The new "temporary" composition with creditors: creditors from viewers to players

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1. Introduction

With Decree-Law no. 83/2015, published on 27 June 2015 and still subject to amendments, the Government intervened yet again in bankruptcy and insolvency matters in order to improve the tools for a prompt and efficient management of corporate crisis, aiming at encouraging the emergence of critical cases and at limiting, to the greatest extent possible, losses in economic forces. At first glance and on the whole, the new instruments appear to be designed to ease access to financing for the business experiencing a crisis, to correctly valuate the corporate assets and to limit the proceedings' duration.

In particular, Composition with Creditors, which was already significantly modified in 2012, has been amended from several different perspectives and the Decree-Law, which introduces some tools meant to ease the access to financing and other means of funding, creates new innovative measures designed to introduce mechanisms and structures of the competitive market in the proceedings.

Let us present the most relevant reforms.

2. Competitive Proposals

With the new regulatory scheme creditors are given the possibility of filing competitive proposals under certain conditions and only after the debtor has filed its restructuring plan and its proposal for composition with creditors together with the attestation report. Such regulatory scheme must be counted among the measures aiming at introducing competitive market mechanisms in composition with creditors: it is designed to ease the undertaking's access to financing and other sources of funding by means of a direct involvement of creditors in insolvency proceedings and, ultimately, to guarantee a correct valorization of corporate assets.

The competitive proposal may provide for the subdivision of creditors in various classes. If the debtor is a limited liability or public company, it may also provide for a share capital increase with the possibility of excluding and/or limiting the shareholders' option right over new shares. It is clear that such provisions are thought to serve two purposes: on one hand, at allowing the proposer to better design the financing sustaining the competitive proposal which could be granted in the form of new financing and/or imposing on the existing shareholders a re-capitalization of the debtor-company; on the other hand, at granting the proposer an instrument – *i.e.* the possibility to adjust the existing shareholders' option rights in case of a share capital increase – to affect the share capital composition, limiting the power of existing shareholders, to whom the crisis may be attributed.

The Decree-Law also impacted other provisions connected with par. 163 of the Italian Bankruptcy Law ("**IBL**"):

(i). The Judicial Commissioner assumes a particularly relevant position in the management of information destined to those who are interested in filing competitive proposals (par. 165 IBL);

(ii). In order to avoid any form of connection to the competitive proposals, even indirect, with the debtor, the Decree-Law excludes the debtor's controlling entity, entities controlled by the debtor and/or subject to the control of the same entity from the possibility of filing competitive proposals; such entities are also excluded from the vote on all proposals (par. 177, subsection 4 of the IBL);

(iii). Proposals may be modified until 15 days from the creditors' meeting (par. 172 and 175 of the IBL);

(iv). During the creditors' meeting, after all proposals have been presented, each creditor may intervene explaining the reasons on the basis of which it does not consider the proposals admissible or advantageous and challenge any other creditor, while the debtor can express its opinion concerning the admissibility or the feasibility of competitive proposals (par. 175 of the IBL);

(v). All proposals are submitted to the approval of the creditors during the creditors' meeting and the proposal obtaining the highest number of votes from creditors admitted to voting is considered approved. If more than one proposal obtains the same number of votes, the debtor's proposal prevails or, if there is parity between two or more competitive proposals, the one that has been filed first prevails (par. 177 of the IBL). Considering the particular position that proposers of a competitive proposal assume – if not actually their conflict of interest – they can vote on their proposal only if they have been segregated in an autonomous class (par. 163 of the IBL). In case no proposal is approved, within 30 days after the expiry of the period of 20 days after the creditors' meeting during which the creditors may express their dissent, the Delegate Judge calls for another vote on the proposal which obtained the relative majority of votes from creditors admitted to voting and sets the date within which the creditors must be informed; in the 20 days after such date the creditors may express their dissent.

3. Competitive Offers

The introduction of new par. 163-*bis* of the IBL, by means of a corrective measure designed on the basis of competitive market mechanisms, again aims at guaranteeing a better and more correct valuation of the debtor's corporate assets. The new provision is meant to avoid the risk, which has been experienced by practitioners, that the so-called "closed" proposals of compositions with creditors – *i.e.* those "pre-packaged" proposals laying down that the going concern or of parts of it will be sold to a pre-determined entity with which the debtor already executed a contract and where the approval of the proposal by the Court usually stands as condition precedent – may mask elusive solutions which do not absolutely aim at correctly valuating the corporate assets and, thus, at pursuing the creditors' best interest. It is no coincidence that the Decree-Law sets forth that in case of a lease of the going concern (or of parts of it) executed before the filing of the petition for composition with creditors – usually with the same entity which would acquire the going concern in case of approval of the proposal by the Court – such contracts must be evaluated by the Judicial Commissioner and the assets object of the contract may be re-allocated according to the results of a competitive auction. Such provision (together with the one on the basis of which the above-explained rules also apply in petitions for authorization filed pursuant to par. 161, subsection 7 of the IBL, to sell any corporate assets while the proceedings are pending) is aimed at completing the means of protection granted to the creditors' interests.

4. Pending Contracts

The Decree-Law modifies par. 169-*bis* of the IBL from various perspectives, clarifying some interpretative issues which emerged in everyday practice after 2012. In particular:

(i). The provision's heading has been reformulated in analogy to the one of par. 72 of the IBL concerning bankruptcy proceedings in order to avoid any possible (and artificial) interpretation aiming at differentiating the notion of pending contract from the one of contract under execution;

(ii). It has been clearly stated that the petition for authorization to termination can be filed also after the petition set forth by par. 161 of the IBL, reneging a certain restrictive opinion according to which such petition could be filed only together with the petition set forth by par. 161 of the IBL;

(iii). It is explicitly stated that it is necessary to initiate adversarial proceedings with the other party to the contract in order to verify if the contract whose termination is asked for is actually under execution and to allow the counterparty to present its objections concerning the applicability of the provision under discussion to the particular contract;

(iv). It is clearly provided that both termination and suspension of the contract are effective from the date of communication of the decree to the counterparty;

(v). The new formulation of the provision, in analogy to what is set forth by par. 72-*quater* of the IBL concerning bankruptcy proceedings, states that, in case of termination of leasing contracts, the leasing company must pay the debtor the sum deriving from the asset's sale price (or the proceedings of its alternative collocation) on market conditions and the residual principal credit; the leasing company also has a claim, treated as other claims accrued before commencement of insolvency proceedings, on the debtor in the amount determined subtracting the claim at the date of filing the petition for composition with creditors and the proceedings deriving from the new allocation of the asset.

5. Urgent Interim financing

The Decree-Law clearly states – evidently in order to limit certain excessively restrictive practices developed by some Courts – that the fact that the authorization can be granted during the anticipated protection of composition with creditors (*i.e.* "*concordato in bianco*") does not entail that the debtor in such phase must also file its restructuring plan or its proposal, the filing of the attestation report being sufficient for the documentation to be complete.

With new subsection 2-*bis* the Decree-Law provides that, while anticipated composition with creditors, petition for approval by the Court of a restructuring agreement or petition pursuant to par. 182-*bis*, subsection 6 of the IBL are pending, the debtor can ask to be authorized to execute contracts for preferential financing if they "*aim at satisfying urgent needs of the company's going concern"* until the end of such proceedings. At first glance, this new regulatory scheme can be distinguished from the interim financing covered by subsection 1 on the basis of three features:

(i). The new urgent interim financing, unlike interim financing, cannot be authorized after the restructuring plan and the proposal have been filed;

(ii). Urgent interim financing must mandatorily be connected with business continuity, while interim financing does not have such requirement;

(iii). For the authorization of urgent interim financing no report by an appointed practitioner attesting that they respond to the creditors' best interest is needed, but it is sufficient that the debtor explicitly states in its petition what the financing is needed for, that it is not able to find other means of funding and precisely states that, without such monies, the going concern may suffer an impeding and irreparable prejudice.

The last subsection (2-*bis*) of the provision is particularly important: the petition for authorization to maintain existing self-paying financing is, in fact, in direct contrast with the fact that while such contracts are under execution, they are not influenced by the filing of the anticipated composition with creditors *ex* par. 161, subsection 6 of the IBL in any way and just continue to be in force. A justification to such subsection may be found in the possibility that the Decree-Law may have tried to protect the Banks, which usually are not willing to maintain such contracts in force with a company undergoing a composition with creditors.

6. Sale of Assets

The revised par. 182 of the IBL sets forth that the Judicial Trustee must publicize any competitive sale pursuant to par. 490 of the Italian Civil Procedure Code ("**CPC**", which has also been revised), and thus must publicize a notice of auction containing all data which may be of interest to the public on the portal created by the Ministry of Justice in an area called "Public Auction Portal". Paragraphs 105 to 108-*ter* of the IBL are applied to any sale performed while the petition of composition with creditors is pending or during the composition with creditors' performance. Pursuant to such referral, revised par. 107 of the ILB applies to composition with creditors (which, in turn, refers to some new provisions of the CPC), stating that:

(i). The price can be paid in instalments on justified grounds and within the time limit of 12 months;

(ii). If payment in instalments is agreed, the successful tenderer may be granted possession of the real estate upon request and under a suitable, autonomous, irrevocable and first request guarantee in the amount of 30% of the price, granted by banks, insurance companies or financial intermediaries carrying on exclusively or prevalently the activity of granting guarantees and subject to external audit by an independent company;

(iii). In case one of the instalments is not paid within 10 days from the due date, the Judge declares the revocation of the successful tenderer, states that what has already been paid is acquired by the composition with creditors as a fine and schedules another auction.

New subsection 5 of par. 182 of the IBL states that the cancellation of any security concerning the assets under auction, of any foreclosure and/or any preservation order and/or of any other constraint can be ordered by the Judge provided that the Court did not differently order in its Decree of approval of the composition with creditors.

7. Composition with Creditors' Performance

The Decree-Law, reforming par. 185 of the IBL, also impacted on the performance of composition with creditors in order to contain its duration and to grant the bodies in the proceedings the possibility of positively affecting deadlocks and situations of inertia by the debtor; to this end, the fact that the Judicial Commissioner can be granted the powers to personally perform all necessary acts assumes particular importance.

Given the introduction of the new competitive proposals, the Decree-Law introduces some specific instruments to enable the bodies in the proceedings to intervene in the non-remote case in which the debtor may prove not to be prone to perform a proposal filed by third parties, in particular in all those cases in which incisive measures are provided for, such as "coercive" share capital increases. In such cases, the proposer whose competitive proposal has been approved by the creditors and the Court can bring to the attention of the Court any delay and/or omission by the debtor; in such case, the Court, in analogy to the above-mentioned case, once it has heard the debtor can grant the Judicial Commissioner the powers to perform all necessary acts. In case of default by the debtor, it is always possible that the composition with creditors is revoked pursuant to par. 173 of the IBL; nevertheless, the Court, once it has heard in its chambers the Judicial

Commissioner and the debtor, may revoke the administrative body of the debtor-company and appoint an Administrative Receiver with a fixed-term assignment so that he can perform any acts which may prove to be necessary to give full execution to the composition with creditors, including the call of the extraordinary Shareholders' Meeting for the resolution concerning the share capital increase. Such powers can be also granted to the Judicial Trustee appointed pursuant to par. 182 of the IBL.

8. Entry in force of the new provisions

As a conclusion to this brief summary concerning the most important innovations to the discipline of composition with creditors set forth by D.L. 83/2015, it seems appropriate to describe the entry in force of the particular provisions, respecting the order followed above.

(i). Competitive Proposals: par. 3, D.L. 83/2015, which modifies, *inter alia*, par. 163, 165, 172, 175 and 177 of the IBL, enters into force on the date in which the Law converting the Decree-Law enters into force and can be applied to compositions with creditors filed after such date; the same discipline is set forth by par. 4 D.L. 83/2015, modifying par. 161 of the IBL;

(ii). Competitive Offers: par. 2, subsection 1 D.L. 83/2015, introduces new par. 163-bis of the IBL and enters into force immediately; it can be applied to compositions with creditors pending at the date in which D.L: 83/2015 enters into force (i.e. 27 June 2015);

(iii). Pending Contracts: par. 8 of D.L. 83/2015 modifies par. 169-bis of the IBT and can be applied to petitions for authorization filed after the date in which D.L. 83/2015 enters into force (*i.e.* 27 June 2015);

(iv). Urgent Interim Financing: par. 1 of D.L. 83/2015 modifies par. 182-*quinquies* of the IBL and enters in force immediately (*i.e.* 27 June 2015) and can be applied to pending proceedings;

(v). Sale of Assets: par. 2, subsection 2 (b) of D.L. 83/2015, which modifies par. 182 of the IBL, par. 11, of D.L. 83/2015, which intervenes on par. 107 of the IBL and par. 13, subsection 1, lett. b), n. 1), lett. e), lett. ee), which reforms par. 490 of the CPC enters into force after 30 days from the publication in the Official Gazette of the technical rules concerning the publicity of auctions on the portal provided for by par. 161-quater disp. att. CPC; par. 13 of D.L. 83/2015, which modifies, *inter alia*, par. 569, 574, 587 of the CPC enters in force immediately (*i.e.* 27 June 2015) and can be applied to pending proceedings, except in cases where the sale has already been provided for, it is disciplined by the previous rules and the new ones can be applied in case of a new auction;

(vi). Composition with Creditors' Performance: par. 3 of D.L. 83/2015 modifies, *inter alia*, par. 185 of the IBL, enters into force on the date in which the Law converting the Decree-Law enters into force and can be applied to Compositions with Creditors filed after such date.

9. Conclusions

At first glance, it must be favorably recognized that the reforms to compositions with creditors, as a whole, do clarify some points that the 2012 and 2013 intervention left unresolved, resolving important interpretative uncertainties which, in turn, created a certain fragmentation in their application.

As far as the most incisive and innovative interventions are concerned, such as urgent interim financing and competitive proposals and offers, it cannot be hidden that, considering the new regulatory schemes' features and the important issues they entail both for their interpretation and application, it is difficult to express any

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prediction for the future. Nevertheless, in this moment it can be noted with a certain confidence that, if urgent interim financing will presumably find a certain application – above all considering that their discipline is procedurally easier than the one concerning interim financing and that they may cover self-paying financing already under execution –, the same cannot be predicted for competitive proposals, whose application implies an uncommon and non-consensual will of the creditors to intervene and is hindered by the undoubted difficulties that the Judicial Commissioner will face in determining which pieces of information can be disclosed and which cannot. As far as competitive offers are concerned, the reforms represent a strong innovation compared to the previous framework and in the end the Decree-Law pursues to contain, to the greatest extent possible, fraudulent proposals to the detriment of creditors. Nonetheless, it must be underlined that the new rules could complicate and burden procedures that in the past would have been extremely linear.

However, it will be necessary to wait for the first actual cases to verify whether creditors will really have the chance to become, as it happens in other legal systems, active players and not remain passive viewers of the proposal for composition with creditors, assuming that the Law converting the Decree-Law will not completely change the framework.

On the other hand, since a high number of amendments is expected to be presented in the Law converting the Decree-Law, such suggests that the discipline of the Decree-Law will be (heavily) modified. Given that, in this transitional period the practitioner must be extremely careful and wait for the ordinary legislative bodies to endorse the discipline upon which this comment is based.