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Italy Finally Approves Statute Amending Bankruptcy Act and Other Laws to Facilitate Restructurings and Reinforce Creditors' Rights

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With Law No. 132 of 6 August 2015 Italy's parliament finally passed (with some amendments) Law Decree No. 83 of 27 June 2015 (as finally converted into law, the "Decree"), amending various provisions of Royal Decree No. 267 16 March 1942 (the "Bankruptcy Act"), the civil code and the code of civil procedure, and certain tax provisions. The amendments aim to facilitate debt restructurings, support distressed companies in their turnaround attempts, and foster quicker liquidations in bankruptcy proceedings. This document supersedes our Stay Current of 6 July 2015, which described the content of Law Decree No. 83 before its conversion into law.

Minimum Requisite to Access *Concordato* Proceedings for Liquidation Purposes

The Decree introduces a minimum requisite for debtors who want to file for *concordato* proceedings with the aim of liquidating the business: the proposal for *concordato* to be submitted to creditors shall ensure the repayment of unsecured creditors for no less than 20% of their claims.

The above requisite does not apply in case of *concordato* proceedings with ongoing concern (*concordato con continuità aziendale*, *i.e.* which do not provide for the liquidation of the business).

Interim Financing

The Decree streamlines and makes more transparent the process for granting to the debtor super-senior interim financing in the context of all types of in-court pre-insolvency restructuring proceedings (*pre-concordato*, *concordato preventivo*, and restructuring agreements under Article 182-*bis* of the Bankruptcy Act). The streamlining is obtained by allowing the debtor to request the granting of the court's approval to the interim financing prior to the filing of certain documents and information. The process is made more transparent by the possibility that the court informally hears the views of the debtor's main creditors. By expressly extending the reach of the interim financing provisions to existing short-term lines, the Decree makes it easier to ensure that the debtor's business can continue during the restructuring process. The extension of the security package of the interim financing to the debtor's claims against third parties increases the protection of new money providers.

Stricter Scrutiny on Fairness and Equitableness of the Proposal

The Decree provides that (i) the debtor must in any case identify and explain in the proposal the specific and economically valuable benefits promised and guaranteed to creditors, and (ii) the judicial commissioner, in his/her report to be submitted to the tribunal and the creditors before the



opening of the voting procedures, shall expressly indicate the potential proceeds and upsides that may derive from damages and claw-back actions that could be exercised by bankruptcy receivers in an insolvency scenario.

Competing Offers in *Concordato* Proceedings

The Decree opens the way to competitive bidding in the context of *concordato* proceedings. This is achieved through two mechanisms:

- In the event the *concordato* proposal envisages the sale or lease (*affitto*) of going concerns or assets of the debtor to a third party offeror already identified, the Decree allows the court, based on a judicial commissioner's report on the offer received, to open a competitive procedure for the sale of such going concerns or assets of the third party original offer not in the best interest of creditors. If the bidding process results in an offer which is better than the original one, the debtor must amend its proposal of *concordato* accordingly. The original initial offeror is reimbursed of its costs up to 3% of the price of its offer.
- One or more creditors holding at least 10% (including claims acquired by such creditors after the filing of the *concordato* petition) of the overall debtor's claims have the right to submit an alternative proposal for *concordato* until 30 days prior to the creditors' meeting scheduled by the court only if:
 - in *concordato* proceedings with liquidation purposes, the proposal for *concordato* submitted by the debtor provides for payments to unsecured creditors of less than 40% of their claims; or
 - in *concordato* proceedings with ongoing concern (*concordato con continuità aziendale*), the proposal for *concordato* submitted by the debtor provides for payments to unsecured creditors of less than 30% of their claims.

Creditors are then allowed to vote the various proposals, with the one having obtained most votes being finally submitted to a final vote of the creditors—and the proposal is approved if voted by creditors representing the majority of claims admitted to vote and, if existing, of the classes of creditors.

The Decree contemplates provisions aimed at neutralizing conflicts of interest, guaranteeing access to information, and ensuring the debtor's performance of the terms of the proposal adopted by the creditors—such as the issue of new equity of the debtor with the exclusion or limitation of existing shareholders' option rights. If the debtor does not fulfill or delays the performance of the proposal approved by the creditors, the court may also temporarily replace the directors with a judicial administrator that can exercise all powers necessary to perform the proposal.

Non-Vote in the *Concordato* No Longer Counts as Favourable Vote

The Decree strikes from the Bankruptcy Act the rule introduced in 2012, whereby creditors who do not cast their vote are considered assenting creditors. From now on, for all *concordato* proceedings filed after 6 August 2015, in order to achieve the majorities required under the Bankruptcy Act, each creditor shall expressly provide its consent to the *concordato* proposal.

Cram-down of Dissenting Financial Creditors in Debt Restructuring Agreements

If at least 50% of the claims *vis-à-vis* a debtor are held by financial creditors—banks or financial intermediaries—the debtor may enter into a debt restructuring agreement under Art. 182-*bis* of the Bankruptcy Act with financial creditors representing at least 75% of the claims of the same



category (*i.e.*, creditors that have homogenous economic interests and legal positions), asking the court to extend the effects of such restructuring agreement also to the dissenting financial creditors, as long as the latter have been duly informed and invited to participate in the negotiations, and there are no viable alternatives that would be more satisfactory for such creditors.

The same mechanisms applies, *mutatis mutandis*, to standstill agreements entered into by the debtor and financial creditors representing at least 75% of the overall financial exposure of the debtor of the same category.

In any case, the dissenting creditors cannot be bound to assume new obligations, grant new finance, or keep available existing credit lines.

Extended Maximum Duration of *Concordato* Proceedings

The Decree extends the maximum duration of *concordato* proceedings from six to nine months from the filing of the *concordato* proposal with the Tribunal.

Criminal Sanctions for Fraudulent Debtors

The Decree introduces criminal sanctions for debtors who dissimulate or artificially create claims to fraudulently influence financial creditors with the view of obtaining their consent to a debt restructuring agreement or a standstill agreement—the criminal sanctions were already applicable in the context of *concordato* proceedings.

Measures to Facilitate Liquidations

The Decree introduces additional rules aimed at increasing the transparency and efficiency of insolvency proceedings. The rules include:

- measures aimed at avoiding a receiver's conflict of interest;
- a tight timeline for the closing of insolvency proceedings, which can now be closed also if litigation proceedings are pending;
- the requirement that a receiver has adequate resources to carry out the liquidation within the new stricter timeline contemplated by the Decree; and
- the possibility of revoking a receiver in the event he does not carry out the liquidation within the timeline contemplated by the Decree.

Introduction of Register of Insolvencies

The Decree mandates the Ministry of Justice to set up a national register of insolvencies, which will contain information relevant to creditors and other market players—including data that will allow creditors to calculate recovery ratios—and will be open to the public. The register will be an important stepping stone in the creation of the European insolvency register contemplated by the recent reform of the European Regulation on Insolvency Proceedings—see our Client Alert “*New EU Regulation on Insolvency Proceedings*” of 29 June 2015.

Enforcement Proceedings

The Decree amends several provisions of the Civil Code and the Code of Civil Procedure with the aim of streamlining and making more transparent the process for the enforcement of claims—and in particular, claims secured by pledges and mortgages—and reducing its costs.



A new Article 2929-bis of the Civil Code allows a creditor to directly (*i.e.* without having to preliminarily file a claw-back action) attach assets sold by a debtor without consideration or on which the debtor has created an encumbrance (*e.g.*, a trust) without consideration.

Until the new provision came into force, a creditor had to file an ordinary claw-back action against its debtor and the third party, asking a court to declare the inefficacy of the sale or the encumbrance. Only at the end of the claw-back proceedings, which could last several years, was the creditor entitled to attach such assets. Now, pursuant to Article 2929-bis a creditor is entitled to directly enforce its claim against the transferred or encumbered assets, even if already owned by a third party.

The proceedings under Article 2929-bis can be followed if:

- a. The creditor files in the relevant public registry its writ of execution (*precetto*) within a year from the recording (in the same public register) of the transactions that the creditor intends to challenge;
- b. The relevant assets are either registered movables (*e.g.* a vessel, an aircraft, a motor vehicle) or immovable (such as property);
- c. The concerned sale or encumbrance is detrimental to the creditor (*e.g.*, in case a debtor has several assets on which the creditor can satisfy itself, the circumstances that one of them was sold without consideration does not allow a creditor to attach that asset through the mechanism of Article 2929-bis).

The debtor, as well as any other party involved in the enforcement procedure, is entitled to file an opposition before a court seeking verification that the requirements of Article 2929-bis are met.

A new provision of the Code of Civil Procedure, Article 614-bis, allows courts to order a debtor to pay its creditor a certain sum for each breach of a court order or for the delay in the execution of the order. The amount due is established by the Court taking into account the value of the case, the type of obligation, and the damages that could be suffered by the creditor in case of breach of the order.

Article 614-bis applies in connection with the execution of court decisions where the losing party is not ordered to pay a monetary amount, but to do (or not to do) something, *e.g.* the restitution of an asset.

Furthermore, a new provision of the Code of Civil Procedure allows a creditor to ask the court to be authorized to search a debtor's assets on certain databases (*e.g.*, the "*Anagrafe tributaria*", a database used for gathering tax-payers information).

Several provisions of the Code of Civil Procedure have been amended to reduce the timing of enforcement proceedings. For instance, the freezing of an asset (*pignoramento*) has to be enforced within 45 days (instead of 90 days); the expert for the estimate of the value of the assets attached has to be appointed by the court within 15 days (instead of 30 days) from the filing, by the creditor, of the documentation required for the sale of the assets; and the following hearing has to be held within 90 days, instead of 120 days.

A completely new approach to auctions for the sales of assets has been introduced, with the aim to give uniform criteria for the evaluation of attached assets. In this regard, the amendments provide, *inter alia*:

- a. Specific criteria for the evaluation of real estate assets (market value, the status of the property, quantification of common charges, etc.);
- b. All sales have to be advertised in a new website, managed by the Ministry of Justice;



- c. All sales have to be delegated to a notary public or a qualified company (in the past, the possibility to delegate the sale was an option for the court);
- d. Real estate assets have to be sold even if the offer is one-fourth lower than the initial price established by the court (until the new measures, a new auction session would have had to be called); and
- e. The price of the real estate assets can be paid in instalments and, in such case, the buyer is authorized to get possession of the property if it can post a guaranty issued by a bank or an insurance company.

Deductibility of Credit Losses for Italian Banks

The new Decree amends the current framework provided by the Italian Income Tax Code, introducing a new deductibility regime for credit losses.

In particular, for the purposes of Italian Corporate Income Tax, Italian banks can now deduct in full—rather than pro-quota on a five-year basis—both write-downs and losses related to non-performing receivables in the current year in which they occurred. Furthermore, the recently approved amendments confirm that also credit losses deriving from the sale of such credits can now be deducted as of above.

The new Decree provides for a transitional *ad hoc* regime with respect to the current financial year, according to which write-down and losses related to non-performing receivables are deductible up to 75% of their value. The quotas of losses from past years can be progressively deducted until the financial year 2025 up to percentages—ranking from 5% to 12%, depending on the relevant financial year on which they will be deducted.

Finally, for purposes of the taxable basis of the Italian Regional Tax on Productive Activities, Italian banks can now consider losses, write-downs, adjustments and readjustments—related to credit depreciation in full—rather than pro-quota on a five-year basis.

Conclusions

The Decree's provisions constitute a comprehensive set of measures aimed at addressing practically all the segments of the value chain of the restructuring and distressed debt markets.

The enhanced provisions on interim financing are intended to:

- facilitate restructurings by providing the debtor with the liquidity necessary to have the time to identify the best restructuring option while at the same time preserving the value of the debtor as an on-going concern; and
- encouraging DIP lending by providing enhanced protections to new money providers which, following the opening of the Italian market to alternative lending—see our Client Alert "*Italy Introduces Measures to Facilitate Alternative Funding*" of 7 June 2014—can now include international funds.

The introduction of a competitive process in the context of *concordato* proceedings is aimed at:

- "keeping the debtor and the shareholders honest" by creating a remedy against non-transparent deals between the debtor and an offeror to the detriment of creditors;
- enhancing returns to creditors by ensuring that the assets of the debtor are disposed of at the highest possible price (as already demonstrated in the *San Raffaele*, *La Perla*, and *Bruno Magli* cases, where a *de-facto* competitive process was conducted even in the absence of express provisions of law);



- providing a more secure framework for distressed M&A transactions, thus encouraging new offers in a transparent and court-supervised process, while at the same time allowing the initial offeror to recover reasonable transaction costs; and
- allowing creditors to file their own *concordato* proposal(s), thus increasing the options available. This provision is particularly relevant in the context of “loan-to-own” strategies, and creditors’ led solutions.

The introduction of a cram-down mechanism in Article 182-*bis* restructurings—a sort of English-style scheme of agreement—will facilitate restructurings by greatly reducing the ability of dissenting financial creditors to extract unfair value by leveraging their hold-out power.

The measures to facilitate liquidation are intended to remove perverse incentives and reduce the timing of liquidation processes, with a view to allowing more prompt recoveries by the creditors.

The setting up of a national register of insolvencies will greatly assist in increasing market transparency and reduce transaction costs.

Streamlining and making enforcement proceedings more transparent will increase predictability and reduce transaction costs, thus increasing the appeal of secured loans.

The tax provisions align the Italian tax system to more common international standards and finally meet the requests the Italian banking system has made for many years. Furthermore, since Italian banks apply the International Accounting Standards, from now on the accounting result will be more and more “similar” to the tax result.

The new measures, which may be followed by additional measures currently under scrutiny by a special committee of experts appointed by the Ministry of Justice, further open the way to domestic and international investors operating in the distressed equity and debt market, as its provisions provide novel instruments to debtors, shareholders, buyers of distressed companies and assets, alternative money providers, special situations funds, and traditional banks.



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