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ENABLING ACT FOR THE ITALIAN INSOLVENCY LAW REFORM

On 11 October, the Senate finally approved Draft Enabling Act No. S-2681 (**Enabling Act**), which, among other things, will reform insolvency law (**IIL**), reorganise the privileges system and formally recognise non-possessory pledges[1].

The Minister of Justice (by decree of 5.10.2017) established a commission (chaired by Mr Renato Rordorf), which has the task of drafting the legislative decrees necessary to implement the Enabling Act by 10.1.2018. The government intends to adopt the legislative decrees before the parliament's term ends.

This client alert summarises the main legislative changes to be introduced by the Enabling Act concerning:

- the reform of the bankruptcy procedures, and;
- the reorganization of the privileges system and the formal recognition of non-possessory pledges.

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(I) REFORM OF THE BANKRUPTCY PROCEDURES

The Enabling Act contains a set of guidelines and principles – deeply inspired by EU and international trends, particularly those in France and the USA – that will restyle insolvency law to guarantee honest, but unfortunate, entrepreneurs a fresh start/second chance by safeguarding the business continuity of distressed companies and considering liquidation an extreme remedy.

As acknowledged in the parliamentary debates, the Senate has not intervened in the regulation of crises of large companies, which remains governed by special laws on extraordinary administrations. In this respect, the Enabling Act mentions extraordinary administrations only in two

[1] The Enabling Act also contains provisions regarding preliminary sale and purchase agreement concerning immovable property to be built.

provisions, concerning: (a) the abrogation of the possibility of ex officio declarations of insolvency (*fallimento d'ufficio*); and (b) the attribution of jurisdiction for insolvency proceedings of large companies and extraordinary administration proceedings to the specialised business divisions of local courts.

With regard to bankruptcy and insolvency, the Enabling Act maintains the distinction between: (a) bankruptcy (now defined as "judicial liquidation") aimed at liquidation; and (b) other insolvency procedures (and similar types of procedures) aimed at enabling debtors to overcome financial difficulties and at guaranteeing business continuity. Accordingly, the distinction between insolvency (in its new, more neutral sense, meaning an irreversible situation in which it has become objectively impossible to carry on the business) and a crisis state (now meaning a situation of probable future insolvency, but one that is reversible) has also been introduced.

A fast-track procedure will be available to companies to enable them to quickly access proceedings seeking a declaration of a state of crisis or insolvency, including for challenges against measures declaring the crisis or insolvency, and then proceeding with the most appropriate procedure – judicial liquidation or another procedure, depending on the debtor's situation.

The most important changes are summarised below.

A. Judicial liquidation (*liquidazione giudiziale*)

Although judicial liquidation maintains the current procedural framework for bankruptcy proceedings, the following radical changes have been introduced:

- **Exclusion of special enforcements and special privileges** (the land privilege (*privilegio fondiario*) will be abolished the second year following entry into force of the legislative decree implementing the Ena-

bling Act): Creditors secured by a land privilege (or by other special types of security interests, which currently enable individual enforcements even when an insolvency procedure is underway – e.g., the financial collateral agreements under Legislative Decree No. 170/2004) will be precluded from pursuing or continuing individual enforcement or precautionary measures. This means that – without prejudice to preemption rights – the timing, modalities and procedures applicable to all creditors for the liquidation of the debtor's assets and the distribution of the proceeds will also apply to creditors secured by a land privilege (or by the other abovementioned special types of security interests);

- **Backdating of the hardening period (Hardening Period) for the claw-back action under Art. 67, IIL**: The Hardening Period will start on the date of the request for admission to judicial liquidation proceedings (rather than the date the proceedings opened). Consequently, the time limit for payments or security interests granted by a debtor that subsequently becomes insolvent to be deemed consolidated (i.e., irrevocable) has been extended considerably. However, the current time limits for bringing the claw-back action under Art. 69-*bis*, IIL are unaffected: the time limits remain three years from the opening of judicial liquidation proceedings and five years from execution of the related agreement and/or the performance of the relevant payment;

- **Reduction of the duration and costs**: This will be achieved through the following: (a) greater management powers conferred on the receiver (*curatore*); (b) replacement (in less complex judicial liquidation proceedings) of the creditors' committee with remote consultations; (c) new, simplified regulation on the

assessment of claims (*accertamento del passivo*), in order to accelerate the assessment (retaining the possibility to have super senior creditors); and (d) reduction of the fees of experts and advisors involved in the proceedings.

B. Crisis alert procedures

A set of rules (inspired by French insolvency law) is provided to facilitate the prompt assessment of the early stages of a crisis, so that the most appropriate solution to ensure business continuity can also be promptly identified and implemented.

The Enabling Act regulates the establishment of special crisis-settlement bodies (OCC) with the local chambers of commerce, to which a company in the early stages of a crisis may apply for assistance to overcome the crisis. Assistance is granted through a negotiated, out-of-court 'alert' procedure and the provision of incentives and protection measures for the company in crisis. The fact that the alert procedures are out-of-court and strictly confidential is hoped to encourage distressed companies to seek assistance, given the stigma usually associated with court-driven insolvency proceedings.

In brief, the procedure entails the following phases.

- **Phase one:** The company's supervisory body will have to notify the company's administrative body of well-founded signals of a crisis, 'internal alerts'. 'External alerts' are to be provided by qualified public creditors, as they will be obliged to report persisting, significant defaults to the supervisory body and the OCC, subject to the ineffectiveness of any privileges securing the related claims.

  A non-exhaustive list of "qualified public creditors" is provided (which includes the Tax Authority and the National Social Security Authority). However, some

authors believe that the requirement to provide 'external alerts' will extend to all types of qualified creditors, including non-public ones such as banks.

- **Phase two:** If requests submitted by supervisory bodies in phase one receive an unsatisfactory or no reply from the administrative body, the supervisory body will have to submit a request to the competent OCC. The OCC will then appoint a panel of at least three experts[2], who will have authority to reach an agreement to resolve the crisis, which must be reached within a maximum of six months. Only if the negotiations are proceeding well but more time is required may the term be extended.

  At this stage, also the debtor may request admission to the procedure before the OCC. Furthermore, the delegated decrees will incentivise (in terms of retaining assets and being released from liability) debtors to timely, and at their own initiate, request admission.

- **Phase three:** If the OCC does not identify appropriate measures to overcome the crisis and declares the debtor insolvent, it will immediately notify the public prosecutor at the court of the place where the debtor is based, for prompt verification of the debtor's insolvency.

C. Pre-bankruptcy arrangements with creditors (*concordati preventivi*)

The Enabling Act encourages pre-bankruptcy arrangements with creditors that ensure business continuity and strongly discourages those entailing liquidation – as is already the case in many other countries.

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[2] One appointed by the president of the local business division of the court of appeal, one by the local chamber of commerce for industry and crafts and one by the trade associations.

With regard to pre-bankruptcy arrangements that ensure business continuity:

- the related plan may contain a moratorium of longer than a year also for the payment of creditors whose claims are secured by privileges, pledges or mortgages, (provided that such secured creditors will retain the right to vote on admission to the pre-bankruptcy arrangement); and
- the new rules will also apply to leased businesses (*affitto di azienda*), including when the lease agreement was entered into before the application for a pre-bankruptcy arrangement with creditors;

Pre-bankruptcy arrangements that entail liquidation will be permitted only if:

- satisfaction of creditors is expected to be markedly increased by third parties contributions; and
- liquidation will ensure satisfaction of at least 20% of the unsecured claims.

D. Groups of companies and restructuring agreements

Another welcome innovation is that companies within a group may now jointly submit a single application for approval of a single debt restructuring agreement, for an arrangement with creditors or for judicial liquidation proceedings. Each company's pool of assets and liabilities remain separate from the others.

With reference to restructuring agreements, the following apply:

- removal or reduction of the minimum 60% threshold provided for Art. 182-bis, IIL, to execute the restructuring agreement, if such agreement provides for the full satisfaction of creditors not party to the restruc-

turing agreement and no protective measures during the negotiations has been required; and

- extension of the rules on restructuring agreements with financial intermediaries (Art. 182-septies[3], IIL) to non-liquidation agreements and moratorium agreements concluded with a group of non-financial creditors, provided that the group represents at least 75% of the claims of one or more legally and economically homogeneous categories.

(ii) REORGANIZATION OF THE PRIVILEGES SYSTEM AND FORMAL RECOGNITION OF NON POSSESSORY PLEDGES

As mentioned, the Enabling Act includes provisions for the reorganisation of the privileges system and the formal recognition of non-possessory pledges.

Only broad guidelines are provided for the reorganisation of the privileges system, thus leaving the government significant autonomy to implement the Enabling Act. Art. 10 merely foresees that the government should:

- reduce the number of special and general privileges; and
- reorganise the legitimate pre-emption rights (cause di prelazione).

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[3] Art. 182-*septies*, IIL, states that if debts with the banks and the financial intermediaries amount to at least half of the total debt, the debtor may identify one (or more) category of banks or financial lenders with a homogeneous legal position and economic interests. If the debtor is able to collect consent from 75 % of the identified category, the debtor can submit a request under Art. 182-*bis*, IIL, (thus, also if 75% of financial creditors do not represent 60% of the total debt) by demonstrating that it has informed all creditors in that category that negotiations are underway and that they may join the agreement. The main aspect of this regulation, which with the reform will extend to all restructuring agreements under Art. 182-*bis*, IIL, is that the reaching of an agreement with at least 75% of the creditors implies that the agreement will be binding also on non-participating creditors.

Much more detail is provided regarding the establishment of non-possessory pledges on tangible and intangible assets, including identified or identifiable futures ones.

Non-possessory pledges have already been partially introduced to the Italian system (by Law No. 119 of 30 June 2016, converting, with amendments, Law Decree No. 59 of 3 May 2016). Full implementation will occur once the ministerial decree has been issued that should, among other things, establish and regulate the computerised register – in which non-possessory pledges will have to be registered to become enforceable against third parties and which will be maintained by the Tax Authority.

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DISCLAIMER: The sole purpose of this alert is to provide general information. It is not a legal opinion and thus may not be considered a substitute for legal advice.