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September 2012

New Italian Measures Facilitate Debt Restructuring and Protect DIP financing - Update

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This is an updated version of the *StayCurrent* Client Alert published on 2 July 2012 "*New Italian Measures Facilitate Debt Restructuring and Protect DIP Financing*", following the conversion of law decree No. 83 of 22 June 2012 (with amendments) (the "**Decree**") into law No. 134 of 7 August 2012.[1]

Notably, the Decree has introduced material changes to the Italian Bankruptcy Act[2] ("**IBA**") that have the effect, amongst other things, of facilitating debt restructuring and company bailouts, thus enhancing investment opportunities in distressed situations (the "**New Provisions**").

The Decree represents the very last step of a reform movement of the Italian bankruptcy system which began in 2004[3] with the aim of improving its efficiency and making the Italian distressed market more appealing for potential domestic and international investors.

In particular, the New Provisions will:

- Change the dynamics of restructuring negotiations, reducing shareholders' leverage and providing a safer environment for negotiations;
- Increase investment opportunities by facilitating loan-to-own strategies and equity investments by third parties; and
- Provide a safe environment for DIP or bridge financings, thus facilitating restructurings and increasing investment opportunities.

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A. RESTRUCTURING TOOLS AVAILABLE UNDER THE IBA.

In order to better understand the changes introduced by the New Provisions, it may be helpful to first summarize the restructuring proceedings available under the IBA and to which such changes apply.[4]

I. Concordato Preventivo.

Concordato preventivo is the proceeding available under Article 160 and other provisions of the IBA ("***Concordato Preventivo***") and consists of an arrangement proposal that, if approved by the creditors holding the majority of the debts and by the majority of the classes, binds all the

creditors (including the ones who have not approved it). The procedure is supervised by the court and is somewhat similar to Chapter 11 in the U.S. In broad terms, the debtor makes a proposal to the creditors, that may be divided in different classes and, if the proposal is approved by the creditors representing the majority of the company's debts and, if creditors have been divided into different classes, by the majority of the classes, the proposal is binding for all creditors. The procedure may also be carried forward through a competitive bidding process. The *Concordato Preventivo* has been used in prominent restructurings such as Mariella Burani Fashion Group and Fondazione San Raffaele del Monte Tabor.

II. Article 182bis.

Under Article 182bis of the IBA ("**Article 182bis**") a debtor may restructure his debts through one or more agreements with his creditors that represent at least 60% of the debtor's total outstanding debts. Such agreements and the underlying plan must be assessed by an expert (appointed by the debtor) and the overall transaction has to be filed with the competent court. The restructuring goes ahead only if the court approves it. Such expert is defined in the IBA at Article 67, paragraph III, letter (d)[5] ("**Expert**"), and plays a pivotal role in both Article 182bis and Article 67 restructurings. Recent prominent restructurings done with an Article 182bis proceeding are Risanamento S.p.A., Ferretti S.p.A. (2012) and Lucchini S.p.A.

III. Article 67.

The procedure available under Article 67, paragraph III, letter (d) of the IBA ("**Article 67**") is an out-of-court procedure that allows a distressed company and its creditors to carry out a restructuring plan without incurring the risk of clawback actions. Payments and security over the debtor's assets granted in execution of a plan assessed by an Expert, suitable for the restructuring of the debts and that can ensure the debtor's prospects of financial recovery, are not subject to clawback actions. This proceeding has been used in prominent restructurings such as Aedes S.p.A., Ferretti S.p.A. (2010) and Seat Pagine Gialle (2012).

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B. KEY AMENDMENTS INTRODUCED BY THE NEW PROVISIONS.

New restructurings will have to take into account the New Provisions. The main effects can be summarized as follows:

i. Interim period available after the filing to choose the most appropriate restructuring proceedings, granting the debtor the necessary protections on the actions taken in the meantime;

ii. Enhanced protection of (a) bridge and DIP financing, even immediately after the filing and before the restructuring is finally approved by the court; and (b) the business of the debtor as a going concern during and after the restructuring;

iii. Easier and more flexible access to restructuring proceedings for debtors also facing capital losses and/or negative net equity;

iv. Possibility to carry out *Concordato Preventivo* proceedings with a going concern; and

v. Increased importance of (and responsibilities for) the independent expert called to assess the reasonableness of the restructuring and the data on which it relies.

I. New features of the Concordato Preventivo*.*

The *Concordato Preventivo*, due to the former legal framework, has been used more as a liquidation tool rather than a restructuring option. The New Provisions have now significantly changed the characteristics and enhanced the potential of this restructuring tool, which has become more similar to a U.S. Chapter 11 procedure.

Notably, a debtor in crisis may now file a petition for *Concordato Preventivo* even if he has not yet prepared a restructuring plan and/or if the negotiations with creditors and other stakeholders are still pending. This means that the debtor may immediately accede to the protections (e.g. automatic stay) offered by the *Concordato Preventivo* and then carry on the negotiations with its creditors benefiting from the relevant breathing spell.

These new features may have the effect of granting debtors additional leverage in the restructuring negotiations given that, once the petition is filed, the stakeholders will be incentivized to react in order to accomplish a restructuring within the assigned timeline. Otherwise, in fact, the alternative scenario will likely be a bankruptcy filing.

With the New Provisions the Italian lawmakers have created a strong connection between *Concordato Preventivo* and Article 182bis proceedings. Debtors are entitled to file an interim petition for *Concordato Preventivo*, reserving the right to either (i) file a detailed proposal for *Concordato Preventivo* along with the relevant documentation, including the underlying restructuring plan, or (ii) switch to Article 182bis proceedings within the timeline assigned by the court (the "**Interim Period**"), preserving in any case the effects produced by the opening of the *Concordato Preventivo* since the filing of the petition.

At the same time, a debtor may file a petition under Article 182bis and, in the course of the proceedings, switch to *Concordato Preventivo*. Also in this latter case, the effect produced by the first opened proceedings under Article 182bis are preserved.

Below is a summary of some of the most important features of the New Provisions regarding the *Concordato Preventivo*.[6]

1. ***Concordato Preventivo* with a going concern**. The *Concordato Preventivo* has been perceived so far as a liquidation tool, which has always represented the major limit of such restructuring proceedings. Within the former legal framework, companies under *Concordato Preventivo* had to face a number of stringent limitations in the management of the business.
   The New Provisions, however, set forth a new legal framework that facilitates to operate a business as a going concern during *Concordato Preventivo* proceedings.

   Article 186bis IBA creates a new ad hoc type of *Concordato Preventivo* aimed at preserving the value of the business to the maximum extent possible, provided that the debtor has filed a proposal for *Concordato Preventivo* and an attached restructuring plan which specifically contemplate the continuity of the debtor's business.

   Some of the provisions that are crucial for this scope are the following: (a) pending contracts cannot be terminated by the other party (even if a public entity) due to the opening of a *Concordato Preventivo* and any contractual provision that states otherwise is ineffective; (b) companies under *Concordato Preventivo* proceedings cannot, for this reason, be banned from participating in public tenders; (c) the underlying restructuring plan may envisage that payments of secured creditors are stayed for a year (and such secured creditors are nevertheless not allowed to vote); and (d) should the *Concordato Preventivo* proposal provide for the sale of the business as a going concern, this may be sold free from encumbrances.

2. **Filing of an interim petition and switching proceedings**. The debtor is allowed to file an interim petition for *Concordato Preventivo* reserving the right to submit the underlying plan within a period assigned by the court and ranging from 60 to 120 days (which may be extended by the court up to a maximum of 180 days in total).[7] Within this term, the debtor may decide to file an Article 182bis restructuring agreement, thus *de facto* switching proceedings. With the order that allows the interim petition, the court sets forth specific information covenants for the debtor, including information relating to the management of the business, throughout the entire Interim Period.

   Please note, however, that the interim petition cannot be filed if the debtor in the previous 2 years filed an interim petition which was not followed by a *Concordato Preventivo* or an approved Article 182bis.

   This provision creates room for a more flexible negotiations process, which will have to fit within a strict timeline but will be open to very different business/industrial solutions.

3. **Pending contracts**. The debtor is entitled to ask the court (or the delegated judge, as the case may be), also in the Interim Period, to (a) terminate agreements[8] still in progress as of the date of the filing of the petition, and/or (b) suspend the performance of (one or more) agreements for a maximum of 60 days (with a further possible extension). The other contractual party will be entitled to an indemnification equal to the damages arising from the failure to perform the agreement, and his claim will be treated as the receivables arisen before the *Concordato Preventivo* petition was filed.[9]

4. **Bridge financing**. Provided that an Expert certifies that it is in the best interest of the creditors after having verified the financial needs of the debtor until the final approval of the court, the debtor is entitled to ask the court, also during the Interim Period, to authorize bridge financings, which would have the benefit of super-priority status in case of subsequent bankruptcy and could be secured by the debtor's assets upon the court's approval. Notably, creditors will be entitled to obtain new pledges or mortgages for such bridge financing. The court may also authorize future bridge financing identified only by the overall amount and the type of financing. Such a possibility empowers (a) the debtor to seek the necessary approvals whilst continuing to negotiate the relevant financing agreements with the lenders and (b) the lenders to safely grant financings that have been formerly approved by the court, while being free to negotiate the desired financing structure.

5. **Ordinary and extraordinary administration and claims**. When a petition for a *Concordato Preventivo* is filed, there is a period of uncertainty from the filing of the petition until the court issues the decree allowing (or rejecting) the *Concordato Preventivo*. Such period often has the negative effect of paralyzing the operations of the company. The New Provisions provide that, as of the date of the filing of the *Concordato Preventivo* petition, the debtor is (a) always authorized to perform acts of ordinary administration, (b) entitled to request the court approval for any act of extraordinary administration, and that (c) claims legally arising during the interim period benefit from the super-priority status. The New Provisions protect from clawback actions all acts, payments, and security granted by the debtor after the *Concordato Preventivo* petition has been published in the Companies' Register (*Registro delle Imprese*).

6. **Timetable**. Newly filed petitions for *Concordato Preventivo* will need to provide a detailed timetable pointing out the exact timing and technical steps envisaged to accomplish the *Concordato Preventivo* (which may be pursued through a liquidation plan or a turnaround plan) filed by the debtor.

7. **Expert assessment required on amendments to the plan**. The New Provisions clarify that, should the *Concordato Preventivo* petition be filed with the court and/or the underlying plan be subject to material amendments, then a new Expert assessment will need to be filed.[10] In addition, if, after the approval of the *Concordato Preventivo* by the creditors, the conditions for its feasibility and implementation have changed, the judicial commissioner will notify all creditors thereof and each creditor will then be allowed to modify its vote before homologation.

8. **Judicial mortgages**. Judicial mortgages created in the 90 days preceding the publication of the *Concordato Preventivo* petition in the Companies' Register (*Registro delle Imprese*) will not be effective *vis-à-vis* other creditors.

9. **Payments of receivables for goods and services due before the filing**. The debtor may ask the court, also during the Interim Period, to approve specific payments for goods or services due before the filing, provided that the Expert certifies that such goods or services are essential for the continuity of the business and to ensure the best satisfaction for all creditors. For new finance, no Expert's assessment is required if payments are made by the debtor using new finance, provided that such new finance is granted with no obligation of repayment or that it is subordinated to any other creditor.

10. **Non-vote is counted as favorable vote**. Creditors are allowed to vote also via mail, email or fax. Creditors who do not vote are considered as assenting creditors and their claims are taken into account for the determination of the relevant majorities.

11. **Share capital losses**. Often companies facing a restructuring have to tackle significant share capital losses. In this respect, the New Provisions provide that the mandatory rules on share capital losses contained in the Italian civil code (which require that, absent a prompt reinstatement of the necessary share capital, the company be put into liquidation) do not apply if the debtor has filed for *Concordato Preventivo,* for the entire process.[11]

II. Article 182bis.

The most significant amendment to Article 182bis relates to the *Concordato Preventivo*: the New Provisions allow a debtor to file an interim petition for *Concordato Preventivo* and, in the course of the proceedings, propose a restructuring agreement under Article 182bis.

In this respect, it should be noted that, if an Article 182bis is proposed in the course of a *Concordato Preventivo*, all the effects produced in the Interim Period by the filing of the petition for *Concordato Preventivo* proceedings and analyzed in previous paragraph I (i.e., pending contracts, bridge financing, ordinary and extraordinary administration and claims, payments of receivables for goods or services due before the filing and share capital losses) are in any case preserved until the final approval by the Court of the debt restructuring agreement pursuant to Article 182bis.

If an Article 182bis is filed independently from an interim petition for *Concordato Preventivo*, some of these features will in any case apply: payments of receivables for goods or services due before the filing and share capital losses.

In addition, the New Provisions have introduced flexible rules for repayment of non-adhering creditors in Article 182bis proceedings and, specifically:

a) claims due as of the day of the court's approval will need to be repaid within 120 days of such approval; and

b) claims not yet due as of the date of the court's approval will need to be repaid within 120 days of the date when such receivable is due.

Creditors of a company approaching an Article 182bis restructuring will therefore need to be proactive in order to negotiate their position.

III. Article 67.

The new legal framework for Article 67 introduced by the New Provisions, and in particular the stringent independency requirements for the Expert, offer a higher degree of transparency of Article 67 proceedings, and will probably make this restructuring tool more attractive in the case of softer restructuring.

The main new features of Article 67, introduced by the New Provisions, are:

1. **Expert's assessment**. The New Provisions shed light on the scope of the Expert's assessment in an Article 67 proceeding, who now has to certify not only that the envisaged restructuring plan is feasible, but also that the data provided by the company is true.

2. **Expert independency.** The New Provisions specify that the Expert to be appointed for the assessment of the restructuring plan is considered independent where he has (i) no connections with the debtor and/or other stakeholders; (ii) no interests in the restructuring proceedings that may affect his independent assessment; and (iii) no business relationship with the debtor in the previous five years.

3. **Criminal liability of the Expert.** The Expert may be subject to criminal liabilities in case of false assessments or concealment of relevant information.

4. **Publication of the restructuring plan**. Proceedings under Article 67 have the advantage of being run completely out of court and therefore being kept confidential. However, the New Provisions allow the debtor to publish his Article 67 restructuring plan in the Chamber of Commerce (*Camera di Commercio*), and such publication triggers tax benefits, as further detailed below.

IV. DIP financing and bridge financing

The Decree has amended Article 182quater of the IBA concerning the protection (i.e. super-priority status) of financings granted to a debtor in the context of, or for the implementation of, a *Concordato Preventivo* or an Article 182bis (the "**DIP Financing**"). Notably, whilst the former provisions provided that the super-priority status only applies to financings provided by a lender which is either a bank or a financial institution registered with the Bank of Italy, the Decree has carved out such restriction and the benefit of the super-priority status now applies to any DIP Financing.

C. TAX ASPECTS.

The Decree[12] has also introduced important amendments in connection with the tax treatment of contingent assets and losses on credits. According to amended paragraph 4 of Article 88, of Presidential Decree No. 917 of 22 December 1986, in case the company enters a restructuring plan as provided for by Article 67, which is published at the Chamber of Commerce (*Camera di Commercio*), or in the case that it executes a restructuring agreement pursuant to Article 182bis, the difference in the company's debt shall not be considered as contingent asset, for the portion exceeding the losses accrued prior to and during the relevant fiscal year.

By the same token, the amended paragraph 5 of Article 101 of Presidential Decree No. 917 of 22 December 1986 provides that losses incurred if the debtor is subject to insolvency proceedings or has reached a restructuring agreement for the debts approved by the court pursuant to Article 182bis are deductible from the profits of the company. According to the amendments introduced by Law No. 134 of 7 August 2012, for the purposes of paragraph 5 of Article 101, the debtor is subject to insolvency proceedings starting from the date of a/an:

- declaratory judgment of bankruptcy;
- decision ordering a compulsory winding-up;
- decree opening a procedure of *Concordato Preventivo*;
- order approving a restructuring agreement under Article 182bis;
- order opening an extraordinary administration procedure for large enterprises in financial distress.

Both provisions aim at tax leveraging the companies intending to enter into these procedures introduced and modified during the years by confirming the availability of tax breaks which were not available prior to these amendments according to the interpretation of the Italian tax authorities.

CONCLUSIONS.

The New Provisions represent a significant step forward in the reform of the Italian bankruptcy system, which is now lining up with the most modern and efficient foreign bankruptcy systems. The changes will likely have a significant impact on the way restructuring negotiations are conducted and their outcome, and will provide a favorable environment for innovative investment schemes and new money providers.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] Please note that the provisions of the Decree concerning restructurings apply to proceedings filed after 11 September 2012.

[2] Royal Decree No. 267 of 16 March 1942.

[3] Please refer to our Stay*Current* Client Alert of 4 August 2010 for a description of the main changes to Italian restructuring proceedings introduced in recent years, available on our website: http://www.paulhastings.com/publicationdetail.aspx?publicationId=1701.

[4] This paper focuses on pre-insolvency restructuring proceedings available under Italian law, highlighting the main features available for debtors and creditors. However, it is worth mentioning that, under the IBA, it is possible to restructure a company even in bankruptcy proceedings, as for the notable case of Parmalat S.p.A., which was restructured in the course of an extraordinary administration proceeding.

[5] In particular, the Expert shall be a professional that meets (i) the requirements set by Article 2399 of the Italian Civil Code; and (ii) the further independency requirements set by Article 67 as amended by the Decree.

[6] Something that was expected in the New Provisions, but is still missing, is a specific regulation for the possibility to file a *Concordato Preventivo* for groups of companies, which is not yet expressly provided by the IBA, although certain tribunals have recognized such possibility.

[7] If proceedings for the declaration of bankruptcy are meanwhile pending, the term is 60 days, which may be extended by the court for an additional 60-day period.

[8] Termination of an agreement pursuant to this provision would not impact the relevant arbitration and/or litigation clause possibly set forth in the agreement itself.

[9] This provision on pending contracts is not applicable to (i) dispute resolution clauses, (ii) employment contracts, (iii) lease agreements under Article 80 IBA, and (iv) preliminary agreements under Article 72(VIII) IBA, for the sale of real estate for residential purposes.

[10] In the initial commentary to the New Provisions, commentators have raised some concerns regarding the uncertainties of this provision, absent a definition of "material amendments".

[11] The effect of this carve-out is very important, considering that the rules of the Italian civil code on losses of share capital may also trigger potential liabilities for directors. However, directors should be mindful of the fact that such exemption does not apply to the period preceding the *Concordato Preventivo*.

[12] The provisions regarding tax benefits are effective as of the date of publication of the Decree (i.e., 26 June 2012).

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