AUGUST 2015

COMMENTARY

Italian Bankruptcy Law Reform Emphasizes Flexibility for Borrowers, Active Role for Creditors

During the last few years, the section of Royal Decree No. 267 of March 16, 1942 (the "Italian Bankruptcy Law") dedicated to pre-insolvency proceedings has been reformed extensively by the Italian legislature. The purpose of the reform is to provide distressed Italian entities with a more modern and flexible insolvency law system based on private rather than judicial initiative. Notably, certain pre-insolvency proceedings—traditionally intended for business liquidations—have been reshaped and improved to provide distressed entities with the tools to manage entrepreneurial and financial crises quickly, thereby limiting the negative impact that such events have on the market.

As part of this reform process, the Italian Council of Ministers enacted Decree No. 83 of June 27, 2015, which, as amended, became law on August 5, 2015 (the "Decree"). The Decree introduces measures designed to, among other things: (i) give distressed Italian entities greater access to rescue financing; (ii) promote the active participation of creditors in pre-insolvency proceedings (e.g., by giving creditors the ability to propose alternative restructuring plans under certain circumstances); (iii) empower Italian courts to approve asset sales as part of a restructuring plan by means of competitive bidding; and (iv) introduce certain special rules applicable to debt restructuring agreements entered into by distressed entities with obligations principally to banks and/or financial intermediaries.

This *Commentary* summarizes the main terms of certain innovations introduced by the Decree to the Italian Bankruptcy Law.

New Rules Applicable to Arrangement with Creditors Proceedings

The Decree mandates that any proposal made by the debtor as part of an arrangement with creditors proceeding (*concordato preventivo*) must provide for the payment of at least 20 percent of the total amount of unsecured claims before the proposal can be submitted to the court for approval. This requirement does not apply to creditor arrangements proposed by entities that will continue to carry on business (*concordato con continuità aziendale*).

In addition, the debtor's proposal must point out the specific, economically quantifiable benefit that the debtor undertakes to provide to each creditor.

Interim Rescue Financings

The Decree broadens the scope of Italian Bankruptcy Law provisions governing interim rescue financings in the context of debt restructuring agreements

(*accordi di ristrutturazione dei crediti*) and arrangement with creditors proceedings. In connection with these proceedings (as well as any pre-application for an arrangement with creditors (*concordato in bianco*) or pending court confirmation of a debt restructuring agreement, the debtor may ask the court to authorize first-priority (*pre-deducibili*) interim rescue financing on an expedited basis upon a showing that the financing is necessary for the debtor to continue operating. Before authorizing such financing, the court may require information concerning the terms of the debtor's envisaged restructuring plan and may consult—on a nonbinding basis—with creditors. Any such authorization is conditioned upon the submission of evidence by the debtor that: (i) there are no viable financing alternatives; and (ii) without the financing, the debtor will suffer imminent and irreparable prejudice (*pregiudizio imminente e irreparabile*).

Competing Offers

If an arrangement with creditors proposal includes a proposed purchase of the debtor's assets or business, or any part thereof, the court can order that the sale of these assets or business is subject to competing offers (*offerte concorrenti*) in accordance with court-approved bidding and auction procedures. The debtor is required to amend its proposal to creditors to reflect the outcome of the competitive bidding process.

Competing Proposals

The Decree gives creditors holding in aggregate at least 10 percent of the unsecured claims against the debtor (based on financial statements submitted by the debtor in support of its petition) the right to submit a competing proposal (*proposta concorrente*) in the event that the debtor's proposal does not provide that unsecured creditors will be paid at least 40 percent of the face value of their claims (as certified by an expert) or, in case of an arrangement with creditors in business continuity (*concordato con continuità aziendale*), that unsecured creditors will receive at least 30 percent of the face value of their claims (as certified by an expert). Any such competing proposal must be filed no later than 30 days prior to the date set by the court on which creditors are to vote on the debtor's proposal and any competing proposals.

If the distressed debtor is incorporated in the form of a limited liability company (*società a responsabilità limitata*) or joint stock company (*società per azioni*), the relevant competing proposal may also provide for capital increase against consideration with exclusion or limitation of any applicable preemption right in favor of the existing quotaholder or shareholders, as applicable. The creditor(s) filing a competing proposal may vote for such proposal only to the extent that they represent an autonomous class of creditors under the proposal. Moreover, if the relevant proposal provides for a plurality of classes, it may be submitted to the creditors only once the competent court has assessed the correctness of the criteria adopted for the formation of the creditors' classes. The proposal(s) may be amended until 15 days prior to the date set by the court on which creditors are to vote.

In the event of competing creditor proposals, the judicial commissioner (*commissario giudiziale*) must provide creditors, no later than 10 days prior to the voting meeting of creditors, with a report containing a detailed comparison of the proposals, including adequate information for creditors to make an informed decision. The creditor proposal approved by the highest majority of eligible voting creditors prevails. In the event of a tie, the debtor's proposal prevails. If no proposal receives the statutory majority of votes, the court will direct a re-vote on the proposal that received the highest number (*maggioranza relativa*) of creditor votes in the first round of voting.

Term for Approval of an Arrangement

The Decree extends the term for the approval (*omologazione*) of an arrangement with creditors from six to nine months, subject to a single additional extension of up to 60 days that may be ordered by the court.

Voting Creditors

The Decree clarifies that entities controlling the debtor or controlled by the debtor as well as affiliated entities are not entitled to vote on an arrangement with creditors proposal.

New Rules Applicable to Debt Restructuring Agreements Involving Financially Distressed Entities

The Decree introduces new rules applicable to debt restructuring agreements involving debtors with obligations to

banks or financial intermediaries that comprise no less than 50 percent of the debtor's aggregate indebtedness. These rules apply only to banks and financial intermediaries.

In a qualifying case, the debt restructuring agreement may provide for the creation of one or more categories of bank or financial intermediary creditors having common economic interests. The terms of the restructuring agreement will be binding on all creditors in a class if: (i) creditors holding at least 75 percent of the amount of claims in the class approve the restructuring proposal; and (ii) all creditors in the class have been duly and timely notified of the pending restructuring and afforded an opportunity to participate in the negotiations. The court must determine that these requirements have been satisfied and that dissenting creditors will receive at least as much under the proposal as they would receive under any alternative option.

If a debt restructuring agreement is approved by creditors (including bank, financial intermediary, and general unsecured creditors) holding at least 60 percent of the outstanding claims, the agreement will be binding on dissenting bank and/or financial intermediary creditors, *provided that* dissenting creditors may not be obligated to provide new credit or financing to the debtor.

The Decree contains comparable provisions with respect to standstill agreements (*pactum de non petendo*), *provided that* approval of a restructuring proposal by the requisite majority of bank creditors remains subject to certification by an independent expert that the signatory creditors to a standstill agreement have common economic interests.

Due Performance of a Court-Approved Arrangement with Creditors

The Decree also introduces new procedures designed to ensure that the debtor complies with the terms of a court-approved creditor arrangement. In the event of a breach or delay in performance by the debtor, the judicial commissioner must promptly inform the court. After consulting with the debtor, the court may in its discretion provide the commissioner with the necessary powers to remedy the debtor's failure to perform. In addition, the court may appoint a judicial administrator (*amministratore giudiziale*) to displace the debtor's management for a specified period and with specified powers.

Legal Considerations

Because the Decree has only recently come into force, it is not possible to predict the impact that the legislation may have on the Italian market. Even so, the innovations implemented in the Decree are significant and represent an additional attempt by the Italian legislature to: (i) provide distressed Italian businesses with more flexible legal instruments to timely address potential business and financial crises; and (ii) give creditors a more active role in pre-insolvency proceedings.

Key points regarding the new regime implemented by the Decree include the following:

- Under debt restructuring proceedings where at least 50 percent of the debtor's creditors are banks or financial institutions, it is now possible to create a specific class comprising such creditors. The decisions or resolutions made by the qualified majority (i.e., 75 percent) of creditors in the class may be binding on the entire class. This innovation should simplify the approval process by preventing—or at least limiting—opportunistic behavior by dissenting bank and financial creditors. It should also address certain issues typically connected with intercreditor arrangements.
- Unlike in the past, creditors now truly play an active role in arrangement with creditors proceedings by having the ability to submit competing proposals and the right to ask the court to oversee competitive bidding on a debtor's assets or business.
- A competing proposal submitted by creditors may provide for an infusion of new capital in the debtor by third parties or the creditors themselves in exchange for new equity and the dilution or elimination of existing equity interests.

Lawyer Contact

For further information, please contact your principal Firm representative or the lawyer listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

Franceso Squerzoni
Milan
+39.02.7645.4001
fsquerzoni@jonesday.com