INSOL INTERNATIONAL

TREATMENT OF SECURED CLAIMS IN INSOLVENCY AND PRE-INSOLVENCY PROCEEDINGS II

INSOL INTERNATIONAL

International Association of Restructuring,
Insolvency & Bankruptcy Professionals

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44(0) 20 7248 3333 | Fax: +44(0) 20 7248 3384
www.insol.org

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PRESIDENT'S INTRODUCTION

Banks and other lending institutions will extend credit provided they can obtain effective security in the event of default. This results in the lender being assured that it has the right to recover its debt in a quick and efficient manner.

When a borrower defaults under a loan agreement, the lender is usually unaware of the extent of the debtor's financial difficulties. There is always a risk that the debtor may be unable to repay other creditors in addition to the lender and be forced into insolvent liquidation proceedings.

Unsecured creditors usually receive very little or nothing through the rateable distribution process employed in such proceedings. However, in most jurisdictions secured creditors stand outside the insolvency proceedings and the credit instruments would give the lender the ability to enforce its rights without utilizing the courts. A secured creditor also has the right to pursue recovery as an unsecured creditor for any balance of the debt which the security does not satisfy.

In June 2007 INSOL published the first edition of this book. The subject matter continues to be of interest and relevance to practitioners and, as a result, the INSOL Technical Research Committee decided that a second edition of this book should be published. INSOL International is delighted to present this new and updated 20 chapter book which includes seven new country chapters (namely, Brazil, BVI, Cayman Islands, Hong Kong, Mexico, Nigeria and Singapore) and 13 updated and revised chapters of previously included countries. The chapters cover a wide range of key issues that practitioners would find useful, including the types of security rights that are available, the enforcement of such rights, circumstances when the granting of secured rights may be challenged and declared void, and the impact of reorganisation of a company on secured creditors, to name but a few.

The project was led by Evan C Hollander of Orrick, Herrington & Sutcliffe LLP, New York. Evan was also involved in the publication of the 1st edition of this book and we are very grateful for his guidance, interest, and ongoing commitment to publish this book to a very high standard. Evan had a great team working on this project and we are indebted to all of them for committing their time to the editing and review process. We would also like to thank the contributors for taking the time to write / update these chapters, despite their busy schedules.

Julie Hertzberg
President
INSOL International

FOREWORD

Consistent with INSOL's mission statement to "facilitate the exchange of information and ideas", the Technical Research Committee first produced in 2007 a comparative study of the treatment of secured claims in pre-insolvency and insolvency proceedings. The template utilized in the prior edition of this guide, developed with the assistance of my predecessor Andrew DeNatale Of Counsel and Head of the Special Situations Lending Group at Stroock & Stroock & Lavan, provided a handy, accessible and well-organized reference tool outlining the issues impacting the enforcement of secured claims in the twelve jurisdictions covered in that edition. Thus, that template has been incorporated with slight modification into this new edition covering the laws in 20 jurisdictions.

The treatment of secured claims is a matter that insolvency practitioners address in virtually every case in every jurisdiction. This new volume clearly illustrates the advantages and limitations of secured status in in pre-insolvency and insolvency proceedings in each of the 20 jurisdictions covered. As more corporations have extended their presence across borders, it has become critical for practitioners and investors to understand the nuances of the treatment of secured claims in multiple locations. It is the Committee's hope that this study will enable practitioners to navigate the complexities that arise in multinational restructurings, and to provide investors with a handy guide for sound practical information regarding the risks and rewards of secured investments in different countries.

The project would not have been possible without the help and support of others. The initial acknowledgement must go to the Technical Research Committee for developing the concept and format of the project, and to my predecessor who oversaw the production of the prior edition of this volume. I also extend my thanks to the contributors, each of whom submitted excellent material for the jurisdictions covered by the project. Finally, I would like to extend my sincere gratitude to my colleagues, Scott Morrison, Vincent Yiu and Nicholas Sabatino for assisting in the editing of the chapters in this volume and Emmanuel Fua, Peter Amend and Monica Perrigino, who assisted in drafting the materials on the United States.

Evan Hollander
Orrick, Herrington & Sutcliffe LLP
USA

CONTRIBUTORS

Australia	**Samantha Kinsey,** INSOL Fellow **Georgia Boyce** King & Wood Mallesons
Brazil	**Gilberto Deon Corrêa Jr.** **Luis Felipe Spinelli** **Gabriel Lucca Garibotti** Souto Correa Advogados
BVI	**Richard Evans** Conyers Dill & Pearman
Canada	**Brian Empey** **Andrew Harmes** Goodmans LLP
Cayman Islands	**Caroline Moran** **Justin Naidu** Maples Group
France	**Richard Jadot** **Valérie Claver** Ravet Associes
Germany	**Dr. Detlef Hass** **Christine Borries** **Dr. Martin Strauch** Hogan Lovells
Hong Kong	**Naomi Moore** **Jeremy Haywood** Akin Gump Strauss Hauer & Feld
India	**Sanjay Bhatt** Kesar Dass B & Associates
Italy	**Giorgio Cherubini** **Giancarlo Cherubini** EXP LEGAL – Italian & International Law and Tax Firm – Rome and Milan
Mexico	**Rodrigo Valverde** **Santiago Corcuera Cabezut** **Irene Cuellar** Curtis, Mallet-Prevost, Colt & Mosle, S.C.
Nigeria	**Ejemen Ofoman** **Wolemi Esan** Olaniwun Ajayi LP
Russia	**Pavel Boulatov** **Julia Zagonek** **Irina Maisak** **Julia Lymar** White & Case LLC
Singapore	**Debby Lim,** INSOL Fellow BlackOak LLC
South Africa	**Prof. Reghard Brits** University of Pretoria
Spain	**Juan José Berdullas Pomares** **Eduardo Fernández Goñi** Garrigues
The Netherlands	**Barbara van Gangelen** **Clark Warren** Houthoff
UAE	**Marcus Booth** **Claire Matheson Kirton** **Alexander Malahias** **William Watson** White & Case LLP
UK	**Richard Calnan** **Rebecca Oliver** Norton Rose Fulbright LLP
USA	**Evan Hollander** **Emmanuel Fua** **Peter Amend** **Monica Perrigino** Orrick, Herrington & Sutcliffe LLP

CONTENTS

ITALY

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

1.1 Personal or movable property

The most common types of security rights for movable property are pledges and liens.

With a pledge, the debtor typically transfers the possession of the pledged assets to the creditor or to a jointly appointed custodian as security for a debt. The ownership usually remains with the debtor but, failing the fulfilment of the secured obligation, the pledged assets may be sold in compliance with applicable law. However, if an irregular pledge (*pegno irregolare*) is executed, the ownership is transferred to the creditor as a guarantee and it is re-transferred once the debt is paid.

Stocks of companies (listed or unlisted), rights, patents, trademarks and credit instruments, such as promissory notes or written evidence of debt, can also be offered as a pledge.

A lien is a charge over the debtor's movable assets granted to a creditor depending on the source of the creditor's right. Liens can be either general (*privilegio generale*), taken over all the debtor's movable assets, or special (*privilegio speciale*), taken over only certain of the debtor's assets. The lien allows the creditor to satisfy its right with priority towards the other creditors, in respect of priorities set out in section 6 below.

A special type of lien is provided for by Article 46 of the Banking Law (Legislative Decree 385/1993). It can be granted by the debtor only, not by a third party, to secure a loan that has a maturity of at least 18 months. This form of lien can apply to any of the following assets, if they are financed by a secured loan:

- existing and future equipment, licences, and instrumental goods produced by the debtor;
- raw materials, inventory, goods in course of production, finished goods, fruits, animals and livestock;
- goods purchased through the loan; and
- proceeds, present or future, of the sale of the items indicated in the points above.

Such a special lien does not require the transfer of the possession of the relevant assets but only written evidence of its filing.

1.2 Real or immovable property

According to Italian Law, security rights over immovable property are mainly granted through a *mortgage* (*ipoteca*). A mortgage is a security right over the immovable property and grants the mortgagee the right to expropriate the property subject to the mortgage and to satisfy the mortgagor's obligations to it by application of the proceeds of the sale of the mortgaged property. A mortgage can be created by law

(*ipoteca legale*), by a judicial decision (*ipoteca giudiziale*) or by a private initiative through notarial deed (*ipoteca volontaria*).

A mortgage can also be created over specific types of movable assets, such as aircraft, ships and motor vehicles (registered movables).

Mortgages are perfected through the registration in the real estate property register of the place where the immovable property is located, or in the relevant register for registered movables.

2. How are security rights enforced? Is a court process or out-of-court procedure required, or are both methods available? What are the practical difficulties experienced when security is enforced?

Generally speaking, security rights are enforced through the intervention of the court.

In fact, pursuant to the Italian legal system, a covenant whereby secured assets become the creditor's property in case of the debtor's default is null and void (Article 2744 of Civil Code – *patto commissorio*). The creditor is not entitled to use the secured assets without the authorisation of the debtor.

In case of default, the secured assets must be sold through a public auction in order to enhance the competition among possible purchasers and maximise the sale proceeds.

Therefore, in order to proceed with the sale of secured assets upon default, the creditor must first formally demand payment of the amount due in accordance with Article 2797 of the Civil Code.

The debtor may challenge such demand of payment in court. In any case, the execution must take place by way of a public auction. The creditor may seek a judicial order in accordance with Article 2798 of the Civil Code, by which secured assets are assigned to it for an amount up to the sum due for principal, plus interest. This is the only way that a secured creditor can obtain ownership of the secured assets without bidding in a public sale.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

After the recent reform of the Italian Insolvency Law, adopted by Legislative Decree No 14 of 12 January 2019 (which for most of the Articles should have entered into force in August 2020 but has been

postponed until 1 September 2021,[1] one of the most relevant innovations is the insertion of two pre-insolvency proceedings, the "alert procedure" and the procedure for the "settlement of the company's crisis", summarised below.

3.1 The alert procedure *(procedura di allerta)*

According to the new law, the alert procedure has been introduced to review the financial activity of the corporate entity whereby the auditor or auditing company warns the management that the accounting indicators are outside of the required parameters and informs the management to take adequate measures promptly to overcome the crisis situation.

The obligation to report an alert also falls to some qualified public creditors (Revenue Agency, National Social Welfare Institution etc.) in the event that the company's debt exposure exceeds diverse thresholds defined by law.

Such reports must be addressed to the Corporate Crisis Settlement Body (hereafter the "OCRI"), set up at each Chamber of Commerce, Industry, Craft and Agriculture.

After receiving the report, a board of three experts is appointed by the OCRI, which provides, in agreement with the company's supervisory bodies, a solution to the crisis by adopting measures that envisage the reorganisation of the business activity.

The different types of obligations are activated in the presence of the so-called "crisis indicators" that are specific economic indices which, with reference to each type of business activity, allow the identification of the existence of a state of crisis in the company in an easier, homogeneous and objective way.

3.2 Settlement of the company's crisis

Within the category of pre-insolvency proceedings, the new law foresees the creation of the settlement of the company's crisis. Unlike the alert procedure, this procedure provides for debt restructuring as an essential and indispensable element because the solution is sought through negotiation with creditors and is favoured by the intervention of the OCRI which acts as a sort of intermediary between the parties.

The initiative to activate this procedure lies solely with the debtor, who can make a request to OCRI in this regard.

Within the shortest possible time, an updated report on the company's equity, economic and financial situation and a list of creditors and holders of property and private rights must be drawn up by the board of experts appointed by the OCRI contact person or by the debtor itself.

Following the negotiations, the agreement reached with creditors is formalised in writing.

If such a procedure does not end successfully or the legal deadlines for its implementation expire without any result, the board invites the debtor to submit a request for access to an insolvency procedure within 30 days.

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

[1] See 'Important disclaimer due to COVID-19 Emergency' at the end of this chapter.

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Following the recent reform of the Italian Insolvency Law, insolvency proceedings in Italian law can be explained as described in sections 4.1 to 4.6 below.

4.1 Composition agreement *(concordato preventivo)*

The entrepreneur can resort to a composition agreement in order to satisfy creditors through business continuity or through the liquidation of assets.

To propose a composition agreement, the entrepreneur must be in a state of crisis or insolvency and propose a plan of activities to be carried out for the satisfaction of creditors, drafted according to the forms required by law, which has concrete possibilities of achievement. Along with the plan, the entrepreneur must also file the report of an independent professional certifying the truthfulness of the company's data and the feasibility of the plan.

After filing the composition agreement proposal and the plan, the court verifies the legal ground of the proposal and the economic feasibility of the plan and appoints the delegated judge and judicial commissioner and sets the terms for the expression of the creditors' vote.

The court can declare the composition agreement proposal inadmissible if it ascertains the absence of the conditions for admissibility and feasibility of the plan and can order the opening of judicial liquidation at the request of the debtor, creditors and public prosecutor.

The request for access to the composition agreement procedure can be re-proposed, provided that a change in circumstances has occurred.

In the period between the submission of the request for access to the composition agreement and its approval, the debtor maintains the administration of its assets and the exercise of the company's business under the supervision of the judicial commissioner. In any case, acts of extraordinary administration are ineffective when performed without the authorisation of the delegated judge.

With respect to pending contracts, the debtor can request authorisation to suspend or terminate one or more contracts when their continuation is not consistent with the forecast in the plan and the plan does not allow for their execution. In any case, the possibility of opposition by the counterparty is reserved and in that case the court or the delegated judge will rule on the matter.

The satisfaction of creditors with privileges, pledges or mortgages can also be incomplete, provided, however, to an extent not less than the level required by law, as described in the remainder of this section.

In order to be approved, the composition agreement must obtain the favourable vote of the creditors who represent the majority of the admissible claims to the vote.

If the majorities required for the approval of the composition agreement are not reached, the delegated judge must immediately notify the court, which then provides a judgment opening the judicial liquidation.

If, on the other hand, the plan is approved, a judgment approving the composition agreement is issued and the plan implementation phase begins according to the procedures drafted by the court.

4.2 Judicial liquidation *(liquidazione giudiziale)*

Judicial liquidation is the procedure that replaces bankruptcy, of which it retains the essential characteristics. Liquidation is aimed at liquidating the assets of the insolvent entrepreneur and distributing the proceeds in favour of creditors based on the value of their security interests.

The judicial liquidation is applicable to the commercial entrepreneur, operating as an individual person, or other collective body, group of people, or public company, with the exclusion of the state and qualified public bodies indicated by law.

Minor entrepreneurs, as characterised by the failure to exceed certain dimensional thresholds of assets, revenues and debts, are excluded from judicial liquidation.

The objective requirement for the opening of judicial liquidation is the existence of a state of insolvency as defined by law.[2]

The bodies responsible for the judicial liquidation procedure and their functions are as follows.

- The insolvency court is the main body responsible for the procedure and operates in collective composition. It has decision-making, appointment and supervisory tasks.
- The delegated judge is the other body with jurisdictional functions. This individual supervises and controls the regulation of the procedure.
- The receiver holds the position of public officer with the task of administering the assets included in the judicial liquidation and the execution of all the operations of the procedure under the supervision of the delegated Judge and the creditors' committee.
- The creditors' committee is composed of three or five members, chosen from among the creditors with the aim of demonstrating a balanced quantity and quality of the credits. It has the fundamental task of supervising the work of the receiver, authorising its acts and expressing opinions in circumstances provided for by the law or at the request of the court or the delegated judge.

With the opening of the judicial liquidation, the debtor is deprived of the management and availability of its assets which are entrusted to the receiver. The receiver is vested with the power to dispose of the assets that would have been subject to judicial liquidation.

[2] Insolvency is defined as the financial position of a debtor that is regularly unable to satisfy its obligations.

Following the opening of this procedure, effects arise in relation to detrimental acts against creditors. Indeed, in such a case, the assets to be liquidated must be restored to the situation pre-existing the opening of the procedure, and that goal can also be achieved through the legal concept of the ineffectiveness, towards the mass of creditors, of the acts that have changed *in peius* the consistency or quality of the debtor's assets.

In general, the law provides that contracts which at the opening date of the judicial settlement are not yet fully performed are suspended until the receiver decides to dissolve the contract or, with the authorisation of the creditors' committee, to take over the debtor's obligations. There are specific provisions for the individual types of contract.

4.3 Over-indebtedness procedure *(procedura da sovraindebitamento)*

In the event of a state of crisis or insolvency, the parties not subject to judicial liquidation (consumers, professionals, minor entrepreneurs, agricultural entrepreneurs, innovative start-ups etc.) can resort to three different procedures:

4.3.1 The debt-restructuring procedure

This procedure is reserved for the consumer and is a particularly favourable procedure for the debtor, as it allows the debtor to avoid the judgment and approval of creditors and be subject only to the evaluation of the judge. The debtor, with the help of a crisis composition body (hereafter "OCC"), presents a debt-restructuring plan to be submitted to the judge for approval. The judge evaluates whether to approve the plan or not: creditors only have the ability to make observations and lack the power of veto.

4.3.2 The minor composition (concordato minore)

This procedure is aimed at professionals, minor entrepreneurs, agricultural entrepreneurs and innovative start-ups and is a simplified form of the composition agreement. The debtor submits, through an OCC, the composition agreement proposal accompanied by the documents required by law. The proposal can provide for the partial satisfaction of privileged loans, as long as it is not less than the threshold established by law. After a preliminary examination by the judge, the proposal for a composition agreement is submitted to the creditors' vote. If approved by a majority of creditors, the composition agreement is also approved by the court and carried out. In the event that, for the reasons provided by law, the composition agreement is revoked, the procedure is converted into a controlled winding-up.

4.3.3 Controlled winding-up (liquidazione controllata)

This procedure is reserved for consumers, professionals, minor entrepreneurs, agricultural entrepreneurs and start-ups and represents a simplified procedure for judicial liquidation. The conversion into liquidation can be proposed upon request of the debtor, a creditor, or a public prosecutor (in the case of acts of fraud or default).

4.4 Compulsory administrative winding-up *(liquidazione coatta amministrativa)*

Compulsory administrative winding-up is an administrative insolvency procedure for particular entities and categories of companies determined by law, such as financial companies, banks and financial intermediaries.

The procedure can be opened due to the presence of serious irregularities in management or administration, for serious or repeated violations of laws or regulations or provisions dictated in the public

interest, for the non-compliance of the activity carried out with respect to the institutional purpose or in the general interest, or for a state of insolvency.

After the liquidation is ordered and the debtor's state of insolvency ascertained, the administrative authority appoints a liquidator – or three in cases of particular importance – and a supervisory committee made up of three or five members, chosen from among particularly experienced people in the company's business field, possibly from among its creditors.

As a result of the initiation of the liquidation procedure, the company loses procedural power in disputes and ongoing relationships relating to property law, which power is transferred to the liquidator.

From the date of the provision ordering liquidation, the same provisions for judicial liquidation shall apply with reference to creditors and pre-existing legal relationships.

The liquidator, after having drawn up the list of creditors, carries out the liquidation of the assets and the distribution of the proceeds to creditors, according to the order established by law.

4.5 Debt-restructuring agreements *(accordi di ristrutturazione dei debiti)*

According to Italian Insolvency Law, the debtor can also file a request for a debt-restructuring agreement which has already been approved by the creditors.

The agreement must be entered into by the debtor and the creditors representing at least 60 per cent of all debts, regardless of the nature of the credit, secured or unsecured. This agreement is called ordinary. However, reform of the Italian Insolvency Law has resulted in the addition of the facilitated agreement, which may be reached with 30 per cent of the creditors, secured or unsecured, and the extended agreement, with 75 per cent of the homogeneous credits, belonging to the same category.

Furthermore, a report drafted by an expert concerning the feasibility of the agreement has to be submitted to the court. Such a report is essential, and the approval of the debt-restructuring agreement by the court is mainly based on its contents. In particular, the report must demonstrate the ability of the agreement to ensure full payment of the so-called "external creditors", i.e. the creditors who are not signatories of the agreement.

A debt-restructuring agreement must be published in the Companies Register at the Chamber of Commerce and is effective as of the date of its publication. The creditors and any other interested parties are entitled to challenge the debt-restructuring agreement within 30 days from the date of the publication.

The court then decides the merits of any challenging petitions and, assuming such challenges are rejected, approves the agreement.

The law provides that any act, payment, or guarantee performed in order to implement and execute the debt-restructuring agreement approved by the court cannot be subject to claw-back action (*azione revocatoria*).

The debt-restructuring agreement is a flexible legal instrument and the main players are the debtor and the creditors, while their advisers and the legal counsel also play a role. In most cases, a single agreement will be entered into by the debtor and its creditors. However, the performance of more than one agreement with creditors may also be allowed. Furthermore, the agreement may provide for a particular

role for some creditors. In particular, major creditors could exercise a surveillance power over the debtor's business, as well as management or control rights.

Such an agreement contains different terms and conditions for payment of the relevant claims and provisions concerning the re-funding of the business in order to allow the continuation of the business activities by the debtor and its restructuring.

4.6 Extraordinary administration *(amministrazione straordinaria)*

As a result of recent financial difficulties involving important Italian companies, Law of No 39 of 18 February 2004 was enacted in order to improve the pre-existing procedure concerning extraordinary administration for large insolvent companies, provided by Legislative Decree No 270 of 8 July 1999.

An insolvent company may institute an extraordinary administration by filing a request with the Minister for Economic Development and, at the same time, filing a petition with the Bankruptcy Court in order to ascertain its insolvency status. According to the provisions of the new law, insolvent companies may apply to the minister for immediate admission to extraordinary administration if they have, either individually, or as a group, established for at least one year that: (a) there were no fewer than 500 employees in the previous year; and (b) there are debts, including those arising from the guarantees issued, for an aggregate amount of not less than EUR300 million.

Once admitted to extraordinary administration, the insolvent company is managed by the extraordinary administrator (*commissario straordinario*) who continues to carry on the company's ordinary business activity pending the outcome of the extraordinary administration.

The outstanding debts of the insolvent company are frozen at the date of declaration of insolvency and paid at the end of the proceeding, during which the creditors are not entitled to start or to continue any execution proceedings upon the debtor's assets.

A surveillance committee of five members, with supervision and control duties, is also appointed by the minister as a consultative body. Two members of the surveillance committee are chosen from among unsecured creditors and three from among experts in the company's business activity or in insolvency law.

Within 180 days of being appointed, the extraordinary administrator is required to file the restructuring plan with the Minister for Economic Development, as well as to file a report with the Bankruptcy Court containing the description of the causes of the company's insolvency, together with an estimate of the relevant assets and a list of the creditors, indicating the respective amounts and priority rights.

The restructuring plan is subject to the approval of the minister. If the minister rejects implementation of the proposed plan, the extraordinary administrator may ask the minister to approve a sale plan, otherwise, the extraordinary administration is converted into an ordinary bankruptcy proceeding.

The restructuring plan can provide for satisfaction of the creditors' claims, both secured and unsecured, through a composition with creditors, which is part of the plan. The composition must detail any relevant clause and condition for the satisfaction of the creditors, as well as any possible guarantee for its performance.

The composition shall be approved if it is passed by the creditors representing the majority of the claims admitted to vote; any creditors who do not deliver their vote to the court are deemed to vote in favour of the composition. If the majority is reached, the court approves the composition.

The debtor does not remain in possession of the business under this proceeding. The extraordinary administrator is appointed by the minister, takes possession of the company's assets and is entrusted with the management of the business.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

According to Article 165 of the Italian Crisis and Insolvency Code, the following transactions are voidable by the receiver, provided that the receiver can prove that the other contracting party was aware of the debtor's state of insolvency:

- transactions at an undervalue;
- payment of receivables due and payable, which have been satisfied by any means other than cash and other usual instruments of payment, if made within one year before the declaration of judicial liquidation by the court;
- pledges and mortgages granted in the year before the judicial liquidation to secure pre-existing debts not yet due and payable; and
- pledges and mortgages granted in the six months before judicial liquidation to secure debts due and payable.

Transactions, if entered into in the six months before the declaration of judicial liquidation, may also be voided if the receiver proves that the other party was aware of, or could have been aware of, the debtor's insolvency. Further payments of debts due and payable and grants of security interests to secure contemporaneous loans are also voidable. These provisions are intended to render suspect pre-bankruptcy transactions ineffective towards the creditors. The receiver's action is *in personam*, although they may affect third parties' interests by granting a right to trace the debtor's assets, wherever they are located.

There are two requirements to be satisfied for the avoidance of transactions. The first is objective, consisting of the actual loss of the debtor's assets which are to be recovered by the debtor's estate, and the second is subjective, i.e. the knowledge of the insolvency by the non-debtor party. The receiver bears the burden of proving a non-debtor's knowledge of state of insolvency.

6. Is enforcement of a security right treated differently in each type of proceeding?

According to Italian law, the provisions concerning the enforcement of security rights are the same for each insolvency proceeding. In the legislator's view, in case of default, the secured assets must be sold by public auction in order to enhance competition among possible purchasers and ensure that the maximum price is paid for the benefit of the debtor and of the other creditors.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Pursuant to Article 153 of the Italian Crisis and Insolvency Code, secured credits (mortgage, pledge, lien) entitle the repayment of principal, interest (pre and post-filing in judicial liquidation) and costs. If the secured creditors are not satisfied in full, their residual claims may share as unsecured creditors for the difference. The order of priority is established by Article 2777 *et seq* of the Italian Civil Code.

The order of priority in respect of movables is as follows:

- expenses incurred by the insolvency procedure take priority over any other claim, including those secured by mortgage or pledge: such expenses include, for example, payments necessary to continue the debtor's business (suppliers, staff etc.), receivers' fees and lawyers' fees – all such items are commonly defined as "pre-preferential claims" (*crediti in prededuzione*);
- wages and salaries as well as employees' allowances (Article 2751*bis*, 1, Civil Code) and damages for lack of payment of social security contributions by the insolvent company;
- professional fees for the previous two years, commercial agents' commission and indemnities relative to the year prior to declaration of judicial liquidation (Article 2571*bis*, 2, 3, Civil Code);
- claims having the rank of priority according to special laws;
- claims secured by pledge, including by irregular pledge where necessary formalities have been complied with;
- claims secured by special privilege;
- claims for social security contributions and compulsory insurance;
- claims for taxes due on income of immovable property; and
- claims for income taxes and indirect taxes.

The order of priority in respect of immovables is as follows:

- expenses incurred by the insolvency procedure;
- claims having the rank of priority according to special laws;
- claims for taxes on real property;
- claims for indirect taxes;
- claims secured by special privilege on immovables; and
- claims secured by mortgage.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

In all the proceedings foreseen by the Crisis and Insolvency Code, the realisation of secured claims is granted to their holders in the same way: creditors who believe their claims to be of a secured nature must advise the bodies responsible for the pre-insolvency or insolvency proceeding. However, for this purpose, the creditors must seek a judicial authorisation. After having heard the bodies responsible for the pre-insolvency or insolvency proceeding and the creditors' committee, the specialised court can establish if, when and how the secured assets can be sold. Thus, even a secured creditor wishing to enforce its rights must file a claim. This rule is applicable to each type of pre-insolvency and insolvency proceeding.

The sale of secured assets takes place within the proceeding and under the control of the judge or, in the case of judicial liquidation, the receiver. The proceeds of the sale are assigned to secured creditors up to the amount of their claims for principal and interest. The difference, if any, must be returned to the estate.

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

Protection for the creditor granted by the Italian legal system towards the guarantor corresponds to that granted towards the debtor. Therefore, information in section 7 above is also applicable to the present question.

In fact, except for specific legal claims, the creditor can start a proceeding against the debtor or the guarantor with the aim of improving the chances of collection.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

If the secured creditor were to fail to comply with the formalities set forth by the law, the security interest would not be enforceable against third parties. This means that the secured creditor would not be given any priority over other creditors.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged?

In the event of the insolvency of an Italian collateral provider, in accordance with general principles of law and the provisions of Article 152 of the Italian Crisis and Insolvency Code, the creditor must file a petition with the court, asking for authorisation to sell the secured assets according to the forced sale procedure as described in section 2 above.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

Under an ordinary pledge of collateral, the debtor remains the owner of the assets transferred to the secured party, although the debtor no longer possesses the collateral as a result of the transfer to the secured party. Therefore, the debtor may not use the property pending the insolvency proceedings, nor can the debtor transfer the pledged assets.

The secured party has an obligation to protect the assets granted to it under the pledge, is responsible for any deterioration or loss of the assets, cannot use them without the debtor's prior consent, and cannot re-pledge them or let third parties use them.

An irregular pledge overcomes the above difficulties. This type of pledge may apply when cash is given as collateral and enables the pledgee to dispose of the assets. In this case, the ownership of the assets passes to the secured party which has an obligation to return equivalent assets to the debtor when it receives payment. However, any payment and the value of the collateral can be netted so that the secured party has only a duty to return the difference.

With regard to the lien, it is not technically a security and does not convey a right *in rem* to its holder but merely qualifies the type of claim.

Under a mortgage, the debtor can grant other guarantees to different creditors. The order of priority among various mortgages issued by the same debtor to different creditors on the same property depends on the date of registration of the document whereby the charge is established according to the rule of "first in time, first in priority".

Regarding special provisions about cash collateral, according to Article 4 of Legislative Decree No 170 of 21 May 2004, a pledge, as well as an assignment of claims or of financial assets, is defined as a "security financial collateral agreement". According to the new rules, when the pledge is granted to a bank, the pledgee is entitled to directly satisfy its claim on the financial assets given as security, and its sole obligation is to immediately inform the debtor or, in case of insolvency, the liquidator thereof in writing and return to the liquidator the proceeds of sale of the financial assets in excess of its claim.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

According to Italian law, during the course of a pre-insolvency and insolvency proceeding, no further security rights can be created with respect to property subject to an insolvency proceeding.

14. What distribution will a secured creditor receive if a company is reorganised?

According to Italian law, the reorganisation of a company is executed through a composition agreement, a debt-restructuring agreement and, in case of companies meeting certain requirements, an extraordinary administration.

With regard to a composition agreement, even if it is not expressly stated, the debtor is required to pay its secured creditors in full because the secured creditor will not otherwise vote for the composition proposal. In the debt-restructuring agreement, the secured creditors may approve the debtor's proposal but, in any case, they have a priority right in the distribution.

In case of extraordinary administration, the secured creditors are paid after the expenses and the debts arising from the activities of the debtor during the proceedings (*crediti prededucibili*).

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

Since they are rights *in rem*, i.e. securities on the real property, they follow the asset within the reorganised company.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

If a secured claim is over-secured, the creditor will receive an amount up to the principal amount of the debt, plus interest (pre and post-petition) and costs, while the difference must be returned to the estate.

If a claim is under-secured, the creditor will not receive the whole amount of its debt, and the negative difference will become an unsecured claim.

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

To be recognised to have full force and effect in Italian jurisdiction, a foreign contractual restructuring arrangement must be made in respect of the requirements set by law for the *debt-restructuring agreements* as described in section 4 above.

* **Important disclaimer due to COVID-19 Emergency:** the preceding report on treatment of secured claims in insolvency and pre-insolvency proceedings in Italy has been written in the context of the reform of the Italian Insolvency Law, adopted by the Legislative Decree No 14 of 12 January 2019. The reforms should have entered into force in August 2020 for most of the Articles. In the current macroeconomic emergency situation, the Italian Law Decree No 23 of 8 April 2020, consisting of massive financial interventions to help companies, has determined that the entry into force of most of the rules of the reform will be postponed until 1 September 2021.

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INSOL INTERNATIONAL

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44(0) 20 7248 3333 | Fax: +44(0) 20 7248 3384
www.insol.org