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Extension of proceedings based on commingling of assets and liabilities

As a court-made doctrine enshrined in French law in 1985^[1] and again in 2005^[2], the commingling of assets and liabilities, i.e. a powerful weapon against the abuse of legal personality primarily committed within corporate groups which allows to extend safeguard, receivership or liquidation proceedings to one or several other person(s) when such person(s)'(s) assets and liabilities are commingled with that of the debtor^[3], has been much written about and commented in these unsettled times.

Article L.621-2§2 of the French Commercial Code, according to which *"the [safeguard] proceedings can be extended to one or several other person(s) when their assets and liabilities are commingled with that of the debtor"*, was precisely at the heart of an **application for a priority preliminary ruling on the issue of constitutionality** dismissed by the *Cour de Cassation*^[4] (French Supreme Court), in particular because:

- The restrictions to the exercise of the ownership right and free enterprise^[5] that may result from this text *"do not constitute an infringement that is disproportionate having regard to the goal pursued"*, i.e. to **re-build the assets/liabilities of persons who have made an abusive use of their legal personality, by pooling their properties together**;
- The argument according to which the holders of shares in a company against which an extension of insolvency/bankruptcy proceedings is sought **have no right to appeal**^[6] is inadmissible *"insofar as the*

challenged provision is not aimed at providing for remedies against decisions made in connection with its implementation”.

Even though the concept of commingling of assets and liabilities has been enshrined twice in French law, it is still not clearly defined. Yet, an analysis of court decisions rendered on this issue enables to outline two alternative criteria:

- **The intermingling of assets and liabilities**, materialized by a **commingling of accounts that makes it impossible to distinguish between the assets and liabilities of one company and that of the other(s)**^[7],
- The existence of **repeated abnormal financial relationships** resulting from the **desire to create such a confusion**, evidenced by either (i) **abnormal financial flows**^[8], or (ii) the **absence of financial flows or, more generally, of any consideration**^[9], as recently recalled by the *Cour de Cassation*.

The facts of the commented decision^[10] are as follows:

Two companies, SARL Jenny’k (the “SARL”) and SCI du 140 rue d’Estienne d’Orves in Clamart (the “SCI”), were bound to each other under a lease agreement. On December 10, 2009, judicial liquidation proceedings were initiated against the SARL. On said date, the SARL owed to the landlord, i.e. the SCI, the sum of 346,664 Euros corresponding to almost seven years of unpaid rents.

Pursuant to a judgment dated January 20, 2011, the liquidation proceedings initiated against the SARL were extended to the SCI, based on the commingling of assets and liabilities between the two companies.

Having noted that the SARL had **not paid any rents for a period of almost seven consecutive years**, that on the commencement of the judicial liquidation proceedings it owed **a 346,664 Euros rent debt** to the SCI and that the SCI “**had taken no step to collect its debt or obtain the termination of the lease**”, the Versailles Court of Appeals, in a judgment dated July 21, 2011, confirmed the extension of the liquidation proceeding, holding that “**such a forbearance stems from a repeated and systematic desire**”.

The appeal lodged by the SCI was dismissed by the *Cour de Cassation* that considered that these findings and opinions “*established the existence of abnormal financial relationships between the SARL and the SCI, which was constitutive of a commingling of assets and liabilities*”.

[1] Law n°85-98 of January 25, 1985 on the receivership and judicial liquidation of companies.

[2] Law n°2005-845 of July 26, 2005 on the safeguard proceedings.

[3] Articles L.621-2§2, L.631-7 and L.641-1, I of the French Commercial Code.

[4] Commercial Chamber of the *Cour de Cassation*, application for a priority preliminary ruling on the issues of constitutionality, October 8, 2012, n°12-40.058.

[5] Referred to in Articles 2, 4 and 17 of the Declaration of the Rights of Man and the Citizen of August 26, 1789.

[6] Provided for under Article 16 of the Declaration of the Rights of Man and the Citizen of August 26, 1789.

[7] Cf. in particular Decision of the Commercial Chamber of the *Cour de Cassation* dated July 4, 2000

[8] Cf. in particular Decision of the Commercial Chamber of the *Cour de Cassation* dated February 2, 1999

[9] Cf. in particular Decision of the Commercial Chamber of the *Cour de Cassation* dated March 5, 2002

[10] Decision of the Commercial Chamber of the *Cour de Cassation* dated January 8, 2013, n°11-30.640

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