Draft law to reform insolvency procedures: group-wide pre-bankruptcy agreements

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Introduction

The Rordorf Commission was established by the minister of justice on January 28 2015, with the aim of developing draft legislation to reform the existing Insolvency Act.**(1)** On February 10 2016 the commission finalised its draft legislation and recommended a new approach to safeguard financially distressed businesses. The aim was to favour the restructuring of distressed companies over liquidation in order to prevent them from becoming finally insolvent.

In this context, the Rordorf Commission modernised some of the legal tools available in Italian insolvency legislation by making them better suited to the above purpose. It also endeavoured to fill serious gaps in the existing insolvency legislation. One of the commission's primary goals was to provide for the coordinated management of financial distress and insolvency in corporate groups through the introduction of group-wide pre-bankruptcy composition agreements.

On February 1 2017 Parliament approved, with amendments, an excerpt of the commission's proposed reforms, which is now under discussion by the Senate. Once approved, the government will be tasked with transposing the reforms into decree-laws.

Group-wide pre-bankruptcy agreements

In the event of a business crisis or insolvency, a pre-bankruptcy agreement is a convenient tool to:

- avoid potential bankruptcy;
- secure business continuity as far as possible; and
- enhance potentially productive assets.

However, in practice, a business crisis often affects an entire 'group' (ie, a plurality of companies relating to or controlled by one holding company), rather than an individual group member. It can be useful in such cases for the crisis to be managed on a consolidated basis by relying on one pre-bankruptcy composition procedure. This would make it possible to:

- retain the unity of direction and coordination that distinguishes a corporate group when its affiliates are in good financial health; and
- maximise the potential for recovery and the asset value of each of the group's companies, possibly through the submission of a single business rehabilitation plan.

However, the existing insolvency law framework not only overlooks the issue of corporate-group crises, but also requires that each insolvency procedure be considered in isolation. The existing legislation does not reflect the peculiarities of a possible group-wide pre-bankruptcy composition agreement, thereby leaving the following issues unregulated:

- the possible involvement of companies registered in different territorial jurisdictions;
- the need to identify a supervisor for the relevant proceedings to ensure consistency and uniformity in managing that procedure; and
- the coexistence of different sets of assets and liabilities in insolvency.

In line with the applicable legislation, the Supreme Court ruled in Judgment 20559 of October 13 2015 that a group-wide pre-bankruptcy agreement is inadmissible in the absence of positive law provisions governing:

- the applicable territorial jurisdiction;
- the appointment of the supervising bodies for the procedure; and
- the formation of creditor classes and appropriate sets of assets and liabilities.

Notwithstanding the lack of suitable legislation and the case law obstructions, there has long been a need for the introduction of a group-wide pre-bankruptcy composition agreement in practice. As undertakings are barred from formally resorting to a single procedure, there are different methods to ensure the unified management of corporate crises (eg, procedures formally self-contained and separated from, but substantially connected to, one another through intragroup rehabilitation plans or credit facilities issued by banks for the restructuring of the parent company and its subsidiaries).

Rordorf Commission draft proposal

Article 3 of the Rordorf Commission's draft proposal aims to fill a major gap in Italian insolvency legislation (ie, through a group-wide pre-bankruptcy agreement). EU Regulation (848/2015) on cross-border insolvency proceedings has prompted national legislatures to take appropriate measures in this regard.

First, the commission proposed that a group's financially distressed or insolvent members be allowed to apply for admission to pre-bankruptcy composition through a single filing. Second, the commission recommended that a statute designed to govern group-wide pre-bankruptcy agreements should specifically provide for:

- the segregation of total assets and debts for each of the group members concerned;
- appropriate criteria for vesting jurisdiction (if the undertakings involved have their registered offices in different judicial districts);
- a single court to have jurisdiction over all relevant proceedings;
- the separation of voting creditors into classes for each group member involved;
- the exclusion from voting of any group members that are creditors of other members involved in the proceedings; and
- appropriate criteria for developing a coordinated plan for the resolution of the group's crisis, possibly through intragroup contractual and reorganising transactions for securing business continuity and best satisfying creditors.

Comment

In submitting the above provisions, the commission aims to balance two opposing needs:

- securing a major business function (ie, the coordinated management of a group of companies subject to insolvency proceedings); and
- safeguarding financial autonomy and the right for any creditors with claims against individual group members to seek redress separately against the assets of the relevant group member.

In the event of a group-wide crisis, coordinated management cannot be forced to commingle the assets and liabilities of different group members. This would result in severe prejudice to, and inequality among, the group's creditors. Each creditor has the right to have its claims prioritised with regard to the company's assets and cash flow of which it

is a creditor, without such assets or cash flow being allocated for the benefit of other affiliates' creditors. Clearly, such right can be secured only by providing for the simultaneous, separate vote of the creditors of each group member.

Intragroup voting concerning intragroup claims should be neutralised as a logical consequence of the attendant conflicts of interest. Other provisions have been recommended with a view to allowing coordinated proceedings to be conducted to handle a crisis affecting a group's multiple affiliates, such as the identification of suitable criteria of jurisdiction and the appointment of a single judge for all relevant proceedings.

The need for the unified management of insolvency proceedings involves the admissibility of a single rehabilitation plan, which should consider:

- the mutual impact of the individual transactions envisaged by the plan; and
- any intragroup organisational transactions.

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Endnotes

(1) For further information please see "Draft statutory instrument for insolvency procedure reform: debt restructuring agreements", "Reform of insolvency procedures: pre-bankruptcy composition agreement" and "Draft statutory instrument for reform of insolvency procedures: alert procedures".

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