

FRANCE

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France: The introduction of alternative financing and the comeback of the revolving mortgage

'Traditional financing' has lost its edge in France

By traditional financing we mean a loan guaranteed by classic securities such as real immovable sureties¹ with, if needed, personal sureties as well.²

Creditors appear to have lost confidence in traditional sureties and a *fortiori* in traditional credit, turning towards alternative financing which meets their expectations. Furthermore, businesses requiring financing are also moving towards modes of financing termed as 'alternative'.

More precisely, classic sureties are being called into question, losing their effectiveness with the opening of insolvency proceedings. In the *Cœur défense* case,³ the French Supreme Court increased recourse to safeguard proceedings, limiting the prerogatives of creditors. Furthermore, in this case safeguard proceedings were granted to a company incorporated in Luxembourg in application of European Regulation No 1346/2000.

These case law resolutions have revealed that property financing runs two risks when safeguard proceedings are opened:

- an infringement on the binding force of loan agreements; and
- a threat to the effectiveness of sureties.

To mitigate these risks, common practice tends to recourse to alternate financial instruments such as the trust. Certain mechanisms like revolving mortgages, which are governed by Article 2422 of the French Civil Code, are encouraged by the legislator in an attempt to revive the economy.

The revolving mortgage was introduced into the French Civil Code by Order No 2006-346 of 23 March 2006.

This mechanism had by then been abolished by Law No 2014-344 of 17 March 2014, because it was said to incite individuals to use their real estate property to secure consumer credit and therefore lead to excessive indebtedness: 'According

to the draftsman, the mechanism of revolving mortgages has been used intensively in the United States and has been a key factor of the subprime crisis. As a result there has been unsustainable indebtedness of certain households that become insolvable as soon as the property market changes as well as economic growth artificially led by consumer credit.'⁴

However, it is necessary to underline that it is not the mechanism of the security itself which may be blamed for the 'unsustainable indebtedness of households',⁵ but rather the loans which are established by banking institutions to individuals. The security is only a mechanism to guarantee the debt arising from a loan.

Less than a year after this repeal, Law No 2014-1545 of 20 December 2014⁶ concerning the simplification of corporate life and containing diverse provisions for the simplification and clarification of law and administrative procedures, reinstated the revolving mortgage under Article 2422 of the French Civil Code.

This security finds itself back in the French Civil Code but only for use for professional purposes to guarantee professional securities.⁷

The advantages of the revolving mortgage for the debtor

The revolving mortgage enables the debtor to re-use its security as the initial loan is gradually repaid in order to guarantee more loans from the same or other creditors:

'A hypothec set up for professional purposes by a natural or legal person may, later on, be assigned to the guarantee of professional debts other than those mentioned in the contract, provided that such contract so provides expressly. The grantor of the hypothec may then offer it in guarantee, up to the sum provided for in the contract and specified in Article

2423, not only to the original creditor, but also to a new creditor, even if the original creditor has not been paid.⁷⁸

There is also a financial advantage as the revolving mortgage makes it possible to avoid having to carry out another mortgage registration for a future guarantee. The saving is not insignificant.

The advantages of the revolving mortgage for the creditor

The new creditor,⁹ to whom the revolving mortgage is given in guarantee, will benefit from the rank of this mortgage, therefore prevailing over the creditors registered prior to the recharge contract. The real surety, certified by a notarial act,¹⁰ will be a first rank revolving mortgage at the loan amount.

The recharge may be given in favour of the initial lender or any other lender but within the limit of the repayments made. Each debt guaranteed has the rank conferred by the initial registration.

When a mortgage's creditors have a recharge over the same mortgage, the date

of publication of the recharge contract will determine, among them, the rank.

In a tense economic period, this mechanism is meant to facilitate the granting and multiplicity of financing. Before the Hamon law, this dispositive was slightly set apart from the scope of guarantees due to its atypical nature. The legal re-establishment of this surety may be welcomed, encouraged and used widely by law and finance practitioners, thereby offering the possibility, for example, to put in place revolving property finance leases.

Notes

- 1 *Privilege de prêteur de deniers* or contractual mortgage.
- 2 Pledge.
- 3 French Supreme Court, commercial chamber, 8 March 2011, No 10-13.988 and Court of Appeal of Versailles, 13th chamber, 19 January 2012, No 11/03519.
- 4 National Assembly report, No 1156, 13 June 2013.
- 5 *Ibid.*
- 6 Art 48.
- 7 New Art 2422 of the French Civil Code.
- 8 *Ibid.*
- 9 Beneficiary of the remortgage agreement.
- 10 Art 2423 of the French Civil Code.

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How good is the good faith? Legal risks on property acquisition still not eliminated

It all looked so well. After more than two decades in which property acquisitions were subject to legal issues, eventually, this year it all should change and improve. The difficult and rather expensive examination of the legal circumstances of the property prior to an acquisition should be a thing of the past. Due to the implementation of good faith in property acquisitions this year, this so called 'due diligence' examination should no longer be needed.

As in Germany, the purchaser of the property will simply rely on the entry in the land register without any restrictions. Even if the entry proves to be wrong afterwards, their good faith in the correctness of the entry will be protected. In extreme cases, the purchaser of the property is in fact able to buy from someone who is de facto not the owner. This applies particularly as long as the seller

is kept in the land register as the owner. This 'purchase in good faith' obviously puts the unsuspecting actual owner at a disadvantage: through no fault of their own, they run the risk of losing their property.

To avoid this, they must enter the corresponding notation in the land register against the incorrect entry within three years. Afterwards, the entry is regarded as correct. Although rather unfavourable for the actual owner, this regulation protects the purchaser acting in good faith. Actually, it should mark the end of due diligence examinations.

It was the declared intention of the legislation to make the acquisition of property easier and more secure. Parts of the real estate industry already started celebrating the 'end of due diligence'. Title insurance companies and some lawyers on the other hand feared losing a substantial part of