

The new rules on composition with creditors

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1. Introduction

By virtue of Decree no. 83/2015, converted into law by Law no. 132/2015 of 6 August 2015, and which entered into force on 21 August 2015, the Italian Government intervened once more in insolvency matters, amending the Italian Bankruptcy Law (“**IBL**”) and adopting measures aimed at: (i) limiting access to composition with creditors; (ii) introducing more competitive market mechanisms in composition with creditors; (iii) focusing on privatization of restructuring proceedings and on tailor made solutions, as well as introducing measures granting – at least on the paper – the creditors wider powers to intervene in the restructuring process, and (iv) increasing the possibility to solve some of the actual problems which practitioners face on a daily basis negotiating restructuring agreements.

2. The new petition for composition with creditors (Articles 160 and 161 of IBL)

The debtor must “ensure” a minimum payment of at least 20% of the corresponding original debt in case of a composition with creditors by assignment of assets. The use in the legislation of the word “ensure” could in theory be construed as binding, if the legislator wanted to imply that the “insurance” is an actual payment to creditors, rather than a prediction made by the debtor as to the percentage of the creditors’ debts that will be satisfied.

The aims of the amendment are simultaneously the early disclosure of the crisis and the reduction of unjustified requests for composition with creditors, but it can also be seen as a measure designed for a better and more efficient appreciation of the debtor’s assets.

3. Competing proposals (Article 163 of IBL)

If the petition for the composition provides for a payment to the unsecured creditors which is (i) lower than 40% of the unsecured credits (in case of a composition with creditors by assignment of assets), or (ii) lower than 30% of the unsecured credits (in case of a composition with creditors based on business continuity on a going concern basis), creditors representing at least 10% of the outstanding credits can file competing proposals in the 30 days before the creditors’ meeting. The competing proposal could suggest the division of creditors into various classes. If the debtor is a limited liability company or a public company, it could also propose a corporate capital increase, with the possibility of excluding and/or limiting the shareholders’ options over the newly issued quotas/shares.

The competing proposal must be filed with an attestation report drafted by an independent expert, as per article 161, third paragraph of IBL. The report could also be limited to the mere feasibility of the composition plan for those aspects that have been already examined by the Judicial Commissioner.

The provisions enabling creditors to file competing proposals allow to:

1. facilitate new finance through an increasing participation of creditors in the composition;
2. ensure a better appreciation of the assets;
3. provide the bidder with a tool to alter the composition of the corporate capital by disposing of the option rights in the case of a corporate capital increase. Through this creditors can dilute the power of existing shareholders, who may have brought about the crisis.

The new legislation also amended other provisions connected with the rules on competing proposals. Indeed:

1. The Judicial Commissioner assumes a particularly relevant position in the management of information addressed to those who are interested in filing competing proposals;

2. In order to avoid any form of connection of the competing proposals with the debtor, any entities controlling, or controlled, or connected to the debtor are not entitled to file competing proposals, and are also excluded from voting on the proposals;
3. Proposals may be amended until 15 days before the creditors' meeting;

New procedures are also set out for the approval by creditors of the competing proposals.

4. Competing offers (Article 163-bis of IBL)

If the composition includes an offer by an entity for the transfer of specific assets, or the whole or part of the business as a going concern, even before it is ratified by the Court, the Court seeks other offers by opening a competitive market procedure.

This new procedure is aimed at avoiding the situation where these "closed" offers are either unclear, or do not fairly estimate the corporate assets, nor pursue the creditors' best interests. The new legislation also sets out that in case of lease of the going concern (or parts of it) executed before the filing of the petition for the composition with creditors – usually with the same entity which would acquire the going concern in case of ratification of the composition by the Court – the assets dealt with in the contract must be re-allocated according to the results of a competitive auction. In case the original offeror does not win the competitive auction, the same has the right to compensation of up to 3% of the price paid.

5. Pending contracts (Article 169-bis of IBL)

The legislator has clarified certain issues relating to pending contracts which came out from common practice after the reform of 2012. In particular, the petition for authorization to the termination of a contract can be filed also after the petition proposing the composition with creditors. Further, the legislator has clarified that (i) it is necessary to hear also the other party of the contract to be terminated/suspended, (ii) the termination or suspension of the contract is effective from the date of notice of the judicial decree to the other party, and (iii) in case of termination of leases, the lessor must pay the lessee any positive difference between the amount gained from the asset's sale (or other disposal on the market) and the outstanding amount of the debt.

6. Approval of the composition with creditors (Article 178 of IBL)

Before the reform of IBL, silence of a creditor admitted to voting was deemed to be approval of the composition with creditors. This provision has now been removed. A creditor is entitled to approve or reject the proposal within a 20-day-term after the creditors' meeting.

The amendment could result in a strong deterrent to entering into a composition with creditors and it may entail a strong reduction in the number of composition with creditors subject to ratification by the Court.

7. Urgent *interim* financing (Article 182-quinquies of IBL)

Under the new legislation, judicial authorization for *interim* super senior financing can be granted also during the preliminary stages of the composition with creditors (*i.e.* "*concordato in bianco*") without the need for the debtor to file a full composition plan and proposal, even though a report drafted by an independent expert is required.

The debtor must satisfy the court that the financing is to "*satisfy urgent needs related to the company's ongoing business*". The main features of such financing are the following:

1. the new urgent interim financing must be authorized by the court before the filing of the restructuring proposal and plan;
2. the financing is needed for the continuation of the business as a going concern;
3. the debtor only needs to state (a) the destination of the financing, (b) that it is not possible to find other means of funding and that, (c) without the financing, the business would suffer imminent and irreparable prejudice.

8. Sale of assets (Article 182 of IBL)

Under Article 182 IBL (as amended) the Judicial Trustee must advertise any competitive sale pursuant to Article 490 of Italian Civil Procedure Code. The notice of auction containing all the information which may be of interest to the public must be publicized on the website created by the Ministry of Justice in an area called "Public Auction Portal".

There are also some changes to the provisions of IBL governing sales carried out in accordance with insolvency procedures, which are applied to any sale or transfer carried out after the filing of a petition for a composition with creditors. In particular:

1. the price can be paid in instalments and within 12 months;
2. if payment in instalments is agreed upon, the successful tenderer may be granted possession of the real estate, upon request and on the basis of a suitable, first request guarantee issued by banks, insurance companies or financial intermediaries for an amount of at least 30% of the price.

9. Operation of the composition with creditors (Article 185 of IBL)

The rules governing the operation of the composition with creditors have also been changed in order to limit the length of proceedings and to provide legal tools in deadlocks or where the debtor is not cooperating, through wide ranging powers granted to the Judicial Commissioner.

With the introduction of the new competitive proposals, some specific instruments are now available in the case in which the debtor is not being inclined to perform a proposal filed by third parties (in particular, in the event of "compulsory" share capital increases), as a Court petition aimed at claiming any delays or non cooperation of the debtor.

Save for the possibility to revoke the composition with creditors pursuant to Article 173 IBL, in the case of non performance of the plan, the Court may now replace the management of the debtor through the appointment of a judicial administrator, having the power to carry out, in a certain time frame, any acts required for the performance of the composition, including calling an extraordinary shareholders' meeting for the approval of a resolution for a corporate capital increase.

10. Come into force of the new provisions

The provisions regarding competing offers and interim financing are already in force and apply to compositions with creditors filed after 27 June 2015. The provisions relating to pending agreements apply to petitions for authorization filed after 27 June 2015.

The provisions governing the new composition with creditors' regime, the competitive proposals, as well as the provisions relating to sales in insolvency proceedings, apply to compositions with creditors filed after 21 August 2015.

With reference to the new sale of assets by auction, this will come into force 30 days from the publication on the Official Gazette of the specific rules concerning the publicity of auctions.

11. Conclusions

At a first glance, the reforms of the composition with creditors' procedure clarify some points which the 2012 and 2013 amendments left unresolved.

With respect to the most significant changes (*i.e.*, urgent interim financing, competing proposals and offers), it is likely the recourse to urgent interim financing, considering the relevant easier procedure and the applicability to pending self liquidating revolving facilities, while at the moment nothing is predictable with respect to competing proposals. Indeed, competing proposals imply an active role (which is not for granted) of creditors to intervene and the Judicial Commissioner may face difficulties in determining pieces of information which can be disclosed or not. The extremely innovative reforms concerning the competitive offers represent a strong innovation aimed at limiting fraudulent proposals and they are positively welcomed, even though they may imply a more complex process.

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Only the first cases and precedents will tell whether creditors may become, similarly to other legal systems, active players in compositions with creditors. It also remains to be seen whether, after these reforms, petitions for composition with creditors will still be filed. Indeed, it is likely that the re-introduction of a minimum level of debt satisfaction for unsecured creditors in compositions involving assignment of assets, and the radical changes to voting procedures will entail a reduction in the number of petitions, and a subsequent increased recourse to alternative restructuring proceedings based on less burdensome requirements.

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