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Recent Changes to Italian Bankruptcy Law

July 26 2012

By Tommaso Foco and Pietro Masi

In an effort to re-launch the economic growth, with Law Decree No. 83/2012 (so called "Decree on Development") the Italian government, inter alia, implemented several significant changes to Italian Bankruptcy Law (legge fallimentare).

Since 2005 the focus of the Italian Bankruptcy Law has shifted from liquidation to reorganization of distressed companies through reorganization plans and/or debt restructuring agreements, with a view to preserving the value of the business and allowing it to make a fresh new start. The changes brought by the Decree on Development move along this path and introduced few but important features to certain pre-insolvency proceedings which, although already available under Italian Bankruptcy Law since 2005, proved to be less effective than expected.

The changes concern the procedures finalized to the execution of restructuring agreements (i.e. the court-composition schemes (concordato preventivo) and the debt restructuring agreements (accordo di ristrutturazione dei debiti)). Both tools are often used to enable the distressed company to get rid of non-sustainable liabilities and to go back into business. The main differences between the two procedures are that the first one provides for a more intensive scrutiny of the bankruptcy court and is binding on all creditors (even those dissenting), while the second one requires a mere confirmation of the agreement by the court and is binding only the creditors which are party the restructuring agreement (which, in any event, must represent no less than 60% of the aggregate liabilities of the company).

The main goals of the new rules are to encourage the possibility of a quick detection of the corporate crisis and of its origins and to enable the debtor to take immediate and effective action in order to overcome the state of financial distressed before it is too late.

With respect to the court-composition schemes (concordato preventivo), the main new features are:

- easier access to the procedure: it is now allowed to submit the application to a court-composition scheme without filing at the same time the restructuring plan and the other documents required by the law, which may be filed within the following 60-120 days. This new feature is taken from the experience Chapter 11 of the US Bankruptcy Code. The rationale is to allow the debtor to seek immediate protection (such as the freezing of enforcement proceedings of creditors) without wasting time in working out the details of the restructuring plan;

- more effective protection against individual actions of creditors: not only enforcement proceedings are freezed, but also interim actions are now prevented;
- maintenance of the ordinary and extraordinary operation of the business: distressed companies are often a risk for their business partners, as in case the company goes bankrupt any payment made by it to its business partners (such as suppliers and banks) is under the risks of being clawed back by the bankruptcy receiver. This often results in the business of the company to go further down, deepening and worsening the state of crisis. To avoid this and to create an incentive for business partners of the debtor not to stop doing business with it, the law now provides that:
  - from the day on which the application is filed with the Register of Companies (i.e. one day after it is submitted to the court), the debtor may be authorized to engage into transactions in the ordinary and extraordinary course of business;
  - third party claims arisen as a result of transactions authorized by the court (even if unsecured) takes priority over all other claims against the company (even secured claims);
  - payments made by the debtor from the time the application is filed with the Register of Companies cannot be clawed back in case the distressed company goes bankrupt;
- along the same lines, the debtor is now allowed to terminate contracts which are non-profitable or excessively burdensome, with prior authorization of the court. This too is a measure aimed at preserving the goodwill of the debtor and increasing the chances of its recovery;
- in order to encourage reorganization rather than the liquidation plans, the Decree on Development provides a specific set of rules for court-composition schemes aimed at allowing the company to continue to stay in business (as opposed to those that involve liquidation and termination of the company and its business). Among such new rules, the following appear to be particularly important: the opportunity to participate in tenders aimed at entering into contracts with public bodies, the inapplicability of the clauses involving the termination of the contract on the ground of the corporate crisis and the possibility to postpone of a year the payment of the privileged creditors.

With respect to the debt restructuring agreement (accordo di ristrutturazione dei debiti), the more significant changes are:

- extended term for the payment of creditors which are not party to the debt restructuring agreement: creditors may be paid within 120 days of the confirmation of the agreements by the court (if debts are already due and payable at that date) or after 120 days since they become due and payable;
- more favourable tax treatment of debts' write offs: contingent assets of the debtor as a result of write offs of debts are not subject to income tax (as already was for write offs agreed in court-composition schemes).

Furthermore, the reform introduced some positive new regarding both proceedings:

- easier access to new finance pending the debt restructuring processes: along the lines of the "first-day orders" of the US Bankruptcy Code, the debtor may submit an application to the court to be authorized to obtain new dip financing from the banks or other sources of credit and to pay creditors which are crucial to ensure continuity of the business;

- reinforcement of independence requirements of the experts engaged to attest the feasibility of the restructuring plan. This innovation was thought to prevent the cases of conflict of interests between the auditors and the debtor. The Decree on Development even provides for criminal liability of the experts responsible of false statements or omission of important information while attesting the feasibility of restructuring plans;
- it is now provided that during the restructuring procedures, the laws on the restoring of the corporate capital in case of losses are not applicable. This is designed to give to distressed companies time to prepare the restructuring plan without the pressure of the compliance with the deadlines set by those rules and, above all, to eliminate the burden to spend money necessary to increase corporate capital after the loss (which might immediately jeopardize any attempt of re-launch and restructuring).
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The Decree on Development was enacted on 22 June 2012 and must be converted into an ordinary law within 25 August 2012. It is subject to possible amendments by the Parliament during the process. All of the above mentioned changes to Italian Bankruptcy Law will enter into force 30 days following the conversion of the Law Decree into ordinary law.

The new set of rules on corporate reorganization makes the Italian legal framework on restructuring more effective, for example affording more protection to all stakeholders involved and creating a market for dip financing. It is expected that this will result in an increase of restructuring work in the next years aligning Italy to all countries where these procedures originated. It is certainly a positive sign considering the roughness of the global crisis and the pressing need to avoid a series of bankruptcies which would seriously jeopardize the Italian economic fabric.