

The Italian bankruptcy law is becoming more investor friendly

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On July 30, 2010 the Italian Parliament passed Law 122/2010¹ which, among others, improved the restructuring proceedings governed by the Italian Bankruptcy Law² (“IBL”).

The improvements operate on two fronts of restructuring deals which had proven to be still unclear (and thus risky) despite the recent reform:

- (a) the ranking of the “new money” provided to distressed debtors by shareholders and/or third party investors³ in an insolvency scenario; and
- (b) the criminal liability of creditors (in an insolvency scenario) with respect to payments received from distressed debtors under a restructuring plan⁴.

In addition to such improvements, Law 122/2010 also enhanced the regime of the automatic stay applying in “182*bis* proceedings”⁵.

¹ Law 122/2010 converted into law (with minor amendments) Legislative Decree 78/2010. Section 48 of Law 122/2010 amends Sections 182*bis*, 216 and 217 of the IBL.

² Royal Decree 267 of 16 March 1942.

³ New Section 182*quater* of the IBL.

⁴ New Section 217*bis* of the IBL.

⁵ Restructuring proceedings under article 182*bis* of the IBL.

Hereunder please find a brief description of the newly enacted provisions.

The new Section 182*quater* of the IBL

1. Ranking of the “new money” in an insolvency scenario

According to the new Section 182*quater* of the IBL, in the event that a restructuring plan under the scheme of either a “composition with creditors”⁶ or a “182*bis* proceeding” proves unsuccessful and the debtor is consequently adjudicated in bankruptcy⁷, the “new money” provided to the debtor by banks and/or authorized financial intermediaries under the unsuccessful restructuring plan ranks “super-senior”⁸ to any other claim.

To benefit from this “super-seniority” the law however requires that the relevant (unsuccessful) restructuring proceeding meets the following conditions:

- in the case of a “composition with creditors”, the opening of the proceeding must have been authorized by the Bankruptcy Court;

⁶ *Concordato preventivo* pursuant to Section 160 of the IBL.

⁷ Bankruptcy meaning *fallimento* pursuant to Section 16 of the IBL.

⁸ “Super-senior” meaning *prededucibile* pursuant to Section 111 of the IBL.

- in the case of a “182*bis* proceeding”, the restructuring plan must have been confirmed⁹ by the Bankruptcy Court.

The new provision covers the unfortunate case of a distressed company which despite the restructuring is unable to recover and falls into insolvency. A not too frequent case, but definitively a possibility which is carefully examined in any restructuring deal.

Prior to the amendment, claims for “new money” extended to distressed companies were deemed unsecured in an insolvency scenario, unless the “new money” was secured by a mortgage, a pledge or a lien¹⁰. Thanks to the new regime the “new money” will in the future be “super-senior” *per se*, regardless of the security package it may be coupled with.

2. Shareholders' loans

The new regime has been extended by Law 122/2010 also to “new money” provided by the shareholders of the distressed company but only up to 80% of the face amount of the relevant shareholders' loans.

Under the previous regime shareholders' loans to distressed companies risked being treated as subordinated claims in an insolvency scenario due to the “equitable subordination” rule¹¹ and were thus scarcely appealable to shareholders.

⁹ where “confirmed” stands for *omologato*.

¹⁰ or authorized by the Court in the case of a “composition with creditors”.

¹¹ Under articles 2467 and 2497quinquies of the Italian Civil Code the repayment of shareholders loans is subordinated to the satisfaction of all other creditors in those cases in which on the date of the relevant loan the borrower showed a material unbalance between its equity and its indebtedness or a financial situation which suggested an equity contribution as being more reasonable than a loan.

Thanks to the change in the law it is fair to predict that shareholders will be less reluctant in financially supporting their companies and this new factor should increase the chances of success of restructuring deals.

3. Bridge loans

Finally, under Law 122/2010 the new regime applies also to “bridge loans” granted to distressed borrowers by banks and/or authorized financial intermediaries in view of the filing for a “composition with creditors” or a “182*bis* proceeding”. However, with respect to “bridge loans” the “super-seniority” is allowed by the law only provided that:

- i.) the loan is set out in the relevant restructuring plan;
- ii.) in the case of a “composition with creditors”, the “super-seniority” is expressly allowed by the Bankruptcy judge upon the opening of the proceeding;
- iii.) in the case of a “182*bis* proceeding”, the restructuring plan is approved by the creditors and confirmed by the Bankruptcy Court.

The new Section 217*bis* of the IBL

This completely new Section of the IBL deals with one of the consequences of an unsuccessful restructuring which lenders to Italian distressed companies fear the most, it being the possible criminal liability associated with (i) payments received from the borrower under the relevant restructuring plan or (ii) the postponement of bankruptcy caused by the (unfortunate) restructuring proceeding.

Indeed, under article 216, 3rd paragraph, of the IBL preferential payments¹² made by the debtor prior to or during the bankruptcy proceeding are punishable by imprisonment of 5 to 10 years (the so-called *bancarotta preferenziale*). The penalty applies (in the case of bankruptcy) to the debtor as well as to the creditors who benefited from the relevant preferential payments.

Furthermore, under article 217 of the IBL negligent misconducts of the debtor prior to insolvency are punishable by imprisonment of up to 2 years (the so-called *bancarotta semplice*). Some of the relevant misconducts can also involve creditors (in which case the penalty applies also to them), the most frequent being the following: (a) having contributed to the aggravation of the distress by tolerating the debtor's refrain from applying for bankruptcy and (b) having executed a transaction with the debtor knowing that it was aimed at avoiding bankruptcy and materially imprudent for the debtor.

In such a legal environment it is clear that a payment received under a restructuring plan could have theoretically been deemed as triggering a *bancarotta preferenziale* or a *bancarotta semplice* in the subsequent insolvency.

To clear this issue (which has kept many lenders away from distressed companies) the legislator (after some second thoughts¹³) has introduced in the IBL the new Section 217*bis*.

Pursuant to this new provision, articles 216, 3rd paragraph, and 217 of the IBL do not apply to payments made and transactions

¹² Where preferential payments means payments or transfers of assets to a creditor which give that creditor an advantage over other creditors.

¹³ The new Section 217*bis* has been introduced by the Parliament upon conversion of the Legislative Decree 78/2010 from which it had been erased.

executed under: (i) a “composition with creditors” or (ii) a “182*bis* proceeding”, provided the restructuring has been confirmed by the Bankruptcy Court, or (iii) an out-of-court restructuring set out in Section 67, 3rd paragraph, lett. d), of the IBL.

The new paragraph 6 of Section 182 *bis* of the IBL

According to the IBL a “182*bis* proceeding” triggers an automatic stay¹⁴ upon publication of the relevant restructuring agreement in the Register of Companies.

This regime has proven to be inadequate with respect to particularly distressed situations in which a standstill is usually needed long before the final execution of the restructuring agreement with the creditors, namely during the negotiations of such agreement.

The new law has addressed this problem by introducing in the existing Section 182*bis* of the IBL a new paragraph 6 which allows a distressed debtor to benefit from an anticipated standstill under certain conditions.

Indeed, according to the new paragraph a distressed debtor can petition the Bankruptcy Court for an automatic stay¹⁵ while negotiating with the creditors under the scheme of a “182*bis* proceeding”, provided that he gives evidence of the ongoing negotiations and of the feasibility of the restructuring plan under discussion by filing certain documents with the Court (among

¹⁴ An automatic stay being an automatic injunction halting actions by creditors to collect debts from the debtor.

¹⁵ The automatic stay under the new paragraph 6 is broader than that under the existing Section 182*bis* because it blocks also actions by creditors aimed at obtaining a right of preference over other creditors (*titolo di prelazione*): for example the judicial mortgages (*ipoteche giudiziali*).

which a statement by an expert confirming that the restructuring agreement being negotiated by the debtor allows payment in full of the creditors not adhering thereto).

This anticipated automatic stay becomes effective upon publication of the petition in the Register of Companies and is thereafter allowed or disallowed by the Bankruptcy Court. Once allowed by the Court, it runs for 60 days following the Court order and automatically expires if the debtor fails to execute and file the restructuring agreement within such 60-day term.

Conclusion

These last changes in the IBL aim at facilitating restructuring deals by eliminating some of the factors which the day-by-day experience has demonstrated to hinder the rescue of many distressed companies, namely the unclear ranking of the “new money” made available to the debtor by financial institutions and/or shareholders, the likewise unclear perimeter of the criminal liability associated with unsuccessful restructurings and finally the often too late automatic stay in “182*bis* proceedings”.

The new provisions – repeatedly urged by the market players - have required a 180° steering from the original structure of the IBL which covered only court-managed restructuring proceedings and left anything else exposed to all possible civil and criminal risks.

This last step together with the recent reform of the IBL now provide potential lenders/ investors in distressed companies a clear and safe legal framework (no claw back; no criminal liability; “super-seniority”) which will hopefully facilitate restructuring deals and contribute to improve the rescue financing market which is scarcely developed in Italy.

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