ALERT MEMORANDUM

Comprehensive reform of Italy's bankruptcy laws

October 26, 2017

On October 11, 2017, the Italian Parliament passed a law (the "Reform Law"), which authorizes the Government to introduce a sweeping reform of Italy's bankruptcy legislation (which dates back to 1942 but was subject to significant amendment in recent years) in accordance with certain principles set out in the Reform Law.

The reform is expected to entail a major overhaul of Italy's bankruptcy and restructuring framework, including by (*i*) introducing alert measures seeking to identify and address distress situations at an early stage, (*ii*) facilitating the restructuring of corporate groups, (*iii*) limiting the use of judicial compositions with creditors (*concordato preventivo*) to going-concern restructurings, and (*iv*) allocating jurisdiction for proceedings concerning large debtors to specialized courts.

The reform will also entail a review of the Civil Code provisions on security interests and is expected to affect various other aspects of Italian corporate law.

The Italian Government has been mandated to implement the reform within 12 months.

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I. General Principles

The Reform Law sets forth certain general principles which the reform shall adhere to. These include:

- a statutory definition of "distress" (*crisi*),[1] consisting of probable future insolvency;
- the establishment of a single judicial mechanism to ascertain the insolvency, applicable to all debtors irrespective of the nature of the ensuing insolvency proceeding applicable to it; and
- ensuring that restructuring proceedings seeking to maintain the debtor's a going concern are granted a procedural priority by the courts.

II. Alert measures

The Reform Law introduces a system that appears to be inspired by the so-called "alert measures" (contemplated in other jurisdictions such as France) and imposes an active obligation upon the debtor's corporate bodies to take the necessary actions to address the situation of distress at a time when insolvency could still be avoided.

This "alert measures" system, however, will not apply to listed companies nor to "large enterprises" (as defined under the laws of the EU).

Each local chamber of commerce will be required to establish certain crisis composition organizations (the "CCO"), which will play a central role in the this context.[2]

In particular, upon request of the debtor, the CCO will assist the debtor in working out a consensual arrangement with its creditors. Pending the restructuring discussions, the debtor may also apply to the court for the adoption of such protection measures (*e.g.*, a moratorium), which appear appropriate to enable a successful outcome of the negotiations. In case no agreement is reached within the 6-month term, the CCO will inform the public prosecutor, in order for it to request the court to ascertain whether the debtor is insolvent.

If the control bodies of a company (*i.e.*, the board of statutory auditors or the supervisory board) or the firm auditing the company's financial statements believe that the company is in a situation of distress, they will be required to promptly inform the board of directors of the debtor. Should the directors fail to act, the control bodies or audit firm of the company must directly inform the CCO.

In addition, certain qualified creditors (such as the tax administration, the tax collection agencies and the social security organizations) will be required to inform the company's control bodies and the CCO of the default by the debtor on material financial obligations. Failure to communicate such circumstances could result in the security interests securing the claims of such qualified creditors being set aside in the case of subsequent bankruptcy.

The Reform Law seeks to incentivize the parties to act promptly. In case the debtor requests the involvement of the CCO at an early stage,[3] it will be shielded from certain criminal liability risks and may benefit from a reduced interest rate accruing on debt owed to tax authorities. Likewise, the liability risk of the members of the debtor's control bodies will be reduced provided that they inform the directors and the CCO of the existence of a situation of distress promptly.

III. Corporate group restructuring

[1] Which will be a requisite to trigger the new alert measures (see Section II), be granted access to *concordato preventivo* proceedings (see Section IV) or propose a Court-ratified restructuring agreement (see Section V).

[2] In practice, once the CCOs are involved (whether upon request of the debtor or as a result of a notice from the debtor's control bodies or qualified creditors), the CCO will appoint a committee of at least three experts who will be in charge of assisting the debtor in addressing the situation of distress.

[3] What the "early stage" means will have to be defined by the Government. The Reform Law provides that such definition will depend on financial indicators, including the gearing, liquidity and inventory turnover rate.

The Reform Law also introduces a long-awaited set of rules, chiefly of procedural nature, governing the insolvency or restructuring of corporate groups.[4]

In particular, the proceedings may be started through a single petition to a single court (regardless of the location of the registered office of the group members) and will be supervised or managed by the same trustees or judicial commissioners (depending on the type of proceedings).

In case of a group composition with creditors (*concordato preventivo*), the group entities must propose to the court and the creditors a single restructuring plan. Creditors of the various group debtors will vote at the same meeting (though separately) on the plan, but intra-group creditors will be excluded from the vote.

The opening of a single insolvency or restructuring proceeding for multiple members of the same group, however, will not cause the commingling of their respective assets and liabilities.

IV. Reform of judicial composition with creditors (*concordato preventivo*)

Over the past 10 years, the judicial composition with creditors (*concordato preventivo*) has been subject to a continued reforming effort, which has resulted in such proceedings increasingly resembling U.S. Chapter 11 proceedings.

The Reform Law once more seeks to amend the rules applicable to such proceedings, with the stated intention of striking a fairer balance between the interests of debtors and creditors.

Specifically, *concordato* proceedings contemplating the full liquidation of the debtor's assets (*i.e.* with no preservation of a going concern) will no longer be permitted, unless third party's funds are contributed to ensure a substantial recovery of unsecured creditors (in no event lower than 20%).

Also, the Reform Law clarifies that the bankruptcy court will have the power to review the *concordato* plan and assess not only its compliance with law but also its practical feasibility.

In order to address potential abuses by debtors of the automatic stay and other protections granted by the bankruptcy law, the Reform Law authorizes the courts to revoke such protections if they are not conducive to a successful restricting.

The Reform Law also clarifies that the claims of secured creditors may be rescheduled (something which was doubtful under current law) so long as they are admitted to vote on the plan..

Moreover, in the event that a single creditor holds the majority of the indebtedness, the approval of the *concordato* plan requires the approval of the majority of creditors, not only by amount of the claims (as under current law) but also by number.

Finally, the Reform Law mandates the Government to revise and simplify the various rules currently existing on debtor-in-possession financing (at present, there are at least 5 different forms of interim or debtor-in-possession financing, none of which has proved effective). The new rules will have to ensure the that the super-priority status of the loans authorized by the court is not undermined in case of subsequent insolvency liquidation of the debtor / borrower.

V. Restructuring Agreements

Since 2015, the effects of certain court-ratified restructuring agreements may become binding on dissenting financial creditors, provided that (*i*) consenting creditors hold at least (*i*) 75% of the financial debt and (*ii*) 60% of the total debt.

Pursuant to the Reform Law such effects may be extended to any dissenting creditor, regardless of the nature of its claims, provided that consenting creditors hold at least 75% of the total debt, so long as the agreement does not provide for a mere liquidation of the debtor's assets.

VI. Impact on corporate law

The Reform Law also affects certain corporate law matters incidental or complementary to the new rules

[4] At present, the existence of a group in an insolvency scenario is relevant only in case of extraordinary administration proceedings (*amministrazione straordinaria*).

on insolvency and restructuring proceedings. Chiefly:

- there will be an obligation for companies and their corporate bodies to adopt appropriate organizational models designed to promptly detect and address a situation of distress;
- in the event that a court grants a protective measure pending the restructuring effort under the auspices of the OCC, the statutory obligation to convene the shareholders' meeting to recapitalize or wind-up the company (triggered in case of losses exceeding 1/3 of the share capital) will be suspended;[5]
- the adoption of a statutory measure for the damages for which the company's directors are liable in case a winding-up event occurs and they take actions outside of the ordinary course of business;
- the extension of the obligation to appoint a board of statutory auditors or external auditors to companies currently not subject to it.

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[5] Under the existing legal framework, such suspension applies only upon filing a petition to be admitted to *concordato* proceedings or ratify a restructuring agreement.