

LEGAL WEEK
22 février 2007

FRANCE

Possessing your interest

Following reform of its bankruptcy law, France's rules on security interest have also been updated



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The French law relating to the taking of security on movable assets mostly dated back to the Napoleonic Code enacted in 1804. Rules concerning specific securities had been enacted since (for example the pledge assigning business receivables the charge on shares) but the general legal frame remained unchanged. Thus the modification recently introduced by the Ordinance of 23 March, 2006 (and the corresponding application decrees of 23 December, 2006) are of major importance for anyone interested in taking security on French assets, be it a bank or a firm dealing with French clients or purchasing French companies, through a leveraged buy-out or otherwise.

The reform facilitates the creation and enforcement of French security interest. Since 1804, the general rule was that to create a security interest, the debtor had to physically deliver the assets to the creditor (or its agent). The security interest ceased when the creditor (or its agent) stopped possessing it. The new rule is that a security interest is valid against third parties when the assets are remitted to the creditor (or its agent) or when it is published in a specific registry available to the public, such registry being effective as of 1 March, 2007.

Unless the assets are listed on a stock exchange, they must be appraised by an expert appointed by the competent court or by both parties — for example, in the security agreement.

A step towards the floating charge

Pledges on stock already existed in the past; however, due to the rigidity of French law, their validity and enforceability could be jeopardised. This risk has been eliminated by the new reform, which sets forth a clear and precise regime. Under the new rules, the charge on stock may cover raw material, intermediary products and any goods belonging to the debtor. However, its scope is limited since only banks may benefit from this new charge.

The charge is made in writing and must mention some items such as: (i) name of the fire insurance company covering the assets; (ii) description of the current and future stock; and (iii) the place where it is (or will be) stored. It must also be published in a specific registry within 15 days of its signing, failing which it is null and void.

The charge created does not follow the stock when it is sold but instead affects the current stock, i.e. it crystallises only when the bank enforces the charge.

- The reform protects the bank by authorising it to:
- have access to the records of the stock;
 - at any time, at its cost, audit the stock; and

THIS CHARGE PROVIDES A FRAME FOR THE CREATION OF A CHARGE ON STOCK THAT IS UNDOUBTEDLY MORE SATISFACTORY THAN THE EXISTING ARCHAIC REGIME. HOWEVER, IN ADDITION TO ITS RIGID AND FORMALISTIC FRAME, IT HAS SOME SERIOUS PITFALLS

As a consequence, the pledge with disposition will not be the only possibility to create a charge on movable assets: it is now possible to create charges without disposition. However, it is to be kept in mind that this new provision increases the risk of conflict between creditors of the same debtor over the same assets; the reform provides some ways to solve them.

The reform has also broadened the range of assets that may be subject to security interest. Interest may now be taken on (i) fungible assets; (ii) future assets, provided that they can be precisely identified; and (iii) a 'set of assets'. These modifications allow to envisage new and imaginative possibilities: a valid charge may be taken, for example, on the output of a factory or even on more unusual assets, such as a library.

With regard to the enforcement of security interest, the rule was that the secured creditor had to obtain an authorisation from a judge to either sell the asset or attach it. French law has always deemed null and void the clauses allowing the creditor to avoid such judicial authorisation.

The Ordinance of 23 March authorises the clauses that enable the creditor to attach the assets without the approval of a judge, when due sums remain unpaid.

- require the debtor to reimburse all or part of the facility secured by the pledge or to increase the stock to the initial value, if the value of the stock has decreased by at least 20%.

Limits of the charge on stock

This charge provides a frame for the creation of a charge on stock that is undoubtedly more satisfactory than the existing archaic regime. However, in addition to its rigid and formalistic frame, it has some serious pitfalls.

In the context of bankruptcy, French law still favours possessory security interests over non-possessory ones: the bank benefiting from a possessory security interest over tangible assets has a lien which allows it to retain the asset subject to the pledge until it has received payment. Since it lacks this lien, the bank benefiting from a charge on stock is not entitled not retain the stock and its position is therefore weaker within a bankruptcy procedure.

One of the innovations of the reform is the possibility of attaching the assets subject to a charge without any judicial approval (see above). For unknown reasons, this is not possible for a charge on stock, meaning a delay in completion. ■

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