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The rights of secured creditors under The new insolvency legislation

Only three years following the Law n° 2005-845 dated July 26, 2005 relating to the safeguard of companies, Order 2008-1345 dated December 18, 2008 and its implementing decree dated February 12, 2009 once again reform French bankruptcy laws with regard to companies in difficulty.

This reform became effective on February 15, 2009, and subject to certain reservations, is applicable to bankruptcy proceedings opened as of this date.

The pursued goal of this reform was to complete what was started in 2005 with the law relating to the safeguard of companies, specifically improving and rendering more attractive new procedures aimed at addressing difficulties as early as possible (in particular the composition and safeguard procedures) which, in practice, are clearly rarely used. Now, the conditions to open bankruptcy proceedings are relaxed, the powers of the manager strengthened and the risk of his removal from the company's management limited.

On this occasion, the 2008 reform revisits certain techniques of French law governing security interests.

In fact, until recently, French law governing security interests was made up of a multitude of specific texts and special regimes.

The French government, driven in particular by the concern to develop credit while ensuring a better security for lending creditors, had significantly reformed French law governing security interests by virtue of **Order n°2006-346 dated March 23, 2006** (see our September 2006 e-newsletter). Business and the globalization of relations had, as such, required that security interests be modernized by simplifying their make-up and increasing their scope.

In this context, and in particular to protect the chances of saving the company and facilitate the continuation of its activity, it became necessary to reconcile bankruptcy law with the existence of numerous security

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interests allowing creditors to avoid a race to the finish line.

The principal changes resulting from the reform to remember are:

1. Creditors benefitting from personal sureties

In particular, to prevent the personal assets of the manager who acts as guarantor for the company in difficulty to be affected by the procedure, the lawmaker unified the personal sureties regime with regard to the composition and safeguard plan.

As such, pursuant to Article L. 611-10-2 of the French Commercial Code resulting from the Order dated December 18, 2008, *"co-debtors who are individuals, having granted a personal surety or having assigned or transferred an asset as a guaranty may rely on the provisions of the agreement that has been certified or approved".*

Consequently, creditors holding personal sureties may not go after physical persons during composition or safeguard procedures. Those benefitting from the law are now all holders of personal sureties as well as persons having granted asset-based sureties for third parties.

These provisions are aimed at encouraging the manager to request the court to initiate a preventive or corrective procedure as soon as possible to resolve the difficulties, even though he has agreed to act as guarantor or has assigned one of his assets to secure the bank's interest.

2. Creditors benefitting from a pledge without dispossession:

The March 23, 2006 reform of French law governing security interests had reorganized the rules relating to pledges without dispossession in the following manner: dispossession is no longer a condition of validity of the pledge, which allows a debtor to grant a pledge over a movable all the while allowing him continued use of such movable.

Article 22 of the Order dated December 18, 2008 addresses how the movable fictionally "retained" by the "undispossessed" debtor is treated during the observation period and the safeguard or bankruptcy plan.

As such, pursuant to Article L. 622-7, paragraph 2, of the French Commercial Code, as soon as the bankruptcy proceedings are opened, a creditor's lien over a pledge without dispossession is henceforth automatically rendered unenforceable, unless the pledged asset is included in a transfer of activity. Now, and notwithstanding the bankruptcy proceedings, the debtor will be able to continue using the assets burdened by a pledge without dispossession. On the other hand, the lien is no longer frozen in the case of asset liquidation.

3. Creditors benefitting from a *fiducie* (trust)

Introduced into French law by a law dated February 19, 2007, the *fiducie* is a very secure guarantee mechanism for a creditor as it allows temporary transfer of ownership to the creditor of an asset belonging to

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its debtor or a third party, as long as such debtor has not settled the debt.

Therefore, in the event of the debtor's default, the creditor may permanently appropriate the assets placed in the *fiducie* which, by virtue of this mechanism, have already been removed from the debtor's estate. As the bankruptcy proceedings only affect the debtor's assets, those placed in the *fiducie* are logically excluded.

The goal of several provisions of the Order is to prevent the enforcement of this *fiducie* security to impair chances to preserve the company, a difficult balance between securing a credit and the necessities of preserving viable companies.

To do so, the law distinguishes between a *fiducie* accompanied by an agreement leaving the assets placed therein at the company's disposal and one that is not. If there is such an agreement, it can be assumed that these assets are vital for the company's operation, and conversely, that they are not.

As such, the opening of bankruptcy proceedings affects the *fiducie* only when the assets placed therein are left available to the debtor: the creditor is deprived of his right to enforce the security interest through appropriation or sale of these assets. This is public policy and applies during the observation period as well as throughout the safeguard or bankruptcy proceedings.

Has the goal of the 2008 reform relating to the law governing companies in difficulty been reached in view of the rights of creditors with security interests?

One may be entitled to believe that a certain balance has been found: security interests are neutralized as long as there is hope for the company's safeguard and survival. If there is none, they become completely enforceable and creditors may fully benefit from them. This is one of the major changes brought forth by the Order dated December 18, 2008.

Finally, it is important to note that, as the reform allows creditors with security interests to enforce their rights in the event the company is transferred in the framework of the safeguard procedure, it can be anticipated that possible buyers will be deterred from coming forth and that the company's liquidation will be virtually inescapable if its survival is not conceivable.

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