ALERT MEMORANDUM

Updates to Italy's Insolvency Code

October 18, 2024

Italy's "Code on Business Distress and Insolvency" (the "Code") has been partly amended and rectified just over two years after its entry into force on July 15, 2022).[1]

The changes are primarily intended to take stock of the initial application of the Code, in order to clarify certain interpretative issues that have arisen and further align it to EU Directive 1023/2019 (the "EU Insolvency Directive"), which the Code sought to implement.

The amendments are set forth in Legislative Decree No. 136/2024 (the "Amendment Decree"), which came into force the day after its publication in the Official Journal on September 27, 2024.

The most salient changes comprise: (*i*) preservation of existing credit lines in case of out-of-court composition proceedings (*composizione negoziata della crisi*; "Composition"), (*ii*) extension of restructuring of tax claims to Composition; (*iii*) clarification of the notion of "liquidation value" for purposes of the absolute and relative priority rules in a judicial composition with creditors (*concordato preventivo*; the "*Concordato*"); (*iv*) revised requirements for a cross-class cram-down in a *Concordato*; (*v*) stability and execution of extraordinary corporate transactions made in a restructuring context; and (*vi*) restructurings of corporate groups.

The changes brought about by the Amendment Decree apply also to all restructurings and other proceedings under the Code pending on the date of its entry into force.

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[1] For an overview of the Code upon its enactment, see our alert memorandum of September 19, 2022.

I. Existing credit lines in a Composition

A Composition is an out-of-court process whereby a distressed debtor[2] may seek to restructure, provided that recovery appears reasonably possible, with the assistance of a third-party expert appointed by the local chamber of commerce. Courts are in principle not involved, except in limited cases (*e.g.*, when a debtor seeks a stay or similar protections pending the Composition).

In this context, debtor's access to financing is obviously crucial, including in the form of preserving the ability to draw from existing credit lines, as the Amendment Decree seeks to facilitate. More specifically:

- with a view to mitigating the impact of the applicable prudential supervisory regime, (*i*) if a financial lender[3] is required thereunder to suspend or terminate an existing credit line in connection with the debtor applying for Composition, such lender must promptly inform the corporate bodies of the debtor, including to disclose the underlying reasons; and (*ii*) such lenders are also prevented from reclassifying their exposures (*e.g.*, to NPE (non-performing exposure)) towards the debtor solely on grounds of its access to the Composition;[4]
- a lender may not suspend or terminate an existing credit line solely on the basis of it becoming aware of its debtor applying for the Composition; and
- lenders towards which protective measures (*misure protettive*) apply may not unilaterally refuse to perform pending agreements (*e.g.*, existing credit lines) nor terminate or accelerate them solely based on non-payment of claims that predate the application for issue of such protective measures (unless required under the applicable prudential supervisory regime).

Finally, in order to balance the above restrictions and constraints, the Amendment Decree clarifies that the continuation of the contractual relationship with the debtor does not automatically entail liability for the lender.[5]

II. Restructuring of tax claims in a Composition

The Amendment Decree also seeks to fill a significant gap, in that it extends to Composition proceedings the ability to restructure certain[6] tax claims.[7]

Because in a Composition any restructuring must be consensual, tax claims may be restructured only pursuant to an agreement between the debtor and the tax administration. This agreement is proposed by the debtor and must enclose (*a*) the opinion of a third-party expert certifying the advantage of the proposal over a judicial liquidation, and (*b*) a report from the debtor's auditors confirming the accuracy of the underlying financial data.

The agreement must then be submitted to the court for its authorization, and terminates in case subsequently the debtor becomes subject to a judicial liquidation or is otherwise found insolvent, or in case the debtor does not

[2] The Amendment Decree clarifies that the Composition is available not only to debtors that are facing financial imbalance or economic difficulties based on which distress or insolvency appears likely, but also to those who are already in a state of distress or insolvency.

[3] Meaning a bank, other financial intermediary, or the assignee of their claims.

[4] However, this provision could not depart from the applicable prudential supervisory regime, and therefore acknowledges that lenders may still be required to proceed with this reclassification on the basis of adequate justifications, taking into account the restructuring proposed by the debtor at the outset of the Composition.

[5] Thus in principle excluding the risk of a lender being held liable for so-called "abusive lending" (*concessione abusiva del credito*), occurring where by lending to a distressed debtor the lender contributes to delaying the date on which the lender is declared insolvent, thereby affecting the other creditors' recovery.

[6] Unlike in case of a court-ratified restructuring agreement (*accordo di ristrutturazione dei debiti*) or *Concordato*, social security claims and VAT claims may not be restructured in a Composition.

[7] Previously, the lack of reference to tax claims was considered as an obstacle for the tax administration to agree to such restructuring.

fulfill its payment obligations thereunder within 60 days of the applicable term.

III. Clarifications on the absolute and relative priority rules in a *Concordato*

A *Concordato* may be used either to effect a piecemeal liquidation of the debtor's assets or to allow the continuation of the debtor's business as a going concern[8] (the "Business Continuity *Concordato*").

In this latter type of *Concordato*, the EU Insolvency Directive granted Member States the option to adopt either an "absolute priority rule" or a "relative priority rule" to the payment of creditors. Except with respect to claims of employees,[9] Italy has opted for the latter in the Code, in the following form:

- the "liquidation value" of the debtor's assets must be distributed to creditors in accordance with their priority (*i.e.*, junior creditors may be satisfied only to the extent that senior creditors have been satisfied in full); whereas
- any excess (*i.e.*, the value of the restructured business in excess of the liquidation value) may be distributed to unsecured or junior creditors as well,[10] *provided*, however, that the treatment of creditors in a dissenting class as a whole is (*i*) at least as favorable as that of creditors in equally ranking classes, and (*ii*) more favorable than that of more junior classes.

However, the concrete application of these provisions has given rise to interpretative uncertainties, primarily regarding the concept of "liquidation value", because neither the EU Insolvency Directive nor the Code provided sufficient guidelines on this notion.

In this regard, the Amendment Decree has defined "liquidation value" as the value of the proceeds that can be expected[11] from the sale (occurring as part of a judicial liquidation) of the debtor's "assets and rights", including such higher value as it could be obtained from (*i*) the sale of the business as a going-concern (as opposed to a piecemeal liquidation) and (*ii*) the exercise of potential claw-back or liability actions.

IV. Changes to the Cross-Class Cram-down

As a general rule, approval of a Business Continuity *Concordato* requires the favorable vote of (*i*) a majority of creditors (by value) admitted to vote, and (*ii*) all voting classes.

However, failure to achieve the voting classes' approval may be overruled by the court (so-called "cram-down") at the subsequent stage of ratification (*omologa*), subject to various conditions.

Prior to the Amendment Decree, these conditions included approval of the *Concordato* proposal by the majority of creditor classes, *provided that* (*a*) at least one class of secured creditors approved it, or (*b*), absent approval by any such class, a class of creditors that, based on the ordinary ranking of claims, would be satisfied, at least in part, with the restructuring proceeds in excess of the liquidation value (based on a valuation of the debtor as a going concern) approved the *Concordato*.

However, this condition had raised interpretative issues, as it was unclear what *"absent approval by any such class*" actually meant. Accordingly, the Amendment Decree has clarified that this expression refers to the *Concordato* plan not having been approved by the majority of classes, in which case the court may still ratify it if the plan has at least been approved by a class

[8] This type of *Concordato* applies whenever under the plan creditors would be satisfied, at least in part, from the value of the going concern. In turn, the business as a going concern may either be retained and run directly by the debtor entity, or indirectly by another entity to which the debtor's business or business unit(s) has been sold, contributed in-kind or leased pending the proceedings or pursuant to the *Concordato* plan once ratified by the court.

[9] In respect of whom the absolute priority applies and, therefore, employees' claims must be satisfied with priority over junior creditors from both the liquidation value of their collateral and any potential excess over it.

[10] The Amendment Decree also clarifies that the court may assess the correct allocation of the liquidation value and excess value only at the final stage of ratifying the *Concordato*, and not also at earlier admission stage.

[11] Based on an estimate as at the date on which the debtor applies for the *Concordato.*

of creditors that (*i*), under the plan, are not offered a full recovery on their claims, but (*ii*) would receive at least a partial recovery even if the absolute priority rule also applied in respect of the value exceeding the "liquidation value".

V. Extraordinary corporate transactions

The Amendment Decree also impacts extraordinary corporate transactions carried out in the context of, or pursuant to, a *Concordato*.

In particular, the Amendment Decree seeks to consolidate and stabilize the effects of these transactions (*i.e.*, mergers, de-mergers, corporate conversions) if these are envisaged in the *Concordato* plan, providing that:

- oppositions by creditors (whether of the debtor or of other companies involved in the transaction) must be lodged in the context of the court hearing convened to ratify the *Concordato*[12] (as opposed to the ordinary venues in case these transactions take place outside a *Concordato*);
- withdrawal rights of the shareholders normally arising in connection with a merger, de-merger or corporate conversion are suspended until completion of the transaction;
- once the *Concordato* plan is ratified by the court,[13] including by means of a non-final ruling (because an appeal is pending or still possible), the underlying corporate resolution (*e.g.*, the shareholders' meeting resolution approving the merger) may not be annulled even if found in breach of the law and, therefore, the relevant transaction may not be affected. The only consequence would be indemnification, whose award must be satisfied as a super-priority claim (*prededucibile*). The same rule also applies in case of termination or annulment of the *Concordato* after its court ratification.

Further, the Amendment Decree also seeks to ensure that, if a plan envisages an extraordinary corporate transaction (*e.g.*, a share capital increase instrumental to a debt-equity swap, a merger, or de-merger), this is effectively consummated even if the shareholders do not cooperate. To that end, shareholders' meeting resolutions may indeed be replaced by the relevant court ruling, and possible ensuing implementing actions shall be carried out by the debtor's directors (or, in case of their inertia, a judicial administrator appointed upon request of any interested party).

VI. Group restructurings

The Amendment Decree also tries to further coordinate and facilitate group-wide restructurings.

In particular:

- a group-wide *Concordato* or group-wide restructuring agreement may be started by means of a single petition filed by the group parent company.[14] Consistently, the Amendment Decree clarifies that a restructuring of a group's tax and/or social security claims may also be proposed by a means of a single proposal that the group parent company submits to a single office of the tax and social security administrations;
- as in the case of a stand-alone Business Continuity *Concordato*, the Amendment Decree provides that creditors of the group companies pursuing this type of *Concordato* may be satisfied with the proceeds from the going concern even if these do not represent the

[12] To this end, the plan must also be filed with the Companies Register and the court ratification hearing may not take place prior to 45 days after the publication therein, in order to enable possible opposing creditors to have the time to file their opposition.

[13] The transaction may not be consummated until ratification. However, the court may authorize its completion if, having heard the judicial commissioner, concludes that the creditors' interests would be jeopardized if completion occurred after the court ratification and provided that the creditors of all other companies involved in the transaction consent or dissenting creditors are paid in full.

[14] More specifically, the company exercising "direction and coordination" over the group or, absent this, the group company with the highest indebtedness participating in the restructuring.

prevailing source of their recovery (the balance coming from the proceeds of the liquidation of other assets no longer used for the business);

- the requirements for court-ratification of a *Concordato* must be met for each group company participating in the restructuring;
- in case a group company participating in the group *Concordato* is a creditor of the group parent company in respect of a loan or financing that the former granted to the latter, its claim is no longer subordinated by operation of law;
- the court may order at any time the separation of the single group-wide proceeding in case it detects a conflict of interest between the different group companies or between the interests of their respective creditors. Similarly, in case of a judicial liquidation, the court must order the separation of the group-wide proceeding in the event that the bankruptcy trustee intends to start a liability action against any group company for abusive exercise of "direction and coordination".

VII. Other Relevant Amendments

Other notable changes brought about by the Amendment Decree include:

- *Concordato* plans must now expressly consider State-guaranteed financings, and are required to set aside, when necessary, a provision to ensure repayment of the State's recourse claims in the event that the guarantee is enforced;[15]
- in case of a *Concordato* whose plan either envisages a piecemeal liquidation of all or part of the debtor's assets or the sale of the business as a going concern, the liquidation shall be carried out by a liquidator appointed by the court. If the plan already envisages an offer from a third party in respect of any such assets / business, the court shall order the launch of a bid process to seek possible alternative offers;
- judicial liquidation proceedings (*liquidazione giudiziale*) must be completed within five years from the date the proceeding is initiated, except in cases of specific difficulties in the sale process, where this deadline may be extended by the Court.

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[15] Based on a pre-existing specific provision of law, in case a claim is guaranteed by the State or specific agencies thereof, if such guarantee is enforced, the State or the agency's recourse claim against the beneficiary is automatically treated as a secured claim prevailing on substantially all other secured creditors, even if the guaranteed obligation was not a secured one. Given the vast use of State-backed guarantees made during the Covid-19 outbreak, this provision introduced by the Amendment Decree may have a material impact on the feasibility of restructurings.