Mapping Preventive Restructuring Frameworks and the EU Directive for the JCOERE Project

Country Report

Italy

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The Italian Perspective on Restructuring

Italy has a range of procedures used to rescue business entities. The legislative framework is expected to be replaced by a new Insolvency Code, the *Codice della crisi d'impresa e dell'insolvenza* (hereafter referred to as the "CCI") enacted in 2019 and which is due to come into force on 1st September 2021.[5] Although the CCI envisages a comprehensive reform of the legislative framework on business restructuring and insolvency, it largely confirms the main elements of the current insolvency framework and transposes into law certain legal principles from case law.

The three types of restructuring processes described below are all covered by the EIR Recast. The *concordato preventivo* includes an optional stay and a cross-class cram-down. The other two procedures are different types of *accordi di ristrutturazione dei debiti* (purely consensual or binding on a minority of dissenting creditors) that envisage an out-of-court phase consisting of negotiation and reaching an agreement with creditors with a view to rescuing the company and is subject to court confirmation. The *concordato preventivo* is described in detail below as it most closely mirrors the provisions of the Preventive Restructuring Directive 1023/2019 ("PRD").

The current trend shows a reduction in the numbers of *concordato preventivo*, which can be ascribed to a series of reforms that have progressively tightened certain requirements, and a growing interest in *accordi di ristrutturazione dei debiti*. This trend may be fuelled by the entry into force of the CCI, since it further tightens the requirements to be fulfilled in case of the *concordato preventivo* procedure.

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[5] The original date of entry into force of the CCI, set on August 14th, 2020, was postponed pursuant to Decree Law 17th March 2020, No. 18, in response to the Coronavirus (COVID-19) crisis.

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PART 1: The General Context of Preventive Restructuring

Function and Aims of Insolvency and Rescue

In Italy, the law pertaining to preventive restructuring has undergone an extensive reform in the CCI, which is due to come into force on 1st September 2021. The CCI has three main objectives; first, it aims to increase recovery in pre-insolvency procedures in the interests of creditors.[6] Second, it aims to enable viable firms in financial difficulty to restructure at an early stage, to avoid insolvency, and to continue their activities.[7] Finally, the Italian framework aims to reduce the duration of and costs associated with preventive restructuring procedures.[8] To achieve these objectives, the Italian legislature has enacted the Delegated Law No. 155/2017, providing guidelines for the CCI.

Italy has established a 'modular' approach to pre-insolvency and insolvency procedures, creating a basic, single procedure, which varies in its approach and outcome depending on the specifics of the case.[9] The CCI has focused on a number of issues including:

(i) the efficiency of the proceeding and the empowerment of institutional bodies with supervisory and control powers to take the initiative;[10]

(ii) prioritising those proposals that allow the business to recover from the crisis as a going concern (not necessarily with the same entrepreneur) and that are able to ensure the protection of the best interest of the creditors;[11]

(iii) attributing defined responsibilities to insolvency practitioners and advisors and weakening the statutory priorities that such professionals used to enjoy in relation to their fees accrued in connection with the restructuring;[12]

(iv) ensuring that judges will be properly specialized in the field of insolvency;[13] and

(v) providing for the creation of a public register containing a list of professionals, who could also be organized as associations or companies, having the requirements to act as court-appointed insolvency practitioners in pre-insolvency and insolvency matters.[14]

Legislative Frameworks

There are three procedures in the new Italian framework that satisfy the definition of preventive restructuring: the *concordato preventivo* (judicial composition with creditors),[15] the *accordi di ristrutturazione dei debiti* (debt restructuring agreement),[16] and the *accordi di ristrutturazione ad efficacia estesa* (debt restructuring agreement binding on dissenting creditors).[17]

The *concordato preventivo* is a judicial composition with creditors, which allows a distressed company to avoid opening a liquidation proceeding by means of an agreement with a majority of its creditors. The plan is proposed by the debtor, or in some cases, by the creditors if they represent at least 10% of the debt, which is referred to as a competing plan.[18] A competing plan can only be submitted in response to a procedure initiated by the debtor and is only relevant if the independent expert appointed by the

[6] See the Explanatory Report of the Delegated Law n. 155/2017 and the Italian Supreme Court's decision, section I, 07 April 2017, n. 9061.
[7] See the Explanatory Report of the Delegated Law n. 155/2017 and the Italian Supreme Court's decision, section I, 13 June 2016, n. 12119.
[8] See the Explanatory Report of the Delegated Law n. 155/2017.
[9] CCI, art 40.
[10] CCI, art 377.
[11] CCI, art 86.
[12] CCI, art 6.
[13] CCI, art 27. In this respect the CCI only partially implemented the principles of the Enabling Law 155/2017.
[14] CCI, art 356.
[15] CCI, art 84-120.
[16] CCI, art 57-64.
[17] CCI, art 61.
[18] The 10% threshold can also be reached by buying credits after the proceeding is opened.

debtor certifies that the debtor's proposal does not ensure the payment of at least 30% of the unsecured claims.[19] At the request of the debtor, the judicial composition features a stay on enforcement actions; priority for new financing;[20] termination of executory contracts; intra-class and cross-class cram-down; and a stay on recapitalisation obligations. The plan becomes binding after its approval by the required majority of creditors and upon judicial confirmation.

The *accordi di ristrutturazione dei debiti* allow for the confirmation of an out-of-court agreement between the debtor and at least 60% by value of a company's creditors, which is supported by the report of an expert confirming that the agreement ensures the full payment of the claims of non-consenting creditors. The key features of the debt restructuring agreement procedure are; a temporary stay on enforcement actions, which is automatically granted by the court upon request by the debtor; a stay on recapitalisation obligations; and priority for new financing.[21]

Finally, the *accordi di ristrutturazione ad efficacia estesa* also allows for the confirmation of an out-of-court agreement. The differentiating feature between this and the *accordo di ristrutturazione dei debiti* is that it is binding on dissenting creditors within a particular approving class. The debtor classifies creditors on the basis of commonality of interest and an equivalent ranking and all creditors in a class are bound by agreement provided that at least 75% of the total amount of creditors in that class have approved the plan. There is no cross-class cram-down provision, as only creditors within a class can be bound by the plan once the required majority is reached. The key features of this alternative debt restructuring agreement are the same as those in the *accordi di ristrutturazione dei debiti*.[22]

PART II: Specific Substantive Aspects of Preventive Restructuring in Domestic Processes and in the Directive

The Stay of Individual Enforcement Actions

As briefly outlined above, the stay of enforcement actions takes several different forms. In the *concordato preventivo*[23] and the *accordi di ristrutturazione dei debiti*,[24] a debtor is entitled to request a stay, which is automatically granted by the court until a court hearing takes place within 30 days, or exceptionally within 45 days following an extension granted by the court. At the hearing, the stay may be confirmed by the court and its duration extended until the court confirms or rejects the plan. A type of stay applies to judicial liens on real estate in that they are unenforceable against the debtor if registered within 90 days prior to the date when the same debtor has filed for *concordato preventivo*. Technically speaking it is not a stay, but rather a case of automatic unenforceability; however, it serves a similar purpose to the stay, since the registration of judicial liens is possible only in the context of a foreclosure.[25] The stay in an Italian *concordato preventivo* extends to all creditors, including employees, however, the Italian social security entity (INPS) provides for a fund that covers workers' claim.

The incoming Italian legislation provides for a debtor, an insolvency practitioner, or the creditors to request the court to lift the stay in the event of fraudulent conduct or when the restructuring plan is unlikely to be successful.

The Adoption of Restructuring Plans

[19] CCI, art 90.
[20] This priority cannot trump secured creditors.
[21] As above, this priority cannot trump secured creditors.
[22] Temporary stay on enforcement actions at the request of the debtor; a stay on recapitalisation obligations and limited priority for new financing.
[23] Decree No 14 of 12th January 2019 – Codice della crisi d'impresa e dell'insolvenze (CCI), art 54 para 2.
[24] CCI, art 54, para 3.
[25] This is confined to judicial liens, leaving unaffected all other forms of securities registered within the same timeframe prior to the *concordato* proposal.

All creditors affected by the plan in the *accordi di ristrutturazione ad efficacia estesa* have the right to vote.[26] In the *concordato preventivo*, voting rights are afforded to all unsecured creditors.[27] Article 109 of the CCI specifically excludes four types of creditors from voting on the plan. These are: secured creditors that will be immediately satisfied in full under the terms of the *concordato*; related parties of the debtor;[28] creditors that purchased their claims within the year preceding the commencement of the procedure and any creditor with a conflict of interest.[29] Interestingly, the plan may postpone full reimbursement of secured creditors for a period not longer than 2 years from the confirmation of the composition per article 86 of the CCI. When the debtor utilises this option, secured creditors are entitled to vote on the plan, despite the plan providing for full reimbursement of their claim. It should be noted, however, that the vote relates to the difference between principal plus interest and the present value of the proposed stream of payments under the plan and therefore not for the entire face value of their claim.[30]

In the *concordato*, the debtor can form different classes based on the legal position of the creditor – senior and junior – and their commonality of interest. The creation of separate classes for secured and unsecured creditors is, to a large extent, unnecessary. Secured creditors will be unaffected by the plan because they are paid in full, therefore they will not be entitled to vote and consequently, there is no need to include them in a "class". Italian law does mandate the formation of the following classes:

(i) tax and social security claims that will not be paid in full;
(ii) creditors whose claim is assisted by guarantees provided by third parties;
(iii) creditors that will not be paid entirely in cash under the plan; and
(iv) in case of a competing plan, the proposing creditors and their related parties.

All unsecured creditors – including secured creditors for the unsecured part of their claim – may be included in one single voting class. It is important to note, however, that secured and priority creditors, although not forming a voting class for the part unaffected by the plan, are always treated separately from one another.

In the *concordato preventivo*, the law requires an examination of class formation prior to voting taking place. The court verifies the criteria used to form the relevant classes before starting the voting process and subsequently re-examines the same criteria as part of the confirmation hearing. Article 48 of the CCI, which regulates court confirmation of an approved *concordato* plan, allows the judge to verify the correctness of the procedure, including the formation of classes. Article 61 of the CCI provides a control on the formation of classes when the court is asked to confirm the agreement, thereby allowing for the extension of its effects to the dissenting minority (*accordi di ristrutturazione ad efficacia estesa*).

The plan in the *concordato preventivo* is approved if the majority by value of eligible creditors has approved the plan and, in case of class formation, if the majority of the classes has approved the plan.[31] If a single creditor holds a majority of the value of all the eligible claims,[32] then there must also be approval by a majority in number of creditors in the class.[33] With respect to restructuring agreements

[26] CCI, art 61.
[27] CCI, art 109. It should be noted that under Italian law, equity holders are excluded from voting.
[28] This includes any creditors that belongs to the same group of companies as the debtor
[29] Secured creditors will have the opportunity to wave their privilege, entirely or in part, just for the purposes of that procedure, in order to be able to cast their vote for the part of their claims that became unsecured.
[30] Their vote is accounted just for the difference between principal plus interest and the present value of the proposed stream of payments under the plan, not for the entire face value of their claim.
[31] CCI, art 109 para 1.
[32] This requirement also applies in case a restructuring plan does *not* envisage the formation of classes.
[33] It is worth noting that the PRD mandates that the majority required by a Member State shall not be higher than 75%. There could be situations where, based on the specific circumstances of the case, the majority required by Italian law is higher than 75% by amount e.g. when a creditor has a claim of 60% by amount, and there are two other creditors each having a claim of 20% by amount, under the Italian rules the class may be deemed to have approved only if a majority representing 80% by amount is reached.

capable of binding dissenting creditors within a class, the plan is deemed to have been approved if a majority of 75% by value of creditors of that particular class is reached.[34]

The Confirmation of Restructuring Plans

Judicial confirmation is a prerequisite to any plan becoming binding on creditors according to article 48 of the CCI. The requirement is that the court must validate the process that led creditors to approve the plan and verify both the legal compliance and economic feasibility of the restructuring plan. Where the debtor has filed for confirmation, any interested party may lodge an objection within the 10 days preceding the confirmation hearing (*concordato preventivo*), or within 30 days of the date of publishing the debt restructuring agreement in the public register (*accordi di ristrutturazione dei debiti*). The court will issue a judgment after deciding on the objections.

In the *concordato preventivo*, the court is expressly required to verify the legal compliance of the process, including the voting procedure; class formation; notification requirements; and the economic feasibility of the plan, in other words, its prospect of success.[35] If the plan is rejected and the debtor is insolvent, the court will open liquidation proceedings at the request of one of the parties or the public prosecutor.[36] The Italian framework does not explicitly require the court to assess whether the new financing is necessary to implement the restructuring plan or if it unfairly prejudices creditors' interests, The court is, however, mandated to reject the plan when there is evidence of fraudulent activity.

Cross-Class Cram-Down

There is a cross-class cram-down mechanism under the *concordato preventivo* procedure, where classes are specifically formed. If a majority of the number of classes vote in favour of a plan, then a plan can be confirmed despite the dissent of one or more classes. Italian law requires that, in addition to reaching a majority of the number of classes, a majority by value of the claims must be also reached. If the debtor opts not to form classes, then 'only' a majority in value of the total amounts of claims needs to be reached. A dissenting creditor, either within a dissenting class or holding 20% of the total amount of valid claims, can object to the cross-class cram down and consequently the court confirmation on the grounds that the plan fails to satisfy the best-interest-of-creditors test. Interestingly, the plan can be confirmed without the agreement of the debtor.

Italy has a presumed Absolute Priority Rule, in that a plan is not permitted to alter the normal ranking of priorities. That said, it has often been deemed as admissible to leave some value to the shareholders notwithstanding the fact that some creditors will not have been paid in full. Arguably, this seems fundamentally contrary to the APR. As a result, it could be suggested that Italy has adopted a hybrid Relative Priority Rule and Absolute Priority Rule system in order to ensure the success of restructuring plans by incentivising shareholders to some extent. Furthermore, recent reforms have mandated regard for equity holders when devising a restructuring plan that envisages the continuation of the business with the same entrepreneur.

It also remains to be seen if the APR applies with respect to restructuring value. If so, it is unclear if it applies solely to creditors or if it includes equity holders. When the plan provides for the direct continuation of the business, the most recent trend in case law seems to be to distinguish between the value of the estate and the proceeds generated by the direct continuation of the business. While the value of the estate should be distributed amongst creditors according to their ranking, the value of the proceeds

[34] CCI, art 61 sets an identical provision in this respect.
[35] CCI, art 48, para 3.
[36] CCI, art 48, para 7.

generated by the activity may be distributed more widely. This appears to be very similar, in its economic results, to the outcome of the joint application of the RPR and best-interest-of-creditors test. While the Italian framework does not explicitly provide for an 'unfair prejudice test', nor is it likely to in the future, it does refer to liquidation as a 'comparator scenario' for the application of the best-interests-of-creditors test. Undoubtedly, when the CCI enters into force, it will make it easier to allow the allocation of part of the restructuring value to equity holders, which is contrary to a strict interpretation of APR. It is worth bearing in mind, however, that neither the 'old' Italian Insolvency Law, nor the new CCI dictate criteria for the distribution of the proceeds generated by the continuation of the business among creditors and shareholders.

Protection of New and Interim Financing

Both new and interim financing are protected in restructuring agreements and also in the judicial compositions with creditors. Specifically, this financing enjoys priority over unsecured creditors in the context of subsequent insolvency procedures. Financing also cannot be subsequently declared void, voidable or unenforceable and the financiers cannot be subject to criminal or civil liability.[37] Priority in the case of subsequent insolvency proceedings will not vest where the debtor knowingly provided false information and the financier was aware of this fact, in other words there must be good faith on their part.

PART III: Specific Procedural Aspects of Preventive Restructuring in Domestic Processes and in the Directive

The Threshold of Insolvency

In the CCI, insolvency is defined as the inability of the debtor to meet its obligations as they fall due; generally this manifests itself as defaults.[38] According to well-established case law, an entity that is being wound up, either piecemeal or as a going concern, may only be declared insolvent if its debts exceed the value of its assets, in other words a balance sheet test. When the proceeds of the assets of a liquidation are assessed as sufficient to pay all creditors in full, the company may not be declared insolvent although it may be unable to pay claims as they fall due based on a cash-flow test. The CCI also distinguishes between insolvency and 'crisis'. The latter is defined as the situation of economic and financial difficulty making it probable that the debtor will become insolvent from a cash flow standpoint.[39] 'Crisis' means inadequate prospective cash flow to meet planned obligations as they fall due. That said, both the judicial composition with creditors (*concordato preventivo*) and the debt restructuring agreement (*accordi di ristrutturazione dei debiti*) are available to debtors that are either in 'crisis' or in insolvency, as described above. Therefore, it is not necessary for businesses to be insolvent in order to be able to access these procedures, as being in 'crisis' is sufficient.

Debtor in Possession

When a debtor files for a *concordato preventivo* the court is required to nominate an insolvency practitioner[40] whose function, before the confirmation of the plan, is to monitor and oversee the debtor, as well as to support creditors in their assessment of the proposal through the provision of independent information. After confirmation, the insolvency practitioner may be vested with the power to enforce the plan if the debtor itself does not implement the plan. Recent reforms, by means of article 118 CCI, have widened the power of the IP in cases of non-implementation of a confirmed restructuring plan. In this instance, the IP's powers will generally include those normally held by a meeting of shareholders.

[37] CCI, art 324.
[38] CCI, art 2, para 1(b).
[39] CCI, art 2, para 1(a).
[40] CCI, art 44 para 1b: *commissario giudiziale*.

The insolvency practitioner is also required to inform the court of any misconduct by the debtor or any other circumstance or occurrence that might have a negative impact on the restructuring process. He is not given a right of administration in this case, however, leaving the debtor in control of the running of the business.

Any operations falling outside of ordinary business activity, however, may need *a priori* authorisation by a judge.[41] For the debt restructuring agreement, unless an involuntary liquidation petition has been filed, the court is not required to nominate an insolvency practitioner. This is logical, as the filing of a confirmation request for a debt restructuring agreement can also aim to block the petition for involuntary liquidation, but it is not the norm.[42] In cases of restructuring agreements that were binding on dissenting creditors, the insolvency court previously had discretion on the appointment of an insolvency practitioner with a view to ensuring that the negotiations were made in good faith and lawful. It is unclear if it remains following the recent reforms.[43]

Rights *in Rem* under the EIR Recast and the PRD

Italy defines rights *in rem* as rights purported to bind a certain asset to guarantee the reimbursement of a certain claim. The main contractual rights *in rem* are:

- *Pegno* (pledge), which is a right *in rem* on moveable assets, granted by the debtor or by a third party, as a collateral of a credit;
- *Ipoteca* (mortgage), which is a right *in rem* on immoveable assets or on some goods included in public registries (vehicles, ships, and aircraft) as a guarantee of a credit;
- some special liens provided for by banking law (article 46 of the TUB).

In addition, the law provides for the automatic creation of certain rights *in rem* when parties enter into certain transactions and relationships. These liens concern, for instance, some tax claims and costs incurred to enforce on an asset in the context of a litigation. Some cases result in creditors automatically enjoying a general priority over all of the assets of a debtor. These are not technically considered rights *in rem*, as the collateral is not represented by a specific asset or a collection of indefinite assets, rather, it is extended over an entire estate. Furthermore, it is contended that these should not be considered rights *in rem* under the EIR Recast either.

As previously discussed, the stay extends to secured claims if it is granted upon the filing of a petition for judicial composition with creditors or the confirmation of a restructuring agreement. Deferral of payment under the plan, which provides for the continuation of the business, may last for a maximum of 2 years after confirmation. This deferral of payment of secured claims may be imposed over the dissent of relevant classes through a cross-class cram-down. It is also possible for the debtor to create a plan that pays a secured creditor less than the face value of the claim, provided that a payment of at least equal value of the collateral is granted, essentially a case in which the creditor would be in no worse position if it were faced instead with liquidation. The deficiency in the claim can then be treated as an unsecured claim (described as a 'bifurcation'). Significantly, the consent of the affected secured creditors is not required under the Italian framework. This does not appear to be aligned with the protection intended by article 8 of the EIR Recast.

The right to enforce against the secured asset situated within the territory of another Member State is a right protected under article 8 of the EIR Recast. However, this right may allow the relevant secured

[41] Pursuant to CCI, art 118 para 4, after the confirmation of a *concordato* plan, if the insolvency practitioner detects that the debtor is unduly omitting or delaying the implementation of the plan, it must be reported to the court, which can authorise the IP to carry out the acts needed to implement the plan.
[42] CCI, art 44, para 4.
[43] Art 182 *septies* para 4 of the previous Insolvency Law; the recently enacted provision CCI, art 61 regarding the *accordi di ristrutturazione ad efficacia estesa* (debt agreement binding on dissenting creditors) has extended the scope of this procedure, making it available also to bind dissenting creditors, but has not replicated the provision empowering the court to appoint an IP (thereby making the possibility to appoint an IP uncertain in the new framework).

creditor to use that asset as a ‘hostage’, whenever the disposal value (the cost the debtor would bear to replace the asset) is significantly higher than the market value (the value the creditor would obtain foreclosing on the asset) thereby obtaining a higher recovery by threating foreclosure. This increases the costs of a struggling business by virtue of the need to replace the asset. It also potentially causes a loss of revenue during the intervening period, which may threaten the success of a restructuring plan. In addition, article 8 EIR Recast protection may put the creditor with the asset outside of the primary jurisdiction in a much stronger position than a creditor with property inside the relevant jurisdiction, as article 8 does not offer the same protection in the latter case. Such a dynamic, especially if applicable on a plurality of assets or if the disposal value is much higher than the market value, as is the case for ‘tailor-made’ assets, will erode the margins available to successfully achieve a restructuring. The view of the Italian respondent is that this is clearly at odds with the purposes of the preventive restructuring framework.