INSOLVENCY & RESTRUCTURING - ITALY

Amendments to pre-bankruptcy agreement procedure

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Pre-bankruptcy agreement procedure

Decree-Law 83/2015 on urgent measures concerning private law provisions, rules of civil procedure and the organisation and functioning of judicial administration in insolvency matters entered into force on August 21 2015. It marks yet another change to the insolvency regime, with new statutory provisions being adopted almost every year since 2005.

Decree-Law 83/2015 has introduced changes to the rules, among other things, on:

- bankruptcy;
- debt restructuring agreements under Article 182*bis* of the Insolvency Act; and
- the pre-bankruptcy agreement procedure.

This update provides a supplemental overview of recent changes to the pre-bankruptcy agreement procedure (for further details please see "Parliament introduces amendments to Insolvency Act"), which include:

- the treatment of executory contracts where either party is subject to the pre-bankruptcy agreement procedure (Article 169*bis* of the Insolvency Act); and
- bridge loans in support of firms that are subject to the pre-bankruptcy agreement procedure (Article 182*quinquies* of the Insolvency Act).

Executory contracts

Previously, the statutory framework governing pre-bankruptcy agreements contained no specific provisions for the treatment of executory contracts (eg, contracts pending between the debtor admitted to the pre-bankruptcy agreement process and a third party in bonis, which are still being performed as of the commencement of insolvency proceedings). The void was not filled by the 2005 insolvency law reform. Thus, legal scholars have debated whether Articles 72 and following (pending relationships), which govern similar cases in which one of the parties to an executory contract has been declared bankrupt, should also apply in the event of a pre-bankruptcy agreement, and whether in such event the debtor should be required to take a position in its application for admission to the pre-bankruptcy agreement procedure on all pending legal relationships to which it is a party, with a view to proposing a specific treatment of such contracts to all of its creditor counterparties. With the 2012 amendments (Decree-Law 83/2012), the legislature remedied this issue by adding an *ad hoc* provision (Article 169*bis* of the Insolvency Act (contracts being performed)). This provided that any contract not yet fully performed should automatically remain in force, even during the insolvency procedure, subject to the debtor's option to request a tribunal and/or the delegated judge – depending on whether the request was filed at the pre-agreement stage, if any, or during the pre-bankruptcy agreement procedure – to grant approval for one or more such contracts being dissolved outright or for their enforceability to be suspended for up to 60 days, extendible for up to an additional 60 days.

This rule was amended in 2015 when its heading was changed to "executory contracts", a phrase that was closer to the wording of Article 72 of the Insolvency Act. Further, it now specifies that the new provision should apply to all "contracts still to be performed or not yet fully performed" by both parties "as at the filing date of the application". Thus, it can now be excluded that contracts which have already been fully performed by one party can be dissolved and/or suspended – first among them being banking contracts in respect of which the bank's obligation has already been performed in full, as is the case with loan or advance agreements, while the only account holder's obligation is still to be performed.

Changes have also been made to the way in which judicial approval for suspension and/or dissolution of executory contracts can be obtained in terms of timing and procedure. The legislature has specified that the debtor's request can be submitted immediately, along with the application for admission to the pre-bankruptcy agreement procedure under Article 161 of the Insolvency Act or even after the issue of the court's decree granting admission to the procedure. Thus, it is now acknowledged that this option can be exercised following the opening of the procedure, and that the debtor's business performance may also be taken into account if needed while the pre-bankruptcy agreement procedure is underway. As regards the procedure, it has been specified that the competent insolvency authority:

- can gather summary information before deciding on the request;
- must express its decision in a reasoned decree; and
- must hear the performing party to the executory contract beforehand, to allow it to express its opinion on the debtor's request for dissolution or suspension of contract.

As for the effective date of dissolution and/or suspension of performance of the contract involved, the legislature has specified that this "shall begin to operate upon the authority's decree being notified to the other contracting party". In the event of dissolution of contract, the counterparty is entitled to compensation in an amount equivalent to damages as relief, which must – as previously required – be satisfied as a debt that arises before the opening of the pre-bankruptcy agreement procedure. The rationale behind the last sentence of Paragraph 2 is to provide a guarantee of sorts to the performing party to an executory contract. Recognition of the benefit of pre-deduction of any claims that arise as a result of the counterparty duly performing its obligations after the opening of the pre-bankruptcy agreement procedure is an innovative measure. This pre-deduction is arguably also permitted in the event of dissolution of contract, to be deemed effective *ex nunc* (ie, not retroactively).

The introduction of specific provisions governing executory leases (Article 72*quarter* of the Insolvency Act – an *ad hoc* provision that also applies in bankruptcy proceedings) is another notable change. The provision, as newly incorporated into the last paragraph of Article 169*bis* of the Insolvency Act, requires that, if a lease agreement is dissolved on request by a lessee accessing the pre-bankruptcy agreement procedure, the lessor is entitled to have the relevant asset returned to it, but must pay the debtor "the sum, if any, by which the amount obtained from selling, or otherwise disposing of, the leased asset at market value exceeds the principal amount outstanding". The sum will be counted as part of the estate in the procedure. Further, the duly performing lessor will be entitled to an indemnity, to be treated as a claim arising prior to the procedure, which is equal to the difference between the debt outstanding as of the filing date of the lessee's request and the proceeds from reallocating the leased asset (rather than being equivalent to damages, as is the case with other executory contracts dissolved in pre-bankruptcy agreement proceedings).

Bridge loans

Under the 2015 reform, the legislature addressed the complex matter of bridge loans (ie, loans that can be issued to businesses that are subject to the pre-bankruptcy agreement procedure), due to the "extraordinary necessity and urgency to reinforce the existing rules on the provision of finance to firms in difficulty".(1)

The first innovation that the article introduced is a qualification that the debtor's request for a bridge loan can be filed before ancillary documents to the application for admission to the pre-bankruptcy agreement procedure are filed, including:

- an agreement performance plan;
- a professional verification report;
- a statement of the debtor's equity, income and financial position;
- an analytical statement and estimate of the debtor's assets; and
- a nominal list of creditors and holders of real or personal security interests.

Paragraph 3 provides for a newer type of bridge loan than that under Article 182*quinquies*(1) of the Insolvency Act. The latter provision requires the debtor to file a report prepared by a professional appointed by the debtor as a prerequisite for the court's approval; after reviewing the debtor's total financial needs up to the homologation date, the professional will attest that the finance requested is sufficient to ensure the creditors' best satisfaction. The main innovation of the bridge financing process under the new Paragraph 3 is that it can be carried out without this expert report being required.

This relaxation of the filing requirements has been justified by the legislature by the increased need for this type of bridge financing. However, it is counterbalanced by more stringent requirements regarding the request for approval, which must:

- specify that the loan requested will be used only to meet the firm's business needs (unlike the bridge loans provided for under Paragraph 1, which must be applied to ensure the creditors' best satisfaction);
- contain the debtor's representation that it cannot borrow the relevant funds from other sources; and
- indicate the impending, irreparable harm that the debtor would suffer if the relevant bridge loan were not issued (ie, *periculum in mora* or danger of delay).

The request will be decided by a tribunal in a reasoned decree within 10 days of *periculum in mora* and the grounds for the request (regarding the intended use of the loan for business purposes and the debtor's inability to borrow similar funds from other sources) being identified. Like the claims arising from loans under Paragraph 1, if the debtor is eventually declared bankrupt, the lender's loan claim will be covered by the benefit of pre-deduction under Article 111 of the Insolvency Act.

This provision also specifies that the request for a bridge loan may seek the "maintenance of any self-liquidating loan facilities outstanding at the time the request is filed". Self-liquidating loans fall within the class of bilateral executory contracts, which, in light of Article 169*bis* of the Insolvency Act, are expected to remain automatically in force if the debtor is subject to a pre-bankruptcy agreement procedure. Thus, making their maintenance conditional on approval from the competent insolvency authorities would appear not to be in line with the general rules discussed above. Since banks commonly suspend or terminate lines of credit granted to debtors accessing the pre-bankruptcy agreement procedure, the provision under scrutiny is designed to allow a business in difficulty to obtain the reinstatement of such credit facilities through an *ad hoc* judicial decree, which the bank will be far less likely to avoid.

Finally, another major change to the applicable statutory framework means that a firm that is subject to the pre-bankruptcy agreement procedure can now assign accounts receivable to the lending institutions as collateral for bridge loans borrowed in the course of the procedure, in addition to giving pledges and mortgages (as was the case under the existing provisions), so that the lender can have its claim satisfied upfront by the debtor.

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Endnotes

(1) The matter is governed by Article 182*quinquies* of the Insolvency Act, introduced by Decree-Law 83/2012, converted into Act 134/2012, which has now been supplemented with a new Paragraph 3 so that the relevant article comprises seven paragraphs instead of the original six, in addition to

some minor changes.
