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RESTRUCTURING TOOLS FOR DISTRESSED COMPANIES

in connection with the COVID-19 emergency

IN A NUTSHELL

The global COVID-19 pandemic has triggered an extremely severe economic shock which is fundamentally different from anything the economy has been through before. The exogenous shock affects entire industries and businesses of all sizes, possibly all businesses eventually. The danger of a snowball effect is certainly not to be underestimated.
This newsletter is aimed at providing an overview of the main restructuring tools available under Italian law to enable distressed but potentially viable businesses in the pre-insolvency 'twilight zone' to restructure their affairs and continue as going concerns.

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As the COVID-19 pandemic grows and economic implications intensify, businesses in most industries must take the steps necessary to ride out this disruption, as the expected scope and duration of the COVID-19 emergency remains unclear. The existing uncertainty hits both financially reasonably healthy companies, which depend on a smooth inflow of liquidity, and companies with fundamentally solid business models. Companies suddenly face sinking revenues, which will likely lead to significant cash flow challenges. Moreover, the COVID-19 pandemic has placed unprecedented stress on the ability of businesses to service their debt. Especially businesses with limited cash reserves are quickly approaching a moment of illiquidity that qualifies as an inability to pay under applicable insolvency laws, which is often coupled with the (temporary) impracticality of a cash flow forecast.

There are concrete steps that companies can take to assess their needs, formulate a realistic cashflow forecast for the coming months and take the necessary actions to stem business losses and sustain operations. In this respect, the way managers act now to transition their organizations through the crisis will determine their future in the years that will follow.

While it is clear that we are operating in extraordinary times and tough decisions will need to be made, decision-making processes must be documented to show that considered thought is given by the directors of the companies and sound judgement applied to all decisions being made.

Moreover, the current duties to file in many EU Member States, including Italy, would require prudent directors of companies to file for restructuring or insolvency proceedings in the personal interest of limiting the risk of any personal liability if the business situation further deteriorates in weeks to come.

However, many EU national legislators, including the Italian one, have temporarily suspended the duty to file for insolvency proceedings based on over-indebtedness (and/or rendered inadmissible third-party petitions for the declaration of insolvency of the debtor), introduced moratorium and other “hibernation” measures. These measures should put the affected companies and their directors in the position and give them time to take the necessary initiatives required, in particular, to take advantage of the financial support measures made available to tackle the liquidity needs or to make financing or restructuring arrangements with creditors and capital providers to preserve the business continuity.

“Hibernation” measures for companies which have entered the twilight zone of pre-insolvency owing to the effect of the COVID-19 pandemic

On April 6, 2020, the Italian Council of Ministers approved the Law Decree No. 23 of April 8, 2020, published in the Official Gazette n. 94 of April 8, 2020 and effective as from April 9, 2020 (the “**Liquidity Decree**”).
The Liquidity Decree provides for the following “hibernation” measures:

1. Temporary inadmissibility of any petition - for bankruptcy or for the declaration of insolvency under the Italian ‘*extraordinary administration*’ procedures for large enterprise (*amministrazione straordinaria*) or for the insolvency of companies subject to compulsory administrative liquidation (*liquidazione coatta amministrativa*) - **filed between March 9, 2020 and June 30, 2020** (petitions, if filed, cannot be heard and shall be declared inadmissible by the insolvency court). This measure applies to petitions for bankruptcy filed by either entrepreneurs themselves or third parties (but for those submitted by the Public Prosecutor if it also requests precautionary or protective measures to safeguard the assets of the debtor). However, to protect the *par condicio creditorum*, the deadlines for bringing claw-back actions are suspended in relation to petitions filed during the same period and for which, after their dismissal, a bankruptcy declaration is subsequently issued.

2. Temporary suspension (until December 31, 2020) of the obligations to recapitalize or take other measures in case of reduction of the value of share capital of companies due to losses (in the event of its reduction by more than one third even if the value of share capital is reduced below the minimum amount required by law). However, the obligation for directors to promptly convene a shareholders' meeting in the event of a reduction in share capital value of more than one third due to losses is not suspended, but the shareholders’ meeting will not be required to adopt the measures otherwise provided by law in such event (i.e., a formal reduction of share capital, a recapitalization or a liquidation or, as the case may be, the transformation of the company). Nevertheless, **until December 31, 2020, the company shall not be liquidated due to the reduction or loss of share capital.**

3. Regarding the preparation of financial statements for the financial year 2020 (and to some extent also regarding the financial year 2019), **the evaluation of the items on a going concern basis** as per article 2423-bis, paragraph 1, no. 1) of the Italian Civil Code **may in any case be applied** if it was possible to do so in respect of the most recent financial period ending before February 23, 2020. This is coupled with the extension by 60 days of the deadline for the approval of financial statements for the financial year 2019 introduced by the previous Law Decree No. 18 of March 17, 2020, so-called “*Decreto Cura Italia*” (Heal Italy Decree).

4. **Suspension, except for urgent cases, from March 9, 2020, to May 11, 2020, of the hearings (and other judicial activities) in civil and criminal proceedings**, thus making it more difficult to start and continue, inter alia, enforcement actions *vis-à-vis* debtors.

Moratorium measures

Both the Healing Italy Decree and the Liquidity Decree have introduced moratorium measures, as follows:

(i) upon debtor's request, **suspension until September 30, 2020, of the repayment of instalments of loans and lease rents falling due before September 30, 2020**;

(ii) **suspension of the deadlines of debt and payment instruments** (bills of exchange, money orders, etc.) that fall due between March 9, 2020 and April 30, 2020;

(iii) **postponement of tax deadlines** for companies, enterprises and professionals having revenues not exceeding certain thresholds.

Incentives for shareholders to grant new finance

To boost financial support for companies, t**he Liquidity Decree provides for the temporary suspension of** the provisions under Articles 2467 and 2497-quinquies of the Italian Civil Code regarding, *inter alia*, **the subordination by operation of the law of intercompany loans and shareholders' loan granted to companies that are in a situation of over-indebtedness**. This measure is aimed at incentivizing shareholders to support their companies through the granting of new finance, and not necessarily by equity contributions, even when there is an excessive imbalance between the company's debt and net equity or in circumstances where the financial situation of the company is such that an equity investment would be reasonable.

Restructuring tools currently available under Royal decree n. 267/1942 (“Italian Bankruptcy Law” or “IBL”)

One of the IBL’s main goals is to favour the business continuity of distressed but still viable enterprises as a key element for the success of restructuring plans aimed at preventing insolvency liquidation. In particular, proceeding from the assumption that insolvency is above all a private affair between the debtor and its creditors and one that may be better tackled and resolved through negotiation rather than through judicial impulse, Italian jurisdiction made available for businesses that are in “crisis status” (i.e. insolvency or at least a debtor’s financial distress, including temporary illiquidity or inability to pay its debts) three different restructuring and rescue instruments. Payments made, security interests granted, new finance given, and transactions carried out according to any of these three instruments are generally exempted from avoidance actions and are shielded from the risk of civil liabilities and criminal charges in case of subsequent insolvency proceeding of the debtor.

1. CERTIFIED RECOVERY PLAN (PIANO ATTESTATO DI RISANAMENTO) – ART. 67 OF THE IBL

One of the three instruments available under Italian Bankruptcy Law is the certified recovery plan under Article 67 of the same law.

The main purpose of this plan is the recovery of the debt exposure and the rebalancing of the financial situation, i.e. the recovery of a normal economic/financial situation that secures the continuity of business as a going concern.

The certified recovery plan is mainly characterized by:

(i) the private nature of the instrument and the agreements that are connected to it. In particular, it allows the confidentiality of the agreements executed, avoiding negative publicity towards stakeholders and customers with whom the company will continue to have relations. Furthermore, the filing of the agreement at the Enterprise Register is not mandatory;

(ii) the truthfulness of the data and the economic feasibility of the restructuring plan, which shall be certified by an independent expert appointed by the debtor;

(iii) the legal relevance in case of subsequent bankruptcy of the company.

The recovery plan is a unilateral action taken by the debtor to rescue its business activity; therefore, no formal approval by creditors is required. Nevertheless, to ensure the achievement of the restructuring attempt the affected creditors (i.e. banks, financial creditors, trading partners)'s consent is needed in connection with any moratorium and/or haircut and/or debt refinancing or rescheduling set forth in the plan.

The feasibility of the restructuring plan must be certified by an independent expert who must be a chartered auditor appointed by the debtor. The expert must issue an opinion certifying the truthfulness of the debtor's figures and the reasonableness of the plan in terms of the debtor's ability to fulfil the payment obligations and assure continuity of the business as a going concern.

Once the plan has been certified by the expert, the debtor must implement it and can carry on business as normal.

Payments made, security interests granted and transactions carried out under a certified recovery plan are not subject to avoidance actions. They are shielded from the risk of criminal charges relating to preferential payments and simple bankruptcy crimes in the case of the debtor's subsequent insolvency proceedings. Exposure to the risk of civil liability for acts in compliance with a certified recovery plan is significantly reduced. Owing to the absence of court scrutiny and confirmation of the plan, however, it cannot be ruled out that the exemptions from avoidance actions and liability risks might be jeopardized in the context of a subsequent insolvency proceeding (this may occur if it turns out that the recovery plan, though certified as feasible by the expert, had, on the contrary, no reasonable chances to succeed, based on an ex post finding by the bankruptcy court having regard to the situation as existing at the time of presentation of the recovery plan).

The recovery plan is run completely out of court and can be kept confidential (unless the debtor decides to register the plan in the Enterprises Register to gain certain tax benefits).

2. DEBT RESTRUCTURING AGREEMENT (ACCORDO DI RISTRUTTURAZIONE DEI DEBITI) – ART. 182-BIS OF THE IBL

The debt restructuring agreement, under Article 182-bis of the Italian Bankruptcy Law, has a substantially private nature and its main advantage is that it permits debtors (i) to first negotiate an out-of-court settlement with major creditors only, thus depriving of real strength any subsequent attempt by non-participating minority creditors to enter the bargaining process and disturb the already 'wrapped up' or 'pre-packaged' reorganization deal and then (ii) and then obtain the court final validation ("*omologazione*"), which makes the agreement assume a partial judicial content.

In particular, the debtor may reach an out-of-court debt restructuring agreement ("**DRA**") with its creditors representing at least 60% of the total indebtedness. The debtor is free to negotiate and offer different conditions to each creditor, he is not obliged to respect creditors' classes and the pari passu principle. The non-consenting creditors must be paid in full with the possibility of a moratorium of 120 days from (i) the validation decree for claims already due and payable at the date of court validation of the DRA or (ii) the relevant expiry date for claims not due and payable at the validation date.

Should the DRA involve debtors with obligations to banks or financial intermediaries amounting to no less than 50% of the debtor's aggregate indebtedness, the DRA can create one or more categories of bank or financial intermediary creditors with common economic interests. In this case, the terms of the restructuring agreement will be binding on all creditors in a class if (i) creditors holding at least 75% of the number of claims in the class approve the restructuring proposal and (ii) all creditors in the class have been duly and timely notified of the pending restructuring and have had an opportunity to participate in the negotiations.

An independent expert, who validates the truthfulness of the company's figures and the feasibility of the plan, must certify the restructuring plan underlying the agreement (in particular, as far as the entire payment of the non-consenting creditors is concerned).

The DRA must also be filed with the Enterprises Register and published. For 60 days from publication of the DRA in the Enterprises Register, the creditors are prevented from starting or continuing precautionary or enforcement actions against the debtor (but such automatic stay may be obtained, under certain conditions, even during the negotiation of the DRA). During the procedure, the debtor can carry on business as normal without being subject to supervision.

The DRA must then be validated by court decree. Within 30 days from publication of the DRA in the Enterprises Register, dissenting creditors or any other interested party can file an opposition with the court. The court decides on the oppositions (if any) and validates the agreement. The validation decree closes the procedure. After validation, the debtor must implement the DRA with no further intervention by the court and can carry on business as normal in line with the provisions of the DRA. There is no risk of clawback for actions, transactions and payments carried out under and in performance of a DRA. They are also shielded from the risk of criminal charges relating to preferential payments and simple bankruptcy crimes in the case of the debtor's subsequent insolvency proceedings.

The DRA can be terminated if the debtor fails to fulfil its obligations under it.

3. IN-COURT SETTLEMENT WITH CREDITORS (CONCORDATO PREVENTIVO) – ART. 160 AND FF. OF THE IBL

The concordato preventivo ("**CP**"), i.e. the Italian procedure for a composition with creditors functionally akin to Chapter 11 in the US, is a typical in-court debtor-in-possession procedure, subject to supervision by the court, which, for such purposes, appoints a commissioner supervising the debtor and ending with court confirmation of the arrangement with creditors.

The key features are:

1. The plan proposed by the debtor is binding upon dissenting creditors if approved by the required majority (i.e. absolute majority (50 per cent +1) of the total outstanding claims admitted to voting, provided that if there is a plurality of classes, the same majority shall be reached in the majority of classes) and confirmed by the court.

2. The debtor may put forward an offer of in-court settlement providing for less than 100 per cent payment to secured creditors (provided that secured creditors must be offered not less than what they would presumably get from the sale at auction of the collateral, and the proposed treatment of the various classes of creditors under the debtor's proposal cannot disregard the legally established order of priorities among such classes).

3. The contents of the settlement proposal are flexible and may vary from case to case, including either debt restructuring through "haircuts" and/or rescheduling and/or debt-to-equity swap mechanisms or assignment of the debtor's assets to third-parties or creditors.

4. Upon application for commencement (that may be filed even without submitting the plan) the debtor obtains an automatic stay of individual actions.

5. When opposition to the plan is filed either by a creditor belonging to a dissenting class or, in the absence of classes, by dissenting creditors representing 20% of claims with voting rights and the suitability of the plan is challenged, the court can validate the plan only after comparing it to other available alternatives and verifying that the proposal is more convenient for the creditor than alternative options.

6. After court confirmation, the plan is implemented by the debtor under the commissioner's supervision and upon fulfilment of its obligations under the plan, the debtor is discharged from all the prepetition debts that have remained unpaid.

7. Payments made, security interests granted and transactions carried out under a certified recovery plan are not subject to avoidance actions. They are shielded from the risk of criminal charges relating to preferential payments and simple bankruptcy crimes in the case of the debtor's subsequent insolvency proceedings.

In the past, the CP was seen as a liquidation procedure, but recent legal amendments have made it more of a reorganisation procedure. It is now possible to arrange for business activity to continue on a standalone basis or by selling (or contributing) the going concern to third parties. In this scenario, known as "in-court settlement with business continuity", (i) certain measures apply to make it easy for the business to continue, including providing a one-year moratorium on paying secured creditors and paying certain pre-petition debts towards critical suppliers/vendors subject to court's prior authorisation and (ii) no statutory minimum level of satisfaction for unsecured creditors is required (whereas if the settlement provides for liquidation of the company's assets, it must ensure payment of at least 20% for unsecured creditors).

Recent reforms have enacted creditors' chances to have a pro-active role in the context of in-court settlement. Creditors holding in aggregate at least 10% of the unsecured claims against the debtor can propose a competing restructuring plan (unless the debtor's plan provides that unsecured creditors will be paid at least 40% of the face value of their claims in a liquidation scenario, or 30% in a settlement with business continuity, as certified by an expert). Competing plans can also provide for a capital increase in the debtor company against consideration, excluding or limiting any applicable pre-emption rights in favour of the existing shareholders.

Measures aimed at incentivizing bridge and DIP financings granted in view, or in the context, or in performance, of the restructuring attempt

To render the use of the above described restructuring techniques more appealing for enterprises in financial distress, as well as for lenders and potential domestic and international investors, the IBL expressly shields certain pre-commencement and post-commencement financings made in view, or in the context, or in performance, of any such techniques against the risk of exposure to claw-back actions and to criminal liabilities otherwise potentially associated with payments received from the borrower or the postponement of bankruptcy.

Furthermore, **the IBL enhances the protection afforded to certain bridge and DIP financings granted in view, or in the context, or in performance, of the *concordato preventivo* and the *accordo di ristrutturazione dei debiti* (ie, the sole instruments which require a final judicial confirmation) by allowing super-seniority over other creditors in case of subsequent formal insolvency proceedings**. This is aimed at favouring restructuring attempts whereby the working capital required to keep the enterprise group operating as a going concern may be obtained through new financing, instead of through equity contributions, as long as the leading company acting as borrower proposes and implements a reorganization plan, according to one of the three restructuring instruments mentioned above, supported by an expert opinion stating that the plan has reasonable chances to succeed (and allow the reimbursement of the new financing).

Last, **loans granted in debt restructuring transactions involving SMEs are eligible for the Central Guarantee Fund for SMEs** - that is a public guarantee scheme managed by Mediocredito Centrale S.p.A. and directed to SMEs to support their access to bank credit guarantee - provided that the relevant lender grants additional financing for at least 10% of the outstanding amount of the loan being rescheduled.

Measures relating to ongoing in-court settlements with creditors procedures (*concordati preventivi*) and debt restructuring agreements (*accordi di ristrutturazione*)

By Article 9 of the Liquidity Decree, the Italian legislator introduced the following measures aimed at avoiding that, owing to the current economic situation, the successful outcome of in-court settlement with creditors procedures and debt restructuring agreements commenced before the COVID-19 outbreak may be irreparably jeopardized:

1. Concerning in-court settlement with creditors and DRAs already validated (*omologati*) by the Court as of February 23, 2020, **extension by six months of the deadline for compliance with obligations to be performed between February 23, 2020, and December 31, 2021**.

2. Concerning in-court settlement with creditors and DRAs pending as of February 23, 2020, the debtor is entitled to submit a petition to the Court before the validation hearing for **an extension not exceeding ninety days (and not further extendable) for the filing of a new plan and a new proposal (for in court settlement with creditors procedures) or a new DRA**. Nevertheless, such application may not be filed with an in-court settlement with creditors procedures where the creditors' meeting has already been held and the required majorities for approval of the debtor's proposal have not been met.

3. Concerning in court-settlement with creditors and DRAs pending as of February 23, 2020, **the debtor is alternatively entitled to unilaterally request, until the date of the validation hearing, the postponement of existing deadlines (for a period not exceeding six months)**. For these purposes, the debtor must file with the competent Court a brief in which the new deadlines are indicated, together with the documentation aimed at evidencing the need for this postponement.

4. Concerning the "preliminary phase" of in court settlement with creditors (so-called "*concordato preventivo con riserva*" under Article 161, paragraph 6, of the IBL) or DRAs where the "automatic stay" pending negotiations with creditors was granted (Article 182-bis paragraph 7 of the IBL), the debtor may request to the competent Court an extension of up to ninety days for the filing of the in court settlement plan or of the definitive DRA (even if the debtor already benefited from the "ordinary" extension provided for by law). To obtain such extension (and even in cases where a petition for a declaration of bankruptcy has been filed), the debtor must file a reasoned petition before the expiry of the deadline, with specific reference to the events that occurred as a result of the COVID-19 pandemic and that justify the extension of the term. The Court may grant the extension upon the existence of concrete and justified reasons, after having collected the Commissioner's opinion (in case of in court settlement with creditors) or, concerning DRAs, by omitting the fulfilment of the formalities set forth under 182-bis, paragraph 7, first part, of the IBL.

Postponement of the new distress and insolvency regime

Lastly, the Liquidity Decree postpones the entry into force of the new Italian Business Crisis and Insolvency Code (Legislative Decree of January 12, 2019, No. 14), originally scheduled to apply from August 18, 2020, to September 1, 2021. This is meant to ensure that companies, professionals and Courts do not have to deal with the uncertainties connected with the entry into force of an overhaul of the currently applicable regime when the entire economic and legal system of the country is already under considerable stress. The postponement of the entry into force of the new regime will also provide to the Italian Government additional time to align it with the upcoming legislation implementing EU Directive 1023/2019 on the preventive restructuring of companies.

We expect this measure will facilitate the handling of the numerous restructurings that are to be expected in the coming months.

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