BANKRUPTCY IN FRANCE

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"Continental bankruptcy systems are so foreign to our own traditions and laws that little, we think, is to be gained from their study."[1]

"The fact that a Frenchman after examining the laws of the civilized world could achieve a generalization so nearly fitting our ideas goes far to demonstrate his auxiliary thesis that bankruptcy has a definite character."[2]

I. *Introduction.*

By a well-known phenomenon, consideration of a foreign system fosters reflection on our own.[3] Without a reasonable knowledge of another system of law, too often, one falls into the easy error of thinking that the problems of one's own country are unique or, if one does accept the fact that other countries may have similar problems, that the solution propounded for any of these problems by the legal system of one's own country is the best, or the natural or even perhaps the only one.

The study of the comparative law of bankruptcy is particularly valuable at the present time. There is a widespread international concern about the operation of bankruptcy systems. There have been major changes in the legislation of several countries. New legislation is in the process of being enacted or is expected in many other countries.[4]

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[1] Thatcher Report, U.S. Sen. Doc. No. 65, 72nd Cong., 1st Sess. (1932), p. 67.

[2] J. A. McLaughlin, reviewing M. Travers, Le Droit Commercial International, Vol. VII, in (1936), 50 Harv. L. Rev. 379, at p. 380.

[3] A. Tunc, in the preface to A Source Book on French Law by Otto Kahn-Freud, Claudine Lévy and Bernard Rudden (1973).

[4] Apart from the major innovations in the bankruptcy laws of France in 1967, there has been, for example, a new Bankruptcy Act enacted in Australia in 1966 and a new law on bankruptcy in Argentina in April of 1972. A new bankruptcy bill was introduced into both Houses of the Congress of the United States in October, 1973. A new Canadian Bankruptcy

Far reaching reforms were introduced into the bankruptcy system of France in 1967. A knowledge of the history of bankruptcy in France leading up to this important new legislation has both a practical and cultural value. In the first place, it could assist one in the interpretation and in the application of the law of one's own country. It could also suggest areas of possible law reform. The 1970 *Report of the Canadian Study Committee on Bankruptcy and Insolvency Legislation*,[5] for example, made particular reference to the technique of the laws of France to reach persons abusing the corporate veil. Moreover, the study of the French legislation, and the treatises and journals that discuss it could help one to grasp the *style* of French law and to understand why it is that French legal thinking and writing form part of a general literary civilization.[6]

II. *The Early History of Bankruptcy in France.*

The modern law of bankruptcy in France can be said to have commenced with the enactment of the *Code de commerce* in 1807. The origins of the law go back, however, at least to the middle of the thirteenth century when the *cessio bonorum* was available to debtors to prevent imprisonment for debt. Actual bankruptcy proceedings originated in the annual fairs of Champagne and Brie. If a debtor was unable to pay his debts while participating in one of these fairs, he could be imprisoned and his goods could be attached and distributed among his creditors. This early system of bankruptcy was adopted in Lyon in 1420 when the fair of Champagne was moved to that city. Soon, the bankruptcy law of Lyon was recognized as the most advanced system in the country. During the fifteenth and sixteenth centuries it incorporated a number of provisions adopted from the Italian law. Ultimately the law of Lyon was very similar to that of the Italian cities.[7]

Bill is expected soon. A Bankruptcy Law Amendment Committee was appointed in England in 1955. Its report was made in 1957 and has not, as yet, been acted upon. Three major bankruptcy studies have just been completed in the United States, namely, those of, the Advisory Committee to the United States Supreme Court on Bankruptcy Rules, the Brookings Institution, Bankruptcy: Problem, Process, Reform and the Commission on the Bankruptcy laws of the United States. Bankruptcy studies have also been made or are still being conducted in Scotland, Eire, Japan, the Scandinavian and Common Market countries.

[5] Ottawa (1970), pp. 108-109, paras 3.2.024-3.2.027.

[6] A. Tunc, *op. cit.*, footnote 3.

[7] J. H. Dalhuisen, Compositions in Bankruptcy (1968), p. 14, citing Guillon, Essai historique sur la legislation française des faillites et banqueroutes avant 1673 (1904), p. 330; J. Percerou, Des faillites, banqueroutes et liquidations judiciaires (1st ed., 1907), pp. 11 to 25. Professor Kurt H. Nadelmann who knew and worked with Percerou compared him to a musician and said that in respect of bankruptcy, Percerou, more than any other person before or since had "perfect pitch". A conversation with the author on October 18th, 1973.

In 1667 the bankruptcy law of France was restated in the *Règlements de la place de change de la ville de Lyon* and later incorporated in the famous *Ordonnance du commerce* of 1673. This was the first commercial code of France. The provisions of the code applied only to merchants. Both debtors and creditors could petition for a bankruptcy order. An investigation had to take place in order to ascertain whether the debtor was insolvent. There were special provisions for fraudulent bankruptcies. The Italian concept of a suspect period was adopted. The property of the debtor was attached and the creditors were appointed the administrators of the estate. The private character of the administration and distribution of the estate of the debtor was contrary to the old practices at Brie and Champagne which provided for a public system of administration by local officials.[8] There was no provision for a discharge but bankruptcy could be terminated by the use of a composition. Creditors at a meeting holding three-quarters of the total debts could bind all unsecured creditors after the composition was authenticated by the court.[9]

III. *The Period from the Code de Commerce of 1807 Until 1870.*

The *Ordonnance du commerce* of 1673 was the basis of Napoleon's *Code de commerce* of 1807 which was the source and inspiration of the commercial codes of many other countries. Book III of the *Code de commerce* which relates to bankruptcy is unique in that it was the only part of the *Code* written under the personal supervision of Napoleon. His interest in the subject arose out of difficulties he had experienced in the field when certain suppliers, on the verge of bankruptcy, had defaulted in their deliveries to his armies. It is also significant that just prior to the drafting of the *Code* there had been several sensational bankruptcies that had gained much public notoriety. Indeed, there had been a history of financial scandals dating back prior to and during the Revolution which coincided with a period of commercial growth and which were aggravated by the deficiencies of the *Ordonnance* of 1673. Written under these circumstances, it is not surprising that the 1807 *Code* was very harsh on debtors.[10]

So great was the stigma of bankruptcy that the merchant who

[8] Dalhuisen, *op. cit., ibid.*, p. 15; Guillon, *op. cit., ibid.*, p. 102 *et seq.*; Percerou, *op. cit., ibid.*, p. 19.

[9] Stefan A. Riesenfeld, The Evolution of Modern Bankruptcy Law (1947), 31 Minn. L. Rev. 401, at pp. 440 and 441 citing Ordonnance du commerce, 1673, title II, arts. 5-8.

[10] R. Houin, La faillite en droit français, Faculté Internationale de Droit Comparé, Luxembourg, Summer Session, August 2nd and 3rd, 1960, p. 5. Mme Catharine Labrusse, L'évolution du droit francais de la faillite being the introduction to Faillites, René Rodière, ed. (1970), p. 10; Percerou, *op. cit.*, footnote 4, pp. 25 to 30.

became bankrupt was regarded much as the captain who abandoned his ship.[11] A bankrupt was considered a criminal. Bankruptcy proceedings were commenced by casting the debtor into gaol or putting him into the custody of a policeman.[12] A debtor was deprived of most of the privileges of a citizen and cut off from society.[13] All transactions by the debtor from the time he stopped payment on his debts were retroactively annulled. The property of his wife was added to his estate for distribution among his creditors.[14] In addition to being harsh on the debtor, the system was also harsh on creditors. They found that the liquidation process took an inordinately long time to complete and the costs of administration were very great.[15]

The *Code* appears to have overlooked the fact that bankruptcy often results from simple imprudences, completely accidental reverses and wholly fortuitous events. It was more concerned with criminals than with those who acted rashly or were unfortunate.[16]

From 1807 until the reform of 1967, the Commerce Code applied only to debtors who were in business. The insolvency of debtors who were not in business was governed by the Civil Code[17] which did not contain a system of collective execution. Each creditor was free to exercise a variety of rights of seizure of the property of the debtor in order to satisfy his claim. The race was to the swift.

As a result of the harshness of the 1807 Code, it became common for debtors to either flee the country to avoid imprisonment

[11] It was Napoleon who said: "Dans toute faillite il y a un corps de délit, puisque le failli fait tort à ses créanciers. Il est possible qu'il n'y ait pas de mauvaise intention, quoique ce cas soit rare; mais le failli se justifiera. Un capitaine qui perd son vaisseau, fût-ce par naufrage, se rend d'abord en prison; si l'on reconnait que la perte du navire est l'effet d'un accident, on met le capitaine en liberté." Locré, Législation civile commerciale et criminelle de la France (1829-1832), Vol. XIX, p. 477.

[12] This was done in order that the debtor would be persuaded to assist effectively in the administration of his estate and to humiliate him. The question Napoleon said to the Conseil d'Etat, is to avoid that bankrupts, "n'affectassent un air de triomphe ou au moins d'indifférence" and to put the debtor "dans un état d'humiliation conforme à la situation de sa fortune. La prison, ne dut-elle durer qu'une heure, opèrerait cet effet". Locré, *op. cit., ibid.*, p. 478.

[13] Xavier Scalbert, Communication du 28 janvier 1970, à l'Académie de comptabilité (1970), 13 Revue des syndics et administrateurs judiciaires de France 261, at p. 262.

[14] Napoleon had proposed in case of bankruptcy the indivisibility of husband and wife. The *Code de commerce* was particularly harsh on the wife of a bankrupt who was forced to share the fate of her husband. Even after the harsher features of the *Code* were somewhat ameliorated in 1838 there still remained a suspicion of fraud on the wife of a bankrupt, Labrusse, *op. cit.*, footnote 10, p. 46.

[15] Houin, *op. cit.*, footnote 10, p. 5.

[16] Lyon-Caen et Renault, Traité de droit commercial (2nd ed., 1921), Vol. VII, p. 12.

[17] See, for example, arts 1276, 1446, 1613, 1865(5), 2003 and 2032.

or even to commit suicide the moment they ceased to make their payments.[18] Debtors would not voluntarily go into bankruptcy and as they struggled to the end to avoid it and prison which accompanied it, they consumed in the process all their assets.[19] Creditors, as a result, were hurt even more as little or nothing was available for them. This encouraged extra judicial arrangements whereby the debtor was permitted to avoid prison and the dishonour of bankruptcy and the creditors could circumvent the excessive costs and long judicial delays.[20] This, in turn, lead to the first major reform of the bankruptcy provisions of the *Code de commerce* in 1838,[21] by the shopkeeper government of Louis-Philippe, the "Citizen King". The new legislation substantially liberalized the harsher features of the law and provided for more effective administrative procedures.

The 1838 Act remained in force for more than a century with only a few minor amendments.

Bankruptcy resulted from an order made by the *Tribunal de commerce.* This had the effect of depriving the bankrupt of the right to administer his own property which passed to the creditors represented by a trustee. At the same time, creditors lost the right to individually institute or continue proceedings against the bankrupt. The bankruptcy order also fixed the date that the bankrupt was deemed to have ceased to make his payments which establishes the suspect period during which certain preferential transactions could be attacked.

The trustee was required to make an inventory of the property of the bankrupt. He could liquidate the assets or in certain cases was permitted to carry on the business of the bankrupt. When the claims of creditors were proved, the creditors at a meeting were required to decide by a majority how the estate of the bankrupt would be wound up. There were two principle alternatives. The bankrupt might be permitted to make a *concordat* or composition or there would be *l'état d'union* which resulted in the liquidation of all the property of the bankrupt and the distribution of it among the creditors. The Act also provided for stiff penalties against fraudulent bankrupts.[22]

IV. *The Period Between 1870 and 1967.*

Throughout the second half of the nineteenth century, there were

[18] See, Grandeur et décadence de César Birotteau by Honoré de Balzac which was written in 1837 for a description of the commercial customs of the time.

[19] Percerou, *op. cit.*, footnote 7, p. 30.

[20] Houin, *op. cit.*, footnote 10, p. 5; Labrusse, *op. cit.*, footnote 10, p. 11.

[21] Law of May 28th, 1838.

[22] Gilbert Bord, Règlement judiciaire et liquidation des biens (1969), p. 2.

two features of the law that caused much continuing concern. The first was the limited civil procedures available for collective execution. The second was the lack of alternative procedures based upon both subjective and objective grounds arising out of the cessation of payments by a debtor.[23] This was brought to a head by the war of 1870 with Germany. The economic difficulties which followed it caused great hardship within the commercial community to many debtors who, through circumstances beyond their control had to default in the payment of their debts. To assist this class of debtors, a system of judicial liquidation was introduced. It was known as *la liquidation judiciaire*[24] a less severe form of bankruptcy which, along with straight bankruptcy, provided two parallel systems; the one being very strict, almost punitive and the other being considerably less severe. This parallel system in which a distinction is made between the dishonest or incompetent debtor who deserved no indulgence and the honest but unfortunate debtor who is the victim of circumstances still prevails.

The *liquidation judiciaire* could not be requested by a creditor. It could only be applied for by a debtor who was *malheureux et de bonne foi.* It was in the discretion of the court to decide which method of liquidation would apply in a particular case. As a rule, *liquidation judiciaire* was regarded as a favour that the court could bestow upon a worthy debtor.

Each method of liquidation involved different methods of seizure and administration of the debtor's property and in theory each should have given substantially the same results. In practice, *liquidation judiciaire* proved to be quicker and usually gave somewhat larger dividends. The principle attraction to the debtor of *liquidation judiciaire* was that he escaped from the stigma of bankruptcy and he suffered fewer legal and political restraints. Moreover, the debtor was left in the possession of his estate which he was then required to liquidate for the benefit of his creditors assisted by a *liquidateur judiciaire.*

The concept of different methods of liquidation and different sanctions based upon the causes of the bankruptcy and the conduct of the debtor was valid but it did not function well by reason of the technical and procedural defects that operated to the detriment of the creditors.

All modern legislation in France since the end of the First World War has largely been an attempt to improve procedures. This has resulted in increased judicial powers with a corresponding decrease in creditor control.[25]

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[23] Labrusse, *op. cit.*, footnote 10, p. 12.
[24] Law of March 4th, 1889.
[25] Labrusse, *op. cit.*, footnote 10, p. 12 and see *infra*, footnote 63.

Until very recent times, there was no provision under the law of France that permitted or provided either a moratorium or the making of an arrangement by a debtor in order to prevent bankruptcy. As a result of the economic depression after the First World War, legislation was enacted to assist the honest but unfortunate debtor to escape bankruptcy or the *liquidation judiciaire.* This was done by the introduction of procedures known as the *règlement transactionnel* and the *règlement amiable homologué* which were types of arrangements made by a debtor under the supervision of the court in order to prevent bankruptcy. This new legislation was regarded as emergency legislation. It was not considered successful. The laws were either permitted to expire or were repealed.[26]

In 1935, the law was again amended in order to both simplify and speed up the administration. The role of the creditors was even more reduced as the role of the courts was increased.[27] To a limited extent also, the corporate veil was lifted so as to impose sanctions upon the directors of bankrupt commercial corporations who had committed bankruptcy offences.[28]

After the Second World War, there was a growing concern over the increasing number of merchants who failed to observe normal standards of commercial morality. As a consequence, the legislation was again amended in 1947 in an attempt to improve these standards by ensuring that bankrupts were effectively barred from participating in the commercial life of the community. The penalties and restrictions against bankrupts multiplied in order to better fulfil their traditional function both to punish the bad debtor and to prevent him from returning to the commercial community.[29]

Further substantial revisions to the law of bankruptcy were affected by the decree of May 20th, 1955 that ratified far reaching reforms recommended by a commission appointed to reform the *Code de commerce.* These reforms extended the sanctions against debtors who had committed bankruptcy offences and were adjudged bankrupt. To make it even more difficult for them to

[26] The *règlement transactionnel* was authorized by the law of July 2nd, 1919 and amended by the law of April 28th, 1922. It expired on January 10th, 1940. The *règlement amiable homologue* was authorized by the law of August 25th, 1937. It was repealed on January 1st, 1940. See generally, Houin *op. cit.,* footnote 10, p. 3; Dalhuisen, *op. cit.,* footnote 7, p. 54, citing Encyclopédie Dalloz, 2 Droit commercial, faillite et règlement judiciaire, Vol. 10 (1957).

[27] Decree-Law of August 8th, 1935 and see Houin, *op. cit.,* footnote 10, p. 5; Labrusse, *op. cit.,* footnote 10, p. 12.

[28] Decree-Law of August 8th, 1935 and law of November 16th, 1940. See Labrusse, *op. cit., ibid.,* pp. 12, 13 and Renée Alliot, La faillite personnelle et autres sanctions civiles, ch. XII in Faillites, *op. cit.,* footnote 10, p. 393; Bord, *op. cit.,* footnote 22, p. 3.

[29] Law of August 30th, 1947 and see Houin, *op. cit.,* footnote 10, p. 6 and Alliot, *op. cit., ibid.,* pp. 392, 393.

re-enter business, they were prohibited from making an arrangement with their creditors and thereby terminating their bankruptcies. As a result, and by confining bankruptcy only to those debtors who had either committed bankruptcy offences or were grossly incompetent, once bankruptcy was adjudicated, only the liquidation of the debtor's business and distribution of the estate could follow. There was no rehabilitation for the bad debtor in the sense of restoring him to the commercial community unless all of his debts were paid in full. A bankrupt was prohibited from returning to business either in his personal capacity or as a manager or director of a business corporation. In addition, he was barred from entering many occupations and professions and suffered other legal and political incapacities.[30] In essence, bankruptcy was reserved to punish the bad debtor, to keep undesirable elements out of the commercial community and to promote commercial morality. To this end, the interests of creditors could be sacrificed.[31]

The 1955 reforms were implemented in part by replacing the *liquidation judiciaire* with the *règlement judiciaire*. The *liquidation judiciaire* had been exceptional proceedings reserved to only those debtors considered to be worthy. It could not be used by a debtor to terminate bankruptcy. Once a bankruptcy order was made, the estate of the bankrupt had to be liquidated and distributed among the creditors. The *règlement judiciaire,* on the other hand, did not have the same restrictive features, legal and political incapacities or stigma and was not regarded in the nature of an exceptional proceeding. It permitted a court sanctioned arrangement by way of a composition between a debtor and his creditors, designed to save the debtor from financial disaster. For this reason, such arrangements were known as preventive arrangements. Proceedings could be commenced by either the debtor or his creditors. The *règlement judiciaire,* in effect, has become the normal procedure in respect of the honest businessman in financial difficulty who has ceased to make his payments if the court is of the opinion that the business is capable of being rehabilitated. In every proceeding, the court has the choice to order either *règlement judiciaire* or *faillite,* that is, bankruptcy. As a rule, the debtor who has not committed any bankruptcy offence is placed into *règlement judiciaire.* If he has committed an offence, he is adjudicated a bankrupt.

It was soon apparent that the reforms of 1955, like many previous reforms, were not a complete success. There was general

[30] Houin, *op. cit., ibid.,* p. 6; Houin, La réforme de la faillite et de la liquidation judiciaire (1955), 8 Revue trimestrielle de droit commercial 481.

[31] Labrusse, *op. cit.,* footnote 10, p. 13.

criticism of the time it took to complete the administration of an estate. The dividends to unsecured creditors were almost non-existent, the entire estate, in most instances, being distributed to the secured and preferred creditors. The trustee, in most cases, amounted to no more than a tax collector. More than half of the arrangements made under a *règlement judiciaire* were never completed. For the most part, they were terminated by a closure of proceedings by reason of an insufficiency of assets or through converting the proceedings into a bankruptcy. By reason of the severe sanctions imposed upon a bankrupt, the courts would often approve of arrangements that were not realistic in order to save the debtor from bankruptcy. There was a feeling also, that the law took a too legalistic concept of bankruptcy and all but overlooked its economic dimensions. More and more, there was a growing opinion in the country that all every day decisions and activities, including bankruptcies, had a national economic dimension that should be considered. However, the available procedures in both bankruptcy, that is, *faillite* and the *règlement judiciaire* were not well designed to assist the enterprise that merited to be saved to survive. Finally, with the great proliferation of non-commercial corporations that often had a substantial capital, assets and liabilities that were outside of the existing bankruptcy legislation, it was felt that they should equally be subject to the bankruptcy laws as any other corporation.[32] This was all over-shadowed by an anxious concern to make the French law of bankruptcy more comparable with the bankruptcy laws of the other member countries of the European Economic Community.[33]

V. *The 1967 Reforms.*

In 1964 a new bankruptcy study committee, *une "Mission"*

[32] Scalbert, *op. cit.*, footnote 13, at p. 263; Houin, *op. cit.*, footnote 10, p. 7; Houin, Innovations récentes de la loi française en matière de faillite et de procédure préventive in Idées nouvelles dans le droit de la faillite, Université Catholique de Louvain (1968), p. 1; Labrusse, *op. cit.*, footnote 10, p. 14; Philippe Charousset, Etude sur les procédures nouvelles à adjoindre à la procédure de règlement judiciaire, XIIIème Congrès National, Lyon, Association nationale des syndics et administrateurs judiciaires de France.

[33] The Minister of Justice in his circular of March 18th, 1968 to the *procureurs généraux* said that the purpose of the new legislation was "inspirée par diverses constatations tirées de l'expérience par des considérations d'ordre économique et, sur certains points, par le souci de parvenir à un rapprochement de la loi française avec les législations applicable en la matière dans les Etats membres de la Communauté Economique européenne, la réforme du droit de la faillite vise à l'efficacité par plus de clarté, de rigeur et de célérité" quoted by Leon Mazeaud in Les traits principaux de la réforme de la faillite, published in Le droit de la faillite the record of the Seminar of the Bar of Lyon held on September 27th and 28th, 1968 in Goutelas-en-Forez.

speciale, significantly inspired by the Ministry of Finance and originally prompted by the problems arising out of the priority of the claims of the Treasury and social security[34] was established under the joint direction of the Ministries of Finance and Justice. An early study paper on the economic aspects of bankruptcy, that is, *faillite* and *règlement judiciaire* prepared by the Ministry of Finance established the economic emphasis that the final report took and the resulting legislation.[35] The vast reforms of 1967 which came into effect on January 1st, 1968 gave a completely new orientation to the law of bankruptcy in France.

The new law made a fundamental distinction between the "man and the enterprise", the powers of the court were extended, arrangements were more easily affected, administration of estates was accelerated and the bankruptcy procedures were extended to include a larger class of debtors.[36]

Under the 1955 reforms, the court had to choose between *règlement judiciaire* or *faillite.* The debtor who had not committed any bankruptcy offence was placed in *règlement judiciaire* while the debtor who had committed offences was put into *faillite.* Accordingly, a debtor whose business was not a viable one, but who had not committed any of the actions which required him to be put into *faillite* would necessarily be placed in *règlement judiciaire.* On the other hand, a debtor whose business had a good potential would be compulsorily placed in *faillite* if the managers of the business had violated any of the rules of commercial morality. Thus an economically viable enterprise suffered the same consequences and the ultimate lot of its managers. Gradually a concept of a superior economic law began to develop which had its aim to free the enterprise from the man. Increasingly, in practice, the courts would give a liberal interpretation to the facts so that a business would not be liquidated if it appeared that it could be salvaged particularly if it had any substantial number of employees. The courts became less concerned with the conduct of the debtor and more concerned with economic considerations. To a large extent the reforms of 1967 gave legislative approval

[34] Houin, *op. cit.,* footnote 32.

[35] Jacques Delmar, Aspects économiques de la faillite et du réglement judiciaire (Etudes des mécanismes) (1965). In one of the introductory paragraphs to this report, it was said "la faillite est en 1965 une des parties les plus complexes du droit et l'une des pièces les plus mal connues de l'organisation économique. Cette constatation est peut-être la plus importante de celles qui ont été faites par les enquêteurs". Para. 7. The final report of the Committee was made one year later. The Minister of Justice at the weekly meeting of the Cabinet on December 7th, 1966 announced that the report had been approved and that legislation implementing it would be enacted at once. Le Monde, December 8th, 1966, at p. 24.

[36] Scalbert, *op. cit.,* footnote 13, p. 266; Houin, *op. cit.,* footnote 32, p. 2, footnote 18.

to the more liberal attitude of the courts.[37]

The new laws of 1967 tried to reconcile the traditional notions of punishing the man with the modern concept of preserving an economic enterprise. Thus, there was an attempt to separate the application of the more harsher aspects of bankruptcy that could be directed against the debtor from his estate. It endeavoured to distinguish the man from the enterprise in order to salvage viable businesses while at the same time casting out of the commercial community those debtors who did not observe the normal rules of commercial morality. In effect, there was a real attempt to distinguish the effects of ceasing to make one's payments upon the person of the debtor and his estate.[38]

On the one hand, it was recognized that there are honest but unfortunate debtors who find themselves operating a business that could never be profitable. On the other hand, there are those debtors who control or manage enterprises which are temporarily embarrassed but in the long run have a promising future and are capable of being rehabilitated. In neither of these cases, it was felt, should the owners or managers suffer any personal sanctions or penalties but in the one case, the business should be liquidated and in the other, a serious attempt should be made to salvage it as it has an economic value to the community and country at large. Similarly, the same enterprises could be controlled or managed by incompetent or unscrupulous persons. In these cases, it is recognized that such persons should be removed from the commercial community so that they may not be in a position to renew the methods which they choose to adopt to its detriment. Finally, it was accepted, in the case of the person who had committed certain bankruptcy offences, that he is a criminal and should be treated as such.[39]

[37] Scalbert, *op. cit., ibid.,* p. 268; Alliot, *op. cit.,* footnote 28, p. 394.

[38] Jean-Yves Chevallier, Les conditions d'ouverture des nouvelles procédures collectives being Ch. 1 of faillites, *op. cit.,* footnote 10, p. 58; Alliot, *op. cit.,* footnote 28, pp. 394, 395.

[39] Compare this view as to the ends that should be attained through the use of the bankruptcy process with the view of the English Blagden Committee (Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment, 1957, Cmd. 221), para. 55, at p. 20 in respect to the function of the discharge:

> "In our view, the law relating to discharge should achieve three primary objects: (1) to penalize and deter the dishonest bankrupt and keep him under such supervision as to prevent him, for such period as may be considered necessary, from being in a position to renew the methods which he chose to adopt to the detriment of the trading community; (2) to assist the honest and possibly unfortunate bankrupt by relieving him of the incubus of debts incurred, sometimes as the result of accident or ill health, thus, enabling him to have a second chance in life to make good and provide in his own right for his dependents; and (3) so to distinguish the better type of bankrupt from the bad type as to enable the trading community to avoid giving credit to those who have already shown themselves to be unworthy thereof."

The new legislation is significant in the area of comparative law in that for the first time a Latin country has accepted the principle of separating sanctions against a debtor from the administration of his estate.[40]

The new bankruptcy law of 1967 has five branches four of which are referred to in the title of the principal statute which is *Règlement judiciaire, Liquidation des biens, Faillite personnelle* et *Banqueroutes.*[41] This would be translated as judicial settlements, liquidation of assets, personal bankruptcy and criminal bankruptcy The fifth branch of the new law contained in a related *ordonnance* is the *Procedure de suspension provisoire* which is in the nature of a judicial moratorium.[42]

VI. *The Privilege of The Treasury as a Secured Creditor Restricted.*

Apart from the principal legislation of 1967 the reforms included ancillary legislation which substantially reduced the traditional privilege of the Treasury as a preferred creditor. Under the former practice the Treasury, in a bankruptcy had the right to seize ahead of the trustee the assets of a debtor to satisfy its claims. This, not unnaturally, was increasingly resented by the other creditors who had granted credit to the debtor having no idea and with no way to find out whether there were any outstanding tax claims of the Treasury and who could not protect themselves from subsequent claims of the Treasury. The privileged position of the Treasury was also a substantial obstacle in the way of a debtor making an arrangement with his creditors as the claims of the Treasury and related claims for social security were required to be paid in full before an arrangement could be approved. The claims of the Treasury, in many cases, took all of the assets

[40] Mathieu Ferrari, La promptitude de l'intervention judiciaire dans la défaillance financière (1972), 15 Revue des syndics et administrateurs judiciaires de France 211, at p. 221.

[41] Law No. 67-563 of July 13th, 1967 Sur le règlement judiciaire, la liquidation des biens, la faillite personnelle et les banqueroutes enacted by the National Assembly and the Senate on July 1st, 1967 and published in the Journal Officiel on July 14th, 1967. The complete reforms of 1967 consist of the Law No. 67-563, Decree 67-1120 of December 22nd, 1967 Sur le règlement judiciaire, la liquidation des biens et la faillite personnelle, Law No. 66-1007 of December 28th, 1966 Relative à la publicité du privilège du Trésor en matière fiscale; Decree No. 67-1124 of December 22nd, 1967 Portant application de la loi No. 66-1007 de décembre 1966 relative à la publicité du privilège du Trésor en matière fiscale; Ordonnance No. 67-820 of December 23rd, 1967 Tendant à faciliter le redressement économique et financier de certaines entreprises and Decree No. 67-1255 of December 31st, 1967 Tendant à faciliter le redressement économique et financier de certaines entreprises.

[42] Title II of the Ordonnance No. 67-820 of September 23rd, 1967.

leaving nothing for the other creditors who resented being put in a position of being no more than tax collectors.

The law of December 28th, 1966[43] which required the publication of the preferred claims of the Treasury was the first step towards remedying some of what was considered to be injustices in the eyes of creditors. The provisions of this law, the decree of December 22nd, 1967[44] and the order of May 27th, 1968 now require the Treasury to register all of its claims against taxpayers when they exceed 20,000 francs in respect of direct taxes and when they exceed 30,000 francs for other taxes, duties and fiscal penalties. If the Treasury fails to register its claims, it loses its preferred position to have them paid in priority to other claims in any subsequent bankruptcy of the taxpayer.[45]

VII. *The Privilege of Wage-earners.*

When a business ceases to make its payments to its creditors, the claims of wage-earners for wages are protected through a system privileges or preferences.[45a] In both a *règlement judiciare* and a *liquidation des biens* a *superprivilège* is given to wage-earners. This permits the *syndic* to pay claims for wages that accrued due during the sixty working days prior to the pronouncement of the *règlement judiciare* or the *liquidation des biens* from available funds in the estate before the payment of all other claims including those of the Treasury. Payment of the *superprivilège* must be made by the *syndic* with the authorization of the *juge-commissaire*, in the ten days following the pronouncing of the *règlement judiciare* or the *liquidation des biens* if the *syndic* has on hand sufficient funds. Certain other creditors, such as masons, bricklayers, carpenters and other building trades and those who have been employed on public works have a privilege of being paid ahead of other preferred creditors including both the claims of the Treasury and claims for social security. Some wage-earners are given liens on the property of the debtor. These include the liens given to harvest workers and those who repair agricultural implements on the crops of the debtor and the lien of sailors upon the cargo of a ship.

[43] Law No. 66-1007 of December 28th, 1966.

[44] Decree No. 1124 of December 22nd, 1967.

[45] Mazeaud, *op. cit.*, footnote 33, p. 8; Houin, *op. cit.*, footnote 32, p. 1; Géraud De la Pradelle, l'Union, Ch. X, of Faillites, *op. cit.*, footnote 10, pp. 352-353.

[45a] Code du travail law 73-4 of January 2nd, 1973 as modified by law No. 73-626 of July 10th, 1973, Book I, Title IV, Chapter III, arts L143-6 to L143-12, Book III, Title V, Chapter I, arts L351-10 to L351-11, arts L742-6 and L751-15; Law No. 67-563 of July 13th, 1967, arts 42-45, 50 and 51; Civil Code, arts 2101, 2104; Code de la sécurité sociale, art. 138; Code general des impôts, arts 1920, 1926, 1927, 1929; Convention du 31st décembre 1958.

There are also certain general privileges or priorities which include the right to be paid for arrears of wages up to a maximum of six months and holiday pay before the claims of general creditors are paid.

The privileges given to wage-earners are often illusory for very often in the case of either a *règlement judiciare* or a *liquidation des biens* the assets are insufficient to pay the full priority given to wage-earners. In 1972, for example, there were claims for wages in all estates in excess of 86,6 million francs of which only thirty-nine percent was paid leaving a deficiency of 52,7 million francs. The recent failure of the Lip company that manufactured watches resulted in payroll claims of more than two thousand employees. When these could not be paid the employees occupied the factory of the company in Besançon and produced and sold watches from material on hand in order to satisfy their claims.

In order to give greater protection to wage-earners the Government is presently seeking the approval of the National Assembly of a bill that would guarantee the payment of back wages to employees on the bankruptcy of their employers. Under the plan proposed by the bill, the claims for back wages would be paid by a new national insurance system financed by employers. The monthly contribution of the employers would equal 0.01 per cent of their payroll and would be paid to the *Union nationale interprofessionnelle pour l'emploi dans l'industrie et le commerce* and the *Associations pour l'industrie et le commerce.* These are private organizations established and financed by French industry and commerce. The voluntary contributions by employers has given these organizations a strong financial position that has enabled them in the past to pay benefits to unemployed persons in addition to the normal state unemployment insurance.[45b]

VIII. *Procédure de Suspension Provisiore des Poursuites.*

The *procédure de suspension provisoire des poursuites*[46] is one of

[45b] See Rapport fait au nom de la commission des affaires culturelles, familiales et sociales sur le projet de loi (No. 719) tendant à assurer, en cas de règlement judiciare, ou de liquidation des biens le paiement des créances resultant du contrat de travail which is attached to the minutes of the proceedings of the National Assembly for November 14th, 1973 being document No. 763; See also CCH Common Market, Rep. Euro. No. 226, November 21st, 1973.

[46] Ordonnance No. 67-820 of September 23rd, 1967 and Decree No. 67-1255 of December 31st, 1967. See the Report to the President of the Republic, D. 1967. IV. 358 and article 1 of the Ordonnance. The authority to pass this *ordonnance* is given by the law of June 22nd, 1967 that authorizes the government by virtue of article 38 of the constitution to make social and economic decisions by the use of an *ordonnance.* The use of an *ordonnance*, instead of a statute in this particular instance indicates that

the innovative features of the 1967 reforms. It could be compared with an arrangement designed to prevent bankruptcy. The procedure was originally proposed by the Minister of Finance. It is recognized that his concern was largely prompted by the financial difficulties in the 1960's of some naval shipyards along the Seine which employed thousands of workmen and the iron works of Hennebont near Lorient which similarly employed many workmen and had also recently experienced hard times.

The *suspension provisoire des poursuites* is a form of limited judicial moratorium or stay of proceedings that can be imposed in respect of an enterprise that is in difficult but not hopeless financial situation. It is designed to prevent the insolvency of a viable and important enterprise which could lead to its liquidation and thereby result in substantial economic hardship to the country or some part of it. In order to qualify for this procedure, the enterprise cannot have reached the stage of cessation of payments and it must be an enterprise that if it were to go out of business this would likely cause serious disturbance to the national or a regional economy. Moreover, the condition of the enterprise must not be such that the *suspension provisoire des poursuites* is incompatible with the interests of the creditors.

The *suspension provisoire des poursuites* must, however, be regarded as an exceptional procedure and will remain so. It will be the rare occasion that an important enterprise will solicit the benefit of the procedure before it has ceased to make its payments.[47] It is, however, an example of how the new legislation is concerned not so much with the debtor but his enterprise and a concern to do everything reasonable to rehabilitate an enterprise that can be expected to operate at a profit in the economic interest of the state.

The *suspension provisoire des poursuites* applies to both individuals in business and commercial corporations.[48] Proceedings

this represents a political decision to achieve certain economic ends. An *ordonnance*, is as a rule, regarded as a temporary measure. If circumstances change or the results achieved are disappointing, it may be easily repealed: Jean-Yves Chevallier, Les conditions d'ouverture des nouvelles procédures collectives, being Chapter I of Faillites, *op. cit., ibid.*, p. 71; Jean Hémard, La suspension provisoire des poursuites et l'apurement collectif du passif, published in Le droit de la faillite, *op. cit., ibid.* The *procédure de suspension des poursuites* may be compared with the *sursis extraordinaire* in the Bankruptcy Act of Switzerland, Loi fédérale sur la poursuite pour dettes et la faillite of April 11th, 1889 as amended by the loi fédérale of April 3rd, 1924. This permits the government of a canton with the assent of the federal council in extraordinary circumstances and in particular in a prolonged economic crisis to impose a moratorium for six months or less in respect to the defined region affected by the extraordinary circumstances, Title 12, arts 317a to 3170.

[47] Houin, *op. cit.*, footnote 10, p. 10.

[48] Art. 1.

may be instituted by the debtor, the creditors or by the court on its own motion.[49] When an application is made, the president of the court designates a judge to make a report on the financial and economic situation of the enterprise within fifteen days. The president of the court within eight days thereafter is required to hear the debtor in his chambers and then refer the case to a plenary session of the court for a further hearing.[50]

If the court is of the opinion that the enterprise is one that if it were to fail, it would cause serious hardship to the national or a regional economy and the debtor has not reached the stage of cessation of payments, it may, if it considers the institution of the proceedings justified, order a provisional stay of proceedings against the debtor. A trustee may be appointed and the court may order all necessary urgent measures.[51]

There are only two criteria provided in the ordonnance for the guidance of the court. These are the importance and value of the enterprise to the national or regional economy. The enterprise must be large enough to have some significant impact upon the economy or a region. It must also supply necessary goods or services to the community or the country at large.[52]

Once the court is of the opinion that an enterprise qualifies for a *suspension provisoire des poursuites* an order will be granted for a term of three months which, in urgent cases, can be extended for an additional month. During this judicial moratorium, the debtor has the opportunity to re-organize his business, get in new capital and come to an arrangement with his creditors. The president of the court or one of the judges acts as a curator for the business. A variety of experts and specialists as needed also may

[49] Arts 3, 4, 5, 6, 7 and 8.
[50] Arts 5 and 6.
[51] Art. 10.
[52] In an early case decided under the *ordonnance*, the application of a manufacturer of parts made from rare and precious metals for the electronic industry was granted by the court, *Tribunal de commerce*, Lyon, February 7th, 1968. In another case, the application of a manufacturer of book binding materials was granted. In this case the *Préfecture* was anxious that the business should not close by reason of the social repercussions that would result from laying off 250 employees. Evidence was also accepted from witnesses representing banks that were anxious to keep an important customer, the mayor and other government officials equally concerned in keeping the business going; *Tribunal de commerce*, Rennes, April 19th, 1968. In a third case, the enterprise was one of the twenty largest metal works of France that employed 200 employees and used many sub-contractors. The court found that if it was to go out of business, it would cause substantial hardship to the economy in the area of Limousin where work was scarce. The settlement approved by the court was the payment of fifty per cent of all unsecured creditors over a period of three years guaranteed personally by the president and general manager of the company and his wife, *Tribunal de commerce*, Limoges, June 6th, 1969 and see (1971), 14 Revue des syndics et administrateurs judiciaires de France 348.

be appointed. The curator may simply supervise the administration of the enterprise by the debtor giving such advice as may be appropriate or he may take over the administration of the enterprise completely. During the moratorium, there is a stay of proceedings on both unsecured and secured creditors and no assets may be disposed of by the debtor other than in the normal course of business without the consent of the curator.[53]

During the moratorium period, the debtor with or without the assistance of the curator will make a plan for the re-organization of the business. A plan must not extend beyond a term of three years. The plan is required to be deposited with the court during the last month of the moratorium. If the plan appears to be serious and offers sufficient guarantees it will be approved by the court and a commissioner will be appointed to supervise its operation.[54] The plan, once accepted is binding upon all creditors secured or unsecured as of the date of the order.

While it is the expressed policy of the *ordonnance* to avoid cessation of payments, nevertheless, as soon as there is a cessation of payments, the proceedings must be converted into the *règlement judiciaire* or *liquidation des biens*.[55] In addition, creditors holding at least fifteen per cent of the total claims may petition for the plan to be terminated where the debtor does not comply with the terms of the plan or the judgment of the court. Similarly the court, on its own motion, may terminate a plan.[56]

Most plans consist of either extension agreements or compositions rather than a complete corporate re-organization. The plans are different than usual arrangement proceedings in that the plan is substantially the unilateral act of the debtor. The creditors are scarcely involved. Indeed, their claims can be sustantially reduced without any real opportunity being given to them to oppose the plan. This may be contrasted with the *règlement judiciaire* which is very closely controlled and where the creditors are very closely involved.

The *suspension provisoire des poursuites* illustrates the recognition of the pre-eminence of the public interest over private claims in the bankruptcy process. It also represents a substantial step towards the socialization of the ordinary commercial law.

IX. *Règlement Judiciaire and Liquidation des Biens.*

The *règlement judiciaire* and *liquidation des biens* are both triggered by a debtor ceasing to make his payments whether the debtor is in business or not.

[53] Arts 14, 17 and 18.
[54] See footnote 48 for an example of plans approved by the court.
[55] Arts 10, 21 and 31.
[56] Art. 38.

The cessation of payments under French law is not to be confused with insolvency in the sense that a debtor's liabilities are greater than his assets. There is a cessation of payments as soon as a debtor stops his payments. In practice, a cessation of payments requires a material default by a debtor in the payment of a due debt so as to reflect a very serious financial condition that in all probability will lead to insolvency but without the necessity of having to prove insolvency. In general, a mere tight cash position is not enough if the assets of the debtor continue to be reasonably adequate. It would be different, however, if a substantial asset of the debtor could not be realized or liquidated. In essence, the concept of cessation of payments is considered the last step before insolvency.[57]

The *Code de commerce* of 1807 contained a number of facts, any one of which was evidence that the debtor had, in fact, ceased to make his payments. Among the facts was the debtor absenting himself, closing the doors of his place of business and all acts consistent with his refusal to pay his debts or to perform his commercial commitments. However, since 1838 the legislation has not contained a list of facts to assist the court in the exercise of its discretion. It is for the judge alone to decide whether the debtor has, in fact, ceased to make his payments. With the increasing complexity of business, this has become more and more difficult.[58]

Formerly, it was not a difficult matter to determine when a debtor had ceased to make his payments. Whoever was responsible for getting in the accounts of a firm would make his rounds calling at the place of business of each person who owed the firm. Whether or not the debtor had defaulted in his payments was immediately established and within a short time was a matter of public knowledge throughout the community. Moreover, prices were stable. The merchants and businessmen passed on their capital to their descendants. There was little discounting and by existing standards of commercial morality, any default was regarded as dishonourable.[59]

Under modern conditions, business is much more complex.

[57] See Paul Didier, De la responsabilité personnelle des dirigeants sociaux d'une affaire déclarée en faillite en droit francais in the Proceedings of the Eight International Symposium on Comparative Law held by the Canadian and Foreign Law Research Centre of the Faculty of Law of the University of Ottawa on August 27th-29th, 1970, p. 283.

[58] Auguste Roux, La notion de cessation des paiements au regard des jugements déclaratifs de faillites et règlements judiciaires (1958), Xème Congrès national de l'Association nationale des syndics et administrateurs judiciaires de France in Marseille. See also Philippe Charaousset, De la substitution progressive de la notion d'insolvabilité à celle de la cessation des paiements at the IVème Congrès national de l'Association nationale des syndics et administrateurs judiciaires de France, at Nantes.

[59] *Ibid.*

With continuous inflation, prices are almost never constant. Businesses are regularly short of working capital and it becomes increasingly difficult to keep a sufficient inventory on hand and at the same time keep turning it over fast enough to pay increasing and multiplying costs and taxes. Business houses must resort to bank overdrafts, government loans and rediscounting. Cheques, bills of exchange and accounts receivable are a means of financing and they become depersonalized as they are pledged or endorsed to third persons. It is not uncommon for a business to owe very much more to suppliers and contractors than the amount of its capital. Large bank overdrafts are common. Costs and prices continually increase. Businesses have their short and long term liabilities, their liquid and frozen assets. Most commercial activity has evolved to the rhythm of the telephone, telex, the business machines, computers and above all else, credit.[60]

As a consequence, it is no longer a simple matter to say with any degree of certainty when a debtor has ceased to make his payments. Increasingly over the years, the courts have been relying more and more on the concept of insolvency to establish cessation of payments. This in turn has been criticized in legal and commercial circles in France for the greater time it takes to obtain an order of the court once a debtor defaults in his payments and other obligations.[61] In the absence in the legislation of the former list of facts which was evidence that a debtor had ceased to make his payments the decisions of the court as to what constitutes ceasing to make one's payments have become increasingly important notwithstanding the normal attitude of civil law jurisdictions to *stare decisis.*

Proceedings for the *règlement judiciaire* and *liquidation des biens* may be commenced either by a debtor or his creditors. A debtor may voluntarily commence proceedings by declaring that he has ceased to pay his debts. This declaration must be made within fifteen days after the debtor first found that he was incapable of meeting his payments. Involuntary proceedings are commenced by a creditor, or the court on its own motion, issuing a summons. In both a voluntary or involuntary summons either a *règlement judiciaire* or a *liquidation des biens* may be requested. As a rule since the 1967 reforms, the *règlement judiciaire* is the normal insolvency procedure for the great majority of debtors.

Another important innovation of the new legislation is that it applies not only to debtors who are in business but to all private corporations whether or not they are in business.[62] In the case of

[60] *Ibid.* [61] *Ibid.*

[62] Bord, *op. cit.*, footnote 22, p. 11; Chevallier, *op. cit.*, footnote 38, p. 66. The purpose in extending jurisdiction over corporations whether or not they were in business was to reach the agricultural co-operatives, building

a debtor who is in business or a debtor that is a private corporation, the *Tribunal de commerce* has jurisdiction. In all cases, the *Tribunal civil* has jurisdiction.

Where the appropriate *tribunal* or court finds as a fact that the debtor has ceased to make his payments, it is required to fix the actual date that payments ceased. This date must be within eighteen months prior to judgment but the *tribunal* at any subsequent time during the administration of the estate may change the date upon further evidence. The *tribunal* will also assign a master known as a *juge-commissaire* to be responsible for the estate and will appoint one to three trustees known as *syndics*. For each court a number of professional *syndics* are permanently assigned.

The *Code de commerce* of 1807 had provided that the creditors would at their first meeting appoint one or more of themselves to be the *syndics* of an estate. This did not work well in practice. The debtor often contrived to have a creditor favourable to him appointed to be the *syndic*. It also became difficult to find a disinterested creditor who would accept the responsibility of acting on behalf of all creditors.[63]

The law of May 28th, 1838 took away from the creditors the responsibility of appointing *syndics*. The *tribunal* was thereafter required to nominate the *syndics* for each estate without any consultation with the creditors. Until 1935 it was the practice for the *tribunal* to nominate one or more interim trustees known as *syndics provisoires* who were responsible for taking urgent or conservatory measures to preserve the estate. The creditors after their first meeting were then required to report to the *juge-commissaire* and the *tribunal* thereafter would appoint permanent *syndics*. The practice developed that the *syndics provisoires* were usually affirmed in their appointments. Largely because of this the office of *syndic provisoire* was abolished by the decree-law of August 1935.

In appointing *syndics* it became the accepted practice of the *tribunals* to appoint only those who were experienced. As a result and by a process of evolution extending more than 150 years the *syndics* have acquired a professional status. This was formally recognized by the decree of May 20th, 1955 and again by the law of July 13th, 1967 when the new bankruptcy legislation provided for a re-organization in the role of a *syndic*.

By the 1807 *Code* the *syndic* had to be a creditor. Since 1955 the *syndic* cannot be a creditor.

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societies and similar corporations which in the strict sense could not be regarded as doing business.

[63] On *syndics* generally see Houin, *op. cit.*, footnote 10, pp. 22-24 and Bord, *op. cit.*, footnote 22, pp. 66-76.

Most *syndics* work exclusively as a *syndic* and have no other occupation. As a rule, *syndics* like many senior business executives in France have a law degree but have not practised. In the larger cities the only *syndics* are full-time professional *syndics*. In small centres where there is not the same volume of bankruptcy work lawyers or chartered accountants may sometimes act as part time *syndics*.

To be a *syndic* one must have a good name and reputation in the community and must have passed both oral and written examinations. The *syndic* must abide by a detailed, prescribed code of professional conduct. He is specifically prohibited from engaging in any activity incompatible with the role of a *syndic*. There are rules in respect of conflicts of interests. He cannot accept, for example, an appointment to act as a *syndic* if he is related to the debtor closer than to the fourth degree.

All *syndics* must be members of a National Association which includes a number of regional associations. The National Association comes under the general supervision of the Minister of Justice. The Court of Appeal designates the *syndics* to be attached to each *tribunal* throughout the country on the nomination of the *tribunals*. Only a *syndic* attached to a *tribunal* may be appointed to an estate coming under the jurisdiction of the *tribunal*. Among the responsibilities of the regional associations is to exercise general supervision and control, including the disciplinary power over all *syndics* in the region.

The *syndic* is remunerated through a tariff of fees which are taxed at the conclusion of a case by the *Tribunal de commerce*. The *syndic* is not regarded as an independent professional or businessman providing a necessary service. He is more than an officer of the court such as a lawyer is. The *syndic* is considered to be a *mandataire de justice* who holds an official position in the judicial process.

The system of *syndics* has evolved over a long period of time. Most *syndics* are well qualified and highly experienced professionals. In the foreseeable future it is expected that all *syndics* in both the large and small cities will act as such on a full-time basis. In general, the *syndics* are well regarded and the system seems to work well.[64]

[64] There are approximately 550 *syndics* at present in France of which approximately 350 practise on a full-time basis. The population of France is about 50,000,000. There are about 5,000 bankruptcy cases a year about half of which originate in Paris. Most cases are closed almost at once because there are no assets. Assuming that most of the present 200 part-time *syndics* cease to practise over the next few years as is hoped, there is a concern among the *syndics* that there will not be sufficient work to permit some 400 to 450 *syndics* to practise full-time as *syndics* and at the same time earn a reasonable income.

An important result flowing from a judgment pronouncing either *règlement judiciaire* or *liquidation des biens* is the constitution of the *masse* or estate, represented by the *syndic* who, alone, can either act on behalf of it or pledge it.[65] While this expresses one of the classical concepts of bankruptcy in French bankruptcy law, it was never specifically expressed in the *Code de commerce* or any of the subsequent statutes until the law of 1967. There has been much discussion since the beginning of the nineteenth century as to the true nature of the *masse*. The supreme court of France recently settled the discussion to some extent by holding that the *masse* of creditors in a bankruptcy constituted a juridicial person distinct from the creditors who compose the *masse*.[66] The technique of using the concept of the *masse* serves both to classify the creditors that will participate in the debtor's estate, that is those creditors who had claims against the debtor as of the date of the judgment and to organize the creditors, as represented by the *syndic* for the administration of the estate.[67]

The *syndic,* while nominally the representative of the creditors as represented by the *masse,* is, in fact, the mandatory or agent of the court and administers the estate under its supervision and direction. All important decisions must be authorized by the *juge-commissaire.* Almost the only remnant of creditor control is the office of the *contrôleur.* The *juge-commissaire* may appoint one or two *contrôleurs* from among the creditors. It is not mandatory, however, that they be appointed and in fact they are very seldom appointed and their powers are not clearly defined. Their principal duty is to generally supervise the administration of the estate, but their authority is more apparent than real.[68]

The new law of 1967 has accentuated the judicial character

[65] Art. 13 of the Law of July 13th, 1967.

[66] Civ. Sec. Com. 17 janvier 1956, D.S. 1956. J. 265.

[67] While the concept of two estates in reference to the bankruptcy is not often discussed by common law commentators, it does permit a logical explanation of certain features of the bankruptcy law of the common law countries. One must assume to explain, for example, the joint liability of the debtor and the trustee that on the bankruptcy of a debtor a second estate is created in the trustee. All of the property of the debtor vests in the trustee but the liability to pay the debts of the debtor is duplicated. Both the debtor and the trustee have a joint liability. By reason of the stay of proceedings imposed by the Act, no action may be taken against the bankrupt. On the discharge of the bankrupt, his liability to pay his debts is released. The liability of the trustee to pay the debts of the bankrupt still remains to the extent of the property of the bankrupt that comes into his hands. The theory of the two estates also permits a rational explanation for the distribution of subsequently found assets among creditors after the discharge of the bankrupt. If the liability to the creditors was completely released, the creditors would have no legal claim to the newly discovered assets. See Report of the Study Committee on Bankruptcy and Insolvency Legislation, *op. cit.*, footnote 5, paras 2.3.20-2.3.22, pp. 79 and 80.

[68] Arts 11 and 12 of Law no. 67-563 of July 13th, 1967 and see Bord, *op. cit.*, footnote 22, para. 146, p. 76.

of the bankruptcy process. The modern law of bankruptcy in France has been marked by a diminishing active role for the creditors matched by an increasing role of the *Tribunal de commerce.* Progressively judicial control has been substituted for creditor control.[69]

If the court is of the opinon that the debtor can propose a serious settlement and if the debtor has not committed any bankruptcy offences, it will order a *règlement judiciaire.* In such a case, the business of the debtor may be continued only with the authorization of the *juge commissaire.* He can authorize the business to be carried on for a period up to three months which can be extended. During this period, all creditors, unsecured, preferred and secured must prove their claims.[70]

As soon as the claims of the creditors are proved, the debtor then proposes an arrangement.[71] The proposal for an arrangement must describe in detail what the debtor proposes and in particular he must give full details of the payments he proposes to make, the duration of the arrangement and details of all proposed guarantees.[72]

It is a fundamental concept of the law of arrangements in France that all creditors under the arrangement must be treated equally. This was at one time so strictly regarded that it was doubtful whether creditors could be divided into classes. It would seem that it is now possible to have some slight differences in treatment among unsecured creditors if it will facilitate a settlement. Thus, in some circumstances, small creditors might be paid at once subject perhaps to a small discount; long term creditors might be paid in full pursuant to an extension agreement while the bulk of commercial creditors might be paid over a reasonably short period of time with some reduction in their claims.[73] Essentially, the equality provisions are designed to prevent secret payments. Any person seeking and receiving such preferential treatment is guilty of an offence.[74]

The arrangement once it is made must be approved by a majority of the unsecured creditors entitled to vote and owning

[69] Françoise Gore, L'autonomie administrative des créanciers et la législation française en matière de faillite, in Proceedings of the Fifth International Symposium on Comparative Law held in Ottawa in September 1967 by the Canadian and Foreign Law Research Centre of the Faculty of Law of the University of Ottawa.

[70] Art. 40, Law of 1967.

[71] Art. 67, *ibid.*

[72] Art. 68, *ibid.*

[73] Dalhuisen, *op. cit.,* footnote 7, p. 61, citing among others, Louise, De l'inégalité de traitement entre les créanciers dans le concordat, thèse, Paris (1935); Gabolde, Le respect de l'égalité des créanciers dans le concordat (1940), 3 Revue générale du droit commercial 109.

[74] Art. 147, Law of 1967.

together two-thirds of the claims entitled to vote. When it is approved by the creditors, it must thereafter be approved by the court and then published.[75]

If the creditors or the court do not approve of the proposed arrangement *liquidation des biens* will be ordered. Similarly, if at the time of the original summons the court is of the opinion that the debtor is not in a position to propose a serious settlement to his creditors, or if the debtor refuses to make a proposal the court will order *liquidation des biens*. Likewise, if a *règlement judiciaire* is ordered and the debtor declares himself incapable of proposing or obtaining acceptance of an arrangement *liquidation des biens* will be ordered.

The effect of an order of *liquidation des biens* is to vest all of the debtor's property in his creditors as represented by the *masse*. The debtor is entirely relieved of the administration of his estate. The trustee is obliged to liquidate it and distribute it among the creditors. When this is done, the *masse* or the *union* as it is sometimes called is dissolved. Any balance of a creditor's claim is now released and each creditor with an unpaid balance of his claim may individually exercise any available remedy against the debtor for the balance of his claim. With the disappearance of the *masse* or *union* the powers of the trustee come to an end. He can no longer act in the name of the *masse*. He must pass his accounts before the *juge commissaire*.

Where a *règlement judiciaire* or *liquidation des biens* has been ordered in respect of a corporation and the assets are not sufficient to satisfy the claims of the creditors, the court on the application of the trustee or on its own motion can order that the *dirigeants*,[76]

[75] Art. 70, *ibid.*

[76] There are two types of limited liability companies in common use in France. There is the *société anonyme* (S.A.) which is equivalent to the limited liability company or corporation and the *société à responsabilité limitée* (S.A.R.L.) which is in the nature of a limited liability partnership but which has no real equivalent in the law of Canada, England or the United States. There is, in addition, the *société en commandite par actions* which is a partnership with share capital. It is similar to a *société anonyme* except the managing director is personally liable for any losses. It is not in common use today. The *société anonyme* may be managed by either a president and board of directors or by a shareholder's council and management committee. An alternative method of management authorized by the law of July 24th, 1966 is by a *conseil de surveillance* or shareholders council and a *directoire* or management committee. A *société à responsabilité limitée* is managed by one or more *gérants* or managers who need not be members of the company. If there is more than one *gérant* they have full joint and several powers. Consequently, *dirigeants* refers to the administrators, the president, the general directors, the members of the *directoire* and the members of the *conseil de surveillance*. *Dirigeants de fait* will include those who by reason of the investment they have in the corporation or for any other reason effectively permits them to influence or interfere with the management of the company. L. J. Hall, Doing Business in France (1973), 123 New L.J. 83, 98, 133; Didier, *op. cit.*, footnote 57, pp. 287-288.

that is, those who direct or control the corporation or any one or more of them to be responsible for the debts of the corporation in whole or in part. The *dirigeants* may avoid responsibility only if they can prove that they managed the affairs of the company with reasonable diligence.[77] This in practice has been found very difficult to prove. Where an order is made and a *dirigeant* does not satisfy the debts of the company to the extent ordered he can be put into *règlement judiciaire* or *liquidation des biens* in his personal capacity.[78]

In other cases involving a *règlement judiciaire* or *liquidation des biens* of a corporation, a *dirigeant* of a corporation may be declared to be personally in *règlement judiciaire* or *liquidation des biens* if behind the facade of the corporation he carried on business in his personal interest, disposed assets of the corporation as if they were his own or who in his own interest carried on the business of the corporation in such a manner that it can only lead to the cessation of payments.[79] Since the introduction of this provision there have been many applications to the court. The corporate veil has been regularly and effectively pierced to reach those who direct or control a corporation and who abuse their position.

X. *Faillite.*

While the *règlement judiciaire* is the normal procedure for the relief of debtors who have ceased in their payments, *faillite* or bankruptcy still plays an important role. It has a twofold function of punishing the bad debtor and of promoting commercial morality by keeping the bad debtor out of the business community. This is another dimension of the prevailing concern throughout the new bankruptcy system of separating *"l'homme de l'enterprise"*. Thus, in order to protect an enterprise from the actions of its *dirigeants* an order of *règlement judiciaire* may be made in respect of a corporation but *faillite* or personal bankruptcy may be ordered in respect of the *dirigeants* of the company if they were guilty of commercial misconduct.

Among the circumstances that bankruptcy will be declared is where the debtor has misrepresented his accounts of his business, hidden assets, fraudulently admitted non existent debts, engaged in personal economic activity either through an intervening party or through a corporation in order to conceal his actions, used company goods or funds as his own, obtained by fraud a composition either for himself or his business which was afterwards annulled, committed acts of bad faith or inexcusable imprudence

[77] Art. 99 of the Law of 1967.
[78] Art. 100, *ibid.*
[79] Art. 101, *ibid.*

or gravely infringed normal commercial rules and customs. These rules and customs include engaging in commercial activity or holding the office of manager or director in spite of legal prohibition from doing so, not keeping accounts normal to the business, purchases resold at less than purchase price in order to postpone cessation of payments or for the same purpose resorting to ruinous means to obtain funds, excessive personal or company expenses, expenditure of large sums in extremely risky operations, contracting for another's account without any reciprocal undertaking, of engagements too onerous at the time of their conclusion having regard to the debtor's financial position or of his enterprise and excessive continuance of operational deficits which could only lead to cessation of payments.[80] There have been to date, however, very few applications made to the courts pursuant to these provisions.

To punish the bad debtor and to promote commercial morality, there are a number of civil and political sanctions imposed upon a bankrupt. He may not, for example, vote nor stand for any elected office nor hold or exercise any public administrative or judicial functions which include being in the armed forces, a postman, bailiff, auctioneer, banker, stockbroker or company director. If he is a member of the Legion of Honour or holds the Military Medal, he may neither wear the insignia nor exercise any of the rights attached to the honours. If he is a reserve officer, he is struck off the reserve list. He no longer may receive mail.

In other cases, where the conduct of the person is less serious, the court may impose sanctions similar to those resulting from bankruptcy but without adjudging him to be a bankrupt. For example, the court may prohibit the person from having any part in the administration of any commercial enterprise.[81]

Once a debtor or a person associated with the direction of a business which has ceased to make its payments is adjudged bankrupt, it is only possible to obtain a discharge from the status of bankruptcy on very narrow grounds. It is not insignificant that the word used for the discharge from bankruptcy is *réhabilitation*. The grounds upon which a bankrupt can apply for an order of *réhabilitation* is that he has paid in full with interest all of his debts and the costs of the administration of his estate. In the case of a person held to be responsible for the debts of a corporation, all of the debts with interest of the corporation and the costs of administration must have either been paid in full or an arrangement by way of an extension agreement to pay all the debts in full has been approved by the creditors.[82] An order of *réhabilitation* may

[80] Arts 106 and 107, *ibid.*

[81] Art. 109, *ibid.*

[82] Art. 114, *ibid.*

be obtained either in the lifetime of the bankrupt or after his death.[83] Very few orders are, in fact, made.

As all of the debts of the debtor must be paid before an order of *réhabilitation* may be obtained, the question of the release of debts on the *réhabilitation* or discharge of a debtor does not arise. Similarly, in the case of *liquidation des biens* where the claims of creditors are not paid in full, there is no release of their claims. When the estate is closed and the *union* or *masse* is dissolved, each creditor is free to exercise any legal means available to individual creditors to collect upon the balance of his claim.[84]

XI. *An Assessment of the 1967 Reforms.*

It cannot be said that the far reaching reforms of 1967 were not needed. Indeed, legislative reforms in bankruptcy in all countries have been introduced slowly and usually a long time after the need first became apparent. It is, however, too early to say with any degree of certainty whether the reforms have achieved their purposes. To the extent that it was hoped to make the French law of bankruptcy more compatible with that of the other countries of the European Economic Community, this has been achieved. But in achieving this and in the major change in emphasis in the philosophy of bankruptcy as reflected in the legislation, success is not so apparent. This is not surprising. There are deep historical, social and economic forces in bankruptcy. When there is a major change in the direction of the legislation, it requires a comparable change in the attitude of judges, lawyers, debtors and creditors and indeed all who come in contact with the legislation. This, of necessity, takes a considerable time.[85] There has, however, been time to make certain observations about the new legislation.

One feature that is still not contained in the bankruptcy legislation of France is a procedure for a debtor to make a preventive arrangement designed to keep a debtor in financial difficulty out of bankruptcy whether it be *règlement judiciaire* or *liquidation des biens*. Such an arrangement can only be achieved on the unanimous consent of all the creditors which as a rule is difficult to achieve.

The apparent haste in drafting the legislation has resulted in a certain lack of precision which has caused concern among some practitioners. The claims of the draftsmen that the new legislation has simplified procedures has been challenged as illusory. It has been said that what would formerly be regarded as relatively simple estates are now more difficult, complicated and, in some cases, almost impossible to administer. The alleged "simplicity, clarity

[83] Art. 124, *ibid.*
[84] Art. 90, *ibid.*
[85] See Scalbert, *op. cit.*, footnote 13, p. 275.

and celerity" in reality said one commentator is "complexity, obscurity and increased delay".[86]

While there is general approval of the overriding concept of the new legislation of the desirability of separating the man from the enterprise, this has not always been possible having regard to the procedures available.[87] The choice between the different methods of collective execution depend on the honesty or dishonesty of the debtor or on his good or bad faith. The *règlement judiciaire* is made available to the honest but unfortunate debtor which will usually lead to an arrangement being made between the debtor and his creditors.

If, however, there has been misconduct on the part of the debtor and regardless of the viability of the enterprise, he owns or controls, he will be adjudged bankrupt and this will necessarily lead to the disappearance of the enterprise through the liquidation of the debtor's estate. In allowing bankruptcy offences to prevent a debtor from availing himself of the *règlement judiciaire,* the law itself undermines its professed policy of the separation of the person of the debtor and his conduct from his enterprise which should survive independently from the debtor's personal behaviour. In fact, the future of the enterprise is determined not by the extent it is viable and may be rehabilitated or how necessary it is to the economy of the country or one of its regions but by the conduct of the debtor. Instead of separating the man from his enterprise, the enterprise is tied to the destiny of the man. The automatic liquidation of a debtor's estate on the cessation of payments irrespective of the economic interest of the country has not been completely avoided. Separating "the man from the enterprise" promises more than what the legislation delivers.[88]

On the other hand, with the amelioration of the sanctions against the honest and unfortunate debtor, much more realistic arrangements are being proposed under *règlements judiciaires.* Before the reforms, sympathetic courts often would approve a *règlement judiciaire* in respect of a debtor when the only alternative was bankruptcy. The result was that many uneconomic businesses

[86] Pierre Morange, Réforme du règlement judiciaire et de la faillite, commentaires et critiques (1971), 14 Revue des syndics et administrateurs judiciaires de France 1.

[87] Alliot, *op. cit.*, footnote 28, p. 391.

[88] Alliot, *op. cit., ibid.*, p. 394; Dalhuisen, *op. cit.*, footnote 7, p. 57. In tying the future of the enterprise to the conduct of the debtor, France is no different than England and Canada where the courts have a discretion to refuse to approve an arrangement where it is more expedient in the interest of the public or of commercial morality to punish the debtor than to consult only the interests of the creditors. Similarly, in the United States the courts may not confirm an arrangement if the debtor has been guilty of certain acts or has not been in good faith in proposing the arrangement.

were allowed to survive, but usually only temporarily, which had an adverse effect upon the economy. The new procedures of the 1967 reforms have produced in a very short time a marked decrease in the number of *règlements judiciaires*. In Paris, *règlements judiciaires* are now ordered in only ten per cent of all filings as opposed to almost twenty-five per cent under the former legislation.[89] In more than fifty per cent of the cases, dividends are paid to unsecured creditors.

In one respect one may speculate whether or not the separation between the man and the enterprise has been extended far enough. While there is an obvious advantage to creditors to have what has been a good customer survive in business, there could be some reluctance on the part of the creditors to go to some trouble and personal sacrifice to salvage a viable business and then give it back to the debtor. A logical extension of the existing legislation where it is demonstrated that the debtor has no equity in a business, is to divest the business entirely from the debtor, permit the trustee or creditors to rehabilitate it and then sell the enterprise as a going concern for the benefit of the creditors. This would be the ultimate in the separation of the man from the enterprise.

XII. *Conclusion.*

The French bankruptcy system has often had a different focus than our own. Yet our systems more closely resemble each other than they differ. Indeed the French experience has much to offer the Canadian lawyer on both the philosophical and the practical level.

Charles Warren divided the history of bankruptcy in the United States into the period of the creditor, the period of the debtor and the period of the national interest.[90] The history of bankruptcy in most other countries could be divided into similar periods. France, however, with its reforms of 1967 has perhaps gone further in stressing the pre-eminence of the public or national interest in the bankruptcy process. Few other countries have taken the same national and economic approach. The bankruptcy legislation of most other countries has emphasized the liquidation aspect of bankruptcy over rehabilitation. This has often proved to be economically wasteful. In times of high unemployment it is an approach that any country may well feel that it can no longer afford.

Law reformers attracted to the French approach will need to walk a narrow path between the proposal of measures to rehabil-

[89] Scalbert, *op. cit.*, footnote 13, p. 274.
[90] Charles Warren, Bankruptcy in United States History (1935).

itate a potentially viable enterprise by adjusting the obligations of a debtor with his creditors and measures to support an uneconomic enterprise to provide jobs or a needed service. In each case it could be in the public interest that the enterprise should not fail and be kept operating. In the one case it would be a legitimate function of the bankruptcy system to come to its aid. In the other case, it is a proper function of government, to take over or subsidize such an enterprise in the public interest.

On a practical level, a reasonable knowledge of another system of law cannot but help to give a better perspective of one's own system. In the field of bankruptcy France has had a long and rich history. There is an abundance of commentaries and much source material available in connection with the French bankruptcy system that could be used to advantage by Canadian lawyers in their day-to-day practice. As an example, some knowledge of the French jurisprudence relating to cessation of payments, the constitution of the *masse,* the juridical nature of an arrangement and piercing the corporate veil in bankruptcy has a very practical value to the Canadian lawyer conducting a bankruptcy practice.

In Canada with its two systems of law there is an especial reason why the Canadian lawyer should be reasonably conversant with the system of law other than his own. Apart from the accessibility of the law of Quebec to the common lawyer of Canada, the system of civil law at once most available and most approachable for the common lawyer is the French.[91] It is easier to study comparative law in Canada. It is unfortunate that we do not do more of it.

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[91] See Tunc, *op. cit.*, footnote 3.