Italian Bankruptcy Law, Fourth Act: the "new" debt restructuring agreement with banks and financial intermediaries

The recent law decree No. 83 (hereinafter, the "Law Decree"), approved by the Italian Council of Ministers on June 23, 2015 and published on June 27, 2015, still subject to further amendments within a 60-day term from the date of publication, has introduced several amendments to the Italian insolvency law (hereinafter, the "IIL"), in three key areas , namely: (i) a greater competitiveness in the solutions available to companies in crisis / distressed situations; (ii) an increased privatisation of the reorganization / restructuring proceedings; and (iii) more favourable treatment of tailor made solutions.

Among the above mentioned amendments, it is important to highlight the new provisions relating to debt restructuring agreements pursuant to Art. 182 *septies* of the IIL, in situations where the majority of the involved creditors are banks and financial intermediaries.

In particular, the new Art. 182 *septies* of the IIL provides for a special regime according to which the debt restructuring agreement would be binding not only on the financial creditors who entered into the agreement, but also upon those financial creditors who did not support the agreement (i.e., "outside" creditors), even though they were eligible to participate in the negotiations.

The new provision is aimed at resolving problems that practitioners are facing on a daily basis on different restructurings tables, where – with increasing frequency – some banks and financial intermediaries decide (more or less reasonably) to "step back" from the negotiations relating to a debt restructuring agreement,: such behaviour sometimes having the effect of blocking the debt restructuring agreement, with the need subsequently for the debtor to adopt more invasive/extreme insolvency remedies and proceedings, with consequences not only on the actual debt collecting possibilities for creditors, but also on the same business activity on a going concern basis, as well as on the safeguarding of employment.

Please find below more details on the above mentioned new provisions of the law.

<u>The "forced" adhesion to the debt restructuring agreement</u>

The first condition for the application of Art. 182 *septies* of the IIL is the requirement that at least half of the whole indebtedness of the debtor is due to banks and financial intermediaries.

Once that requirement is met (in addition to the general requirement of debt restructuring agreements, according to which the agreement shall be entered into by creditors holding at least 60% of the total amount of claims), the provision allows:

- "classification" of the financial creditors, subdividing them into one or more categories according to a criterion of uniformity of legal position and economic interest; and
- the debtor to request, with the petition for the approval of the agreement, that the effects of the agreement be extended also to those financial creditors who were included in one of the abovementioned classes and had not entered into the agreement, with the positive result of

overcoming the (often recurring) obstacle of the unanimity condition imposed by credit institutions during the negotiations of any financial restructuring.

Therefore, the innovative effect of this provision is that the agreement is opposable to, and binding for any third-party financial creditors who were not parties to it (either because they were inactive or, as often happens, because they withdrew or took no part in the negotiations).

Specific conditions need to be met for this to take place, namely:

- all the financial creditors of the same class, including the “outside” financial creditor, shall have been informed about the commencement of negotiations, and have been invited to participate in them in good faith; such condition should be quite easy to demonstrate on the basis of documents attesting the call to the restructuring table, as well as other relevant documents which were made available (i.e., restructuring plan, financial statements and certification of the independent expert); and
- at least 75% of the financial creditors included in such class must be willing to adhere to the debt restructuring plan; it should not be an issue, considering that, in daily restructuring practice, the main financial creditors (covering the abovementioned financial percentage) are often willing to adhere to the financial restructuring, and usually raise objections only in the event there are smaller exit lenders: indeed, the exit lenders, taking advantage of their minor claims, usually try to force and demand immediate repayments, with the effect of jeopardizing the same restructuring plan that is not usually able to fund payments during the first year, when the granting of a grace period aimed at allowing the normal course of the business to continue is appropriate (if not essential).

<u>The protection measures in favour of the “forced” adherent to the debt restructuring agreement</u>

The financial creditor bound, as mentioned above, by the contents of a debt restructuring agreement, in which he did not participate (and, in any case, to which he did not give his consent), is entitled to file an opposition during the proceedings for the approval of the agreement, challenging the request for extension to himself of the effects of its terms.

In case of opposition, the Court may approve the debt restructuring agreement once it has verified that the “forced” financial creditor:

(i) actually has a legal position and an economic interest uniform with those of the other financial creditors, “voluntary” adherents, included in the same class;

(ii) received a full set of information on the agreement and on its effects and was actually put in a position to participate in the relevant negotiations; and

(iii) is likely to obtain, on the basis of the performance of the debt restructuring agreement, a degree of satisfaction of claims “not lower than any other actual and workable alternatives”.

<u>An example of the application of the new provision</u>

Assume the debtor company has the following debt exposure towards financial creditors:

	Alfa Bank	**Beta Bank**	**Gamma Bank**
Secured (mortgage)	500	300	200
Unsecured	-	100	900

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Let us assume that the debtor has, pursuant to Art. 182 *septies* of the IIL, "classified" the banks by making a distinction between secured financial creditors (by mortgage) and unsecured financial creditors.

Finally, let us assume that:

- all of the three banks have agreed to adhere to the repayment plan proposed by the debtor with reference to the unsecured debts; but
- with reference to the secured claims, only Alfa Bank and Beta Bank are prepared to adhere to the agreement, while Gamma Bank is dissenting (or inactive).

In this case, taking into consideration that in the class of secured creditors (by mortgage) the adhering creditors (Alfa Bank and Beta Bank) are representing 80% of the creditors included in that class (and, thus, more than 75% required by Art. 182 *septies* of the IIL), upon approval of its debt restructuring agreement the debtor could request the extension of the treatment provided to the class of secured creditors (by mortgage) and negotiated with Alfa Bank and Beta Bank, also to the dissenting/non adhering Gamma Bank.

<u>Possible critical issues in the application of the provision</u>

Even though, from the point of view of practitioners acting for debtors, the new provision can be considered favourably, the legislative wording leaves many open questions (which will hopefully be clarified upon conversion into law of the Law Decree).

In addition to certain difficulties arising from the reasonableness / correctness of the subdivision of creditors into classes, an issue of particular interest for banks and financial intermediaries may be the following: it is not clear whether, besides situations of a mere "temporary" subjection (as, for instance, a simple rescheduling), or of quantitative rescheduling of claims (as, for instance, in the event of modification of the interest rates), it would be possible to impose on financial creditors – that were "forced" to adhere to an agreement, in the negotiation of which they have not participated – any amendments related to the *quantum* (amount of claim): in other words, could a financial creditor be subject to/undergo a forced "*write off*" of its claim or part thereof?

With reference to the subdivision of creditors into classes in composition with creditors proceedings, the answer should be positive, but in the event of a debt restructuring agreement it would involve exceeding the limits of the clear contractual nature of the same, in the broader interests of the crisis / distress remedy. On the basis of the above answer, there would be a risk of losing the clear, and necessary, distinction between a "forced" legal remedy, depending on the vote of at least 51% of the claims, without prior negotiations with the debtor (composition with creditors), and a voluntary settlement of the business crisis / distressed situations (debt restructuring agreement), which does not involve the opening of an insolvency procedure in a strict sense.

In light of the above, this will be a very welcome clarification upon conversion into law of the Law Decree.