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Agreements between debtors facing financial difficulties and their creditors. Why migrate to Italy?

RESTRUCTURING UNDER RECENT ITALIAN INSOLVENCY LAW REGULATIONS

Trade debtors may resolve their financial crisis either through insolvency proceedings, or by coming to different types of agreements with their creditors. These agreements usually avoid the costs of insolvency proceedings, solve the financial crisis more rapidly than insolvency proceedings and aim at promoting the debtor's rescue, preserving the business as a going concern, and procuring a stronger covenant for creditors through the restructuring of the business.

Prior to 2005, informal agreements with creditors (so-called *concordati stragiudiziali*) were limited under Italian insolvency regulations applicable to non large trade debtors by the existing provisions on voidable transactions, including payments made against the order of priorities set by the law, and by criminal sanctions applicable to debtors and creditors who postponed the filing of formal insolvency proceedings and who preferred some creditors to others (so-called *bancarotta preferenziale*).

The 2005-2006 reforms ((2006) 5 ILP 168-170) of the Italian Insolvency Regulations incorporated the existing regulations with a number of propositions which evolved during the judicial process of interpreting the original regulations. Further amendments were approved on 14 September 2007 with legislative decree n and became effective on 1 January 2008.

These 2005-2007 regulations encourage non large trade debtors (rather than consumer debtors) facing financial difficulties (so-called *'stato di crisi'*) to negotiate agreements with their creditors, aimed at promoting the debtor's rescue. The trade debtor must, in the three years preceding the insolvency proceedings or since its establishment if less, have an asset value of less than €300,000, a turnover of under €200,000 per annum and debts of less than €500,000.

The new regulations amended the existing regulations concerning preventive creditors' settlement (so-called *concordato preventivo*) proceedings and partially regulated agreements with creditors and may be compared, to a certain extent, either to administration or to individual or company voluntary agreement under the Insolvency Act 1986 ('IA 1986').

These regulations are expected to reduce the existing and extensive use of informal agreements between debtors and their creditors, due to the limited risk of challengeability of any transaction performed, of potential liability for any damage arising out of the delay in applying for insolvency, as well as of the breach of criminal law provisions.

Recent insolvency law judgments and cases raised broad discussions on the possibility of: (a) migrating the legal seat as well as the centre of main interests ('COMI') in a different jurisdiction; and (b) taking advantage of the provisions of EU Regulation on Insolvency 1346/2000. Consequently, knowledge of the principles of insolvency regulations of different jurisdictions may be of some help for insolvency practitioners. This article provides an overview on the existing Italian regulations concerning workouts with creditors.

REGULATED WORKOUTS. PREVENTIVE CREDITORS' SETTLEMENT PROCEEDINGS (CONCORDATO PREVENTIVO) (ART 160-182 IIA)

The proposal and its contents. The formation of classes of creditors

The trade debtor's proposal must be based on a rescue plan the terms of which will depend on the existing circumstances. Specifically, the plan may provide for: restructuring of payment obligations as well as satisfaction of creditors' claims by any means, such as the sale of debtor's assets; the assumption of debts by others; the transfer to the creditors, as well as to companies controlled by them, of shares, bonds eventually convertible into shares, or other like interests (such as financial tools or debt titles); and transfer of the company's assets to a third party (so-called *assuntore*). The third party may include creditors or companies created or to be formed, whose shares are expected to be transferred to creditors pending the proceedings, as a consequence of the agreement with the debtor.

The proposal – which may be modified during the proceedings, before the creditors' vote – usually provides for full satisfaction of secured creditors, including those entitled to a preferential payment (*privilegio*) as well as holders of a pledge (*pegno*) or mortgage (*ipoteca*). However, the debtor may also propose a partial satisfaction of secured creditors' claims when the amount proposed is not lower than the one expected following compulsory winding up proceedings (so-called *fallimento*), based on the value of the goods or business on which their priority lies, as ascertained by a sworn report prepared by an expert or a certified auditor.

The debtor may divide creditors into classes, based on the nature or the priority of their claims, as well as to their title and/or homogeneous economic interests, and propose different types and measures of payment to creditors belonging to different classes. The amount to be paid to each class of secured creditors should not, however, change the order of priorities.

Proposals: (i) approved by a majority in excess of 50 per cent (in value) of unsecured creditors admitted to vote, even when divided in classes; and (ii) validated by the competent court, bind any creditor, inclusive of those who did not accept the terms, voted in favour or took part to the proceedings. The creditors keep their rights against debtor's guarantors, as well as the members of a partnership.

The proceedings. Admission to the proceedings and its effects

The debtor is required to file to the competent insolvency court an application which describes the statement of affairs as well as the proposal made to the creditors. The following documents are required to be enclosed to the application:

- an up-to-date debtor's financial report;
- an analytical report of the debtor's activities;
- a schedule of the creditors, which shows their credits and their grounds for priority;
- a schedule of owners of rights over the debtor's assets;
- a schedule of the company's as well as of the partners, if the debtor is a partnership; as well as an estimate of its value; and
- a report, to be made by an independent expert – which assesses the accuracy of the debtor's data, the proposal's feasibility, and the debtor's ability to pay the creditors accordingly – plays a central role in the proceedings.

Notice of the application is delivered to the public prosecutor's office. An adjournment not exceeding 15 days may be allowed for the debtor to modify or complete the plan and to file any other documents required by the insolvency court. If the debtor's proposal does not meet the legal conditions, the insolvency court will declare the proposal as inadmissible; and, upon petition made by a creditor or the public prosecutor, the insolvency court may declare the debtor insolvent and start compulsory winding up proceedings (*fallimento*).

If the debtor's proposal meets the legal conditions, the insolvency court will issue a decree which: (a) appoints a delegated judge as well as a Judicial Commissioner as a sort of supervisor/trustee; and (b) imposes on the debtor the requirement to pay a deposit for the procedural costs within 15 days.

The debtor is required to deposit an amount equal to 50 per cent of the estimated expenses for the entire proceedings or an amount not lower than 20 per cent of such expenses, as determined by the delegated judge. If these costs are not paid within 15 days, the insolvency court will issue an Insolvency Order.

The admission decree imposes a moratorium against any creditor's enforcement or freezing proceedings until the validation order becomes final, stops the accrual of interest on unsecured debts for the entire duration of the proceedings, and ensures 'debtor in possession', within the limits of the proceedings.

This makes *concordato preventivo* similar to US Chapter 11 proceedings and different from the UK administration proceedings, although the debtor is not entitled to perform certain acts without the delegated judge's prior approval.

If the debtor has hidden or disposed of part of its assets, knowingly omitted to notify one or more claims, showed non-existent liabilities or committed unauthorised acts or acts intended to defraud the creditors, or if at any time the conditions required for the preventive creditors' settlement are not met, the insolvency court, upon the report of the Judicial Commissioner, may revoke the proceedings, giving notice to creditors as well as the public prosecutor. Upon application of one or more creditors or of the public prosecutor, in such circumstances, the insolvency court may also issue an Insolvency Order.

Any transaction, payment and guarantee over the debtor's assets carried out or granted pursuant to *concordato preventivo* proceedings not validated by the insolvency court may not be challenged by the official receiver (*curatore*) in subsequent compulsory winding up proceedings which makes this proceeding attractive to creditors. During this proceeding, however, the debtor is not entitled to terminate agreements entered into by the debtor before filing the application, unless a contract clause automatically terminates or accelerates the contract upon the occurrence of this type of proceeding.

Creditors entitled to vote and approve of the proposal

The proposal put forward by the debtor needs to be approved by the creditors, based on the application as well as on the Judicial Commissioner's report. Unsecured creditors are usually entitled to vote for the proposal during the hearing and may do so in writing (by telegram/telefax/email/registered letter) within 20 days from the creditors' meeting.

Secured creditors are usually unaffected by the proposal, unless they otherwise consent and, therefore, are deemed not to have voting rights, save where their claim is only partly secured or if the debtor proposed a partial satisfaction of their secured claims, or they waived, either wholly or partially, their priority. Secured creditors are considered as unsecured ones for the unsecured part of their claim and may, therefore, within such limits, vote for the proposal.

The debtor's spouse, relatives until fourth degree, and those who became an assignee of the debtors' claims in the year preceding filing of the application are not entitled to vote on the proposal.

Any proposal is approved if a majority in excess of 50 per cent of the entitled creditors vote in favour. If the proposal provides for classes of creditors, a majority in excess of 50 per cent of creditors belonging to each class and admitted to vote, to be expressed in the majority of classes, is required. If the preventive creditors' settlement is not approved by such majorities, the insolvency court may declare the debtor insolvent and, consequently, open the compulsory winding up proceedings.

Court validation proceedings

As soon as the proposal is approved, the court is required to validate the proposal and issue a validation order (so-called *decreto di omologazione*) based on the debtor's proposal, the voting procedure results, and the Judicial Commissioner's report. Any dissenting creditor, as well as the Judicial Commissioner, may take part in this part of the proceedings.

International Feature

Biog Box

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The court validates the proposal if no opposition is filed against it. If any opposition has been filed, the court may evaluate: (i) any challenge to the proposal; and (ii) if the proposal made to the creditors is expected to have a real prospect of success. The insolvency court will validate the proposal if the returns to creditors belonging to dissenting creditors (or creditor classes) are not lower than the ones reasonably expected by the liquidation of the debtor's assets (so-called cram down rule).

If the court does not validate the proposal, the court may declare the debtor insolvent and consequently open the compulsory winding up proceedings. Any amount due to claims which are opposed, conditional or belonging to creditors which cannot be found, is handled according to the court's instructions.

Enforcement. Termination or voidability of the validated agreement

If the proposal provides for the sale of goods, the validating decree will appoint one or more liquidators as well as a creditors' committee of three to five members to assist the liquidators and to determine appropriate action. Any sale of the business or part of it, its assets or liabilities requires the creditors' committee's authorisation. The same sales procedure provided for in compulsory winding up proceedings apply, when possible.

Any validated agreement which does not provide for assignment of assets to a third party may, however, be terminated within a certain term or declared null and void for specific reasons (art 186 IIA).

(PARTIALLY) REGULATED WORKOUTS Rescuing agreements (*Accordi di ristrutturazione*) (art 182 bis IIA)

Trade debtors facing financial difficulties (*stato di crisi*) may agree on a compromise or arrange with their creditors representing at least 60 per cent by value of the claims and publish it in the Company House register (*registro delle imprese*). The agreement is effective from its publication in the Company House register and binds those creditors which approved it, as soon as the agreement is validated by the competent insolvency court.

The debtor is required to file an application for validation to the competent insolvency court together with: (a) copy of the agreement as well as the advertisement in the Company House register; (b) an expert's report assessing the plan's feasibility and, in particular, its ability to satisfy creditors which have not agreed to the plan; and (c) specific documents concerning the debtor's situation. Creditors are not entitled to start or continue any enforcement proceedings or any proceedings against the debtor's assets for a period of 60 days from the publication of the agreement in the Company House register.

Any creditor and/or any other interested third party may challenge the agreement within 30 days from its publication in the Company House register. The court decides on these applications and ascertains whether or not the agreement pertains to a considerable part of the company's liabilities and does not prejudice the creditors.

The court may validate the agreement through a decree published in the Company House register. Appeals against validation decree

must be filed within 15 days from publication date. If the court does not validate or considers the agreement non-admissible, the debtor's application is rejected and, if the conditions are met, proceedings aimed at declaring the debtor insolvent may be started upon application of any entitled party.

The validated agreement binds only creditors who expressly approved it, and not those which did not take part in it, whose debts need to be fully satisfied, and may be enforced without any interference by the agreement.

Any transaction, payment and/or guarantee over the debtor's assets carried out or granted according to a validated *accordo di ristrutturazione* is unchallengeable by the bankruptcy trustee, if the debtor subsequently is declared insolvent and a compulsory winding up proceeding is opened.

Certified plans (*piani attestati*) (art 67.1.3 lett d IIA)

The debtor may prepare a plan – either unilateral or agreed with either all or some creditors, as well as with third parties – aimed at reducing its liabilities and rebalancing its financial position.

If the plan is certified by an independent expert, and its date has been certified, any transaction, payment and/or guarantee over the debtor's assets carried out or granted is unchallengeable by the bankruptcy trustee, if the debtor is declared insolvent subsequent to the plan's approval and enforcement. The now mentioned exemption, together with the plan certification made by an independent expert, makes these plans appealing for creditors more than formal agreements with creditors (so-called *concordati stragiudiziali*) which, however – notwithstanding the amended and new insolvency law provisions – still play a limited role in the Italian restructuring scenario.

MIGRATING TO ITALY?

The principles above show how Italian Insolvency Regulations, as amended by the 2005-2007 reforms, provide for:

- *Incentives for debtors*, towards the assumption of entrepreneurial risk, by reducing negative consequences in case of failure. However, where no reasonable prospect of the company avoiding insolvent liquidation exists, directors must take every step to minimise potential loss to creditors by an immediate filing for compulsory winding up proceedings (so-called *fallimento*). Where, on another hand, the value of the company's assets may be maintained, directors should continue trading, selling the business at a price higher than the one achievable in a compulsory liquidation.
- *Different options for the debtor's creditors (or the main ones)*, which may: (a) bind creditors, either partially or totally; (b) impose (or not) a stay to individual enforcement proceedings; (c) avoid risk of voidable transaction if, following completion of a regulated (or partially regulated) workout, insolvency proceedings are opened.
- *Awards for private initiative within insolvency proceedings*, with a significant reduction of court's role as well as any other public scrutiny.

These principles give Italy a workable restructuring process for both debtors and creditors. ■