In the Legislative Decree No. 78, dated 31 May 2010 (the “Decree”), the Italian Government adopted a set of urgent measures to ensure the stability of the financial system and competition, including significant provisions in the context of restructuring procedures in Italy. The Decree is effective from 31 May 2010. The Italian Parliament must convert the Decree with any possible amendments, into law before the end of July otherwise the Decree will be deemed ineffective from the outset.

In this client briefing, we will summarize the main provisions set out in the Decree and its impact on Italian Bankruptcy law.

The most significant provisions introduced by the Decree are the following:

• provisions which allow lenders willing to provide rescue or interim financing to a distressed company in Italy to acquire legal priority (in the form of ‘super seniority’ or ‘DIP financing’) over the existing creditors of the company in the context of pre-bankruptcy creditors’ composition (“concordato preventivo”) and debt restructuring arrangements (“accordi di ristrutturazione dei debiti”) (the “Restructuring Procedures”);

• disapplying the rules on equitable subordination in the context of Restructuring Procedures and up to an amount equal to 80% of the amount of the shareholder loan;

• extending the stay on enforcement and precautionary measures against the company for a period of sixty days in the negotiation phase preceding the publication of the restructuring arrangement.

The Good: Legal priority – Rescue and interim financing

The reform of the Italian Bankruptcy Law introduced by the Decree gives priority ranking to new loans (“DIP financing” or “super seniority”) or interim financing to an Italian distressed company, as well as shareholders loans, provided in the context of pre-bankruptcy creditors’ composition or restructuring arrangements. Such financing will therefore be satisfied with priority upon liquidation of the assets of the company to the general body of creditors.

Prior to the Decree, the Italian legal system did not allow the creation of or recognize creditors’ priority rights upon the insolvency of a debtor, other than in very limited cases. Giuseppe de Palma, Banking & Finance partner and member of the restructuring group comments: “Many of the crises seen in the past 18 months originated from short-term liquidity crises, rather than fundamental business difficulties, due to the need to address high levels of indebtedness. The new rule recognizing legal priority to rescue and interim financing granted to distressed Italian companies, is without doubt encouraging in the current economic situation, and represents a significant cultural change in the context of restructuring and insolvency proceeding.”
Client briefing
The good, the bad and the ugly: changes to Italian restructurings

The Decree, introduces for the first time legal priority to loans granted to a distressed company over the existing creditors of the company. This is on the basis that the new finance is provided:

1) in the context of either the in-court pre-bankruptcy creditors’ composition ("concordato preventivo") or out-of-court (but subject to the Court’s sanctioning) debt restructuring arrangements

2) by banks and financial companies ("intermediari finanziari") enrolled in the registers set out in Articles 106 and 107 of Italian legislative decree No. 385 of 1 September 1993 (the "Italian Banking Act"). The Decree only refers to banks ("banche") and Italian authorized "financial companies" (registered under Articles 106 and 107 of the Italian Banking Act). Reference to banks should logically (taking into account the rationale of the new provisions introduced by the Decree granting legal priority) be meant to include non-resident banks lending into Italy, which are either in the position to rely on the passport under relevant EU legislation or properly authorized by the Italian competent authorities. However, in light of the limited spectrum of the regulated entities contemplated by the Decree, it is expected that non-banking institutions (such as turnaround fund or special situation funds), which are not authorized to lend or engage in financial activity in Italy (and not registered under Articles 106 and 107 of the Italian Banking Act) will not be able to rely on the new provisions introduced by the Decree granting legal priority.

Giuseppe de Palma, Banking & Finance partner and member of the restructuring group adds: "New finance lent by non-resident non-banking institutions (such as turnaround or special situation funds) remains problematic, as these funds do not appear to fall under the scope of application of the new rule recognizing legal priority."

However, no legal priority is expressly recognized for finance provided in the context of the work-out plans ("piano di risanamento") contemplated under Article 67 (3) (d) which are certified by an independent expert. It appears that the reason for the exclusion of finance provided in the context of work-out-plans is that there is no involvement by a court or other authority in the preparation, review or execution of such plan (please note however that, protection from claw-back is afforded to such finance).

Prof. Avv. Carlo Felice Giampaolino comments: "The restructuring arrangements set out in Article 182-bis appear in practice to be the preferred out-of-court rescue procedures, if compared to the work-out plan set out Article 67, thanks to the Court’s involvement, which provides greater certainty on the recovery from the financial distress."

Specific provisions also provide that "interim" financing granted to the distressed company prior to the opening of the above-mentioned Restructuring Procedures, acquire legal priority subject to the following conditions being met:

a) the interim financing is granted by banks and financial companies ("intermediari finanziari") enrolled in the registers set out in Articles 106 and 107 of the Italian Banking Act (see 2 above);

b) the interim financing is for the purposes of the filing of a petition with the competent court for admission to the pre-bankruptcy creditors’ composition or to obtain the Court's approval on the debt restructuring arrangement;

c) the interim loan must be expressly contemplated under either the proposed plan for reaching a pre-bankruptcy composition with creditors or the debt restructuring arrangement; and

d) the pre-bankruptcy creditors’ composition or the debt restructuring arrangement must be sanctioned by the Court.

The possibility to grant "interim" financing before the opening of the relevant Restructuring Procedures should increase the possibility to find lenders willing to lend and at the same time foster the use of restructuring procedures as an alternative to bankruptcy.

For sake of completeness, the Decree also provides that the fees due to the independent expert (who must certify in its report the feasibility of the restructuring plan, whether in the context of the pre-bankruptcy creditors’ composition or the debt restructuring arrangements) gain legal priority, provided that the pre-bankruptcy creditors’ composition or the debt restructuring arrangement are sanctioned by the Court.

The creditors providing "interim" financing, the expert's fees, as well as shareholders loans (see below), will not however be able to vote and or be included in the calculation of the majorities required either to approve the pre-bankruptcy creditors’ composition or the debt restructuring arrangements or the approval of the stay on enforcement and precautionary measures in the negotiation phase, as further explained below.

The Bad?

Fabio Guastadisegni, Litigation partner, adds "The giving of financing to Italian distressed company raises concerns on banks and financial institutions, in light of possible criminal allegations that the lenders may face if the company does not recover and is subsequently subject to bankruptcy or an analogous proceeding. The initial drafts of the Decree seemed to address these concerns by introducing specific exemptions from the typical criminal liabilities..."
considered in the context of the restructuring procedures. The current text of the Decree is silent on this matter. It remains to be seen if during the conversion by the Parliament, these provisions will be re-considered and hopefully bring more clarity on the criminal liability exemptions in the case of financing granted within the context of restructuring procedures.”

Shareholders Loans

Currently Italian legislation contemplates that shareholder/intercompany loans granted to a company within the same group may be subordinated by operation of law to all other debts of such company, if granted at a time when, taking into consideration also the business carried out by the company: (i) the company’s indebtedness was excessively high compared to shareholders’ equity, or (ii) the company’s financial situation was such that a shareholders’ contribution would have been reasonable under the circumstances. In addition, any payment received in repayment of such shareholder/intercompany loans may be clawed-back by a receiver in bankruptcy of the borrower should the borrower become insolvent within one year from the date the relevant payment is made.

The new provision introduced by the Decree, derogates from the equitable subordination rules, by allowing shareholders to acquire priority over the existing creditors of the company provided that the shareholder loan is provided in the context of specific restructuring procedures (namely, the debt restructuring arrangements and pre-bankruptcy creditors’ composition (“concordato preventivo”)) and up to an amount equal to 80% of the amount of the shareholder loan.

This change will be of extreme importance for the shareholders loans which are expressly contemplated in the relevant restructuring procedures and facilitate, legal priority for such funding.

Carlo Felice Giampalino, Litigation partner, comments: "The provisions recognizing legal priority to shareholders loans, up to an amount equal to 80% of the loan, expressly derogating from the equitable subordination rule, takes into account the need to encourage shareholder liquidity injections (not only in the form of equity) also in view of the future recapitalization of the company by banks. Directors will however still need to carefully consider possible liability issues, taking into account the creditor’s priority rights upon insolvency. The directors’ liability issues would be mitigated if the criminal exemptions were re-introduced during the conversion process.”

The Ugly:

Stay on enforcement actions and precautionary measures – extension to the negotiation phase

A stay on enforcement and precautionary measures for sixty days is one of the key features of current restructuring arrangements under Italian Bankruptcy Law. This stay is extended to the negotiations phase.

Whilst this will avoid the threat of enforcement or precautionary measures being brought by creditors for the period of sixty days preceding the filing of the Restructuring Arrangements, in order to benefit from the stay in the negotiation phase, the company must first seek the court's approval. The debtor will need to file a petition to the Court, including, in addition to the documentation to be filed in connection with the debt restructuring arrangement, the proposed restructuring plan together with:

(i) a self-certification by business/company confirming that there are on-going negotiations with at least 60 % of the company's creditors; and

(ii) a declaration by an independent expert confirming that it will be possible to repay in full and in a timely manner those creditors which are not or refused to be a party to the negotiations.

The Court, upon review of the documentation, will fix a hearing within 30 days from the filing of the petition, a hearing and provided all conditions are met, will grant they stay on any pending and new enforcement actions and precautionary, for a period of sixty days. Within such period, the company must file the “final” debt restructuring arrangement supported by expert’s report. Whilst the availability of a stay during the negotiation stage will no doubt encourage the rescue culture, the formalities required to obtain such a stay appear to be at first glance quite cumbersome, and it remains to be seen how this will operate in practice.

More to come

It is interesting to observe how the current economic climate has been driving the legislative reforms. These latest reforms from Italy share common themes with those proposed in the UK proposals last summer by the Insolvency Services consultation paper "Encouraging Company Rescue". See our briefing note "For a few dollars more …. company rescue proposals" dated June 2009. Interestingly the UK proposals suggesting priority for creditors and DIP finance in the UK have since been shelved. Further developments in the UK are expected in the context of extending
the small companies moratorium and making it available to all companies, including those who are proposing a scheme of arrangement.

Although the Italian reforms covered in this briefing are already effective, possible amendments could be introduced by the Italian Parliament converting into law the Decree. A further update will be circulated at this time detailing any significant changes.