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Client Alert Commentary

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Recent Developments in Insolvency Law

Italian legislative amendments promote rescue over liquidation for companies facing insolvency, in line with this year's European Commission recommendation.

Italian lawmakers have passed two decrees which will provide welcome relief to distressed companies, promoting rescue over liquidation and bankruptcy proceedings by early intervention. The Law Decree dated 23 December 2013, No. 145, converted into law of 21 February 2014, No. 9 (the Decree), and (ii) the Law Decree of June 24, 2014, published on the Official Gazette No. 144 of June 24, 2014 (the Growth Decree) amending, inter alia, Royal Decree No. 267 of 16 march 1942 (the Bankruptcy Law) include the following changes:

- An amendment to the super-seniority regime of debts created in connection with a petition for the reservation of pre-bankruptcy agreement
- Pre-emption rights in favour of the employees of the debtor in case of sale or lease of the distressed businesses
- The possibility for a debtor under a pre-bankruptcy agreement with a going concern (*concordato in continuità*) to obtain the competent court authorization to participate to public tender procedures
- Amendments to the procedure of extraordinary administration applicable to large businesses.

Super-seniority

The Growth Decree has abrogated a recently introduced provision affecting the super-seniority regime applicable to debts incurred by the debtor in the preparation of, or in connection with, a petition for reservation of admission to a pre-bankruptcy agreement pursuant to article 161, paragraph 6 of the Bankruptcy Law (the Reservation Petition). The Reservation Petition was introduced in 2012 to allow debtors to file a petition to be admitted to a pre-bankruptcy agreement by filing an application with a very limited set of information (mainly data of the company, list of creditors and financial statements relating to the last three financial years), to be subsequently integrated in accordance with the orders of the competent court. The debtor could subsequently choose to either continue pursuing the pre-bankruptcy procedure or switch to a debt restructuring agreement entered into pursuant to article 182 – *bis* of the Bankruptcy Law with its creditors. The Reservation Petition is aimed at allowing debtors to benefit from certain protections, including super-seniority of new finance, applicable to restructuring procedures, pending the definition of the restructuring plan or the achievement of the consent of the required quorum of debtors, thus enabling the company to early address a situation of distress.

The Decree introduced a rule[1] that granted super-seniority ranking to credits connected to a Reservation Petition *only* if the debtor had filed timely the complete set of information to request admission to a pre-bankruptcy procedure and if the court had admitted the debtor to the pre-bankruptcy procedure. The amendment had been highly criticized because banks, creditors and suppliers became reluctant to support the business of the debtor at the stage of the Reservation Petition, since, in case of failure by the

debtor to timely file the complete set of information or in case of rejection by the court of the application, the new creditors' receivables would not have been super-senior. Also, the newly introduced provision did not contemplate the case in which the court would not admit the debtor to a pre-bankruptcy procedure because the debtor opted to enter into an agreement pursuant to article 182-*bis* of the Bankruptcy Law, as the law allows.

In addition to the above, commentators emphasized that the provision did not clearly rule out super-seniority of the above-mentioned credits, thus adding uncertainty to the legal framework applicable in such crucial phases of a restructuring proceeding.

With the Growth Decree, the Italian legislators cancelled the interpretative rule, clarifying that credits incurred by the debtor in the preparation of, or in connection with, a Reservation Petition are super-senior. Such super-seniority should apply also to credits arisen when the interpretative rule was in force, considering the interpretative, rather than innovative, nature of the rule, provided that no judgement by a competent court on the seniority of such credit took place before the entry into force of the Growth Decree.

Pre-emption rights in favor of the employees

The employees of a company that is declared bankrupt — under a pre-bankruptcy agreement, extraordinary administration (*amministrazione straordinaria*) or mandatory winding up (*liquidazione coatta amministrativa*) — can form a cooperative company. That cooperative company has the right to be preferred to third parties, at the same terms and conditions, in the acquisition or lease of the business (*azienda*), part of the business (*ramo di azienda*) or pools of assets (*complessi di beni*) and contracts belonging to the distressed business.

Apparently, only the sale of single assets is excluded from the scope of application of the pre-emption right. While, seemingly, the pool of assets and contracts needs not be composed of assets and contracts functionally connected, but only comprising a plurality of assets, to trigger the pre-emption right.

In addition, the new rule does not specify the requirements and form that the notice triggering the pre-emption right (*denuntiatio*) should have, nor the term within which the pre-emption right must be exercised.

In the absence of an express provision of law, it is reasonable to expect that the court may set the formalities and the term to exercise the pre-emption right, possibly applying the provisions of article 104, paragraph 4 of the Bankruptcy Law, which grants a five-day term to exercise the pre-emption right. Such timing would be compatible with the need to rapidly define the procedure, while the term set forth by law in connection with the exercise of other legal pre-emption rights — ranging from 30 to 60 days — would be unreasonably long and would cause excessive uncertainty.

The Decree also specifies that in case the lease or sale is awarded to the cooperative formed by the employees, such employees can be paid in advance the sums to which they are entitled as a mobility indemnity (*indennità di mobilità*) and unemployment indemnity (Aspi). Those employees who do not adhere to the cooperative shall be subject to the regular unemployment indemnity regime.

Court authorization to participate in public tenders

Pursuant to the new provisions enacted with the Decree, debtors who filed a petition to be admitted to a pre-bankruptcy agreement with going concern (*concordato in continuità*), may participate in public tender procedures, provided that the court grants its authorization with the prior opinion by the judicial officer, when appointed.

Further, in order to increase the pre-bankruptcy proceeding's chances of success and compatibility with the performance of the public contract, the public contracting entity now may directly pay sub-contractors and other third party creditors involved, pursuant to the court's guidelines.

Extraordinary administration procedural amendments

The Decree allows the Ministry of Development to grant a further 24-month extension of the term to complete a dismissal plan of a company under extraordinary administration, thus extending to four years the possible maximum duration of the dismissal plan. The extension is subject to a favorable report by the judicial officer (*commissario giudiziale*) confirming that the extension increases the business' chances of continuation.

The Decree also added a clarification with regard to the value of the assets to be dismissed by the debtors under an extraordinary administration procedure.

Pursuant to Article 63 of Legislative Decree of July 8, 1999, No. 270, the determination of the sale price by the expert appointed by the extraordinary commissioner must be calculated deducting the forecasted badwill for the two following years. In consideration of the reduction, the purchaser must undertake to continue the business for the two following years, meeting the employment level requirements set forth in the deed of sale.

It was debated whether the price so determined was to be deemed mandatory, and not capable of being amended by the officer in charge of the proceeding, in order for the sale to be validly effected. The Decree now allows more flexibility, clarifying that the value of the assets to be calculated pursuant to the applicable law should not be considered a mandatorily applied amount for the sale to be valid.

The purchaser's obligation to meet the employment level requirements for at least two years, as described above, is still in force.

European framework developments

Parallel to these developments in Italy, the European Parliament voted on 5 February 2014 on the European Commission's (EC's) proposal to modernize Europe's rules on cross-border insolvency amending the European Insolvency Regulation (1346/2000/EC).[2] The proposal aims to reduce disparities between national laws that can create uncertainty and an unfriendly business environment thus negatively affecting cross-border investments.

Pending the final approval of the amendments to the European Insolvency Regulation (1346/2000/EC), the EC published in the Official Journal of the European Union the Recommendation 2014/135/EU on a new approach to business failure and insolvency (the Recommendation) aimed at addressing some of the issues which have already emerged in the context of the consultation for revision process mentioned above.

The Recommendation is not binding and Member States are not required to enact domestic legislation to implement it. Although the Commission will monitor if, and to what extent, Member States implement the Recommendation over the next 18 months, it is difficult, at present, to anticipate the impact it will have in practice, also due the fact that some aspects are inextricably linked to substantive local law issues and will therefore require a complex process to overcome possible resistance at a national level.

The Recommendation proposes, in particular, to provide for (a) a restructuring framework allowing debtors to restructure their business with the objective of preventing insolvency and (b) a second chance for good faith entrepreneurs so that, unless there has been dishonesty, such entrepreneurs are discharged of their debts within three years of the start of any repayment plan or process that implements a liquidation process in relation to their assets.

The Recommendation calls on EU Member States to amend their respective national restructuring legal frameworks to include provisions that allow the debtor to access restructuring schemes as soon as it is apparent that there is a likelihood of insolvency, retaining control over the day-to-day operation of their business. The Recommendation also suggests to introduce:

- The possibility to request a four-month stay of individual enforcement actions, which can be renewed up to a total of 12 months
- The possibility to adopt a restructuring plan binding on all creditors with the favourable vote of the majority of creditors and the court approval of the plan
- The possibility to obtain new financing necessary to implement a restructuring plan without any risk that the financing can be declared void, voidable or unenforceable as an act detrimental to the general body of creditors
- The possibility to implement a restructuring plan without court proceedings, although the court should be able to intervene and appoint a mediator or supervisor if appropriate
- The detailed description of matters to be included in any restructuring plan, so that the court can confirm plans with expediency and, in principle, in a written procedure

Although some amendments may be necessary to fully align to the Recommendation, Italian Bankruptcy Law is substantially in line with it: in the recent years, the Italian legislators introduced several amendments to the Bankruptcy Law particularly with the aim of promoting rescue over liquidation proceedings by early intervention and giving debtors the ability to start afresh (see our Alerts No. 1363 of July 12, 2012, No. 1151 of February 24, 2011, No. 1080 of September 13, 2010).

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Insolvency reforms in Europe

[1] Purportedly, an interpretative rule meant to clarify the interpretation of an existing principle rather than amending the existing law and, as such, applicable to all Reservation Petitions, including those filed before the entering into force of the Decree.

[2] The amendments mainly aim at:

- Extending the rules to cover rescue proceedings
- Creating an EU-wide system of web-based insolvency registers
- Avoiding the opening of multiple proceedings
- Dealing with the insolvency of groups of companies