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Reform of French legal provisions governing security interests: Simplification and modernization

The reform of French legal provisions governing security interests, initially scheduled for May 2021, should finally be enacted by September 23, 2021 and enter into force on January 1, 2022. It will be carried out by way of an Ordinance, pursuant to the authorization given by the legislator to the Government under the so-called PACTE Law of May 22, 2019.

In the wake of the reform already carried out in 2006^[1], the 2021 reform shows a clear desire to simplify and modernize French legal provisions governing security interests. This objective is both necessary and ambitious, as its scope impacts major areas of our laws, such as the law governing distressed and bankrupt companies, which is also being overhauled in the context of the transposition of the European Directive of June 19, 2019 (No. 2019/1023) on restructuring and insolvency.

The **objectives of the reform**, as they emerge from the orientations defined under Article 60 of the so-called PACTE Law^[2], are as follows:

- Improving the legibility and intelligibility of French legal provisions governing security interests for the

sake of legal security and attractiveness of French law;

- Reinforcing the effectiveness of such provisions while guaranteeing a balance between the interests of creditors, debtors and guarantors.

A draft Ordinance was circulated in June 2021 following the consultation organized by the Ministry of Justice with legal practitioners, economic circles and academics on a preliminary draft published on 18 December 2020. The Ordinance must be published by September 23, 2021 at the latest.

Traditionally, there are two categories of security interests: **personal securities interests** (*sûretés personnelles*) and **in rem security interests** (*sûretés réelles*). While the purpose of a personal security interest is to add one or more other debtors to the principal debtor, the purpose of an in rem security interest is to specifically allocate one or more assets to guarantee the payment of the debt.

The personal guarantee, a personal securities interest *par excellence*, is at the heart of this reform, but some in rem security interests will also be impacted.

Reform of personal guarantees (*cautionnements*)

As the reform of March 23, 2006 did not concern personal guarantees, it became essential to rework this instrument which plays a key role under French law, in order to make the rules governing it more readable and to improve its efficiency, while protecting the natural person guarantor.

As such, and for simplification and unification purposes, the legal provisions on personal guarantees **are grouped within the French Civil Code**, whereas they are currently also found in the French Consumer Code and the French Monetary and Financial Code. The first demand guarantee (*garantie à première demande*) introduced into the French Civil Code in 2006 is not affected by the 2021 reform and it is to be hoped that the changes now being made to the rules governing personal guarantees will resolve disputes over the distinction between these two types of personal security interests.

The draft Ordinance includes personal guarantees in the definition of a **commercial transaction** (*acte de commerce*) set out in Article L. 110-1 of the French Commercial Code. As such, the guarantee of a commercial debt will thus be deemed to be commercial, between all persons, whereas it is currently civil in nature, except in certain cases defined in particular by case law. This change in the law should help reduce the significant amount of litigation on this subject.

A personal guarantee given by a natural person that is **manifestly disproportionate** to the income and assets of the guarantor may be reduced. This sanction, as opposed to the impossibility to enforce the guarantee as is currently the case under French law, is preferable for the beneficiary creditor.

The draft Ordinance enshrines the obligation for any professional creditor to **warn the natural person guarantor** “*whenever the commitment of the principal debtor is inadequate with the latter’s financial capacities*”^[3].

The French Consumer Code currently requires the **insertion of a standard handwritten note** for personal guarantees issued by natural persons for the benefit of professional creditors, **failing which such guarantees are deemed null and void**.^[4] This very strict formality, which gives rise to a substantial amount of litigation, will be replaced by a new, less restrictive statement, now inserted in the French Civil Code^[5], which will benefit all natural persons and will be imposed on all creditors.

The **obligations to provide information to the guarantor**, which are currently set forth in the French Civil Code, the French Monetary and Financial Code and the French Consumer Code, will be grouped together in the French Civil Code and will henceforth benefit all natural persons who are guarantors towards professional creditors. The system of annual information of guarantors by credit institutions, as currently provided for in Article L. 313-22 of the French Monetary and Financial Code, will therefore be repealed.

The guarantor **will henceforth be able to raise against the creditors** “*all objections, personal or inherent to the debt, which are available to the debtor*” ^[6], as opposed currently to only the objections inherent to the debt^[7] which is not without prejudice to the accessory nature of the personal guarantee. The reform should in this respect avoid a recurrent dispute on the determination of objections which are purely personal to the debtor and objections which are inherent to the debt.

Reform of some in rem securities interests:

The draft Ordinance **abolishes a certain number of general liens as well as special pledges** that are now obsolete and introduces instead a single set of ordinary law provisions. This abolition concerns the pledge over inventories under the French Commercial Code, the pledge over a motor vehicle, the pledge over equipment and tools, so called oil warrants (operators and holders of stocks of crude oil or petroleum products may issue stock warrants as security for their borrowing, while retaining custody thereof at their plants or depots) as well as special types of pledges over hotel equipment and furniture, war supplies and industrial products.

New Article 2323 of the French Civil Code resulting from the draft Ordinance defines in rem security interest as “*the allocation of a property or a set of properties, present or future, to the preferential or exclusive payment of the creditor*”, which covers *gages* (i.e., pledges on tangible movable property only), liens and *nantissements* (i.e., pledges on intangible movable property only).

In addition, with respect to in rem security interests, the guarantor will now benefit from the new protective set of rules and remedies available to natural person guarantors under the reform (in particular, the duty to warn, the obligation to inform the creditor, the so-called *bénéfice de discussion* (i.e., the right of a guarantor to require that the creditor should exhaust all recourses against the principal debtor before turning to the guarantor) and *bénéfice de subrogation* (i.e., once the creditor has turned to the guarantor to recover his due, the latter is subrogated in all the creditor’s rights in this respect.)

With a view to **simplifying and unifying in rem security interests on immoveable properties**, the draft Ordinance abolishes the distinction between real estate liens. Traditionally, a distinction is made between special real estate liens (*privilèges immobiliers spéciaux*) (which confer a preferential right and a priority right

and allow the property to be seized irrespective of whoever has control of it) and so-called general liens (*privilèges dits généraux*) which cover all of the debtor's assets, including real estate property. All of these will henceforth be general liens integrated into the framework of legal mortgages.

The draft ordinance enshrines the **assignment of receivables as a security** (*cession de créance à titre de garantie*) which, unlike the assignment of professional receivables known as "cession Dailly", will guarantee any type of commitment and not only credit transactions. In addition, the **assignment of sums of money as a security** (*cession de sommes d'argent à titre de garantie*), commonly known as pledge over cash (*gage d'espèces*) and widely used in practice, is now part of French law^[8].

While the analysis of the draft Ordinance shows that the simplification objectives seem to have been achieved, the reinforcement of the effectiveness of French legal provisions governing security interests thus revised will have to be tested in the light of the French law governing distressed and bankrupt companies which is also being overhauled within the framework of the transposition of the European Directive on restructuring and insolvency (cf. above).

[1] Ordinance No. 2006-346 of March 23, 2006 on security interests

[2] Law No. 2019-486 of May 22, 2019 on business growth and transformation - https://www.legifrance.gouv.fr/loda/article_lc/LEGIARTI000038497746/

[3] Article 3 of the draft Ordinance - Article 2299, as amended, of the French Civil Code

[4] Article L. 331-1 of the French Consumer Code

[5] Article 3 of the draft Ordinance - Article 2297, as amended, of the French Civil Code

[6] Article 3 of the draft Ordinance - Article 2298, as amended, of the French Civil Code

[7] Article 2313 §2 of the French Civil Code

[8] Article 11 of the draft Ordinance - Article 2374, as amended, of the French Civil Code

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