 Debtors recover the capacity of issuing bank checks.

9.4 Automatic stay for those creditors signatory to the compromise agreement during the entire term of said agreement in respect of the payment of their claims to the extent said claims are within the scope of the compromise agreement (they cannot either ask for new guarantees, conversely the time limitation of their claim is suspended during the term). Judicial actions other than those for the payment of the debt payable remains open to creditors (cancellation of a contract, recovery of tools ownership/consignment stock etc.).

9.5 Limited grounds for personal liability of the debtor’s manager: for example, the filing for Conciliation will freeze the obligation of the debtor to file for receivership or judicial liquidation within 45 days as of the day it has reached the stage of insolvency.

### **(10) During the negotiations period**

10.1 The Conciliation does not trigger any automatic stay. An individual stay can be ordered by Court on a case-by-case basis as indicated under 9.2 above.

10.2 Debtor's stay in possession

### **(11) Validation versus endorsement**

The choice between the simple validation and the judicial endorsement of the compromise agreement will depend on several factors and circumstances.

11.1 Validation

(a) Main effects

- Automatic stay does attach to the compromise agreement for its entire duration for all signatory creditors.

-The compromise agreement will benefit co-obligors and guarantors in the same way as the debtor.

(b) Publicity

11.2 Endorsement ("*homologation*")

(a) Conditions

The following 3 cumulative conditions apply:

- (i) the debtor may not have reached the state of insolvency or, if he has, the compromise agreement will put an end to that stage;
- (ii) the continuity of the debtor's business operations are guaranteed;
- (iii) the interests of non-participating creditors may not be adversely affected as a result of the compromise agreement.

(b) Procedure

Only the debtor's management can request judicial endorsement. No time period is set forth for the Court to process a request for endorsement and issue its endorsement decision which can in practice be quite long due to the need to hear various stakeholders including the debtor's works council (see par. (d) below).

(c) Main effects

- Automatic stay does attach to the compromise agreement for its entire duration for all signatory creditors.

-The compromise agreement will benefit co-obligors and guarantors similarly as the debtor.

- As detailed above, Qualified Creditors benefit from a new money privilege in case of subsequent safeguard, receivership or judicial liquidation;

(d) Publicity

Various third parties will be heard by the Court before issuing its endorsement judgment, which could result in leaks to the public. Those third parties include the Conciliator, the public prosecutor, works council representatives, participating creditors or regular business partners and any other relevant person including the external auditor.

The terms and conditions of the compromise agreement are not published (only the judgment) except in respect of any contractual guarantees granted and the amount of new money privilege. This published information should give enough sensitive information to non-participating parties (i.e., trade creditors, credit insurers) in order to assess the magnitude of the financial support granted to the debtor pursuant to the compromise agreement.

A copy of the compromise endorsement agreement is also communicated to the external auditors if there are any.

The endorsement judgment is communicated to the Conciliator and the public prosecutor.

**(12) Failure or breach**

12.1 Failure to reach a compromise agreement

The Conciliator will issue a report to the Court, which will put an end to the Conciliation. If the debtor has reached the stage of insolvency at that time, the Court will decide on the opening of a receivership.

12.2 Debtor's non-performance

Whether the compromise agreement is simply validated or endorsed by the Court, non-performance by the debtor will trigger in principle the following consequences:

- (i) cancellation of the compromise agreement;
- (ii) cancellation of any maturity postponement agreed upon in the agreement;
- (iii) cancellation of partial debt cancellation (minus the proceeds already received at the time of the cancellation)
- (iv) lift of the automatic stay for signatory creditors.

In itself, the cancellation of the compromise agreement does not lead to the opening of another insolvency proceeding. However, the Conciliation can be converted into a receivership during the term of the compromise agreement if the conditions for the receivership are met in which case the same consequences as those stated in this section 12.2 will apply.

**(13) Statistics and Practical considerations**

a. Available statistics from the French Ministry of Justice dated July 2009 indicate the following (account being taken that only a few Commercial Courts have collected the necessary data on conciliation and *mandat ad hoc* schemes (48 and 63 respectively out of 135): approximately 300 Conciliation procedures took place in 2008 (which could probably be multiplied by 2,5) as compared to 650 *mandat ad hoc* (which could probably be multiplied by 2), 550 safeguard, 14,000 receivership and 29,000 judicial winding-up.

b. By allowing debtors to seek the benefit of the Conciliation procedure instead of filing for receivership - while they are already in a state of insolvency for less than 45 days - French law has softened the traditional importance of that concept that is used to trigger the opening of a receivership or judicial liquidation procedure. However, if the debtor has reached the state of insolvency at the time of

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filing for the Conciliation, it will be necessary for the President to decide whether that state has been reached for more or less than 45 days.

c. Debtors are clearly in the driving seat during the Conciliation procedure (by deciding to file for the opening of that procedure, making a selection among their creditors invited to the negotiations etc.). At the end of the Conciliation procedure, debtors keep in principle that seat at the time of choosing between the judicial endorsement of the compromise agreement or simply its validation by the Court. The choice between a simple validation and a judicial endorsement of the compromise agreement will depend on several factors. The publication of the endorsement judgment might have a negative impact on trade creditors. The judicial endorsement will also create a 10-day period of uncertainty which corresponds to the period opened to third party for right of recourse (“*tierce-opposition*”).

d. The intervention of a third party professional, the Conciliator, in addition to that of other specialised professionals (experts, advisors), side-by-side with the debtor’s manager, is a powerful tool and key asset in an attempt to reach a compromise agreement. Usually, Conciliators are professionals having privileged contacts with stakeholders or intervening parties (Courts, public prosecutor; banks, public administrative bodies etc.). All will depend in practice on the credibility, competence and qualities (diplomatic or negotiation skills) of the Conciliator and on the trust momentum that the Conciliator will succeed in establishing with the debtor’s management.

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