INSOLVENCY & RESTRUCTURING - ITALY

Changes to the Insolvency Act concerning composition and moratorium agreements

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Introduction

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 June 27 2015. The main aim of the new measures is to promote early disclosure and efficient regulation of business crises. Thus, a number of measures were introduced to streamline insolvency procedures and make them more effective, while reinforcing the efficacy of out-of-court settlements. These measures were discussed in previous updates.(1) This update focuses on changes to the Insolvency Act concerning the assignment of assets and the performance of composition agreements, and a new form of debt restructuring for the benefit of businesses with debts owed to banks or other financial institutions.

Assignment of assets and performance of composition agreements

In order for a debtor to retain its assets, it may file a proposal for composition with creditors that includes the assignment of assets.(2) This tool is widely used in business practice; as a result, the legislature decided to define more clearly the applicable provisions of the Insolvency Act.

Prior to the introduction of the reform measures, only the rules governing the sale of assets in bankruptcy (ie, Articles 105 to 108*ter* of the Insolvency Act) applied to composition agreements that included the assignment of assets. Under Article 108(2) of the Insolvency Act, the relevant court was empowered to issue a decree to purge assets being sold in bankruptcy of encumbrances following their sale and receipt of full payment.

Under the reform measures, the court that supervises a composition agreement must issue a decree purging all encumbrances from assets that are sold, transferred or assigned after an application for composition has been filed (Article 182(5) of the Insolvency Act).

The main innovation of this change is that the supervising bodies survive the homologation of the composition agreement. Previously, a judicial commissioner was solely responsible for supervising the execution of a composition agreement, as set out in the court's homologation order. In exercising his or her supervisory powers, a judicial commissioner was required to report to the relevant court any facts that were likely to harm the creditors' interests.

The reform measures also revised the rules on the performance of composition agreements by introducing new collaborative duties. Specifically, if a debtor is made responsible for the performance of a composition agreement, it has a duty – pursuant to the new Article 185(3) of the Insolvency Act – to execute the proposed composition as approved by the creditors and ratified by the court supervising the insolvency proceedings. However, should the debtor fail to collaborate, the court may vest a judicial commissioner with the power to execute the composition agreement *in lieu* of the debtor (Articles 185(4) and (5) of the Insolvency Act).

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If the entity responsible for performing the composition agreement is a limited company and its directors fail to act accordingly, the court may remove them from office and appoint a judicial administrator in their place. In order for the administrator to ensure that the proposed composition agreement is performed, he or she will be vested with the power of the company's directors and shareholders. For example, where the proposed composition entails an increase in the debtor's capital, the administrator can be empowered:

- to convene an extraordinary general meeting for the adoption of the relevant capital increase resolution; and
- to vote at the general meeting of shareholders (Article 185(6) of the Insolvency Act).

Debt restructuring and moratorium agreements

Under Article 182*septies*, which was added to the Insolvency Act under Decree-Law 83/2015, a new form of debt restructuring was introduced for the benefit of a business with debts claimed by banks or other financial institutions.

Pursuant to Article 182*septies*(1), a debtor can group its creditor financial institutions into different classes. If an agreement can be reached with at least 75% of creditors in each class, the debtor may apply to court for the agreement to be extended to the remaining creditors in the same class which have not entered into the agreement (Article 182*septies*(2) of the Insolvency Act).

Therefore, the reform measures allow a debtor that is primarily indebted to banks or other financial intermediaries, which intends to use a debt restructuring agreement to save its business, to rely on an effective tool to overcome disagreements or obstructions that might be raised by creditors.

However, there are some limits to the debtor's ability to apply for the extension of such an agreement. First, acceding and non-acceding creditors in the same class must have the same legal status and economic interests. Second, in compliance with the good-faith principle, a debtor must have notified the creditors involved of the negotiations to reach agreement and enabled them to participate effectively in the negotiations (Article 182(2)).

Further, under the reform measures, the debtor must serve notice of its application to extend the effects of the proposed agreement to the financial institutions that will be affected, in addition to discharging its notification requirements on debt restructuring schemes under Article 182*bis* of the Insolvency Act. A 30-day limitation period will run from the date of serving notice, during which creditors may oppose the agreement.

Regarding the applicable judicial proceedings, the reform measures provide that when a composition agreement is ready for homologation, the supervising court should examine:

- the similarity between the legal status and economic interests of the creditors that will be affected by the extension of the agreement's effects and those of the financial institutions that have acceded to the agreement; and
- the observance of the good-faith principle and the notification of creditors to which the agreement will be extended and whether they have been provided with an opportunity to participate in the negotiations.

Further, the supervising court must to establish whether the claims of non-acceding creditors can, by the terms of the agreement, be satisfied to an extent not lower than that achievable through any feasible alternatives. In other words, the court will be called upon to review the different means for satisfying claims that are available to the creditors concerned.

The introduction of a principle whereby dissenting creditor financial institutions are coerced into contracting applies not only to debt restructuring schemes, but also to moratorium agreements. Debts claimed by banks or other financial intermediaries – whether overdue or outstanding – are fundamental to moratorium agreements. However, in this case the aim of the contract is to agree extended terms of payment rather than alternative means to satisfy claims.

Under the new provisions, if more than 75% of the creditors accede to a moratorium agreement, it can be extended to all creditor banks and other financial intermediaries with the same legal status and economic interests (pursuant to Article 182*septies*(5)).

As in the case of debt restructuring agreements with banks and other financial institutions, an essential condition for the extension of a moratorium agreement to non-acceding creditors is strict compliance with the good-faith principle. However, non-acceding banks or other financial intermediaries are still entitled to file opposition requesting that the moratorium agreement have no legal effect against them within 30 days of being served the relevant notice of agreement and the practitioner's report by registered or certified email.

By issuing a reasoned decree, the supervising court will adjudicate on oppositions after satisfying itself that the statutory conditions described above for the judicial approval of debt restructuring agreements with banks and other financial institutions apply. The decree whereby a court adjudicates on oppositions by creditors not acceding to the moratorium agreement can be appealed under Article 183 of the Insolvency Act within 15 days of the relevant notice being issued (Article 182*septies*(6)).

The deferment of collection of relevant claims is expected to be the main effect that moratorium agreements will have on non-acceding creditors. This is because under Article 182*septies*(7) of the Insolvency Act, the following measures cannot be imposed on non-acceding creditors:

- the granting of credit facilities;
- the continued observance of the debtor's right to use existing credit lines; or
- the issue of new loans.

The article further specifies that the continued granting of the enjoyment of assets under existing leasing agreements should not be deemed to amount to the performance of obligations.

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Endnotes

(1) For further information please see "Parliament introduces amendments to Insolvency Act" and "Amendments to pre-bankruptcy agreement procedure".

(2) A composition with creditors is an insolvency procedure whereby an enterprise in financial difficulty seeks an agreement with its creditors to avoid being declared bankrupt. The procedure is supervised by a court and one of more judicial commissioners. For further information please see "Terminating a composition with creditors under the Bankruptcy Act".