

Considerations for Directors When a Company Is in Financial Difficulty

This quick guide summarises the duties that directors of companies incorporated in France are subject to, and how those duties change when the company is insolvent or at risk of being insolvent.

It also gives an overview of the personal risk to directors when the company is in financial difficulty.

This note is intended as an overview and should not be relied on as legal advice. Should you require legal advice in relation to your specific circumstances, please contact the Restructuring & Insolvency team members whose contact details are at the end of this note.



Directors' Duties When Solvent

- Each director owes individual duties to the company, to promote the success of the company for the benefit of its shareholders as a whole.
- Directors' duties must be exercised in good faith.
- The directors can be held liable, with both civil and criminal liability, individually or jointly, to the company or third parties for breach of applicable laws and regulations, the company's constitutional documents or for mismanagement of the company.
- There may be other specific duties, depending on the form of the company.

Financial Distress

Directors' Duties When Insolvent, or at Risk of Being Insolvent

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- If a company is facing serious financial difficulties (but not yet insolvent) the director(s) can apply to the court for the appointment of an agent (mandataire ad hoc) or a conciliator (conciliation) to carry out specific rescue measures and assist in negotiations with the main creditors on a confidential basis.
 - If the company faces serious difficulties, but is not yet insolvent, the director(s) can also resort to safeguard proceedings or accelerated safeguard proceedings to restructure all or part of its debts, while benefiting from the protection of the insolvency regime.
 - However, if the company can no longer pay its current debts with its available assets for more than 45 days, the legal representative of the company or the director must file a declaration to the court to file for insolvency (*déclaration de cessation des paiements/dépot de bilan*). Not doing so is considered as mismanagement.
 - Depending on the financial situation of the company and the possibility of redress, the director can either file for rehabilitation or liquidation proceedings.

It is important for directors to understand their directors' duties, as well as how their actions and the decisions the board makes when the company is in financial distress could expose them to personal liability and risk.

Below is an overview of the potential claims and potential exposure for directors if the company is insolvent or at risk of insolvency.

Wrongful Trading

Continuing to Trade

- The directors may be liable for wrongful trading if they continue to trade in circumstances where the company has been unable to pay its current debts with its available assets for more than 45 days.
- The directors can be ordered to compensate creditors for any additional losses that they suffer as a result of that continued trading.

Extending Credit

- A director (including shadow director) may be liable for granting or extending credit or specific advantages to a company facing irremediable financial difficulties, to keep it artificially operating when it should have filed for bankruptcy.
- In cases of safeguarding, restructuring or liquidation proceedings liability is limited to circumstances of (i) fraud, (ii) indisputable interference with management of the subsidiary/debtor, or (iii) providing guarantees obtained from the creditor, in return for disproportionate credits or loans. If liable, the director can be liable for all or part of the company's debts.

Mismanagement Errors

Once insolvency proceedings have been initiated, a director can be liable for all or part of the company's debts if, as a consequence of mismanagement errors a company's assets do not cover its debts.

Bankruptcy

It is compulsory for a director to cooperate with the receiver and/or the judicial representative appointed by the court following filing for rehabilitation or liquidation proceedings, otherwise a personal bankruptcy action may be brought against the director.

Liability Towards Employees

Under certain conditions, the employer obligations can be imposed on a third party, including a director (legal entity) or a shadow director.

Wrongdoing

Directors may also be exposed to non-pecuniary/professional sanctions ("*faillite personnelle*") and/or criminal sanctions known as "*banqueroute*". The below are examples of types of action that may lead to sanction:

- Using the company to conduct and conceal business transactions for the director's benefit
- Using the company's assets or credit for the director's benefit, or to the benefit of another legal entity in which the director holds a direct or indirect position
- Fraudulently continuing to trade at a loss (whether to further one's own interests or not), knowing that this would lead to the company's insolvency
- Fraudulently embezzling or concealing all or part of the company's assets or fraudulently increasing the company's debts
- Failing to file for insolvency within 45 days of the date on which director(s) knew, or ought to have known, of the company's insolvency
- Obtaining credit at rates that are significantly higher than commercial rates or selling assets below market value, with intent to avoid or delay the opening of insolvency proceedings
- Undertaking, on behalf of a third party, without consideration, commitments deemed too onerous at the time they were undertaken in view of the company's situation
- Paying or causing the payment to a certain creditor, by defrauding other creditors, after the insolvency date and knowing that such a date had occurred
- Obstructing proceedings by voluntarily refraining from cooperating with the administrator/liquidator
- Concealing accounting documents or failing to keep the accounts

Preference

Any payment made, or contract created, in the period before the insolvency can be voidable if it was not made or concluded in the interest of the company and/or had a detrimental effect on other creditors.

Where the company is subject to insolvency proceedings (rehabilitation or liquidation), directors can be subject to professional sanctions if they paid or caused the payment, after the date of insolvency, of a pre-petition creditor to defraud other creditors.

In addition "*de jure*" or "*de facto*" directors who carried out certain wrongful transactions in the framework of insolvency proceedings, such as paying a pre-petition creditor by preference, could face criminal sanctions.

Practical Tips to Mitigate Liability

- If the company is facing financial difficulties that are likely to cause insolvency (but crucially the company is still solvent), the director can request the intervention of an agent (*mandataire ad hoc*) or a conciliator. These preventive measures are confidential. This can limit the directors' exposure in this sensitive period, while negotiating (confidentially) the restructuring of the debt with the main creditors.
- If these preliminary preventive measures are insufficient, safeguard proceedings (public) are also an option to restructure its debt, while benefiting from the protection of the court.
- To limit the risk of acts taken before insolvency being nullified, any agreements, settlement agreements, etc. can be subject to the "homologation" of the court.
- Great caution should be taken before making any redundancy plans or taking serious structural decisions for the company. In many cases employee representatives or work councils must be consulted.
- Parent company directors should ensure it remains independent, refrains from interfering in the subsidiary's management or providing excessive financial support.
- Appointing various directors can also reduce the risk of liability, as the decision-making and the liability is not then resting on one person – but this is not customary in France.
- Directors should not take any action with the intention of putting a creditor in a preferential position if the company is facing financial difficulty.

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