Recent developments for Italian R&I rules.
Interim funding, moratorium and criminal law provisions.

Overview
The Italian parliament\(^1\) has introduced changes to the rules on corporate turnaround and rescue procedures. These changes are aimed at addressing certain important issues which have come to light during recent large Italian restructurings and are effective from 31 July 2010.

In particular:

> it has been expressly stated that payments and transactions to implement a Composition with Creditors, an Article 182-bis Arrangement or Article 67 Plan (explained below) fall outside the scope of preferential bankruptcy and simple bankruptcy (please see page 2);

> financing granted by banks and certain regulated financial institutions to implement an Art. 182-bis Arrangement or a Composition with Creditors already validated by the competent Court, will be given super priority status (\textit{prededucibili}) (please see page 4);

> financing granted by shareholders to implement an Art. 182-bis Arrangement or a Composition with Creditors previously validated by the competent Court will be given super priority status for up to 80 per cent. of the financing amount (please see page 4);

> financing granted by the above mentioned banks and regulated financial institutions needed to allow filing for a Composition with Creditors or an Art. 182-bis Arrangement may be given super priority status provided that certain conditions are met (please see page 4); and

> pending the outcome of negotiations for an Article 182-bis Arrangement debtors are, subject to certain conditions, allowed to file a request for a moratorium with the competent Court. The request must be published in the Companies’ Register and the moratorium period starts from the date of publication (please see page 5).

\(^1\) Law 122/2010, effective as of 31 July 2010, that amended the previous Law Decree 78/2010 (each as defined below).
**Background**

The Italian bankruptcy law was most recently reformed between 2005 and 2007. One of the principal aims was to support and facilitate the turnaround of companies and provide consensual/pre-bankruptcy solutions for companies in financial crisis.

To achieve this aim:

> the traditional pre-bankruptcy composition with creditors (**concordato preventivo**), that was (and is) the sole Italian insolvency procedure allowing cram-down without a public receiver removing the powers of the board of directors, was completely reformed introducing a significantly higher degree of flexibility (**"Composition with Creditors"**);

> two new consensual restructuring procedures were introduced:
- Article 67 restructuring plans (**piani di risanamento** (**"Art. 67 Plans"**));
- Article 182-bis debts’ restructuring arrangements (**accordi di ristrutturazione dei debiti** (**"Art. 182-bis Arrangements"**)).

One key feature of these new procedures was the exemption from claw-back of the payments and transactions carried out in order to implement the restructuring.

These new changes show the Italian legislator attempting to address the following three key issues faced on an Italian restructuring:

> **Criminal liability** - the risk that certain steps generally required for a successful turnaround transaction (such as making payments to only some creditors, borrowing or lending financing, creating security interests as well as delaying filing for an insolvency procedure pending the outcome of negotiations) give rise to potential criminal liability risks for directors and, in certain circumstances, for shareholders and lenders;

> **Interim funding** - the extremely unfavourable regime applicable to any interim financing needed prior to the implementation of a turnaround procedure (no super priority status, claw-back risk, no security, risks of civil and criminal liability);

> **Moratorium** - the absence of an effective moratorium, at least during the initial phase of the restructuring negotiations.

**Criminal liability – the new Article 217-bis**

The 2005-2007 reform of the Italian bankruptcy law did not amend any Italian criminal insolvency provisions. This meant that there was an inconsistency between the provisions of the new corporate turnaround and rescue procedures and the existing criminal law.

According to the Italian bankruptcy law:
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> any negligent delay in filing for the commencement of insolvency proceedings may expose a party to criminal liability for the so-called “simple bankruptcy” unless there are well-grounded and strong reasons justifying such delay (in particular, it is a criminal offence, inter alia, “to act with serious imprudence in order to delay the bankruptcy”, “to increase the company’s financial difficulties by refraining from filing for bankruptcy or with any other gross negligence” and “to fail to properly keep the required accounting books during the three-year period preceding bankruptcy filing”); and

> making payments to, or creating or simulating security interests in favour of, some creditors with the aim of favouring them over other creditors may expose a party to criminal liability for “preferential bankruptcy”.

These are primarily directors’ liabilities, however any other person who gave a contribution to criminal action taken by the directors may be deemed liable for aiding and abetting the criminal offence.

Generally, a turnaround procedure involves several steps that, at least from a factual perspective, fall within the scope of simple bankruptcy or preferential bankruptcy. As such, if the turnaround is not successful and the distressed company is subsequently adjudicated bankrupt (or submitted to certain other insolvency procedures), such action could expose the parties to the risk of criminal liability.

Italian law No. 122 of 30 July 2010 that came into force on 31 July 2010 (“Law 122/2010”) deals with this issue by introducing a new Article 217-bis according to which:

“the provisions of article 216, third paragraph [i.e. preferential bankruptcy] and article 217 [i.e. simple bankruptcy] do not apply to payments and transactions carried out in order to implement a Composition with Creditors, an Art. 182-bis Arrangement or an Art. 67 Plan.”

According to a preliminary analysis, this exemption should be deemed subject to the following limitations:

> after the failure of the turnaround procedure and the default of the distressed company, the competent Court will scrutinise the selected turnaround procedure to ascertain whether or not it was reasonable when originally implemented. If the outcome of the above mentioned scrutiny is not positive, the exemption from criminal liability would not apply; and

> it does not extend to payments and transactions carried out prior to the implementation of the selected turnaround procedure and/or in the context of the negotiations of Art. 67 Plans and/or Art. 182-bis Arrangements or Composition with Creditors that are not ultimately validated by the competent expert or Court (as applicable).

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New rules for interim financing

Italian law-decree No. 78 of 31 May 2010 (“Law Decree 78/2010”), converted into law with amendments by Law 122/2010, has introduced a new Article 182-quarter of the Italian bankruptcy law. This reform means that the following financing is treated as a statutory expense of the procedure (prededucibile), i.e. super-senior, in any subsequent insolvency proceedings. Such financing must be provided by banks and financial institutions enrolled with the Bank of Italy under Articles 106 and 107 of the Italian banking act:

> financing to implement an Art. 182-bis Arrangement or a Composition with Creditors previously validated by the competent Court;

> financing granted to allow the filing for a Composition with Creditors, if all the following conditions are satisfied:
  - the financing is expressly contemplated in the plan to be filed for the Composition with Creditors; and
  - such treatment is expressly ordered by the Court when admitting the filing (see below for court order risk);

> financing granted to allow the filing for an Art. 182-bis Arrangement, if all the following conditions are satisfied:
  - the financing is expressly contemplated in the industrial and financial plan to be filed together with the Art. 182-bis Arrangement; and
  - the Art. 182-bis Arrangement is then validated by the competent Court (see below for validation risk).

The first provision, together with the exemption from claw-back actions introduced by the 2005-2007 reform, will certainly facilitate the granting of new money by the existing lenders of a distressed company. It may also create the much needed conditions for the Italian market to develop with respect to distressed companies’ financing, though limited to banks and financial institutions enrolled with the Bank of Italy.

The “Court order/validation risk” connected to the second and third provisions may limit their use only to cases where existing lenders of a distressed company – presumably after completion of an independent business review – wish to provide finance to allow the turnaround and avoid extraordinary administration / bankruptcy (generally associated with low recovery rates for the lenders).

According to the new Article 182-quarter, any financing granted by shareholders in order to implement an Art. 182-bis Arrangement or a Composition with Creditors previously validated by the competent Court, is treated as a statutory expense of the procedure (prededucibile), i.e. super-senior, in any subsequent insolvency proceedings for up to 80 per cent. of its amount.

“The first provision ... may ... create the much needed conditions for the Italian market to develop with respect to distressed companies’ financing, though limited to banks and financial institutions enrolled with the Bank of Italy”
It is worth noting that the interim financing described above (either by banks or shareholders) will not to be taken into account for the purpose of the creditors’ vote of the Composition with Creditors and for the minimum consent requirement (i.e. 60 per cent.) for Art. 182-bis Arrangements.


### Moratorium for Art. 182-bis Arrangements

The previous regime applicable to Italian corporate turnaround and rescue procedures was the following: (a) Article 67 Plans do not provide for a moratorium (this aspect has not been changed); (b) Composition with Creditors and, for a limited period of 60 days also, Art. 182-bis Arrangements provide for a moratorium that starts from the perfection of the filing; (c) unlike U.S. Chapter 11, the proposal for the creditors (or, in the case of Art. 182-bis Arrangements, agreement with creditors representing 60 per cent. of the company’s debts), a detailed plan and a full set of documentation are prerequisites for filing for Composition with Creditors and Art. 182-bis Arrangements; and (d) no moratorium or similar protection is available to distressed companies while preparing the documentation required for each filing.

Law Decree 78/2010, as amended by Law 122/2010, has introduced a new paragraph in Article 182-bis of the Italian bankruptcy law according to which the debtor may request a moratorium during the negotiations for an Art. 182-bis Arrangement.

The debtor must file the following documents with the competent Court:

- the request for the moratorium;
- an up to date economic and financial statement;
- a detailed list and estimate of the value of the assets and a list of the creditors (including all relevant receivables owed to the company) and security interests,
- a list of those having *in rem* or personal rights over assets of the debtor (owned or in use);
- a proposal of the Art. 182-bis Arrangement;
- a statement of the debtor confirming that negotiations with creditors representing at least 60 per cent. of its debts are on-going; and
- a statement of an expert, meeting the requirements for the certification of the Art. 182-bis Arrangement, confirming that the restructuring proposal, if accepted by the relevant creditors, allows the regular payment of the creditors that are not negotiating the Art. 182-bis Arrangement or that have already confirmed that they are unable to enter into such negotiations.
The debtor’s moratorium request must be published in the Companies’ Register and takes effect from the date of publication. During the moratorium period creditors cannot start or continue any interim relief or enforcement action over the assets of the debtor in relation to pre-existing receivables.

The Court will schedule a hearing within 30 days from filing and will give notice of the hearing to the creditors. At the hearing the Court will verify the conditions for the granting of the moratorium and if the outcome is positive will grant to the debtor a term of 60 days for the filing of the final executed Art. 182-bis Arrangement and the related documentation (including the expert’s certification). The Court’s decision will be published in the Companies’ Register and may be challenged creditors within 15 days from the publication.

If the above mentioned filing is not made in a timely fashion the moratorium will expire. Alternatively the standard 60 day period of moratorium will apply starting from the date of such filing.