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Recovery:

French Insolvency Regime Remains Unfriendly To Creditors Despite Recent Reform Of Safeguard Proceedings

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The impact of the widely awaited reform of the Business Safeguard Act ("Loi de sauvegarde des entreprises" of July 26, 2005), effective Feb. 15, 2009, on French insolvency proceedings, does not, in Standard & Poor's Ratings Services view, make France a friendlier jurisdiction for creditors.

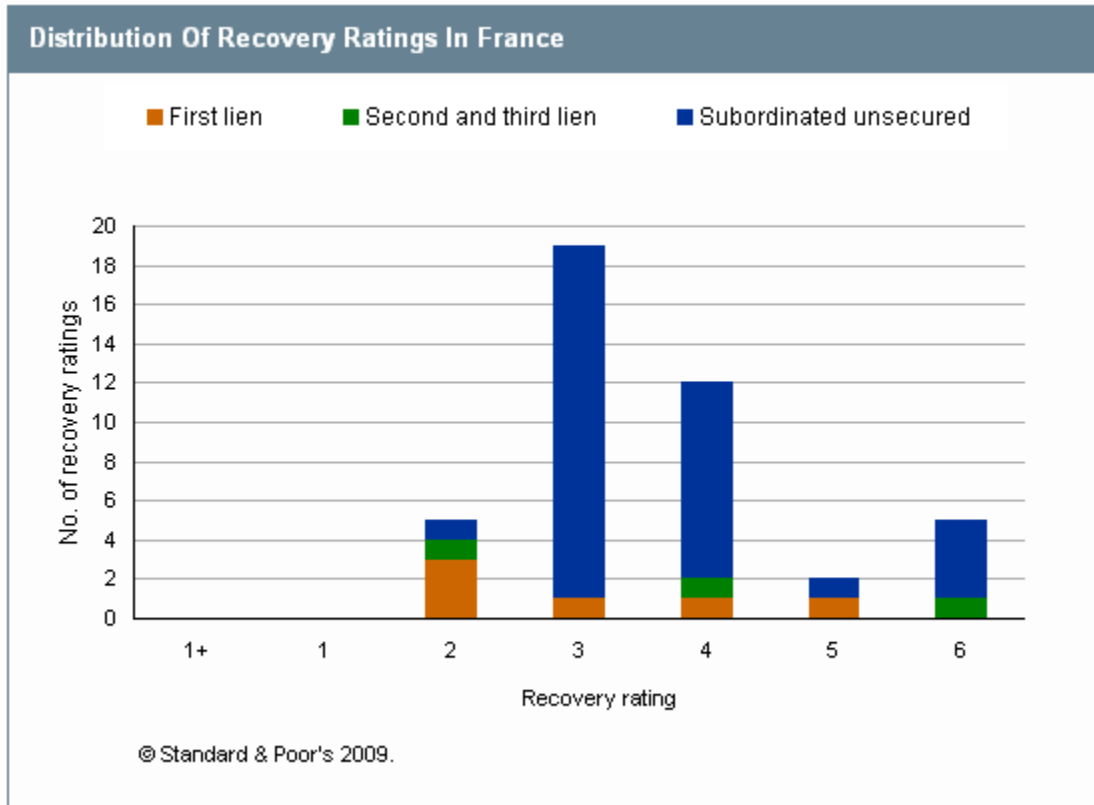
As a result, Standard & Poor's continues to assess France's insolvency regime as a Group B jurisdiction based on creditors' lower degree of control and influence over insolvency proceedings vis à vis other constituencies such as debtors. For details on our ranking of the French insolvency regime, see "Debt Recovery For Creditors And The Law Of Insolvency In France," published March 22, 2007, on RatingsDirect).

The reform appears to clarify certain creditors' rights but its main stated objective is to make safeguard proceedings more attractive for debtors. In addition, the revised law contains several measures reinforcing debtors' positions.

In practice, we expect insolvency proceedings in France to remain lengthy and somewhat unpredictable for creditors, affecting their ultimate recovery prospects. We consequently expect to continue to cap our recovery ratings on debt issued by entities subject to French insolvency proceedings at '2', which denotes the highest possible recovery rating that could be assigned to an issue in a Group B jurisdiction. At the same time, we anticipate maintaining the corresponding issue rating on such debt at not more than one notch above the corporate credit rating on the debt issuer. In fact, we rate only a few debt issues in France where expected recovery firmly in the 90%-100% range has led to an upward differential of one notch. (For further details on our recovery rating scale, see "Jurisdiction-Specific Adjustments To Recovery And Issue Ratings," published June 20, 2008.

Table 1 below shows that out of 34 recovery ratings we have assigned to French companies' debt issues, only six are notched up with a recovery rating capped at '2'. We have assigned no '1' or '1+' recovery ratings, whereas issues carrying these ratings represent 18% of our universe of recovery ratings in Europe, where Standard & Poor's considers most jurisdictions (except Spain and Italy) as more creditor friendly than France.

Chart



Creditors Face Rising Uncertainty Because Debtors Have Increased Incentive To File For Safeguard Proceedings

The safeguard proceeding ("Procédure de Sauvegarde") is a formal reorganization procedure that only solvent debtors can initiate. Before the reform, debtors applying for safeguard proceedings had to prove that, although not cash flow insolvent ("en cessation de paiements"), they were experiencing difficulties likely to lead to insolvency. It was often challenging for debtors to provide such proof.

From now on, debtors simply need to show the inability to overcome their difficulties. This relaxed test could increase the number of opportunistic filings for safeguard proceedings. The courts will have to use their judgment to prevent distressed but not bankrupt companies from looking for the legal protection that safeguard proceedings provide and that enables debtor companies to benefit from a minimum 6-month stay and force their creditors into negotiations.

We understand the law was changed to facilitate and increase the use of safeguard proceedings and to promote restructuring, preserve jobs, and discourage liquidations. In 2008, out of 55,000 insolvency procedures, only 700 filed for safeguard proceedings, according to the professional association of administrators (AJMJ).

Debtors' Are Gaining Power At Creditors' Expense

Directors of debtor companies have greater influence in the administration and reorganization of their companies under the reform. Debtors can now propose a "preferred administrator" to the court. In addition, the administrator's supervision has been substantially limited. The power to ask the court to authorize management decisions outside the ordinary course of business, or to permit a partial cessation of the business, or to offer creditors substitute security is now the debtor's exclusive prerogative.

Debtors lead the preparation of company safeguard plans in collaboration with administrators and propose them to creditors. Debtors are also in charge of drawing up lists of company owned assets. Lastly, the risk that company directors can be ousted and their shares sold or frozen by the court as part of a restructuring plan have been removed.

Certain Creditors' Rights Are Clarified

The reform now enables all holders of bank debt, including debt acquired on the secondary markets from credit institutions, to participate in bank creditor committees. Previously, only bank creditors could participate in committees, whereas financial creditors such as hedge funds were excluded. The timing of the committee process has been simplified and committee voting rules have also been amended. The majority required to approve a restructuring plan is now two-thirds, based on the value of claims represented by committee members. The requirement for an additional majority according to the number of creditors in the committee has been removed to prevent obstruction by small creditors.

In addition, bondholders are now asked to participate in an assembly to vote on restructuring plans once they have been adopted by the two existing bank and trade creditors' committees. A single meeting is convened for all bondholders--domestic and international--and a two-thirds majority by value of claims is required for approval. Previously, bondholders were consulted in accordance with the terms of each bond issue but had no clear decision-making power in adopting restructuring plans.

All committee members are now allowed to submit proposals to debtors and administrators as restructuring plans are prepared. The law also provides that creditors can be treated differently according to their respective situations.

Ultimately, restructuring plans submitted to creditors can now include debt-for-equity swaps that can be imposed by a majority of creditors.

Overall, the reform has clarified the rights of creditors (including bondholders) in France. However, at the same time debtors' rights have been reinforced, leading to the weakening of creditors' rights. In contrast, in U.S. Chapter 11 procedures (which inspired the French Safeguard Law in 2005), the debtor remains in possession and sets the agenda in the court's case but the official committee of creditors has an important role in the administration of the case, including participating in the formulation of the debtor's reorganization plan. In practice, the objective of U.S. bankruptcy reorganization is to serve as a value maximization process, resulting in distributions of enterprise value that reflect the strength of the various stakeholders' positions within the parameters of the priorities of creditors' claims. (see "Debt Recovery For Creditors And The Law Of Insolvency In The U.S.," published June 20, 2008).

Two Restructurings Underway In France Show Fundamental Divergences In Process And Treatment Of Creditors

Two French companies, Belvedere S.A. and Akerys Holdings S.A., followed radically different courses in their recent restructurings. Belvedere, a wine and spirits producer, entered court-administered safeguard proceedings in July 2008. The temporary stay freezing payments to Belvedere's bondholders was extended to mid-July 2009, which is the new deadline for Belvedere to submit a restructuring plan to creditors. Homebuilder Akerys began negotiating with its bondholders in November 2008 to amend the terms of its bonds in aid of an out-of-court restructuring plan. We understand that the majority of bondholders have already approved the plan.

Despite the different paths chosen by the two companies, Belvedere and Akerys share important common features. Standard & Poor's rated each company in the 'B' category prior to their restructuring initiatives. Each had sufficient cash to meet its then current financial commitments as per our rating definitions in the 'B' category (under Standard & Poor's ratings definitions, the obligor rated in the 'B' category currently has the capacity to meet its financial commitments and adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its commitments). Belvedere and Akerys' debt issues are rated on Standard & Poor's recovery scale at respectively '4' and '5', indicating our expectations for "average" (30%-50%) and "modest" (10%-30%) recovery in the event of payment default. Lastly, each default resulted from a strategic action taken by the issuer. In comparing the Belvedere and Akerys cases, we conclude that the creditors' degree of involvement, the timeline to resolution, and the overall fluidity of the process will, in our view, likely result in contrasting outcomes for creditors.

Belvedere voluntarily entered safeguard proceedings on July 18, 2008. Belvedere reportedly repurchased a quantity of its own shares, in the process possibly breaching the limitations governing share repurchases. In our view, while the share buyback may not have triggered a default, it nevertheless allowed bondholders to immediately accelerate the debt. Belvedere had not previously missed scheduled interest or principal payments and reportedly had sufficient cash to meet upcoming interest payments.

One month prior to the company's entry into safeguard proceedings, we had lowered the corporate credit rating on Belvedere to 'B-' from 'B', and placed the rating on CreditWatch with negative implications. The rating actions followed the stronger-than-anticipated default potential that Belvedere faced because one of the auditors had expressed reserves relating to a potential covenant breach in the group's senior secured debt. The ratings reflected Belvedere's highly leveraged profile, mitigated by ownership of leading and diversified brands, adequate liquidity in our view, and a commitment to deleverage through asset disposals.

Belvedere's safeguard filing led to our downgrade of the company, on the same day, to 'D' (default) from 'B-'. At the same time, we lowered the issue rating on Belvedere's €375 million senior secured floating-rate notes to 'D' from 'B-'. The '4' recovery rating on the notes remained unchanged, based on our valuation of the company on a break-up basis and after deducting priority claims. The filing imposed an immediate stay on all payments to creditors.

We understand that bondholders subsequently challenged Belvedere's filing, arguing that the breach could have been remedied without resorting to insolvency proceedings. The court rejected the bondholders' challenge, on the grounds that it was unfounded. Other aspects of the safeguard litigation are reportedly also highly contentious, as we understand in particular that debt filings made by certain bondholders are being challenged. On Jan. 29, 2009, the

court granted Belvedere a six-month extension to present a restructuring plan to creditors. Belvedere now has until July 16, 2009, to file its plan. As a result, the stay could last in total for one year.

The outcome of the Belvedere safeguard proceedings is difficult to predict. The court has wide discretion to impose a plan and failure to agree on one may result in a court-imposed plan involving uniform payment extensions of up to 10 years.

Akerys, meanwhile, chose to pursue out-of-court negotiations with its creditors to restructure its debt.

In October 2008, Akerys engaged an investment bank to advise it about various strategic alternatives. At the time, Standard & Poor's downgraded Akerys to 'CCC' from 'B'. We then lowered our corporate credit rating on Akerys to 'SD' (selective default) on Feb. 10, 2009. On the same date, we also lowered the issue rating on Akerys' €300 million senior secured floating-rate notes due 2014 to 'D' from 'CCC-'. The '5' recovery rating on the notes remained unchanged, based on our discrete-asset valuation of the company and after deducting large priority debt and the weak security package for noteholders.

The October 2008 rating actions were based on our view that Akerys' revised financial policy introduced the possibility that the company would engage in a below-par exchange offer, suggesting Akerys' potential unwillingness to meet its financial commitments. Absent the possible exchange offer, we viewed Akerys as weak though not necessarily prone to near-term default. In February 2009, our downgrade of Akerys to 'SD' and its debt issue to 'D' followed the company's nonpayment of its coupon due Feb. 1, 2009, which we consider a default under Standard & Poor's criteria.

In November 2008, Akerys' bondholders agreed to allow restructuring discussions to continue without creating an event of default. In early February, Akerys reportedly missed its quarterly coupon payment and proposed a restructuring plan to noteholders, under which it would exchange the group's outstanding €300 million notes for €80 million of new notes and €220 million of exchangeable bonds. Akerys announced in mid-February that more than 50% of the required 95% of bondholders had approved the exchange offer.

The plan also waives the February interest payment and creates a 90-day grace period to implement the restructuring plan. Akerys indicated in mid-February that bondholders had overwhelmingly consented to the 90-day grace period. In our view, this suggests that bondholders actively agreed to an out-of-court solution.

At this early, pre-emergence stage, assuming that Akerys fully implements the restructuring plan and completes the exchange offer, we are likely to rate Akerys at no higher than 'B-'. We expect the recovery rating on the new senior secured €80 million notes to be no higher than '3', indicating our expectations of meaningful (50%-70%) recovery in the event of a payment default. Although we could envisage higher numerical coverage than 70% for these notes, we would likely cap the rating at '3' to incorporate the very weak security package provided to the Akerys noteholders under the French insolvency regime.

Related Research

- "Standard & Poor's Ratings Definitions," Feb. 25, 2009;
- "Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt," Oct. 20, 2008;

- "Corporate Ratings Criteria 2008," April 15, 2008 (see page 12).

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