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WHITE PAPER

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The Reform of Italian Insolvency Law: A New Preventive Restructuring Framework

Italy recently enacted a new insolvency code (the "New Insolvency Code"), which takes effect August 14, 2020. The New Insolvency Code sets up, inter alia, (i) a new preemptive restructuring framework; (ii) new rules encouraging new and interim financings by both lenders and equity holders whose claims can be satisfied with priority over both secured and unsecured claims in case of subsequent insolvency; (iii) new tools providing for the repayment in full of dissenting creditors, but at the same time (iv) the possibility to satisfy a claim by equivalent and to extend any stay of individual actions or maturity extensions to dissenting creditors.

In particular, as a first in the Italian insolvency framework, the New Insolvency Code establishes new out-of-court proceedings providing for specific alert mechanisms, assisted negotiations with creditors, and procedures aimed at preventing crises (thus insolvency), as well as insolvency proceedings specifically tailored for groups of companies. The New Code will be in line with the newly enacted European "Harmonization Directive" no. 2019/1023, encouraging the prevention of crises, an easier recovery therefrom, and restructuring proceedings mainly based on the principle of continuation of distressed businesses.

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The Italian government recently enacted legislative decree no. 14 of January 12, 2019 (the "Code"), providing for the reform of Italian insolvency proceedings and an almost complete rewriting of the 1942 bankruptcy law (the "Bankruptcy Law"), in line with the guidelines of the new European directive no. 2019/1023 of June 21, 2019, on restructuring and insolvency.

The Code will enter into force on August 14, 2020. Although certain provisions are already effective—e.g., those relating to the newly imposed corporate governance structures—the Code will only apply to proceedings initiated after August 14, 2020. Applications and proceedings pending at that date will continue to be regulated by the Bankruptcy Law. The Code does not regulate the so-called "extraordinary administration" for large companies (200/500 employees and at least €300 million in debt), statutory administrative liquidation (*liquidazione coatta amministrativa*), or the insolvency of public companies which remain regulated by the relevant existing sector-specific laws.

MAIN FEATURES OF THE REFORM

Recovery of Distressed Businesses

The Code provides that the new main objective of restructuring proceedings will now be the continuation and restructuring of the distressed businesses. Liquidation proceedings are left as means of last resort. In this respect, a "crisis" becomes the first formal step before proper "insolvency," and the term "judicial liquidation proceeding" (*liquidazione giudiziale*) definitively replaces the term "bankruptcy" (*fallimento*), which is usually linked to a negative social stigma.

The new European directive requests Member States to create preventive frameworks ensuring that action is taken well ahead of a default. By crafting a specific definition of "crisis," the Code establishes a new fully effective obligation upon distressed businesses to (and in a quite short timeframe) carry out all necessary remedial steps early to overcome crises and, potentially, insolvency. Under the Bankruptcy Law, businesses had no obligation to remediate to their financial distress, except when facing insolvency. The new system created by the Code is based on a forward-looking approach aimed at ensuring and monitoring the adequacy of companies' cash flows and the sustainability of their debts, both short and medium term.

This, coupled with the new early warning system described below, lays out a new overall approach aiming at ensuring the recovery of distressed businesses at an early stage.

Early Warnings and Out-of-Court Assisted Negotiation Proceedings

The Code provides for new and confidential out-of-court early warning procedures for spotting and potentially remediating crises at an early stage (the "Out-of-Court Early Warning and Assisted Negotiations Procedure"), without (expensive and time consuming) court-supervised proceedings and without existing contracts, including financings being automatically suspended or terminated. For this purpose, (i) an *ad hoc* body (*Organismo di composizione assistita della crisi*, or "OCRI") established within the competent chambers of commerce will assist the companies during negotiations with creditors for a maximum of six months; (ii) creditors will be involved at an early stage to cooperate in good faith with the company and the OCRI through a series of reporting obligations; and (iii) reward measures for the debtors aimed at encouraging any prompt response to crises' symptoms are introduced, such as tax reliefs, relief from criminal liability (if the resulting damages are not particularly consistent), or discounts on penalties (if the resulting damage does not exceed certain thresholds and the debtor's assets guarantee the satisfaction of at least one-fifth of the unsecured creditors' claims).

All corporate businesses (also now including limited liability companies, or società a responsabilità) must statutorily adopt specific and appropriate administrative and accounting structures to promptly spot crises. Such supervisory bodies—namely, supervisory boards, statutory auditors, and audit firms—shall (i) verify the adequacy of the company's governance; (ii) warn the board of directors of any potential crisis; and (iii) in case the board does not take any remedial step, promptly report to the OCRI in order to commence the necessary negotiations and avoid any possible liability deriving from acts or omissions of the board of directors taken after such report.

Similar reporting obligations are imposed on (i) qualified creditors' classes (i.e., Tax Authority, the Social Security Institute, and the collection agent) that, in light of defaults by the company exceeding specific thresholds, must warn the company to take the necessary remedial actions within 90 days or otherwise inform the OCRI; and (ii) banks and financial intermediaries which

must give appropriate notice to such supervisory bodies upon changes, reviews, or revocations of existing loans or credit lines.

The OCRI will have the authority to compel creditors to negotiate. Creditors have no obligation to execute or adhere to any remedial plan agreed in Out-of-Court Early Warning and Assisted Negotiations Procedure. Creditors participating in such procedure are bound by a confidentiality obligation not to disclose any information regarding the company's financial situation and any remedial step taken by such company. Creditors will benefit from:

- A clear obligation for the companies to truthfully and completely disclose to creditors their financial situation, as well as to carry out timely any necessary step to increase the chances of success of the negotiation proceedings;
- A certified snapshot of the companies' financial situation, which the OCRI will carry out upon commencement of the proceedings; and
- The fact that the Code provides that throughout negotiations companies must manage their estate "in the main interest of the creditors"—i.e., likely via management procedures that at least do *not worsen* creditors' expectations of satisfaction following the Out-of-Court Early Warning and Assisted Negotiations Procedure.

Restructuring Agreements With Creditors

Restructuring agreements (*accordi di ristrutturazione*, formerly regulated under art. 182-bis of the Bankruptcy Law) may now be reached with creditors representing either 60% or 30% of the overall amount of the credits. If only 30%, such an agreement can be validly entered into only if the company (i) does not ask for the dissenting creditors' claims to be frozen and (ii) waives any temporary protective measure it may benefit from.

Cramdown provisions are now extended to dissenting creditors of any kind, not only to banks and financial intermediaries (as provided for under the Bankruptcy Law), falling within the same class of the approving creditors—i.e., sharing the same legal position and economic interests of the approving creditors of that same class—provided that, inter alia:

- All creditors falling within the relevant class are involved in the negotiation of the restructuring agreement;
- The claims of the approving creditors represent at least 75% of the overall number of creditors of such class;
- The restructuring agreement provides for the satisfaction of the dissenting creditors' claims for an amount at least higher than the one which would result from judicial liquidation proceedings; and
- The restructuring agreement provides for the continuation of the company's business. This last requirement, however, does not apply when the cramdown affects banks and financial intermediaries representing at least 50% of the company's overall debts.

Even when affected by cramdown provisions, dissenting creditors are still entitled to exercise their rights against the company's co-obligors or guarantors and any secondary-liable obligor (*obbligati in via di regresso*). The cramdown can never impose on them an obligation to carry out new services, to grant new credit lines or to keep in place any existing ones, nor to grant any new financing. A lessee may keep benefiting from any leased assets without it being considered as imposing a "new service" on the dissenting lessors—i.e., the possibility for such lessors to undertake repossession actions may, in principle, be limited.

Subject to certain conditions, the above cramdown mechanics also apply to dissenting creditors in case of any provisional standstill agreement (*convenzione di moratoria*) between the company and the approving creditors aimed at regulating the effects of the crisis through (i) extension of the term for payment obligations; (ii) waiver of certain actions or the suspension of any executive or provisional actions; and (iii) any other measure not involving a waiver of claim.

Judicial Composition Proceedings (*Concordato*)

The Code provides that all restructuring requests relating to a single company must be examined together in a single proceeding. As for judicial composition proceedings (*concordato*), any vote relating thereto may occur via telematics means. The competent court will be where the company has its *center of main interests* ("COMI"), as defined under European law. Within such courts, the relevant proceedings will be managed by a court section specialized in restructuring matters.

Priority will be given to judicial composition proceedings on a business continuity (*concordato preventivo in continuità*), pursuant to which the business may be carried out either by the company directly or indirectly by third parties. The main objective pursued must be to preserve the business's employment levels and its value, even through its partial sale.

Those composition proceedings providing for the liquidation of the company's business (*concordato preventivo liquidatorio*) may be approved only if they (i) involve the granting of new money by third parties (*nuova finanza*), which improve creditors' expected satisfaction by at least 10%, as compared to judicial liquidation proceedings; and (ii) provide that unsecured creditors must be satisfied for at least 20% of their claims.

In any event, judicial composition proceedings:

- Must be based upon a business plan assessed by the court as legally and economically feasible (today Bankruptcy Law explicitly excludes the court's power to judge the plan also from an economic perspective);
- Must provide for the categorization of creditors into specific classes, which are mandatory for those creditors that (i) have tax or social security claims that cannot be entirely satisfied pursuant to the business plan; (ii) benefit from third-party guarantees; (iii) are to be satisfied with means other than money; and (iv) have proposed the judicial composition proceedings and any related party; and
- May set forth standstill provisions regarding the payment of secured creditors lasting for up to two years from the court's approval, provided that such creditors will maintain voting rights proportionally to the amounts of the payments regulated in the business plan (today Bankruptcy Law only provides for one year-long standstill provision without voting rights for the creditors).

Company's recourse to new funds is highly incentivized. New creditors will benefit from super-priority for their claims, and such priority is guaranteed even if composition proceedings are unsuccessful, and judicial liquidation proceedings are later opened. The company may be authorized by the court to request new loans (or guarantees or the maintenance of self-liquidating credit facilities) in the interim period preceding the court's approval, in order to ensure the business's continuity (even if the plan ultimately provides for its liquidation).

Judicial Liquidation Proceedings

The Code provides for a more efficient judicial liquidation proceedings, mainly through (i) the establishment of a new special registry of highly specialized statutory auditors that may be appointed to take charge of any of the restructuring proceedings and (ii) the creation of a dedicated website for carrying out the relevant sales (*portale delle vendite pubbliche*).

The liquidation of the company's single assets is possible only if it ensures a higher satisfaction of creditors' claims, as compared to the liquidation of all or part of its business or the transfer of claims, assets, and/or contracts identifiable as a pool. Any transfer may occur through the contribution of such business into (newly created) companies whose shares may be assigned to the creditors participating to the proceedings.

Three consecutive sale attempts—through open tender procedures—are envisaged for the liquidation of real estate assets before their price may be reduced to half of that offered in the last attempt.

(No Longer *Automatic*) Stay

The Code provides that companies may ask for a stay of provisional or enforcement actions by the creditors (i.e., *misure protettive*, or "Stay") during the Out-of-Court Early Warning and Assisted Negotiations Procedure—i.e., even before any judicial insolvency procedure is started, provided that a court is called to either determine the duration (maximum 12 months) of, or revoke, such Stay.

Companies may ask for such a Stay also upon filing for any judicial restructuring proceedings and, with respect to debt-restructuring agreements, even before filing for the court's approval thereof (i.e., while negotiations for the finalization of such agreements are still pending)—provided that the court may always amend or revoke it. Differently from what the Bankruptcy Law currently provides, the Stay is no longer *automatic*—i.e., deriving from the sole filing for a judicial restructuring procedure. The company must ask for it.

Restructuring Proceedings for Group of Companies

The Code sets forth innovative proceedings for the management of the crisis or insolvency of corporate groups. Companies belonging to the same group, each facing financial difficulties and each having its COMI in Italy, may file a single restructuring application with the same court. The resulting proceedings will be managed by a single insolvency receiver. This will not entail any commingling of their assets, not even in case of the opening of a single liquidation procedure in relation to all of them.

Such companies may present either a single business plan or multiple interconnected ones. Such plans may provide for the liquidation of some of the group's companies together with the continuation of others. The creditors of each single company (i) must be better satisfied than if the companies presented independent business plans and (ii) are admitted to vote at the same time but separately. Relevant majorities are to be calculated for each company independently.

The Code, however, does not regulate cross-border restructuring proceedings, which remain regulated by EU Regulation no. 848/2015.

THREE KEY TAKEAWAYS

1. Distressed businesses now have the chance to recover at an early stage thanks to new out-of-court negotiations with creditors and stricter rules regulating restructuring agreements and cramdown provisions.
2. Judicial liquidation proceedings (ex-bankruptcy) are now left as means of last resort. Overall, judicial restructuring proceedings are now more efficient and mainly based on businesses' continuity.
3. The Code sets forth, inter alia, new rules for the stay of creditors' actions and truly innovative proceedings for the restructuring of corporate groups.

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