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French Bankruptcy Law and Enforcement Procedures

Commercial Code – Article L. 632-2 §2

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1. In 2005, French bankruptcy was amended by the law regarding the Safeguarding of Businesses (the “Reform of 2005”).¹ This Reform has amended Book VI of the French Commercial Code, entitled “Businesses in Difficulty.” The new law also affects enforcement procedures in a most interesting way. But before describing the impact on the enforcement process, garnishment in particular, let me give you the main objective of the Reform of 2005.
2. One of the key features of the Reform is the creation of a novel category in bankruptcy proceedings that entails the suspension of action by an individual creditor to the benefit of a debtor who is not yet insolvent – and this is what is so different from other categories of French bankruptcy proceedings. The debtor needs only to demonstrate financial difficulties that may lead to insolvency.² In other words, the debtor needs to “*meet current liabilities with its (immediately) available assets*” to benefit from the new safeguarding proceeding. The idea is to

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¹ Law no 2005-645 regarding the Safeguarding of Businesses (hereafter “*Reform of 2005*”), enacted on July 26, 2005, Official Journal July 27, 2006, p. 12187, partly available online in English on <http://legifrance.gouv.fr>. On this law, see in the English language: Georges Cavalier, *Improvement of Bankruptcy Proceedings in France: The Right Step Towards Investors*, in THE CHALLENGES OF INSOLVENCY LAW REFORM IN THE 21ST CENTURY, Schulthess, p. 533 (2006); L. Gaillot, *Sweeping Reform for French Bankruptcy Law* (2006), available online on the International Insolvency Institute website (www.iiiglobal.org).

² Art. L. 620-1 institutes a safeguarding procedure to be commenced on the petition of the debtor that shows difficulties that it is unable to overcome on its own and that would lead to a cessation of payments.

create an early-warning mechanism that would prevent ailing enterprises from becoming insolvent.

3. But along with this, which aims to restructure the debtor at an early stage, the Reform of 2005 also aims to render bankruptcy proceedings more “*creditor friendly*.” The old procedure was indeed too “*socially oriented*” towards restructuring the debtor and maintaining employment, rather than satisfying creditors. The reason for this shift in approach is to encourage creditors to participate in court-driven safeguarding proceedings. Among the creditor friendly provisions are claims that accrued prior to the bankruptcy judgment and for which creditors omitted to file a petition in due time; these claims will no longer be extinguished. Also, creditors may no longer be held liable for abusive support,³ that is to say, a creditor shall not be liable for the losses caused as a result of the credits extended.⁴
4. Therefore, in this creditor friendly environment, one may be surprised by a provision of article L. 632-2 of the Commercial Code, which reads in paragraph 2 (also taken from the Reform of 2005):

³ Many other examples can be found. For instance, during the conciliation procedure aiming to reach an amicable agreement between a non-insolvent debtor and its creditors, new article L. 611-11 of the Commercial Code extends the scope of the first-rank priority payment to creditors granting credit or a payment delay to the debtor (the so called “new money privilege”). Art. L. 611-11 reads as follow: “*If safeguard proceedings, reorganization proceedings or liquidation proceedings as a result are commenced, those persons who, under the approved agreement referred to under Article L611-8(II), have made a contribution of fresh funds to the debtor in order to ensure the continuation and long-term future of the business's activity will be paid, up to the amount of this sum, according to their preferential lien before all other claims prior to the commencement of the composition proceedings, according to the rank fixed under Article L622-17(II) and Article L641-13(II). Under the same conditions, those persons who, in the approved agreement, supply new assets or services in order to ensure the continuation and long-term future of the business will be paid, for the amount of the price of the assets or services, according to their preferential lien before all claims born prior to the commencement of the composition proceedings.*” Also, the constitution of creditors’ committees and the designation of controllers give a more active role for the creditors in the drawing up and adoption of safeguard or rescue plans (e.g., art. L. 626-30 and L. 621-11 of the Commercial Code).

⁴ Under art. L. 650-1 of the Commercial Code, “*Creditors may not be held liable for harm in relation to credits granted, except in cases of fraud, indisputable interference in the management of the debtor or if the guarantees obtained for the loans or credits are disproportionate.*”

“Any notice issued by the Treasury to a third party holding property,⁵ any garnishment or any opposition⁶ shall also be voidable when it was delivered or carried out by a creditor after the date of cessation of payments and in knowledge thereof.⁷”

5. This provision is the stumbling block of two different approaches: one taken by the bankruptcy law, and the other taken by the enforcement law. To understand how this apparently conflicting viewpoint is solved in the foreground (II), one must first grasp the background (I).

I BACKGROUND

6. The setting of article L. 632-2 §2 is composed of a landscape – the so-called suspect period (A), the panorama of which is affected by an enforcement process (B).

A Suspect Period

7. What is the suspect period? The suspect period, relevant to article L. 632-2, is the period between the date when the court considers the enterprise insolvent (hereafter the date of cessation of payments) and the date of entering into effect of said court decision.⁸ In short, it is the period between “functional” insolvency and “declared” insolvency.⁹
8. Let’s take, for example, a bankruptcy proceeding that was opened, let’s say, on February 29, 2008 against Ms. X, who owns a garment business. In the court decision, the date of cessation of payments was

⁵ It is a notice constituting an enforceable instrument, which is issued to third party holding property claimed by the Treasury. For instance, if a taxpayer does not pay its taxes, it is possible for the Treasury to seize its funds directly over its banking account (the third party will be the banker).

⁶ The “opposition” is usually defined as a motion to set aside, which is the only appeal available to those parties against whom a default judgment has been passed: art. 571 of the French Code of Civil Procedure provides: *“The motion to set aside aims at retracting a judgement rendered by default.”* However, in the context of art. L. 632-2, the term “opposition” does not probably have this meaning (see M. JEANTIN, P. LE CANU, *DROIT COMMERCIAL – ENTREPRISES EN DIFFICULTÉ*, Précis Dalloz, 7th ed. (2007), no 616). It targets other types of “opposition” such as, for instance, the opposition from the seller’s creditors of a going-concern to the payment of the price (art. L. 141-14, Commercial Code, provides: *“Within ten days of the date of the second publication referred to in Article L. 141-12, any creditor of the previous owner, whether his debt is due or not, may lodge an appeal against the payment of the price at the elected domicile via a simple extrajudicial document”*). See generally, J.-P. Arrighi, *Les nouveaux cas de nullité de la période suspecte*, Gaz. Pal. Oct. 9-10, 2005, p. 2990 (no 36 seq.).

⁷ Unofficial English translation of: *“Tout avis à tiers détenteur, toute saisie attribution ou toute opposition peut également être annulée lorsqu’il a été délivré ou pratiqué par un créancier après la date de cessation des paiements et en connaissance de celle-ci.”*

⁸ Commercial Code, art. L. 631-8 §1: *“The court shall determine the date of the cessation of payments. If a date is not determined, the date of cessation of payments shall be declared that of the date of the court’s decision.”*

⁹ Harrap’s Law Dictionary, Dalloz, 2004, V^{is} “période suspecte.”

said to be November 19, 2007. Indeed, the date of cessation of payments was obviously prior to the court's decision fixing the date, as there was no prior official publication of any date. The period between the date of cessation of payments (November 19, 2007) up to the date of the court's decision (February 29, 2008) is characterized as "suspect." The debtor, who still has control over assets, but who is also aware of the incapacity to pay debts, may use this period to squander all or part of the assets, or to favor one creditor over another.

9. This is the reason why article L. 632-2 paragraph 2 makes it possible to invalidate certain actions such as garnishment that may have occurred during the suspect period. Therefore, the further we go back in time, the greater the number of enforcement decisions that could potentially be invalidated. To limit legal uncertainty, the court cannot set the date of cessation of payments earlier than 18 months prior to the court's decision.¹⁰ In the example of Ms. X, the date of cessation of payments could not have been set before August 29, 2006, that is, 18 months earlier than February 29, 2008.
10. Therefore, while favoring creditors, the new law *Safeguarding of Businesses* deprives other creditors of their legal rights, for example those benefiting from a garnishment granted prior to the opening of the procedure. Thus, a creditor entitled to garnishment may see the enforcement action invalidated because of the subsequent opening of bankruptcy proceedings.¹¹ But what, precisely, is garnishment? Garnishment is the process directing a person (garnishee) to hold on to the funds owed to someone who is in debt to another person (garnishor). For instance, I, the creditor, sold fifty pairs of jeans to Ms.

¹⁰ Commercial Code, art. 631-8 §2 which provides: "*The date of the cessation of payments may be moved once or more times, without however going back more than eighteen months before the date of issuance of the order recognizing the cessation of payments.*"

¹¹ This situation has to be distinguished from the more common and general situation where the opening of bankruptcy proceedings brings about the stay of individual enforcement. Indeed, in the Suspect Period, the bankruptcy proceeding is not yet formally opened, and under French law applicable prior to the 2005 Reform, an already effectuated garnishment was not affected by a subsequent bankruptcy proceeding (for an example relating to a notice issued by the Treasury to third party holding property: Cass. com. June 16, 1998, D. 1998, p. 216). See also K. D. Kerameus, *Civil Procedure*, International Encyclopedia of Comparative Law, Martinus Nijhoff Publishers, 2002, vol. XVI, § 63.

X. She did not pay, and has no intention of paying me. I therefore deliver a garnishment; I send a notice to Ms. X's bank, requesting the bank to transfer ownership of Ms. X's account for the total amount of her debt to me. So garnishment is, in fact, a type of enforcement procedure. Now let's move on to the French enforcement process.

B. Enforcement Process

11. First, French law on civil enforcement dates back to 1991.¹² In general, the law provides that enforcement does not belong to the court of original jurisdiction, but rather to the Judge of Execution.¹³ As a matter of principle,¹⁴ although no special authorization is required to enforce proceedings, the Judge of Execution will often be seized to rule on the difficulties relating to enforceable instruments and the arising dispute.
12. Second, creditors have the choice of measures to secure the enforcement of their claim.¹⁵ Garnishment is one of the two main types of enforcement on *movables*. French law differentiates garnishment (*saisie-attribution*),¹⁶ from levy on corporeal movable things (*saisie-vente*).¹⁷ There are the two main types of enforcement on movables, as opposed to the single levy on *immovables* (*saisie-immobilière*).¹⁸
13. Among the multitude of enforcement procedures, a high percentage results in monetary enforcement. Money claims are in the field of garnishment.¹⁹ Under French law, one reason for the popularity of

¹² Law no. 91-650 *on the reform of the civil enforcement of judgments*, dated July 9, 1991 (thereafter the "Law of 1991"), complemented by decree no 92-755 *on new rules relating to civil enforcement for the implementation of "the Law of 1991,19"* dated July 31, 1992 (thereafter the "Decree"). These entered into force on January 1, 1993.

¹³ This institution was provided in France by the law no 72-626 instituting a Judge of Execution and on the reform of civil procedure, dated July 5, 1972, but it never became effective since the decree of application was never issued.

¹⁴ This is not the case for levy on immovable where the court authorization is still required.

¹⁵ Law of 1991, art. 22 §1.

¹⁶ "Garnishment" is called, in French, *saisie-attribution*, which, from the practical point of view, covers the more specific "garnishment of salaries" (*saisie des rémunérations*). See generally N. Cayrol, *V^{is} Saisie-Attribution*, *Juris-classeur Voies d'exécution*, bundles no. 640, 641, and 642 (2008).

¹⁷ There is also the levy on corps (*saisie des récoltes sur pied*).

¹⁸ See generally J. BELL, S. WHITTAKER, S. BOYRON, *PRINCIPLES OF FRENCH LAW*, Oxford University Press (1998), pp. 110-111.

¹⁹ Because garnishment is very popular, and for ease of discussion, this paper focuses only on this particular enforcement procedure. Additional reasons can be found in the fact that levy on corporeal movable things is usually not available when the debt is below 535 € and garnishment must therefore prevail (art. 82 of the Decree). Also, because garnishment brings about the automatic and direct transfer of the garnished claim,

garnishment is the efficiency because of the immediate transfer of the garnished claim to the garnishor.²⁰ It allows a creditor to have an enforceable instrument (*titre exécutoire*) and where substantive requirements are met (including the certainty, the liquidity and the maturity of the claim) to be immediately satisfied. As soon as the garnishment summons is notified, irrespective of the actual date of payment by the garnishee. At this time, the receivable is removed from the debtor's asset and immediately transferred to the creditor's asset.

14. For instance, a creditor (garnishor or *saisissant*) can deliver garnishment to a bank (garnishee) holding the debtor (*saisi*)'s money.²¹ The delivery process of the garnishment is conducted by a bailiff (*huissier de justice*) by means of a summons.²² Upon reception of the garnishment the bank (garnishee or *tiers saisi*) must give notice of the proceeding to the debtor within 8 days.²³
15. Starting from the notice of garnishment given by the bank, the debtor can of course contest the garnishment before the Judge of Execution.²⁴ This action must be carried out within one month.²⁵ Again, the debtor may contest the amount due and/or the regularity of the bailiff's summons. In many instances, there is no litigation, and the automatic transfer of ownership is independent of a judicial pronouncement. The payment is delayed for only one month starting from the time of the notice of the garnishment to the debtor.²⁶

subsequent garnishors or other levies (such as levy on corporeal movable things or *saisie-vente*) can only be satisfied from the remaining part of the garnished claim, which has not been transferred. This privilege of the first garnishor (*privilège du premier saisissant*) does not exist in levy on corporeal movable things (art. 43 §2 of the Law of 1991).

²⁰ Art. 43 §1 of the Law of 1991.

²¹ The attachment of a bank account is the most frequent case of garnishment and is subject to the same rules. In particular, banks as garnishees are generally bound, like any other garnishee, to give information as to the existence and the extent of the garnished claim notwithstanding the confidential character of the relationship between the bank and its client (Cass. com. May 6, 1981, D. 1982 p. 33, Gavalda; JCP 1982 II 19708, Vasseur).

²² Art. 46 of the Decree.

²³ Art. 58 §1 of the Decree.

²⁴ Art. 65 of the Decree.

²⁵ Art. 66 of the Decree.

²⁶ Art. 61 of the Decree.

16. So, on one hand, you have a bankruptcy law which favors creditors but which also contains a provision – art. L. 632-2 paragraph 2 – that is detrimental to creditors holding a garnishment granted during the suspect period. On the other hand, you have an enforcement procedure – garnishment – that gives direct and immediate ownership on the claim, irrespective of any subsequent opening of bankruptcy proceedings.²⁷
17. The reason for this conflict is that bankruptcy proceedings adopt a *global policy* of the debtor’s situation, which does not just take into consideration individual creditors. Enforcement law, however, is governed by a very *individualistic policy* of creditors, where a special first-in-time rule (*prix de la course*) applies. Now that we have covered the general background of Article L. 632-2, let’s turn to the foreground of our subject.

II FOREGROUND

18. The focal point is not the fact that this conflict might be solved in favor of one policy or the other, but is, rather, the conditions under which the solution is found. There are two cumulative conditions under which garnishment can be invalidated; the first condition is chronological: the garnishment must be delivered by a creditor “*after the date of cessation of payments.*” Logically one would try within one year from the court decision²⁸ to advance the date of cessation of payments in order to get the garnishment invalidated.²⁹
19. The second condition is much more difficult to meet. The garnishment must have been delivered by a creditor in knowledge of the date of cessation of payments. The knowledge of the date of cessation of payments is equal to the knowledge of the cessation of payments

²⁷ Art. 43 §2 of the Law of 1991 provides, in relevant part, that “*the subsequent opening of a bankruptcy proceeding leading to recovery (redressement judiciaire) or liquidation (liquidation judiciaire) shall not affect such direct transfer.*”

²⁸ Art. L. 631-8 last § provides: “*The petition for modifying this date must be filed with the court within a year after the court decision opening the proceeding.*”

²⁹ See L. Lauvergnat, *L’annulation de la saisie-attribution pratiquée en période suspecte (A propos de l’alinéa 2 de l’article L. 632-2 du Code de commerce)*, Dr. et proc. 2007, p. 254 (no 4 seq.)

itself.³⁰ This is what I call a subjective condition. While it is essential to define the exact meaning of the words “knowledge of the date of cessation of payments” (A), the analysis of this central point would not be complete if the relative consequences (B) were not discussed.

A Knowledge of the date of cessation of payments

20. The subjective condition related to “knowledge of the date of cessation of payments” is not unknown in French law. Indeed, the first paragraph of Article L. 632-2, which existed prior to the Reform of 2005, contains a similar condition:

*“payments for overdue debts made after the date of cessation of payments and acts for consideration accomplished after such date shall be voidable if those who dealt with the debtor had **knowledge of the cessation of payments** (emphasis added).”*

21. The similitude in the drafting of paragraph two prompts looking at case law construing the first paragraph. This case law states that the knowledge of cessation of payments must be evidenced at the time the acts mentioned in the first paragraph were accomplished.³¹ In addition, case law seems to impose a rebuttable presumption on professional creditors – such as banks – dealing with the debtor.³² The sole fact that banks and debtors maintain usual business relations implies that the bank knew of the cessation of payments.³³ Professional assignments of debts have been invalidated because of the sole fact that the debtor’s bank account had a negative balance, which also implies that the bank knew about the cessation of payments.³⁴

22. It is indeed a presumption created by case law, the bank may just “suspect” the cessation of payments. But, the suspicion of, and the actual knowledge of the cessation of payments, is two different things.

³⁰ For such a shortcut, although not explicitly mentioned, see *Id.* (no 7).

³¹ Cass. com. June 25, 1991, Bull. civ. IV, no 238.

³² Paris Court of Appeal, May 26, 1994, D. 1994 IR 207; Rev. proc. coll. 1995, p. 450, Lemistre.

³³ Cass. com. May 11, 2003, Rev. proc. coll. no. 4, p. 386, G. Blanc.

³⁴ Amiens Court of Appeal, Dec. 7, 2001, Rev. proc. coll. no. 4, p. 386, G. Blanc. However, the rejection of a cheque and the notification of withdrawal of chequebook facilities do not show the knowledge of cessation of payment’ status (Besançon Court of Appeal, Apr. 10, 1998, Act. proc. coll. 1998, no 98).

The risk is high that this reasoning carried out for paragraph one be transposed to paragraph two.

23. We can go even one step further: the mere fact that a garnishment is performed may lead the judge to presume that the creditor had knowledge of the cessation of payments. Previous case law has already decided this way.³⁵ Fortunately, the first published case law under new paragraph two of Article L. 632-2 does not seem to follow this presumption. The French city of Dijon Court of Appeal recently decided that the issuance by the Treasury - of a notice to a third party holding property (*avis à tiers détenteur*³⁶) during the suspect period - was not sufficient to establish the Treasury's knowledge of the cessation of payments. The fact that the debtor did not pay the VAT to the Treasury was not enough evidence to prove that the company was in cessation of payments.
24. Should the cessation of payments be evidenced by additional factors such as non-observance by the debtor of terms of payment granted by creditors? An affirmative answer was given to this question by a lower court.³⁷ But a few weeks ago, the Paris Court of Appeal condemned this approach and decided that a notice issued by the Treasury to a third party holding property does not explicitly prove the knowledge of the debtor's cessation of payments. This decision was reached even if the Treasury knew, a few days before issuing the notice, that the debtor did not observe the terms of payment agreed in a previous rescue proceeding.³⁸ This case law, relating to notices to a third party holding property, can undoubtedly be transposed to garnishment.³⁹ In conclusion, this subjective condition should not be interpreted too

³⁵ Cass. com. May 19, 1958, Bull. civ. no 96; Cass. com. Feb. 2, 1965, Bull. civ. III no 87; see also Dijon Court of Appeal, Rev. proc. Coll. 1991-1, p. 106, no 10, Y. Guyon. More generally, the comments of Messrs M. Cabrillac & J. Argenson under Cass. com. Feb. 2, 1981, JCP 1981 ed. CI, no 9780.

³⁶ See supra footnote no 5.

³⁷ Commercial court of Bobigny, Oct. 25, 2006, D. 2007, no 4, p. 228, A. Lienhard; Gaz. Pal. 2007 somm. 1336, Roussel Galle.

³⁸ Paris Court of Appeal, 3rd ch., Dec. 13, 2007, D. 2008, no 4, p. 221, A. Lienhard.

³⁹ This was the case of an old case law where the old garnishment procedure (under the 1967 law) was involved (Cass. com. Feb. 2, 1981, JCP 1981 ed. CI, no 9780, M. Cabrillac & J. Argenson).

broadly by the judges because the consequences attached thereof are decisive.

B Consequences

25. In French law, although the invalidation of the enforcement procedure will not be automatic when carried out during the suspect period, the following consequences of garnishment invalidation may be predicted: towards the creditor, and if the garnishment process is fully terminated (i.e. the automatic transfer of ownership, but also the payment to the garnishor), then the garnishor must return the funds. Although the law does not explicitly specify this point, case law recently decided that the garnishor must return the funds to the representative creditor (*mandataire judiciaire*) and not to the garnishee.⁴⁰
26. If the garnishment process is not fully terminated (i.e. the automatic transfer of ownership occurred, but not the payment to the garnishor), then no return is due because the payment was not made by the garnishee. However, the ownership is already in the patrimony of the garnishor who loses the acquired right to be paid.
27. This new provision of French law may be questionable under article 6 of the European Convention on Human Rights (“the Convention”) which provides:

“In the determination of his civil rights and obligations..., everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law...”

⁴⁰ For an example: Cass. com. May 30, 2006, appeal no 05-10832 (unpublished).

28. European Court case law clearly confirms that enforcement be protected by the Convention.⁴¹ Article 1 protocol 1 of the Convention, in relation to the protection of property,⁴² may be an additional basis for attacking article L. 632-2 §2. But this is another episode for the next Nagoya Symposium!

⁴¹ Enforcement procedure is part of the right to a fair and public hearing: *Hornsby v. Greece*, March 19, 1997, § 45, ECHR 1997.

⁴² Art. 1 of Protocol 1 provides, in §1: “*Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*”